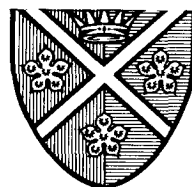


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PUBLIC FINANCE IN THE THATCHER ERA:

A Critical Assessment

by

Arthur Midwinter

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Introduction: In Pursuit of Sound Finance

In terms of political ideology, we tend to regard the parties as having substantive differences over the role of the state, public spending and taxation, and certainly in terms of rhetoric, this was so in the 1980s. The rhetorical divide is apparent again in the run-up to the 1992 General Election, with the Conservatives returning to the attack on Labour's alleged financial incompetence, reflected in the campaign slogan, "Labour's Going For Broke Again". This refers to the growth of public borrowing and the necessity for loan facilities from the IMF to deal with the economic crisis of 1976 which followed the major increase in oil prices.

In this paper, we examine the public finance strategy and performance of Conservative Governments since 1979. Mrs Thatcher's electoral victory of that year marked a change in posture towards public spending, with an overt commitment to its reduction. It was seen as being at the heart of Britain's economic problems. The emergence of a New Right within the party, (if not the Government) gave an ideological impetus to reform resembling the 'Selsdon Man' approach which was quickly abandoned by the Heath Government in 1970.

The theoretical basis of New Right politics is a combination of three aspects of economic theory : *economic liberalism*; which argues from first principles that markets provide the best mechanisms for individuals to maximise their welfare ; *monetarism*; which argues that control of the money supply is the key to the control of inflation; and *public choice* ; which applies economic concepts to the analysis of politics and bureaucracy. The normative predisposition of most adherents to such theories is that of reducing the scope of government, to create incentives and stimulate

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enterprise. In terms of budget strategy, this translates into a fundamental concern with public spending, taxation and government borrowing.

For the new Conservative Government this meant a dispensation with the perceived political consensus of the past. Margaret Thatcher paid 'due penance' (Foster, 1984) for her part in past Conservative administrations which neglected the doctrines of sound finance. Keith Joseph and Nicholas Ridley both recognised the contribution of the public choice theorist William Niskanen for his critique of the inefficiency of bureaucratic monopoly provision of public services, and the tendency to 'oversupply' (Niskanen, 1971).

The relationship between the worlds of ideas and practice is not straightforward. Governments face policy problems and constraints in a political environment which requires *realpolitik*. The purposes of theory differ from the purposes of ideology and from policy. Theories are ways of analysing real world phenomena, often through abstraction and simplification. Ideology is a set of values and beliefs about the nature of society often 'born of conviction' (Riddell, 1985, p 7). Neither is easily translated into effective policy.

Margaret Thatcher has been credited with creating a coherent political doctrine - Thatcherism - and a number of academic works have spawned on the topic (Skidelsky, 1988; Edzell and Duke, 1991 ; Minogue and Biddiss, 1987). Biddiss (1987) argues that whilst Thatcherism is not a rigorously systematized ideology, it can be useful displayed as a term to denote a certain set of values and leadership style. Critics, however, say her understanding of economics is minimal, and simple-minded (Hahn, 1988).

More useful is the term the 'New Conservatism'. Nigel Lawson, for example, denies that the central tenets of the 'New Conservatism' are in any way a break with the Conservative values of the past. Instead they reflect a pragmatic approach to government which concentrates on the 'controllable' - money supply, budgets and tax levels - with monetarism and public choice reinforcing those values and extending the diagnosis to a critique of budget-making; to a concern with 'borrowing'; and with bureaucratic inefficiency (Lawson, 1981, pp 9-11). This analysis is best captured by Niskanen in his book *Bureaucracy and Representative Government*. Whilst Niskanen acknowledges that abstract economic reasoning supported by personal observations and casual evidence lacks the set of critical tests necessary to support the theory, he believes firmly that his behavioural hypothesis is consistent with his own experience in government. Governmental resource allocation operates through a single stage budget review and approval process. Bureaucrats can judge 'the going rate' and add a few percentage points to the budget bid to allow for ritual cutting. They have a monopoly of information and a 'passive sponsor' who does not know the minimum budget necessary to supply the service. The weakness of political control mechanisms leads to oversupply, as bureaucrats strive to maximise their budgets to achieve greater salaries, perks, power and patronage.

The central assumptions of the model have been subject to considerable criticism (Goodin, 1982; Jenkins and Gray, 1983; Dunleavy, 1986) and there is little in the way of convincing empirical verification for the central thesis. The importance of Niskanen's work, however, probably lies more in its acceptability to the ideological reflexes of politicians in power. His prescriptions of 1971 - greater competition, privatisation, better information and analysis, and a reduction in the role of government - became central to

the political agenda of both the Reagan and Thatcher Administrations in the 1980s.

Bureaucratic dominance led to budgetary growth funded by increased public borrowing. Margaret Thatcher believed that to restore the proper limited role of government would permit 'honest finance' (i.e. balanced budgets) and a reduction in taxation (Thatcher, 1977, p 35). Her repeated attacks on high spending, borrowing and taxes said little about reducing services, as much of the savings would come about through greater efficiency - without the need for major surgery (Metcalf and Richard, 1986; Fry, 1988). The budget strategy sought real reductions in spending, taxation and borrowing.

The Conservative Performance

The analysis of public spending statistics is fraught with difficulties (Thain and Wright, 1988). Initially public expenditure was planned in 'constant prices' referred to as *volume planning* which sought to measure the changes in the volume or amount of services. In 1981, the system was changed to *cash planning*, which does not entail the automatic uprating for cost increases as in volume planning, but simply a judgement about 'how much' public expenditure can be afforded. This means it is no longer possible to relate public spending to changes in service levels, and current practice is to refer to *real terms* (relative to the retail price index) and *cash terms*. Given the well established tendency for public sector costs to rise more quickly than the economy in general, public spending could grow in 'real terms' even if service provision did not (Pollitt, 1977).

A third measure of public spending growth is its relationship to GDP. Again, this can imply growth in public spending in real terms even when, as

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a percentage of GDP, it is held constant, if the economy is growing. In 1980, the Conservative government was committed to achieving reductions against all three indicators. The June 1979 budget envisaged cuts of 5 per cent in volume terms, from the budget inherited from Labour, with further reductions in subsequent years. In fact, it actually grew by 2 per cent in volume terms.

In the early 1980s, Britain faced an economic recession which contributed to the rise in public spending. The realities of government led to a modification of the strategy, and indeed, public spending was boosted in 1983, a General Election year. The policy objective became holding spending stable in real terms in 1984, and then holding spending stable as a proportion of GDP in 1986 (Thain and Wright, 1988). Reductions were achieved for a few years, but since 1989, it has been held broadly stable, and is planned to rise marginally in 1992-3. Thain and Wright (1988, pp. 4-5) observed that spending rose remorselessly after 1978-9:

The 1987 White Paper claimed that General Government Expenditure had risen to a peak of 47.5 per cent of GDP in 1982-83, and thereafter was on a downward trend to stand at under 45 per cent in 1986-87. It was however clear that it would not be until 1989-90 that the proportion would fall to the level inherited from the Labour Government in 1978-79.

From the most recent Treasury estimates, this has allowed a real terms increase in public spending of 18% since the election of the Conservative Government. Indeed, it was only in the period of the economic boom (1987- 1989) that real reductions both as a proportion of GDP and in real terms were achieved.

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This brings us to the question of financing this growth, which has been an increasing concern in budget strategy, and it is here that the British experience of the New Right in practice diverges from America. Whilst increased federal spending was matched by increased borrowing in the USA, in Britain, higher taxes and borrowing were the original response, followed by maintaining taxes and achieving a public sector surplus in the late 1980's. The Treasury view was that Britain had an 'excessive and unsustainable' level of borrowing (HM Treasury, 1984, p 20).

Increases in Value-Added Tax and National Insurance contributions facilitated higher spending and some cuts in income tax. Income from North Sea Oil rose from £0.5 billion in 1978-9 to £10 billion in 1984-5, which provided a useful cushion on tax demands. The economic recovery in the latter half of the 1980s buoyed Treasury revenues from corporation and income tax. Indeed, for a few years the Government was able to repay some of its debts.

The other factor in the equation is the income from privatisation and asset sales, which jointly produced income of around £10 billion per annum in the late 1980s. This has allowed tax receipts to be less than public spending as a share of GDP. Such spending is treated as negative public spending in Government accounting. Its effect is to permit higher government spending than the official figures suggest. Whereas spending grew by 9 per cent in real terms from 1979-86, when asset sales are included, the real increase is 17 per cent (Jordan and Richardson, 1987, p 84). Hogwood (1992), shows how this has become of increasing importance in the late 80s, averaging £12 billion per annum (or 6 per cent of spending) compared to £2.8 billion or 1.6 per cent in the last Labour budget. It is tempting to regard this as a

Conservative version of 'creative accounting' as practised by Labour local authorities (Parkinson, 1986).

Explaining The Conservative Performance

For most of this century, public expenditure in Britain, as in other Western countries, has grown in real terms. Americans coined the phrase 'big government' to capture the phenomenon (Rose, 1984). Attempts to explain the growth of public spending were firstly the domain of public finance, a sphere of economics. These tended to identify socio-economic forces which 'caused' expenditure growth, and treated politics as an endogenous variable. Wagner, for example, related government expenditure growth to economic development, and argued that public spending would grow relative to societal output, in a 'law of increasing state activity':

The law --- is the result of empirical observation in progressive countries, at least in Western European civilization; the explanation, justification and cause is the pressure of social progress and the resulting changes in the relative spheres of private and public economy, especially compulsory public economy. Financial stringency may hamper the expansion of state activities, causing their extent to be conditioned by revenue rather than the other way round, as is more usual. But in the long-run the desire for development of a progressive people will always overcome these financial difficulties. (Wagner, 1883)

This prediction did not hold true for the 1980s, as public expenditure growth has in fact been contained within the limits of economic growth.

Such studies assume an almost passive role for the political system, reacting to developments, not seeking to influence them. Peacock and Wiseman (1961), in their major work on British public expenditure, added a political dimension to the analysis. They argued that public spending is affected by

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politics and ideas about the role of the state. Whilst general economic influences can be found, these could not reduce the importance of political factors. The importance of their work was the attention they drew to taxation as a political constraint. They argued that major wars committed public resources and raised the political acceptable level of taxation, which permitted non-defence expenditures to grow in the aftermath:

Expenditures may fall when the disturbance is over, but they are less likely to return to the old level. The state may begin doing some of the things it might formerly have wanted to, but for which it had hitherto felt politically unable to raise the necessary resources. (Peacock and Wiseman, 1961, p 27)

Decisions on how much to spend and tax are taken by political institutions within the political system. Economic growth and demographic change are constraints and opportunities, not determinants of spending. Politicians mediate and respond to these forces, outcomes do not arise mechanistically (Easton, 1963).

A second field of economics is public choice, which applies the tools and framework of economic reasoning to the functioning of democracy and bureaucracy. Individuals are assumed to be rational actors operating in their own self interest. Coalitions of voters and interests lobby for specific spending in their own interest. Politicians are only concerned about maximising votes (Buchanan and Tullock, 1962) and the weaknesses of incentives to efficiency in the political system result in spending growth. Voters consume more public services through taxation than they would if they paid directly for the services consumed. As an explanation for the trends of the 1980s, it simply will not do. First, the biggest growth in spending was in social security, which hardly benefits the civil servants responsible directly. Second, the areas of priority identified by the

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Conservatives did grow (defence and law and order) and the areas identified for cuts were cut (industry and housing). The politicians were not passive actors, but clearly exercised some strategic direction.

Rather, the Government has behaved as Klein suggested, with the result that some programmes grew and others fell. Thus :

---one would expect governments to plan public expenditure rather like an investment portfolio and concentrate marginal extra spending in these areas where it brings the highest marginal political support. (Klein, 1974, p 406)

Political science approaches to analysing expenditure growth have tended to separate out environmental from political variables. Klein argues that the evidence is rather strong that it is socio-economic rather than political factors that matter. Boyne (1985) however, argues that such studies are 'light on ideas and heavy on numbers which add up to very little', and that what is needed is a theoretical framework based on *the causal priority of politics*.

Boyne's approach was to locate arguments about public spending within the Easton framework of a political system, which argues that the sources of public policy are the characteristics of the environment and the internal characteristics of the political system. Environmental conditions do not determine outcomes, but must be translated into inputs and from these to outputs. The environment presents constraints and opportunities, and the influence is indirect. They are mediated through a process of political choice, viz

Environment ---> Political System ---> Outputs

This is not to fail to recognise that politics can also try to influence the environment by shaping values and attitudes. It is merely to stress that socio-economic factors influence but do not determine political decisions. Thus the rapid growth of unemployment in the early 1980s did result in higher public spending, because the Thatcher Government chose to maintain access to benefits. It did not lead to any reflationary package to tackle unemployment. Increased longevity did lead to higher spending on pensions and health care, but the fall in school population was not translated into real reductions in schools expenditure.

The Easton model should be expected, however, to include what Klein calls the governmental process, or Rose calls the black box, by explicitly recognising the importance of the dynamics of the budgetary process in public spending decisions. In Britain, as in most western countries, this is through an incremental process in which decision-making is concentrated on marginal changes to the existing budget base. Incrementalist approaches recognise the scope for change in any single year is limited by the constraints of the status quo. These are political and economic :

The modern welfare state is constrained by a fine mesh of commitments spun around it through the years. In theory, a new government could seek to repeal or alter the established commitments of government. But in practice there is little political incentive, for most established programmes create clients who expect these programmes to continue. (Rose, 1984, p 49)

This inertia of established commitments makes it difficult for governments to achieve major changes except over long periods. Rose points out that over two-thirds of public spending is on four long-established programmes,

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social security, health, education and defence, programmes for which there is a high level of public support.

The incremental budgetary process reflects that political reality, and by concentrating on adjustments at the margin, reinforces it. Changes made will reflect assessment of the political consequences, rather than economic efficiency. Occasionally, as with the poll tax, these assessments will go wildly wrong.

If we are looking for an explanation of developments in the Thatcher years, then, we require a political choice approach. The government's political strategy was to reduce spending, taxation and borrowing, mainly by efficiency savings. There was no overt commitment to reduce benefits. As Peacock (1988, p. 115) notes :

The crux of the problem of keeping government expenditure under control lies in the fact that, whereas there may be general support for preventing a rise in the public sector relative to GDP, few if any, voters will have a direct interest in foregoing the advantages they derive from improved government services, subsidies and grants.

Despite the rhetoric of waste and inefficiency, little financial savings have resulted from the efficiency reviews undertaken, and often these have been rejected as politically unacceptable (Metcalf and Richards, 1987). American New Right thinkers are more clearly aware that fundamental reductions to entitlements are necessary to cut government spending (Stockman, 1986; Niskanen, 1989).

Apologists for the failure to cut expenditure have pointed to uncontrollable increases (Bruce Gardyne, 1984), but these in fact reflected the political

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judgement of the day that such entitlements should not be cut. Whilst this would make some sense in the short-term, it does not in the long run. Indeed, a major review in 1985/86 of social security resulted in trimming entitlements, not in amputation (Deakin, 1987). These choices reflected the political balance within the Conservative Party, and the fact that a minority only of the first Cabinet could be labelled 'Thatcherite'. As the *Right Approach to the Economy* (1977, p. 4) noted, they were committed to the fundamentals to the welfare state, and :

--not being a prescription for poorer social provision, it is a recipe for better housekeeping in all the public services. If we are to maintain standards of services we must root out waste and unnecessary bureaucracy.

Governments, of course, do not operate in a vacuum and have to react to events. It is significant, therefore, that the Treasury is seen to have lost a number of battles in Cabinet over spending in the early Thatcher years (Mullard, 1987). The government's policy commitments to increase defence spending, expand law and order, and maintain health spending and pensions, could have been revised when the desired efficiency savings did not materialise. Spending cuts were concentrated on capital programmes or subsidies (e.g. rents for public housing, grants to industries) which are eminently 'cuttable'. Labour's cuts in capital of the late-70s however reduced the scope in that direction.

If the Conservatives failed to cut spending in real terms as they wanted, this is because of the unreality of the assumptions on efficiency savings and the unacceptability in political terms of cuts in services. In short, the result is a process of political choice, not uncontrollable forces. Thus :

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The decision to increase is a conscious, deliberate collective policy response by the government to the realities of the present. (Leon Brittan, quoted in Mullard, 1987).

In practice, the Conservatives' performance is not too dissimilar from most new governments. They arrived with an overly optimistic strategy on the scope for cuts, just as did the Heath Government in 1970, and as did Labour in the scope for growth in 1974. Levitt and Joyce (1987) observed that "the Labour and Conservative administrations of the 1970s were virtually mirror images of one another: under the former, rapid growth following tight constraint, under the latter cuts followed rapid growth".

Longer Term Comparisons

The Conservative election victory in 1979 has been identified as a watershed in public finance (Pliatsky, 1982). Others suggest the key date was 1976, following the oil crisis, reflation and the balance of payments crisis, and the subsequent IMF loan. As one Labour sympathiser observed :

The central feature was not in handling the recession of 1975, but in turning the short-term imperative of restraint into a permanent philosophy for public expenditure. (Bosanquet, 1980, p 39)

In this final section, we compare the performance of recent British governments. We are aware of the constraints which differing economic conditions and social expectations impose, and that we cannot, in the space of an academic article, take full account of these. Rose (1985) argues that there is a marked difference between political intent and performance, and that the differences between the parties are less than their rhetoric implies. Nevertheless, important differences may remain.

A number of studies have compared political performance over public spending. Klein's (1974) analysis started from the proposition that, traditionally, Labour is the party of public spending, and the Conservatives the party of retrenchment and tax-cutting. His paper shows that a rising trend occurred from 1951-1970. Prior to this, the 'displacement effect' had allowed rising social expenditure to be funded from tax levels raised to finance the Second World War (Peacock and Wiseman, 1961). In real terms, the average increase was 2.75 per cent from 1951-64, 4.18 per cent under Labour from 1964-70, and 5.02 per cent under the Conservatives from 1970-74.

However, disaggregating these totals, Klein found that 1957 was a watershed year. Prior to that, spending growth had been only 0.26 per cent between 1953-7. In part, this was the displacement effect of post Korea spending, but it also reflected the divide between monetarists and Keynesians in the Cabinet which led to the Thorneycroft resignation in 1958. R.A. Butler has described Conservative fiscal policy of the early '50s as the "march to economic freedom" (Butler, 1971, p 172), whilst Enoch Powell has consistently argued that the growth of public spending from 1957 was the cause of inflation and unemployment (Mullard, 1987).

Continuing with Klein's analysis, the rate of growth of public spending *fell* under Labour from 1974-79, to an average of 2.5 per cent per annum, and since 1979, the Conservative record is 1.3 per cent per annum. If we further disaggregate Labour's term of office, we find that 1976 was indeed a watershed year, the first of two years of real cuts in public spending. This compared with a 12 per cent increase in 1974-5, following on from an 8 per cent increase under the Conservatives in the previous years. Heclo and

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Wildavsky (1981) have correctly identified 1965-8 and 1973-6 as key periods in post-war public spending, though they argue that these increases were *not* what the Government of the day wanted - but reflected the problems of linking public expenditure planning with economic planning when growth turned out to be less than planned. Thus, for example:

As 1971 progressed, Conservative ministers took fright at these numbers and embarked on a policy of massive economic stimulation, despite vigorous arguments of some inflation worried ministers and civil servants. (Heclo & Wildavsky, 1981, p. xix).

Higher spending, tax reductions and increased borrowing resulted in Britain:

moving into the shocking period of 1973-74 with about as comprehensive a pro-inflation package as the wit of man could have devised. (Heclo and Wildavsky, p xix).

Labour's social spending increased, and higher public sector pay added to the problems. Then came the IMF loan, cash limits, and public spending cuts (Wright, 1977).

In Table 1, we set out the trends in public spending since 1963, both in real terms annual changes, and as a ratio of GDP. This shows that in most years the degree of change is marginal, by 2-4%, and that in 19 of the 25 years, expenditure grew in real terms. The biggest single cut and increase were achieved by the 1974-79 Labour Government.

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Table 1: Public Spending Trends Since 1963

	<i>Per Cent GDP</i>	<i>% Change in Real Terms</i>	<i>Change in GDP</i>
1963 - 1964	36.75	-	-
1964 - 1965	36.50	+ 3.50	+ 4.20
1965 - 1966	37.75	+ 5.90	+ 2.40
1966 - 1967	39.50	+ 6.30	+ 1.60
1967 - 1968	43.25	+12.70	- 0.20
1968 - 1969	41.50	- 0.50	+ 6.90
1969 - 1970	41.00	+ 0.60	+ 1.90
1970 - 1971	41.25	+ 2.90	+ 2.30
1971 - 1972	41.75	+ 3.70	+ 2.40
1972 - 1973	41.75	+ 4.90	+ 4.90
1973 - 1974	43.50	+ 8.20	+ 3.90
1974 - 1975	48.75	+12.00	- 0.02
1975 - 1976	49.25	NIL	- 1.00
1976 - 1977	46.75	- 2.40	+ 2.80
1977 - 1978	43.25	- 4.90	+ 2.70
1978 - 1979	44.00	+ 4.90	+ 3.50
1979 - 1980	44.00	+ 3.30	+ 3.30
1980 - 1981	46.75	+ 1.80	- 4.20
1981 - 1982	47.25	+ 1.40	+ 0.30
1982 - 1983	47.50	+ 2.70	+ 2.20
1983 - 1984	46.50	+ 1.60	+ 3.90
1984 - 1985	47.00	+ 2.70	+ 1.60
1985 - 1986	45.00	- 0.10	+ 3.70
1986 - 1987	44.00	+ 1.70	+ 3.80
1987 - 1988	42.00	+ 0.10	+ 5.00
1988 - 1989	39.50	- 2.50	+ 3.80
1989 - 1990	40.00	- 2.10	+ 1.70
1990 - 1991	40.00	+ 0.20	- 0.30
1991 - 1992	41.50*	+ 2.90	N/A
1992 - 1993	42.00*	+ 3.60	N/A

* Planned

Source : HM Treasury (1991) Autumn Statement 1991.

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By contrast, public spending as a ratio of GDP is more amenable to growth and cutback. It has however grown in 16 out of the 25 years. The period of sustained reduction under Mrs Thatcher only lasted from 1984-5 to 1988-9. This coincided with a period of rapid growth in GDP from 1982-3 to 1989-90, with some years as high as 4-5%. By contrast *real* reductions in expenditure were achieved only in 1988-89 and 1989-90, and these were mainly the result of a fall in social security spending reflecting lower unemployment, and some big cuts in grant to local government which in practice tend to result in higher local taxes rather than lower spending (Elcock et al, 1989).

Social Security spending fell by nearly £4 billions in this period, as Table 2 below shows.

Table 2: Social Security Spending 1986-7 and 1991-92 (real terms)

	(£ billions)
1986 - 1987	60.8
1987 - 1988	60.4
1988 - 1989	57.1
1989 - 1990	56.6
1990 - 1991	56.1
1991 - 1992	60.8

Source : HM Treasury (1991) Autumn Statement 1991

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This finding is reinforced by new research by Brian Hogwood . He argues :

---expressing total public expenditure as a percentage of GDP could be misleading, since transfer payments (such as social security payments) were paid over to the non-government sector and spent there. Public expenditure on goods and services can give a better picture of the resources actually used up in the public sector. The proportion of public expenditure accounted for by goods and services actually increased under the Conservative government ---. (Hogwood, 1992)

Thus spending on goods and services *rose*, as a proportion of GDP, in contrast to the ratio of total public expenditure.

Most of this evidence points to 1976 as a watershed year rather than 1979. Public spending since then has become less volatile, and more stable. This clearly reflects disillusionment with planning particularly economic forecasting under Labour governments. Jim Callaghan (1988) regarded this as less reliable than the weather maps on television. Denis Healey openly admits to abandoning Keynesianism in 1976:

I was more concerned to find that the fundamental Keynesian concept of demand management had become unreliable. Keynes believed that a government could maintain full employment of a country's productive capacity without creating inflation, by increasing or reducing the demand for its output, through adjusting taxes or government spending. But it had become impossible to discover with any accuracy how much additional demand the government should inject into the economy so as to produce full employment. (Healey, 1989, p 379)

For Healey, economics had acquired a spurious respectability through the use of numbers, yet forecasts of the PSBR or money supply were consistently wrong - in 1974-5 for example by as much as £4 billion. Bosanquet (1980) also finds continuity in attitudes to waste and inefficiency between the Callaghan and Thatcher Administrations:

The government seemed to have no belief in public services. It put much weight on the element of waste in the public sector. For years we had anecdotes about the surplus bureaucrats of the NHS and falling reading standards in schools. These tales often turned out on close examination to have little substance as to be fairly minor issues but they had a major impact on opinion. The Labour Government itself contributed greatly to the crisis of opinion about public spending. If we did not appear to believe in the public services ourselves, how could we expect others to? (Bosanquet, p.39)

Secondly, let us turn to comparisons on the financing of expenditure. The Conservative strategy reflected its own preference for indirect taxes. The combination of public spending growth with a desire to "reduce an excessive and unsustainable level of borrowing" (HMS Treasury, 1984, p 20) focused the immediate strategy on tax increases (and to a minor extent, increased charges for services such as council rents, prescription charges and for the products of nationalised industries). The two increases were in *indirect* taxation, higher VAT (almost double) and higher national insurance contributions. Higher income from North Sea oil, from £0.5 billion in 1980 to £10 billion in 1984-5, also helped, allowing a modest reduction in income tax. The results of this was a substantial rise in the tax burden of 21 per cent in real terms from 1978-9. This was to facilitate both rises in spending and reductions in borrowing. The economic recovery over the latter half of the '80s led to more buoyant revenue from corporation tax and income as unemployment fell.

Table 3, however, shows that taxation remained quite stable under Labour as a percentage of GDP, and actually fell in its last two years. By contrast, taxes rose rapidly under the Conservatives, and remain higher than in 1979. This led Hogwood to conclude :

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Insofar as there is a Thatcher effect on total taxation it is that her government raised taxation more consistently than any previous postwar Conservative government. (Hogwood, 1992).

Table 3: Ratio of Tax to GDP *

1973 - 1974	33.25
1974 - 1975	35.50
1975 - 1976	36.00
1976 - 1977	36.00
1977 - 1978	35.00
1978 - 1979	34.00
1979 - 1980	35.00
1980 - 1981	36.00
1981 - 1982	38.50
1982 - 1983	37.50
1983 - 1984	45.75
1984 - 1985	37.75
1985 - 1986	37.00
1986 - 1987	37.50
1987 - 1988	37.75
1988 - 1989	37.00
1989 - 1990	36.75
1990 - 1991	37.75
1991 - 1992	36.75

Source : HM Treasury (1990) Financial Statement and Budget Report 1990 - 91, p 20

* Non North Sea Taxes, National Insurance Contributions and the Community Charge as a per cent of non North Sea Money GDP.

The Conservatives also made the tax system as a whole less progressive, in contrast to the period 1968-78, although it is still more progressive than before then (Kay and King, 1990).

Where there is a marked difference between the parties is in performance over the PSBR. Whilst this was broadly stable prior to 1973, the Heath

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Government increased it from 7.4 per cent of public expenditure to 13.4 per cent and Labour maintained a high level in its term of office. Whilst high borrowing was a feature of the first Thatcher administration, it declined and went into surplus in the late 80s, before returning to over £10 billion in the current year. Whilst in the 1960s, the PSBR was around 6 per cent of public spending, the average under the 1974-9 Labour Government was 14 per cent. Under the Conservatives this has fallen to 4 per cent. Is this then evidence of greater fiscal prudence ?

Richard Rose (1985) argues that politicians like placebo policies - measures intended to reduce symptoms of anxiety without having any effect on the body politic, and avoid the costs of fiscal load. Thus *borrowing* achieves this by bridging the gap between spending and taxes. He also regards *privatisation* as a placebo policy as it simply alters the delivery of public programmes, not their funding, and at most promises a marginal reduction in cost.

Whilst the Conservatives reduced borrowing, they increased income from privatisation of public enterprises and asset sales. Together these accounted for between four and five per cent of public expenditure in the late eighties (Hogwood, 1992). Heald argues that when these factors are taken into account the "much trumpeted fiscal surplus is largely illusory" (Heald, 1991, p. 80). Nevertheless, some of the borrowing has been reduced by higher taxes, in line with government strategy, but perhaps 10 per cent remains funded by short-term means.

Conclusions - What Special Financial Competence ?

In practice, public spending and taxation in the Thatcher years reflect a combination of ideology and pragmatism. Despite spirited defences of this record (Pirie, 1988) it has been one of restraining the growth of spending rather than securing the fundamental reductions sought in 1979. In this sense, the Conservatives followed the pattern set since the mid-60s, of governments coming to power with manifesto commitments difficult to fulfill in their entirety. By 1983, the learning period was over, and the manifesto commitment changed to maintaining firm control of public expenditure. The result of which has been higher spending and taxes in real terms, lower borrowing but greater use of privatisation and asset sales to finance expenditure.

The gap between strategy and performance is not surprising. Governments do not function in a political vacuum, but in an increasingly interdependent world, and in the face of rapidly changing socio-economic constraints. Its priorities have been protected and advanced, and cuts delivered in the less favoured programmes. These reductions fell mainly on local government. Again, cuts in government grant had begun under Labour, and was continued dramatically during the Thatcher decade. Local government adopted similar responses - creative accounting, increased charges, efficiency savings, and tax increases. These in turn led to the Government abolishing the domestic property tax and replacing it with a flat-rate community charge - a poll-tax - and removing this element of local expenditure from the expenditure planning totals. Its unpopularity led to its abandonment and pending replacement by a new form of property tax.

Reductions were concentrated on around 20 per cent of spending in the smaller programmes. Harrison (1989) calculates that there was a 19 per cent cut in *overseas services*, a 30 per cent cut in the *trade, industry, energy and employment programme*, a 67 per cent cut in the *housing programme*, a 15 per cent cut in *transport*, and a 7 per cent cut in the *environmental services programme*. Whilst some of these were savage, others were more apparent than real. Harrison argues that much of the reduction of the trade, industry, energy and employment group reflected the improved financial performance of the nationalised industries. The reduction in the housing programme was offset by big rises in housing benefit.

Housing benefits taken as a whole - including payments to private sector tenants - rose dramatically during the 1980s from £1 bn in 1982-3 to £3.5 bn in 1987/8. Further growth has been trimmed as a result of changes in social security payments - but the total is still expected to grow rapidly as a direct result of the Government's success in raising rents in both the public and private sectors. This explains why, in spite of all the Government's efforts to achieve the opposite result, the share of costs borne by tenants actually fell between 1978-9 and 1985-6 by ten percentage points. (Harrison, 1989, p 71)

These programmes also have important characteristics which make them easier to cut, in that they are heavily composed of grants and capital expenditure. Although the latter had been cut heavily by Labour in the mid-70s, thus reducing the scope for cuts, capital nevertheless remains an easy target in terms of organisational acceptability, as it has only minor effects on the organisation itself. Thus :

A large part of trade and industry spending consisted of grants to industry. Spending on houses and roads was largely capital spending. Stemming future plans of capital expenditure is easier than cutting services which are currently being provided. Cutting capital spending means not signing contracts, whilst cutting current spending involves shedding employees. (Flynn, 1989, p 26)

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In practice, the New Conservatism has concentrated its spending cuts in a time-honoured way, as ,

The burden of these cuts and squeezes has fallen on those programmes which are not subject to demand-related pressures, on those not regarded as politically sensitive by decision-makers, and on these programmes primarily administered outside Whitehall. (Thain and Wright, 1988, p 6)

The Government reacted to these socio-economic constraints by shifting its policy objectives from cutting public spending in real terms, to public spending as a proportion of GDP. Whereas the 1980 budget had planned a 4 per cent reduction by 1983-84, by 1984 this had changed to holding spending at broadly its real terms, by 1986 it had become holding it broadly stable as a proportion of GDP, (Thain and Wright, 1988, p 4) and by 1988, provision for real growth had been built into the budget estimates of around 1.25 per cent per year. This strategy has reflected the performance of GDP rather than the performance of government in cutting expenditure.

The *real* shift in economic thinking is the view that government spending is not a suitable instrument for the stimulation of economic activity. Again, there is an element of continuity from Labour. As Jim Callaghan informed the 1976 Labour party conference:

We used to think that you could spend your way out of a recession and increase employment by cutting taxes and boosting Government spending. I tell you in all candour that the option no longer exists, and that insofar as it ever did exist, it only worked on each occasion since the war by injecting a bigger dose of inflation into the economy, followed by a higher level of unemployment as the next step. Higher inflation followed by higher unemployment. We have just escaped from the highest rate of inflation this country has known; we have not yet escaped from the consequences : high unemployment. That is the history of the last twenty years. Each time we did this, the twin evils of unemployment and inflation have hit hardest those least able to stand

them. Not those with the strongest bargaining power, no, it has not hit those. It has hit the poor, the old and the sick. We have struggled, as a Party, to try to maintain their standards, and indeed to improve them, against the strength of the free collective bargaining power that we have seen exerted as some people have tried to maintain their standards against this economic policy.

Now we must get back to fundamentals. First, overcoming unemployment now unambiguously depends on our labour costs being at least comparable with those of our major competitors. Second, we can only become competitive by having the right kind of investment at the right kind of level, and by significantly improving the productivity of both labour and capital. Third, we will fail - and I say this to those who have been pressing about public expenditure, to which I will come back - if we think we can buy our way out by printing what Denis Healey calls 'confetti money' to pay ourselves more than we produce. (Callaghan, 1988, p 426).

This cautious attitude remains in the public statements of the Shadow Chancellor about the prospects for public spending under a Labour Government, although scope does exist, even within the limits of economic growth, for higher public spending than occurred in the Thatcher years. In that sense, there is an alternative, although the lessons of the past are that too rapid an increase will bring economic problems, restraint and possibly cutbacks. A Labour Government would immediately have to find around £10 billion to compensate for spending financed by sales at the moment, but the evidence of the Thatcher years is that borrowing need not be inflationary, and this is clearly an option, particularly for capital spending.

The other element of the post-war consensus, free welfare services, particularly health and education, have continued to grow under the Conservatives. As Rose has shown, support for increasing spending and taxes for social services almost doubled from 34% in 1929 to 61% in 1986 (Rose, 1987, Table 9.4). Regular attitude surveys show continued high levels of support for the basic services of the welfare state. The

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Government's strategy has now greater emphasis on competition, choice and efficiency in social and public administration rather than crude cutting, but even here management reforms have been less than popular.

The Government's record in public finance is less than its rhetoric would imply. To have achieved the restraint of spending growth it did was a considerable achievement. The efficiency savings were valuable, if insubstantial in terms of spending as a whole. In terms of New Right arguments, however, higher public spending and taxation has not prevented economic growth for much of the 1980s. Any new government coming into power will face rising unemployment, balance of payments deficits, and the need to find longer term sources of finance other than asset sales. The Conservatives may have abandoned notions of Keynesian reflation for purposes of economic management, but the first budget under John Major showed a rise in planned public spending and higher borrowing. This was interpreted as the "end of Thatcherism" in the *Financial Times* (7 November, 1991). As key elements of the changes were to reflect higher social security spending and lower tax income because of unemployment, this is an overstatement. Rather it is a continuation of the strategy under Thatcher, where borrowing was used in the recession of the early-80s, although it was seldom admitted (Jordan and Richardson, 1987). Indeed, in pursuing management and efficiency reforms in education, health and local government, the Major Government remains firmly on the Thatcherite path, if not as radical as the radical right would want.

The Thatcher years characterised a return to classical incrementalist budgeting. The reforms in public expenditure policy and control which sought to enhance policy analysis were abandoned, and replaced by narrow cost control and efficiency reviews. Evidence shows that the government

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achieved restraint in the growth of public expenditure. It had identified high public expenditure as the cause of Britain's economic ills. The nature of the relationship between public expenditure, inflation and our economy should be left to economists to argue over. We would merely note that, over the period of firm control of public finance, the annual average growth rate in GDP was *less* than under both the Wilson and Heath Governments, but higher than under Wilson/Callaghan (See Table 3), and that the performance of that government was clearly hampered by the oil price increase crisis of its first two years.

Table 3: Average Annual Growth in GDP

Labour	1964 - 1970	+ 2.9%
Conservative	1970 - 1974	+ 2.9%
Labour	1974 - 1979	+ 1.6%
Conservative	1979 - 1990/91	+ 2.4%

A number of general trends can be identified of interest to researchers in public finance. First, years of rapid growth of public spending are usually followed by years of retrenchment. (e.g. 1965-1970, 1973-1978). Secondly, it is not inevitable that public spending grows faster than GDP. The exercise of political choice can prevent this. Thirdly, even stable growth in public expenditure does not in itself prevent economic recession, as present experience shows. Fourthly, taxation remains higher as a

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percentage of GDP under the Conservatives than it was under its Labour predecessor.

The Thatcher legacy is the restraint of expenditure growth, higher taxation, lower inflation, lower borrowing, and higher unemployment. Whether this constitutes an economic miracle is debatable, and given the emphasis on short-term financing of public expenditure (assets/privatisation sales) and the decline of North Sea Oil revenues, higher taxes remain a distinct possibility in the 1990s. It does not seem to this analyst that the Conservatives have any special claim to financial competence. The real policy differences between the parties are over spending priorities and patterns of taxation - in short over political values - rather than their competence to govern.

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