Thatcherism

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On Tuesday, March 17, 1981, the last day of parliamentary debate on Chancellor Geoffrey Howe's draconian deflationary budget, a rather obscure Conservative Member of Parliamant from Norfolk-Northwest, with the rather distinguished name of Brocklebank-Fowler, made history. He became the first Tory MP to resign the Whip and physically cross the floor of the House of Commons, the two sword lengths that have separated the government and the opposition since the early 1900s. Brocklebank-Fowler's defection is not in itself an event with which to bore one's grandchildren. But it is a sign of the times in Britain—times of increasing political tension and disillusionment.

Significantly, when Brocklebank-Fowler crossed the floor, he joined not the Labour Party, the party of official opposition, but the Social Democratic Party, newly formed by right-wing ex-Labour MP's. While schisms in the Labour Party already threaten the foundations of Britain's two-party system, the Conservative Party's problems go beyond Brocklebank-Fowler. The resumed budget debate was already several hours old when he defected, and no one had yet spoken in support of the chancellor's budget. The most significant contortions of the afternoon were those of Mr. James Prior, the Minister of Employment, well known as a "cabinet wet," Mrs. Thatcher's derisive epithet for those members of her inner sanctum not absolutely committed to monetarist policies. Poor Mr. Prior evaded the issue by defending odd bits of the budget's periphery, while avoiding its general message. Norman St. John-Stevas, recently fired from Thatcher's cabinet because of his opposition to monetarism, also delivered a scholarly indictment of the government's economic strategy, concluding that "man is a moral being first, an economic being second." This advice contrasted with that delivered by the Prime Minister earlier in March, when, temporarily in possession of a pulpit, she had insisted that "the creation of wealth is a Christian duty." St. John-Stevas was not alone. Other Conservative MP's expressed their dismay and anger over the budget. Significantly, the Chancellor's closing comments in defense of both budget and monetarism ended in uproar. It was, as the *Financial Times* said, "One of the most bizarre Alice through the Looking Glass budget debates of all time."

Precipitating the political uncertainty and realignment is a disastrous economic situation. Britain's economic performance in the 1960s and 1970s was poor but, despite relatively slow growth from 1957 to 1967, in the last year Britain's Gross Domestic Product (GDP) per capita was second among OECD countries only to the United States. By 1978, Britain had been overtaken and substantially outdistanced by West Germany, France, and Japan. Similarly, although before 1967 Britain's inflation rate was relatively moderate, it accelerated dramatically after 1972, and in 1975 was twice the OECD average. Balance-of-payments equilibrium was, in general, better achieved, but only at the expense of depressing domestic demand to curb a persistent tendency for imports to exceed exports. The resulting oscillations in budget-led expansion and contraction were conducive neither to a healthy investment climate nor to tractable labor relations. Productivity growth was sluggish, and unemployment rose steadily from 2.6 percent in 1973–74 to more than 6 percent in 1978.[1] Mrs. Thatcher did not inherit a rose garden.

Since Thatcher has taken office, the British economy has gone from bad to worse. GDP has fallen by 5 to 6 percent, with manufacturing and construction especially hard hit. In 1980 manufacturing output suffered its largest single-year decline in British history. Bankruptcies have soared to record levels, as has un-

1 Richard Caves and Lawrence Krause, *Britain's Economic Performance* (Washington, D.C.: Brookings Institution, 1980).

employment, which official estimates now place around the 2.5 million mark, more than 10 percent of the work force. The substantial balance-of-payments surplus merely reflects the chronic weakness of the domestic economy and an eroded ability to import. Exports have suffered from a massively overvalued pound, maintained by a combination of North Sea oil, high interest rates, and the confidence that monetarism instills among speculators in international currencies. Inflation, which the government had declared its number-one enemy, remains in double figures. If traditional performance criteria (unemployment, inflation, growth) are used as a measure, the monetarist experiment is a shambles.

Yet Mrs. Thatcher and Sir Geoffrey have stuck to their guns and, via the budget, have blasted away again at the British economy. The budget's additional £4,500 million in taxes is the largest tax increase in British history and must push Britain deeper into recession. Is this desperation—clinging to monetarism because it's the only policy that they've got? We think not. The Prime Minister and Chancellor remain convinced that monetarism will work, that the lamentable state of the economy simply reflects the nature of the cure, a kind of short-run deterioration before things get better. To understand this perspective it is necessary to scrutinize the theoretical underpinnings of Thatcherite monetarism.

Monetarism has a prior and distinguished history in the guise of the Quantity Theory of Money, the rudiments of which can be traced back at least two centuries before the time of Adam Smith.[2] The modern version of monetarism posits three relationships that link the actions of government, the money supply, and the price level: the first connects government deficit spending and the money supply; the second, the money supply and consumer spending; and the third, consumer spending and changes in wages and prices.

The most widely publicized characteristic of monetarism—the focus on the money supply (variously defined) as both an index of trends in the economy and an instrument of government policy—derives from the second relationship. Monetarists believe that the relationship between the general public's *demand for money balances*, that is, desired holdings of cash and bank deposits, and *money income*, simply the general public's income in nominal terms, is both stable and predictable. The stability of this relationship ensures that the demand for money balances grows in line with money income; indeed, the monetarists often repre-

2 Phyllis Deane, "Inflation in History," in *Perspectives on Inflation*, ed. David Heathfield (London: Longman, 1979).

sent the former as a fixed proportion of the latter. Thus, if the stock of money in existence grows more rapidly than money income, consumers find their asset portfolios out of balance. They find themselves holding too much money and will respond by spending, by trying to convert some of their excess money holdings into commodities and/or financial assets. Higher spending presses prices and wages upward. But at inflated prices and higher levels of money income, the theory predicts consumers will want to hold more money. Their demand for money balances will thus increase and so equilibrium will eventually be restored. The adjustment mechanism is not changes in real income or production but the price level. Thus the second and third relationships provide the heart of monetarism, old and new: *the belief that changes in the money supply must eventually affect prices*. This is the basis of the "monetarist policy role" whereby growth in the money supply is tied to growth in productivity. Any excess monetary growth is deemed to dissipate in inflation.

But what of the first postulated relationship, that between government deficit spending and the money supply? Monetarists allege that failure to constrain the rate of monetary expansion derives from profligate public expenditure, which obliges the government to borrow. The expansion of public debt, measured by the Public Sector Borrowing Requirement (PSBR), can directly add to the money supply and hence, as the monetarists believe, fuel inflation. Thus the monetarists postulate a chain of causation that runs from government spending to inflation via the supply of money.

All three of the mediating processes described are problematic. First, PSBR does not stand in a simple monotonic relationship to the growth of the money supply, as is acknowledged by the Treasury and reflected in the structure of the accounting identity that specifies and measures the components of monetary growth. Specifically, the impact of government borrowing on the money supply depends on *how it is financed*. If the money is borrowed from individuals and nonbank institutions, so-called funded borrowing, it is financed by genuine savings and is not inflationary, although the monetarists argue that it still has adverse effects because it pushes up the cost of borrowing and "crowds out" private-sector productive investment. The part of PSBR that adds to the money supply is the "unfunded" component, financed by borrowing from the banks, which can then use the injection of reserve assets as the basis for credit expansion. A recent study demonstrates that for the last three financial years "unfunded" (and therefore inflationary) borrowing was virtually zero, amounting to less than 0.1 percent of GDP for that period.[3] Given that the same year saw an increase in the

3 Nicholas Kaldor, "Monetarism and UK Monetary Policy," *Cambridge Journal of Economics*, vol. 4 (December 1980), p. 305.

money supply of £18 billion, it is clear that the source of monetary expansion must lie elsewhere than with a prodigal government. A cursory examination of the figures shows that bank lending to the private sector, another component of monetary growth, and therefore another item in the accounting identity described above, was the major source of monetary expansion.

The linkage between money and spending is no less controversial. It depends on the motives for holding money. Keynes emphasized the role of money as a link between the present and the future, allowing people to avoid making commitments in a context of uncertainty. Post-Keynesians emphasize the availability and uncontrollability of the plethora of money substitutes—such as credit cards, trade credit, commercial bills, and so on—that characterize a sophisticated credit-money economy and that make definition, not to mention control, of the money supply arbitrary.

The third linkage, the process by which changes in the money supply affect prices, the so-called transmission mechanism of monetary policy, remains something of a mystery. The several possible linkages cited in the literature ultimately avoid precise specification of the way spending influences corporate and union decision making to impact on prices and wages. Evasion here is not surprising, given the disjuncture between the aggregate level of monetarist analysis and the micro-level at which decisions that determine the level of prices and wages are made.

Milton Friedman evades these criticisms with a retreat into his own brand of positivism. Theoretical deficiencies are discounted; his "scientific laws" are derived from empirical relationships documented by behavior in the real world:

> We can know that a bird flies and have some insights into how it is able to do so without having a complete understanding of the aerodynamic theory involved. Similarly we know from the experience of many countries over many centuries that . . . when the quantity of money increases at a decidedly faster rate than the output over any extended period, the result is inflation.[4]

Friedman's bald empiricism obscures the real transmission mechanism of monetary policy: *deflation*. Attacks in recent months by public-spirited opponents have forced the monetarists to "come clean" about their real aims. Friedman, on the defensive, described the monetary transmission mechanism thus: "Reduced monetary growth produces a subsequent slowdown in spending, reflected first in output and employment, later in inflation." Monetary stringency

4 Milton Friedman, "Monetarism: A Reply to the Critics," *London Times*, March 3, 1980, p. 19.

adversely affects spending and depresses aggregate demand, squeezing out inefficient firms and pushing up unemployment. Then come the rather heroic assumptions about price and wage determination, which, incidentally, do not fit comfortably with British experience. Firms facing declining demand reduce prices, and trade unions, intimidated by rising unemployment, are induced to accept lower wages. Inflationary expectations adjust downward, and eventually the economy moves back to the "natural" rate of unemployment, the monetarists' curmudgeonly version of full employment, but with a lower rate of wage and price increase.[5]

Can monetarism, now understood as the ugly side of Keynesianism, work? It is clear that it would be very costly. A simulation using the Treasury's own computer model of the British economy suggested that the inflation rate would fall by one percentage point after four years, at a cumulative cost equivalent to 4 percent of a single year's GDP and a year's additional unemployment for 2.5 percent of the labor force.[6] This implies that the government's targeted 8-percentage-point fall in inflation would cost over 30 percent of GDP and 5 million person-years. Surely that is not just costly but prohibitive. Walter Eltis, an anti-Keynesian, in a qualitative gallop through the same terrain as the Treasury's computer, came to much the same conclusion: "Sadly Sir Geoffrey has almost certainly been misled by optimistic forecasts and by monetary theory, which is still insufficiently thoroughly thought through and tested (to put it mildly) to bear the weight he has placed upon it . . . Gambles as big as this sometimes come off, but not often."[7] In addition, deflation does not have a good *historical* track

5 The "natural" rate of unemployment is "the level that would be ground out by the Walrasian system of general equilibrium equations, provided there is imbedded in them the *actual structural characteristics* of the labor market and commodity markets, including *market imperfections*" (Friedman, ibid., our emphasis). A Walrasian general equilibrium system requires very strong assumptions, including no economies of scale, no uncertainty with respect to the future, and no one buyer or seller large enough to affect prices. It is far from clear what Friedman, the positivist, means by "actual structural characteristics" or "market imperfections" when the Walrasian system has not yet accounted for a firm, a labor union, or a government. The one inference that saves the definition from ambiguity if not self-contradiction is that the "natural" rate of unemployment, while affected by institutional forms, is so in only a trivial way, perhaps the way the law of gravity might be affected by changes in temperature.

6 *Monetary Policy—A Report from the Treasury and Civil Service Committee of the House of Commons*, 3 vols. (London: HMSO, 1981).

7 Walter Eltis, "Gambles as Big as This Howe Budget Sometimes Come Off—But Not Often," *London Sunday Times*, March 15, 1981, p. 16.

record for controlling inflation. Studies of the last British experience with monetarism between 1935 and 1938 suggest that unemployment of 14–15 percent was required simply to hold wage increases to the growth of labor productivity. And even that unemployment rate—which would now mean over three million people on the dole—would only have stopped inflation from rising; it would not necessarily have reversed it.

But monetarism has more to offer than a theory of inflation. Even if control of the money supply were sufficient to restrain price increases, it is not sufficient to ensure economic growth. The latter, according to Thatcher, has been stifled by excessive government intervention and inefficient, overmanned production processes. Here Thatcherism converges with those currently fashionable American views that see the productive potential of an economy as cumulatively hobbled by the interventions promoted by Keynesian demand management and propose as an alternative a liberation of the "supply side." A return to the "market" will unleash private productive initiative and thereby expand the output of goods and services but, Thatcher emphasizes, only after an interim, shake-out period during which the preconditions for expanded productivity are reestablished. These preconditions include the breaking of inflationary price and wage expectations; they also include forcing business management to shed unproductive workers and unions to dispense with restrictive shop-floor practices under threat of bankruptcy and unemployment. Thatcher, unlike President Reagan and his supply siders, emphasizes the necessity of this interim hardship period of substantial unemployment and business failure before the miracles of the market can assert themselves. Both justify a program of dismantling the welfare state and reasserting the "freedom" of the market. Fundamental here is the shared premise that the market, left alone, will ensure a growing economy, a productive work organization, an optimal mix, and a "fair" distribution of income and tasks.

The question is, Will Thatcherism, as a theory of political economy, work independently of the defects of monetarist economic doctrines linking the government deficit, the money supply, and the price level? To answer this question we must examine the structural characteristics of markets as they exist in the United Kingdom today.

It is not clear why the British economy has performed so poorly in comparison with its competitors. Unspecified "structural characteristics" or "social attitudes" are often adduced as residual explanatory factors. It is clear that Thatcherism conceives the market as a form of organization that can resolve Britain's economic problems once inflation has been eliminated. Unfortunately, the market cannot simply be wheeled in to coordinate economic activities. It is no natural referent, but a *social* form, and as such is subject to strategic response, collective reconstitution, and normative legitimation. Thus, in the case of Britain, an ahistorical conceptualization of the "market" must be replaced by one that encompasses the relationships among four economic agencies: the two components of corporate enterprise—big industrial capital and finance capital—and labor and the state.

The 1968 industrial census revealed that the top 100 manufacturing companies—the first agency—produced nearly half of manufacturing output and fewer than seventy-five firms accounted for more than half of Britain's industrial assets—a much higher degree of concentration than that prevailing in the United States or Western Europe.[8] Such concentration might be presumed to facilitate organization among large firms and to constitute a powerful collective presence for industrial capital within the state. The virtual powerlessness of British industrial capital to counter the foreign exchange rate consequences of North Sea Oil and government high interest rate policies belies such an inference. Between the fourth quarters of 1976 and 1980 the sterling exchange rate increased by 50 percent, which is equivalent to a tax of 50 percent on exporters of British-made products. Self-sufficiency in energy too has turned into a burden for British industrial capital, for her Japanese, German, French, and American competitors have benefited from their respective states' efforts to finance oil imports with manufactured goods exports. The overvalued pound has been pushed up still further by short-term speculative capital inflows attracted by Thatcher's high interest rate policies. The costs to British manufacturing have been devastating. For example, from December 1979 to December 1980, manufacturing output skidded down by 15 percent and Britain's share in world trade continued its long post–World War II decline. The process by which the "market" is to restore British manufacturing growth and improve market shares lost to her competitors is not clear. What is clear is that government nonintervention in the foreign market or active government intervention to push up the sterling interest rate has greatly reduced the competitive strength of British manufacturing exporters.

Ironically, these developments are a consequence of the historic strength and independence of British industrial capital and particularly of its international character. British overseas production as a percentage of domestic output amounts to a full 40 percent, which is 2.5 times the comparative U.S. figure, 5 times that of Germany, and 8 times that of Japan.[9] Comparative insularity led

8 Stuart Holland, "Planning Disagreements," in *Beyond Capitalist Planning*, ed. Stuart Holland (Oxford: Blackwell, 1978), p. 140. The 30 largest firms, those with over 40,000 employees, produced 35 percent of all UK manufacturing output in 1972. No other European country had more than 12 firms of this size operating within its national boundaries; and in only one case, the Netherlands, did the firms' share of manufacturing output exceed 20 percent. See the London Group of the Conference of Socialist Economists, *The Alternative Economic Strategy* (London: CSE Books and the Labour Coordinating Committee, 1980), p. 27.

9 *Multinational Corporations and World Development*, UNDESA, cited in London Group, *Alternative Economic Strategy*, p. 28.

German, French, and Japanese capitals to coordinate their actions by developing ties with their national banking systems and their national states. In comparison the extensive British Empire gave British capital a foreign portfolio investment option. As a consequence, the character of British capital has historically been financial rather than industrial. Thus the City (the embodiment of British finance capital) has been more influential in state policies than its counterparts elsewhere, as reflected in the preoccupation of British governments with a "sound" currency and in their historic efforts to impose an overvalued pound.[10] In the past as today, British industry has paid the price by a combination of lost foreign markets and competition from cheap imports.

Large-scale British capital emerges as considerably less organized to control its profitability and destiny than its counterparts in Germany, Japan, and France. It would be unimaginable for big industrial capital in these countries to sit by, disorganized, as their share in the "market" was destroyed. Only in the United Kingdom are capitalists so uncoordinated and disconnected from the state that an abundance of oil would metamorphose into a comparative disadvantage for industry.[11]

The relative anarchy among British industrial capitals has also promoted a split between individual and collective corporation rationality in the area of product selection and development. Specific needs can not only be created and developed but also catered to in a variety of ways. Successful corporate strategy involves coordinated decisions about the form in which products are made available in the "market." If, for example, a few firms can gain a shared monopoly position in all forms of ground transporation, as with General Motors, and associated enterprises in the United States, they can maximize profits by eliminating the market for less profitable product forms such as electric trolley or interurban

10 The most famous policy decision to sacrifice the interests of industry to those of finance capital was Winston Churchill's decision in 1925 to return to gold at prewar parity: see Susan Howson, *Domestic Monetary Management in Britain, 1919–38* (Cambridge, Engl.: Cambridge University Press, 1975). For a more general discussion of the relationship between financial and industrial capital see Frank Longstreth, "The City, Industry and the State," in *State and Economy in Contemporary Capitalism*, ed. Colin Crouch (London: Croom Helm, 1979).

11 William Lazonick examines some of the reasons for the lack of coordination among British capitalists in the cotton textile industry and refers to studies of the steel, coal-mining, and shipbuilding industries that make similar points. See Lazonick, "Industrial Organization and Technological Change: The Decline of the British Cotton Industry," mimeographed (Cambridge, Mass.: Harvard University, 1980). The work of Alfred Chandler on the failure of British corporate enterprise to move from entrepreneurial and family enterprise to managerial enterprise for more than fifty years after American firms had made the transition provides the foundation for all such studies. See Alfred D. Chandler, Jr., and Herman Daems, eds., *Managerial Hierarchies: Comparative Perspectives on the Rise of the Modern Industrial Enterprises* (Cambridge, Mass.: Harvard University Press, 1980).

railroads.[12] In the United Kingdom the creation of a nuclear energy market and obstruction of efforts to develop markets for new coal technologies or renewable energy resources may be profitable for Babcock and Willcox, but by unnecessarily escalating the social costs of energy it engenders higher wage demands and lower profits to corporations taken collectively. After the resources are allocated, they become embedded in a larger matrix of interdependent decisions. Once the car is the predominant mode of transport, then housing, occupational, market, and other decisions are oriented around its availability. But only the automobile and oil companies benefit from the fact that restructuring a transportation system, once in place, is a very costly proposition to the society. Both collective capital and consumers can become captive to the investment policies of private corporate decision makers.

In other countries, capitalists have collectively countered the tendency to product irrationality and higher living costs by coordinating investment planning for specific products through the state. In such cases the state can act as a watchdog for the interests of collective capital by subsidizing privately irrational but collectively rational product forms. For example, bus and rail fares to the Parisian are one-fourth to one-third their cost to the Londoner.[13] From here it is a small step to active state participation in selecting and subsidizing potential product "winners" on an international scale, as is done in France, Japan, and Germany. Here as elsewhere the failure of British industrial capitalists to coordinate their actions has led to a condition of collective weakness. The antisocialist rhetoric of Conservative governments bodes poorly for investment coordination and planning, but in turn Labour government intervention is opposed for fear that potential public accountability in some product decisions would threaten the immunity of the corporations from public accountability in other areas. Today the stakes are high for British capitalists. They are caught between Scylla and Charybdis: either stick with Thatcher and risk bankruptcy or organize with labor and risk nationalization under a Labour government.

Another problematic result of historic independence is underdeveloped ties with the second agency, the banking system. British finance capital did not evolve into holding companies for industrial empires as in the United States but instead provided outlets for portfolio investment abroad. The City's fortunes as finan-

12 The General Motors investment strategy to eliminate alternative, less profitable product forms is described in Bradford Snell, *American Ground Transport: A Proposal for Restructuring the Automobile, Truck, Bus and Rail Industries* (Washington, D.C.: U.S. Government Printing Office, 1974). For elaboration of this and other examples of product irrationality in the American context see Michael Best and William Connolly, *The Politicized Economy*, 2nd ed. (Lexington, Mass.: D. C. Heath, 1981), ch. 4 and 5.

13 Anotole Kaletsky, "Why Fares Are So High on London Transport," *London Financial Times*, June 23, 1980.

cial entrepôt of the world were suddenly and dramatically refurbished by the emergence of a $1 trillion Eurocurrency market and petrocurrency recycling. United Kingdom banking is less restricted than its competitors in the industrialized world. Whereas in Germany and France large portions of the banking system are nationalized and all are heavily regulated, in the United Kingdom bankers' freedom to maximize profits is unrestricted and largely unquestioned.

But finance capital is not invulnerable. In the last analysis it requires a healthy industrial base. Expansion of credit is limited by the expansion of output, and financial markets are built on belief and trust. The fear that a major bank may be insolvent can create a self-fulfilling prophecy as depositors rush to withdraw their funds. The stability of financial markets is vulnerable to mere rumors of loan defaults by overcommitted corporations or Third World governments, or to failed speculative gambles in currency, real estate, or commodities. Once underway, the fear of financial ruin is contagious. For this reason the state must act as lender of last resort and defend financial institutions when in need.

The third agency, the labor "market," is no less susceptible to strategic reconstitution than are commodity or financial markets. The comparative failure of British capital to attack labor organization decisively both directly within the plant and indirectly via the power of the state, as in the United States, or to develop corporate welfare programs, as in Japan, led to the political organization of labor on a greater scale than elsewhere. The relatively conciliatory approach of British capital to organized worker resistance goes back to the passage of a series of acts in the 1860s and 1870s that secured the legal status of unions and the rights to strike and picket without imprisonment. The craft system of labor organization and the decentralized nature of collective bargaining continue to predominate today in the United Kingdom, where restrictive practices do inhibit the domain of managerial prerogative over workplace organization in ways hardly imagined by trade-union counterparts elsewhere.[14]. But this strength is, in part, a consequence of the great weakness of the trade union movement: a lack of influence over investment strategy.

Capital reigns more supreme in the United Kingdom than in France or Germany, where international options, regulated banks, and state regional and industrial policies circumscribe the investment strategies of big capital. The limited leverage labor has over investment derives from its defense of existing jobs. Labor has little say in the location, amount, or form of investment. In autos, steel, mining, and shipbuilding this defensive policy, while successful in the short run,

14 A recent comparison of labor organization in a number of industrialized countries concluded that the greater shop-floor bargaining strength of U.K. unions has constrained productivity growth. See Andrew Kilpatrick and Tony Lawson, "On the Nature of Industrial Decline in the U.K.," *Cambridge Journal of Economics*, vol. 4 (March 1980), p. 90.

ultimately causes rigidity in the organization of work and limits the competitiveness of British capital.

An alternative investment model is provided by Lucas Aerospace, where workers have achieved some success in pressing for the development of socially useful products. Threatened with unemployment and weary of producing weapons of mass destruction, shop stewards have worked directly with consumer groups to generate proposals for energy conservation equipment, wind and wave energy systems, new kinds of rail vehicles and canal revitalization. This evolving social form combines the idealized market advantages of direct links between consumers and producers with planning mechanisms that democratically coordinate choices and set priorities. But governmental intervention remains a prerequisite for the development of such arrangements.

In addition to increasing unionization, inflation affects the labor "market" in another way that is obscured by monetarist theory. Thatcherite efforts to "squeeze" inflation out of the labor market by increasing unemployment have not been successful to date, primarily because wage demands are restricted by more than the pressure of unemployed workers. Social custom and moral standards have acted as invisible sanctions justifying and thereby reinforcing income differentials in the past. Different rates of wage inflation have upset historical income differentials associated with a hierarchy of positions in the social division of labor, and hence politicized the struggle over income distribution that threatens further to disrupt economic production. Thatcher's success requires the market to be perceived as a social form that distributes incomes justly. If it is not so perceived, the level of unemployment required to bludgeon workers into acceptance of reduced wage demands in a democratic polity may be very high indeed.

The fourth collective agency is the state. Thatcherism is a political philosophy that attributes any and all failures of economic performance to the power of government to tax, spend, print, and borrow money. Therefore, the path to rejuvenating the British economy is one of reducing government intervention and increasing the role of the market. Thatcherism obscures the role that the welfare state has played as a scapegoat for the dislocations rooted in the lack of democratic accountability that characterizes the market as a social form. These dislocations create pressures for government intervention, but the corporate control of investment limits the options available to the government in response. As a result, Thatcherism fails on its own terms. Thatcher's efforts to rely upon the market have only exacerbated the economic crisis in a number of ways. Some examples:

• The Thatcher government has let the foreign exchange market go. It has subjected manufacturing to a severe squeeze, reduced output, and induced deindustrialization. Given the pervasive and growing degree of import penetration, when—and if—economic growth resumes, imports will grow very rapidly. The consequent depreciation of sterling will likely generate a new round of inflation, due to the rundown state of British industry.

• The Thatcher government has repudiated controls on banking, thereby forsaking the one instrument vital to state control in monetarist theory, the money supply. Private banks have resisted government monetary policy when it has run counter to their profitabilty. Thus the money supply is not determined by the state but the market. In 1980 money supply growth of over 20 percent was more than double the government's target, as banks capitalized on the high interest rates and distress-borrowing of troubled firms. To regain control of the money supply, the Thatcher government would have to redesign and strengthen public controls on the banking system.

• As the Thatcher government has attempted to deflate the economy to reduce the PSBR, it has indirectly increased claims on public money in three ways. First, every person thrown out of work has, according to Treasury estimates, increased total unemployment compensation by £3,500. Falling income has also reduced government tax revenues. Second, every increase in the interest rate to curb inflation has increased the costs of financing public debt. Third, by pressing firms to the wall, the government has had to bail out both public corporations, including British Leyland and British Steel, and private-sector firms such as the major computer company, ICL. As a result, the government's spending in 1980 surpassed the previous year by 22 percent. The borrowing target of £8.5 billion for 1980–81 was surpassed in six months and may exceed £13 billion for the year. This dynamic lies behind the tax increases of the 1981 budget.

• The Thatcher government has run down the public sector. Increasingly, people are forced to substitute private purchased commodities for previously public goods, a process that raises the cost of living. Net domestic fixed capital formation by public-sector corporations fell from £943 million in 1976 to £166 million (at current prices) in 1979. In 1980 nearly one million people joined private health insurance plans, a half million opted out of state-financed schools, and this year 100,000 council houses (a British form of public housing) are scheduled for sale. Running down the public sector will do irreparable long-term damage, as U.S. cities have found as they now attempt to reconstruct electrified public transportation systems sold off fifty years ago. But in the short run, as more needs previously met by public provision are displaced into the market, they are transmitted into increased wage demands, higher costs, and lower profits to capital as a whole. The relief promised by offsetting reductions in local government taxes has not occurred. In fact, local government tax rates are being increased 20 percent on the average in 1981.

• As the Thatcher government has used the blunt instruments of monetarism to deflate the economy, it has heightened the sense of random economic violence striking innocent people. Besides the massive unemployment and deterioration in public services, the desperate search to reduce wage costs has increased sweatshop and putting-out systems of work organization. These conditions risk eroding the legitimacy of the market system and, in turn, the allegiance of people to the prevailing economic and political institutions, precisely at a time when Thatcher is appealing to people's national loyalty and sense of public interest to enhance worker productivity, limit wage demands, and curb claims on the public budget. What monetarism does not account for are the social norms such as public spirit, cooperation, and ethics that guide and restrain human conduct and thereby affect the efficiency of the "market," a point well understood by earlier economists. Adam Smith, for example, wrote:

> People could safely be trusted to pursue their own self-interest without due harm to the community not only because of the restrictions imposed by law, but also because they were subject to built in restraint derived from morals, religion, custom and education. [15]

The monetarists are not so sophisticated. Nor do they account for the fact that these social norms are themselves subject to erosion by the evolution of the market and government policies.[16] Ironically, this tendency of monetarism to gnaw away at self-sanctions anchored in social norms and legitimate institutions creates pressure for coercive monitoring by state bureaucrats. Hence the ugly political side of monetarism's market "freedom."

In short, the market has failed its monetarist adherents. Celebrated as the solution to the ills of the welfare state, it has backfired. It is not, of course, perceived in this way. Instead Thatcher blames the "wets" and the immorality of MP's who vote for expenditures and then resist paying the bills. The growing number of critics blames Thatcher. Friedman opines that it has not been a true monetarist experiment, because it was not sufficiently deflationary to drive down government spending. Lurking at or below the surface is the implication that if it were not for democratic pressures, the market would work.

15 Cited in Fred Hirsch, *The Social Limits to Growth* (London: Routledge & Kegan Paul, 1976), p. 137.

16 Kenneth Arrow examines the links between social norms and the efficiency of the market in *The Limits of Organization* (New York: Norton, 1974), pp. 26 and 36–37. The implications of the market's tendency to erode social norms for state policies are explored in William Connolly and Michael Best, "The Decline of Economic Virtue," *democracy,* vol. 1, no. 1 (January 1981), pp. 104–15.

Thatcher's strategy for dismantling the welfare state involves increasing unemployment, bankrupting business, deindustrializing the country, privatizing public services—and blaming democracy for resistance to these policies. A truly alternative strategy would start with the proposition that curbing inflation without massive unemployment requires an incomes policy that limits the price- and wage-setting powers of corporations and unions. But an incomes policy has two prerequisites: first, a publicly accountable investment strategy oriented to reducing the costs of living so that workers are not squeezed by rising expenses, and, second, democratic processes that replenish institutional legitimacy and commitment to the common good. Wage and price controls administered by a state bureaucracy over a citizenry lacking civic virtue will be a nightmare. No army of government bureaucrats could enforce public policies on a populace guided by individual economic self-interest alone. The problem is that monetarism will continue to fill the vacuum created by the contradictions of liberalism until a democratic socialism is developed that can mobilize popular support around such a real alternative strategy.