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## REAGANOMICS: THE LESSONS AND PITFALLS OF THE BRITISH EXPERIENCE

by Daniel Cornford

The Reagan Administration's budget and tax cut proposals are being heralded by many as the solution to America's economic problems. There is a widespread assumption that the "supply side" economic theories that underlie the new policies will revitalize the American economy, and that all segments of American society will be the ultimate beneficiaries. While a discordant minority both inside and outside of Congress has questioned these assumptions, "Reaganomics" has achieved an exalted status as the new economic orthodoxy.

The AFL-CIO is the major institution opposing Reagan's economic policies. But labor has not succeeded in mobilizing widespread opposition to Reaganomics. The fallacies of this abstract economic orthodoxy must first be exposed, and the best way to do this is to examine the actual and potential consequences of its application. An excellent starting point for such an exercise is to scrutinize recent British experience.

Just over two years ago Margaret Thatcher, the Conservative Party leader, was elected Prime Minister on a platform very similar to the Republican platform of 1980. Heavily influenced by such supply side economists as Milton Friedman, Thatcher pledged to rejuvenate the declining British economy by cutting government spending, reducing income taxes, and generally freeing business from supposedly burdensome government controls and regulations.

The problems of the British and American economies are not absolutely identical, and neither are the policies of Reagan and Thatcher. But there are many important parallels, and the lessons to be drawn from the British experience are instructive. After Thatcher met with Reagan in the White House in February of this year she is reported to have said, with reference to economic policy, that she was "impressed with the striking similarity between their aims and policies." Time Magazine described parts of Reagan's Inaugural Address as containing "themes, even phrases that have become familiar litanies of the Thatcher government."

## THATCHER'S REAGANOMIC POLICIES AND PROGRAMS

Margaret Thatcher's policies were designed to reduce the rate of inflation, and at the same time, to stimulate the sagging industrial sector of the economy. Inflation could be sharply reduced, it was assumed, by raising the interest rates (at least temporarily) and by cutting government spending. Both of these policies supposedly would reduce the money supply which would reduce the rate of inflation. It was also hoped that cuts in public spending would result in more money being channeled into private capital investment. Accordingly, quite severe cuts were made early on in the Thatcher regime in the fields of education, health, housing and social services generally. Interest rates rose as high as 22.5% at one point and have been held deliberately at around 20% for most of the last two years.

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The first Thatcher budget of June 1979 made significant cuts in income tax rates, especially for those in higher income brackets. Those earning more than \$50,000 a year, for example, had their tax rates reduced from 83% to 60%. The orthodox theory both here and in England is that tax cuts (especially for the wealthy) will be funnelled into productive domestic industries. It is assumed that all these measures will significantly slow the rate of inflation, and make British and American goods more competitive in world markets. While Thatcher admitted that there might be some temporary dislocations and readjustments, she promised dramatic results before too long in revitalizing the British economy.

#### THE IMPACT OF THATCHER'S POLICIES

Unemployment: By any measure both the absolute level of unemployment and the rate of increase of unemployment in Britain have been staggering. The figures for May 1981 show that 2.7 million workers, 11.1% of the labor force, are unemployed. When Thatcher came to power in the spring of 1979 just over 1 million people were unemployed, approximately 6% of the labor force. Between March 1980 and March 1981, one million workers lost their jobs. In some especially depressed areas of South Wales and Northern Ireland unemployment levels are over 20%. About one-third of those who left school in 1980 could not find work. This gloomy picture cannot be explained simply by the onset of a recession in most of the Western industrial economies, as the following comparisons indicate: in calendar year 1980 unemployment increased by 3.9% in Italy, by 13% in France, and by 26% in Germany, but by 64% in Britain. All the major independent economic forecasting agencies agree that unless there is a change in England's economic policy, 3 million British people will be unemployed by the end of the year, and perhaps as many as five million by 1985.

Economic Growth: In the last year of the Labour government's experience (1978-79), the British economy grew at a modest 1.5% annual rate. In the first year of the succeeding Thatcher government the national output declined by 3%, and 10,000 businesses went bankrupt--the highest incidence of bankruptcy ever. Industrial production declined by over 10% (compared to 2-3% for Western industrialized countries as a whole). This again established a record. Never before, even during the depths of the depression in the 1930s, had there been such a precipitous decline in industrial investment.

Thatcher also abolished foreign exchange controls two years ago, and what she expected from this and from her capital gain and corporate tax reductions was active capital investment in British industry. It did not occur. Instead, there was an increased flow of money out of England and into Krugerrands, Canadian real estate, and American factories, banks, and ranches. Even British industrialists would not reinvest in British industry. (See Jane Kramer, New Yorker, May 11, 1981).

Inflation: It might be thought that at least a high level of unemployment and a low or declining rate of economic growth would lead to a lower rate of inflation. Such has not been the case. In the two years before Thatcher came to power the rate of inflation was 7.6% and 10.6% respectively. In the summer of 1980, after Thatcher had been at the helm of the government for over a year,

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inflation raged at the phenomenal rate of 22%. While the rate has since declined, most forecasts estimate that it will be 13-14% in 1981. It is worth noting here that a central tenet of conservative neo-classical economics has consistently been that high rates of unemployment will substantially lower the rate of inflation. The theory is not demonstrable in England at this time.

Government Spending: Perhaps the most ironic consequence of Thatcher's economic policies has been that despite her initial commitment to severe retrenchment of government spending, she has in fact ended up increasing government expenditures. As a percent of total expenditures between 1979-80 and 1980-81, government spending rose from 41.5% to 44.5%. Why did this happen? The major reason was that the depressed state of the economy required vastly increased "transfer" payments, including welfare and even more significantly, unemployment benefits. The increase in "welfare" payments was not just for the poor. Although the Thatcher government was supposedly committed to letting market forces determine the fate of firms and industries, it was obliged to bail out industries that are absolutely critical to the whole infrastructure of the British economy, such as British Steel, British Airways and British Leyland (which accounts for the vast majority of British automobile production).

Budget deficits have also increased in England because the depressed economy brought declines in government revenues. For example, one study estimated that the direct and indirect cost of supporting an unemployed married man with two children was \$13,000. The London Sunday Times which cited this study went on to note that from \$15-16 billion was being spent on the unemployed. How many people, the Sunday Times asked, might be employed if the government invested this sum in specific job-producing programs?

Economists Denounce Thatcher Policies: At the end of March, 1981, in an unprecedented step, 364 British University economists, including many of unquestioned distinction, denounced the government's economic policies in a formal statement addressed to Thatcher and her primary economic minister. The statement said that there was no evidence that present government economic policies "will bring inflation permanently under control and thereby induce an automatic recovery in output and employment. Present policies will deepen the depression, erode the industrial base of our economy and threaten its social and political stability."

One month previously a Select Committee of the House of Commons on monetary policy (with a majority of Conservatives) reported, after consultation with numerous experts both at home and abroad, that there was little direct causal relationship between the money supply and inflation; that government spending was not inherently inflationary and did not stifle the private sector; and that high interest rates, combined with an overvalued currency, could do irreparable damage to the manufacturing base of the economy.

The Political Response to Thatcherism: After two years of Thatcher's disastrous economic policies a serious political backlash against the Conservative Party appears to be in the making. The Labour government scored sweeping gains in last month's nationwide local elections, and a recent opinion poll gave the Labour Party a 19% lead over the Conservative Party. Demonstrations of the unemployed, reminiscent of the 1930s, have become more frequent and militant. For example, 500 jobless workers on May 31st completed a 180 mile, 30 day walk from Liverpool to London. The march took in 20 cities where

unemployment was high, and the marchers were greeted by over 100,000 cheering sympathizers when they arrived in London. The 12 million member Trades Union Congress (the British equivalent of the AFL-CIO) sponsored "The People's March for Jobs" with a donation of \$120,000.

CONCLUSION: THE NECESSITY AND POTENTIAL FOR OPPOSING REAGAN'S  
ECONOMIC POLICIES

While the impact of Reagan's economic policies may not be as catastrophic as Thatcher's have been, the British example cannot be ignored. The available empirical evidence seems to indicate (a) that cuts in government spending and direct income taxes do not revitalize an economy, either by reducing the rate of inflation or by encouraging productive investment; and (b) that the consequences of such retrenchment may be considerably higher unemployment and a slower rate of economic growth. Californians should also note that the impact of Reagan's policies coincides with considerable fiscal retrenchment at the state level, in the absence of any surplus "bail-out" money to offset the effects of Prop. 13.

A recent Harris poll on the Administration's economic policies (conducted between June 3rd and June 7th) indicates that there is a solid base from which the labor movement and other groups can launch an attack on Reaganomics. By a 58-32% majority, people do not believe that a year from now the rate of inflation will be below 10%; by 52-42%, the majority does not believe that in the next 12 months unemployment will be reduced; by 72-21%, the majority believes "the rich and big business" will be much better off in the next year; and conversely, by 68-29%, the majority believes that "the elderly, the poor, and the handicapped will be especially hard hit" in the coming year.

The time for a thorough going critique of the new economic orthodoxy is at hand, and out of this must come a coherent, concrete alternative set of economic policies based on more realistic and proven assumptions, and grounded on more humane principles.

-- Daniel Cornford

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