

J. J. Richardson:

## Political Problems in Reducing Public Expenditure: The Experience of the Thatcher Government in Britain

Artiklen tager udgangspunkt i en beskrivelse af den reaktive, konsensusøgende "policy style", som normalt præger engelsk politik. Der gives dernæst en historisk oversigt over forgæves forsøg på at få styr på det offentliges udgiftspolitik, som optakt til en sammenligning af Thatcher-regeringens målsætning og den politik, den faktisk har ført. Analysen viser, at Thatchers regering, som alle tidligere regeringer, er blevet fanget af policy processens grundlæggende og traditionelle egenskaber, som blandt andet har medført de sædvanlige interne stridigheder i kabinettet vedrørende placeringen af de offentlige besparelser. Konklusionen er, at regeringens policy stil og (manglende) resultater på det udgiftspolitiske område har været hel traditionel. Regeringen afviger alene fra tidligere regeringer derved, at den i offentligheden har skabt sig et (falsk) image som en regering, der udgør et radikalt brud med fortiden.

### 1. The British Policy Style and its Importance

Before moving to a discussion of the Thatcher administration and its attempts to reduce public expenditure, it is important to discuss the nature of the British policy process as a whole. Spending decisions are not taken in isolation from the political system itself, unaffected by the general political culture and the specific values relating to policy-making and implementation. It is hoped, therefore, that the reader will bear with an over-long introductory section, for the experience of the Thatcher government 1979 to the time of writing (January 1982) can only be properly understood in the cultural context in which it has operated. Whilst the Thatcher government tried hard to change some values in society - for example, people's expectations of the role of government in solving societal problems - it was, as we shall see, as much a victim of the deeply entrenched style of government as any of its predecessors.

The very phenomenon of the sectorisation and segmentation of policy-making in Western democracies means that contrasting policy processes may exist within the same political system.

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This paper is part of a series of studies into the UK policy process, funded by the Nuffield Foundation.

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Indeed in the Swedish context I have suggested that Anglo-American observers have been at fault in their characterisation of the Swedish policy style, partly because different policy sectors process problems in different ways.<sup>1</sup> In Britain also, I have suggested that different ministries may exhibit quite different attitudes towards policy change. For example, in the case of water reorganisation in 1973, the Department of the Environment consciously challenged well entrenched interests in an attempt to introduce radical policy change. They were opposed in this move by the more incrementally inclined Ministry of Agriculture Fisheries and Food.<sup>2</sup> Thus a model of the policy process which accurately describes one policy area may be quite inappropriate as a description of another, and quite misleading descriptions of national systems can result. Indeed, any one policy sector may itself exhibit more than one policy style or its policy style may change over time.

It may also be the case that the policy issue itself may be a determinant of the way in which problems are 'processed' within the political system. Thus Lowi, in what is the best known categorisation of issues, has argued that different types of policy promote different types of political activity.<sup>3</sup> He notes that a variety of different political behaviours (what I would term policy styles) exist in a society and feels that he can explain these behaviours by reference to the types of issues at stake. Lowi would presumably dissent from the notion of a national policy style and could instead demand that the policy content would have to be first stipulated. The Lowi scheme has appeal based on logic. In other words, the idea that relations will vary when the state is attempting to distribute benefits and when it is enforcing regulations is attractive. James Wilson, though criti-

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1) See J.J. Richardson, "Policy-Making and Rationality in Sweden: The Case of Transport", British Journal of Political Science, July 1979, pp. 341-53.

2) See J.J. Richardson, A.G. Jordan and R.H. Kimber, "Lobbying, Administrative Reform and Policy Styles: The Case of Land Drainage", Political Studies, Spring 1978, pp. 47-64.

3) Theodore J. Lowi, "American Business, Public Policy, Case-Studies, and Political Theory", World Politics, Vol. XVI, No. 4, July 1964.

cising Lowi's scheme, also suggests that the issue affects the politics - in his case suggesting that a distinction should be made between policy innovation and policy adaptation.<sup>4</sup>

Whilst readily conceding that not all policies are handled in the same way I nevertheless believe that it is equally true that policies are generally not so distinctive as to prevent them being accommodated in a basic simple typology of policy styles. In particular, it seems useful to concentrate on what may be two primary features of policy-making systems. Thus many descriptions of individual policy systems are more or less related to two factors. (1) A government's approach to problem-solving - often characterised in terms of the incrementalist-rationalist debate. In trying to avoid the somewhat sterile debate of what is incremental and what is rational we have elsewhere<sup>5</sup> suggested that it is more useful to characterise approaches to problem-solving in terms of governments adopting either an anticipatory-active attitude towards societal problems, or taking an essentially reactive approach to problem-solving. (2) The second 'primary' factor appears to be a government's relationship to other actors in the policy-making and implementing process. For example, how do governments 'deal' with the thousands of interest groups in a modern society? Is a government very accommodating and concerned to reach consensus with organised interests, or is it more inclined towards imposing decisions notwithstanding opposition from groups? Policy style can, in this way, be defined as the interaction between (a) the government's approach to problem-solving and (b) the relationship between government and other actors in the policy process.

Such a definition enables us to categorise societies into four very basic 'policy styles'. Thus, some societies seem to be located in a category which we might see as emphasising consensus and a reactive attitude to problem-solving. Others appear to be located in a category also stressing consensus but with

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4) James Q. Wilson, Political Organisations: NY, Basic Books, 1973.

5) See J.J. Richardson, Gunnel Gustafsson and A.G. Jordan, "The Concept of Policy Style", in J.J. Richardson (ed.), Policy Styles in Western Europe, London: Allen & Unwin, 1982.



to shape the outcome by participation in the advisory process. The aim is to secure through bargaining at least passive acceptance of the decision by the interests affected.<sup>6</sup>

Brown has also noted the same tendency and indeed goes so far as to suggest that in the breadth of British policy-making it is remarkably hard to find a satisfactory example of radical policy innovation.<sup>7</sup> In fact it is probably more accurate to argue that what one may see as the dominant policy style is in reality a procedural ambition. There is a preferred type of machinery, reflecting normative values - which is to avoid electoral politics and public conflict in order to reach consensus or 'accommodation' in the labyrinth of consultative machinery (both internal and external) which has developed. The 'game' has of course a number of variants based on the theme of 'bureaucratic accommodation'.<sup>8</sup>

This view of political life in the UK is of course open to the objection that it is altogether too cosy, too complacent and ignorant of the degree of real conflict in the system. Moreover, it might be argued that it is based on an analysis of particular types of issue - the routine, technical, low political salience issues, where (a) there are well organised groups and (b) they can be easily 'accommodated'.<sup>9</sup> Specifically, in the context of this paper, it might be argued that the public expenditure process - the allocation of resources - is so fundamental in its importance as to be likely to exhibit a quite different process to say decisions relating to the regulation of pig breeding. Yet the (justifiably) most acclaimed study of the British expenditure process by Hecló and Wildavsky<sup>10</sup> stresses the very

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6) See J.E.S. Hayward, "National Aptitudes for Planning in Britain, France and Italy", Government and Opposition, Vol. 9, Part 4, 1974, pp. 398-99.

7) R.G.S. Brown, The Administrative Process as Incrementalism, Open University Press, 1974, p. 39.

8) For a fuller discussion of variations of the British policy style see A.G. Jordan and J.J. Richardson, "The British Policy Style or the Logic of Negotiation?", in J.J. Richardson (ed.), Policy Styles in Western Europe, Allen & Unwin, 1982.

9) See Ralf Dahrendorf, "The Politics of Economic Decline", Political Studies, Vol. XXIX, No. 2, June 1981, pp. 289-90.

10) See Hugh Hecló and Aaron Wildavsky, The Private Management of Public Money, London: Macmillan, Second Edition, 1981.

notions of community and compromise which elsewhere<sup>11</sup> we have identified as a dominating feature of the political landscape.

Thus even the centre of what is generally seen as a highly centralised state, turns out to be little more than a collection of competing interests which ultimately have to bargain and compromise. According to Crossman Cabinet ministers "come briefed by our departments to fight for our departmental budgets, not as Cabinet Ministers with a Cabinet view".<sup>12</sup> As former Prime Minister Edward Heath has observed, "what does happen is that Ministers are expected by their departments to fight their own corner and if one Minister is going to get an increase in expenditure, then the others will ask if they cannot have the same thing".<sup>13</sup>

This is not to say that exceptions never occur. The decision in late 1980 to increase spending on the young unemployed saw the Department of Employment receive £250 million while other ministries were cut, but there were rather obvious (electoral) reasons why the Cabinet as a whole should acknowledge this problem. When it comes to the Treasury's attempt to recoup this extra spending, another main characteristic of Cabinet government was revealed. There is an enduring non-identity of aims between the Treasury and spending ministers. As the then Chief Secretary to the Treasury, John Biffen, put it in September 1980, "it has been the experience of all Treasury Ministers through the ages, quite irrespective of party affiliation, that spending departments always have an interest a little different from the necessarily austere view that has to be taken by the Treasury".<sup>14</sup> The Cabinet meets too seldom, with members too committed to their own interests, too busy for much intradepartmental reflection, with careers bound up in departmental not 'team' prestige, to be an effective

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11) See J.J. Richardson and A.G. Jordan, Governing Under Pressure. The Policy Process in a Post-Parliamentary Democracy, Oxford: Martin Robertson & Co., 1979.

12) R.H. Crossman, The Diaries of a Cabinet Minister, Vol. I, London: Hamish Hamilton & Cape, 1975, p. 275.

13) Edward Heath (in conversation with A. Barker), "Heath on Whitehall Reform", Parliamentary Affairs, Vol. XXXI, 1977-78, pp. 363-90.

14) See press reports, 15 September 1980.

mechanism for central choice and co-ordination. A system of competitive sectorisation operates out of which a consensus usually emerges, rather than a single coherent will being imposed.

The central thesis of this article is therefore that we should expect the rather pluralistic expenditure process to be rather similar on its fundamentals, to other policy processes in the UK system. Though, ultimately, the allocation of resources ends in imposition, in a technical sense, the policy which is imposed is usually bargained. That this should be so stems from the nature of the individual departments themselves. As Christoph rightly suggests:

The vast majority of Whitehall departments manage policies affecting identifiable clienteles, organized or otherwise. While part of the job of civil servants is to analyse, verify, and cost the claim of such groups, and forward them to higher centres of decision, it would be unnatural if officials did not identify in some way with the interests of their client-elles, and within the overall framework of current government policy advance claims finding favor in the department.<sup>15</sup>

## 2. Attempts to 'Buck the System'

Notwithstanding the existence of a rather dominating policy style affecting both sector-based and cross-sectoral problems, there have been some strategic attempts to change this style. There has, in fact, been a recognition that style is closely linked to incremental outcomes. Where radical policy proposals have been introduced (local government reorganisation and airports policy), Britain has lacked the necessary determination to carry them through to effective implementation against organised resistance. Thus, on the occasions when Hayward's suggestion that there is a preference for a 'humdrum' (roughly equated with incremental) policy style<sup>16</sup> does not hold true, it is likely that it will hold true at the implementation stage (in other words, groups have three bites of the same cherry. They have a great influence at the issue-emergence stage, they are integrated into

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15) J.B. Christoph, "High Civil Servants and the Politics of Consensualism in Great Britain", in M. Dogan (ed.), The Mandarins of Western Europe, New York: Wiley, 1975, p. 47.

16) See J.E.S. Hayward, op.cit., 1974.

the issue processing stage and often have a veto at the policy implementation stage).

But governments have, from time to time, come to office seemingly determined to 'buck the system'. The Attlee government of 1945-50 was certainly the most radical and innovative (in policy terms) government since the Second World War (though its programme had strong group origins) and, indeed, managed to introduce the bulk of its policies in the immediate postwar period. Since that government, Britain has seen three governments which seemed set to show a quite different (radical) 'face' - the Wilson government elected in 1964; the Heath government elected in 1970; and the subject of this article, the Thatcher government elected in 1979. Each in different ways appeared, at the time of its election, about to change from the dominant policy style. The most innovative Wilson creation was the ill-fated Department of Economic Affairs (DEA). This development reflected Wilson's belief that "...Britain could hope to win economic security only by a fundamental reconstruction and modernisation of industry under the direction of a department at least as powerful as the Treasury".<sup>17</sup> Some five years later, Wilson himself abolished the DEA. Indeed, by the time Wilson left office, he was best known for his pragmatic, incrementalist, 'beer and sandwiches' (late-night negotiations with groups) style of policy-making.

He was succeeded in June 1970 by Edward Heath's government, which had been foreshadowed by much planning relating to possible changes in the machinery of government. It is not unreasonable to see the 1970 White Paper, The Reorganisation of Central Government (Cmnd 4504), as a landmark in attempts to make the British policy style more 'rationalistic'. The main proposals in the White Paper were, firstly, strengthening of the centre in terms of fewer, but larger, departments, with the new Central Policy Review Staff (CPRS) designed to remedy the fact that governments "may pay too little attention to the difficult, but critical task, of evaluating as objectively as possible the alternative policy options and priorities open to them". Secondly, it was

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17) See H. Wilson, The Labour Government 1964-70. A Personal View, London: Weidenfeld & Nicolson, 1971, p. 3.

proposed to develop a system of Programme Analysis and Review (PAR) alongside the existing Public Expenditure Survey (PESC)<sup>18</sup> system for monitoring public expenditure. PESC was mainly concerned with the overall departmental budgets whereas PAR was to look at the relative value of individual projects. We should thus see the White Paper as a determined attempt 'to do things differently' in the policy sphere - as the introductory paragraph claimed, "this Administration has pledged itself to introduce a new style of government". In total, it added up to an alternative system, which in fact presented a real challenge to vested interests both within and outside Whitehall. With hindsight it is certain that Mr. Heath failed to appreciate just how big a challenge this was to the traditional and deeply entrenched pluralist system both within and outside government. The 1970 White Paper was lacking in appreciation of the complex political forces which were at work in the policy process. There is now no longer any pretence that a comprehensive pattern of resource allocation through comparison of costed alternatives is to be developed across Whitehall. (Though the notion of 'effectiveness' is still in good currency with Mrs. Thatcher in the form of Sir Derek Rayner's cost cutting 'scrutinies'). Yet again we saw the gyroscopic effect of policy style. Any significant deviation being quickly corrected by either pressure from outside groups, or from the Whitehall system itself. Indeed, one of the puzzles of British politics is to reconcile the fact that Britain selects its political leaders through a lengthy 'apprenticeship' system and yet new governments appear uniformly optimistic about the amount (and direction) of change that they can exert. Nevertheless they all have to make accommodations to reality in the sense that many key events prove totally beyond their control, and because the interests which prevented radical policy change under previous governments have not miraculously disappeared as a result of a general election. This is particularly true in relation

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18) For a discussion of PESC and PAR see Heclo & Wildavsky 1981; M. Wright, "Public Expenditure in Britain: The Crisis of Control", Public Administration, Vol. 55, Summer 1977, pp. 143-69; M. Wright, "From Planning to Control: PESC in the 1970s", in M. Wright (ed.), Public Spending Decisions. Growth and Restraint in the 1970s, London: Allen & Unwin, 1980; and Harold Copeman, "Analysing Public Expenditure: (1) Planning, Control and Price", Journal of Public Policy, Vol. 1, No. 3, 1981, pp. 289-306.

to possible changes in the allocation of resources. Once interests are in receipt of public resources they will mobilise to defend the existing allocation and will thus act like a magnetic field holding the policies in place. As The Economist observed after only eighteen months of the Thatcher government, pragmatism soon wins under the pressure of crisis management and the inclination of self-preservation.<sup>19</sup> Yet as we shall see below, Mrs. Thatcher's government, elected in May 1979, came to office determined to radically change the course of economic policy. There is no doubt that she herself was absolutely determined that the image of the 'Iron Lady', which the Russians had helped to create in response to her defence policy whilst in Opposition, would be carried through to reality in office.

### 3. The 1979 Government's Objectives

A clear indication of the new government's primary objective had emerged at least two and a half years before the election itself. In a much publicised statement of Conservative policy, in October 1976, the Party stated that one of the main aims of its political strategy was "to enable the country to live within its means, through the reduction and control of public expenditure and the rebuilding of a healthy and thriving mixed economy in which taxes can be lower and profits can fulfil their proper function."<sup>20</sup> The linchpin of the strategy was the view that public spending cuts were essential if "...we are to bring the economy into balance, and avoid an explosion of the money supply and an acceleration of the rise in prices..."<sup>21</sup> The cuts, the Party admitted, would in some cases lead to reductions in the scale of some public services. It is important to note that the deep concern over levels of public expenditure was in fact not significantly out of sympathy with the prevailing climate of opinion in Britain - indeed, as we shall see below, a reduction of public expenditure levels was by then a policy of the sitting Labour

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19) See The Economist, 4 October 1980.

20) The Right Approach, Conservative Central Office, 1976, p. 8.

21) Ibid., p. 24.

government itself. Moreover, the Conservatives felt that their desire to reduce public expenditure was supported by "...politicians and informed opinion across a very wide political spectrum".<sup>22</sup> An important aspect of the Conservatives' support for monetarism was their 'natural' belief that initiative was being throttled by the development of the modern state. Thus a clear policy theory lay behind their determination to cut public expenditure - namely that reduced personal taxation, which a cut in public expenditure would facilitate, would suddenly unleash a great surge of enterprise and initiative in Britain, which would in turn lead to the rapid economic growth which had eluded us for a quarter of a century. Leading Conservatives, (particularly Mrs. Thatcher) were convinced by the theory that once taxation reached a certain level, a strong disincentive to work resulted. It is important to emphasise the fundamental significance of this belief. It was significant in at least two respects. Firstly, it initially lead the new government to pursue quite contradictory policies - namely the reduction of direct personal taxation by increasing indirect taxation and thus pushing up the rate of inflation, notwithstanding the fact that as a government one of its primary objectives was to reduce the rate of inflation. Secondly, it eventually lead to disillusionment amongst its own supporters, when the Laffer Curve predictions relating to the benefits of reducing direct personal taxation proved to be false.<sup>23</sup> The Conservatives' approach was thus firmly rooted in two clearly identified and well articulated theories.

(1) That excessive growth in the money supply (resulting from excessive public expenditure) caused inflation. (2) That there was a direct link between people's efforts and their levels of personal taxation.

The two theories were prominent in the Conservative General Election Manifesto and in Mrs. Thatcher's campaigning for the May 1979 General Election. Their presentation was in classic nineteenth century liberal terms, with Mrs. Thatcher's own brand

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22) Loc.cit.

23) For a discussion of the relationship between tax rates and incentives see Michael Beenstock, "Taxation and Incentives in the UK", Lloyds Bank Review, October 1979, No. 4, pp. 1-15.

of populist overtones. Thus her Foreword to the Manifesto argued that

No one who has lived in this country during the last five years can fail to be aware of how the balance of our society has been increasingly tilted in favour of the state at the expense of individual freedom. This election may be the last chance we have to reverse that process, to restore the balance of power in favour of the people.

In specific policy terms the Manifesto repeated the pledge to master inflation by 'proper monetary discipline', with publicly stated targets for the rate of growth of the money supply. A gradual reduction in the size of the government's borrowing requirement was also argued to be vital:

The state takes too much of the nation's income; its share must be steadily reduced. When it spends and borrows too much, taxes, interest rates, prices and unemployment rise so that in the long run there is less wealth with which to improve our standard of living and our social services... We shall cut income tax at all levels and reward hard work, responsibility and success.

As Butler and Kavanagh suggest, the Manifesto reflected Mrs. Thatcher's preference for 'the high ground'.<sup>24</sup> During the campaign her homespun philosophy, based on the notion of a family paying its way was clearly evident. Thus in a broadcast on 2 April she re-assured the electorate that the radical image which the Party had developed did not mean tearing everything up by the roots. "Paying your way is not tearing things up by the roots. Paying your way is good husbandry, paying your way is planning for the future...".<sup>25</sup> The tough radical image which is still with Mrs. Thatcher in 1982, was itself a problem for Conservative campaign managers who recognised the need to soften the leader's image and avoid the impression of aggressiveness.

One of the greatest ironies of the whole of the period of office of the Thatcher government has in fact been the creation and encouragement of a tough radical image (for its practical importance see below section 7) in the sense of a new start,

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24) D. Butler and D. Kavanagh, The British General Election of 1979, London: Macmillan, 1980, p. 154.

25) Ibid., p. 168.

when in fact what the Conservatives were advocating was in principle little different from the policies of the Labour Administration which was defeated in the House of Commons on 28 March 1979. Thus Mr. Healey as Labour Chancellor of the Exchequer had been trying to implement just the type of policies which the Conservatives were advocating, i.e. a strict monetary policy, with published monetary targets, cash limits in the public sector and a policy of trying to reduce personal taxation in order to increase incentives. (Indeed, the Labour Government's 'Conservative' policies had been the very cause of the rift in the Labour Party which continues today). The main system of cash limits, which now covers over 60 per cent of public expenditure was in fact introduced by Mr. Healey<sup>26</sup> in 1975-6. (Cash limits on certain building programmes were first introduced in 1974-5). Mrs. Thatcher's government has continued the cash limit system and in 1982 the system will be combined with volume planning to produce a system of cash planning in the public sector. The years of the 1974-79 Labour government in fact look strikingly similar to the Conservative government 1979 to the present. For example, in July 1976 Mr. Healey announced that the growth in the money supply would be limited to 12 per cent. The total public sector borrowing requirement (PSBR) would be held at £9,000 million. In doing so, cuts in aid to industry, defence, health and social services, food subsidies, local authority loans would be made and all new council house (i.e. public sector) housing contracts were to be frozen. By September 1976 the government was seeking additional credit of £2,300 million from the IMF and in December 1976 Mr. Healey announced public spending cuts of £2,500 million over two years. By the 1978 Budget, the Labour government was looking even more like a Conservative government with the introduction of a £2,500 million tax cut. The tax cuts were seen as a way of encouraging pay moderation and as increasing incentives to industry. There was continued emphasis on the PSBR with a forecast of £8,500 million for 1978-9. The government was anxious to claim credit for the fact that the PSBR forecast was 5 per

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26) For an excellent discussion see M. Wright, 1977. See also Cash Limits on Public Expenditure, Cmnd 6440, April 1976.

cent of market price GDP "...a long way below the 1975-6 peak of 9 per cent".<sup>27</sup> The monetarist philosophy of the Labour Government was clearly evident in July 1978 when the Treasury published a review of the British economy since 1945. It pointed out that an accommodating monetary policy in 1972 and 1973 (both years of Conservative government) had "...permitted a rapid expansion of the money supply which contributed towards the subsequent further acceleration in inflation in the period from 1973 to 1975".<sup>28</sup> Following this experience

...the focus of monetary policy is now specifically the control of the money supply for which a formal target - in the form of a preferred range for annual growth - was announced in 1976. Control of the money supply, in helping to rebuild a climate of confidence and stability in financial markets and to reduce expectations of future increases in prices, is now seen as one of the two main strands of counter inflation policy, the other being policy in pay and prices.<sup>29</sup>

This statement, with the exception of the reference to pay and prices could equally have been issued by Mrs. Thatcher's government some three years later (and even on the question of pay policy the Thatcher government had pay 'norms' for the public sector). Mr. Healey's money supply target for the year ending April 1979 was in the range of 8-12 per cent. By December 1981, the Conservative government was predicting a growth in money GDP (there was by then a deliberate de-emphasis of the importance of the conventional definition of the money supply M3) for 1982-3 of 11 per cent. In January 1982 it had to admit that sterling M3 had increased by 12 per cent in the first ten months of the target period - equivalent to an annual rate of 15 per cent (though the figures were still being distorted by the effects of a civil service dispute in 1981). The story was similar in terms of interest rates. Thus under the Labour government, in November 1978 the Bank of England announced a rise of 2 per cent in the minimum lending rate (MLR) to 12 per cent and the Chancellor explained that "...in the light of current uncertainties,

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27) Treasury Economic Progress Report, No. 97, April 1978, p. 4.

28) Treasury Economic Progress Report, No. 100, July 1978, p. 4.

29) Ibid., p. 45.

he thought it prudent to err on the side of caution and establish short-term rates slightly above that then prevailing in the market".<sup>30</sup> Moreover, public spending's share of GDP is now higher than when Labour left office in 1979. We should therefore be extremely cautious in accepting the popular view that the Thatcher government did in fact represent a radical departure from previous economic policy in the UK. Apart from its lack of a prices policy and the fact that its pay policy only applied to the public sector, it is more accurate to see Mrs. Thatcher and her Chancellor Sir Geoffrey Howe as continuing the broad outlines of economic strategy as attempted by her predecessor Mr. Callaghan and his Chancellor Mr. Healey.

#### 4. The Thatcher Government in Practice

Sir Geoffrey Howe announced his first Budget on 12 June 1979. The Budget statement was entirely consistent with earlier Conservative statements. The new policy was presented as a complete change in attitude towards the way in which the economy worked. It was designed to remove the constraints imposed by the tax system and by "the unduly large role previously played by government - releasing initiative and enterprise". The government's policy will be to establish sound money through firm monetary discipline, and fiscal policies consistent with it, including strict control over public expenditure.<sup>31</sup> Direct taxes (mainly income tax) were cut by £3.5 billion with consequent increases of £2.5 billion in indirect tax in 1979-80. The Chancellor argued that the expenditure plans of the previous government would have made it impossible to meet the then 8-12 per cent target range for monetary growth without higher interest rates and taxes. In fact he had decided to lower the target range to 7-11 per cent in the period to mid-April 1980. This required a cut in the PSBR, which had been forecast at £10 billion prior to the Budget, to £8 billion in 1979 (the outturn in 1978-79 had in fact been £9 billion). The cut represented a reduction from 5

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30) Treasury Economic Progress Report, No. 105, December 1978, p. 6.

31) Treasury Economic Progress Report, No. 110, p. 1.

per cent to 4 per cent in the PSBR as a proportion of GDP. As an immediate measure the MLR was raised in an attempt "...to deal with the immediate problem of monetary growth being above the target range".<sup>32</sup> A start was to be made on expenditure cuts, "...the first stage of a long-term programme to reduce both the role of government and its borrowing, to re-affirm the place of the individual and to help finance income tax cuts". The Budget therefore included a squeeze on the cash limits already set by Labour and cuts in programmes, to be followed by a thorough review of spending of the years ahead (see Table 1 below).

An important consequence of the Budget was that it had a serious impact on the rate of inflation. Thus the government admitted that the Budget itself would add approximately 4 per cent to the Retail Price Index (RPI), which was the main indicator of the rate of inflation, leading to a rise in the rate of inflation to approximately 16 per cent in the third quarter of the year. (Once the Budget effect had taken place it was expected that the rate of inflation would fall back to 13 per cent in the following year). The justification for this hefty push to the rate of inflation was that the tax reduction would "improve incentives with the objective of raising the sustainable long-term growth rate of output and productivity ... everything else being equal this will reduce the extent to which a given rise in wages will add to unit labour costs and hence prices".<sup>33</sup> The government, in an attempt to reap the advantages of the cuts in income tax, introduced a new index of inflation - the Tax and Prices Index, TPI. This, it pointed out, showed an increase of 13.4 per cent in the year up to August 1979 compared with the RPI increase of 15.8 per cent. Trade union negotiators were therefore urged to take account of the tax position of their members in formulating new (hopefully more moderate) wage demands. (The government was later to de-emphasise the importance of the TPI when it was forced to increase the tax burden such that the TPI rose faster than the RPI). Initially at least the Government was prepared to trade off its objective of reducing the rate of inflation

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32) Ibid., p. 2.

33) Treasury Economic Progress Report, No. 112, p. 2.

Table 1. Expenditure Cuts in 1979 Budget

	£ million at 1979 Survey prices
Housing	300
Water authorities	55
Community land	50
Urban programme	7
Property Services Agency	25
Regional development grant deferral	145
Other industry, mainly NEB	65
Training and employment	172
Education	55½
Arts, libraries and National Land Fund	4½
Increased prescription and dental charges	34
Overseas aid	50
Trade	30
Gas, electricity, BNOG and other energy	323
Transport (roads 10, railways 15)	25
Scotland	76
Wales	16
Northern Ireland	35
<b>TOTAL</b>	<b>1,468</b>
Cut in contingency reserve	250
Defence (increase)	-100
<b>TOTAL NET CUTS</b>	<b>1,618</b>

In addition to these cuts there are the effects of the cash limits policy, expected to reduce planned programmes by £1,000 million in 1979-80, and estimated receipts of £1,000 million from disposal of assets.

Source: The Budget 1979, Treasury Economic Progress Report, June 1979.

against its objective of reducing personal taxation in an attempt to increase incentives.

The problem of conflicting objectives was also painfully evident in the Government's relations with the nationalised industries. (For a discussion of the overall impact of the nationalised industries on the government's strategy see below section 5). As we have seen, the government saw controlling the PSBR as a central feature of its economic strategy. The PSBR had to

be controlled, so it believed, in order to keep the money supply within the targeted limits. As it happens the borrowing by the nationalised industries was deemed by the previous Labour government to be within the PSBR. The Conservatives saw no reason to change this decision and so the borrowing requirements of the nationalised industries became of central importance to the government's economic strategy. This has been a point of bitter dispute throughout the government's terms of office. In particular the government has forced many of the nationalised industries (particularly electricity and gas) to raise prices faster than the average rate of inflation in order to generate a high proportion of investment funds internally. (In effect present consumers are being charged for future investment). This has fuelled inflation, the reduction of which has become the government's primary objective. Thus the government has trapped itself in a circular economic argument which runs as follows. Inflation is caused by excessive growth in the supply of money which in turn is caused by excessive public spending (funded by government borrowing). Inflation can only be controlled by use of strict monetary policy and strict controls of the PSBR. As the nationalised industries happen to be defined as being within the PSBR their borrowing must be strictly limited. Therefore their prices must be raised, which of course increases the rate of inflation which is exactly what the government's whole strategy is designed to avoid. In the case of gas and electricity the rapid increase in prices was partly justified on the grounds of energy conservation. However, the rapid rise in the prices charged by the nationalised industries was such that in 1980 they rose by 30 per cent, though by the end of 1981 the rise had been reduced to 11.1 per cent, roughly in line with the rate of inflation.

Another area where the government's own policies contributed to its difficulties in trying to reduce the rate of inflation, was interest rate policy. Thus in November 1979 the government increased MLR from 14 per cent to 17 per cent. The Chancellor considered it was necessary to take such action "...to bring the growth of the money supply within the target range. The increase in the minimum lending rate, which demonstrated the government's determination to act with firmness, went beyond the rise

in market interest rates at home".<sup>34</sup> (In fact MLR was nominally abolished in 1981 in an attempt to allow a greater role for market forces in setting interest rates. In practice the authorities appear to exercise just as much control as before). The policy of high interest rates, which has remained a characteristic of the government's tenure of office so far has of course increased industrial costs, accelerated the rate of bankruptcies and has raised the cost of house mortgages, which in turn has raised the rate of inflation still further. In fact the government did not intend to have a policy of high interest rates as it initially assumed that the money supply could be reduced by other means (i.e. reduced public expenditure). The pressure from industry, for the government to lower interest rates, has at times been intense and the government has therefore found a constant dilemma in its interest rate policy of following its economic theory or responding to its 'natural' allies in industry. As a result (and as a result of international money market factors) there have been considerable fluctuations in the interest rate. Each time the rate went down it was greeted by industry as welcome relief only to be greeted by howls of protest when it went back up again. Thus in Autumn 1981, after a rise in rates, industrialists protested that the rise had in a matter of weeks increased industry's costs by £1,000 million.

The link between interest rates and the exchange rate for sterling was also an issue of dispute between government and industry. Thus the high rate of the pound was often blamed on the policy of high interest rates and was cited as causing very considerable difficulties for British exporters (particularly in US markets). As a result the government was often under considerable pressure to reduce the exchange rate in order to help exports yet feared that if it did so it could add a further stimulus to the domestic rate of inflation. In fact the government had clearly stated, in its first Budget statement of 1979, that the exchange rate was a matter for market forces, though as we shall see it had seemingly abandoned this view by 1982 by which

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34) Treasury Economic Progress Report, No. 116, p. 1.

time exchange rate policy had come to play a far more central role (see section 7).

Space does not permit a detailed review of the economic measures taken by the Thatcher government 1979 to the present.<sup>35</sup> There were, however, two central themes throughout the period, (1) the Government continued to insist that there was no alternative to the strategy as outlined in the Medium Term Financial Strategy (MTFS) published with the Budget in March 1980. (There were however 'adjustments' of the MFTS to take account of the deepening recession, e.g. it allowed the PSBR to rise well above target in 1980-1). The 1980 strategy reflected the policies outlined earlier, i.e. a progressive fall in the volume of public spending, a substantial reduction in government borrowing as a proportion of national income, reduced levels of taxation, and a steady reduction in the growth of the money supply. Thus the MTFS predicted that the target range for the growth of sterling M3 would be 7-11 per cent for the period February 1980-April 1981, with a planned reduction to 6 per cent by 1983-4. The PSBR was to be reduced in 1980-1 to not more than approximately £8 billion, causing a reduction in the proportion of PSBR of GDP from 4 per cent (in 1979-80) to 3 per cent in 1980-1. By 1983-4 the total of public expenditure was planned to be 4 per cent lower in real terms than in 1979-80. The projections contained in the MTFS are summarised in tables 2 and 3 below.

Table 2. 1980 Projected Ranges for Growth of the Money Stock

	(Sterling M3)*			
	1980-81	1981-82	1982-83	1983-84
Percentage change during year	7-11	6-10	5-9	4-8

\*As explained in the Green Paper Monetary Control (Cmd 7858), the way in which the money supply is defined for target purposes may need to be adjusted from time to time as circumstances change.

35) The most convenient source is the series of monthly Treasury Economic Progress Reports. Excellent summaries are to be found in Stephen Lewis and Anthony Harrison, "Public Spending. A Failure of Control", Public Money, Vol. 1, No. 1, June 1981. See also The Economist, 21 November 1981, pp. 104-05. The most detailed source for the Government's expenditure plans are the Annual White Papers on Public Expenditure.

Table 3. 1980 Projections for Public Sector Borrowing

	£ billion at 1978-79 prices					
	1978-79	1979-80	1980-81	1981-82	1982-83	1983-84
Total expenditure	74.0	74½	74½	73	71	70½
Total receipts	-65.0	-66	-67½	-67½	-69½	-71
Implied fiscal adjustment	-	-	-	-	2½	2½
General Government borrowing requirement	9.0	8½	7	5½	4	3
Public sector borrowing requirement (PSBR)	9.3	8	6	5	3½	2½
PSBR as percentages of GDP at market prices	5½	4 ¾	3 ¾	3	2½	1½

The Medium Term Financial Strategy concluded with a reiteration of the Government's faith in monetary theory, namely that "...there would be no question of relaxing the money supply policy, which is essential to the success of any anti-inflation strategy". The optimism of the Strategy was based on the assumption that public expenditure could be cut in the following areas - industry, energy, employment programmes, housing, education, and in the provision for net borrowing by the nationalised industries. Two points are particularly worthy of note in the context of the areas earmarked for cuts. Firstly, the Government's view that "by the end of the period the projection is that nationalised industries in aggregate, will be making net repayments of borrowing, as current losses are reduced and underpricing of electricity and gas is eliminated"<sup>36</sup> was tremendously optimistic by any past standards. Secondly, the view that expenditure on employment measures could be reduced was also tremendously optimistic in view of the evidence of a long term trend of rising unemployment in the UK. On both counts events proved far more difficult to manage (see below section 5).

In fact by the end of 1981 it was not unreasonable to suggest that the Medium Term Financial Strategy (even as later adjusted

36) Treasury Economic Progress Report, No. 120, p. 7. See also Cmnd 7841, March 1980.

to take account of the deepening recession) was virtually in ruin. Thus the rate of inflation, which the government had hoped to reduce to single figures by the end of 1981, was still some 12 per cent (compared to the then average for industrial countries of 10.1 per cent). The money supply, on the sterling M3 definition, was hopelessly off target with an annual growth rate of approximately 16 per cent in the period February-December 1981. In fact it is a very difficult technical question as to whether the money supply policy had been tight or very lax. The political debate certainly assumed a tight monetary policy with the government proud of its attempts to control money supply and its opponents critical. There was, however, very real technical difficulty in actually knowing what the money supply was and rival definitions abounded. On the conventional M3 definition the policy of tight control had not been implemented but using other monetary indicators, e.g. private sector liquidity (PSL2) it was possible to argue that there had in fact been a tight monetary policy. For example, by 1981 the government was talking of growth in output in money terms GDP as indicating that a successful brake had been applied. Indeed, one of the academic architects of the government's monetary policy publicly confessed in December 1981 that the government's restrictive monetary policy was to blame for bringing about the worst recession since the 1930s. He was reported as saying that the adherence to its monetary targets had pushed up interest rates and thus the exchange rate to unwarranted heights. He had come to reject the view, originally held by the Government, that once the monetary target was set, everything else should just follow in its train, even if that meant high interest rates and high exchange rates. The Government's policy of reducing the tax burden had also been a failure and it had to admit that the tax burden had actually increased since it took office (as a result of tax changes not taking full account of inflation). Indeed taxes rose more sharply in the UK in 1981 than in any other leading industrialised nation, according to the OECD.<sup>37</sup> Thus tax revenues, including social security contributions, rose by 2 per cent from 34 to 36 per

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37) See The Times Business News, 28 October 1981.

cent between 1979 and 1980. As a result of the 1981 Budget, in which in addition to refusing to raise tax allowances in line with inflation, the Chancellor increased taxes on beer, tobacco, petrol and increased national insurance contributions, the Government had increased the direct tax burden on the average taxpayer to levels higher than when Labour left office in 1979, i.e. incentives had been reduced. For example the 1981 budget meant that the average family paid 26.8 per cent of their earnings in tax in 1980 but this had increased to 28.9 per cent in 1981. (In fact the UK was eleventh in the OECD table according to the percentage of GDP taken in taxes). The Government had thus traded its policy of increasing incentives by reducing taxation for its attempt to keep the money supply (via controlling the PSBR) under some form of control. On the public expenditure front, the Government's record looked equally disappointing when measured against its stated aims. Thus public expenditure by the end of 1981 was actually higher in real terms than when the government took office in 1979. Whereas the government had planned that the volume of expenditure in 1982-3 would be 3 per cent lower than when Labour left office it is likely to be over 4 per cent higher.

As the Financial Secretary to the Treasury, Nigel Lawson, stressed to a meeting of bankers in Zurich in January 1981, the achievement of the government had been in reducing the planned increases in public expenditure, as inherited from the previous Labour government. Reducing the planned increases had of course been politically unpopular, though he was then still hoping that by 1983-4 public expenditure would be some 4 per cent lower than in 1979-80 and would by 1982-3 be 11 per cent lower than the planned figure for 1982-3 as put forward by the last Labour Government. Hope it seems, still triumphed over experience!

For details of the expenditure trends in the main programmes, see Table 4 below.

Essentially the Government had fought (and continues to fight) a number of bruising battles in some areas, e.g. education, only to find that gains (in terms of cuts) in one sector were overwhelmed by increases in another area, e.g. costs of unemployment benefits. The political debate was therefore structured in terms

Table 4. Trends in Main Programmes

	1976-77	1977-78	1978-79	1979-80	1980-81
Defence	98.4	96.2	95.7	98.5	103.3
Overseas aid	96.2	101.8	113.9	111.5	113.6
Contributions to EEC	1,756.0	3,950.0	4,837.5	5,162.2	2,375.0
Other overseas	98.2	121.9	97.6	100.4	102.6
Agriculture	60.5	47.8	41.0	42.6	48.5
Industry	89.2	58.8	72.8	60.4	80.4
Transport	89.3	75.5	73.7	75.1	71.4
Housing	96.8	83.9	77.9	81.2	70.1
Other environmental	91.8	88.7	89.9	86.1	82.2
Law	102.2	100.0	100.9	104.9	110.1
Education	99.7	95.6	97.3	98.0	94.6
Health	101.0	101.5	104.1	104.5	105.2
Social Security	103.2	108.6	118.5	121.4	125.4
Other	93.2	89.8	89.3	91.0	92.0
Common	101.8	99.2	98.2	101.4	101.7
Scotland	98.5	95.2	97.2	98.7	95.9
Wales	100.4	97.2	98.4	99.6	96.8
Northern Ireland	99.7	99.0	107.2	106.0	107.5

Source: Public Money, Vol. 1, No. 1, June 1981, p. 53.

Note: All tables are in fbn at 1980 survey prices; those in index form use 1975/76 as base = 100.

of the Government's damaging expenditure cuts, when it was actually cutting, in real terms, relatively few areas but was trying to cut back on planned increases. It is appropriate at this point, therefore, to consider the main areas where the Government had real difficulty in trying to reduce public expenditure.

##### 5. The Areas of Greatest Difficulty

In very broad terms it seems reasonable to argue that the Government's main setbacks were in three key areas: 1) public sector pay; 2) borrowing by the nationalised industries; 3) the costs of rising unemployment. The Government itself would argue that a fourth area, local government expenditure, was also a key factor in creating problems on the expenditure front.

The question of pay in the public sector proved to be a very early setback to the Government. The government in fact inherited both a rising rate of inflation from Labour and a series of 'bread today and jam tomorrow' public sector pay settlements which had been entered into by Mr. Callaghan's Government during the so-called 'winter of discontent' prior to the 1979 election. The Labour Government had set up a Commission to compare public and private sector pay. This comparability exercise (the 'Clegg Commission') proved to be a central factor in raising the levels of public expenditure because during the election campaign the Conservatives pledged to honour the comparability awards. In this sense (apart from simple electoral considerations) the Conservatives fell into the trap of the policy style described earlier. Thus the Commission reflected a belief that difficult problems, like pay in the public sector, could actually be 'processed' successfully through setting up a committee or commission. As public service pay amounts to some 30 per cent of total government expenditure it was a fatal error of judgement to agree to hand pay determination over to any independent commission. (In the civil service too there had been a long-standing 'fair comparison' system which the Conservatives eventually abandoned, leading to a protracted civil service strike. It also, eventually, abolished the Clegg Commission). The damage caused by the Clegg Commission and civil service comparability machinery was readily illustrated by figures published by the Treasury in December 1981<sup>38</sup> which showed that during the 1979-80 pay round the 'Clegg awards' helped push public sector pay well ahead of rates in the private sector. The Confederation of British Industry produced its own estimates of the same period<sup>39</sup> which showed that pay to central and local government had increased by 25 per cent in 1979-80, with figures of 17.6 per cent in the nationalised industries and 16.7 per cent in private manufacturing in the same period. But in the 1980-81 pay round the public and private sector settlements came much closer together and indeed central and local government settlements were slightly lower at 8.1 per

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38) See Treasury Economic Progress Report, No. 140, p. 6.

39) See CBI Monthly News, January 1982, No. 1, pp. 6-7.

cent than private manufacturing (9.1 per cent). In the current pay round the government has been trying to implement a 4 per cent pay 'norm' in the public sector, though in a number of cases it has had to tolerate much higher settlements. For example, local authority workers received 7 per cent, the police received 13 per cent, the firemen 10 per cent, water workers 9 per cent and the miners over 9 per cent. In a very real sense the failure to control public sector pay was one of the greatest defeats for the government's avowed strategy so far. As the 1981 White Paper on Public Expenditure assumed a 4 per cent pay increase in the public sector, even this more moderate pay round could seriously upset the expenditure plans for 1982-3.

The second main area where it has encountered really severe problems has been with the nationalised industries. Typical of the problems has been the steel industry. Thus, shortly after taking office, the Secretary of State for Industry, Sir Keith Joseph, announced that the government would not fund British Steel's losses beyond March 1980. (In fact in 1978-9 BSC has lost £309.4 million and during 1979 the position continued to weaken). This has proved to be a hopelessly unrealistic target. The Corporation lost a massive £545 million in 1979-80. By the end of the year Government support for BSC had mounted to 971 million. In 1981 the Corporation's borrowing limit was increased to £6,000 million with a total of £1.28 billion in aid for BSC in the period 1980-2. The Government faced similar problems in other nationalised industries such as British Leyland, British Airways, the railways, and the coal industry. Indeed, the Prime Minister's personal frustration led her to ask the Central Policy Review Staff (CPRS) to examine the whole question of the relationship between government and the nationalised industries. As The Economist reported, she complained that "I scrape around for savings of £1 million here or £5 million there, and this lot come back looking for hundreds of millions more".<sup>40</sup> Basically the Government could not escape from the long-term financial problems of the industries, although it has introduced a number of 'privatisation' (partial denationalisation) measures which

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40) See The Economist, 8 August 1981.

will produce once and for all benefits to the Treasury. (The most notable example being the sale of a significant proportion of the assets to the British National Oil Corporation, planned for 1982. Other 'privatisation' schemes included British Aerospace and Cable and Wireless).<sup>41</sup> An added benefit, apart from the revenue from the sale of assets is that the resulting companies (part public, part private) can be considered to be outside the PSBR. The issue of the financing of the remaining public corporations (the vast bulk in fact) continues to be a question of bitter conflict between the corporations and the Government.

The third area where problems have been severe is the direct result of the recession - namely funding the costs of the unemployed, and funding the costs of various programmes designed to keep people off the labour market. Some one-third of the total of public expenditure is demand determined and therefore not subject to the cash limit system. In February 1981 the Treasury estimated that for each 100,000 increase in unemployment the cost to the Exchequer was £340 million. By January 1982 the total unemployed in the UK had risen to over 3 million compared to 1.3 million in 1979. The sheer cost of funding this ever increasing burden was, therefore, bound to have serious effects on the level of public expenditure. In November 1980 the Chancellor had estimated that over £1 billion had then been added to the PSBR as a result of the recession being deeper than expected. The costs of funding those actually unemployed had, of course, to be added to the cost of various job protection and job creation schemes funded by the Government in an attempt to moderate the rate of increase in unemployment. In particular the young unemployed were a sensitive political issue and one of the leading moderates in the Cabinet (see below) James Prior, when Secretary of State for Employment, was successful in securing increased expenditure for the job creation programme. The Government is now, even under a so-called hard-line Secretary of State for Employment, committed to a £1,000 million training programme for the young unemployed in an attempt to guarantee every 16 year old a job, a basic industrial training or further education

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41) See A.G. Jordan, Privatisation: Variations on a Theme, 24 pp., University of Aberdeen, 1981.

for September 1983. Basically the Government had recognised that it would be political suicide to face an electorate (by May 1984 at the latest) with a very high percentage of school leavers unemployed - hence the scheme to remove all 16 year olds from the labour market for two years. Indeed, the mounting levels of unemployment present the greatest electoral threat to the government and to its financial strategy and it is to be expected that as the election draws near, further concessions will have to be made on this front as the unemployment question is now of course an issue of tremendous political salience.

The question of local authority expenditure has also developed into a major political issue with bitter conflict between Government and the local authority associations. So bitter has the conflict been that the Government has in fact formulated proposals which could fundamentally change the relationship between central and local government in the UK. The Government's view has all along been that local authority spending is 'too high'. Thus for example, as early as July 1979, Mr. Heseltine, the Secretary of State for the Environment, issued a circular to local authorities which gave them a clear and early warning of the need to cut expenditure (local authority expenditure accounts for approximately one-third of total public expenditure). The public battle between Mr. Heseltine and the local authorities and their supporters has continued throughout the Government's period of office. The normally well-regulated local government policy community is now characterised by deep and bitter conflict rather than the consensus and compromise of earlier years. Mr. Heseltine's position is that despite a series of cuts (one issue has been a dispute over just how big the cuts have been) local authority expenditure is still too high. The central issue has been the fact that a number of local authorities (particularly Labour but not solely) have failed to observe the spending 'targets' set by central government. A whole series of disputes over the targets have resulted (including legal action which ruled that the Minister had acted unlawfully in cutting the rate support grant of six London boroughs). This dispute has culminated in an attempt by Mr. Heseltine to secure a means of controlling the power to raise rates (local property taxes) by local authori-

ties. Having failed to secure the desired degree of control by using the traditional rate support grant system (whereby central government funds approximately 60 per cent of local government spending) Mr. Heseltine introduced the Local Government Finance Bill in the autumn of 1981. This proposed that a local authority should have to hold a local referendum if it wished to introduce a 'supplementary' rate increase, once the rates had been set for the financial years (there has been an increased tendency for local authorities to issue supplementary rates over the last few years to cover increased expenditure during the year). This proposal was seen by the local authorities (both Conservative and Labour) as striking at the very foundations of local government in Britain. They received support in this view, not only from the official Opposition but also from very many Conservative MPs. Eventually the measure was withdrawn in the face of this bitter opposition (and after a Commons revolt by some of the Government's own supporters) and it has been replaced by a bill proposing to ban supplementary rates altogether. It remains to be seen whether this measure will in fact be passed. Mr. Heseltine has also modified the rate support grant system in an attempt to force councils to spend less on services and more on capital investment. This detailed intervention is also proving highly controversial. (In fact a common feature of both central and local government expenditure over the last two years is that capital expenditure has been hit very severely - thus hitting British industry - whilst the politically more difficult job of reducing expenditure on labour intensive services has been to a large degree avoided. Though it should be noted that the Government has had success in reducing the numbers employed in the central civil service).

One great difficulty in assessing the conflict over local government spending is that the debate has been largely structured around the Government's view that local authorities have been irresponsible and have failed to control their expenditure. In fact the local authorities have probably been much more successful in controlling their expenditure than has the central government itself. The battle has arisen because local authorities have not cut their expenditure as much as the Government had planned.

It is extremely difficult to disentangle the spending figures but the most reliable estimate suggests that local government managed to reduce its expenditure by some 3 per cent in real terms since 1979-80.<sup>42</sup> Local government capital and revenue expenditure has fallen from 29.9 per cent of total public expenditure in 1975-6 to 25.6 per cent in 1980-1 and was planned to fall to 24.2 per cent in 1981-2, i.e. local government spending has been falling while central government spending has been rising. Between 1975-6 and 1981-2 central government expenditure increased (in terms of 1980 survey prices) from £54,377 million to £58,655 million. Over the same period local government spending fell from £24,686 million to £19,200 million. In real terms central government expenditure over the period increased by 8 per cent whereas local government expenditure fell by 21 per cent.<sup>43</sup> It is difficult, therefore, to escape the conclusion that central government, having failed to control its own expenditure, turned towards local government to save the day for the Medium Term Financial Strategy. In fact the political power of the local authorities began to re-assert itself by the end of 1981. In December it was clear that the local authorities had won their 2 year battle with the Conservative Government when it was announced that they would be allowed to spend £1,000 million more than laid down in the White Paper on Public Expenditure earlier in the year. As The Times reported, the government gave way because "it could not face the political consequences of the chaos and damage that would be caused by forcing authorities to reduce staff and services by nearly a tenth in a single year".<sup>44</sup> Local authorities were, like other public sector organisations adept at cutting those services which had the greatest political salience, e.g. help to the aged, books for schoolchildren. Whatever the level of cutbacks imposed (either real reductions or reductions in planned increases) there seemed to be an unwritten rule

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42) See George Jones et al., Local Government Chronicle, 11 September 1981.

43) See Tom Caulcott, "The Unreal World of Spending Controls", Municipal Review, December 1981, No. 620, p. 152.

44) See The Times, 2 December 1981.

that the affected organisations would trim those areas of their activity most likely to inflict political damage on the government. Early on in the life of the Thatcher government the term 'waiving the shroud' (prompted by Health Authorities making politically sensitive cuts in areas such as care for the handicapped) gained wide currency within Government circles. It was a recognition of one of the fundamental weaknesses of the Government's position - namely even if it could persuade its own ministers to cut their programmes (which it generally could not) the actual implementation of the process lay in the hands of other agencies anxious to defend their sectors by any means, fair or foul.

#### 6. Cabinet Conflict and the Emergence of a More Flexible Approach

The continuing conflict between the Government and the local authorities was of course echoed by a similar conflict within the Government itself and amongst its parliamentary supporters. In fact the most central feature of the Government's period of office to date has perhaps been the well publicised battles within Cabinet between what have become known as the 'wets' and 'dries'. (A 'wet' is someone who is a consensus politician, wedded to the process of compromise, not heavily influenced by ideology, and who does not support the monetarist theories of Mrs. Thatcher and her supporters. The wets in the Cabinet were basically keen or at least willing to see increases in public expenditure). Indeed Mrs. Thatcher's much publicised Cabinet reshuffle in September 1981 was predictably cast by the media in terms of the by then well-worn scenario of wets vs. dries. Thus Mr. Prior, who had emerged as the leading Cabinet spokesman for the wets, was unwillingly moved to the post of Northern Ireland Secretary. Another prominent wet, Sir Ian Gilmour, who had publicly challenged the Government's monetary strategy, was sacked, as were two other wets, Lord Soames (Lord President of the Council and Leader of the House of Lords) and Mark Carlisle (the Secretary of State for Education and Science). Somewhat earlier Norman St John Stevas, also a leading wet, had been dropped from the Cabinet, after publicity for his anti-monetarist views. Many observers saw the September 1981 re-shuffle as a re-assertion

of Mrs. Thatcher's personal power and as a victory for the hard-liners in the Cabinet. David Watt, writing in The Times was much nearer the truth when he saw the change as perhaps the high water mark in the power of Mrs. Thatcher and the 'dries' against their opponents in the Cabinet. It was more indicative of the limits of their power.<sup>45</sup> Even after the re-shuffle the 'wets' were still in the majority and in January 1982 Mrs. Thatcher agreed to a full Cabinet meeting to discuss strategy for the forthcoming budget. This was an almost unique occasion as Cabinets are not normally afforded such an opportunity. In fact the history of the Cabinet under Mrs. Thatcher was little different from the history of previous Cabinets - namely a struggle between the Treasury team on the one hand and the spending ministries on the other. As it happens Mrs. Thatcher had been particularly unlucky in one of her spending ministers, Sir Keith Joseph as Secretary of State for Trade and Industry. He was certainly one of the more fundamentalist of the monetarists in the Cabinet and a strong personal supporter of Mrs. Thatcher. The talk on his arrival at the Department was of its gradual run-down as Government progressively withdrew from its interventionist role in industry. In fact Sir Keith was one of the greatest failures of the Government and left the Department with a reputation as the last of the big spenders. (He is now at Education and Science where he has 'softer' external groups with which to deal, e.g. universities, and may achieve greater success as a result). Moreover, she had operated with a Cabinet very similar to that formed by Mr. Heath in 1970-4 and which was responsible for a very rapid increase in public spending. As always, the PM has to form a Cabinet not too unrepresentative of the party as a whole and it was therefore inevitable that the Cabinet would reflect the continuing conflict within the party as a whole over her own monetarist beliefs.

It was of course never clear at any given time whether the 'wets' or 'dries' were in the ascendancy but the results in totality do seem to confirm the view that the Cabinet was, like its predecessors, as much a prisoner of the fundamental nature of

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45) See The Times, 16 September 1981.

the policy process (and of international developments) as it was master of its own destiny. As different ministers also had different views of the desired destiny this virtually guaranteed that a process of trading, incremental bargaining and adjustments and a 'fudged' compromise would result. The particular issues changes, but the process was following a fairly well trodden path. Thus when defence was threatened with cutbacks in planned growth (the Conservatives had pledged to increase defence spending in their manifesto) the Secretary of State for Defence, Francis Pym (in fact also a 'wet'), successfully mobilised the Defence Chiefs and Conservative backbenchers to defend his budget. (He was later moved sideways and replaced by John Nott, said to be much tougher on spending). In other cases the Prime Minister herself was ready to make concessions which inevitably increased public expenditure. For example, in February 1981 the PM was personally involved in the decision to give way on the question of the National Coal Board's plan to close uneconomic coal mines. In effect the threat of a miner's strike caused the PM to change her mind and agree to increase expenditure to cover the cost of not closing a number of pits. One of her closest colleagues, John Biffin was honest enough to admit at the time that when faced by tough pressure the Government would back down. He did not, he said, enter politics to be a Kamikaze pilot. The Government was, he said, 'at heart very Tory and pragmatic'.<sup>46</sup> More specifically the climbdown on pit closures illustrated a fundamental weakness in the cash limits policy. In theory the policy was designed to avoid political difficulties by distancing Government from day to day issues. Thus in the case of coal the Government had set a cash limit and had decided that the coal industry should break even in 1984. Yet faced by the possibility of industrial trouble from the miners it increased the cash limit for coal by £300 million. (Though in the case of the civil servants it felt on much firmer ground and eventually withstood industrial action fairly successfully). By June 1981 it was evident that the whole of the Cabinet, wets and dries alike, could not exhibit the traditional Tory pragmatism to which Biffin had

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46) See The Times Business News, 24 February 1981.

earlier referred when it backed away from a further attempt to reduce taxation in favour of supporting the plan (referred to above) to provide every school leaver with either a job, training, or further education until the age of 18. By the end of 1981 the Treasury was seemingly resigned to the fact that the preceding two years of bruising battles with spending Departments (caused by several attempts to reduce expenditure) had probably squeezed as much as was politically possible from the Departments and their vociferous client groups. In essence it had to accept that there would be an overrun on public spending, from planned totals<sup>47</sup> and its efforts were apparently confined to 'damage limitation'.<sup>48</sup> Events too have had their impact. For example, extreme violence in some of the inner cities, such as Liverpool, has produced Government money as has the severe winter, in terms of aid to hard-hit local authorities.

Outside the Government, its own backbenchers have also become increasingly restive as their constituents lose their jobs and as industrialists have applied pressure for an easing of the hostile economic climate in which they operate. Throughout the period of office there has been vociferous pressure from some of the Government's backbenchers. They now have sacked Cabinet Ministers, such as Sir Ian Gilmour and Norman St John Stevas, (as well as former Prime Minister Edward Heath) to articulate a counter-policy to that of the Chancellor, Sir Geoffrey Howe. Towards the end of 1981 there were very clear signs that the backbenchers had been pushed too far by the Government's successive attempts to cut expenditure, control the money supply and by its policy of high interest rates. Thus, as indicated earlier, the local authority referendum proposal had to be dropped. Fourteen government backbenchers abstained in a vote on Sir Geoffrey Howe's unpopular mini-budget in December (see below) and the proposal to reduce the real value of unemployment benefit by 2 per cent is also likely to be dropped as a result of such pressure (the Cabinet itself had rejected the Treasury's proposal

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47) There has, however, been a problem of underspending on certain programmes in the past. See Government Economic Service Working Papers, No. 31 and No. 4.0.

48) See The Times Business News, 26 October 1981.

to reduce benefits by 5 per cent and the 2 per cent reduction was the compromise which had resulted). Though there were also revolts against other measures (not directly linked to expenditure questions) the real effort was to defeat the Treasury's proposals. As The Economist noted at the turn of the year, the Treasury had lost all the significant battles since the public spending round (i.e. process) had commenced in September. By January this year Mrs. Thatcher was admitting, in a radio interview, that she would have cut expenditure more severely if her party would have let her. The significance, as one observer suggested, was that by the end of 1981 the fierce battles appeared to be virtually over. "She would have liked to secure deeper cuts than have been achieved every year since she came to office. What was different last autumn was that she accepted fairly early on that she could not get the cuts she wanted. For once the Cabinet did not tear itself apart over public expenditure".<sup>49</sup> Even Sir Keith Joseph was claiming that it was inaccurate to talk of public spending being cut. It was rising less fast.<sup>50</sup>

The pressures to retreat from the amended Medium Term Financial Strategy, which embodied the Government's primary economic policy objectives, was also felt outside government and parliament. Naturally the Labour Party and the trade unions opposed the Government's policy as did virtually every client group in the UK (even university Dons marched on parliament in protest against expenditure cuts!). That kind of pressure was of course to be expected and was indeed politically damaging. Of greater significance was the developing pressure from industrial interests for a change in policy. By the end of 1981 the pressure for a lowering of the exchange rate and for lower interest rates, which had been present throughout the term of office, was transferred into a more generalised demand for a stimulation of the economy and for specific policy changes (such as the advocacy of the removal of a national insurance surcharge paid by employers - effectively a tax on employment). As early as March 1981 the CBI had produced its own economic programme advocating an expansion of government

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49) See The Times, 16 January 1982.

50) Report in The Times, 30 November 1981.

spending by £1,500 million a year for each of the next four years. It predicted that if the government did not change its policies output would grow by less than 1 per cent a year by 1985, unemployment would rise to well over 3 million, inflation would fall only slowly and company profitability would remain weak. The £1,500 million per year package would primarily be designed to stimulate major capital investment programmes, such as roads, railway electrification which would directly benefit industry. (The CBI was at the same time suggesting cuts in public sector employment and this of course distanced it from the TUC. However, the CBI Annual Conference in 1981 did pass a resolution calling for a joint CBI/TUC initiative to help deal with rising unemployment.<sup>51</sup> The Association of British Chambers of Commerce also added its voices in calling for a £2,000 million investment package in defence, telecommunications, roads and railways, with positive support for industry through the introduction of two-tier interest rates and other specific measures.<sup>52</sup> The pressure for some stimulus to the economy was of course both public and private. Industrialists were certainly more willing to criticise the government in public, but there is no doubt that Conservative MPs have come under increasing pressure in their constituencies from industrial interests. The likelihood is that this developing pressure will re-enforce the Government's own political instincts when a general elections draws near.

Current signs are that significant U turn of the December 1981 mini-budget will be the start of a U turn in the image of the Government in an attempt to regain the centre-ground of British politics (particularly in the face of the advances by the new Social Democratic Party). Though the mini-budget had some 'tough' aspects (for example increased medical prescription charges) it increased public expenditure by £5,000 million above planned levels. Moreover the Chief Secretary to the Treasury (by then Leon Britton, as John Biffen had been moved to Trade) was publicly arguing that the increase in public expenditure

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51) See J.J. Richardson, "Private Sector Responses to Unemployment in the UK: The CBI Initiative" (forthcoming).

52) See The Times Business News, 10 December 1981.

showed that the Government was prepared to be flexible. The increase, he argued, showed that the Government was neither inflexible nor blinkered. The decision "...disposed effectively of the notion that the government refused to adjust its plans to respond to changed circumstances [and was] a conscious, deliberate, collective response by the Government to the realities of our present position".<sup>53</sup> Other Government spokesmen also began to emphasise those indicators where the Government could claim some success. For example, Terry Burns, the Treasury's Chief Economic Adviser, pointed out that the PSBR, as a percentage of GDP, had fallen from 6 per cent to 4 per cent and that the 1982-3 target of £9 billion looked attainable. (In fact it looks as though the £10.5 billion target for 1981-2 will be met thanks to buoyant revenues).

#### 7. Conclusion. Radical Image and Traditional Policy Style

The fact that broadly speaking the Government's actual behaviour did not really match its stated objectives, together with the fact that more recently ministers have been proclaiming their flexibility, is in very stark contrast to the public image of the Government - particularly Mrs. Thatcher herself. Throughout her Premiership she has gone out of her way, in public, to stress that she was being radical and tough and intended to continue that way. Thus shortly after taking office she was asked what have you changed and replied "I have changed everything". She has been particularly anxious to avoid the accusation that she was making the kind of policy 'U turns' for which her Conservative predecessor, Mr. Heath, had become famous. Her speech writers were singularly successful in inventing catch-phrases which emphasised the tough unbending approach. Thus, in addressing the 1980 Conservative conference she assured her audience that "this lady at least is not for turning" and on another occasion replied to her critics that "I'm not turning, you turn". She also constantly insisted that There Was No Alternative to the Government's strategy and as a result acquired the nickname TINA. Even as

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53) The Financial Times, 12 December 1981.

recently as the 1981 Conservative conference she was still insisting that the Government would stick to its path. "If ever a Conservative Government starts to do what it knows to be wrong because it is afraid to do what is right, then that's the time for the Tories to cry 'stop'. But you'll never need to do that while I am Prime Minister". The result of this tough, abrasive, inflexible image, which as I have suggested was quite unrelated to the reality of the Government's actions, was that Mrs. Thatcher (and her Government) have become extremely unpopular. By the autumn of 1981 she was the most unpopular Prime Minister since polls began. (She was, however, more popular than the Opposition leader Mr. Foot, but only because he was the most unpopular Opposition leader since polls began"<sup>54</sup>).

It is the greatest irony of Mrs. Thatcher's Government that the myth of tough radical change, which hid what was in general the traditional policy style described in section 1, should both be the cause of the Government's unpopularity and at the same time was probably the cause of its greatest success. Thus in the midst of much policy failure the Government had managed to create a climate of opinion in Britain which was in many sectors conducive to change. In particular British industry, amidst public cries that the industrial base was being destroyed by the Government's economic strategy, has for the first time since the second world war, really begun to increase its competitiveness and has made rapid progress in reducing the gross overmanning which had become a central feature of Britain's industrial decline. The hostile climate has encouraged managers to take tough decisions and has encouraged workers to accept radical changes in industry. Even in the public sector, where the nationalised industries have played a central role in reducing the Government's monetary targets, there has been very rapid de-manning. For example, the British Steel Corporation has shed some 70,000 jobs in two years. Publicly owned British Leyland has also gone through a similar de-manning exercise. It is a little difficult to fully explain why for the last two years industry has started to make the painful adjustments which have been long recognised as necessary but which have hitherto been avoided. But there is little

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54) See Ivor Crewe in The Times, 9 October 1981.

doubt that a widespread belief has emerged that Mrs. Thatcher really was tough and that as a result, Government would not step in to rescue every enterprise or subsidise continued overmanning. British Leyland is perhaps the classic case where the Chairman, Sir Michael Edwardes, has implemented a very tough management style and has been able to do so because, for the first time, Leyland workers believed that the Government really would let the company go into liquidation. So in cases like steel and British Leyland, the Government has, at very great financial cost, secured a much needed de-manning exercise. Moreover, the fact that the Government did not panic into a large and rapid stimulus to the economy, but has so far allowed unemployment to rise to very high levels, has had a very salutary effect on everyone who has a job. In essence the Government has had some success by not doing things as the world recession took its effect.

This non-activity has had three specific effects. Firstly wage demands have moderated considerably as workers, particularly in the private sector, began to recognise the link between wage rates and employment levels in their own enterprise. Secondly the strike record has improved dramatically. Thirdly, and most important, the productivity of British industry has shown a marked improvement. Thus between the fourth quarter of 1980 and the third quarter of 1981, output per person in manufacturing rose by almost 10 per cent, and output per person hour by 8 per cent.<sup>55</sup> The high levels of unemployment, which the Government has so far tolerated, together with the general effects of the recession, have both helped to reduce inflation and to increase efficiency. And there are no signs of the start of an industrial recovery.

In conclusion one might say that the Thatcher Government has found it impossible to cut the total level of public expenditure and has in general not been a radical innovative government. As The Economist observed after the December 1981 Budget the Government under Mrs. Thatcher has been as 'rigid as an eel'.<sup>56</sup>

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55) See Treasury Economic Progress Report, No. 141. See also C.F. Pratten, "Mrs Thatcher's Economic Experiment", LLoyds Bank Review, January 1982, No. 143.

56) See The Economist, 5 December 1981.

The Government's attitude towards unemployment can be seen as a break with tradition. However, unemployment was already at a historically high level when Labour took office and the postwar policy of maintaining full employment had therefore already been abandoned (Jim Callaghan had as PM warned the country that unemployment would continue to rise until inflation was squeezed from the system), Mrs. Thatcher has been unusual in the extent to which she has been prepared to withstand political unpopularity and pressure for a large reflationary package to 'deal' with unemployment. The difficulty with this policy is that eventually she has to face the electorate (this time with a new and so far very popular moderate, consensus party, the SDP, in the field). It seems inconceivable that, faced with the prospect of electoral defeat, that Mrs. Thatcher's Government will not further amend its policies in order to reduce unemployment to more acceptable levels. To do so will, however, prove difficult without even more specific and costly Government intervention. Even as the economy begins to pick up (as it appears to be doing) it is highly unlikely that firms will readily return to the previously excessive manning levels of the past, i.e. the link between growth and employment has probably been broken. If this is true then only massive, publicly funded schemes for the unemployed can produce electoral success for Mrs. Thatcher. Her policy of allowing expenditure to rise above planned targets, the de-emphasis of monetary targets (the Governor of the Bank of England has for example recently stated that the Government's approach to monetary policy has become more pragmatic) and the return to managing the exchange rate which has become so evident recently, all suggest that Mrs. Thatcher, like her predecessors, can be as pragmatic as is necessary when the time comes. As one observer has noted she may not be keen on U turns but she is certainly on an upward learning curve.