

THE DAVID HUME INSTITUTE



**UNDERSTANDING MRS THATCHER:
CONSERVATIVE ECONOMIC POLICY,
1979-1987**

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FOREWORD

Those of us who have been called upon from time to time to give economic advice to governments soon learn that there is no guarantee that what we might regard as cogent arguments in favour of some policy will have an immediate appeal because of their logical consistency. If governments accept our advice, it is usually for a variety of reasons which extends far beyond any catalogue of our own. The present government is no exception. While clearly influenced by ideas put forward by liberal economists and philosophers, it has chosen to heed those which are consistent with preserving political cohesion and continuance in office. One is therefore astonished when surprise is expressed at the lack of a coherent intellectual framework employed by governments. To have kept the government machine moving along the predestinate grooves of a particular ideology is a certain way of making sure that such an ideology will never be put into practice.

In this Hume Occasional Paper, Professor David Simpson goes much further and argues that to use a liberal free market philosophy even as an interpretative device in explaining the origins if not the destination of Thatcherite policies is positively misleading. A much better perspective is gained, he argues, by applying the analysis of the development of capitalism associated with Joseph Schumpeter (1883-1950), like Hayek an Austrian economist. Schumpeter was a very remarkable man. He wrote on every conceivable aspect of economics, though he is best known for his views on change in modern economies, beginning with his first book on economic development in 1911 and ending with the fifth edition of *Capitalism, Socialism and Democracy*, published posthumously in 1976. Between times, he wrote superb commentaries on economic method, the history of economic thought and public finance, was for a short time Austrian Minister of Finance in Renner's cabinet after World War One and later ran a private bank that failed and left him very much in debt. He held chairs in Graz, Bonn and Harvard, having emigrated to the USA in 1932. He married successively an Englishwoman, a Viennese and an American. It was of Schumpeter that the famous story is told that he had three ambitions: to be the most famous lover in Vienna, to be the best equestrian in Austria and to be the most respected economist in Europe.

"What a pity," he said, "that I never learned to ride a horse!"

Schumpeter's *Capitalism, Socialism and Democracy* offers the clue to David Simpson's approach. (It was, incidentally, one of the books which appeared on the famous reading list which Sir Keith (now Lord) Joseph issued to his officials when he became Secretary of State for Trade and Industry!) Schumpeter put the entrepreneur at the centre of the stage in the promotion of economic development. To the extent that the market power of the entrepreneur is unhindered by custom, religion, government and labour, to that extent also will an economy be in the van of economic growth. This is not to argue that entrepreneurial freedom is either desirable or possible. The problem of the Thatcher government, so David Simpson claims, is how to combine the removal of constraints on enterprise with continuing political support - for example, by widening the distribution of property.

The David Hume Institute issues the usual disclaimer that it subscribes to no collective view on questions of values and its Trustees do not necessarily agree with authors' views. I might add that while I have some reservations about David Simpson's interpretation of economic policy, I am sure that I shall not be alone in commending his paper as a most stimulating and enlightening example of Schumpeterian-style economics at its best, where a few central ideas can be used in an illuminating way to interpret familiar but often confusing facts of economic life.

Alan Peacock
Executive Director

SUMMARY

Mrs Thatcher's economic policies are part of a world-wide tendency for governments to withdraw from direct participation in economic activity in favour of market forces, a tendency which can be observed in countries as disparate as New Zealand, Hungary and Senegal. Yet these policies are deeply misunderstood - even in this country. The editor of the *Financial Times* has written that 'Thatcherism is more a matter of attitudes and instincts than a clearly thought-out political philosophy', and that the government's economic policies do not 'fit together within a coherent intellectual framework'.

It is perfectly true that the government has shown scant regard for the neo-classical principle of competition in its privatisation of telecommunications, gas and electricity and in the mergers which it has permitted in the domestic airline and oil industries. Nor do large subsidies to selected industries and to home owners fit comfortably with the economic theories espoused by many of its supporters (including Professor Friedman). Mrs Thatcher's continuing emphasis on the virtues of an enterprise culture, on innovation and on the private ownership of capital finds little support in conventional economic theory.

However, when viewed from the perspective of the writings of Joseph Schumpeter, the Austrian economist who analysed the evolution of modern capitalism in terms of changing attitudes, values and institutions, these policies appear to be intellectually perfectly coherent. Although from a neo-classical standpoint the power of large trade unions and large corporations is equally to be deplored, it is perfectly correct from a Schumpeterian perspective to seek to reduce the power of trade unions while leaving untouched the market power of large corporations. It is the latter which are primarily responsible for those innovations which lie at the heart of the process of economic growth, while the trade unions play a largely obstructive role.

From a Schumpeterian viewpoint, the government's economic policies can be seen as being directed towards the removal of those constraints which, increasingly since the earlier part of this century, have restricted the growth of industrialised economies. Such constraints are principally taxes, government controls on business, and the growth of the public sector, whose bureaucracy forms an unholy alliance with the trade unions to

stifle the opportunities and rewards which are necessary for enterprise to flourish, and thus for the economy to grow.

This paper looks at the likely consequences of Mrs Thatcher's policies, using a Schumpeterian framework. It suggests not only that a permanent improvement in the rate of growth of the British economy can be expected, but also that the same policies are likely to have the effect of increasing the government's own political support. It is suggested that a further widening of the distribution of property provides the basis for a continuing growth of output and of political support. The analysis also points to two sources of potential weakness in Thatcherite economic policies. A less restrained, more rapidly growing industrialised economy is likely to be more subject to disturbance in the form of unemployment and bankruptcies. It may also produce a degree of social inequality which may eventually become politically unacceptable.

UNDERSTANDING MRS THATCHER:
CONSERVATIVE ECONOMIC POLICY, 1979-1987*

by
David Simpson

Introduction

The economic policies of Mrs Thatcher have lacked neither commentators nor critics. This is scarcely surprising since they represent such a radical departure from those of her predecessors. As Sir Alan Walters has written, 'the economic policies of her government were a negation of the conventional wisdom of some four decades'.¹

In the writings of most commentators, Mrs Thatcher's policies have been identified with the orthodox or neo-classical school of economic thought, perhaps because her first administration repeatedly proclaimed its belief in monetarism and the free market. Mrs Thatcher's gurus appeared to be Friedman and Hayek.

Critics, however, have pointed to an inconsistency between words and deeds. Free market principles did not seem to count for much in the privatisation of British Telecom and British Gas, or in the take-over of British Caledonian by British Airways, or in the swallowing up of Britoil by BP. Competition is to play only a limited role in the generation of electricity, following the privatisation of that industry. While Mrs Thatcher has passed three Acts to limit the market power of labour monopolies, nothing has been done to curb the market power of large corporations. The government is also accused of having shown no interest in privatisation as an instrument of policy before 1984. Consequently, one distinguished critic (the editor of the *Financial Times*) has complained that 'government policies do not fit together within a coherent intellectual framework' and that 'Thatcherism is more a matter of attitudes and instinct than a clearly thought-out political philosophy'.²

It is true that those ingredients of economic policy which

* I am grateful to Dr David Reisman for his helpful comments on an earlier version of this paper.

Mrs Thatcher has emphasised — the importance of enterprise, private ownership, low taxes, and the ending of bureaucratic controls — have little or no place in neo-classical economic theory. But they are central components of the intellectual framework of Joseph Schumpeter, who devoted much of his professional life to an analysis of how the mixed economy evolved and operated. Schumpeter was born in Vienna in 1883 and studied economics and law at the university there. He was of the same generation of the Austrian School as Von Mises, and one generation older than Hayek.

Competition is one of the topics on which Schumpeter differs from the neo-classical school and from some of his fellow-Austrians. Like Mrs Thatcher, Schumpeter takes a tolerant view of monopolies. Indeed, in the Schumpeterian view, very large corporations are positively conducive to the growth of the economy since they encourage competitive innovation, whereas trade unions, on the whole, obstruct it.

Another feature which distinguishes Schumpeter is that he absorbed something of Marx's vision of the instability and ultimate decline of capitalism. Schumpeter would have been delighted by Mrs Thatcher's achievements, but he would have been sceptical about her chances of doing more than provide a temporary halt in what he anticipated would be a long march into socialism in post-war Britain. In 1950, the year of his death, Schumpeter predicted that the British economy would soon become so fettered by bureaucratic controls, high taxes, the extension of public ownership and the restrictive practices of the trade unions that it would no longer be able to deliver sustained economic growth. Public opinion would put the blame for this failure on free market forces, and the consequent shift of the political balance to the left would be reinforced as small businesses were swallowed up or destroyed by larger corporations.

For the next twenty-five years events appeared to justify Schumpeter's warnings. Yet in the 1979 General Election, the voters did not place the blame for the poor performance of the British economy upon the market mechanism, but upon the fetters which constrained it. Since 1979 Mrs Thatcher has systematically set about removing these fetters by lowering the rate of income tax, abolishing or relaxing government controls and regulations on business activity, limiting the power of the trade unions, and trying to contract the size of the public sector and re-create an enterprise culture. What is remarkable is how closely Mrs Thatcher's policies have followed a Schumpeterian prescription. By re-examining Schumpeter's work, we may perhaps be able to learn something about the areas of potential strength and of potential weakness in Mrs Thatcher's economic policies.

In this paper, we shall argue that what principally distinguishes the economic policies of Mrs Thatcher's first two

governments from previous post-war administrations is that while the latter can be seen as having tried to make the mixed economy work, Mrs Thatcher's policies represent an attempt to reverse certain trends of the past half-century and to return, where possible, the values and institutions of the British economy to a state which closely resembles that which Schumpeter described as pure capitalism.

Walters³ has identified four areas of economic policy which formed the agenda of the government when it first entered office in 1979. These were (1) the achievement of financial stability, (2) the abolition of regulations and controls on the private sector, (3) the privatisation of state-owned industries, and (4) the reform of the trade unions. To these may be added a fifth, (5) the promotion of home ownership. Although the first of these policy areas was 'the most urgent', it seems that the achievement of financial stability was envisaged as being a prerequisite for the attainment of other, more fundamental, policy objectives. Nevertheless, the long-running debate on Mrs Thatcher's economic policies has focused largely on the macro-economic issues. To the extent that the micro-economic policies, more fundamental to Mrs Thatcher's long-run objectives, have been debated, each topic has been treated in isolation. Perhaps this is one of the reasons why the government's policies have frequently been perceived as lacking unity and coherence.

Sections I and II of the paper review, respectively, the principal events and the policies of the period 1979-87. The Schumpeterian analysis is introduced in section III, and in section IV the coherence and unity of Mrs Thatcher's policies are discussed in that context. The success of the government's policies are evaluated in section V and the conclusions of the paper are summarised in section VI.

I Principal Economic Events, 1979-1987

The policies of Mrs Thatcher's government, like those of the government of any other advanced country in the last quarter of the twentieth century, have been played out against a background of events most of which it has been powerless to influence, let alone control. During the period under review, the microprocessor revolution has gathered pace. A stream of new and improved products and processes appeared on the market at an increasing rate. Two features of this particular area of progress in technology may be noted: first, it has not just been confined to one or two industries, but has pervaded the whole economy. Not only has it contributed to the recorded growth in productivity, but it has also caused directly and indirectly many less skilled workers to lose their jobs while at the same time creating a demand for

more highly skilled workers.⁴

Between 1978 and 1984 the production of oil from the UK sector of the North Sea more than doubled. Adding to this the three-fold rise in the world market price for crude oil in the years 1979/80, the contribution of North Sea oil to the GNP rose from £2 billion in 1978 to £16.3 billion in 1984.⁵ Not only did government revenues rise by a factor of twenty but the exchange rate of the pound against the dollar was kept higher throughout this period than it would otherwise have been, and at critical moments the oil factor contributed to sharp upward movements in that rate.

The level of unemployment dominated economists' perceptions of the labour market before 1979, and concentration on the aggregate figures increased after that date following the steep rise in unemployment between 1980 and 1982. Movements in the aggregate rate of unemployment reflected *inter alia* changes in other, more fundamental, labour market forces. There were changing demographic influences and continuing increases in female participation, part-time employment and self-employment.⁶

There have also been changes in tastes and in attitudes towards work and leisure since 1979, which have proceeded so gradually as to be almost unnoticed. One evident effect is the apparently insatiable demand for the provision of certain goods and services by government. Like the governments of other Western countries, the Thatcher government has had a continuing battle to keep the growth of its expenditures within acceptable bounds.

But perhaps the most significant change of all in our period is the change in political attitudes. There has developed an apparent acceptance that the government's ability to solve economic problems is limited. Other notable changes in attitude include the recovery by managers of the 'right to manage', an unwillingness on the part of workers to accept 'just any' job, less sympathetic attitudes towards trade unions, and a loosening of the bonds of mutual obligation in the community.⁷ Admiration has begun to displace resentment as the prevailing attitude towards high earnings. Each of these changes may be no more than a straw in the wind, but taken together they indicate a change in the political environment within which all economic activity takes place, and which therefore is likely to influence outcomes in the long term if not in the short.

In addition to these influences, which might be repeated in other countries at other times, there were some unique events which were peculiar to Britain and the British economy between 1979 and 1987. There was, first of all, the Falklands War in 1982. Had this not occurred when it did, the government might not have been re-elected in 1983, and the subsequent major disposals of state assets and some of the trade union legislation would not have taken place. Had the coal strike of 1984-85 been

lost, few would doubt that the subsequent course of economic events would have been different. Finally, there was the 1979-81 recession. In terms of its timing, depth and duration, this recession could be described as unique but in terms of some of its other characteristics it was familiar: inflation was snuffed out, unemployment rose sharply, many firms were forced into bankruptcy while the productivity of the surviving firms rose. In these respects it conformed to what Schumpeter, many years earlier, had described as a 'remedial recession'.⁸

II Economic Policies, 1979-1987

When Mrs Thatcher's government entered office in 1979, it envisaged a long-term programme of economic reform, perhaps lasting as long as eight to ten years.⁹ This was considered the minimum period necessary if the British economy was to realise its potential for economic growth. An essential prerequisite of the reform programme was the achievement of a low and stable rate of inflation. The remainder of the government's programme fell into four categories:

- 1 the decontrol and deregulation of the private sector, so that 'the market rather than the bureaucracy determines the price and allocation of resources';¹⁰
- 2 trade union reform;
- 3 the contraction of the public sector, beginning with the sale of council houses and continuing with the sale of state-owned industries;
- 4 the extension of home ownership.

1 Decontrolling the private sector

Into this category fall such measures as lowering rates of income tax and abolishing such direct controls as those on capital movements, on prices and on minimum wages. Exchange and price controls were abolished immediately. The standard rate of income tax was gradually reduced from 33 per cent in 1978/9 to 27 per cent in 1987/8, while personal allowances rose by 22 per cent in real terms during the same period. The decontrol of rents, minimum wages and transport fares has been postponed. The government also took some hesitant steps towards deregulation or liberalisation of some markets, such as those for stocks and shares (1986) and for telecommunications (1981).

The government has claimed¹¹ that there was a decline in what it has called enterprise culture in Britain in the 1960s and 1970s, including periods during which its Conservative predecessors were in power. Symptomatic of this decline, it is said,

was the fall in individual share ownership during that time. Throughout its present period of office, the government has therefore gradually but systematically abolished the disincentives to individual share ownership as it has perceived them to exist during the previous two decades. The government has also introduced a variety of fiscal schemes devised to encourage and assist would-be entrepreneurs and, more recently, a scheme for the portability of occupational pensions.

2 Trade union reform

A significant change which has taken place in the British economy since 1979 is the decline in the power and influence of the trade unions.¹² Some commentators have attributed this to the government's own trade union legislation, ie, the Employment Acts of 1980 and 1982 and the Trade Unions Act of 1984, which limited rights of picketing and secondary action, provided for ballots before strikes, and for the election of union leaders. In fact, several government policies and initiatives, including the decay of nationwide collective bargaining, widening pay differentials as well as privatisation, employee share schemes and the encouragement of profit-related pay have, each in their own way, served to weaken the position of trade unions.

3 Contraction of the public sector

Earlier Conservative administrations did reverse previous nationalisation measures in the case of one or two industries, notably steel and road freight transport. These were unique events, not part of a programme of systematic divestment of state-owned assets. There was no attempt to use these asset sales to change the distribution of property ownership, neither did any previous government attempt a programme of selling council houses.

Early in the government's first term it embarked on a programme of council house sales, a policy which had featured prominently in its election manifesto. By contrast, the privatisation programme was scarcely advertised at all, and only rather hesitant progress was made between 1979 and 1983. Major disposals of state-owned industry did not begin until 1985. However, by 1987, fourteen large companies and a number of smaller ones, employing a total of 600,000 people, had been transferred from public to private ownership. As a result of this process, the publicly owned sector of industry was reduced by one-third.¹³

The remainder of the public sector has remained virtually untouched. There has been some tinkering at the margins: deregulation of buses, the liberalisation of British Telecom in 1981, contracting out of some services provided by local authorities and by regional health boards, and some attempt to

rationalise the purchasing systems of these authorities. But the welfare state (the National Health Service and Social Security) has continued to absorb an increasing proportion of public expenditure and of gross domestic product. The expansion of the welfare state has outweighed the contraction of the state-owned industry sector induced by privatisation, so that the overall size of the public sector has not only increased in absolute terms between 1979 and 1987, it has also increased as a proportion of GDP.¹⁴ This would be unremarkable were it not for the fact that the government itself had laid great stress on the need for a reduction in the overall size of the public sector. What should have been an instrument of economic policy became a quantified target.

4 Home ownership

The government pursued three policies which tended to increase the number of houses owned by their occupiers and to reduce the numbers owned by local authorities. Beginning in 1979 a programme was introduced whereby council house tenants could purchase their homes on generous terms. Under this programme more than one million dwellings, out of a stock of some seven million, have been transferred from public to private ownership. Secondly, central government funding for the construction of houses in the public sector has been steadily reduced, so that the number of new publicly owned houses started fell from 171 thousand in 1976 to eighty-one thousand in 1979, and to thirty-one thousand in 1987. Thirdly, the policy allowing mortgage interest to be deducted from taxable income has made home ownership more attractive than it would otherwise be. Together with a policy of encouraging personal share ownership, home ownership may be seen as contributing to a broader objective of widening the distribution of the private ownership of property.

III A Schumpeterian Perspective

In the last section we outlined Mrs Thatcher's principal policies. In this section we begin by arguing that these policies are not consistent with a neo-classical view of how the economy works. We then introduce an alternative, Schumpeterian, perspective, and in section IV we show how the government's policies are quite consistent with such a perspective.

In the minds of most professional economists, government policy has been identified with a neo-classical theory of the economic process, primarily because upon entering office in May 1979 it chose to emphasise a monetarist approach to stabilisation policy.¹⁵ Neo-classical theory was also associated with the 'free market' rhetoric which government supporters

adopted, while adherence to a strict interpretation of monetarism was united with an impassioned advocacy of the neo-classical approach to economic policy in the writings and speeches of Professor Friedman, whose views were frequently quoted during the government's first term. But when viewed from the standpoint of neo-classical theory, many of the government's most important policies appear to have been inconsistent, anomalous or simply irrelevant.

It has frequently been pointed out, for example, that the government's professed belief in 'free markets' is inconsistent with the lack of attention which it has paid to matters of competition in its privatisation programme. Specifically, in the cases of British Telecom, British Gas and British Airways, the government has been accused of confusing privatisation with liberalisation. The monopolistic or oligopolistic structure of these organisations has been left virtually untouched. Indeed, competition in the domestic market has been reduced by the mergers of British Airways with British Caledonian and BP with Britoil, both of which the government has permitted. These decisions are consistent with a policy of 'mercantilist' intervention in order to secure 'victories' for British firms in international markets; other examples which have been cited include subsidies to motor-cars,¹⁶ aerospace and aero engines. Another alleged anomaly is the government's persistence in adhering to tax relief on domestic mortgage interest payments. The market power of trade unions has been curbed but nothing has been done to limit the market power of large corporations.

Such policies appear anomalous, inconsistent or irrelevant only if one insists upon a neo-classical view of the economic process. While there is a place in the neo-classical scheme of things for different forms of market structure, and therefore for policies of deregulation or liberalisation, there is little place in neo-classical (or neo-Keynesian) theory for different forms of ownership, and therefore there is no place for the concept of privatisation. Neither is there any place in neo-classical theory for self-reliance and the other values of an enterprise culture, nor for the attitudes (attitudes to government, attitudes to work), nor for the political instruments (expanding the number of small businesses, expanding the proportion of owner-occupiers) to which the government evidently attaches so much importance. On all of these factors, neo-classical theory is either silent or indifferent.

Yet within the Schumpeterian analysis all of these factors are immediately recognisable. Schumpeter saw questions of ownership, values, attitudes and the changing political balance in society as central to the movement of an advanced economy, as he perceived it, from a state of 'pure' capitalism to a state of 'fettered' capitalism.

Schumpeter defined pure capitalism as a 'scheme of values, an attitude towards life, a civilisation'.¹⁷ He envisaged a pure capitalist society as being characterised by private ownership of capital, division of labour, and resource allocation by market forces unhindered by significant government intervention, whether in the form of taxation, ownership or regulation. The essence of capitalism was change.¹⁸ Change was brought about by competitive innovation among entrepreneurs, who were identified in the pure capitalist period with owner-managers of firms. The transient existence of monopolies and oligopolies was entirely consistent with vigorous competition in the Schumpeterian sense.

But pure capitalism carried within itself the seeds of its own destruction. Change within the capitalist period would bring about 'an atmosphere of almost universal hostility to its own social order'.¹⁹ While both Smith and Marx had noted that capitalism encouraged a rational and calculating cast of mind, Schumpeter observed that this critical faculty would eventually be turned against itself. Capitalist values would gradually lose their hold on the public. Personal saving for old age would be replaced by acceptance of state responsibility. There would be increasing government control of the economy, via higher taxation of incomes, increased public ownership and increased regulation.

Another important feature of the process of decomposition of pure capitalism was an increase in the concentration of ownership of firms. The elimination by competition of the host of small and medium-sized family firms would tilt the balance of political attitudes in the country further to the left. The growth of large corporations would destroy individual entrepreneurship: innovation would become routinised. Within the corporation, ideas of self-help would diminish, to be replaced by notions of reliance on the state for support. The expansion of government control would lead to the creation of a bureaucratic class, which, in alliance with the workers, would 'raid' the business class.

In these various ways the pure capitalism of the early period would gradually be transformed into a state which Schumpeter described as 'fettered capitalism', where the rapid economic growth characteristic of pure capitalism is constrained by an unsympathetic environment of taxes, regulations, values and institutions. It is a plausible description of the mixed economy which operated in Britain from 1945 to 1979.

It is the contention of this paper that Mrs Thatcher's policies are consistent with an attempt to reverse the process of the decomposition of capitalism. In other words, to alter the characteristic organisation, institutions and attitudes of the economy away from 'fettered' capitalism and towards 'pure' capitalism. In the following section we show how the four policy

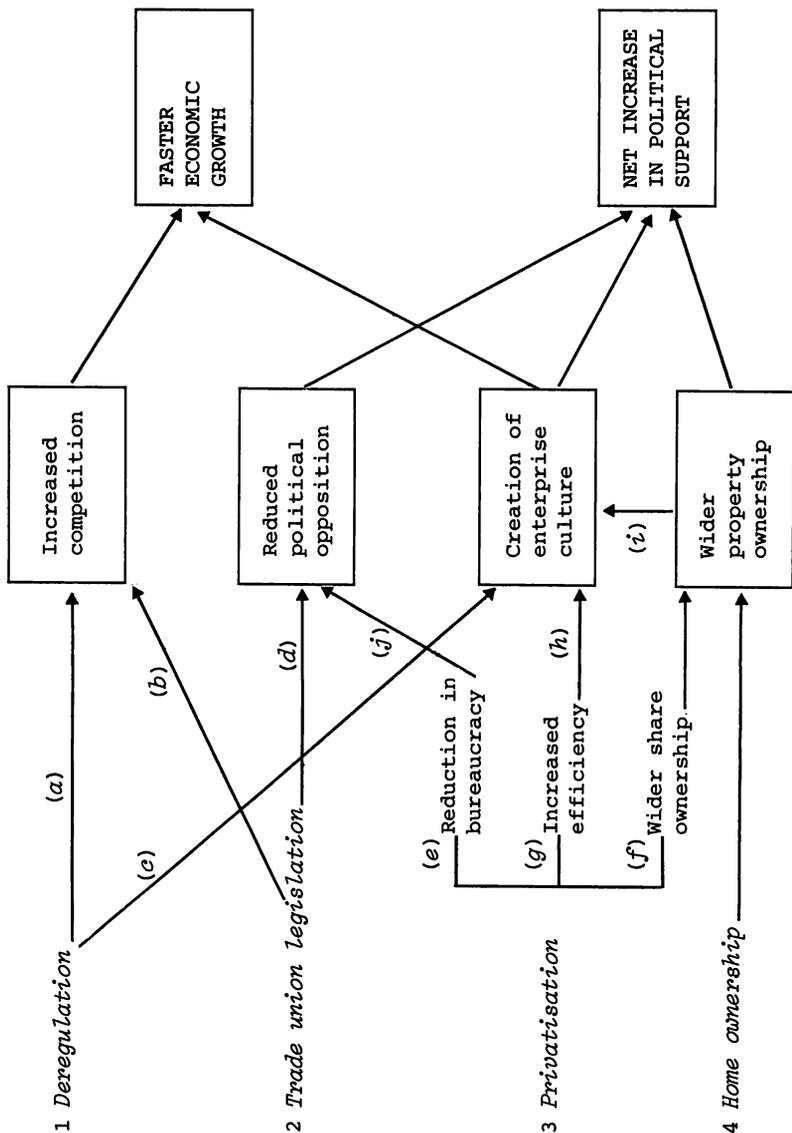


Figure 1

measures identified in the Introduction are consistent with certain intermediate and ultimate objectives of policy, using relationships drawn from Schumpeter's analysis.

IV The Consistency of Mrs Thatcher's Policies

In Fig. 1 we illustrate the principal connections between the measures adopted by the Thatcher government in four separate areas of economic policy and what we have identified as two ultimate objectives of policy: (1) faster economic growth and (2) a net increase in political support. The diagram also shows some intermediate objectives, namely increased competition, reduced political opposition, the creation of an enterprise culture, and wider property ownership. No doubt other labels could have been chosen and other connections shown²⁰ but the justification for this diagram is to be found in the following paragraphs.

Most economic theory would suggest that the abolition of direct controls, whether on prices or quantities, offers greater scope for increased competition, (a). In the neo-classical view more competition should lead to the most efficient operation of markets and thus to faster growth. But in this view increased competition means not only liberalisation or deregulation but it requires also the removal of monopolistic and oligopolistic influences. Although the present government has tried to reduce the bargaining power of the trade unions, (b), it has left untouched the market power of the larger corporations which, in neo-classical theory, equally threaten the ideal of perfect competition.

From the perspective of Schumpeterian competition, however, trade unions tend to restrict innovation and thus growth, while monopolies and oligopolies, on the whole, do not. Their market power provides both the opportunity and the reward for successful innovation. The government has also placed great emphasis on what it believes to be the incentive effects of lowering both the higher and standard rates of income tax. It believes that such measures stimulate what Schumpeter called entrepreneurship and what the government prefers to call an enterprise culture, (c). Less well known are the changes in the tax regulations which the government has gradually introduced with the object of encouraging personal financial investment at the expense of contractual schemes.²¹ These measures can be regarded as efforts to stimulate an enterprise culture by deregulation. They can also be regarded as ways of widening the ownership of property, if individual pension plans and life assurance policies can be regarded as property.

The decline of trade union power not only has favourable

effects on competition and thus growth, it also represents a decline in one of the important sources of political opposition to the government, (*d*). A decline in the power of a source of political opposition is equivalent to a net increase in political support. As we shall see, it is remarkable how often the government has been able to adopt a single measure of policy which at the same time has served both its economic and political interests.

It has been argued, of course, that the decline in trade union power has been due not to the legislative actions of the government, but to other factors, principally unemployment and the changing industrial pattern of demand for labour. It may be that the decisive factor is neither legislation nor unemployment but the underlying shifts in public opinion and in the attitudes of trade union members themselves. Ten years before Mrs Thatcher, Mr Heath had tried to use legislation as a means of curbing trade union power and had been decisively defeated. The 1984 Act, which requires the use of ballots before strikes, appeared to weaken the trade union leadership only because the rank and file frequently voted against strike action. Had the rank and file been in favour of strike action, the legislation would surely have had the effect of strengthening the hand of the leadership.²² The shift in attitude is apparent when comparing the miners' strike of 1984-85 with the one of 1974. The considerable public sympathy which existed for the strikers in 1974 had turned to, at best, indifference by 1984.²³

Of the four areas of economic policy we have identified, privatisation has created by far the widest network of effects, both direct and indirect.²⁴ There are three major direct consequences which are likely to follow from the particular method of privatisation adopted by the government: an increase in the internal efficiency of the organisation concerned, (*g*), a reduction in bureaucracy, (*e*), and a wider distribution of share ownership, (*f*).

An increase in internal efficiency may be expected to come about as a result of pressure from shareholders to increase profits by lowering costs. Any benefits of an increase in internal efficiency will only be realised by consumers to the extent that the privatised organisation is operating in competitive conditions. However, even in the absence of competition, pressure from shareholders will lead to greater awareness of the need for profit-seeking and cost-effective behaviour at all levels within the organisation, and will thus lead to the dissemination and promotion of the values of an enterprise culture, (*h*). Wider share ownership directly promotes an enterprise culture, (*i*), in three ways: (1) private ownership of capital extends the range of choice for the individual citizen or household, (2) the amount and nature of savings for the future

become a matter for individual rather than collective decision, and (3) direct involvement in a business may promote an awareness of its problems and interests.

Privatisation brings about a reduction in the bureaucracy both within the organisation being privatised (as a result of the cost-reducing pressures from shareholders) and in the government department which previously supervised the newly privatised organisation. It is not so much the direct reduction in the numbers of administrators which is important: it is rather the loss of influence, prestige and thus power which comes about from the demonstration that the bureaucratic function is, at best, redundant.²⁵ The bureaucracy, like the trade unions, constitutes a source of political power hostile to conservative government, according to Schumpeter. Thus, any reduction in the power of the bureaucracy, (*j*), reduces potential political opposition.

For the same reasons as share ownership, home ownership promotes the values associated with the enterprise culture, and empirical evidence suggests that home ownership tends to be associated with voting behaviour sympathetic to right-wing political parties.

V An Evaluation of Mrs Thatcher's Economic Policies

In the previous section we have outlined some arguments to show why the economic policies adopted by the government might have been expected to lead both to faster economic growth and to an increase in its potential political support. In this section we try to assess the extent to which, in practice, these relationships have actually worked in the manner suggested. Specifically, we pose three questions:

- 1 Has less fettered capitalism led to faster economic growth?
- 2 Have the economic policies under review improved the government's political support?
- 3 Has Mrs Thatcher been able to achieve a permanent or only a temporary reversal of the post-war drift towards socialism?

By historical standards, as well as by contemporary comparison with other major industrialised countries, the rate of growth of GDP in the UK since the recession of 1979-81 has been high and stable. It is too early to establish conclusively to what extent this performance has been the result of government policies. It is easier to pronounce on the direct effects of individual measures of privatisation than it is to disentangle the specific consequences of taxation or trade union reform. Many smaller firms operating in competitive markets have indeed

prospered following their privatisation, but the significance of the increased profitability among some of the larger privatised organisations is clouded by restraints on competition in the markets they serve. It may be argued that much of the improved growth performance in the economy is due to factors other than government policy (eg, North Sea oil revenue) and it may be argued on the other side, with equal justice, that government policy measures will have lasting benefits for the performance of the economy which are not yet evident.

Supporters of the government have claimed an 'unprecedented' improvement in manufacturing productivity since 1979.²⁶ If the government wishes to take credit for this, it must presumably also accept responsibility for the harmful effects of the recession of 1979-81. In the Schumpeterian analysis, but not the neo-classical, there is a place for the concept of a remedial recession. The main function of this type of recession is to eliminate those activities which are no longer viable and to bring to an end a period of unsustainable expansion. Such a view of the workings of the economic system is incompatible with the Keynesian/neo-classical synthesis, where recessions can be avoided altogether by means of the judicious application of macro-economic policies.

Those who take the latter view hold the government responsible for the loss of output occasioned by the 1979-81 recession. The present government, on the other hand, appears to take the Schumpeterian view that such recessions are inevitable and that they have good effects (productivity gains) as well as bad effects (bankruptcy and unemployment). Walters argues that fiscal policy had negligible effects on the events leading up to the 1979-81 recession and that any monetarist contraction simply moved the recession forward in time, and had little effect on either its depth or longevity.

The results of the General Elections of 1983 and 1987 suggest that Mrs Thatcher's policies have hitherto been politically popular. How much further can they be carried without loss of political support? Whatever may be said about the popularity or otherwise of deregulation and trade union reform, the popularity of most of the privatisation measures hitherto - of selling council houses and of granting mortgage interest relief - is hardly in doubt. So long as undertakings which are privatised can be operated with no less a degree of customer satisfaction and internal efficiency than existed under public ownership, and so long as their employees and other citizens are able to purchase shares on favourable terms, there is no reason why the programme of privatisation should not continue to be politically popular.

The primary political motive for pursuing wider property ownership is not, of course, to seek popularity²⁷ as such but

to increase the degree of freedom²⁸ or bargaining power of the individual household. An alternative way in which this freedom may be increased is by means of social security provision.²⁹ From the point of view of a Conservative government the former arrangement is preferable in that it promotes self-reliance and the other virtues of the enterprise culture while dispensing with the economic and political costs of bureaucracy. The prospect of achieving a permanent shift in the nation's political attitudes in the individualistic direction lies in the realisation of a much wider distribution of property than has been attempted hitherto. The political advantages to the Conservatives of a wider distribution of property ownership have been cogently argued by Howell (1986). The political gains from further measures of privatisation *per se* are likely to be limited.

In 1949 Schumpeter reviewed the state of economic and political affairs in Great Britain. He posed the question whether it was likely that those trends which he had first identified in 1942 would be arrested or even reversed in the foreseeable future. In a passage which anticipated many of the problems of the British economy over the next thirty years, he concluded that while there might well be periodic 'breathing spells' for 'private enterprise' under Labour as well as under Conservative governments, a break in social trends was unlikely.³⁰ He expected a continuing movement of the institutions, attitudes and values of British society away from those characteristic of pure capitalism, through 'fettered capitalism' (the mixed economy), and eventually towards socialism.³¹

What appears to distinguish the economic policies of Mrs Thatcher's government from all previous post-war administrations, whether Conservative or Labour, is that while these governments can be seen as having tried to make the mixed economy work,³² Mrs Thatcher's policies represent an attempt to return the British economy to a state of pure capitalism. The key question is this: are the changes Mrs Thatcher has been able to achieve *permanent*? Can these reforms last?

It is tempting to answer 'yes' to this question. Thatcherite policies have been largely accepted not only by the official opposition³³ but throughout the world, in countries as diverse as Hungary, New Zealand and Senegal.³⁴ Widening the base of property ownership is surely an irreversible means of shifting the balance of political opinion in the country to the right.

But it is always dangerous to project the present into the future. The Achilles heel of pure capitalism may lie in its instability and inequality. As Schumpeter pointed out, economic growth under capitalism is *by its very nature* disruptive; the less constrained capitalism is, the more disruptive growth is likely to be. In a recent study of job creation in America, David Birch has pointed out that the healthiest economies are

always the most turbulent. Such economies not only attract the greatest number of business start-ups, they also tend to show the greatest number of failures. Turbulence is an inescapable consequence of rapid growth, but it may not be politically popular. Nor can we be sure that the increased inequality of incomes, which has likewise been the corollary of rapid growth, will continue to be politically acceptable.

VI Conclusions

For the thirty years following his death in 1950, Schumpeter's predictions that Great Britain would drift slowly through an increasingly fettered capitalism towards some form of socialism seemed quite plausible. But he overlooked the possibilities of the learning process in a democratic society. This society has discovered, by experience, the difficulties and disadvantages of operating a market economy constrained by widespread government controls, high levels of income tax, state producer monopolies and powerful trade unions. These lessons appear to have been learned, and Mrs Thatcher's good fortune has been to take political advantage of them.

We can state our specific conclusions as follows:

- 1 When placed in an appropriate (ie, Schumpeterian rather than neo-classical) context, Mrs Thatcher's economic policies may be seen to be consistent with one another and with the attainment of certain identified objectives.
- 2 In this perspective, Thatcherite economic policies appear to be conducive to faster economic growth. Not only that, they will tend to shift the balance of political opinion in Britain to the right, thus reinforcing the government's own political support.
- 3 There appears to exist a potential, as yet scarcely tapped, for the government to gain still further political support by accelerating the trend towards a wider distribution of the ownership of property.
- 4 While Mrs Thatcher's policies may be consistent with a faster rate of growth, the resort to a less fettered form of capitalism leaves unresolved, perhaps even exacerbated, questions of instability and inequality.
- 5 If the potential unpopularity of these two side-effects can be contained, there appears no reason why Mrs Thatcher should not be able to achieve a permanent change in economic organisation away from the mixed economy and towards a more pure form of capitalism. This could be consistent with increased personal freedom for all citizens.

6 If this can be achieved, it would represent a reversal of the social trends anticipated by Schumpeter for Great Britain in the post-war period.

Notes

- 1 Walters (1986), p v.
- 2 Geoffrey Owen in the *Financial Times*, London, 9th April 1987.
- 3 Walters, pp 4-5.
- 4 See Northcott, Fogarty and Trevor (1984). There is also evidence from several British industries of a shortening time period for new product development as a result of the introduction of microprocessor technology.
- 5 See Department of Energy (1987).
- 6 See Handy (1984).
- 7 One symptom of the decline in the sense of mutual obligation is the two-way deterioration which has been taking place in the relationship between doctor and patient. The tendency for patients to sue doctors is on the increase (measured by higher malpractice insurance fees), while equally there is a growing tendency for general practitioners to leave week-end work to locums.
- 8 Schumpeter (1976), p 429.
- 9 Walters, p 4.
- 10 Walters, p 5.
- 11 HM Treasury (1985), p 1.
- 12 Trade union membership fell from 13.3 million in 1979 to 10.7 million in 1985 (Department of Employment, 1987a, p 85), while the number of working days lost through strikes fell from 9.4 million in 1978 to 1.9 million in 1986 (Department of Employment, 1987b, p 547). Two days before the General Election in May 1979 a MORI opinion poll reported that 73 per cent of those interviewed felt that trade union power would be the most important issue facing the new government. In April 1987 another MORI poll showed that only 1 per cent of those interviewed felt that trade union power was an important electoral issue (*Financial Times*, London, 6th April 1987).
- 13 Net of disposal costs the government earned more than £11 billion from the sale of these assets. Privatisation has been the major factor behind the increase in share ownership since 1979. According to a survey sponsored by the Treasury and carried out in the first two months of 1987, ie, before the British Airways sale, some 20 per cent of the adult population owned shares, compared to about 7 per cent in 1979. About 8 per cent held shares only in privatised companies or in the TSB Group. See HM Treasury (1987), p 2.

- 14 There are many reasons, including demographic factors, unemployment and the sensitivity of debt interest payments to inflation, why it may not be wise to attach too much importance to annual movements in the ratio of government expenditure to GDP. This is a cross which the government has created for itself.
- 15 A detailed defence of the government's macro-economic policies from 1979 to 1983 is offered by Walters (1986), while the opposite view is argued with equal conviction by Kaldor (1982). For a view of government policy during this period which is critical of monetarism but broadly sympathetic to the government, see Howell (1986). See also p 11 above.
- 16 It has been estimated that over the period 1975-84 British governments spent about four billion dollars on subsidies to the British Leyland Motor Company in its various forms. This is ten times the sum which the Japanese government has allocated to its country's fifth-generation computer research programme, 1981-90.
- 17 Schumpeter (1976), p 384.
- 18 'Capitalist reality is first and last a process of change' (Schumpeter, p.77).
- 19 Schumpeter, p 143.
- 20 Many readers may be surprised to note that we have not included among our list of objectives any macro-economic variables, despite the government's early attachment to such aggregates as the public sector borrowing requirement, various measures of the money supply, and the ratio of public expenditure to GDP. These are, at best, intermediate objectives. From the point of view of what we believe the government's ultimate objectives really to be, it is not the size but the composition of these aggregate variables which is significant. They therefore do not, in this view, constitute appropriate indicators of performance, and, perhaps for this reason, the government has lately appeared to distance itself from them. We have chosen to identify increased political support as an ultimate objective, because this is what Schumpeterian analysis leads us to expect will be the consequences of the stated policies. The economic growth objective can be more simply justified: 'Underlying the entire programme of reforms', Walters writes, 'was the belief that the uncertainties of inflation, regulations and the lethargy and waste of nationalised industries and the restrictive practices of trade unions had retarded Britain's economic growth and made her perform well below potential' (Walters, p 5).
- 21 HM Treasury (1985), p 1.
- 22 The same Act required unions to ballot their members on the question of maintaining political funds. The fact that every union voted in favour strengthened the leadership and was a

- setback for the government. In February 1988 there is some evidence that ballots are strengthening the influence of union negotiators in wage bargaining.
- 23 The unyielding position adopted by the NUM leadership in the 1984-85 strike, that no pit should be closed short of physical exhaustion, played into the hands of the government. Had the miners' leaders instead demanded that no pit should be closed without the availability of alternative job opportunities, the government might have had more difficulty in securing the tacit support of the public.
 - 24 See Yarrow (1986).
 - 25 It has been suggested that the Department of Trade and Industry has lost some inter-departmental influence within Whitehall as a result of the privatisation programme. The White Paper on the privatisation of the electricity supply industry in England and Wales, published on 25th February 1988, suggests that the possibility of a more competitive structure for the industry has been sacrificed to a desire to achieve a rapid break-up of the power of the CEGB, whose staff have bitterly resisted any change in the status quo.
 - 26 In seeking an explanation for the 52 per cent increase in British manufacturing exports between 1974 and 1976, and 1981 and 1983, Walters identifies an underlying improvement in productivity. He said that the reasons for this are 'difficult to develop in terms of standard economic theory', but what he has in mind is clearly a process of Schumpeterian competition. See Walters, p 168.
 - 27 The radical measures which have been adopted by the Thatcher government have been pursued with political skill. In each area of policy, progress has been usually one step at a time, each step being small enough not to provoke resistance, while allowing the opportunity to take stock before making the next move (cf, Walters, p 5).
 - 28 This concept is easy to understand but not so easy to define. A good example is the enhanced freedom of action which the ownership of a car confers upon a household.
 - 29 They need not be alternatives; in practice they can be, and often are, complementary.
 - 30 Schumpeter, pp 415-420. Hayek was equally pessimistic: see Peacock (1984), p 23.
 - 31 The watershed between capitalism and socialism would be marked by the 'socialisation of the labour market', ie, the establishment of a permanent statutory incomes policy.
 - 32 Schumpeter described this as 'trying to run the capitalist engine in the labour interest', a task he believed to be ultimately self-defeating (Schumpeter, p 425).
 - 33 Of all the state's assets privatised since 1979, the Labour Party committed themselves at the General Election of June

1987 to the return to the public sector of British Telecom and British Gas only. At the same time they pledged themselves, if elected, to continue the policy of council house sales and to retain some provisions for membership ballots in trade unions.

34 See Shackleton (1986).

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