Ian Gough

International competitiveness and the welfare state: a case study of the United Kingdom

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FOREWORD

This Report was written as part of a comparative study of international competitiveness and welfare statism in five countries. In addition to the United Kingdom, the broader study includes France, Germany, Sweden and the United States. The case study of the United Kingdom discussed in this Report takes as its focus and point of departure the experiences of the United Kingdom during the 1980s under the policies of Mrs Thatcher, policies associated with what is referred to in Australia as 'economic rationalism' and 'the new right'. While there are differences between the economic and social policies introduced by the Thatcher Government and those pursued in Australia in the last decade, there are similarities too, reflecting similarities in the economic problems confronting the two nations, as well as the broad policy framework adopted. There can be few in Australia, whatever their political persuasion, who would doubt that the two main themes of this Report, International Competitiveness and the Welfare State, lie at the heart of this country's economic and social difficulties. For this reason alone, we in Australia have much to gain from a better understanding of the United Kingdom experience. And when that experience is analysed by such an insightful and provocative writer as Ian Gough, the benefits are all that much greater.

Readers of material published by the Social Policy Research Centre (as we are now called) will need no introduction to Ian Gough. His seminal book **The Political Economy of the Welfare State,** although first published in 1979 remains a classic, one that rewards a reading in 1990 as much as it did a decade ago. But Ian Gough is sufficiently frank and honest to acknowledge that not everything that he wrote in 1979 has been borne out by subsequent events. This Report gives something of a flavour of how his thinking has developed in the intervening years.

The Social Policy Research Centre was fortunate to be able to welcome Ian Gough as an Honorary Visiting Fellow for the period from March to May 1989. During his time at the Centre, Ian gave a series of seminars, some of which covered the material included in this Report. The discussion provoked at the time by his analysis is testimony to the relevance that the material has to Australian events and policies. I would like to take this opportunity to thank Ian for the very important contribution that he made to the Centre during his visit last year. He left us not only with a deep respect for the quality and vision of his research, but also with many fond personal memories of a fine scholar and excellent colleague.

Peter Saunders
Director
Social Policy Research Centre

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INTRODUCTION

> *'Britain has now been in decline for a hundred years. It has become the most observed and analysed decline in modern history, provoking a speculative literature of enormous dimensions. Few explanations have not been proffered, few causes not dissected, few remedies not canvassed at least twice. The decline has been the central fact about British politics for a century, a major preoccupation of its political intellectuals and intermittently, but increasingly, of its political leaders. Two facts stand out - the absolute decline in the power and status of the British imperial state, and the relative decline of the British economy with its long-standing failure to match the rate of expansion of its rivals.' (Gamble, 1985, xiv)*

> *'In Great Britain, 'crisis' has long been a permanent state of affairs which, inexplicably, never seems to change anything. The word has associations with the sick-room, or even the death-bed ... But here we are dealing with an invalid who constantly resurfaces from his ordeals, orders a large breakfast, and with exasperating complacency tells the would-be mourners that there was never really anything to worry about. It will all be different from now on, he adds. This cheerful prediction is as regularly mistaken as the doom-laden prophecies he indulges in when the thermometer shoots up.' (Nairn, 1979).*

Awareness of, and concern over, the economic decline of Britain has been around for over a century, ever since the US and Germany overtook Britain in the production of key industrial products. The debates, even the book titles bemoaning this fact in the 1890s are harbingers of the more recent period of introspection seventy years later. Yet Britain's relative economic standing has diminished further and faster in the post-war years. In 1950 it still accounted for one quarter of world exports of manufactures (down from one third in 1899), but by the mid 1970s this had fallen to under 10%. From being the leading economy in Western Europe in 1950 Britain had declined by 1980 to become one of the poorest. As the Hudson Report authors put it:

> *'Despite an extraordinary tradition in science and technology, British innovations seem to have to go elsewhere to be exploited, applied and manufactured. Despite having produced the greatest economists of the last two centuries, Britain finds is economy mismanaged.'*

Since then a government headed by Mrs Thatcher has come to power with the express and overiding purpose to develop radical, long-term solutions to the British economic crisis. In so doing it has linked Britain's economic decline to the expansion of the civil activities of the British state, and notably to the British welfare state. 'Thatcherism' has played a notable role in developing the discourse which has shaped our research project.

This report was written for a five-country comparative study of international competitiveness and welfare statism, organised by Alfred Pfaller of the Freidrich Ebert Stiftung in Bonn. The findings are to be published in a book: **Can the Welfare State Compete? A Comparative Study of Five Advanced Capitalist Countries?,** edited by A. Pfaller, I. Gough and G. Therborn (Macmillan, 1990). The other countries studied were the USA, Germany, France and Sweden. The country studies were intended to trace their changing competitiveness and to relate this to changes in their 'welfare statism'. The latter was defined in terms of social and economic citizenship rights, and in charting it we were keen to include resource inputs, service outputs and social outcomes in our measures.

My report is organised in four main chapters, considering in turn:

- British policy debates on international competitiveness,
- trends in the competitiveness of the UK economy,
- developments in economic policy, and
- changes in 'welfare statism' - British social policies and their outcomes.

It covers the period since the beginning of the international crisis in 1973, but its main focus is on the 'Thatcher experiment' since 1979. This report was completed in 1988 (though it has been updated for the book). Much has changed in the last two years, but I believe that much of this story remains relevant, if other countries are to learn from the lessons of the UK in the 1980s.

CHAPTER 1

POLICY DEBATES ON INTERNATIONAL COMPETITIVENESS

Different nations exhibit different policy discourses, which require different techniques to 'map' them. A US study, for example, can rely on the views and analyses of individuals - economists, intellectuals, publicists, etc. - and of the 'think-tanks' within which many of them work. A Swedish study can consult the representatives of the well-established interest groups which dominate the policy-making process. Britain combines elements of both: it has class-based interest groups and parties akin to other European countries, but during this period many of the older corporatist institutions and processes have been dissolving, and new policy positions have been developing. At times like this, other opinion-formers, whether individual thinkers, reporters, or the media, play a more important role than in times of stability. The major actors I shall investigate are as follows:

1. The major political parties: Conservative, Labour and Liberal, plus after 1980, the Social Democratic Party.

2. The representatives of major societal interests, notably the Confederation of British Industry (CBI), the Bank of England and the Trades Union Congress (TUC).

3. Research and proselytising organisations; on the political Right they include the Institute of Economic Affairs, the Adam Smith Institute and the Policy Studies Institute; on the Left the Labour Research Department and the (post-Keynesian) Cambridge Political Economy Group; and in the political centre the Policy Studies Institute, the Tawney Society, the 'Clare' group, the Institute for Fiscal Studies, the Employment Institute etc.

4. Intellectuals (such as Friedrich Hayek and Nicholas Kaldor), newspapers (notably the Financial Times, the Times, and the Economist) and journalists (such as Samuel Brittan and Peter Jay). Finally

5. Government statements and publications, of which the Chancellor's Autumn Statement and the Public Expenditure White Papers published every spring are perhaps the most important.

The House of Lords Select Committee on Overseas Trade (1985) attracted a considerable volume of written and oral evidence which I shall draw on.

Before commencing the survey of debates, we should raise the question, debates about what? It is a curiosity of Britain that international competitiveness has rarely been the central object of economic discussion. This has meant that debate has focused on other, related issues: in the 1960s and 1970s the balance of payments and inflation, and in the 1980s unemployment. Though the economic decline of Britain is always there in the background, I have often had to 'construct' issues of competitiveness from discourse on other subjects. With this in mind, it is possible to discern five main explanations of the declining international competitiveness of the British economy in the 1970s and 80s:

1. Too much government

2. Powerful trades unions/poor industrial relations

3. The inadequacies of capital

4. Policy mistakes

5. An archaic state

1. TOO MUCH GOVERNMENT

Since we are concerned with the welfare state it is appropriate to begin our survey of policy debates with the view that declining competitiveness is, in the words of Mrs Thatcher in 1968, the fault of 'too much government'. A prominent series of articles in **The Sunday Times** in 1977 developed this theme by positing that rising public expenditure 'crowded out' private expenditure (notably investment) and thus contributed to a deteriorating economic performance (Bacon & Eltis, 1977, 1978; Keith, 1977). The reasons adduced for the incompatibility of the welfare interventionist state and economic success are many, but can be roughly grouped into demand-side and supply-side factors.

The first blames fiscal irresponsibility on the part of previous governments for the high rates of inflation in the 1970s. That a high rate of inflation is undesirable was mostly taken for granted, and when this position was defended it was rarely in terms of its effects on competitiveness. However there is no doubt that a link was assumed: inflation upsets rational economic behaviour, and forces everyone, but especially powerful unions, into destructive action (Joseph, 1979, 98). With the collapse of the assumed trade-off between inflation and unemployment (the Phillip's curve) in the mid-1970s, 'monetarism' rapidly established itself as the leading paradigm to explain the novel combination. Friedman (e.g. 1980a, 1980b) was important both as theorist and proselytiser, whilst bodies such as the Institute of Economic Affairs, and financial journalists Jay and Brittan were influential in spreading the ideas among opinion formers and the general public. Monetarism, like Keynesianism, is difficult to define, but the core argument is that money supply determines the aggregate price level. For most monetarists this is linked to a more general belief in the efficacy of markets and the non-efficacy of government macro-policy intervention. (Heald, 1983; Jackson, 1985, 25). The rational expectations school of economics goes further in this respect, and has had some impact within economic debate. By claiming that **any** government-inspired reflation of demand will lead to expectations of faster price inflation, it can argue that all demand-side policies are self-defeating. In this way Britain's economic problem has resulted from the pursuit of erroneous policy goals (full employment rather than price stability) and the use of inappropriate policy instruments (short-term fiscal policy rather than a medium term monetary policy).

A systematic 'supply side' analysis of the British economic predicament came later to British debates on economic policy, and never absorbed some of the nostrums (such as the Laffer curve) which emerged in the US. One strand focuses on the effect of high and unbalanced tax levels on incentives to work, save and invest, though this has been a more popular theme of business interest groups, free market research institutes and the post-1979 government (Hoskyns, 1985, 128; Institute of Directors, 1984; Lawson, 1985, 13) than of economists. Another variation stresses the inhibiting effect of government regulations and planning controls on entrepreneurial activity (Joseph, 1978). But the prime focus of supply-side arguments in Britain in the 1970s was labour market rigidity. However this does not absolve the interventionist welfare state, since it in turn, it is argued, enhances trade union power. The British system of flat-rate unemployment benefit and widely available supplementary benefit, for example, undermines the incentive to work and also limits the degree of wage flexibility. Wage regulation (in the form of Wages Councils and equal pay for women - there is no minimum wage in Britain) also exacerbates real wage rigidity and thus reduces the ability of the British labour market to adjust rapidly to new conditions (Minford, 1983). These ideas combined in the concept of the natural rate of unemployment, which has reappeared in the theories of non-monetarist economists and New Centrist politicians as 'NAIRU': the non-accelerating inflation rate of unemployment (Layard, 1986). Some estimates suggest that this was as high as 10% in the early 1980s - due in part to the nature of social security benefits and tax measures in the UK.

2. POWERFUL TRADES UNIONS/POOR INDUSTRIAL RELATIONS

This has a long pedigree as explanation of Britain's economic decline; indeed it formed part of the consensus view of the problem in the 1950s and 60s. In the last two decades however it has split into distinct, and in some respects, counterposed perspectives: one blaming 'too powerful unions' and the other stressing the archaic nature of the British industrial relations system.

According to neo-liberal economists and politicians of the New Right the British union movement has inhibited economic performance, first by contributing to real wage rigidity and, second, by blocking more efficient working practices and thus the adaptability of the economy. Examples of the real wage rigidity argument are to be found in

Hayek (1984), who bemoans the unique privileges of British unions (stemming from the 1906 Act) and the disaster of 'politically determined' wages. (This differs sharply from the monetarist view that unions are not a cause of inflationary pressure). The pay explosions of 1969-70, 1974-1975 and 1979-80 have been linked to subsequent periods of falling international competitiveness (ABCC). Others (Joseph, 1979) argue that unions are not the cause of inflation, but make it harder to control and thus hamper economic recovery. The second, supply side, reasoning is that the organisation of British unions acts to oppose innovative work practices, flexible allocation of labour and modernisation generally. The rational expectations school of neo-classical economics assumes that all markets clear instantaneously and thus that all unemployment is voluntary (Minford, 1983). The peculiar features of the British labour market responsible for supply side failure are, variously: a high rate of strikes especially disruptive, unofficial strikes; the decentralised organisational structure based on shop stewards; the craft demarcations between many small unions; and the 'backward', class based attitudes extolling an 'us versus them' mentality and hostility to the free market (Hayek, 1984; Joseph, 1979; Times, 1979). Moreover the expansion of public sector workers in the 1970s created a powerful group cushioned from market forces by the non-tradeable nature of their products combined with high trade union density (Keith, 1977). In all these ways British unions overstep their proper role and 'have robbed their members of ... their own productivity' (Joseph, 1979, 103).

One further theory argues that political pressure from the unions has engendered the profligate government policies discussed earlier. Various economic theories of politics have been applied to explain the particular way that the economic and political market places overlap in Britain (Jay, 1975; Brittan, 1977). However all agree that the combination is self-reinforcing. Union pressure, the statutory links with the Labour Party and party competition for votes stimulate an interventionist, Keynesian welfare state, which in turn strengthens the labour market position of workers, and popular expectations that this state of affairs will persist. In this way the circle between 'too much government' and 'too powerful unions' is self-reinforcing, and both undermine international competitiveness. This interwoven view of Britain's decline has had a powerful impact on the policies pursued by the Thatcher administration since 1979.

This perspective is not confined to neo-liberal economists however. Other writing from a neo-Marxist perspective have argued that the defensive strength of British trade unions is a contributory cause of the British economic crisis (Kilpatrick & Lawson, 1980; Stafford, 1983). They note the long, uninterrupted history of trade union organisation, their high and rising membership (up to 1979), the lack of external invasion or internal divisions, their dense organisation at the point of production and the decentralised system of collective bargaining. All these specific features impede the introduction of new technology and working practices and thus impair international competitiveness. At the same time the economism of British trade unionism has prevented the emergence of more global, political strategies to tackle the resulting policy stalemate (Purdy, 1976). This perspective has evident parallels with Olson's theory of institutional sclerosis.

Others give greater weight to the failings of British management, or to the combined interaction of capital and labour within an archaic industrial relations system. The culture and recruitment of managers in manufacturing industry is blamed for their poor quality. It has been demonstrated that the quantity and quality of trained managers is a significant factor affecting UK shortfalls in productivity, in association with poor labour-management relations (Caves, 1980). Others have situated this within the British class structure and stressed the backward, ossified nature of social relations within the sphere of production as the major explanation (Currie & Smith, 1981; Hodgson, 1981). This has generated proposals for forms of worker participation, though along very different lines, by the Labour Party and the Alliance.

3. THE INADEQUACIES OF CAPITAL

A quite distinct perspective explains the decline of British competitiveness by reference to the inadequacies of British capital, rather than British labour. This explanation has two stages: first, that investment has been too low, and second, that this is due to the organisation and management of British capital. The latter in turn is used to explain (via a third set of arguments) why state economic policies have consistently failed to rectify the British economic predicament.

The view that Britain's relative economic decline is due to inadequate levels of investment has a long pedigree, and was particularly prominent in the 1960s. However in the 1970s it began to be criticised, first because relative investment levels in Britain began to catch up with those of its competitors, and second, because numerous studies have shown that it is the efficiency of investment - the incremental capital-output ratio - which explains much more of Britain's lag in manufacturing productivity (Prais, 1983; Manison, 1978). However in the 1980s the thesis revived somewhat in response to the slump in manufacturing investment in 1979-81 (ASTMS, Labour Research), and the sustained fall in public infra-structure investment since the mid-1970s (Alliance, 1968; Smith, 1986). Thus there is a set of explanations which focus on the level and/or effectiveness of investment as the critical reason for poor competitiveness.

Some then go further, to relate this phenomenon to the peculiarities of British capitalism, of which two are identified. The first sees the domination of multinationals over the British economy as a cause of the British post-war crisis. A relatively large proportion of multinationals are British, and Britain has experienced a relatively large penetration of foreign multinational capital. For example it is claimed that in 1981, 60% of UK manufacturing exports came from UK companies with overseas affiliates, and another 35% by affiliates of overseas companies (ASTMS). Together, it is claimed, this means that the UK is peculiarly exposed to the 'meso-economic' power of such capital - especially since Britain's entry into the EEC (Holland, 1975; Labour party, 1973). Whilst it has been disputed that this alone would lead to deindustrialisation or declining competitiveness, in combination with other factors this can generate a cumulative spiral of downward decline (Currie & Smith, 1981).

The second, older and more common, explanation is the sharp division between finance capital (the City of London) and industrial capital in Britain. The City, it is argued, is both excessively foreign-oriented and excessively short-sighted and risk-averse when assessing possible investments in Britain. The rise of the Eurodollar market in London and the subsequent resumption of large scale capital exports with the relaxation of foreign exchange controls are examples where the interests of the two sections of capital conflict, such that profitable overseas investment has priority over re-industrialisation at home (Hudson, 1975; Longstreth, 1979; Ingham, 1984; Leys, 1986). The Wilson Committee report on the City (1980; see also CBI) argued that there was no evidence of a shortage of investment funds, but in reply to this others contend that it is the absence of sustained, long-term loans at low interest rates which disadvantages British industry. The banks of competitor nations lend generously and lend long (Lever & Edwards, 1980; NEDO). By contrast British financial institutions have global interests, which make them peculiarly unable or unwilling to supply venture capital to domestic industry. Paradoxically the very strength of finance capital in Britain is disadvantageous to its indigenous industrial capital.

This perspective draws on a line of historical scholarship which shows that British economic history during and since the 19th century diverged rom that of subsequent industrialising countries. Hobsbawm's account (1969) of the withdrawal of British capital after 1860 from industry into trade and finance, and its diversion from domestic investment to Empire and world markets, has been repeated by many others. Also influential has been Wiener's analysis (1981) of the paradox that the first industrial society has a markedly anti-industrial culture. Aristocratic hegemony, rural myth-making and other cultural developments marginalised (and regionalised) industry, such that the aspiring offspring of the bourgeoisie sought careers in government or finance rather than manufacturing.

Debates between historians are not normally the stuff of economic policy-making, even in Britain (though see FBEAMA and Rover for examples where manufacturers cite such factors in explanation of Britain's poor competitiveness). However in the 1970s they entered the policy debate more directly by informing the new Alternative Economic Strategy of the Labour Party (1973; see also Glyn, 1985). The proposals for nationalisation and new public enterprise, planning agreements, selective import controls, exchange controls, a National Enterprise Board, a National Investment Bank and economic democracy all flow in part from the linked view that the poor performance of the UK is due to the structure of British capital and a history of reluctant, inadequate and inappropriate state intervention. It is to this latter explanation that I now turn.

4. POLICY FAILINGS

Mistaken economic policy-making is another long-standing explanation of Britain's poor economic performance (Caves et al., 1968). Indeed it is implicit in all those who believe that the British predicament has a long history, for why was it not long ago recognised and corrected? Of course, what the mistakes have been will reflect values and economic models, but there is surprising agreement on several of them.

First, a perennial complaint has been the priority accorded to a high value of sterling. In an innovative study Posner (1978) found agreement amongst economists from a wide variety of different schools of thought that two crucial mistakes of recent years had been the failure of the Labour government to devalue sterling in 1964 or 1966, and the high value of sterling set by the Heath government in 1971. More recently a variety of interests have remonstrated that the competitiveness of British industry has been harmed by the rise of £ as a petro-currency and the volatility of the currency (wider fluctuations than other European currencies) (ASTMS, GM, LCC, SMMT, CBI). There are two other policy areas around which a consensus seems to have formed. One is the failure of the British education system, both the education of the elite (Hudson, 1975; House of Lords, 1985; Allen, 1976; Sampson, 1983; Nairn, 1977, 1983; Phelps-Brown, 1977; Manison, 1978), and the training and education of the working population (e.g.: Prais & Wagner, 1983). The contribution of adequate and appropriate education and training to improved economic performance attracted a wide degree of support across the spectrum in the 1980s (e.g.: NEDO/MSC, 1984; Labour Party, 1985; Alliance, 1986; CBI, LCC, ASTMS). The other is the inadequacy and misdirection of the British R & D effort. (TENA, LCC, EEF, ABCC, NEDC, ICL). In particular the over-emphasis on military and related research is prescribed as a leading cause of UK industrial failure across a wide range of industries (Smith, 1984).

Then there are other policy areas about which there is less unanimity, but where many outside the New Right agree that policies have been wrong or deficient. First, past governments are criticised for giving inadequate support to British exporters to combat the covert protectionism and hidden subsidies of some foreign competitors. It is argued that British economic and trade policy embodies a free trade mentality at a time when competitors are using non-tariff barriers and other forms of unfair competition. This criticism is voiced for example by the telecommunications industry after the unilateral liberalisation of the British market in 1981 (TEMA, ASTMS, EEF, ABCC, Villiers). Second, critics in the 1960s would complain about 'stop-go' macro-economic policies and their effects on home demand and output. The 'Cambridge school' have erected on this a more general 'vicious circle' theory, whereby slow growth of domestic demand inhibits investment and productivity growth, which in turn depresses export performance and output growth (Kaldor, 1966; Eatwell, 1982; Smith, 1986). This finds an echo in recent years in complaints by manufacturers that slow growth of the domestic market is a cause of poor export performance (FBEAMA, SMMT, Rover). More recently, the monetarist policies of the early 1980s are found wanting, and demand reflation is proposed, by politicians and parties from Edward Heath and Tory 'wets' leftwards. The common ground is the conviction that tight monetary and fiscal policies, coupled with a too high exchange rate, too high interest rates and an unselective obsession with reducing government and borrowing, is harming not only employment but longer term growth prospects. Third, British industrial policy - or rather the lack of a coherent, long term strategy for industry - is criticised. The 1985 House of Lords report closely echoed the Hudson committee report of almost a decade earlier in its desire for more co-ordinated, medium term public intervention towards the private sector. Centre and left economists are almost unanimous that here there are long-standing policy efficiencies (Alliance, 1986; Labour party, 1985; Tory Reform Group, 1986). It is interesting though that this does not seem to be supported by the CBI or many industrial representatives (beyond the need for more support for exporters noted above).

Lastly, there is the view, on the whole limited to the labour movement, that British membership of the EEC is a major cause of de-industrialisation, unemployment and the deteriorating manufacturing trade balance since 1973 (TUC, ASTMS). It is harmful both because it has encouraged multi-national capital to relocate in Europe, and because it prevents British governments undertaking the necessary measures to plan and restructure the economy. Associated with this is the argument that the lack of a policy of planned trade has exacerbated Britain's vulnerability to world competition. This gives rise to proposals for selective import controls to provide a breathing space within which policies for reindustrialisation can take effect (Eatwell, 1982).

5. THE ARCHAIC STATE

However policy failings hardly amount to a credible explanation of the British disease unless the reasons for their persistence can be specified. Here too there is considerable consensus across a wide variety of theoretical and political positions: the archaic nature of the British state is perceived to be a root cause. The charges vary: the patrician, Oxbridge-educated liberal administrators of the war and post-war period (Barnett, 1986), the Victorian 'imperial bureaucracy' that is the British civil service (Sampson, 1983), Treasury indifference to the needs of industry and its commitment to the symbolic role of sterling (Pollard, 1981), the illusions of the British establishment about its world role and its military over-commitment (Blank, 1977), the absence of a modernising movement, reflecting the aristocratic dominance of English society and the British state (Nairn, 1983; Anderson, 1987), the 'culture of containment' and the institutional sclerosis it engenders (Middlemas, 1986), a subservience to the interests of the United States (Nairn, 1983; Hudson, 1975). But there is a common effect: the British state is not equipped to cope with the reality of Britain's place in the post-war world, the loss of its overseas assets, empire and influence, and the consequent greater reliance on trade and industry. Improved state intervention thus presupposes reform of the British state.

A final causal regress, espoused by some, connects this state of affairs to the peculiarities of British capital. It is the dominant influence of the City of London and financial capital which explains the indifference of the Treasury to the needs of British industry. Since the late nineteenth century the interests of finance and industrial capital have periodically conflicted, and since the Second World War they have rarely been harmonious. For various reasons the interests of industrial capital and the CBI have never been able to prevail over those of the City and its spokeman, the Bank of England (Ingham, 1984; Pollard, 1981; Leys, 1986). (Within this reading the two most commonly agreed policy mistakes of recent years - the failure to devalue sterling in 1964 and its overvaluation in 1971 are not accidents, but a systematic reflection of the hegemonic domination of finance capital over UK policy making). Alternatively, a more symbiotic relationship is postulated whereby the traditional foreign policy of Britain requires a world role for the City, the two being conditional on American support (Gamble, 1981; Blank, 1977). In this perspective the deindustrialisation of Britain is the price paid for the prosperity of the City of London and the special relationship with the United States of America. Others contend that multinational industrial corporations and banking/finance institutions are progressively harmonising their operations and their interests, especially since the ending of exchange controls in 1979. Either way, one paradoxical result is that British industrial capital is hostile to the sort of dirigiste policies supported by its counterparts in other countries since they tend to be advocated by labour governments and incorporate quasi-socialist goals (Rowthorn, 1983).

This perspective on the decline in international competitiveness of the British economy is necessarily less precise than the alternatives discussed earlier. Nevertheless it informs a series of policy positions which vary from new forms of state intervention (a coherent industrial strategy), through institutional reform (notably of the Treasury and other economic ministries) to more radical proposals for nationalising and constraining British financial institutions and/or multinational capital, such as the Alternative Economic Strategy of the Labour Party mentioned earlier.

The above offers no more than a crude chart or taxonomy of recent perspectives on the British economic dilemma. It does not map out the correlations and overlap between these explanations and policy stances, nor does it describe how they have reacted upon each other and have changed through time. This cannot be done here, but a crude summary can be offered. The deepening economic crisis in the 1970s engendered a polarisation of politico-economic perspectives between the New Right and the New Left. Broadly speaking, **for the New Right failing competitiveness has been due to too much government and too powerful unions, whereas for the New Left it has been due to capital failure and an archaic state.** The success of the Thatcher government in operationalising the New Right perspective will be considered below. The failure of the 1974-79 Labour government to introduce successful economic and industrial policies based on the alternative Economic Strategy (which was in turn premised on this New Left perspective) led to a protracted attempt to ensure that the same would not happen again under a future Labour government.

However this polarisation of economic doctrine has in turn stimulated a 'New Centrist' analysis, adumbrated by for example the Clare Group, the Oxford Economic Policy Review, the Institute for Fiscal Studies, and the Centre for Economic Policy Research, and a new political formation: the SDP/Liberal Alliance. This third perspective points the finger at **systematic policy mistakes, poor industrial relations and political polarisation itself.** This had led to novel policy proposals which combine Keynesian demand-side policies with New Right supply-side policies (e.g. see Matthews and Sargent, 1983). At the same time, the dominance of 'Thatcherism' has brought about a dilution of some New Left policies within the Labour Party, including its earlier commitment to leave the EC. At the present time all aspects of Labour Party policy are under review.

CHAPTER 2

THE COMPETITIVENESS OF THE BRITISH ECONOMY

INCOME, OUTPUT AND EMPLOYMENT

One of the most marked symptoms of national economic decline is the comparative income of UK residents compared with other advanced countries. Figures based on purchasing power parities have undergone considerable revisions recently which have improved Britain's relative standing, but the overall pattern is one of rapid descent until the 1980s since when its relative position has stabilised (OECD, 1987). For example compared with the EEC-12 country average the UK income per head fell from 128.5% in 1960 to 107.9% in 1970 to 100.7% in 1980, since when it has begun to rise - to 103.9% in 1985. Compared with the whole of the OECD the relative income of the UK has stabilised at 89% of average OECD income in the 1980s. Nevertheless over time other nations have overtaken Britain: West Germany in 1969, France in 1972 and Japan in 1980. The Hudson report (1974) predicted that Italy would 'be in a position to reach Britain's level by 1980', and this has proved all too accurate. Nevertheless it appears that the relative slide has since stopped.

Table 2.1: Output and Employment

	1973	1976	1979	1981	1986
GDP f.c. (1980=100)	94.3	94.5	102.4	99.0	113.8
Industrial prod	99.5	95.2	107.1	96.6	110.2
Manufacturing output	114.2	107.0	109.5	94.0	104.7
Manuf employment (m)		7.3	7.3	6.2	5.2
Total employment		22.6	23.2	21.9	21.7
Self-employment		2.0	1.9	2.1	2.6
Total nos in work		24.8	25.4	24.3	24.5
Unemployment (m)		1.3	1.2	2.4	3.2
" (%)	2.4	5.0	4.8	9.5	13.1
Output per person employed (1980=100)					
Whole economy	(96.6)	(96.1)	102.6	101.6	116.9
Production industries	(91.7)	(91.8)	102.7	105.7	141.9
Manufacturing industries	(98.4)	(99.6)	103.9	103.1	134.3
		1973-76	**1976-79**	**1979-81**	**1981-86**
Average annual rates of increase:					
GDP		0.0	2.7	-1.7	2.8
Inflation (GDP deflator)		18.9	13.2	15.9	5.1
Output per employed person		-0.2	2.5	-0.1	2.8

Sources: National Income and Expenditure, Economic Trends
Notes: Figures in brackets are re-weighted by myself

Some general indicators of economic performance are given in Table 2.1. They show a stagnant economy over the period of the first oil shock with a very high rate of price inflation and rising unemployment. A moderate recovery ensued but unemployment and inflation moderated only slightly. Then a sharp recession in 1979-81 reduced GDP, depressed industry and manufacturing and doubled unemployment whilst inflation accelerated. A sustained recovery since then has raised national income per head by about 3% a year whilst cutting back inflation to historically low levels. At the same time mass unemployment developed and continued to rise (until 1987) whilst employment (as opposed to self-employment) has shown little dynamism. One result of this however has been a sustained increase in levels of productivity, especially in industry (which includes oil) and manufacturing, since 1981. I shall return to this later.

Nevertheless, a major concern in Britain over the last decade has been the phenomenon of 'de-industrialisation', or the decline of output and/or employment in manufacturing and industry. Interpreted relatively, this state of affairs has existed since 1955, when the share of the workforce employed in industry in Britain reached an all-time world record of 48%. Interpreted absolutely, we find de-industrialisation of employment beginning over two decades ago, following the peak of 11.5m industrial employees in 1966. Since then employment in industry has plummeted by 34% and in manufacturing by 25% (Rowthorn & Wells, 1987, ch.10). The absolute numbers working in manufacturing today are back to the levels recorded at the start of the Industrial Revolution! As regards output, we find that the share of value added in manufacturing as a percentage of GDP has also declined dramatically - from 32.1% in 1960 to 27.4% in 1971 to 21.0% in 1983 (House of Lords, 12). Nevertheless it is possible for these trends to indicate a dynamic economy (positive de-industrialisation) as much as an unhealthy economy (negative de-industrialisation). Real output is one important indicator here, and this shows that the recession of 1979-81 witnessed a process of absolute de-industrialisation at work: by 1981 industrial output was at a lower level than in the early 1970s, whilst manufacturing output had fallen by one fifth since then. By 1986 some recovery had occurred, but manufacturing output remained below the level it achieved 15 years earlier. These figures, and others in Table 2.1, point to a process of negative de-industrialisation, wherein industrial output and real incomes stagnate, the labour displaced from manufacturing fails to be absorbed into the service sector, and unemployment rises (Rowthorn & Wells, ch.1). They must be set against the more optimistic picture suggested by recent productivity trends.

FOREIGN TRADE

Singh defines an 'efficient' manufacturing sector as one which can

> *'provide (currently and potentially) sufficient net exports to meet the country's overall import requirements at socially acceptable levels of output, employment and exchange rate' (Singh, 1977, 134).*

If we are to relate de-industrialisation to the question of international competitiveness, we need to take into account the external balance of payments. However the British balance of payments is decidedly difficult to interpret as a measure of international competitiveness. Do we study the manufacturing balance; the overall visible balance; the balance including services, finance and other invisibles; or something wider still? The correct answer for Britain may differ from other countries for several reasons. First, ever since the mid-19th century Britain has run a deficit on its visible balance; and even in the post-war period, when both the absolute size and share of manufacturing employment and output reached their maxima, Britain could not be compared with Germany for example in its reliance on manufactured exports. Britain has for the last century relied on services and financial earnings to balance its payments (and to provide the funds for net capital exports at certain historical periods). Second, the UK has experienced an unparalleled shift in its structure of overseas trade since the Second World War; the deficits on food and raw materials all but disappeared, financial and other service exports boomed, interest and profit inflows picked up again with the re-emergence of London as a financial capital, and - on top of all this - oil and natural gas were found in great quantities in the North Sea and exploited at great speed. Taken together this has meant that the trade structure has changed out of all recognition since 1945: a claim which cannot be made for any other major OECD economy (Rowthorn & Wells, 1987, chs.5, 6). A surplus on manufactured trade has turned into a deficit, a deficit on primary products has turned into a surplus, net interest and other income has boomed, yet the outflow of capital has mushroomed still faster. To disentangle these and other trends Table 2.2 analyses the period since 1973 in more detail.

The following conclusions can be drawn. First, the current balance was in deficit from 1973 onwards until 1979 (except for a temporary surplus in 1978) to be followed by large surpluses between 1980 and 1985. By 1986 however these had been wiped out and the UK is now faced with a growing deficit again. Almost all forecasts predict that this will widen until at least 1990.

Table 2.2: Balance of Payments, Current Values (£b)

	1973	1976	1979	1981	1986
Manufactures		4.9	2.7	4.6	-5.5
+ Oil		-3.9	-0.7	3.1	4.1
+ Other visibles		-4.9	-5.7	-4.3	-7.0
= VISIBLES	-2.6	-3.9	-3.4	3.4	-8.5
Financial services		1.9	3.5	4.7	8.4
+ Government flows		-0.7	-0.8	-0.9	-1.4
+ Other services		1.0	1.1	-0.1	-2.0
= SERVICES	0.7	2.2	3.8	3.7	5.0
+ Interest, profits, divs	1.3	1.6	1.2	0.9	4.7
+ Transfers	-0.4	-0.8	-2.2	-1.7	-2.2
= INVISIBLES	1.6	3.0	2.8	3.0	7.5
(of which 'City' earnings)		(1.5)	(1.7)	(3.2)	(9.4)
CURRENT BALANCE	-1.0	-0.9	-0.7	+6.3	-1.0
Net overseas investment	-0.1	-0.4	-2.2	-7.1	-20.6
BASIC BALANCE	-1.1	-0.6	-2.9	-0.7	-21.6
Other capital transactions	1.0	0.3	2.1	0.6	9.9
Net asset transactions*	0.9	0.6	-0.1	-6.4	-10.7
Balancing item	0.1	0.3	0.6	-0.1	11.7
(Net foreign assets)	(2.7)	(4.6)	(12.2)	(28.9)	(114.4)

* assets -/liabilities +

Source: CSO, UK Balance of Payments, 1987.

Second, the massive improvement in the first half of the 1980s owed much to the exploitation of North Sea Oil. Large deficits on the fuel account following the 1973 oil price rise were eroded by 1980 and replaced by large and expanding surpluses up to 1985. The turnaround in 1986 reflected the levelling out of oil production coupled with a sharp fall in its price. Thus **excluding oil** the current account deteriorated from a surplus between 1975 and 1981 to record a deficit in 1983 which has widened since then.

Third, for the first time since the Industrial Revolution (some say since the Roman occupation!), British trade in manufactured goods moved into deficit in 1983, and has continued to worsen since then. In 1963 exports of manufactured goods were 2¾ times as large as imports. By 1973 most of this surplus had been eliminated, but two recoveries peaking in 1977 and 1980 helped maintain an overall surplus until 1982. Yet by 1984 the House of Lords Committee calculated that manufactured imports exceeded manufactured exports by £4b, or 1.2% of GDP. In volume terms there was no trend change in UK exports over the decade from 1974, but the volume of imports doubled. It is thus growing import penetration which accounts for this deterioration: in 1978 imports as a share of home demand amounted to 24.9%; by 1983 they had risen to 31.4%. Of course, as specialisation increases both exports and imports will increase relative to output. But as the House of Lords Committee put it (1985, 16): 'Unfortunately many industries have experienced rising import penetration without a corresponding rise in export performance'. This deterioration reflects the absolute fall in manufacturing output noted above. We shall return to study the competitiveness of British manufacturing industry in more detail below.

Fourth, in contrast UK trade in invisibles has remained in surplus and since 1982 has doubled its contribution (at current values) to the current balance. Within this category it is common to distinguish services and income flows. UK net service exports have expanded due to flourishing financial services such as insurance, banking, consultancy and royalties. Similarly interest, profits and dividends from abroad have mushroomed since 1982, though their net contribution to the current balance always fluctuates greatly. It can be seen that the broad contribution of the 'City of London' to the UK balance of payments has trebled since 1981. All told, invisible exports accounted for 50% of all UK exports in 1986 (up from 35% a decade earlier): this exceeds the share of any other major country including the US (40%) and especially West Germany and Sweden (around 20%) (Economist, 31/10/87, p.108). It is not possible to study the competitiveness of the British economy if one concentrates exclusively on visible trade.

Fifth, the basic balance has moved roughly in parallel with the current balance since the War - until the mid-1970s when the two dynamics became divorced. Since 1979 in particular it has moved erratically on its own accord reflecting the enormous net outflow of capital from the UK. Whilst the basic balance has always been in deficit (like that of the other reserve currency country - the USA) the deficit has mushroomed especially since 1983 reaching £21.6b in 1986, or 5.7% of GDP. This was roughly equivalent to the net outflow of direct and portfolio capital investment in that year. Hence a growing deficit on current account has been magnified by a strong outflow of long-term capital, which has not yet been counterbalanced by the inflow of earnings from that capital. The deficit on the basic balance has been financed by substantial short-term credits (Note - but the size of the 'balancing item' for 1986 should caution us: the reshaping of international money and capital markets is straining the credibility of the British government's balance of payments statistics). As a result of capital outflows Britain has built up its net foreign assets from £4.6b in 1976 to £114b in 1986, making it the world's biggest creditor after Japan ('A rentier nation once more', Economist, 13/12/86, p.25). This sum bears a rough relation to the accumulated 'rents' from North Sea oil - a point at the centre of some of the debates on the British economy surveyed later on.

The House of Lords Committee Report summarised what is inevitably a complex story in the following way.

> *'With the first oil crisis in 1973-4 ... the oil deficit (became) the major feature of the balance of payments. Yet after only five years that deficit was totally eliminated by the advent of North Sea oil, and by 1984 there was a surplus of £7b. The invisible balance ... has continued to rise throughout the period but when all items are taken together in the current account ... the picture changes. The massive surplus on current account of £7b in 1981 ... has vanished. It is easy to see why. The non-oil balance has collapsed from a small surplus to a deficit of £12b in just three years. The major feature in that decline is the turnaround of the balance of manufactured trade of £8.5b which more than accounts for the fall on the current account' (1985, 11, 16).*

In other words, the rising penetration of manufactured imports is more than offsetting the traditional and now growing strength of UK trade in invisibles.

This view is strengthened when we relate the balance of payments to the level of economic activity. In the decade from 1973 to 1983 the output of the British economy excluding oil actually declined by 2%. One effect of this economic stagnation was that raw material and other imports and energy consumption were lower than they would otherwise be. One estimate of the latter argues that 'North Sea oil has made Britain self-sufficient in fuel, whilst depression has made her a major net **exporter** of fuels.' (Rowthorn & Wells, 249; ch.12). In other words, the British balance of payments situation would have been worse if economic activity and employment had not been so depressed. Considering real economic activity and the trade balance together, the message is that the overall competitiveness of the UK economy has diminished since 1973.

Let us now consider in more detail the key source of this declining competitiveness: manufacturing industry. A recent OECD study (OECD, 1985) has produced various indices of competitiveness for the 1970s, distinguishing between high, medium and low technology sectors according to shares of R&D expenditure. Two indicators are important and suggest different conclusions. The first - an index of specialisation by industrial fields, showing whether Britain produces more than it consumes in particular industries - is moderately encouraging. It reveals no clear pattern of change over the decade, and no secular decline within the hi-tech sector. As would be expected for an advanced industrial economy there is in general greater specialisation in the higher technology sectors, in particular drugs, electrical machinery and instruments (and almost certainly aerospace, for which no figures are available). There is a notable shortfall only in office machinery and computers among the hi-tech industries. The second index - the ratio of exports/imports in trade with developing countries (a better measure than with all countries) - is more pessimistic. The ratio for all manufacturing fell in the early years of the decade, and again in 1978/1979 after which there was a slight recovery in 1980. On this measure the UK would appear to have a competitive advantage in aerospace and drugs, but performs poorly in all the other hi-tech sectors, with a secular deterioration in the fields of instruments (which embraces the bulk of telecommunications equipment) and electrical machinery. Furthermore there was a marked decline in the export/import ratio in some medium technology industries, notably motor vehicles where the ratio fell precipitously from 3.3 in 1970 to 0.6 in 1979 (OECD, 1985, Table 6).

For the more recent period we can turn to the House of Lords Select Committee Report on Overseas Trade, which has analysed changes between 1978 and 1984, a period of still sharper deterioration in the UK trade balance. It shows that in 1984 every single branch of British manufacturing industry exhibited a balance of trade deficit, i.e. imported more than they exported, with the sole exceptions of chemicals, mechanical engineering, 'other transport equipment' and two other smaller industries.

> *'The major contributors to the deficit other than food, drink and tobacco are motor vehicles and their parts; paper, printing and publishing; and timber and wooden furniture. But contributions of over £1b also come from electrical and electronic engineering, footwear and clothing, textiles and office machinery and data processing equipment. Thus both traditional industries and more modern sectors such as electronics are included in the deficit' (1985, 16).*

When attention is focussed on the **changes** in trade balances over the six years motor vehicles remain the weakest sector, but once again the decline is manifest across high, medium and low technology sectors. The same applies when import penetration is the index used. Geographically, the British deficit tends to be concentrated on trade with more developed economies, and most notably with West Germany. A notable exception to this decline in recent years has been the defence industry. UK arms exports rose to 20% of the world total in 1986, making it the second arms exporter in the world after the USA - it will have been noted above that aerospace has, along with drugs, been Britain's leading hi-tech industrial performer. Nevertheless the overall conclusion is that the deteriorating foreign trade performance of British industry has continued into the 1980s and is not the result of one or two spectacular failures, though these exist; rather it is widespread across modern and traditional industries.

COMPETITIVENESS: PRODUCTIVITY, COSTS AND THE EXCHANGE RATE

We are now in a position to consider more general measures of competitiveness, by relating the information on the real economy and foreign trade. It is most usual to begin with unit labour costs at current exchange rates. Putting non-price competitiveness to one side for the moment, this will in turn reflect: 1. hourly labour costs, 2. productivity and 3. exchange rates. Table 2.3 brings together some relevant data and compares UK performance with that of the US and West Germany.

Table 2.3: Indices of Competitiveness

		1973	1976	1979	1981	1986
(1980=100):						
Relative normalised unit labour costs		67.3	67.5	82.5	105.2	90.0
Relative export prices		75.7	76.9	90.4	98.1	87.7
Import price competit.		86.7	83.6	93.1	99.3	91.4
		1971	**1976**	**1980**	**1981**	**1986**
GB=100:						
Unit labour costs:	US	80	74	46	48	60
	FRG	114	141	(65?)	92	97
Hourly labour costs:	US	236	209	126	146	161
	FRG	151	208	165	145	173
Labour productivity:	US	294	284	273	302	267
	FRG	133	147	(255?)	157	178

Sources: Top half: House of Lords, 1985, Table 3.3; Economic Trends (various), Table 46.
Bottom half: NIER, 1984, Table 2; NIER, 1987, Table 4.

British unit labour costs at current exchange rates rose from the end of 1976 (relative to a weighted average of its competitors) and this deterioration accelerated in 1979 and 1980. At the start of the present decade they stood at more than double the US and Japanese levels. Since then they have fallen quite considerably, especially vis-a-vis Japan and West Germany. (Since 1984 they have risen relative to US levels due to the decline of the $, but this is an exception to the general improvement). However British unit costs still exceed those of most of its major competitors. In 1986 they were on a par with West Germany, but higher than Japan (by 37%), France (by 52%) and the USA (by 67%). So the picture is one of improvement from a disastrous position to a still vulnerable one. To explain this we must disaggregate the measure into its three component parts, beginning with movements in the £ exchange rate.

Since the early 1970s it is noticeable that the sterling exchange rate has been more volatile than that of other major currencies except the US dollar. (Economist, 18/10/86, p.11). From 1970-72 (=100) its weighted effective exchange rate fell rapidly to around 60 in 1976-78, then appreciated to around 80 in 1980/81 especially against the dollar, then depreciated still lower to about 55 in 1985 since when it has risen again. Clearly such major swings have had a considerable impact on the export prices of British goods. The appreciation of sterling harmed UK competitiveness in the first two years of the Thatcher government, and is doing so again now; but in between times its substantial depreciation contributed to the relative improvement noted above. However this was offset by a marked rise in domestic unit labour costs: a 13% increase from 1982-86 (in local currency) was matched only by France among our major competitors. Since 1981 paradoxically real earnings in the UK have multiplied faster than any other major country (Economist, 13/9/86, p.107).

Let us move on then to consider hourly labour costs in manufacturing at current exchange rates (but excluding any reference to output and productivity). Already by 1970 Britain was one of the cheapest labour countries in the developed world, with only Japan exhibiting much lower costs. (By contrast with West Europe it was Britain's low 'social charges' which produced this result). In the next decade up to 1980 West European labour costs pulled further ahead and Japan began to catch up, but trends in US labour costs more than offset this advantage to Britain by falling precipitately to levels below those in the rest of Europe. From 1980-86 the UK gained a clear advantage vis-a-vis the USA and Japan, where hourly labour costs at current exchange rates have grown, and has maintained

Table 2.4: Productivity Trends
% pa

	1976-79	1979-82	1982-86	1976-86
UK	1.0	2.9	4.3	2.9
Big 7 countries	3.5	2.2	3.9	3.3

its cheap labour advantage over West European countries. Here the falling value of the £ has offset the faster rise in domestic earnings in the UK. The upshot is that even in 1986 'Britain appears as the industrialised country with the lowest labour costs, with the sole exception of Ireland' (NIER, 1987, 71). The decline and then improvement in competitiveness cannot be explained in terms of earnings or social charges.

This means that it is the third factor - labour productivity - which, alongside exchange rate fluctuations, must explain the observed changes in UK competitiveness. And of course Britain's past failing in this regard is at the centre of the policy debates which we shall shortly consider. Output per person hour in British manufacturing has been growing faster in recent years compared both with the previous period and other competing countries (NIER, 1987, Table 3).

This shows an almost stagnant manufacturing sector in the late 1970s accelerating to overtake the productivity growth rates of other major Western countries in the 1980s - lending some support to the view that British industry both needed and has received a 'kick up the pants' in recent years. However this marks an improvement from an extremely low base. In 1980 US labour productivity was 2.73 times higher than Britain, West German 2.55 times higher and French and Japanese levels 1.93 and 1.96 times higher: an extraordinary gap between otherwise similar economies, which has narrowed only slightly as a result of recent trends. Another estimate by Thurow calculates that the other major economies had in 1983 between a 55% and 80% productivity advantage over the UK. A detailed sectoral analysis has corroborated this picture for British manufacturing, in contrast to agriculture and construction where it found the UK had comparable productivity levels to the US (Smith et al, 1982). Interestingly it found that vis-a-vis the US the main slippage occurred in the 1940s, since when relative productivity levels have not greatly changed; but this is unlikely to hold for the other competing countries which have gained ground over the UK throughout the period since the Second World War. Thus it will require at least a continuation of recent comparative productivity trends to offset such an accumulated disadvantage.

Table 2.5: R&D Expenditure

	UK	US	W.G.	FRANCE	JAPAN
Total R&D/GDP, 1983	2.3	2.8	2.6	2.2	2.5
Total civil R&D/GDP	1.6	2.0	2.5	1.7	2.5
Annual growth of R&D, 1967-82 (%pa)	0.9	4.1	5.9	5.9	9.8

Source: Cable, 1986, 254.

INVESTMENT AND INNOVATION

To go much further in explaining these facts would take us into the realm of policy debates, but two further measures of competitiveness should be introduced at this point. The first is levels of investment, a measure which used to find Britain towards the bottom of the international league table. However when residential investment is excluded, the difference disappears: from 1971 onwards the UK investment share has been similar to that in the big 7 economies, with the exception of Japan (OECD, 1985A, 18). It appears that the main problem is ineffective use of capital or poor quality of investment. A variety of measures of incremental capital-output ratios, and output per unit of net capital stock, all show that it takes twice or more investment to generate additional output in the UK than in Germany or the USA. This is supported too by case studies of individual industries and firms (Prais, 1983; House of Lords, 1985, 24). Thus it is to the efficiency of investment and management practices rather than to low investment that attention must be directed in the search for causes of the British economic decline.

One last factor may be relevant in understanding this: the level of R&D expenditure. Britain devotes about the same proportion of industrial output and GDP to R&D as other major countries, though, because her GDP is lower than other countries, the absolute level of expenditure is less. However notable differences are found when the direction of R&D is analysed. Since the 1960s about 50% of the total has been devoted to just three sectors - aircraft, defence products and nuclear reactors - a pattern unlike that of any other economy except the USA. Hence the levels of R&D in all remaining sectors, including several key hi-tech industries are considerably lower in Britain than in her major competitors, both relative to industrial output and even more so in absolute terms (Smith, 1984).

TWO CASE STUDIES:
(1) THE AUTOMOBILE INDUSTRY

The British car industry is an example of, and a major contributor to, the above pattern of decline. On almost every indicator its performance has been bad, and there is at the time of writing little evidence that it will improve. There are currently three dominant firms in the British care industry: Austin-Rover, the now-nationalised remnant of the major indigenous car companies, and two US subsidiaries, Ford and Vauxhall. In 1984 they accounted for 18%, 28% and 16% respectively of the UK car market. It is apparent that in international terms Austin-Rover is extremely small: its output of about 0.4m cars a year is about a quarter that of major European competitors such as Volkswagen, Renault, Peugeot and Fiat, let alone the US and Japanese giants. Its present size is the result of a drastic loss of market shares in the 1970s in the face of burgeoning imports. However when calculating the import share for the whole UK industry, account must also be taken of 'tied' imports of components form the overseas subsidiaries of multinational companies. Either way, the 1970s witnessed a major expansion of car imports to the UK (Table 2.6). From the early 1970s to 1979 the UK market was hit by recession and then rebounded to its previous level, but it was foreign firms that took advantage of the rebound. Since 1979 the market has stabilised, as has domestic production at around 0.95m vehicles and the import share. Nevertheless car exports have continued to plummet, from 0.6m in 1973 to 0.17m in 1983. Hence the balance of trade in cars has deteriorated from large surpluses of £3-4b up to 1976 to a rough balance in 1977-80 to major deficits of over £2 1/2b in 1983 and 1984.

This went hand in hand with falling domestic output, employment, earnings and profits. Domestic production fell from 1.9m vehicles in 1972 to around the 1m level in just seven years, and though it has stabilised since then, the rising import of components means that the output of 'car equivalents' continued to decline to 0.7m in 1984. Car workers earnings, which were 17% higher than those of average male manual wages in 1972 have now reached rough parity. Apart from Ford, all UK producers have reported losses since 1979, including a cumulative £1b loss at Austin-Rover between 1979 and 1983 (Marsden et al, 1985, p.19). However in part this reflects renewed investment in the major UK plants in the 1980s, a development which it is hoped will reverse the above trends. Productivity too is increasing, but from a low level. A House of Commons Report reported that value added per employee in West Germany in 1974 was 83% above the average for UK firms. (Marsden, 1985, 26). Lastly, R&D expenditure and employment in motor vehicles in the mid-1970s was poor compared with competing countries, and led to a collapse of UK and BL patenting after the middle of the decade.

Table 2.6: The Car Industry: Imports and R&D

	1969	1974	1979	1984
Imports, % of UK market:				
Assembled car imports		27	37	35
Tied imports		1	20	22
Total	10	28	57	57
	UK	**USA**	**WG**	**FR**
R&D/Value added (%)	3.9	6.2	5.9	5.4
Total R&D employment	13000	98000	22700	14300

Sources: Top half: Jones, 1985, Table 1.
Bottom half: Jones, 1983, Table 1.

Thus on every one of our measures, the competitiveness of the UK motor vehicles industry declined in the 1970s, and on several it has continued to deteriorate in the 1980s. The question is whether the recent rise in investment and productivity, the management and other restructuring of existing firms, the link-up with Honda and the new Nissan investment in Sunderland, can reverse this trend. Recent results for Austin-Rover do not bode well however. In 1986 its market share hit a new low of 16%, its total production fell 20% and substantial new losses of £150m were recorded. It is too soon to say whether the British car industry will maintain its present precarious position in the face of increasing international competition.

(2) TELECOMMUNICATIONS

Telecommunications is a sector which has been a flagship for the Thatcher government's liberalisation and privatisation policies since 1981. Before that it was organised in the traditional European way with a dominant public agency (the Post Office; and British Telecom after 1981) linked to a small, closed ring of private suppliers (GEC, Plessey, STC). In many respects, despite the very different nature of the industry, the pattern follows that of the car industry: declining competitiveness in the 1970s, followed by restructuring in the 1980s which has yet to produce any clear improvement and in some respects has (temporarily?) worsened the situation. Although it is difficult to assemble comprehensive data on the competitiveness of the telecommunications industry (it does not correspond to any one of the ISIC categories) the following indicate recent trends.

The UK had 25% of world exports of all Telecom equipment in 1960, but this had fallen to 5% by 1985. Yet despite this long-term trend it was only in 1983 that her trade went into deficit. The UK is below the OECD average in telephone sets per head, though it will soon move into a leading position in the digitalisation of the telephone network. Like all countries its R&D expenditure has multiplied in recent years following the technological revolution in telecommunications, but the investment rate of UK common carriers still falls short of almost every one of its competitors. Once again the international competitiveness of a traditional British stronghold has been eroded, and the restructuring response to this predicament in the 1980s has yet to yield any firm results.

In conclusion the competitiveness of British manufacturing industry continued to decline until around 1981, whatever the measure used. Since then the record is a mixed one: productivity has accelerated which has some beneficial impact on unit labour costs (counteracted by the rapid rise in earnings); on the other hand the manufacturing balance of trade has deteriorated still further, though the trend has been masked by revenues from North Sea oil.

Table 2.7: Telecommunications Data

	1978	1981	1985
Output of elec & instrument eng (1980=100)	102	93	131
Output of telephone/telegraph equip	85	100	115
UK Exports of Telecom equipment (£m)	98	131	242
UK Imports	54	96	317
Balance of trade	44	35	-75

Investment per capita, $US, 1980 exchange rates

	UK	US	WG	FR	SW
1975-77	53	71	59	85	37
1983-85	49	67	104	83	93

Sources: Top half: Foreman-Peck and Manning, 1986, Tables 2, 3.
Bottom half: Ypsilanti & Mansell, 1987, Table 2.

CHAPTER 3

POLICY RESPONSES

1974-79

The period 1974-76 was one of 'utter dislocation of the economy' for Britain (Caves, 1980, 31), more so than for its major competitors. GDP declined in 1974 and 1975, and for the whole period 1973-78 registered a mere 1.1% p.a. rise, less than half of the OECD growth rate. Inflation exceeded 25% p.a. and was more than double the OECD average from 1975-77. The balance of payments deficit reached a peak of $8.6b in 1974, exceeding that of any other nation. Unemployment doubled from 1974-76.

The policy response of the Labour Government can be divided into two periods: the first year 1974-75, and the remainder of its term from 1975 to 1979. The first year was dominated by short-term policy commitments (to settle the miners strike, to repeal the Industrial Relations Act, to abolish the Pay Board and the incomes policy of the Heath government) and expansionary and redistributive measures, including food subsidies, higher pensions and a rent freeze. At the same time work was begun drafting a new Industry Bill which was to implement part of the Alternative Economic Strategy which had been developed in opposition. This strategy proposed new public enterprises, a system of planning agreements with key private corporations, a National Enterprise Board, price controls, industrial democracy and withdrawal from the EEC. It would thus have represented a far-reaching shift towards socialist dirigisme. It also rejected statutory controls on incomes. This radical manifesto received the electorate's narrow endorsement in the October 1974 election, but from that moment on the AES began to be diluted and augmented by quite disparate policy elements. Subsequent policies to improve competitiveness can be grouped into three: the remains of the industrial policy, new anti-inflation macro-economic policy, and the 'Social Contract' incomes policy.

The Industry Bill was amended throughout its Parliamentary passage and emerged an emasculated shadow, with virtually no statutory powers: the new National Enterprise Board was left managing loss-making concerns such as British Leyland and Rolls Royce. Following renegotiation of the terms of Britain's membership of the EEC, a referendum in 1975 voted by a large majority to continue membership. CBI opposition to the Bullock committee report on industrial democracy in 1977 forestalled any legislation. Thus no major plank of the AES was enacted. Instead, industrial policy focused on the rescue of industries in crisis, on regional policies and employment schemes to manage the rising unemployment level, and on Stock Relief tax allowances to reduce the incidence of corporation tax. The only tangible sign of any form of corporatism were the sectoral working parties established under the NEDC. 'By 1976-77 the new measures which had been the centre of so much attention had become tangential to industrial performance.' (Morris, 1985, 886).

Simultaneously, a shift in macro-economic policy was occurring. The expansionary fiscal and monetary policies which had persisted from 1971 through to the end of 1974 (Caves, 1980) were reversed. In his Budget statement of 1975, Mr Healy rejected a counter-cyclical budget despite falling output and rising unemployment. The £ reserve crisis of summer 1976 led to substantial public expenditure cuts of £1b in 1977/78, the sale of some shares in BP, and an end to the regional employment premium. Furthermore, under IMF pressure, the Bank of England announced explicit monetary targets. The policy shift was publicly spelt out by the Prime Minister in his by now famous speech to the 1976 Labour Party conference (written, it is alleged, by his son-in-law Peter Jay, a proselytiser of New Right political economy):

> *'We used to think that you could just spend your way out of recession and increase employment by cutting taxes and boosting government spending. I tell you in all candour: that option no longer exists. And insofar as it ever did exist, it worked by injecting inflation into the economy. And each time that happened unemployment rose.'*

Nevertheless, the OECD (1984) notes that the government remained uncomfortable with some of the implications of its new policy stance and 'remained in many respects interventionist'. Another economist argues that by 1976 'fiscal policy was now subordinated to monetary policy and both were subordinated to long-term anti-inflation goals. But the Labour government still kept faith with the full employment goal enunciated in the 1944 White Paper and with incomes policy as a means of achieving it'. (Moseley, 1984 129; OECD 1984, 9; Krieger, 1986). This leads me on to the last component of Labour's economic policy.

In 1975 a series of voluntary agreements (the 'Social Contract') was negotiated between the Labour government and the TUC, with sanctions via procurement policies for employers that did not comply. In 1975-76 a maximum £6 flat rate wage increase was agreed up to an income ceiling; in 1976-77 a more stringent 5% increase weighted towards the low paid was negotiated. This was followed by a government-only pay policy for the public sector of 10% in the following year and by a proposed 5% policy for 1978-79, but by this time any trade union co-operation had disappeared. The Social Contract at first sight appeared to echo the ideas of the democratic 'social contract' proposed in Labour's Programme 1973. However the other elements of the AES were neither promised nor delivered as a quid pro quo; indeed the Social Contract was negotiated as an alternative to the ill-fated Industry Bill (Hodgson, 1981). Nor can it be construed as part of a corporatist package of policy measures, for by this time deflationary fiscal and monetary policies were taking effect. By 1978 it was increasingly perceived as a pay policy pure and simple. Although the rate of inflation was quickly brought down from 24% in 1975 to 8% in 1978, the index of manufacturing production and productivity barely increased. Industrial militancy and opposition to the policy escalated, and contributed to the downfall of the government in 1979.

THE 'THATCHER EXPERIMENT'

> *'To master inflation, proper monetary discipline is essential with publicly stated targets for the rate of growth of the money supply. At the same time a gradual reduction in the size of the government's borrowing requirement is also vital ... The state takes too much of the nation's income: its share must be steadily reduced ... The reduction of waste, bureaucracy and over-government will yield substantial savings. We shall cut income tax at all levels to reward hard work, responsibility and success.' (Conservative Party Manifesto, 1979).*

Many of the themes of those who argue that too much state intervention is the fundamental cause of Britain's economic malaise are encapsulated in this statement. Nor is it difficult to establish the direct influence of various New Right thinkers and bodies on the Thatcher administration. One revealing example is provided by Sir Keith Joseph who, on becoming Secretary of State for Industry in 1979, gave all his senior civil servants a reading list distilling the panoply of neo-liberal influences on his thinking from Adam Smith through Tocqueville to Hayek (Bosanquet, 1983). Thus 'Thatcherism' is a useful real-world experiment in applying and testing some of the theories of Britain's declining competitiveness adumbrated above. Alongside the role of the state, the power of trades unions is an important sub-theme.

The major economic policies of the Thatcher governments which have a bearing on competitiveness can be categorised as follows.

1. 'Monetarist' macro-economic policies

2. Reducing the scale of the public sector

3. Labour market deregulation

4. Product and capital market deregulation

In all these areas it is necessary to distinguish rhetoric and policy enactment, whilst recognising the importance of the former. (Tomlinson, 1986). In my view the role of radical rhetoric has emerged because of the central role in the government's thinking of price stability, of expectations in generating and maintaining inflation, and hence of the government's credibility, its self-control and its refusal to contemplate U-turns in eliminating inflation from the

British economy. By continually reiterating its commitment to a long-term haul, the government was binding itself against future policy changes by raising the electoral costs to the government itself should it reverse its policy stance. Thus the rhetoric is a part of the policy. Despite this it is true to say that the government has been characterised by remarkable caution in economic and social policy, proceeding to reform of trade unions and the welfare state, for example, only when the political cost-benefits looked most favourable. It is this combination of an unwavering commitment to certain long-term goals with short-term caution which characterises the Thatcher administrations.

1. 'MONETARISM'

As a system of ideas, monetarism is difficult to define, but most would agree on the following components. First, the quantity theory of money: the belief that demand for money balances is stable, predictable and not sensitive to interest rates, and the consequent argument that changes in the supply of money have important economic consequences on monetary variables. It is thus argued that money supply is the major determinant of nominal GDP, and that after a lag its main effect is on the price level. Second, the expectations-augmented Phillips curve with its corollary that there is a natural rate of unemployment, below which inflationary pressures will accumulate. Third a monetarist approach to the balance of payments and the exchange rate, and fourth, antipathy towards stabilisation policy and support for long-term or medium-term targets of government intentions (Laidler, 1981; Whiteley, 1986). This may represent more a collection of empirical results or a policy stance than a distinct economic model (Jackson, 1985), but it was a major influence on at least the early years of the Thatcher government. However we have noted that some components were introduced by the Labour government; in particular the time period appropriate to economic management shifted from the short term of Keynesian demand management to medium term targets; monetary policy replaced fiscal policy as the priority instrument; and within monetary policy instruments the money supply displaced interest rates (Moseley, 1984). In the light of this what was new about the conservative economic policy?

I think four things changed. First, eliminating inflation as the essential pre-requisite for a sustainable improvement in economic performance became the over-riding goal of macro-economic policy. Though price stability was certainly promoted by the previous Labour administration, it was the Thatcher government which irreversibly shifted the goal of economic management in this way (OECD, 1986; Moseley, 1984 - though see Begg, 1987). Second and associated with this, demand management ceased to be the key goal of fiscal and monetary policy; also downgraded as policy aims was the control of interest rates, the balance of payments and the exchange rate. Third, lower government borrowing in the shape of targets for the public sector borrowing requirement (PSBR) assumed a central importance as a policy instrument. Fourth, the importance of clear, believable rules governing government behaviour was promulgated; in particular people should be certain that there will be no 'U-turn' should recession threaten (Begg, 1987; Moseley, 1984). These four features demarcate Thatcherism from prior Labour and Tory administrations, and have singled it out as the pioneer of monetarist orthodoxy in the Western world.

Nevertheless, the difficulties of applying monetarism in practice soon became apparent. This was the first time that such nostrums had been implemented in an advanced western economy, and the experiment involved much 'search behaviour' and trial and error as well as theoretical reasoning and ideological commitment (Jackson, 1985). In particular several thorny issues had to be resolved. First, should the government launch a 'cold turkey' treatment of drastic and sudden monetary restraint (as advocated by Hayek and Minford), or should it gradually reduce money supply growth via a set of medium-term targets (as advocated by Friedman)? The latter won the argument (at least the political arguments), and the Medium Term Financial Strategy was announced in 1980: a set of targets for the growth of the money supply and other financial variables such as the public sector borrowing requirement (PSBR) for four years ahead. A second problem concerned the choice of which monetary target to control. The options vary greatly, they move at different rates and even at times in opposite directions to each other. This was resolved in favour of £M3: notes and coins plus all Sterling bank deposits held by UK residents. Third, the Treasury and Bank of England disagreed on how to control the money supply, the former favouring direct control and the latter indirect control via the manipulation of interest rates. In practice it was a third variable, the PSBR, which it was argued had a central influence on both money supply and interest rates and which thus became the central focus of government intervention (Jackson, 1985, 46-7).

Thus the government initiated a novel financial strategy which projected lower rates of growth in the money supply £M3 falling from a 7-11% p.a band in 1980/81 to 4-8% in 1983/84, and a reduction in the PSBR from 3 3/4% of GDP to 1 1/2% over the same period. In this way fiscal and monetary policy were tied together, the former being subordinate to the latter (Fischer, 1987). However the first year saw money supply increasing by 20% (9% in excess of its maximum target) and PSBR reaching £13b or 5.7% of GDP. Despite this, inflation fell rapidly from 20% to 12% over 1980-81. The rapidly deepening recession of that year was one factor that led to the overshoot in government borrowing. The credibility of the financial strategy required that monetary and fiscal policy be tightened in the 1981 Budget in the teeth of a depression, during which 25% of manufacturing employees were to be sacked. This it achieved by maintaining course and eschewing any reflation. 'The government did nothing. "That", as Sherlock Holmes remarked, "was the curious incident"'. (Budd, 1987, 190). It was this event which more than any other signalled the shift in British macro-economic strategy.

In some ways 1981-82 marked a watershed. After this act of anti-Keynesian defiance, the government slowly modified its monetarist stance partly in response to its perceived deficiencies and partly because political and economic factors favoured a shift of priority towards supply-side policies. Kaldor and others were critical of the whole monetarist strategy, arguing among other things that the velocity of circulation is unstable, that the link between money supply and inflation is not established, that the money supply is not exogenous and that there may be reverse causation at work whereby economic activity determines money supply (Kaldor, 1980, 1983; Jackson, 1985; Hodgson, 1984). Many more including Friedman were critical of the central role accorded the PSBR. On the other hand Minford (1987), for example, argues that the policies were crucial in driving down inflationary expectations. The OECD has tended to back the critics. Noting that the inflation rate began to fall in 1981 despite the overshoot in money supply it concluded 'The medium-term causal links between the PSBR, growth of sterling M3 and the rate of inflation, which had been stressed as fundamental in the first MTFS in 1980, were not evident in the short term'. Nor did subsequent events lend any support to a lagged relationship. (OECD, 1984). By 1982 the government had begun to accept the 'base drift' in money supply and chose higher targets, it evinced a new concern with interest rates and the value of the £, and the central role of £M3 was played down. In recent years the growth of nominal GDP has come to assume greater importance as an informal policy target. More especially under Nigel Lawson management of the exchange rate has been resurrected (since mid-1986 the pound has unofficially shadowed the D-mark) though Mrs Thatcher has ruled out putting sterling into the EMS.

Table 3.1: Financial Indicators

	1980	1981	1982	1983	1984	1985
Growth in £M3, % p.a.	17.7	14.1	10.9	8.6		
PSBR/GDP	5.4	3.3	3.2	3.2	3.1	2.0
Cyclically adj budget surplus/GDP	2.1	5.3	5.6	3.7	3.2	
Rate of inflation, GDP deflator	19.9	11.8	7.4	5.1	4.2	5.4
GDP growth, % p.a.	-3.8	0.7	2.4	2.8	3.5	
Interest rate (Treasury Bills)	15.1	13.0	11.5	9.6	9.3	11.6

Sources: Fischer, 1987, appendix data; Begg, 1987, Table 2.3

How effective then was the new macro-economic policy? The major success has been in reducing inflation at a faster rate than expected, to a level parallel with the OECD and below that of European OECD countries. Yet Table 3.1 shows that money supply growth remained high though PSBR was steadily reduced after the peak of 1980. However the cyclically adjusted figure for the budget surplus reveals that fiscal policy was tightened still further in 1981 despite the recession and, despite some loosening, has remained deflationary ever since. Matthews and Minford (1987) argue that the government's macro-economic policies were crucial in squeezing inflationary expectations out of the British economy. Many other observers are more sceptical. The OECD (1984) recognises the achievement in bringing down inflation, but argue that the policy drove interest rates up to high levels (they have remained high in real terms) and allowed sterling to appreciate, which combination drastically reduced investment, escalated unemployment and resulted in a large loss of cost competitiveness. The severe recession of 1980-81 put the burden of adjustment on those sectors most vulnerable to international competition, in particular manufacturing. As already noted it also dismissed any clear links between money supply and inflation. This sgenerally unimpressive story is often cited as proof of 'Goodhart's Law': 'Any observed statistical regularity will tend to collapse once pressure is placed upon it for control purposes.' (The Times, 8/2/80)

2. CUTTING BACK THE PUBLIC SECTOR

'Public expenditure is at the heart of Britain's economic difficulties' (HMSO, Public Expenditure White Paper, 1979).

The present administration's overall economic strategy involves reducing tax rates, privatising major parts of the public sector and holding public spending at a broadly constant real level. Hence I shall focus on spending, taxation and privatisation in what follows.

Despite the uncompromising declaration of its first White Paper, the Thatcher government has utterly failed to reduce public spending, especially by contrast with the previous Labour administration. Table 3.2 shows that in real terms general government expenditure (which includes debt interest) has risen by 29% since 1979/80, an average of 4% a year. Coupled with falling GDP in the first three years, this caused its share of GDP to rise by 3 1/2 percentage points to 47% in 1982/3 - a level only exceeded in 1975/6. On the other hand, if the government had been more successful in attaining its public expenditure targets, the recession would have been much deeper than it turned out to be (Whiteley, 1986). Since 1982 faster growth has reduced its share to a 44% (excluding privatisation proceeds dealt with below), though this remains higher than the level it inherited from Labour. The 1988 White Paper plans a slower growth of 1.25% p.a. up to 1990/91, and a further decline to 41.25% of GDP. As in the period 1976-79 it was capital spending which continued to fall up to 1982, since when it has stabilised. The accumulation of capital cut-backs has meant that net investment in public sector infrastructure has hovered just above zero since 1981 (Hills, 1987). Within total spending significant shifts in programme size have occurred (Chart 3). Social security has absorbed a vast increase, along with defence, law and order, employment and training, and health. Housing expenditure has been sharply cut back, along with economic and infrastructure spending. A further analysis is postponed until our discussion of the welfare state.

The government's failure to cut taxes - a target squeezed between the rise in state spending and the priority attached to reducing public sector borrowing - has been still more notable. Partly due to falling GDP, total taxation reached a post-war high of 39% of GDP in 1982, a rise of 5 percentage points in just four years. Since then, and notably since 1986, the share of taxes has begun to decline though they remain higher than at the previous peak of 1975. Despite the greater than expected contribution from taxes on North Sea oil, other taxes have recently outstripped 1975 levels as a share of GDP. The restructuring of the tax burden has however proceeded apace. One of the administration's first measures in 1979 was to reduce the standard rate of income tax from 33% to 30%, and the top rate of personal tax from 83% to 60%; at the same time as raising VAT from 8.5% to 15%. As a result the share of expenditure taxes in consumer spending has risen steadily for more than a decade. Other dynamic sources of tax revenue include National Insurance contributions and the petroleum revenue tax discussed above. Despite this, income taxes were raised (by non-indexing tax allowances) in 1981 to tighten fiscal policy following the overshoot in the PSBR in 1980/81. From 1982 onwards however the government has begun to renew its policy of cuts in direct taxes on individuals and firms. The standard rate has been progressively reduced to 25% between 1985 and the 1988 Budget, when the maximum rate was also cut to 40%. After 1981 tax allowances were raised faster than inflation, which removed 1 million people from income tax by 1984/5 (OECD, 1985). The standard corporation tax rate too has been cut from 40% in 1981 to 27% in 1987 (Matthews & Minford). Thus in the years since the early monetarist experiment (when all taxes rose), the government has systematically switched the tax burden from direct taxes on income to other sources. Current revenues are buoyant due to the fast rate of economic growth, and permitted extensive cuts and a radical reform of the taxation system in the 1988 Budget.

Table 3.2: Public Expenditure and Taxation

	1975/6	1979/80	1982/83	1986/87
Expenditure				
Gen. govt. expend, 1986/7 prices, £b	149.1	149.4	158.1	165.1
Gen. govt. expend, excl. privatisation	149.1	150.1	158.6	169.5
As % GDP	48.5	43.3	46.7	42.9
As % GDP excl. privatisation	48.5	43.4	46.8	44.0
Taxation	**1975**	**1979**	**1982**	**1986**
Total taxes/GDP	36.5	34.7	39.1	37.9
North Sea Oil taxes/GDP	-	0.9	2.6	1.0
All other taxes/GDP	36.5	33.8	36.5	36.9
Taxes on income/total personal inc	15.6	12.8	13.6	12.6
National insurance/employment inc	11.0	11.3	13.1	14.3
Expenditure taxes/consumer expend	18.8	21.9	24.4	24.2

Sources: HMSO, 1988
OECD, 1984, Table 4
NIE, 1987, Tables 1.1, 3.1, 3.3, 4.1, 5.4, 7.2, 9.1

The administration's failure, at least in the early years, to rein back the expansion of the public sector has prompted a debate as to why (Mullard, 1987). Some argue that public expenditure responds to demand and cost pressures acting upon individual programmes which the government is relatively powerless to stop. Thus, demographic pressures and above all the escalation of unemployment drove up demand-led transfer payments, whilst the 'Clegg' pay awards to public sector workers inherited from the Labour administration inflated current spending (Rose, 1984). Others argue that any government must take note of electoral opinion and the balance of power within the Cabinet: on this reading Mrs Thatcher was outnumbered in her first two years by Cabinet colleagues who disagreed with her overall approach, which undermined the ability of the Treasury to resist the claims of spending departments. The Falklands conflict in 1982 consolidated her position which resulted in public expenditure and taxation levelling out thereafter (Riddell, 1983). This position is related to those who contend that there is a politics of Thatcherism which seeks a fundamental reversal of the scale of the interventionist state, and that the government's record must be evaluated over the long term. This is because public spending responds to pressures from powerful groups of suppliers and consumers, which the government must first tackle if it is effectively to restrain the expansion of state finances (Bruce-Gardyne, 1984; Brittan, 1983; Matthews & Minford, 1987; Le Grand, 1985).

The debate comes down to the question whether political choice or economic/political constraints have determined the government's record on public spending and taxation. According to one recent study (Mullard, 1987; see also Levitt & Joyce, 1987), both factors have been at work. Transfer spending has been predominantly demand-led: once the government decided not to challenge the fundamental entitlements of social security, the rise in expenditure proceeds inexorably. However, current resource expenditure from 1979-83 reveals a different pattern: both relative costs (including the Clegg effect) and increased output explain about half the increase. In the fields of law and order, defence and health the latter, policy-related factors were dominant. Furthermore, after the 1980/81 pay increases to public sector workers, their pay relative to average earnings has been reduced by 10%, and for many groups has not kept up with inflation (Trinder, 1987). I would conclude that public spending was driven mainly by exogenous factors in the first three years, though policy-determined shifts towards defence and law and order spending were effected. Since then however the government has progressively gained control over state spending, and is now tackling some of the electoral and pressure group constraints which limit its freedom of manoeuvre (see below). The 1988 Budget reflects the government's enhanced scope to 'steer' the public finances coupled with a growing confidence in its ability to do so. It illustrates once again that 'Thatcherism' combines a resolute adherence to strategic goals together with a flexibility over tactics.

Privatisation of state assets has been pioneered by the Thatcher government. In fact there were few commitments to privatisation in the 1979 manifesto, but from 1981 onwards government policy shifted away from monetarism towards the supply side policies of denationalisation and deregulation. The former dominated the second term of office from 1983-87 and are planned to continue in the third. The major supply-side arguments advanced by the government for denationalisation are that it enhances efficiency and economic freedom, and enables management to withstand excessive pay demand by powerful groups of workers (Steel & Heald, 1985). However during this period another rationale was adumbrated: that privatisation permits reductions in state borrowing without raising taxes, and this has equalled if not displaced the original competitive arguments.

In a quirk of accounting they also reduce the Treasury's figures for public expenditure since the proceeds are treated as 'negative expenditure', rather than as an alternative source of revenue. Hence British privatisation policies mark a bridge between the monetarist and supply-side components of the government's economic programme. However some claim that in consequence competition policy has been sacrificed to the revenue raising potential of asset sales (Steel & Heald, 1985). The proceeds and some of the major items are shown in Table 3.3. These are huge transfers of property with substantial effects on the (government's) measure of public spending, as shown in Table 3.1.

Table 3.3: Privatisation Proceeds

Year	£b
1982/3	0.5
1983/4	1.1
1984/5	2.1
1985/6	2.7
1986/7	4.4
est 1987/8	5.0
1988/9	5.0
1989/90	5.0

Source: PEWP, Table 2.16

3. LABOUR MARKET DEREGULATION

The legislation to curb the power and reduce the legal immunities of trade unions is sufficiently explicit and extensive to warrant treating it separately from other labour market policies. The government acted against union powers for two economic reasons: first, their monopoly power was thought to explain why real wages remained so resilient during the deepest recession in the post-war period, and second, the various restrictive practices they had nurtured reduced labour market flexibility and depressed productivity. However a political rationale can also be discerned: economic renewal required taming sectional interests and the ostentatious rejection of the perceived 'corporatism' of the 1970s (Moran, 1987). Curbs on trade unions can thus be treated alongside the demotion of other intermediary bodies, from local authorities to the Supplementary Benefits Commission. Trade unions were thus an explicit target of government policy from 1979, unlike some other supply-side innovations.

Once again the Thatcher administration proceeded cautiously to begin with, but then substantially shifted the British system of industrial relations in the Employment Act 1982 and the Trade Union Act 1984. These have removed legal immunities for most picketing and secondary industrial action, strengthened the rights of individuals not wishing to join closed shops, instituted secret ballots for certain key union policy decisions, removed union immunities from civil action and restricted the unfair dismissals procedure (OECD, 1985, 26). Much of this can be interpreted as an attempt to shift internal power within unions from 'militant' leaders to the 'silent' rank and file (Kelly, 1983). At the same time mass unemployment had seriously eroded union membership - down from the peak of 13.3m in 1979 to 11.1m or 52% of employees in work in 1984 - and altered employment practices to an unprecedented degree, via such arrangements as the growth of part-time work, unstandardized shift patterns, self-employment, temporary employment, and the decline in apprenticeships etc (Metcalfe & Richardson, 1986). Lastly, the government had adopted an uncompromising stand over strikes in the public sector (OECD, 1985), culminating in its victory over the miners in the year-long strike from 1984-85.

Other policies to deregulate the labour market include the tax changes noted above and the social security changes to be discussed below. Of the latter, the non-indexation of benefits in line with earnings, the taxation of some benefits and the restriction of entitlement to others, are the most important. Together they have brought about a sharp fall in replacement ratios, in a country which already had low relative levels of social security benefit (OECD, 1986). As such the government intends and believes that they enhance the incentive effect of the combined tax-benefit system (Matthews & Minford, 1987). But there have been other measures outside the tax-benefit system. First, the Young Workers Scheme from 1982-86 offered employers £15 a week for every young worker they took on, provided they paid them less than a certain amount (£50 a week in 1985) - an attempt directly to lower wages. Second, the protection offered employees against unfair dismissal had been restricted. Third, the scope and powers of the Wages Councils have been cut back. These exist to set minimum wages and work conditions for 2 3/4m low paid workers, but since 1985 young people under 21 years have been removed from their jurisdiction and the Council's powers to control the conditions of employment have been abolished. These measures required the government to de-ratify ILO Convention 26.

In all these ways then the Thatcher administration has sought to undermine constraints on labour market flexibility. It remains debatable how far it has succeeded. On the one hand, the contribution of such supply-side factor to current levels of unemployment is disputed. Some (e.g. Matthews & Minford) claim that the poverty and unemployment traps are significant and harmful, and criticise the government for not doing enough to remove them. The OECD (1986) however argues that minimum wage legislation and benefit replacement ratios are not an important cause of unemployment and wage rigidity. However it agrees that reforms of unions and industrial relations have been important in enhancing competitiveness. Layard and Nickells (1985) calculate the contributions of different variables to the rise in male unemployment between 1956 and 1983 as follows:

Benefit replacement rate	+0.4
Employers' labour taxes	+1.9
Unions	+2.3
Demand factors	+6.4
Other variables	+0.8
Actual Change	+11.8 percentage points

The overall conclusion points to a mixed success in improving competitiveness. 'The weakening of the unions has certainly contributed to greater flexibility in the labour market in changing working practices but has still not succeeded in imparting any downward flexibility in real wages' (OECD, 1985, 27). From a neo-liberal perspective, Matthews & Minford (1987) concur: as in the USA weaker unions have resulted in enhanced efficiency in the use of employed resources, but in contrast to the USA this has not reduced real wages or created more jobs. On the other hand others argue that collective bargaining may reduce labour turnover, improve morale and above all build up a consensus over wage increases, and thus that unions have a positive role to play in combining better efficiency with wage moderation (Tomlinson, 1986).

4. PRODUCT AND CAPITAL MARKET DEREGULATION

Here there are four areas in which the Thatcher administration has pursued a deregulatory policy of 'rolling back the state': ending exchange controls, privatisation, competition policy, and tax reform. Elsewhere industrial policy has continued past practice, precisely by eschewing any coherent policy! In other words the greater institutional continuity (Devine, 1986) of industrial policy under Thatcher signals that there was no coherent system of intervention to dismantle, unlike other domains of economic and social policy. However we shall focus on the four areas where an undoubted shift has taken place.

One of the first acts of the new administration in 1979 was to abolish all exchange controls for UK residents (non-resident sterling holders had been free of control since convertibility in 1958). This was followed by the removal of controls over bank lending and credit in 1980 and consumer credit in 1982. The latter has resulted in an explosion of consumer credit financing a sustained expansion of consumer expenditure since 1981. The abolition of exchange controls has undoubtedly contributed to the prolonged outflow of portfolio capital noted in section 1, and a shift by UK multinationals to UK sourcing of overseas direct investment. In turn this has multiplied UK investment income from overseas, which has led the Economist (13/12/86) to claim that Britain is 'a rentier nation once more'. In 1986 the Financial Services Act reorganised the London Stock Exchange and paved the way for the 'Big Bang' in October 1987 - the launch of deregulated-cum-self-regulated City markets. The emergence of Self Regulatory Organisations in the City is an interesting story, since it marks a form of 'statist corporatism' which has been rejected by the present government in virtually all other domains of economic life (Moran, 1987). It remains to be seen whether they will provide sufficient curbs on insider dealing and other practices, in the context of more deregulated global financial markets, to ensure London's continued resurgence as a world financial centre (Goodhart, 1987).

Deregulation, in the sense of 'the removal of statutory restrictions on market entry' (Kay & Thompson, 1987), is another undoubted policy innovation of the Thatcher administration. Businesses covered include long-distance coaches, bus services, gas production, electricity supply, opticians, house conveyancing, domestic airlines and the Post Office monopoly in carrying mail, as well as the changes affecting British Telecom discussed below (Cable, 1986). Tendering has also been introduced for various local authority services, such as refuse collection, and in the National Health Service. The results are difficult to ascertain. By 1984/5 private contractors supplied only 11% of NHS laundry services, 2% of NHS cleaning services, and 2% of local authority refuse collection (Kay & Thompson, 1987). The regulation of long distance coaches has resulted in lower fares and higher quality, but has not seriously dislodged the dominant position of the National Bus Company who may therefore be able to restore a near-monopoly position in the future (Devine et al., 1986). On the other hand, the booming stock market from 1984 onwards has contributed to a spate of mergers, especially of the conglomerate or diversified type (Cable, 1986, 239). The 1980 Competition Act has been criticised for the unpredictability and arbitrariness with which it has reviewed and acted on these mergers (Devine, 1986).

Privatisation is the third, and perhaps the most revolutionary, area of state disengagement in economic policy. Its contribution towards the reduction of government borrowing has already been noted, but its main rationale is a supply-side one: to increase efficiency via the exposure of enterprises to capital market sanctions and product market competition. The list of enterprises already privatised is extensive. In the 1979-83 period, between 5% and 100% of government holdings in Britoil, British Aerospace, the National Freight Corporation, the National Bus Company and Cable & Wireless were sold. After the 1983 election the programme accelerated with the sale of 51% of British Telecom shares priced at £3.9b, followed by British Gas (£8b), British Airways and the British Airports Authority. Recently announced is the privatisation of the electricity supply industry and the regional water authorities. A write-off of the £2.7b past losses of the Rover car group is also seen as preparing the way for its planned sale to British Aerospace. Though the revenue raised is vast, it is clear that in some cases the share price could have been higher: BT shares instantly rose 90% at the start of trading after privatisation. The cost of write-offs and financial restructuring also have to be taken into any overall account.

Many commentators question whether privatisation necessarily enhances competition. In some industries such as cars, shipbuilding and international airlines, world competition is fierce and will act on public as well a private companies; other industries, such as water, electricity distribution, posts and telecommunications, are close to natural monopolies, such that privatisation replaces a public with a private monopoly (Cable, 1986). One study found that, where competitive product markets are absent, public enterprises often perform better than private, and consequently that denationalisation into a monopoly environment can be positively harmful, unless accompanied by deregulation (Kay & Thompson, 1987). Others claim that profitability and efficiency have improved even where competition is absent or weak due to the liberation from detailed government interference (Matthews & Minford, 1987). Yet in the case of BT a new system of regulation has been established which may undermine this argument (see below). The Economist probably reflects the current consensus of informed opinion:

'Driven by its desire to raise cash, the government has tended to sell off industries which have always been state or municipal monopolies (gas, telecoms) rather than industries which used to compete but were nationalised. So coal, steel, Rover stay untouched. Yet these are they very industries which would benefit most from competition. They should surely come ahead of water authorities (and, probably, the British Airports Authority) in the queue.' (18/7/87, 19)

Tax reform is the fourth area of policy innovation which impinges on the operation of capital and product markets. The Thatcher administration has sought to cut direct taxes, encourage small firms, and establish a less directive and discriminatory system of company taxation. Some aspects of tax reform have already been covered. The 1984 Budget moved towards a less discriminatory system of company taxation: it abolished the National Insurance Surcharge levied on companies' payrolls and projected a cut in the standard rate of corporation tax from 50% to 35% over three years, but offset this by phasing out initial investment allowances and abolishing stock relief (OECD, 1985). The previous system of taxation offered a greater incentive to invest in plant and machinery (and thus in manufacturing industry vis-a-vis services) than in any other major OECD country, and this unselective encouragement, it was argued, contributed to the poor capital-output ratio discussed in section 1 (Thompson, 1986, ch.7). The reform provided a similar system of capital allowances to other countries plus a lower rate of corporate taxation. The overall effect is likely to be to discourage investment and to make it more responsive to market signals. Another theme has been tax exemptions for small businesses: in 1983 a lower small companies tax rate was introduced (it is now 25%) together with numerous tax incentives for small businesses, a policy which has continued since. Lastly, the 1988 Budget took a giant stride towards US-style tax reform: the standard rate of income tax was cut to 25% and all higher rates above 40% were abolished, whilst a few allowances were restricted (e.g on company cars, though tax allowances to home buyers were left essentially untouched). Capital gains taxation was integrated more closely with income taxation, but greater incentives were offered to entrepreneurs to sell their businesses. The express rationale for these revolutionary changes was to liberate entrepreneurial forces and encourage further supply-side growth. 'It takes us in one giant stride towards American levels of taxation', wrote Hugo Young in the Guardian (16/3/88), 'It shows that for this government there is no going back, and not even any standing still. It reveals the uncompromising starkness of the dream and the enormous confidence with which it is now being pursued.'

The remaining parts of industrial policy have been marked by broad institutional continuity, albeit with shifts of emphasis. To begin with, under Sir Keith Joseph at the Department of Trade and Industry, policy was marked by substantial planned cuts in expenditure and a 'ferocious' free market rhetoric (Wilks, 1985). In practice public expenditure on industry, trade and energy has fluctuated a great deal, but its overall share of state spending has fallen sharply from 5.1% in 1978/9 to 2.4% in 1986/7. Subsidies to British Leyland and Rolls Royce were continued and British Steel was given a huge write-off, but no new rescues of firms were undertaken (Devine, 1986). In 1981, a more positive policy began to emerge designed to encourage high technology 'sunrise' industry and small firm investment, and to move away from the rescue of declining industries. The 'Alvey' initiative to develop fifth generation computers marked a significant move towards 'state-led inter-firm collaboration on the Japanese model' (Wilks, 1985, 136). On the other hand total government spending on science and technology has risen by less than GDP, falling as a share from 1.3% in 1982/83 to 1.2% 1987/8, and retained its bias towards defence-related projects (civilian spending also fell from 0.7% to 0.6% over the same period (HMSO, 1988, Table 2.121).

Regional policy was continued but cut back, and in 1984 was restructured to provide more selective, discretionary assistance to smaller areas. This was complemented by a renewed focus on inner city areas via inner city partnerships and other interventions directed from Whitehall rather than local authorities. The upshot was a shift of priorities from regional to urban assistance, but within a more deregulated overall stance on the location of industry: office development permits have been abolished and Industrial Development Certificates relaxed (Devine, 1986; Cable, 1986). Lastly, the government has been in the vanguard of opposition to the CAP in the EC, and more recently has opposed many other Community initiatives. These include the enhanced regional policy and several collaborative scientific projects such as the European Space Agency's pure space science budget and CERN. The Thatcher administration has not hesitated to carry through its message of state disengagement to EC affairs, though here again it continues a tradition of UK suspicion and disinterest.

Overall, the Thatcher government's policy on capital and product markets has reversed the post-war consensus: 'Current policy is motivated primarily by concern for regulatory failure even at the expense of ignoring market failure' (Kay & Thompson, 1987, 181). The government has rejected its responsibility for what it calls 'picking winners', and favours a more neutral set of taxation and regulatory interventions. On the other hand, its wish to develop more cost-effective support, and to restrain local authority powers in this field (see section 4), has paradoxically led to more direct intervention by Whitehall in certain policy areas. In its general stance it resembles contemporary US policy, but with one notable exception: the British government - unlike the American - has neglected large sectors of industry and manufacturing (Thompson, 1986). In this sense there is a continuity of policy - or rather of the lack of one.

TELECOMMUNICATIONS: LIBERALISATION VERSUS PRIVATISATION?

> *'Under the Thatcher government after 1979 Britain's experience in telecommunications is without precedent in Western Europe' (Morgan & Webber, 1986, 5).*

Resolute action by the Thatcher administration has wrought two revolutions in UK telecommunications policy: liberalisation in 1981 was followed by privatisation in 1984. In the 1981 Telecommunications Act the telecommunications function of the Post Office was hived off and invested in the newly formed British Telecom (BT). The formerly rigid rules governing equipment sales and value added network services (VANS) were liberalised; and subsequently another company Mercury (a subsidiary of Cable & Wireless) was licenced to operate a digital network with public access. Thus an unequal duopoly was substituted for a traditional monopoly, though BT were freed to buy wherever they chose. The pioneering privatisation of BT occurred under the 1984 Act when 51% of government shares were sold. At the same time a new regulatory body - the Office of Telecommunications (OFTEL) - was set up. By these measures Britain has liberalised its telecommunications market along with the USA and Japan, but in the absence of similar arrangements in Europe. What have been the results in the general field of competitiveness? Some data have already been presented in chapter 2.

The traditional suppliers of equipment (GEC, Plessey and STC) have suffered as BT has sought overseas sourcing, for example from Thorn-Ericsson. Output and exports have risen in a dynamic market, but the trade balance in telecom equipment has deteriorated sharply as imports from the US, Japan and Sweden have mushroomed. This would seem to be an inevitable short term consequence of 'a strategy which puts market-led demand before indigenous supply capacity' (Morgan & Webber, 1986, 8). Second, the longer term consequences are less clear. Foreign multinationals are choosing Britain as their chief location in Europe as a result of its liberal market. Productivity is rising fast with falling payrolls in both BT and the suppliers, but in lines per employee and other measures BT productivity still lags behind all other advanced countries. Increasing collaboration between supplier firms is likely, though the 1986 proposal to merge GEC and Plessey was blocked by the Monopolies and Mergers Commission. The competition with Mercury may make BT trade unions less hostile to work changes. All these trends may be expected to enhance productivity and thus longer run competitiveness. For the rest of the economy UK business has benefited as the tariff structure is shifted (in response to competition from Mercury) to favour business users: the UK now has the lowest business tariffs in Europe. It is likely that the City of London has been a major beneficiary.

On the other hand, BT's interest in product development has waned since privatisation, and many of the productivity effects may be due to the changing world market conditions. Above all, there has been virtually no injection of competition with BT, which retains formidable powers. The government's desire to raise funds favoured denationalising BT as a single concern, rather than breaking it up along the lines of the AT & T divestiture in the USA. Consequently, 'privatisation tempered the government's "animal spirits" with respect to liberalisation' (Morgan & Webber, 1986, 13). Thus the policy may reduce the future dynamism of telecommunications in the UK without improving the competitiveness of British supplier firms (and in the short term damaging them). (Foreman-Peck & Manning, 1986; OECD, 1985; Economist, 1987, 14/2/87, p.62).

THE CAR INDUSTRY: RESTRUCTURING - AND RESALE?

In the case of the car industry the Conservative administration has continued with previous policy far more than it has changed it - though privatisation of the Rover Group is once more on the cards as I write. The desperate state of the UK car industry by the end-1970s, and the patchy signs of recovery in the 1980s, have already been documented. The current phase of government policy began in 1975 with the reluctant nationalisation of British Leyland. In 1978 Sir Michael Edwards was appointed chairman and began a government-funded programme of rationalisation, adaptation, new model development - and confrontation with the trades unions. The funding and general government support continued after the change of government, even with Sir Keith Joseph as Secretary of State. In 1980 the first of the BL project contracts with Honda of Japan was signed - a pioneering form of international collaboration which has most probably saved the firm from further falls in output and market share. In 1984 Jaguar was hived off and sold in a public flotation, and the government indicated it wished the rest of the corporation to be privatised. However an attempt by General Motors to purchase the Land Rover section was forestalled in 1986 by a nationalist political reaction in all political parties. With an election due the government backed down, although it authorised the sale of Leyland Trucks to DAF in 1987. In March 1988 it was announced that British Aerospace had an option to purchase the whole company, now named the Rover Group. To this end it was revealed that the £2.7b past losses were to be written off (the EC Commission permitting) in order to make the sale more attractive.

Thus the privatisation and disengagement aims of the administration have begun to win out over the inherited policy stance during the last three years, though it remains to be been whether it will realise them. Rover Group performance and competitiveness has improved on most counts in recent years, but it remains a vulnerable small producer of volume cars. The proposed sale to British Aerospace has caused some surprise (Economist, 5/3/88), and may risk future output and employment, whilst offering little to combat the structural problems the group faces. It is likely that the government would ideally favour selling Rover to another car company - and therefore by definition a foreign company. This would extend the policy of 'cosmopolitan capitalism' it has endorsed in telecommunications. However public opinion at present prevents this from happening - one of the few areas of the privatisation programme about which this can be said. If the Thatcher administration sells Rover to British Aerospace it will signal that in cars too the government has finally broken with bipartisan policy, and prioritised privatisation over a longer-term industrial strategy. (Jones, 1983, 1986; Economist, 1985, 1988).

CHAPTER 4

TRENDS IN THE WELFARE STATE

The modern British welfare state, despite Edwardian foundations, is a product of World War II (Parry, 1986). In 1942 the Beveridge Report recommended a unified and universal system of flat-rate national insurance; in 1944 the Coalition government under Churchill committed itself to full employment and passed Butler's Education Act providing universal, free primary and secondary education; and on July 5th 1948 the Attlee Labour government inaugurated the free and universal National Health Service (NHS), put into operation the new National Insurance Scheme covering retirement, widows, sickness and unemployment (among other contingencies), and in a final *coup de grace* abolished the remnants of the Poor Law from the statute books. Thus in the space of four years Britain acquired a 'mature' welfare state which served as a pioneering model for other countries.

Over the next three decades no changes of substance occurred in the NHS, although it was complemented in 1970 by new local authority Social Service departments responsible for residential and domiciliary services for children, the elderly and others. No new Education Act was passed, but comprehensive secondary schooling was introduced in the mid-60s. In social security however a series of changes whittled away at several of the Beveridge principles: non-statutory occupational pension schemes boomed and were 'recognised' by the state scheme in 1961 when earnings-related national insurance contributions were also introduced; earnings-related sickness and unemployment benefits augmented the flat-rate benefits from 1966; and in the 1960s the numbers receiving income-related Supplementary Benefit (previously National Assistance) started to climb - contrary to the Beveridgean intention that selective benefits would serve only as a 'safety net' for the small minority not entitled to mainstream insurance and universal benefits. This was augmented by other new or expanded income-related schemes in the early-1970s. In 1975 two decades of political disagreement on pension reform were resolved when legislation to set up a state earnings-related pension scheme (SERPS) was passed, and in 1977 child benefit for all children replaced family allowances and child tax relief. The Heath government in 1972 also introduced the first major reform of housing policy since the post-war years when local authority housing subsidies were cut, and tenants assisted with yet other income-related benefits. Yet none of these shifts (apart from the Social Security Act 1975) involved fundamental reform: they were incremental encrustations on the basic Beveridge/Butler/Bevan edifice. 'Many areas of social policy were insulated from the sharpest political debate, and never recaptured the central position in British public policy they enjoyed in the 1940s' (Parry, 1986, 160).

All this may be changing. In 1975-76, the Labour government successfully introduced the first plans to cut back some items of social spending. Second, the election of 1979 brought to power a government committed to rolling back the state. In its first two periods of office it has acted to cut and retrench state housing, some social benefits, taxation and the powers of local government; but it has steered clear of the central institutions of the welfare state. However, in its third term of office it has begun fundamentally to reform the social security, taxation and education systems, and has signalled its intent to tackle the National Health Service next. Thus 1988 may be the year in which the post-war welfare state was finally and radically restructured.

1. UNEMPLOYMENT

I begin with unemployment for two reasons: first, it is impossible to analyse trends in British social policy over the last decade without taking into account the emergence of mass unemployment. Second, full employment policy is the other 'leg' of the 'Keynesian welfare state' and is thus an integral aspect of British 'welfare statism'.

Britain was one of the first countries to experience mass unemployment in the 1980s. After edging beyond the half million mark (about 2%) in the 1960s, unemployment exceeded one million in 1975 and remained at around 1.4m or 5½% from 1976-79. In the deep two-year depression from 1979-81 it then doubled to 3m people or 12% of the employed population. From 1981 to 1986 the numbers unemployed continued to grow albeit more slowly to a peak of 3.3m, 13.6% according to the official figures. However numerous changes to the official definition make comparisons over time hazardous: one measure of the unadjusted figure (i.e. using the same count as in 1981) puts

Table 4.1: Employment and Unemployment

	1979	1983	1987	Δ79-87
Working age population	32.6	33.3	34.1	+1.5
- 'Inactive' population	6.7	7.5	6.7	+0.1
= Working population	25.9	25.8	27.3	+1.4
Manufacturing employees	7.1	5.5	5.1	-2.1
+ Other employees	15.4	15.0	16.2	+0.8
= All employees	22.5	20.5	21.3	-1.3
+ Self-employed	1.8	2.1	2.6	+0.8
= All in work (incl. HM Forces)	24.7	23.0	24.2	-0.5
∴ Unemployed	1.2	2.8	3.1	+1.9
% Unemployed	5.1	12.1	12.8	+7.7%
of which: nos long-term	0.3	1.1	1.2	+0.9
% long-term	25.0	36.0	42.0	
Nos of Special Employment Measures	0.26	0.44	0.78	+0.52
- register effect	n.a	0.31	0.59	
- register effect less YTS		0.17	0.30	

Sources: Lloyds Bank Economic Bulletin, 105, Sept. 1987, Table 4
Unemployment Unit Bulletin, August 1987.

the numbers out of work in 1986 at 3.8m or one in six of the employed population (Unemployment Unit, Aug. 1987). Since late 1986 both the official and the unadjusted count show a rapid decline in the unemployed to 9.2% (official figure) in January 1988. Within this total, long-term unemployment has grown the fastest and shows no sign of declining: more than one million have been out of work for more than one year. It is long term unemployment which has the most serious consequences for both income and health, especially mental health, according to numerous studies.

Table 4.1 explains this development by comparing trends in employment and the working population. The same demographic patterns which have halted the expansion of the dependent population in the 1980s have inaugurated a period wherein the working-age population is growing again. Superimposed on this was the haemorrhage of jobs between 1979 and 1983 when 1½m manufacturing jobs alone were lost. Since then manufacturing employment has continued its decline, but service employment in particular has staged a recovery. Between 1983 and 1987 whilst the numbers out of work continued to grow, total employment began to recover. However the jobs were almost all female and part-time (Britain has the highest proportion of part-time work in the OECD after the Nordic countries and Holland), (Economist, 4/7/87; 103), and the numbers at work have not recovered 1979 levels. By contrast self-employment has boomed since 1979 encouraged in recent years by the Enterprise Allowance Scheme (CSO, 1987). This alerts us however to the role of other government special employment schemes in reducing the numbers shown as out of work. The table provides estimates of their mounting effect. By 1987 over 3/4m people were attached to these schemes and the unemployment total was deflated by one third million (if the YTS trainees are excluded - see below). If there had been neither statistical redefinitions nor special measures, unemployment would have exceeded 4m by 1986 (Lloyds Bank, 1987).

As in other countries the distribution of unemployment is uneven, impacting most heavily on the more disadvantaged groups. The chances of unemployment are higher for unskilled and manual workers; for young workers under 24 years; for blacks of West Indian or Indian/Pakistani/Bangladeshi origin (CSO, 1987). However Britain does appear to be almost unique in having lower rates of female unemployment than male: a consequence of the deindustrialisation process noted earlier (Therborn, 1985). Regional differences are marked, though post-war regional policies may account for the fact that they are much narrower than in the 1930s. The South East, Greater London, East Anglia and the South West have jobless rates below the national average; the North and Scotland exhibit rates of about 16% (August 1987) whilst in Northern Ireland it reaches 24%.

The emergence of wide-scale unemployment in the mid-1970s was followed by the establishment of a plethora of special employment and training schemes under the auspices of the Manpower Services Commission. The MSC is a 'tripartite' body with complementary Area Manpower Boards responsible to the Secretary of State for Employment, but it has wide-ranging powers, a large staff and a budget of over £2,000m. The Thatcher administration initially intended to reduce its activities, but after 1981 has expended them. There has thus been a degree of continuity in the administration of the special employment schemes since the mid-1970s, although the policy goals have shifted, notably in the current 1987 Employment Bill. I shall focus on the two major schemes: the Youth Training Scheme (YTS) and the Community Programme (CP).

Since 1983 the YTS has provided a one-year training-cum-work experience programme for every school leaver who wishes to take it up; in 1986 this was extended to two years. Places are provided by paid private employers (a minority) or local authorities, voluntary bodies and other 'managing agents'. Trainees are paid £27 per week and £35 in their second year. The YTS is the first systematic state training programme to be provided in th UK; it is also claimed to be cost-efficient and have c.50% success rate in leading to subsequent employment. However critics claim that it offers poor quality training by comparison with Britain's competitors, and is more akin to a low quality work experience scheme. The CP provides work programmes targeted on the long-term unemployed, mainly environmental improvement and services for disadvantaged groups under the auspices of local authorities and voluntary bodies. Seventy-five per cent of the work is now part-time and it is concentrated on young males. Workers are paid a sum of £67 per week for a maximum of one year. The programme is criticised for the low rate of pay, the consequent low take-up by older men, its discrimination against women, and its poor success rate in placing people in permanent work. The major claim made on its behalf is that it is targeted on the most vulnerable group: the long-term unemployed.

The government now appears to be altering the pattern and aims of its special employment schemes, marking a partial break with past commitments. From 1986 regular 'restart interviews' are to be given to the long-term unemployed to steer them towards work or training programmes. Also in 1986 the government introduced a new Job Training Scheme for the young long-term unemployed, although it has fallen well short of its original targets. The distinctive feature is that trainees are no longer paid either an allowance or a wage but simply continue to draw supplementary benefit as though they were claimants. In November 1987 the government proposed a new 'unified training programme' to merge the CP and JTS schemes targeted on the long-term unemployed. This will extend the linkage between social security and work experience/training by paying participants 'benefit-plus', i.e they continue to receive supplementary benefit, as in the JTS, with an extra £5-10 per week. It is not clear as yet whether this will amount to a new form of training grant, or semi-compulsory work for claimants. Since no extra resources are provided for the scheme it seems unlikely that it will develop into an element of a new unified training programme. The new Employment Bill proposes that anybody refusing to take a place on a designated training scheme will have their benefit cut. This combination of measures has been interpreted by some as the first step towards a form of American-style 'workfare' (Economist, 'Forward to the workfare state', 28/11/87; 25-7). If this is so it marks a break with previous policies and a significant integration of social security and employment programmes.

2. SOCIAL EXPENDITURE AND OUTPUTS

I turn now to the social benefits and services which from the traditional core of the welfare state. Table 4.2 summarises the trends in social expenditure since the first economic crisis of 1973/74 and the change of government in 1974. The Labour government of 1974 began by expanding expenditure on all services at an even faster rate than previously. Spending and public sector employment all soared in the British welfare state's last and finest boom (Parry, 1986; Levitt & Joyce, 1987). Then came the cuts of 1975 and the further retrenchment ordered by the IMF in 1976. In real terms spending on all social programmes slowed down markedly and the share of social expenditure in GDP fell. The major cut was in capital expenditure programmes, economically and politically the easiest to reduce in a short space of time (Mullard, 1987). Nevertheless the net result of the Labour administrations

Table 4.2: Social Expenditure

	1973/74	75/6	78/9	83/4	86/7	Δ78/9-86/7
			Volume Terms: £b 1986/7 prices			
Social Security	25.4	30.2	34.2	41.8	46.5	+36%
Health	12.5	15.1	15.1	17.6	18.8	+24%
PSS	2.1	2.7	2.8	3.2	3.5	+28%
Education	18.1	17.7	17.6	18.0	18.7	+6%
Housing	8.5	9.9	8.8	5.0	4.0	-55%
Social expenditure	66.6	75.6	78.5	85.6	91.5	+17%
			Per cent GDP			
Social security	8.1	9.8	10.2	12.0	12.2	
Health	4.0	4.9	4.5	5.1	4.9	
PSS	0.7	0.9	0.8	0.9	0.9	
Education	5.8	5.8	5.3	5.2	4.9	
Housing	2.7	3.2	2.6	1.4	1.1	
Total social exp.	21.3	24.6	23.4	24.6	24.0	

Sources: Atkinson et al. (1987), Table 7.1; Hills (1987), Table 1

Notes: The figures are adjusted to take into account changes in the balance of tax and direct expenditures (e.g. in child benefits before 1978/9, and the transfer of part of sickness benefits to employers in 1983/4), in the taxation of benefits, and in the transfer of benefits between programmes (e.g. Supplementary Benefit, rent payments in the first two years are shown under housing expenditures).

Deflators:
Social security - mainly by RPI
Health - implicit NHS deflator in Nat. Inc. & Expend. Accounts
PSS - GDP deflator
Education - implicit education deflator in NIE Accounts
Housing - mixed GDP and RPI deflators

of 1974-79 was a substantial increase in resources devoted to social security and the health and personal social services (but a decline in education spending and a levelling out of housing spending), and a rise in the relative claims of the welfare state on national resources.

Despite the intention of the Thatcher government to reduce state spending, especially on social and economic services, in its first term it presided over a further sizable increase in social expenditure. This was so in absolute terms and, because of the recession, especially relative to GDP - indeed the share of spending on the welfare state recaptured the heights it had reached in 1975. Once again transfer spending, notably on the social security programmes, soared whilst capital spending was cut back still further, notably local authority house building. In the government's second term the rate of absolute increase slowed down, though it was by no means reversed, and a faster rate of economic growth meant that its share of GDP began once again to fall. The switch of priorities was generally continued with a fast increase in social security spending, slower growth in health, personal social services and education, and further cuts in housing (even after adjustments are made to the official figures - see footnotes to Table 4.2). Thus within a rising aggregate expenditure on the welfare state the Thatcher government has effected a sustained shift in priorities away from housing towards income maintenance.

The years since 1979 have also witnessed a surge in the 'alternative welfare states'. For example tax expenditure on mortgage interest relief claimed by house buyers has more than doubled in real terms from £2.1b in 1978/9 to

£4.5b in 1986/7 (Hills, 1987, 99). After a slow growth the value of occupational pensions rose rapidly from £3.7b in 1978/9 to £5.6b in 1983/4 (Atkinson, 1987, 226). Hence since 1979 there has been a swing of emphasis away from social welfare towards what Titmuss has called fiscal and occupational welfare.

Since 1975 there has also occurred a shift from local government to central government expenditure, which has reversed a consistent pattern for the local authority share to rise since the Second World War (Gough, 1979, ch.5). Between 1975 and 1983, the proportion of local expenditure in GDP fell from 16% to 13%. At the same time the share financed from central government grants etc. also declined from 67% to 50% (Glennerster, 1985). This marks a fundamental change in central-local relations, an issue which has been at the forefront of the political agenda since 1979 (see below).

To understand what these figures mean in terms of real benefits and services, we must turn to analyse trends in needs, demand and clienteles (Tables 4.3, 4.4. See also Parry, 1986, section 2; Levitt & Joyce, 1987; Atkinson, 1987). The dominant factor since 1979 has been the trebling of the numbers unemployed. The growing number of claimants, especially the unemployed, accounts for two thirds of the real growth in spending since 1978/9 noted above (Hills, 1987, 94). Despite this the numbers receiving unemployment benefit *per se* rose by only 63% up to 1986: it remains conditional on past employment record and is limited in duration. 'The income maintenance system for the unemployed is little different today from that introduced in 1934' (Atkinson, 1987, 229). As a result it is the income-related Supplementary Benefit system which has borne the brunt of the rising demand: the number of non-pensioner claimants have risen 150%, and the average payment has grown by 61% due to the declining resources of the long-term unemployed (see below). The final income guaranteed to SB claimants has risen slightly in real terms: when compared with retail prices excluding housing (since housing costs are met separately) it has registered a 5% increase since 1979. However SB rates have fallen well behind the rapid rise in average disposable incomes of those in work. Pensions and child benefit have risen slightly in real terms, but have also declined as a share of net earnings. Up to 1988 then no basic benefit has been reduced in real terms, but the welfare state safety net is now about 12% lower relative to average living standards.

Table 4.3: Social Security Benefit Levels

(% changes 1978/9-1986/7 at constant prices)

	Clients	Expend.	AvBenefits
Pensions	+12	+16	+4
Child benefit	-9	-4	+5
Unemployment benefit	+63	+39	-15
Supplementary benefit	+62	+161	+61
(of which: non-pensioners)	(+150)		

% changes November 1978-April 1987 at current prices:	
Supplementary benefit basic rates	+95%
Retail price index	+96%
Retail price index excluding housing	+86%
Personal disposable income per capita	+123%
(∴ Real personal disposable income per capita	+14)%

Sources: Hills (1987), Tables 2, 3; Piachaud (1987), Table 1.

The standards in the direct service areas of the welfare state - particularly the NHS - have been the subject of bitter debate for five years now. The government has regularly claimed that it has provided a substantial and sustained increase in resources for the NHS, notwithstanding its pledge to restrict overall state spending. Opposition politicians, health service providers and consumers on the other hand have argued that services 'on the ground' are being starved of resources. Part of the explanation for the dispute is due to the role of the relative price effect (RPE) and demographic pressures in health services (Table 4.4). The Conservative government did increase spending considerably in its first five years, albeit at a slower rate than under its predecessor. However the RPE continued to be positive and quite large due to pay increases: it halved the rate of growth in volume terms. Although the post-war rise in the size of the dependent population came to an end in this period, the numbers of very elderly continued to grow and have exerted an upward pressure on costs (the over-75s cost, on average, six times as much as those of working age in health and personal services) (Levitt & Joyce, 1987). When this is taken into account spending in relation to need grew by about 0.8% p.a., and in hospitals by only 0.3% p.a. furthermore, the DHSS estimates that medical advances in medicine absorb 1/2% p.a. extra resources, assuming as all these estimates do that productivity does not improve. Thus the contradictory positions of the different parties can be resolved: spending has increased but it has not called forth any improvement in standards. In the years since 1984, volume spending on the NHS has levelled out (Economist, 23/1/88; 27), so that spending in relation to need has almost certainly declined. Of course NHS standards have also declined relative to average standards of consumption which grew by 17% from 1979-86.

Table 4.4: Social Service Levels

(% changes 1979/80-1984/5)

	Real terms	Volume terms	Need terms
NHS	+16.7	+8.3	+4.3
Hospitals		+5.4	+1.5
PSS		+7.9	+3.9
Education	+1.0	-6.0	+10

Sources: Robinson (1986)

Notes: Real terms: deflated by GDP deflator
Volume terms = real figure after taking account of the relative price effect
Need terms = volume figure after taking account of changes in demographic demand

In primary and secondary education the situation is very different: real reductions in volume expenditure have been achieved, but the number of primary and secondary pupils has fallen faster, resulting in a rising per capita expenditure (Robinson, 1986). However in further and higher education quite marked reductions in unit costs have been achieved as tightened budgets have been stretched over more students.

Housing has been hit harder than any other area of welfare state spending since 1979. The decline in public house building continued the cuts begun in 1976: housing starts have fallen from 180,000 in 1975 and 1976 to 84, 000 in 1979 to 36,000 in 1985. This has exacerbated the deterioration of public sector assets, as gross investment is almost outweighed by depreciation since 1981 (Hills, 1987). What has been new is, first, the rapid extension of council house sales to sitting tenants (see below) and second, the switch to income-related current spending. Current subsidies have all but disappeared as council house rents have been raised towards market levels: between 1980/1 and 1982/3 alone rents were raised by 40% in real terms as subsidies were withdrawn. About half of these cuts reappeared as higher income-related housing benefit to council house tenants although the value of housing benefit to non-pensioners has been reduced (Atkinson, 1987).

In a recent comparative study of policies to curb public expenditure, Tarschys (1986) presents a long list of current techniques. It is interesting that UK governments, and notably the Thatcher government, have experimented with almost all of them, and pioneered several of them. They include: targets for public borrowing, reduced adjustment for inflation (cash planning), cash limits, privatisation, increased controls on local government and other para-state bodies (see below), external audits (the appointment of Lord Rayner as independent auditor) and constitutional changes. If the last is not strictly possible in the UK since there is no written constitution neither has it proved necessary; and in the 'Star Chamber' system of vetting public spending plans Britain has further centralised the control over state priorities and financial planning (Glennerster, 1985). However the result has not matched the administration's intent or determination. In the early years after 1979 social expenditure expanded in real terms driven by recession. Since growth has resumed the goal of reducing spending on the welfare state has been quietly replaced by the target to reduce its share of GDP (Economist, 23/1/88; 21). Yet the resources for some services have been squeezed as a result of deliberate restructuring and inadequate recompense for cost and demand growth. If the retrenchment of the British welfare state does not match the Thatcher rhetoric, this should not obscure the fact that parts of the welfare state have been reduced in scale.

3. OUTCOMES: POVERTY, INEQUALITY AND REDISTRIBUTION

Tables 4.5 to 4.9 summarise what has happened to the distribution of incomes over the last decade, and attempt to disentangle the effects of unemployment and social retrenchment which we have thus far considered separately.

Table 4.5: Composition of Household Income
(Percentage of Total)

	1976	1979	1985
Wages and salaries	69	66	60
Self-employment income	9	9	9
Rent, dividends, interest	6	7	8
Private pensions and benefits	5	5	7
State pensions and benefits	12	14	16
Total household income (=100%)	£88b	£153b	£283b

Source: Stark, 1987, Table b.

Table 4.6: Spread of Earnings

Gross weekly full-time earnings as % median:	1976 Men	1976 Women	1986 Men	1986 Women
Top Decile	160	166	173	170
Upper quartile	126	126	132	133
Lower quartile	81	80	77	79
Lowest decile	68	66	60	65
Median earnings per week (=100%)	£66	£42	£185	£123

Source: Stark, 1987, Table k.

First, market incomes have become more dispersed, notably since 1979. The share of aggregate household incomes derived from wages and salaries has shrunken due to unemployment, whilst the shares accruing from property income, occupational welfare and state benefits has increased (Table 4.5). At the same time income from both labour and property is distributed more unequally than a decade ago. Earnings have become more dispersed since 1976 - especially among men where the spread of earnings between the top and bottom decile widened by 20% (Table 4.6). Since 1979 another trend has been superimposed on this: the tendency for investment and private pension income to become concentrated among the upper income groups (O'Higgins, 1987, Table 4.2). The recession and associated changes has thus widened inequality in factor incomes. Has the growing expenditure on state welfare benefits offset this? Table 4.7 compares the distribution of market and net incomes using O'Higgins' (1985, 1987) careful study based on the annual Family Expenditure Surveys.

Table 4.7: Income Redistribution

(Share of income (%))

		1976	1979	1984
Market income:	top 5%	16.0	15.8	17.5
	top quintile	44.4	44.9	48.6
	4th quintile	9.4	8.7	6.1
	lowest quintile	0.8	0.5	0.3
Net Income:	top 5%	13.2	13.0	13.8
	top quintile	37.6	38.2	39.2
	4th quintile	12.8	12.3	11.4
	lowest quintile	7.8	7.2	8.1

Source: O'Higgins, 1987, Tables 4.1, 4.2, 4.4
Notes: Quintiles ranked by market income through table.
Market income = earned income, investment income, self-employment income and occupational pensions
Net income = market income + cash transfers - income tax and employees national insurance contributions

Taxation and state benefits are clearly critical in redistributing income vertically, as a comparison of market and net income shares reveals. The fourth (second from bottom) quintile has lost access to market incomes over the period and, like the bottom group, is becoming more dependent on transfers. Since 1979, the income share of the bottom quintile after state benefits and direct taxes has increased by one percentage point, but this is due to a change in composition as the aged move up the income scale and their place is taken by unemployed families. Thus the proportion of children in the lowest quintile has increased form 5.6% in 1979 to 12.5% in 1984 (O'Higgins, 1987, Table 4.3). When the figures are adjusted to take account of these compositional shifts, the share of the bottom 20% in net income registers almost no change (O'Higgins, 1987, Table 4.1). Since 1979, 'the turning point in recent years' (O'Higgins, 1987, 53), the (adjusted and unadjusted) share of the top income groups in net income has grown, but by less than their share of market income. Thus the tax and transfer system has moderated but not negated the trend towards greater inequality since 1979.

When indirect taxes and welfare state benefits in kind are included in the analysis they effect a further slight narrowing of differentials in living standards. Over the period the distributive impact of indirect taxes became more regressive following the increase in VAT in 1979. The distribution of health and education expenditure was

Table 4.8: Final Income After Redistribution

(Share of final income)

Share of final income	1974	1979	1985
Top 10%	22	22	24
Top 20%	37	38	40
Lowest 40%	38	37	36
Lowest 20%	7.2	7.1	6.7

Source: Stark, 1987, Table i

largely unchanged in the aggregate, but housing subsidies became more concentrated on the lower income groups. The net effect does not fundamentally alter the trends in net income. Table 4.8 (not comparable with the preceding tables) shows that final income after all taxes and benefits has also become more unequal especially since 1979.

The impact upon families at the bottom end of the income distribution is shown in Table 4.9. The numbers on and below the Supplementary Benefit level have mushroomed in recent years to 9 million people or one in six of the population, a higher proportion than at any time since the war. If the poverty standard is raised to 40% above the SB level, roughly the line at which another study suggests people are excluded from conventionally acceptable levels of consumption and activities (Mack & Lansley, 1985), then 16.4 million people fall below it. Whilst the number of poor elderly people has remained stable, the numbers of both the working and the unemployed poor - and of poor children - has risen sharply (O'Higgins, 1985, Table 9).

Table 4.9: Families in Poverty

(Millions of individuals)

	1979	1985
Below Supplementary Benefit level	2.1	2.8
Receiving Supplementary Benefit	4.0	6.1
∴ On or below Supplementary Benefit	6.1	8.9

Source: Piachaud, 1987, p.25

What then have been the outcomes of the employment and social policy changes noted above? The distribution of factor incomes has become more unequal as the salary and property income share of the top income groups has expanded. The increasingly income-related social security system has continued to modify these inequalities, but it has not removed them. Consequently the numbers in official poverty have swollen and the dispersion of living standards has widened. But it is economic policy and mass unemployment which has brought about the move towards a dual society, not (as yet) the government's social policies for the welfare state. O'Higgins concludes: 'Recession, rather than (political) reaction, has been the main pressure resulting in a rise in poverty and inequality' (1985, 303). 'When access to market income is truncated, social spending has a demand-driven, reactive role in limiting the rise in inequality' (1987, 65). The social welfare system must run hard simply to stand still: in the event it has not run hard enough. It is the combination of high unemployment and neo-liberal economic policies with relatively unchanged social policies which explains the inegalitarian outcome of the Thatcher experiment.

4. SOCIAL POLICIES: RESTRUCTURING THE WELFARE STATE?

Apart from employment policy I have not so far considered the social policy stance of the Thatcher government. In its first two administrations it undertook a selective restructuring of the welfare state, concentrating on housing and social security together with a radical reform of central-local government relations. Since the election of June 1987 it has initiated a series of Bills to restructure the education, housing and taxation systems - presaging a more direct focus on the core areas of the welfare state.

I begin with local government because perhaps no other domain of British life has been subjected to such fundamental policy shifts in the last decade, and because it remains an important deliverer of education and housing services and of some health services and social benefits. The Labour administration of 1974-79 inaugurated what Rhodes (1984) has called an era of 'incorporation', whereby national associations of local authorities were used to regulate their members and try to ensure that they pursued the cuts demanded by central government. The incoming Conservative government quickly rejected this approach and pursued a strategy of central 'direction' of local government. The major legislative landmarks have been as follows:

> 1980: the Local Government Planning Act empowered Whitehall to determine the appropriate level of spending for each local authority, and to cut its grants to specific authorities whose expenditure was too high.
>
> 1982: the Local Government Finance Act amongst other things removed local authorities' rights to levy supplementary rates (property taxes).
>
> 1984: the Rates Act enabled central government to determine the maximum limit to domestic rates, and to 'cap' rates which exceeded this limit. This effectively ended the right local authorities have possessed since 1601 to set their own tax levels.
>
> 1986: The Greater London Council and six metropolitan County Councils were abolished.
>
> 1987: a new Local Government Finance Bill proposes a radical reform of local government finance to take effect from 1990 in England and Wales (earlier legislation will introduce it in Scotland in 1989). It will replace household rates with a community charge or poll tax levied at a fixed rate (within each local authority area) on every adult; replace business rates with a 'uniform business rate' determined by central government; and initiate another new system for distributing central government grants to local authorities. The poll tax is intended to make local councils more responsive to their electorate's wishes by requiring every adult to pay local tax, though low income families will be exempt from part of the poll tax. It has been criticised as a regressive tax which will require considerable surveillance to enforce. The *Economist* for example fears the 14th century precedent which occasioned the peasants revolt! (20/12/86; 27/6/87; 8/8/87)

The net effect of these changes is a remarkable centralisation of the British state and of its welfare state. This is paradoxical since the Conservative regime came to power in 1979 committed to reduce Whitehall's interference in local government. The reasons for this fundamental policy reversal appear to be economic and political: the wish to restrain high-spending local authorities in the pursuit of its macro-economic strategy, and the elimination of the 'new urban socialism' as a model for alternative policies (Rhodes, 1985; Cochrane, 1985; the Economist, 16/3/85; 38-40).

Housing is the one area of social policy where the Thatcher administration within a short time achieved and even exceeded it manifesto commitments. It has been in the vanguard of neo-liberal social policy for several reasons, most notably the popularity of owner occupation as a tenure in Britain and the common perception that it, unlike local authority tenancy, is unsubsidised (Gough et al., 1983). In a series of measures the Conservative administration has transformed the British housing market and the role of the state within it. First, the 1980 Housing Act and its Scottish equivalent gave local authority tenants the right to buy their homes at a discount of between 33% and 50% if they had been tenants for more than three years. Another act in 1984 reduced the qualifying period to two years and upped the maximum discount to 60%. By the end of 1985 860,000 council dwellings had been sold out of a stock of 6½m - mostly houses rather than flats (CSO, 1987). Second, the 1980 Act also introduced a new subsidy system for local authority housing which, in combination with the reform of local government finance, has permitted subsidies to be cut and council house rents to be raised as indicated earlier. Third, public sector housing investment has been sharply cut back, and linked to an authority's progress in selling its housing stock. Finally, in the 1987 manifesto the Conservative Party promised further legislation to deregulate the housing market, which is now passing through Parliament. It proposes that all new lets in the public and private sector will be free of all rent control, modifies tenancy laws, enables council tenants to opt out of local authority control, and completes the move towards the ending of subsidies for public sector housing.

The upshot of these measures is to increase owner occupation and favour the private sector, to eliminate council house subsidies and to deregulate the housing market. However tax expenditures on house purchase have not been cut back and in the aggregate have expanded very rapidly (see above). One effect of this is a remarkable widening of house prices between the South and North of Britain which may impair labour mobility. A second effect is that tenure differences have widened as local authority housing assumes more the status of a residual service for the poor and disadvantaged groups. Third, homelessness is climbing despite a surplus of dwellings (Atkinson, 1987; Economist, 26/12/87; 25). Lastly, the overall distribution of state housing expenditure has become more regressive - except at the bottom of the income distribution where income-related housing benefit has cushioned the increase in rents. However this is now to change under the social security reforms considered next.

The 1979 Conservative manifesto described the social security goals of the future government as: to simplify the system and cut bureaucracy, to improve incentives to work, and to concentrate benefits on those in 'real need' (MacGregor, 1985). In its first term it began to act on the first two goals but not the third. (For details of trends in benefit levels see above). To reduce administrative costs, it has devolved the payment of initial sickness insurance benefit to employers, and all income-related housing benefit to local authorities. The latter especially is an example of the technique which Tarschys (1985) refers to as 'decentralising hard choices'. It also abolished the Supplementary Benefits Commission, an example of removing awkward, corporatist bodies which exert upward pressures on state spending, and cut back administrative staff at a time when the number of claimants was escalating due to rising unemployment. To improve work incentives it abolished the earnings-related sickness and unemployment insurance benefits, leaving in place only the Beveridgean flat-rate benefits. It also made these benefits liable to tax. The 1980 Social Security Act de-indexed pensions and long-term benefits from their link with earnings, and abolished the statutory indexation of short-term benefits. It also widened the gap between long-term and short-term benefits, and instigated more active anti-fraud measures to detect social security abuse. The overall effect of these initial measures was to maintain the absolute value of 'safety-net' benefits, but to enhance the stigma associated with claiming them, according to MacGregor (1985; see also Gough et al., 1983).

That the Thatcher administration has from the beginning wished to go further in restructuring the social security system is apparent from a string of 'leaked' documents, including a 1982 paper by the Central Policy Review Staff listing options to achieve radical cuts in public spending, and a paper by the Cabinet's Family Policy Group in 1983 (Economist, 18/9/82; 25-26; Guardian, 17/2/83; Wicks, 1987, ch.3). Following the 1983 election and the appointment of Nigel Lawson as Chancellor, it was recognised that there was no further scope for 'easy' cuts in public spending. In 1984, a Green Paper 'Public Expenditure: the Next Ten Years' was published setting out future projections of public spending and suggesting ways of lowering them. Out of this emerged the 1984 Review of Social Security, and the subsequent Act of 1986 which has been implemented in stages up to April 1988. Its goals are to direct benefit to those in genuine need, to be consistent with the government's overall economic strategy (with regard to costs, incentives and labour market flexibility) and to reduce the existing complexity and administrative costs: aims remarkably similar to those adumbrated in 1979. The original Green Paper's most radical proposal was to abolish the 1975 State Earnings-Related Pension Scheme (SERPS); however opposition from all parties including the private insurance industry forced the government to moderate this idea, although it promised the most sizeable future cost savings.

The 1986 Act will modify the non-Beveridge parts of the social security system. The SERPS pension will be cut for those retiring after 1998 and it will in future be calculated on life-time earnings rather than the best 20 years, which will reduce the entitlements of the intermittently employed, mainly women. Contracting out from occupational pensions or SERPS into private pension plans will also be possible. It is intended to halve the burden on the Exchequer by 2033, and will shift the provisions of pensions further towards the private and occupational sectors. The other target of the reforms is Britain's burgeoning means-tested or income-related benefit system. Supplementary Benefit will be replaced by Income Support, broadly at similar levels except for those under 25 years. Second, housing benefit will be reformed to equalise treatment between those in and out of work, but also to raise the claw-back rate at which benefit is reduced as income rises. This will reduce the number of beneficiaries and is expected to reduce Exchequer costs. Third, Family Credit will offer a new and more generous income supplement for working parents on low incomes. Fourth, discretionary SB payments will be absorbed within a cash-limited and smaller Social Fund and will mainly be given in the form of loans to be repaid from future benefits.

It is difficult at this time to predict the distributive and economic impacts of these changes. That there will be gainers and losers is agreed by all, but their respective numbers is hotly disputed. Critics argue that a majority of the poverty population will lose income, especially when other policy reforms (the poll tax, the new employment policy etc.) are taken into account (Social Security consortium, 1987). It would appear that long-term reform along negative income tax lines has been ruled out, but that further moves towards US-style 'workfare', coupled with the phasing out of universal child benefit, are possible.

Following the 1987 election the government has also inaugurated the first major Education Act since 1944, and the first important reform since the introduction of comprehensive schools and polytechnics in the 1960s. The current education Reform Bill proposes, first, to remove much of local authorities' power over schools, by increasing parental choice of school and enhancing the power of head teachers. Second, for the first time in Britain a national curriculum will be imposed and all children will be uniformally tested at 7, 11, 14 and 16 years. Third, schools will be allowed, if parents and governors want and the education department agrees, to opt out entirely from local authority control: they would become 'grant maintained schools' and receive direct funding from central government. Whilst the proposals for a national curriculum and for devolution of some powers to head teachers have been widely welcomed, the removal of the powers of local education authorities and especially the opt-out proposals have been criticised as a major reversal of post-war education practice and a direct attack on a universal education service. The financing of higher and further education is also to become more centralised in order to gear its output more closely to the requirements of the economy. Together with a small, earlier extension of grants for private schooling, the Bill will extend parental choice and encourage more 'exit' from the state system of education by middle class families; yet at the same time subject the still-dominant state sector to more centralised control than hitherto.

This leaves the National Health Service as the one remaining plank of the post-war welfare state which has thus far escaped reform. However following the 1987 election it has been the subject of heated political debate as the government cautiously edges its way toward the first major review since 1948 (see e.g: 'A week in the death of the NHS', New Society, 11/12/87; 304). The 1979 and subsequent Conservative Party manifestos have pledged themselves in general terms to maintain resources, but to (a) cut bureaucracy and waste, and (b) encourage private health provision and insurance. Despite the substantial areas of policy continuity with the previous Labour administration (such as the redistribution of resources between health regions and specialities), moves were made by the first two Thatcher governments to implement these and other policy goals (Klein, 1985).

Measures to improve efficiency include the abolition of an intermediate level of administration (the Area Health Authorities), increasing the role of professional management, the wider use of performance indicators and contracting out (Gough et al., 1983). The latter has not dislodged in-house organisations from their predominant role, but it is likely that the process of tendering has undermined union powers and producer rigidities (Klein, 1985; of Atkinson, 1987). The second goal - encouragement of the private sector - has been advanced by abolishing the Health Services Board which regulated the activities of private providers, by reversing the previous pay-beds policy, by changing consultants' contracts, and by restoring tax exemption of employer-provided medical insurance for lower paid employees (Atkinson, 1987). Initially this boosted coverage of private medical insurance from over 2m persons in 1978 to over 4m by 1981. Since then however the rate of increase has tailed off (CSO, 1987, Table 7.32). The number of commercial, mainly American, hospitals and nursing homes has also risen by 50% since 1981, though they provide only a tiny minority of beds (CSO, Table 7.31). (The exception is the boom in private old peoples' homes, but I am ignoring the personal social services in this survey). A third policy shift has been the startling 1000% rise in charges for drugs since 1979, although because of exemptions their share of NHS funding has not fundamentally changed. Most important of all, the volume of resources directed towards the NHS has not been increased and on some counts has fallen since 1983 (see above).

In 1988 the government has finally embarked on an internal review of the NHS, amidst strikes and other demonstrations against alleged cuts in funding and low pay. The government appears to be in a dilemma, in that the simplest, and from its perspective, the politically most desirable reform would be to offer tax incentives for private insurance; yet this is most likely to reduce efficiency in the state sector. On the other hand more radical restructuring may well spark major opposition given the overwhelming popularity of the NHS in its present form. It would seem probable that the government will opt for the former approach, utilising the private sector as a 'safety valve' to reduce demand pressures stemming from cutbacks in resourcing, by enabling more of the middle classes to 'exit' from the state sector (Klein, 1985).

The above shifts mark a fundamental questioning of the post-war British welfare state consensus, especially when read in conjunction with the changes in taxation and employment policy detailed earlier. Some common themes can be discerned:

the encouragement of market choice and options for 'exit',
a broader role for private and occupational provision,
the removal of local government powers with more extensive centralised intervention in the social policy domain,
a sustained redistribution of income and wealth towards the upper income groups.

Middlemas (1986) and others have dwelt on the 'moment of 1944' when the 'post-war settlement' began to be constructed, a major component of which was the Beveridge/Butler/Bevan welfare state. The recent Budget and series of welfare reforms may mark the end of that welfare state and its replacement by something very different. History may discern another dividing line: the moment of 1988.

CHAPTER 5

CONCLUSION - THE INTERELATION OF WELFARE STATISM AND INTERNATIONAL COMPETITIVENESS

I offer here only brief conclusions on the impact of growing international competition on the British welfare state. Arguments and evidence on the reverse impact - of welfare statism on the competitiveness of the British economy - are left over for another chapter. The arguments of the previous sections can be summarised as follows.

1. Following a prolonged period of relative decline the British economy entered a phase of absolute decline and negative de-industrialisation in the 1970s under the pressure of intensified international competition. Initially this was aggravated by the policies of the Thatcher government - a case of the cure being worse than the disease - but since 1982 a steady recovery has lead to improved competitiveness on some counts (notably productivity) alongside further deterioration on other counts (notably the trade balance).

2. The erosion of the British economy under pressure of international competition in the 1970s helped polarise political debate and policy proposals: a New Right and a New Left emerged. The former explained the British predicament in terms of an over-active state coupled with too powerful trade unions - a combination which was mutually reinforcing. Expressed in terms of a simple systems model, the effects on competitiveness were as follows:

Powerful TUs

State

Wrong macro-economic policies
Excessive state intervention

Labour market rigidity

Loss of competitiveness

The New Left analysis was a mirror image of this substituting inadequacies of capital as the prime failure within civil society, but also stressing the autonomous inherited failings of the archaic British state:

Structure of capital
(Hegemony of City)

Archaic
State

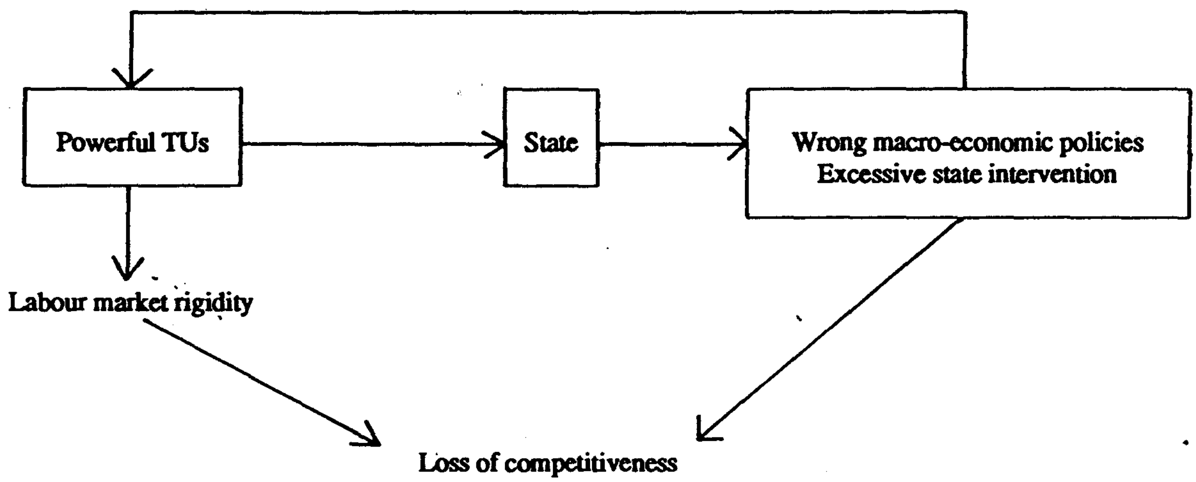
Wrong macro-economic policies
Absent industrial policy

Insufficient investment

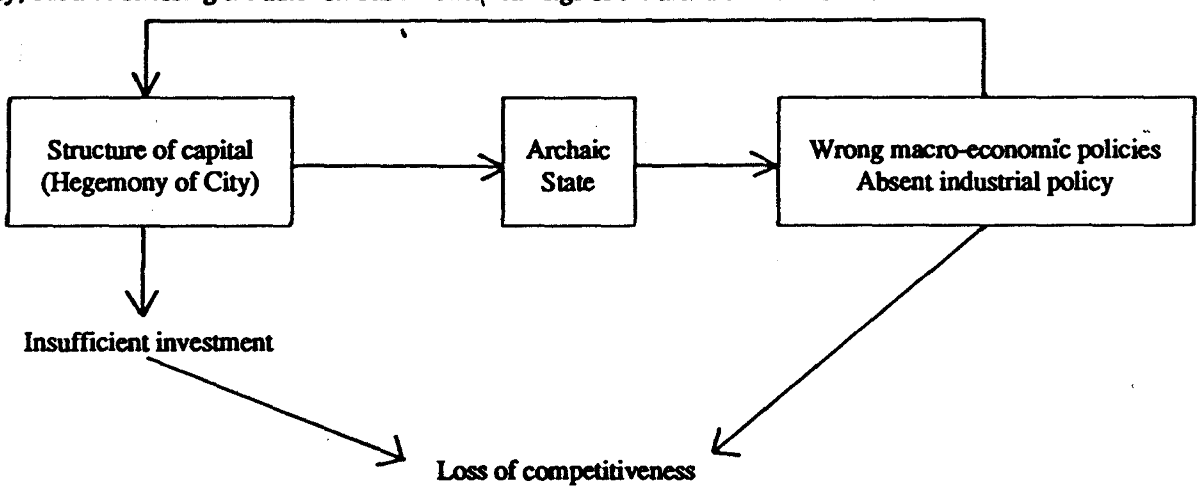
Loss of competitiveness

ERRATUM

The figure which appears in Chapter 5, page 44, should be represented as follows:



The New Left analysis was a mirror image of this substituting inadequacies of capital as the prime failure within civil society, but also stressing the autonomous inherited failings of the archaic British state:



3. The policy prescriptions flowing from the New Left analysis were never implemented by the 1974-79 Labour government, but in general terms the Thatcher government has vigourously implemented New Right economic policies since then. These have comprised:

   a. monetarist macro-economic policies from 1979-82 followed by less rigid but decidedly non -Keynesian policies since then

   b. cuts in direct taxes, rigid controls over public spending and extensive privatisation of state assets. Profound upward pressures stemming from the sharp recession confounded the government's plans to reduce absolute expenditure and tax levels, but in recent years the share of both in national income has fallen, with some help from the privatisation programme

   c. curbs on the de jure and de facto powers of trade unions, coupled with some considerable deregulation of the labour market. This has contributed to the acceleration of productivity growth but has not prevented an unsustainable rise in real wages

   d. extensive competition policies including the abolition of exchange controls, deregulation of product and finance markets, privatisation and tax reform. These appear to have had no clear effect on investment and efficiency levels.

In the case of both British Telecom and Rover cars earlier moves towards liberalisation and rationalisation have been superseded by privatisation, which may yet threaten their industries' competitiveness.

4. Policies (a), (b) and (c) above have direct and indirect implications for welfare statism in Britain. From 1979-87 the major changes have been:

- falling relative levels of benefits and services coupled with absolute declines in housing and probably health

- greater opportunities for market 'exit' from state welfare programmes

- some expansion of occupational and private provision of social services and benefits

- greater centralisation of the control and administration of welfare services

- the emergence of mass unemployment and a class of very long-term unemployed

- redistribution towards the rich and to a much lesser extent the middle income groups, coupled with rising relative poverty

The collective guarantee of living standards has receded in Britain as a result of both 'automatic' and 'political' factors. On the one hand, a welfare state designed for a period of full employment and diminishing inequalities in factor incomes has had to cope with mass unemployment, dualisation and widening inequality (partly as a result of government policy). On the other hand, the successful mobilisation of a New Right political program under the government of Mrs Thatcher has targetted the collectivist ethos of the welfare state and many individual social programs. It is the combination of these two trends which makes the British (and American) experience of the last decade quite different from that of Germany and France, let alone Sweden.

It would seem then that the UK does provide a 'classic' example of a country where heightened competition (in the context of long-term decline) has generated a reaction which is calling into question all aspects of post-war 'welfare statism'. Following the failure of social democratic policies in the late 1970s, the pressure of competition drove up unemployment and income and spatial inequality as the de-industrialisation of Britain got underway. Both the constraints of international competitiveness and the by-then almost universal belief that 'there is no alternative', conspired to erode the previous consensus on welfare statism. From around 1974 to 1979 there is evidence of such a shift in opinion amongst 'opinion formers', the government of the day, and the general public. The contradictions of Keynesianism (at least in its British form), the failures of the Labour party in power and the availability of a coherent alternative socio-economic strategy all contributed to a paradigm shift within Britain.

On the other hand, this explanation is too simple, for two reasons. First, whilst the depressed state of the world economy contributed to the British recession at the turn of the decade, since then Britain has been protected by its oil from some of the new competitive pressures of the 1980s. Second, some of the analyses, proposals and policies of the New Right and the Thatcher government contradict and interfere with the goal of improving competitiveness. Instead they are directed at eradicating 'collectivism' in British life irrespective of the economic effects. There is no recognition of the countervailing perspectives, outlined above, that a restructured welfare statism can advance economic competitiveness. In part, the British welfare state has been eroded **despite** the pressures of international competition.

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ASTMS - Association of Scientific, Technical and Managerial Staff
FBEAMA - Federation of British Electrotechnical and Allied Manufacturers Association
LCC - London Chamber of Commerce
NEDO - National Economic Development Offfice
SMMT - Society of Motor Manufacturers and Traders
TEMA - Telecommunication Engineering and Manufacturers Association

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