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Reaganomics and Thatcheritis

by Allan H. Meltzer

Opponents of President Reagan's program take a quick look at Britain and smile. They believe after two years the U.S. economy will have many of the characteristics of the current British economy -- high unemployment, an uncertain recovery, low investment, a large budget deficit and double digit inflation. They believe, in short, that Reaganomics will produce Thatcheritis.

Prime Minister Margaret Thatcher came to power following elections in the spring of 1979. She promised a medium-term strategy to repair the damage done to the British economy by the failed policies of her predecessors in both parties.

Thirty years of welfare state socialism and Keynesian tinkering had left the British economy in a mess. Inflation for the previous decade was at the top of the European average, along with Spain and Italy. Real growth was the lowest in Western Europe. Taxes were high, incentives low and overmanning of private and public jobs visible to anyone who looked. British Steel, British Airways, British Leyland, British this-or-that had been nationalized. The nationalized firms drew checks on the Treasury -- which is to say on the taxpayers -- to pay their large losses, many of them the result of overmanning. Yet, despite public employment programs and overmanning, total employment increased at an average rate of one-tenth of one percent from 1960 to 1979, and unemployment more than doubled.

Mrs. Thatcher promised that her government would reduce tax rates, reduce the growth of government spending, sell many of the nationalized
firms and much of the nationalized housing to private owners, control
money growth, reduce inflation and reform the labor laws. The program
was considered too much of a wrenching break with the past to be introduced
at once, so the strategy called for gradual implementation and gradual
achievement. No one thought success would come quickly, and many expected
that a recession would not be avoided.

Looking back after two years, it is surprising that so much was
promised and so little was done. Income tax rates and spending cuts
were passed shortly after the government took office, but taxes on spending
increased. Britons now pay a 15% sales tax on everything they buy.
The Bank of England was told to control money growth.
The Bank's record is a mixture of good intentions and poor performance.
The Thatcher government promised to improve the Bank's performance but
has not succeeded. Some pieces of the nationalized industries were sold,
but most remain as they were.

The burden of anti-inflationary policies fell mainly on the private
sector. While unemployment rose to a postwar record, the wages of government
employees rose about twice as fast as private sector wages. To slow the
increase in the government's budget deficit, due mainly to rising public
sector wages and payments to the unemployed, Mrs. Thatcher's government
raised taxes on oil companies and consumers. Recently, under the pressure
of the nightly riots, spending increased again.

There are some achievements. Inflation has been reduced. Exchange
controls have been eliminated. But, the gap between promise and achievement
in Britain is very wide. Valid explanations of the gap include slow growth of
world output and world-wide disinflation of the last two years but, valid
or invalid none can explain the record away.
Mrs. Thatcher's government began to retreat from the medium-term strategy when the Cabinet refused to reduce government spending last fall. Since then, some ministers have continued to talk about the medium-term strategy. They have done little to implement it.

Some features of President Reagan's and Prime Minister Thatcher's programs are similar. There are some important differences in the two countries, however. We have not persisted as long or gone as far toward welfare state socialism, so we will find it somewhat easier to reduce the growth of government now that we have chosen to do so. Our inflation rate has been lower. Government and union rules reduce labor mobility in both countries but much less in the United States than in Britain. Perhaps most important of all, the Reagan administration has done more to implement its fiscal program in six months than the Thatcher administration has done in two years.

Congress approved a program to reduce the growth of government spending, to tax current income from capital investment at the same rates as labor income and to tax capital gains at the lowest rate that many of us remember. Further, the fiscal program provides greater certainty about future tax rates than most of us have known during our working lives.

These and many other features of the new tax and spending policy are better publicized but no less important than the steps to reduce inflation. I believe that many observers underestimate both the importance of the now freely floating exchange rate in the transition from high to low inflation and the importance of administration monitoring of Federal Reserve policy to assure that monetary policy is not, again, inflationary.

The administration's record is not flawless. It accepted auto import quotas and the all savers' bill that subsidizes the savings industry. It
waffles and dodges on some farm subsidies. And it has not been tested yet by recession and rising unemployment. Within the next six to nine months, we are likely to learn whether the administration will keep to its long-term strategy in a period of high or rising unemployment.

There is a difference between promise and performance. Only people who do not distinguish the two will fail to see the difference between Reaganism and Thatcheritis.
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