Thatcherism and Reagonomics: Supply-Side Economic Policy in Great Britain and the United States

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Severe economic problems—a high rate of inflation, an escalating level of unemployment, and periodic interruptions in economic growth—have plagued the economies of Great Britain and the United States for most of the last decade. The seeming failure of traditional economic policies to ameliorate these problems led either indirectly or directly to the election in both nations of leaders determined to alter in a far-reaching way the economic policies of their governments. In Great Britain, the public sector unions' "Winter of Discontent" in 1978-79 with Labor Prime Minister James Callaghan's attempt to combat inflation with an incomes policy paved the way for the election of a Conservative government in May of 1979. In the United States, President Jimmy Carter's failure to advance policies that would improve the performance of the economy resulted in a smashing Republican victory in November of 1980.

Prime Minister Margaret Thatcher and President Ronald Reagan, convinced that traditional economic policies were not only ineffective but also one of the principal sources of the current economic malaise, espoused an economic philosophy that rests on a set of economic assumptions deeply conservative in nature—an elitist theory of economic growth, a limited role for government in restoring economic health, and a belief in the "natural" superiority of economic laws and the market as the most efficient allocators of resources. These assumptions underpin the supply-side economic policies adopted by both governments.

It is the purpose of this paper to explore the assumptions of supply-side economics and to sketch the similarities and differences in economic policies in Great Britain and the United States. The paper concludes with a brief look at the problems involved in measuring the impact of supply-side economic policies, and at a level of cultural analysis that suggests that economic policies are not among the principal reasons for the economic decline of either nation.

THE SUPPLY-SIDE ALTERNATIVE

The basic claim of the supply-side economic policy advocate is that the economic problems of the 1970s and the early 1980s are the direct consequence of increasing taxes on all forms of income that reduce the financial incentives to save, to invest, and to produce. If tax rates are cut and government expenditures reduced, the income returned to the private sector will
provide both the incentive and the wherewithal to invest and to restore productivity growth.

Arthur Laffer, perhaps the most prominent tax-cutting advocate, insists that "tax rate reductions increase employment, output and goods, and lower unemployment rates, and lower inflation." He argues further that the increase in economic activity resulting from tax cuts will ensure, in a very short period of time, that government tax receipts do not fall and produce large governmental budgetary deficits. Thus, tax cuts are good not only for the health of the economy, but also for the health of governmental budgets.

It is a primary thesis of supply-side economics that aggregate economic behavior will respond favorably to increased financial incentives, that is, increased opportunities for profits. Rather than the centralized, collective decision making of governments, it is the decentralized, individual decision maker that is the most important and most efficient allocator of economic resources. Government intervention in the economy impairs the operation of market forces and limits the scope of the individual. Economic individualism, and not interventionistic government policy, is the key to economic well-being.

Yet the emphasis on the market and on individuals is not precise enough. Supply-side advocates insist it is the interrelationship of the free market and the enterprising individual that is crucial to economic growth. Israel Kirzner argues this point very bluntly:

What institutional frameworks are best suited to tap the reservoir of entrepreneurial alertness which is certainly present—in potentially inexhaustible supply—among the members of society? The free market is characterized most distinctively . . . by freedom of entrepreneurial entry. What is important about the market economy is that unexploited opportunities for reallocating resources from one use to another of higher value offer the opportunity for pure entrepreneurial gain. The most impressive aspect of the market system is the tendency for such opportunities to be discovered. Socialist economies, or those where government policy inhibits the operation of the free market, are simply not likely to tap either the advantages of the market or of the talented individual.

Although not explicitly stated, supply-side economics subscribes to the percolator theory of economic growth, that is, resources should be placed in the hands of enterprising individuals who will produce new goods and services. The benefits of economic growth will then "percolate" or "trickle" downward to workers and consumers. In a moment of candor, David Stockman, Reagan's director of the Office of Management and Budget, stated that supply-side economic theory was merely "trickle" down economics renamed. On the other hand, supply-siders do explicitly argue that demand management policies ultimately fail because they place resources in the hands of consumers who only exhaust resources rather than
create new wealth through the production of goods and services.

The advocates of supply-side economics reveal a conservative belief about how wealth (economic growth) is produced and who produces it. In its essence, supply-side economics assumes an elitist theory of economic growth. For the supply-sider, the age of the great entrepreneurs offers abundant historical evidence to support their point of view. Andrew Carnegie, John Davison Rockefeller, and J. Pierpont Morgan epitomize the enterprising individual who, in his pursuit of wealth, not only enriched himself but society as well.

Given this view of the nature of economic growth and who is responsible for growth, it is not surprising that supply-side economics also alters the role of the government in the management of economic affairs. Supply-side economists insist that a diminished role for government is necessary to increase the efficiency of the market. More importantly, a diminished role for government will undo the heavy costs government intervention imposes on human freedom. Milton Friedman describes vividly the damage done by government intervention:

We have gone very far in the past fifty years in expanding the role of government in the economy. That intervention has been costly in economic terms. The limitations imposed on our economic freedom threaten to bring two centuries of economic progress to an end. Intervention has also been costly in political terms. It has greatly limited our human freedom.¹

This view has been whole-heartedly adopted by President Reagan’s economic advisers. In the *Economic Report of the President, 1982*, prepared by the Council of Economic Advisers, it is asserted that:

Political freedom and economic freedom are closely related. . . . No nation in which the government has the dominant economic role has maintained broad political freedom; economic conditions in such countries are generally inferior to those in comparable nations with a predominantly market economy.²

The call for a diminished role for government is strengthened by supply-side advocates who make effective use of the combination of the conservative value of economic individualism and the liberal value of limited government. In the United States, “Off our backs (politically), and out of our pockets (economically)” is the layman’s expression of this complex of sentiments.

Harkening back to Adam Smith, supply-side economists insist that the economic laws of the market operate best in the absence of government interference in the economy.³ By restraining government intervention in economic affairs, the market mechanism is allowed to work more efficiently in fixing wages and prices over a greater range of economic activity. Economic laws are “naturally” superior to the “artificial” policies of governments. Furthermore, such economic laws operate in a far less ar-
bitrary fashion than do the economic policies of government. In this sense, economic laws are neutral and do not produce the "unnatural" allocations of economic rewards that the distributional policies of Keynesian economics do.

Under supply-side economics the government acts as a facilitator rather than as a regulator and director. The overall effect of this change in the role of the government in the economy from an active intervenor to that of facilitator will be a dramatic improvement in the functioning of the economy and a surge of healthy growth in investment, output, and productivity.

Thus, the economic policies of supply-siders are bound to differ substantially in form and content from the demand management economic policies of Keynesians. Yet, it is not the differences in economic policies between these two schools of thought that are most crucial. It is the triad of economic assumptions of supply-side economists—the nature of economic growth and who is most likely to produce growth, the proper role of the government vis-a-vis the economy, and the "natural" superiority of economic laws over governmental economic policy—that is most crucial to an understanding of the economic policies of the supply-side advocate. These assumptions form the foundation for the specifics of supply-side economic policy. It is on this bedrock of conservative convictions that governmental economic policy is to be built.

Given these economic assumptions, it is not surprising that the economic policies of the Thatcher government and the Reagan administration are remarkably similar. In the brief compass of this paper, it is not possible to examine these policies in any great detail. Rather, the economic policies of both governments are grouped under five general headings. The policies that fall under each heading are then outlined.

COMPARISONS OF THE ECONOMIC POLICIES OF THE THATCHER GOVERNMENT AND THE REAGAN ADMINISTRATION

Both the Thatcher government and the Reagan administration have set out their economic goals in bold terms. In the Financial Statement and Budget Report, 1981-1982, Sir Geoffrey Howe, Chancellor of the Exchequer states: "The Government's objectives for the medium-term are to bring down the rate of inflation and to create the conditions for a sustainable growth of output and employment. It is committed to a progressive reduction in the growth of the money stock and to pursuing the fiscal policies necessary to achieve this without excessive reliance on interest rates." The unwavering determination of the Thatcher government to reach these goals can be grasped by noting that an almost identical policy statement can be found in the Financial Statement and Budget Report for the previous and following years. Furthermore, the budget for 1982-83 clearly indicates that the prime minister, despite strong pressure from within her own party, was adhering closely to her plans for economic recovery.
Whereas the British statement on economic policy is stated with quiet
determination, the American position on economic policy is a clarion call.
In testimony before the Senate Appropriations Committee in January 1981,
David Stockman, the director of the Office of Management and Budget,
proclaimed:

The administration will shortly propose a bold, innovative economic
recovery plan integrating the classical economic principles of sound
budget policy, sound tax policy and sound money. The plan will be a
clear break with past policy. The principal elements of the plan will in­
clude slowing budget growth, reducing tax rates, curbing and stabiliz­
ing monetary growth, and lightening the regulatory burden. . . . The
results will be a speedy recovery of the financial markets, accelerated
real growth, and reduced inflation, as saving and investment rise,
deficits fall and the market system works more efficiently."

Despite the mixed signals of the 1982 Congressional elections, a worsening
rate of unemployment, and a painfully slow recovery from recession, Presi­
dent Reagan has indicated his determination to "stay the course."

Virtually all the policy steps taken by Mrs. Thatcher and Mr. Reagan
are no more than an attempt to implement the ideas outlined in these brief
statements. Ultimately, the test for both nations is whether the premises of
supply-side economics and the policies flowing from them, will in fact lead
to the desired results. The similarities in the economic policies of the two
governments are quite striking despite significant differences between Great
Britain and the United States in terms of political institutions, the size of the
respective economies, and the differing degrees of economic
interdependence.

**SIMILARITIES**

Before sketching the similarities in the economic policies, it is impor­
tant to note that it is the combination of policy steps and the economic en­
vironment created by those policy steps that is crucial to the supply-side vi­
sion of a healthy economy. Thus, it is a mistake to focus on any particular
policy. The supply-side policies of Reagan and Thatcher cannot be reduced
to simple monetarism. Instead it is the combination of policies and the
economic environment resulting from them that is expected to reverse com­
pletely the notion that the economy stands in almost constant need of
government intervention.

Two caveats are also necessary before proceeding. First, although im­
portant differences in details exist, the economic policies are presented
without specifying the details which would obscure the basic similarities.
For example, in Great Britain the prime minister's budgetary policies are af­
fected by the level of unemployment in ways that is not true for the United
States. The Thatcher budget, unlike the Reagan budget, must allocate a
significantly greater amount of resources to the unemployed. Second, con-
siderably less attention is paid, from this point on, to the policy contrasts between Keynesians and supply-siders. Nonetheless, it should be noted here that Keynesians insist that supply-side economic policies are having precisely the negative consequences they predicted. Supply-siders respond in two ways. One response is that supply-side policies will not begin to produce favorable results until the damage done by demand management policies is corrected. A second response comes from the ideological purists. They insist that supply-side theories are not being given a real test; too many deviations from supply-side theory have become part and parcel of the economic policies of both regimes.

FISCAL RESTRAINT:

Both the Thatcher government and the Reagan administration have called for fiscal restraint. Both regimes have attempted to cut their respective budgets with the aim of producing, in the long run, a balanced budget. This has not meant an absolute decline in the level of government spending but rather a slowing of budgetary growth. Despite the persistence of the current recession, both leaders have reiterated their determination in their most recent budgets to resist pressures to reflate the economy in any substantial or significant way.

**TABLE 1**

**BUDGETARY GROWTH IN GREAT BRITAIN AND THE UNITED STATES, 1975–1982**

<table>
<thead>
<tr>
<th></th>
<th>Great Britain</th>
<th>United States</th>
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<tr>
<td></td>
<td>(1980 Survey Prices)</td>
<td>(1982 Constant Dollars)</td>
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<tr>
<td></td>
<td>Pounds in Millions</td>
<td>Dollars in Billions</td>
</tr>
<tr>
<td>1975</td>
<td>81,283</td>
<td>$260.2</td>
</tr>
<tr>
<td>1976</td>
<td>79,202</td>
<td>$274.3</td>
</tr>
<tr>
<td>1977</td>
<td>74,375</td>
<td>$280.6</td>
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<td>1978</td>
<td>77,951</td>
<td>$293.8</td>
</tr>
<tr>
<td>1979</td>
<td>77,776</td>
<td>$297.2</td>
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<tr>
<td>1980</td>
<td>79,245</td>
<td>$316.7</td>
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<tr>
<td>1981</td>
<td>79,225</td>
<td>$327.5</td>
</tr>
<tr>
<td>1982</td>
<td>77,900 (est.)</td>
<td>$338.7</td>
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*The United States Budget in Brief*, Fiscal Year 1984, Composition of Budget Outlays in Current and Constant Prices.

The table above reveals quite clearly that budgetary growth in Great Britain and the United States had already slowed before the election of Margaret Thatcher and Ronald Reagan. By holding prices and dollars con-
stant, the real growth in government spending in both nations can be charted. The Thatcher government has called for a reduction in government spending as a proportion of gross domestic product from 45 percent in 1981-82 to 44.5 percent in 1982-83 and 41 percent in 1984-85. President Reagan in a television address to the American nation on September 24, 1982, claimed; "The budget bill that I signed this summer cut $35 billion from the 1982 budget and slowed the growth of spending by $130 billion over the next three years. We cut the government's rate of growth nearly in half." The second round of budget cuts, amounting to more than $13 billion, announced in that same speech dramatically highlighted the Reagan's administration plan to slow budgetary growth during fiscal 1983. Yet even deeper cuts would not enable his administration to reach the target of a balanced budget in fiscal 1984. Indeed, the Reagan budget for fiscal 1984 projected deficits of $188.8 billion, $194.2 billion, and $147.7 billion for fiscal 1984, 1985, and 1986 respectively.

These projections have led to considerable debate among supply-siders as to where the American economy stands on the "Laffer curve." If the economy is on the left side of the curve, as former Assistant Secretary of the Treasury Paul Roberts insists, then tax increases will not unduly impair economic incentives and will aid the government in reducing the budgetary deficits. On the other hand, Arthur Laffer maintains that the economy is on the right side of the curve and tax increases will further damage economic incentives and will further widen the gap between tax receipts and government expenditures.

Slowing budgetary growth is also in accord with the perceived need to return resources to the private sector. The crushing size of governmental budgets and their ensuing deficits sop up funds that the private sector desperately needs if growth in investment, output, and productivity is to occur. Only by slowing the growth of government, supply-side advocates insist, will it be possible to find the resources necessary to healthy growth.

MONETARY RESTRAINT:

Both regimes have called for the safeguard of firm monetary control. In practice, this has meant tight money and high interest rates. The aim of both governments is to curb and stabilize monetary growth. Prime Minister Thatcher has maintained that the "major innovation" in the British budget since she took office is a plan that outlines a "progressive reduction in monetary growth over a period of years." Budget plans also "set out a complementary path of declining public expenditures and public sector borrowing" that will hasten the achievement of a stable money supply.

In the United States the Chairman of the Federal Reserve System, Mr. Paul Volcker, has reiterated time and time again, that curbing the growth in the money stock is the only sure way to dampen inflationary
tendencies deeply embedded in the American economy. In July of 1981, he pointed out to the Joint Economic Committee of Congress the dangers of reversing present monetary policy: “If the Federal Reserve . . . were to deviate from its policy of monetary restraint in an effort to lower interest rates, any seeming short-run relief would have to be balanced against the substantial risk—for the United States and the rest of the world—of excessive credit growth, a further hardening of inflationary expectations and still greater interest rate pressures in the future.”

Despite public attacks by Reagan administration officials, including Donald Regan, Secretary of Treasury, *The Economic Report of the President, 1982* affirmed that the Federal Reserve System’s monetary policies were substantially in line with the President’s economic policies.

The Thatcher government and the Reagan administration see the restraining of monetary growth as necessary not only to dampen inflationary pressures, but also to establish monetary rules or targets. These targets are more explicitly stated in Great Britain given its somewhat greater emphasis on monetary policy. Thus, the growth of M3 in 1982–83, Sir Geoffrey Howe declared, will be in the “target range” of “8 to 12 percent.” Monetary rules or targets are, supply-siders insist, indispensable guides that provide the necessary predictability to economic actors in the free market. Without such guides, the investment climate is deeply uncertain and investors will be reluctant to undertake economic expansion in such an environment. Supply-side advocates argue that the volatility of the stock market in both nations is primarily due to the absence of explicit monetary rules, or worse, a failure by governmental officials to stick to a consistent monetary policy.

### TABLE 2

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<tr>
<th>INTEREST RATES IN GREAT BRITAIN AND THE UNITED STATES, 1973–1982</th>
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<tr>
<td><strong>Great Britain</strong></td>
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<tr>
<td>(Base Lending Rate)</td>
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<tr>
<td>1973</td>
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<td>1974</td>
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<td>1975</td>
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<td>1981</td>
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<tr>
<td>1982</td>
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</tbody>
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**SOURCES:** *Economic Trends*, Interest Rates, Security Prices and Yields *Federal Reserve Bulletin*, The Prime Rate Charges by Banks on Short-Term Business Loans
The table above details interest rates since 1973. Neither nation has seemingly been able to achieve a stable growth in the money supply without incurring the highest interest rates in the history of either nation.

**TAX CUTS:**

Both the Prime Minister and the President have insisted on across the board tax cuts. Mrs. Thatcher has cut income taxes and the national insurance surcharge, but has raised the value added tax significantly during her tenure. In both nations across the board cuts have, in fact, been weighted in favor of upper income groups, and those most likely to be the producers of economic growth. The lowering of the tax rate on capital gains in the United States is a clear example. President Reagan has also been successful in pushing through Congress a tax bill that includes an accelerated depreciation schedule for capital equipment. Such provisions are intended to enhance capital investment and counter the decline in productivity. Yet despite the tax cuts, as a result of social insurance tax increases, value-added tax increases, "'bracket creep,'" and the adoption of "'revenue enhancement'" measures and "'user fees,'" real taxes are still rising for most income groups in both countries. Nor do continued budgetary deficits offer any hope that real taxes will decline in the foreseeable future.

Nonetheless, the Reagan tax proposals are designed to be an "'integral part of the comprehensive economic program'" to improve "'the after-tax, after-inflation rewards to work, saving, and investment.'"** In Great Britain, proposed changes in taxation reach across the entire range of tax policies from income taxes to customs and excise taxes.

Lower tax rates, particularly on interest, dividends, capital gains, and corporate income, will produce, supply-side advocates maintain, an increase in output by enhancing financial incentives to save and to invest. Tax cuts on wages will increase both the incentive to work and the supply of labor. Thus, decreasing taxes on all income levels, but especially upper income groups, will restore incentives to both producers and workers and bring about a real expansion of aggregate output. Moreover, a cut in tax rates, certain advocates of the "'Laffer curve'" insist, is necessary to boost tax receipts.** Tax rates are now so punitive that further upward adjustments will actually lead to falling rather than rising tax receipts.

**REVIVE PRIVATE ENTERPRISE:**

Thatcher and Reagan both see a multi-pronged effort as necessary to restore the private sector to full health.** In addition to the tax provisions noted above, both regimes have called for a lightening of the regulatory burden. A reduction in the number of regulations will allow the market to function more efficiently. Since capital investment is such a critical factor in economic growth, both leaders view a closer relationship between govern-
ment and industry as essential to ensuring adequate amounts of capital investment in the appropriate industries. Although this may at first appear as irreconcilable with the supply-side vision of a diminished role for government, it is only a superficial irreconcilability. When it is recalled that government should act as a facilitator of healthy economic growth, government involvement in investment decisions is then seen as natural and appropriate.

Government involvement, however, will differ between the two nations. President Reagan insists that "the most appropriate role for government economic policy is to provide a stable and unfettered environment in which private individuals can confidently plan and make appropriate decisions. . . . Establishing an environment which ensures efficient and stable incentives for work, saving, and investment now and in the future is the cornerstone of the recovery plan." By contrast, the British governmental role is more positive. Sir Geoffrey Howe declared that "measures to encourage enterprises and risk taking are essential if we are to replace the jobs that are disappearing elsewhere in the Economy. We must be ready to set aside the resources to encourage them. . . . This Budget has been designed . . . to help redress the balance of the economy in favor of business and industry." In the Budget Statement for 1982–83, the chancellor affirmed that "our prime purpose is to help private commerce and industry to help itself by cutting its costs" and that the "paramount aim of this Budget is to help industry, to encourage business, and to create jobs."

Given the aging industrial plants of both nations, Reagan and Thatcher see an important governmental role in reindustrialization. In several ways, such a governmental role recalls the early days of industrialization. In the middle and late 19th century the American and British governments actually assisted in the capital accumulation process by thwarting efforts by farmers to have rates regulated, by labor to organize and bargain collectively, and by consumers to prevent monopoly pricing. Supply-side advocates insist that reindustrialization need not be accompanied by the abuses that were a part of the first stages of industrialization. They point to the many governmental policies, such as unemployment and retirement benefits, that supply-siders would leave largely intact, and which would prevent a recurrence of earlier abuses.

MORE MONEY FOR DEFENSE:

Great Britain and the United States see the Soviet Union as a threat to world peace. Thus, Reagan and Thatcher have called for increases in defense spending over the next several years. Given their supply-side economic views, this is one of the very few areas where an increase in governmental spending is viewed as legitimate. The Thatcher government is calling for a real 3 percent increase in defense spending each year during the
period 1981–82 to 1984–85. A substantial fraction of this increased spending will go toward the purchase of the American Trident missile. Despite the burden increased defense expenditures place on plans for economic recovery, the prime minister shows no sign of retreating from this position despite widespread opposition from the Labor Party, and the new alliance between the Liberals and the Social Democrats.

The case is even more extreme in the United States where President Reagan announced a plan that calls for a $180 billion increase in defense spending over the next decade. As a consequence:

Real military spending is expected to grow 9 percent annually between 1981 and 1987. Over that period, military spending will rise from 5.6 percent to 7.8 percent of GNP, and from 25 percent to 37 percent of total Federal spending.

Although America already bears the greatest per capita burden of any nation for defense spending, the Reagan plan will add to that burden. The adverse effects of this increased expenditure will be partially offset by a reduction in expenditures for social programs. But, even the president’s closest advisers concede that such a level of defense spending will impair the administration’s efforts to strengthen the economy.

This review of American and British economic policies documents the overwhelming similarities of those policies. Only in isolated instances do the policies diverge from one another, and even there it is a matter of emphasis rather than a fundamental difference. The economic policies of both nations rest on the supply-side vision of how the economy works and what is necessary to restore the economy to full health. Finally, both governments appear determined, even in the face of short-run economic setbacks, to pursue virtually unchanged the policies they set out at the beginning of their administration.

DIFFERENCES:

There are several differences that limit the comparability of the economic policies of the Thatcher government and the Reagan administration. Yet the differences that exist fall largely outside the arena of economic policy. The supply-side economic philosophy that underpins the economic policies in both countries ensures that any differences in policy are likely to be traced to noneconomic rather than economic factors.

INSTITUTIONAL DIFFERENCES:

The most obvious institutional differences include: a parliamentary system with responsible parties versus a presidential system with decentralized parties, a unitary system versus a federal system, and unified control of the monetary system versus a fragmented control of the monetary system. Given the importance of monetary policy to both regimes, the last
difference might be perceived as crucial. But this difference is only of limited significance because, as noted earlier, Paul Volcker, the chairman of the Federal Reserve System, is sympathetic to Reagan’s economic policies, notwithstanding Mr. Volcker’s sympathies, the Reagan administration has, on occasion, attempted to use the Federal Reserve System as a scapegoat for high interest rates, and pointed to its monetary policies as one of the factors slowing economic recovery.

Despite these institutional differences, both Thatcher and Reagan have shown that determined leadership can overcome institutional obstacles and produce very similar economic policies. Furthermore, they have demonstrated that executive leadership is viewed as the key to the resolution of economic problems and such leadership cannot be challenged successfully even by determined legislative opposition. Finally, the two leaders have shown that a decisive reversal in economic policy from Keynesian demand management measures to supply-side measures can occur under quite different institutional frameworks.

DIFFERENCES IN THE SIZE OF THE ECONOMIES:

The American economy, as the table below reveals, dwarfs the British economy. The greater size of the American economy has two important consequences for the economic policies of both nations. First, the sheer magnitude of the American economy ensures that any development in that economy will have a significant impact on the British economy and, indeed, on the world economy. As a consequence, British economic policy must react to economic events in America in ways that need not concern Reagan’s economic advisers.

Secondly, the greater size and complexity of the American economy limits the “fine-tuning” that economic policies can provide. This may be somewhat of an advantage because American economic advisers probably have a greater margin for error in forecasting the consequences of any given set of economic policies. By contrast, British economic advisers must function in a setting where outside events can have far-reaching effects, and where errors in forecasting can quickly produce adverse effects on economic performance.
TABLE 3

GROSS NATIONAL PRODUCT FOR GREAT BRITAIN AND THE UNITED STATES, 1973-1982

<table>
<thead>
<tr>
<th>Year</th>
<th>Great Britain (Pounds in Millions)</th>
<th>United States (Dollars in Billions)</th>
</tr>
</thead>
<tbody>
<tr>
<td>1973</td>
<td>74.3</td>
<td>1,252.0</td>
</tr>
<tr>
<td>1974</td>
<td>84.5</td>
<td>1,379.4</td>
</tr>
<tr>
<td>1975</td>
<td>105.5</td>
<td>1,479.9</td>
</tr>
<tr>
<td>1976</td>
<td>125.9</td>
<td>1,640.1</td>
</tr>
<tr>
<td>1977</td>
<td>143.9</td>
<td>1,862.8</td>
</tr>
<tr>
<td>1978</td>
<td>166.0</td>
<td>2,091.3</td>
</tr>
<tr>
<td>1979</td>
<td>194.3</td>
<td>2,357.7</td>
</tr>
<tr>
<td>1980</td>
<td>225.8</td>
<td>2,573.9</td>
</tr>
<tr>
<td>1981</td>
<td>249.4</td>
<td>2,871.8</td>
</tr>
<tr>
<td>1982</td>
<td></td>
<td>3,033.0</td>
</tr>
</tbody>
</table>

SOURCE: Economic Trends, Factor Incomes in the Gross National Product

DIFFERENCES WITH REGARD TO ECONOMIC INTERDEPENDENCE:

Closely related to differences in size is the differing degrees of the interdependence of the economies of Great Britain and the United States. The American economy is much more self-contained than the British economy. The gross domestic product of the United States is sufficiently large to enable agriculture, manufacturing, and service industries to operate at an optimal level. In addition, the sheer size of the domestic market provides numerous and extensive opportunities for American firms to take advantage of, and benefit from, economies of scale not available to their British counterparts. Only in the case of agriculture, where American farmers are so efficient, is the export market deemed an essential factor in a healthy agricultural sector and political pressure mobilized to protect agricultural exports.

By contrast, the British economy is heavily dependent on the economies of other nations. A significant fraction of Britain's gross national product (GNP) is directly attributable to foreign trade. Indeed, foreign trade accounts for 29 percent of Britain's GNP, whereas foreign trade accounts for only 9 percent of American GNP. Given their smaller domestic economy, British businesses must seek access to the domestic market of other nations. The greater interdependence of Britain's economy is perhaps the most important factor that limits the success of British capitalism as compared to the success of American capitalism.
Overall, American economic advisers have an easier task than British advisers. With a largely self-contained economy, American economic policies can be formulated without undue concern for economic conditions in other countries. Furthermore, the full impact of such policies is less likely to be impaired by outside forces. British economic advisers, on the other hand, must function in an economic environment characterized by interdependence and where world economic conditions can adversely affect the intended effects of economic policy. Yet, despite these differences supply-side theory ensures that the economic policies of both nations retain their essential similarity.

IMPACT OF SUPPLY-SIDE ECONOMIC POLICIES

Given the limited purpose of this paper, it will not be possible to explore the impact of the economic policies of the Thatcher government and the Reagan administration in any detail. Rather, this section points to several issues that must be addressed before the consequences of supply-side economic policies can be ascertained. These measurement issues are primarily of interest to economists. Yet political scientists have increasingly expressed interest in the impact side of public policy analysis. Thus, a brief review is appropriate.

A lowering of the inflation rate, a reduction in unemployment, and increased productivity, would seem to be indicators that signal the impact of supply-side economic policies. However, care must be taken to establish a casual link (if possible) between improved economic indicators and supply-side economic policies. This is an exceedingly difficult task. Econometricians have grappled with these kinds of problems with not altogether satisfactory results.

Attention must also be paid to time frames. After more than four years there should be some ways to measure the long-term impact of Thatcher’s policies. Yet British economic advisers now claim that a minimum period of three to six years is necessary before the government’s economic policies will begin to reverse the present decline and produce positive results. The chancellor acknowledged in his March 1982 Budget Statement that “reversing this decline would require a major effort, an effort that would need to be sustained over the lifetime of more than one parliament.” After nearly three years the short-run effects of Reagan’s policies should be beginning to appear. In both countries inflation rates have fallen significantly, but unemployment continues to rise. No long term trends with regard to productivity growth are as yet discernible. Obviously, more time must pass if supply-side economic policies are to be given a full test. Keynesians, of course, are already convinced that such policies will have disastrous consequences. Supply-siders are equally convinced that the reverse is true.

If the debate between these two schools of thought cannot be resolved,
perhaps economic policy needs to be looked at from a larger point of view. A number of authors argue that the present economic malaise is not due to the narrow problem of deciding which set of economic policies to pursue at all. Rather, they suggest that industrial civilization has exhausted itself. Robert Heilbroner, for example, insists that “the values of an industrial civilization, which for two centuries have given us a sense of elan and purpose, now seem to be losing their self-evident justification.” He restates and amplifies this position in several works particularly Business Civilization in Decline.

The waning of the industrial spirit is perhaps even more acute in Great Britain. According to Martin Wiener, the British people, and particularly the British elites, have never fully acceded to the transformations wrought by the industrial revolution. Indeed, this failure may be the downfall of Prime Minister Thatcher’s economic plans. Wiener writes: “The least tractable obstacle of British economic ‘redevelopment’ may well be the continuing resistance of cultural values and attitudes.” He persuasively documents this thesis with telling evidence from virtually every aspect of British life.

Even in the absence of the waning of the values of industrial civilization cited by Heilbroner, or the cultural resistance cited by Wiener, economic growth has, according to Fred Hirsch, inherent social limits. He argues forcefully that growth is limited in two major ways:

First—the paradox of affluence—economic growth in advanced societies carries some elements of built-in frustration: the growth process, when sustained and generalized, fails to deliver its full promise. Economic growth runs into social scarcity. Second—the reluctant collectivism—continuation of the growth process itself rests on certain moral pre-conditions that its own success has jeopardized through its individualistic ethos. Economic growth undermines its social foundations.

Thus, from a number of different starting points with differing degrees of sophistication and rigor the cultural analysis converges in such a way that virtually every conceivable route out of the present economic malaise is closed. Only a transformation of industrial civilization, these authors intimate, can alter the landscape of the future. Moreover, their writings may contain some unhappy truths about the prospects for a renewal of economic growth in America and Britain. If their arguments have any validity, economic policies, regardless of their ideological roots, will have only a very limited impact on economic conditions. Unfortunately, it will be extremely difficult to develop the tools to assess these cultural arguments.

CONCLUSIONS

This paper has explored the problems that produced a political turn to the right in Great Britain and the United States. Disaffection with Keynesian
policies led to the election of leaders determined to adopt supply-side measures. These measures rest on economic assumptions that are deeply conservative in nature—an elitist theory of economic growth, a limited role for government in restoring economic health, and a belief in the “natural” superiority of economic laws and the market as the most efficient resource allocators. The economic policies of both nations, built on these premises, have been shown to be remarkably similar. Although differences do exist, the differences fall largely outside the arena of economic policy making, and thus do not significantly affect the policies adopted by both regimes as a part of their recovery plans.

Given the limitations of supply-side policies, it is clear that they will not replace entirely countercyclical Keynesian policies in either nation. Keynesian policies have proven to be an appropriate response to recessions that are the result of business cycle fluctuations. Despite the post-war expansion, supply-siders insist Keynesian policies are not well-suited to improving long term economic growth while preserving price stability. The supply-side argument is simple: in the post-war era all the conditions for sustained economic growth were present. It was merely a historical accident that Keynesians were in power. If supply-siders had been in power, growth would have been even greater.

Another weakness of demand management policies is that over the long term they do not necessarily increase incentives to save, to invest, and to produce. Supply-side policies purport to increase precisely these incentives. Unfortunately, supply-side policies work slowly and it is a serious question whether elected public officials can risk, or are willing to risk, waiting until such policies begin to have the favorable impacts of robust expansion, new investment and new jobs, when elections seem always just around the corner.

Finally, the issue of which is the appropriate set of economic policies—Keynesian demand management measures or supply-side measures—for restoring the economies of Great Britain and the United States to full health may be hopelessly irrelevant. Serious authors from a wide range of backgrounds and perspectives have argued that the economic malaise plaguing both nations can best be traced to the exhaustion of industrial values rather than to any particular set of economic policies. If this cultural analysis is valid, the debate over economic policy between Keynesians and supply-siders is worse than futile.

Obviously, more research is necessary, and more time must pass, before the impact of competing economic policies on economic performance can be fully measured. More research and more time is also necessary before the tools can be developed to assess the cultural analysis. In the interim, both nations appear fated to suffer fluctuating rates of inflation, socially unacceptable levels of unemployment, and agonizingly slow economic growth that is periodically interrupted by recessions.
Notes


5G. Gilder, Wealth and Poverty (New York: Basic Books, 1980), is a modern restatement of Adam Smith's classic Wealth of Nations. Gilder's arguments as to the causes of contemporary society's economic malaise echo Smith's thesis that government interference in the economy impairs the effectiveness and the efficiency of economic law. See also Friedman, cited at note 4, pp. 48-54, for his analysis of Smith's thinking on the proper role of government.


15The arguments for monetary targets are examined in: Monetary Targets and Inflation Control, OECD Monetary Studies, (Washington, D.C.: OECD, 1979).


21"Budget Statement," House of Commons Parliamentary Debates, Weekly Hansard,


