The economy 1

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POST-WAR OVERVIEW

The end of Empire

At the end of World War II it became clear that the best days of the British empire were over. For a number of reasons, policy makers had to face up to the fact that British economic prosperity could no longer rely upon the advantages of controlling a wide range of colonies.

The lesson of two world wars for Britain was that the maintenance of a far-flung empire was no longer feasible in both economic and military terms. The onset of the Cold War in the late 1940s polarised the world into two great power blocs and Britain could certainly not stand alone in this new world order. She had to shelter under the nuclear umbrella provided by the United States. Defending an empire in the face of Soviet and, later, Chinese power, was not going to be possible. At the same time a Labour government had been elected in 1945. On the whole the party was ideologically opposed to imperialism. Although the pragmatic elements in the Labour party recognised the economic benefits of clinging on to the colonies, the political will to remain as a great imperial power was weakening.

India was granted independence in 1947. There was a moratorium on the independence movement for ten years or so (corresponding to the return of the Conservatives to power), but the dismantling of the empire resumed at the end of the 1950s. The disaster of Britain’s failed attempt to maintain its dominance of the Middle East in the 1956 Suez crisis and the advent of Harold Macmillan as a realistic, pragmatic prime minister in 1957 provided a spur to this process. During the late 1950s, 1960s and early 1970s most of the empire in Africa, South-East Asia and the Caribbean was granted independence.

Put simply, the empire had underpinned British prosperity for over a hundred years by providing both a source of cheap raw materials and ready markets for her own manufactured goods. Although preferential trade agreements were made with the former colonies to protect Britain's privileged economic position, things would never be the same again. When Britain joined the European Community at the beginning of 1973, it had to give up these special trade agreements, and so the benefits of empire were finally lost.

What this meant for the British economy was essentially twofold. First, the country would now have to pay the full price for its raw materials in world markets (except for the temporary trade agreements referred to above). Secondly, Britain would have to compete on even ground with all the other industrial powers for markets for its manufactured goods. There was an economic dividend arising from the loss of empire in that defence expenditure could be cut back drastically, but the net effect on Britain was detrimental. The problem was exacerbated by the post-war recovery of the western European economies and the 'economic miracle' which Japan was enjoying.

The management of economic decline

As a result partly of its imperial status, and partly the sophisticated industrial infrastructure built up over two hundred years, Britain retained its position as a leading economic power into the 1950s. Thereafter, however, the story has been one of relative economic decline, when British performance is measured against its main competitors.

This is not to say that this was the fault of successive British governments. To some extent the relative decline can be seen as inevitable. What it has meant, however, is that governments have had to deal with this reality and to try to reduce the effects of the process. The repercussions of decline were considerable. Among them were the problem of maintaining public services, maintaining capital investment when the profitability of British industry was declining, the difficulty of staying competitive in a world where competition was intensifying and, perhaps most seriously, of dealing with poverty which inevitably resulted from the decline of traditional industries in several specific regions.

From the 1950s until the 1990s economic management in Britain can be viewed very much in this vein. For two generations the country was forced to adjust to its new, lower, economic status. Governments could not realistically hope to reverse British fortunes. All they could do was to ameliorate the effects of relative decline. So, for example, the Labour governments of Harold Wilson in 1964–70 attempted to modernise British industry, but this largely failed in the face of a number of economic crises. The development of the Concorde aircraft at that time was a typical example. British science and engineering was capable of producing the world's first supersonic airliner, but it never reached full-scale commercial production. The same happened to an infant computer industry which was easily overcome by American and Japanese competition.

Membership of the European Community (later European Union) provided one possible long term answer to this process. However, it was not until the 1990s that the benefits of European integration began to show real progress.

European integration

When Britain became a member of the European Community in January 1973, there were genuine fears that the inherent weaknesses which by then existed in the economy would bring special problems. Faced by membership of a free market, with more intense competition for overseas customers, it was felt by many that Britain would suffer. Among the problems of the economy were lack of capital investment, low levels of labour productivity, unsettled industrial relations and poor management. Britain seemed to lag behind its European partners in all these areas. Worse still, the British market was now thrown wide open to European exporters.

The new economic structure

While Britain was moving from being a world imperial power to a European player, the nature of its economy was also changing. The old, traditional industries steadily declined and were replaced by new, service-based or 'tertiary' activities. The manufacturing infrastructure, which had been the basis of British prosperity, began to disappear. Staple industries such as textiles, iron and steel, shipbuilding and coal mining all suffered gradual decline. In increasingly free global markets, British heavy industry could not compete with the rest of Europe, Japan, parts of the Third World and the new 'Asian tiger' economies such as Korea, Taiwan and Malaysia. The diminishing importance of these industries can be seen in table 1.1.

Table 1.1 Decline in manufacturing industry in the UK

Year	*% of male workforce*	*% of female workforce*
1981	32	17
1991	25	12
2001	22	8

Source: Office for National Statistics.

The most serious effects of this process were experienced in the 1970s and 1980s. The economy failed to adjust to the new realities and economic decline worsened. Towards the end of the 1980s, however, progress began to be made. Partly as a result of the reforms of the Thatcher era, which are described below, and partly fuelled by the strength of the higher education system (a legacy of the growth of this sector in the 1960s), Britain was ready for the emergence of new industries. Such sectors as finance, leisure and entertainment, technology, computer software, communications and electronics were growing in Britain as quickly as anywhere else in the world. In these fields Britain could and did compete successfully with Far Eastern powers, the USA and Germany. This shift in the 'balance' of British industry is shown clearly in table 1.2.

Table 1.2 Table shows the percentage of the workforce employed in distribution, hotels, catering, finance and other services

Year	*Men*	*Women*
1981	45	73
1991	44	83
2001	59	86

Source: Office for National Statistics.

This is not to say that manufacturing disappeared completely. In the 1990s Britain became an attractive subject for inward investment. Foreign companies, particularly from the Far East, set up factories all over the country, producing cars, electrical equipment, telecommunications equipment and computer technology. The decline of trade union power, resulting in more settled industrial relations, relatively low wage levels and large government grants and subsidies helped to attract such multinational corporations as Toyota, Nissan, Honda, General Motors, Siemens and Motorola to Britain.

The net result, by the 1990s, was that the British economy had drastically changed its structure. There was still a large manufacturing sector, but it was now largely foreign owned. The service and technology sectors, on the other hand, were growing fast and were largely home grown.

Globalisation

The governments of the 1990s were forced to face up to a new challenge beyond that of European integration. This was the reality that all markets – in products, commodities, labour and finance – were becoming increasingly global.

The effects of globalisation are yet to be fully revealed, but some certainties have already emerged. In order to survive in world markets it has become clear that Britain will have to develop a number of economic qualities. Among them are a well educated, trained and flexible workforce, management which is geared to world-wide competition, a willingness to respond to intense competition, higher levels of capital investment, leadership in the field of information technology and full involvement with international institutions such as the European Union, World Trade Organisation, World Bank, International Monetary Fund, G7 and the Organisation for Economic Co-operation and Development (OECD).

The management of economic success

As we have seen above, much of the story of post-war economic policy making has been concerned with relative decline. During the 1990s, however, when Britain emerged from the world recession in better shape than Japan, the Far East and her European partners, a new set of circumstances became apparent.

Many of the inherent and seemingly incurable problems of the British economy began to respond to treatment. As we have already seen, industrial relations had improved during the 1980s. In addition, labour productivity began to rise and Britain became known for low, rather than excessively high, wage costs. The new ‘tertiary’, service and technology industries were finding a leading place in world markets. Above all, however, the recurring problem of inflation receded in the second half of the 1990s. The record of British economic management had reached an all time low in 1992 when the country was unceremoniously dumped out of the European Exchange Rate Mechanism – the ERM – (of which more below). This event, known as ‘Black Wednesday’, was the culmination of several years of indecisive attempts to adjust to the new European and global realities. Since 1992, more responsible governments under John Major and Tony Blair have understood that it was necessary to conquer the British economy’s natural tendency to rapid inflation in order to compete successfully.

From the mid-1990s onwards, therefore, Britain has enjoyed a number of years of almost unprecedented low inflation, low interest rates and low unemployment. Economic growth was consistently healthy and there were rises in investment in public services. Relative prosperity was, however, to present as many problems for government as economic decline.

The principal dilemma faced by politicians in this period has been how to distribute the new-found wealth. Those in the centre and to the left of the political spectrum wished to see rises in expenditure of public services such as education, social security, housing, public transport and health. They have also demanded reductions in tax levels for the poorer sections of the community. In this way the inequalities in standards of living may be reduced. On the right of politics, however, economic growth is seen as an opportunity to reduce taxation for all. This, they suggest, will increase incentives, reward initiative and so safeguard future growth. This political tendency is not concerned with inequalities in wealth within the population. For them higher disposable incomes can take the pressure off state-run public services and the private sector can expand to compensate.

Not surprisingly, politicians in all the main parties have tended to gravitate towards the centre of this conflict, suggesting that both of these objectives can be achieved at the same time as long as some compromises are accepted. This new ‘consensus’ will be the subject of further discussion below.

THE KEYNESIAN CONSENSUS

The economic beliefs of Keynes and the Keynesians

The economist John Maynard Keynes (1883–1946) was a prominent British academic and political figure in the 1920s and 1930s. His economic beliefs, however, did not gain full acceptance in the political arena until after World War II. In fact, it is likely that his policies would have been implemented earlier had the war not intervened. Ironically, Keynes died before he could see the practical fruits of his work.

What became known as ‘Keynesian economics’ has many technical aspects beyond the scope of this book. There are, however, a number of principles which are relatively easy to understand. But before studying them we need to examine briefly what had gone before.

So-called ‘classical economics’ had flourished for about a century, from the 1830s to the 1930s. This tradition believed that the economy would inevitably suffer from ‘periodic cycles’, moving regularly from boom periods, when there was rapid economic growth, to periods of slow-down or slumps in which growth was slow or even ceased altogether. Governments, the classical economists argued, should not interfere with these natural processes. Indeed, excessive interference would be detrimental. Rather, the periods of slump would correct themselves. The process would be that, as there was little economic activity, wages and prices would stop rising and might actually fall. The falling prices would encourage consumers to buy more and companies to invest more in capital. The lower wages would mean that more labour would be employed. The effect of these changes would be to kick start the economy into renewed growth and the recessions would come to a natural end. The role of government was to do nothing except to ensure that the currency remained stable by controlling the amount of money in circulation.

These beliefs held up until the Great Depression of the 1930s. In that period the theory ceased to work. The economic recession would not end even though governments obeyed the golden rule that they should not attempt to interfere. Keynes' theories, however, provided an explanation for the new phenomenon.

He suggested that, in the modern economy, there is no reason why economic activity should pick up spontaneously as the classical economists suggested. In short, recessions like this one could recur and grow worse. Keynes offered a new set of policy options. Governments *should* intervene, he argued. They should take positive steps to boost the level of aggregate demand in the economy. Aggregate demand consists largely of consumer spending, government expenditure and capital investment by companies. By ensuring that consumers, companies and government all spent more money in the economy, the recession could be ended, as industry expanded to meet the higher level of demand. At the same time, by careful adjustments, many of the recessions could be avoided in the first place.

How could this be done? In direct opposition to classical economic beliefs, Keynes argued that, by lowering the level of taxation, and by increasing government spending, the overall level of aggregate demand would rise. Even if the policy led to government debt, it could still be justified by the positive economic results. Future generations would be able to pay off the debts out of the increased prosperity which his policies would bring. His ideas became known as **demand management**, underpinned by active **fiscal policy**. The classical economists were sceptical, but by the 1940s Keynes' policies had won the day.

The consensus in action

For the sake of neatness we can say that the keynesian consensus lasted from 1950 (when many of the immediate economic effects of the war had begun to recede) until about 1979, when Margaret Thatcher was first elected prime minister. So we are dealing with a period of about thirty years.

Economic policy making is a complex business, with many variables being manipulated by government. However, the great age of the consensus can be reduced to a few basic principles, as follows:

- The main way to try to manipulate economic activity was to control the level of demand.
- Demand was best controlled through levels of taxation (especially income tax) and government expenditure.
- When economic activity slowed down it was normal for government to reduce taxation levels and raise government expenditure (typically on social security and pensions or on building projects). This usually resulted in a growth in government debt, financed out of borrowing from banks or the general public in national savings schemes.

- When economic activity was growing fast and there was a danger of inflation arising or too many imports being attracted in, the opposite measures were used, i.e. higher taxation and reduced public spending.

Both the Conservative and Labour parties based economic policy making on these principles, with only minor variations.

Competition between the parties was not, therefore based on *principles*, but on how *effectively* they could manage the economy on keynesian lines. Elections were fought less on how best to run the economy than on other issues such as competence, foreign policy, industrial relations policy, the running of public services and which party was best for the business community. There was also some disagreement over how taxation was to be *distributed* among the population. Clearly Labour tended to favour higher levels of tax on high income groups, while the Conservatives opposed high taxes on business profits or on property. Labour also adopted, after 1965, a policy of direct legal controls over excessive rises in prices, wages and business profits. The Conservatives were less enthusiastic, but even they followed the Labour lead on this issue under Edward Heath in 1971–74.

So there was inter-party competition between the parties in this period. There was not a consensus on *all* issues. But the fundamental ideas of keynesian theory were shared by the al the main parties.

THE END OF CONSENSUS AND THE RETURN OF NEO-CLASSICAL ECONOMICS

The first cracks: Edward Heath

Faced by the prospect of a third successive defeat at the 1970 general election, the Conservative leadership took a decision to engage in a complete re-think of the basis of economic policy. In 1969, at the Selsdon Park Hotel in Surrey, this group produced a blueprint for radical change. Or, rather, they proposed a reversion to classical economic ideas as described above. With another crisis apparently looming, the Conservatives won the election and Edward Heath found himself in power with a commitment to the new policies.

He immediately announced that controls on price and wage rises were to be removed. There was to be no aid for failing industries and the government was to disengage itself from strict economic management. In other words there was a return to the pre-keynesian theories. The consensus seemed to be at an end.

By the end of 1971, however, the new policy was in tatters. Inflation was rising alarmingly, as was the level of imports. British industry began to suffer from the effects of rising wages and prices and several large companies were threatening to go out of business. When Rolls-Royce went bust, the writing was on the wall. Heath did what he said he would never do and stepped in to save Rolls-Royce with government money. He also imposed a six-month freeze on wage rises, to be replaced later by strict controls. His Chancellor, Anthony Barber, was forced to raise taxation in order to control aggregate spending and price inflation. The dramatic change of policy was known as Heath's 'U-turn' and the brief pause in the economic consensus was over. Keynesian policy was back.

Nevertheless, the experience left a deep impression on some Conservatives, not least two of its leading figures. One was Keith Joseph, one of the party's leading intellectuals. The other was the education minister, Margaret Thatcher. The seeds had been sown for what was to happen after 1979.

Margaret Thatcher and monetarism

It is normal for economic commentators to take 1979 as a watershed year in British history and this is certainly logical as it saw the election of perhaps the most radical prime minister of the twentieth century. Nevertheless that year did *not* mark a dramatic change in the nature of economic policy making. There were two main reasons for this.

Firstly, and perhaps most importantly, the country was entering a deep and enduring recession. Both inflation and unemployment were rising alarmingly (which defied keynesian logic) meaning that radical measures were not feasible. Secondly, Mrs Thatcher herself was far from politically secure in her first three years in office. A number of senior members of the Conservative party were firmly opposed to a departure from traditional policies. These were the so-called 'wets' and they included such key figures as Lord Carrington, Francis Pym and Peter Walker. However, her victory in the Falklands conflict in 1982 gave her the political confidence to remove her opponents from the cabinet.

So the real watershed came in 1982–83 as the economic climate began to improve and the prime minister was more able to dominate the political scene. By then, however, the seeds had been sown and it is important to identify those seeds. The main element was the theory of monetarism. This represented the basis for what was to come.

Monetarism has two main elements. The best known is the principle that the most effective way to control the economy is to ensure that the money supply (i.e. quantity) does not rise faster than the growth in economic activity. This practice of responsible financial management is designed to ensure high inflation is avoided and that industry can operate within a stable economic environment. At the same time monetarism, as a philosophy, implies that governments should not interfere with the rest of the economy. In this sense it is a *liberal* theory as it proposes minimum state activity.

So it was at the beginning of the Thatcher era that the government largely withdrew from active economic management. Unemployment rose unchecked, but it did have a positive aspect. Wage increases moderated as workers faced intense competition for scarce jobs. The influence of the trade unions also began to wane. The level of strikes fell (a normal situation in times of unemployment) and industrial activity started to pick up. In other words unemployment became a price worth paying for economic recovery, though the inhabitants of the dole queues would not agree!

But it was not until 1982–83 that the next phase of the Thatcher revolution was to begin. We may describe this period as the supply-side stage. Indeed supply-side economics has dominated policy making ever since.

Supply-side economics

Keynesian economics was characterised by the need for governments to control the level of aggregate demand, notably through the manipulation of levels of tax and public expenditure. Supply-side economics returns to the classical principle that such control is counter-productive and that there is a natural process whereby such problems as inflation, or high interest rates will correct themselves automatically. However, this process depends on the ability of the economy to adjust to these mechanisms. In particular the 'supply side' (i.e. production and distribution of goods and services) needs to be both flexible and dynamic.

Margaret Thatcher and her advisers were of the opinion that the long-term problem of the British economy was that the supply side was neither dynamic nor flexible. She therefore saw the role of her governments to correct these faults. The main objectives of policy were the following:

1. To make labour markets more flexible. That implied that wages could freely rise or fall according to market conditions, workers would be able to adapt quickly to new technologies and growing industries and there would be real incentives to work and improve output.
2. To create more incentives for entrepreneurs. By making it an attractive proposition to set up new businesses or to expand existing ones, it is assumed that the economy can expand quickly.
3. Free competition is seen as a means by which businesses will be forced to become efficient.
4. Regulation by the state should be minimised. Too much control over such factors as wages, prices, profits and production systems is believed to stifle business expansion. The most dramatic form of regulation occurs in nationalised industries, so they became a major target of reform.

Most economic policy from the 1980s onwards was, therefore, directed at achieving these ends. As we have seen above, most of the practical measures could not be implemented until after the 1983 general election when the Conservative party was returned to office with a huge parliamentary majority.

TAXATION

One decision had already been made four years before the 1983 landslide. This was the reduction in the level of income tax, effected in 1979. The basic rate fell from 33 per cent to 30 per cent and the higher rates of tax from 83 per cent to 60 per cent. By 1988 there were only two rates of income tax: 25 per cent and 40 per cent. These were almost the lowest rates in western Europe. The reductions in tax revenue which resulted were replaced by an increase in VAT from 8 per cent to 15 per cent and later by increasing revenue from North Sea oil and the privatisation programme.

The purpose of this change was to create greater incentives by allowing entrepreneurs and their employees to retain a much higher proportion of their incomes. The idea that business activity is crucial to wealth creation and must be encouraged through generously low rates of tax on incomes and profits has remained central to economic policy making by both Conservative and Labour administrations. Indeed, as we shall see, Labour governments after 1997 have continued the process of reducing the basic rate of income and corporation tax for just this reason.

There was also a general reduction in other forms of direct taxes such as inheritance and capital gains tax. But Conservative governments after 1979 failed to achieve their greatest ambition which was to seriously reduce the *overall* level of taxes. Indirect taxes, such as duties on petrol, alcohol and tobacco continued to rise as taxes on income were falling.

Tax incentives were only the first element in the change in policy direction. More radical measures were soon to follow. The key developments were as follows.

PRIVATISATION

The process of transferring industries from public ownership and state control to private ownership (i.e. from nationalised industries into public limited companies owned by shareholders) was seen in the 1980s to incorporate four main advantages.

Firstly, it was expected that they would become far more dynamic as their managers pursued higher profits to satisfy the shareholders and to further their own careers. These incentives had been lacking when the industries had been state run. Secondly, it presented an opportunity for a wider range of the population to own shares, including the workers in the privatised industries themselves, and so give them a vested interest in their economic success. Thirdly, the sale of these industries would bring in much needed revenue to the government who could use it either to pay off some accumulated national debt or to finance higher public spending without having to raise taxes. By 1990 the sales of publicly owned assets had yielded nearly £20 billion.

Above all, however, this *disengagement* of the state was very much at the heart of what has become known as 'Thatcherism'. Classical economics assumed that state interference was nearly always negative and Margaret Thatcher always considered herself to be a modern heir to the that classical tradition. So her ideas can be described as 'neo-classical economics'.

The most celebrated privatisation was also the first – that of British Telecom in 1984. It was greeted with loud opposition from the Labour party, but the public's imagination was caught by the prospect of owning shares in this huge, growing industry, and by the promise of cheaper phone calls as fresh investment was to pour into the new private enterprise. When the new shares began to be traded freely on the stock exchange and their price rose sharply, the public were hooked and ready for more. The high point of national excitement was reached when the gas supply industry was put up for sale. A massive advertising campaign was launched to encourage the public to take up the share issue and once again there was a successful flotation with thousands of new shareholders being created and quick profits realised on the rising share price. 'Privatisation fever' was beginning to set in and the government was riding the crest of this wave of enthusiasm. More was to follow. Electricity generation and supply, water, coal, steel, British Airways, British Petroleum and Rolls-Royce Engines were among the principal examples. Under John Major possibly the most significant – and most controversial – of all the privatisations took place when the railways were sold off in 1996.

As we shall see below, privatisation was not only a policy of the 1980s. It is a process which continued into the twenty-first century. The Labour party was converted to privatisation by the time it came to office in 1997, thus abandoning one of its most cherished principles – the public, democratic control of the commanding heights of the economy.

COMPETITION AND LIBERALISATION

The nationalised industries, apart from being state controlled, were also mostly monopolies. Serious competition was forbidden by law in such industries as coal, steel, electricity, telephones, gas and water supply. After privatisation, therefore, there remained the problem of how to ensure that the industries remained competitive when they did not have to contend with normal market forces. Two kinds of response were introduced.

The first was simply to introduce competition: to allow other private firms to compete. This is what occurred with British Airways, municipal public transport, and steel and coal. In other industries, however, competition was not feasible at first. These are the ‘natural monopolies’ where there would be major disruption if more than one firm were operating in the same market. Utility industries such as telephones, gas, water and electricity are clear examples. They required a second type of solution. This was to introduce regulatory bodies which would force them to operate as if they were in a competitive market. This spawned a whole raft of new quangos such as OFTEL (office of telecommunications), OFWAT (Water), and OFGAS (gas supply) which would protect consumers from monopoly power. In due course, genuine competition was introduced in these utilities, but in the 1980s they suffered much criticism for their monopoly status, despite the growth of regulatory bodies.

In the existing private sector steps were also taken to create competition. Most importantly, financial services were de-regulated in 1986, allowing greater competition in the stock market and among banks and building societies. This had several effects. Firstly, it reduced banking costs generally. Secondly it made finance more easily available for consumers, house purchasers and business in general. Thirdly, it reinforced London’s position as the leading financial centre in Europe. The professions were also forced to engage in real competition so that dentists, opticians and even lawyers were allowed to advertise themselves and adjust their charges to attract more business. In general, too, the laws on competition were stiffened and the Office of Fair Trading was given wide powers to ensure that consumers were given a fair deal.

There were also partial privatisations in the 1980s which were usually described as *liberalisation*. The main example was the introduction of *compulsory competitive tendering* (CCT). The scheme forced many state run services to compete with private companies to retain their contracts. This mainly applied to local government activities such as refuse collection, building maintenance, parks and gardens care and road repairs. CCT was also applied to some central government departments with parts of the health and prison service. Indeed some prisons have since been privatised altogether.

The effects of CCT were twofold. It promoted efficiency and competitiveness, but also had the effect of reducing wage levels in many sectors of the economy. Private companies, when bidding for contracts from the state, tended to offer lower wages than the state, so that high paid workers were often replaced by people on lower pay levels. During the 1980s and 1990s increasing numbers of services were subjected to CCT until the incoming Labour party abandoned the scheme after 1997.

LABOUR MARKETS

Supply side economics demands that wage levels are free to rise and fall according to employment conditions. When there is high unemployment, wages (at least in real terms) should fall and vice versa. The same applies to regional variations in economic activity. Wages should be significantly lower in depressed regions than in successful ones so that employers should be attracted to invest where they can reduce their labour costs.

In the 1980s Conservative governments under Margaret Thatcher saw high wage costs as perhaps the most difficult problem to overcome. Their perception of the problem was that organised labour, mainly in the form of trade unions, was simply too powerful. They therefore aimed to alter the balance of economic power between employers and employees.

The first solution was very much of Mrs Thatcher's own creation. She made it clear to workers' leaders that she believed that excessive wage demands simply led to unemployment. This was particularly true in economically depressed areas such as the north east, Merseyside and the Clyde valley in Scotland. Unlike previous governments, however, she asserted that her government would not take measures to combat unemployment. This was to be the price which workers would have to pay for demanding high wages – they would run the danger of losing their jobs. By 1986 unemployment had reached 3.4 million, the highest level since the 1930s. The medicine was severe, but she believed it would cure the disease of high wage costs. Certainly, in the mid-1980s the number of strikes began to fall and wage demands were moderating.

Secondly her government abolished most of the wages councils after 1986. These councils, made up of union and employers' representatives, operated in a variety of industries. One of their tasks was to set minimum wage levels in the industry. The effect was to protect the interests of the workers, but also to prevent wages falling below a certain level when there was a labour surplus. This led to persistent unemployment in some sectors and regions. By getting rid of them, the government struck a blow for more flexible labour markets.

Thirdly, levels of social security benefits, notably for the unemployed were steadily reduced in real terms. Over-generous social security was seen as a disincentive for people to seek work. In other words they meant that workers were unwilling to work for low wages as they would be better off relying on social security. This method of using a ‘stick’ to beat people into work was certainly effective. However, as we shall see below, it was to become one of the main issues of contention between the Conservative and Labour parties in the 1990s.

But these three policies did not compete with Margaret Thatcher’s principal assault on organised labour. It was her struggle against the unions which was to set the tone for both economic and industrial relations policy for twenty years.

Margaret Thatcher and the unions

There can be little doubt that the outcome of the conflict which occurred between the trade unions and the governments of the 1980s dramatically altered the economic and social landscape of the country. It was also to set the scene for the transformation which was to take place in the Labour party after 1987. There were two strands to Thatcher’s attack on the unions. One was a generalised confrontation with their leadership and the other was a programme of legislation designed to curb their power.

Confrontations

Mrs Thatcher was fond of lecturing union leaders and the workers whom they represented about the realities of supply-side economics which are described above. She also looked for opportunities to set the forces of the state against those of organised labour. Many conflicts occurred, but two are worthy of note as perfect illustrations of how and why she was so determined to win victory in what she saw as the frontline of economic reform.

The first concerned a series of disputes which broke out in the printing industry. Two newspaper owners – Eddie Shah and Rupert Murdoch – wished to break the power of the unions in their industry. Unions held a stranglehold in the printing industry, enforcing closed shops whereby only union members were allowed to work, and preventing the introduction of labour-saving technology. In both cases Thatcher made it clear that she backed the employers and was prepared to introduce legislation to reduce union power. Ultimately, and partly as a result of political backing, Murdoch and Shah prevailed. The printing conflict demonstrated two of the problems of union power as perceived by the supply side theorists. One was that powerful trade unions tend to lead to over-manning as, not unnaturally, they wish to see as much employment for their members as possible. The other was resistance to technological progress. Unions can be conservative bodies, suspicious of changes in working practices and unwilling to welcome more efficient equipment if it leads to job losses. So the printing employers' victory led to rapid advances in technology as well as – as the unions had feared – severe redundancies in the industry.

The second battle was more dramatic. This was the great miners' strike of 1984–85. A programme of pit closures had been instigated and, as expected, the miners' union chose a national strike as their way of expressing opposition. Led by the marxist Arthur Scargill, the miners, all members of the National Union of Mineworkers, blockaded the pits, preventing non-unionised labour from replacing them. The police were mobilised to keep the pits open and the courts were in almost continuous session prosecuting miners who were accused of breaking laws restricting picketing and mass demonstrations. Throughout the winter, police, encouraged by the strong backing of the prime minister, battled with enraged miners and their leaders. Public opinion polarised on the issue. It became a symbol of a wider conflict between the free market policies of the government and the fear that the interests of the workers was being sacrificed for the sake of economic dogma.

It is part of Conservative party folklore today that Mrs Thatcher won a resounding victory. The miners were forced back to work and the pit closure programme continued. This, together with her stand against the Argentine invasion of the Falkland Islands two years earlier, earned her the title 'Iron Lady'.

LEGISLATION

The legal reforms which were effected during the 1980s, and into the 1990s under John Major, completely altered the balance of power in the industrial relations field. They also changed the nature of trade unionism for ever. Before considering the consequences, the legislation should be reviewed:

- *1980 Employment Act.* Forced unions to hold secret, democratic ballots in order to take industrial action (mainly strikes). It also introduced secret ballots for union leadership elections. Before this Act union leaders were able to force even reluctant members to take industrial action and leaders were not democratically elected.
- *1982 Employment Act.* This made it more difficult for unions to enforce closed shops, i.e. they could no longer force workers to join unions in order to be given employment.
- *1984 Trade Union Act.* The main piece of legislation. Before this Act unions could not be sued for compensation if industrial action led to losses by affected businesses. The legal immunity of unions has always been one of

their most cherished privileges. The loss of this immunity was the most serious blow to their power. After the Act it was possible for firms to sue unions if a strike or other industrial action was called without a democratic, secret ballot. The Act also enabled union members to opt out of allowing some of their union dues to be paid to the Labour party, thus weakening Labour party–Union links.

- *1986 Wages Act.* Reduced the ability of Wages Councils to set minimum wages in some industries.
- *1988 Employment Act.* Union members refusing to take industrial action could no longer be disciplined. Closed shops were further undermined and most of them disappeared. Union funds could effectively no longer be used for political purposes.
- *1990 Employment Act.* Further losses of legal immunities for unions. It also made it virtually impossible for unions to take industrial action for political reasons: i.e. industrial action was legal only if it was directly concerned with the wages and conditions of members.
- *1993 Trade Union Reform and Employment Rights Act.* This finally abolished wages councils and gave workers rights to join or not join a union of their own choice.

There were a number of consequences of this onslaught on union powers and immunities:

1. Union membership began to fall. To some extent this was caused by the decline in traditional industries where membership had always been high. However, the outlawing of closed shops, the greater freedom of workers to join or not to join a union and their reduced influence also resulted in a leakage of members.
2. Labour markets did indeed become more flexible. Over-manning was reduced in many industries, productivity of workers rose and in some industries wages actually began to fall, thus reducing costs. In other words, the legislation had exactly the effects which supply side economists had expected.
3. The number of strikes and other forms of industrial action fell dramatically. This was partly the result of higher unemployment, but mostly resulted from tighter legal controls and loss of immunity.
4. The reduction in membership cut off a major source of funding for the Labour party. This forced them to search for corporate funding, which may have begun to influence policy making.
5. It forced the Labour party to re-evaluate its long-standing and close relationship with the trade unions.

The Thatcher / Major economic reforms summarised

- Laissez-faire policy towards industry and unemployment, allowing the free market to make its own adjustments.
- Concentration on controlling inflation as the main priority.
- Privatisation of many major industries such as telecommunications, gas, electricity generation and supply, railways, steel, car industry, water.
- Less reliance on fiscal policy, more on monetary controls – interest rates, money supply and sterling exchange rates.
- Reduction in trade union power to make labour markets more flexible.
- Reductions in direct taxes on personal and corporate incomes, replaced by higher indirect taxes.
- Reductions in welfare benefits to reduce the 'dependency culture' and force people into work.
- Stricter controls on monopoly power to promote competition.
- Forcing industries and professions, such as banks, building societies and other financial institutions, legal profession, opticians, dentists, some postal services, public transport, to open themselves up to competition.

LABOUR'S REACTION TO THE END OF CONSENSUS

The reaction of the Labour party to the economic reforms of the 1980s and early 1990s was to dominate the course of politics in Britain in the final twenty years of the twentieth century. For convenience we can divide Labour's reaction into two parts: 1979–87 and 1987–97.

1979–87: trauma

Labour's election defeat in 1979 had partly been caused by the so-called 'winter of discontent' of 1978–79 when a wave of public service industry strikes hit Britain over wage controls. Nevertheless, the left wing of the party was convinced that the reason for the loss was that the party was not socialist enough in its economic outlook. Led by such senior figures as Michael Foot (leader from 1980 to 1983), Tony Benn and Barbara Castle, the Labour left forced the party to adopt a number of proposals which were to shift it markedly away from the Conservative government, which was moving to the right.

The Labour left wished not only to reverse the reforms made by the Thatcher administrations, but to adopt some socialist policies which had not been implemented by previous Labour governments. Among the proposals were the following:

- the privatised industries to be re-nationalised and new candidates for nationalisation to be considered;
- restoration of a steeply progressive direct tax system so that there would be a re-distribution of real income from rich to poor;
- large increases in expenditure on welfare, including generous social security increases;
- the introduction of a national minimum wage;
- the restoration of the powers and immunities of trade unions;
- curbs on company profits and shareholders' dividends;
- the re-introduction of keynesian economic demand management.

These economic policies were added to a range of other radical proposals in defence, foreign policy, law and order and social policy. Together they mark the period in British political history when political opinion was at its most polarised. Consensus politics seemed a distant memory in the mid-1980s.

The verdict of the electorate on the left-wing policies of the Labour party was a resounding rejection. The Conservatives won landslide victories in the 1983 and 1987 elections. To make matters worse for Labour, the economy began to improve markedly after 1986 and a mini-boom (especially in house prices) ensured that their reactionary policies would find little favour. The party was at its lowest ebb since before World War II.

The right wingers in Labour fought a rearguard action against the lurch to the left. Indeed many leading members formed the breakaway Social Democratic Party (SDP) which fought the two general elections of the 1980s, winning many votes but relatively few seats in parliament. Such leading Labour figures as David Owen, Roy Jenkins, Shirley Williams and Bill Rodgers left the party, never to return.

But some moderates stayed in the party, notably the new leader, Neil Kinnock (who had replaced Michael Foot in 1983). Kinnock, who had considered himself a left winger until he became leader, realised after 1987, that the British people had no stomach for socialism. However many criticisms there were of the policies of the Thatcher governments, the electorate did not want a return to the pre-1979 economic system.

Backed by younger supporters for reform such as John Smith, Gordon Brown and Tony Blair, Kinnock began the long road to changing the Labour party for good.

1987–97: reform

Neil Kinnock, his successor John Smith (leader 1992–94) and Tony Blair (leader after 1994) instituted a process of reform which was to culminate in

1996–97 with the emergence of what became known as 'New Labour'. Kinnock's ideas can be summarised as follows:

- Free market capitalism was working. It was therefore unacceptable to the people that excessive state interference or public ownership of industry should threaten economic success.
- Though some union power could be restored, there could be no return to the days when unions were able to hold up economic progress in the pursuit of their own interests.
- Re-nationalisation of most industries was not feasible. Apart from being too expensive, most of the privatised industries seemed to be relatively successful. Privatisation was popular on the whole and it worked.
- High income and corporate taxation was indeed a disincentive to economic dynamism. The levels of before 1979 could therefore not be restored.
- The growing inequalities which were resulting from the operation of free markets could be tolerated provided there was a robust social security and welfare system to protect the less well off. The interests of workers could be protected by a minimum wage system and appropriate legislation to protect workers' rights.
- The state should continue to offer high levels of expenditure on pensions, social security, health and education and general taxation levels would reflect this. However, any increased tax burden would largely rely on indirect taxation (i.e. VAT, duties etc.).

The reforms represented both a pragmatic attitude to economic management, and a compromise with those Thatcherite policies which had proved to be successful.

The changes in Labour's economic stance came too late to win them the 1992 general election, even though there had been nearly three years of deep recession. But the die was cast. Kinnock gave way to John Smith and then to Tony Blair following Smith's early death in 1994. Blair set about turning party reform into full-scale transformation. Hence the development of the idea of 'New Labour'. He denied that his policies were merely pragmatism or compromise. Coined by Anthony Giddens, a prominent Labour supporter from the London School of Economics, the term 'third way' expressed the idea that economic (and other) policies of New Labour were neither socialism nor Thatcherite neo-liberal. They were claimed to be a fresh start.

NEW LABOUR AND THIRD WAY ECONOMICS

Prelude: Britain and the ERM

The development of Labour's economic policy in 1996–97 can be better understood in the light of Britain's experience with economic recession in the early

1990s, and particularly of her ejection from the European Exchange Rate Mechanism (ERM) in 1992.

In some ways the final piece in the Conservative party's jigsaw of supply side economics was the manipulation of Britain's foreign exchange rate. The argument went like this: Britain had been fundamentally uncompetitive for decades. This was borne out by the periodic balance-of-payments crises which had been suffered (notably, 1964, 1966–67, 1975–76). The country had been cushioned from the effects of being less efficient than her main trade competitors by a steadily falling value in the exchange rate of sterling. The effects of the falling international value of the pound is to make British exports artificially cheaper. This has enabled Britain to trade with the rest of the world successfully despite her lack of efficiency and therefore competitiveness. The price to be paid is that low sterling values also means high import prices. As Britain heavily depends on imports (about one-third of total consumption), rising import prices has also created nagging inflation.

Margaret Thatcher, and particularly her Chancellor of the Exchequer, Nigel Lawson (1983–89) were of the view that, if Britain were no longer protected by the low value of sterling, the British economy would be *forced* to be more competitive. She would have to compete on equal terms and, as a benefit, import inflation would be controlled.

Lawson's plan was to 'shadow' the deutschmark. This meant keeping the value of sterling 'pegged' to the value of the German currency, then considered to be Europe's strongest and most stable. The way this was done was to raise interest rates when the value of sterling was to go up, and reduce them we wanted it to fall. In other words the basics of the British economy were forced to 'copy' what was happening in Germany.

Lawson was removed as Chancellor in 1989 and replaced by John Major. Major persuaded Thatcher to join the European Exchange Rate Mechanism. This tied the British currency to *all* the leading West European currencies, not just the deutschmark. This was an even more severe discipline for the economy. When recession struck Europe, however, in 1990 it was clear that the value of sterling was too high in the ERM and that the economy could not survive under these circumstances. After disastrous delay, now the responsibility of the new Chancellor, Norman Lamont, Britain was forced out of the ERM in September 1992 (an event known as Black Wednesday). The value of sterling fell dramatically in the months which followed, relieving the pressure, but causing mounting inflation.

Britain's ejection from the ERM was a huge humiliation and an indictment of Conservative economic policy. It is ironic that the effects were beneficial in the medium term. The inflation subsided, exports picked up because of the low value of sterling and economic growth improved. But these events were to be to the advantage of New Labour rather than John Major's Conservative government.

Labour, especially Gordon Brown, learned some lessons from the ERM disaster. Most importantly, it was seen that attempts simply to force the economy to be more competitive would not work on their own. Positive steps would have to be taken to improve efficiency. Secondly, and in the longer term, attempts by politicians to control the economy as a whole were usually compromised by political considerations. Thirdly, Brown also understood that inflation was not an acceptable price to be paid for other economic policies. These three lessons were to make a significant impact on New Labour's economics of the third way.

Fundamentals of the third way

When Labour took power in 1997, its first Chancellor, Gordon Brown, was very clear as to what economic principles to adopt. They were as follows:

1. Supply-side economics is, in general, effective. However, it is not enough to assume that the production side of the economy will grow satisfactorily if left to its own devices by government. There have to be positive steps of a *micro-economic* nature to underpin the effects of free market economics. Micro-economic policy includes measures designed to give a direct boost to different sections of the economy (such as the labour force, individual industries, regional economies etc.), rather than attempting to control the economy as a whole, which is described as *macro-economic* policy. The precise nature of these micro-economic policies is described below.
2. The social security system should play a positive role in encouraging the unemployed to find work. It is not sufficient simply to set benefits at such a low level that people prefer to work than to be on benefit. Rather, the social security system should provide *incentives* for people to enter the world of work. In other words, benefits should be a carrot rather than a stick.
3. On the whole politicians should not interfere with the workings of the macro economy, either with monetarist or keynesian policies. They are usually reluctant to take decisions which might be good for the economy, but bad for the fortunes of the government, and are always tempted to take popular measures which might damage the economy. Thus they like to reduce interest rates and tax levels but raise public spending before elections, but have to reverse these measures if inflation begins to rise too quickly. Macro-economic policy, therefore, should be taken out of the hands of politicians and given to independent, non-political bodies. As this is done by two of the world's most successful economies – those of Germany and the USA – the evidence in favour of the principle is compelling.
4. The operation of free markets may be beneficial on the whole, but problems arise if there is not genuine competition in the these markets. It is the role

of government, therefore, to ensure that there is genuinely free competition to ensure the best interests of consumers are served and that British industry remains competitive with the rest of the world.

5 The long-term success of the economy is dependent on eliminating the wild fluctuations in economic growth, unemployment and inflation from Britain had suffered for forty years or more. What Gordon Brown called the 'boom and bust' economy had to be replaced by long-term stability.

These policies were in part an extension of past Conservative policies, but also, in some regards, a departure from them. The details below indicate where the continuities and the divergences lie.

Continuities

- Free market capitalism is the best way to create wealth and economic growth.
- Measures to stimulate the supply side of the economy are more effective on the whole than management of the demand side.
- Inflation is the most serious problem for the economy. It causes unemployment, lack of competitiveness and reduces business and consumer confidence. Economic policy should concentrate, therefore, on inflation control.
- Excessively high levels of tax on incomes and company profits are a disincentive to economic enterprise and so should be avoided.

Divergences

- Conservatives are less enthusiastic about interfering with the economy on the micro-economic level.
- Conservatives oppose excessive measures to promote competition. They oppose regulation of industry and business in principle.
- Conservatives are wary of the idea of a national minimum wage. They reluctantly accepted it after 1997, but would set it at a very low level as they believe it may cause unemployment if set too high.
- There is a fear among Conservatives that the Bank of England is too limited in its function of setting interest rates to control inflation. They believe it should have a wider role in controlling economic factors, including foreign exchange rates of sterling.
- The Conservatives remain more determined than Labour to reduce the overall burden of taxation, even if this may mean reductions in spending on public services in the short run.
- Where public services are seen to be failing, Conservatives generally favour outright privatisation, whereas New Labour prefers the solution of creating a

partnership between public and private sectors, in other words only *partial* privatisation.

- The greatest divergence between Labour and Conservative attitudes to economic policy concerns the European Union. This is examined in more detail below, but it revolves mainly around opposition to the adoption of a single European currency and a fear that economic policy making is falling increasingly into the hands of distant, undemocratic bureaucrats and bankers.

A new consensus?

At first sight it may appear that there are a significant number of differences between Conservative and Labour attitudes to economic policy. Closer examination, however, reveals that, if we consider *basic principles*, there is a large measure of agreement. Distinctions are largely confined to detail and emphasis. For example, there is now agreement that the Bank of England's Monetary Policy Committee should set interest rates independently, but Conservative want to widen its role. Similarly, the national minimum wage is now accepted on all sides, but the parties will disagree on the level at which it should be set.

The Liberal Democrats have introduced some fundamental dissent since 1997. They place much less importance on the level of taxation, believing that governments should not fear rises in direct taxation if this is necessary to maintain a good level of public services. The Liberal Democrats are also much less enthusiastic about the involvement of the private sector in services such as education, health and public transport than either Labour or the Conservatives.

But the general picture does suggest a new economic consensus, at least in the domestic sphere, which is as solid as the old keynesian certainties of the 1950s, 1960s and 1970s. It is in the European dimension where genuine divisions exist and consensus remains a distant prospect, at least until the controversy over British participation in the single European currency is resolved.

ECONOMIC POLICIES SINCE 1997

We can now examine the main developments which have occurred since 1997 in more detail. The most important decisions were taken at the beginning of Labour's administration and have proved to be the most radical changes which have occurred since the end of the keynesian consensus.

Macro-economics: monetary and fiscal policy

Monetary policy

Gordon Brown made two immediate decisions which were to dominate policy for years to come. The first, and most important, was to grant operational independence to the Bank of England and to establish a Monetary Policy Committee (MPC) which was to set base interest rates.

The committee has nine independent members, none of them politicians, who meet every month to set the base interest rate of the Bank of England, thus effectively determining mortgage and other main rates on loans and savings. The committee was to publish details of its deliberations and even the internal voting is revealed. It has only one task which is to set interest rates to keep the inflation rate within a maximum set by the government. This is based on the assumption that raising interest rates will curb inflation by reducing borrowing and therefore spending. Conversely, if inflation is falling, indicating a slow-down in the economy, spending can be stimulated by reducing the interest rate.

Initially the ceiling rate was a stiff 2.5 per cent and was still in place in 2002. Should the rate rise above this, or fall below a floor of 1.5 per cent the committee must write an open letter of explanation and, of course, put the matter right as soon as possible. There can be no political interference and no considerations, other than inflation, can be taken into account.

At first sight this might seem a minor detail of policy. In fact it has been viewed as one of the most important economic decisions to be taken since World War II. Its significance can be summarised as follows:

- It provides a stable economic platform, free from interference by politicians. This inspires confidence among consumers, the business community and financial markets.
- If politicians do try to over-expand the economy dangerously through keynesian fiscal management they will simply be thwarted by the Monetary Policy Committee which will raise interest rates to keep inflation down.
- It demonstrated the government's determination to behave in an economically responsible manner.
- It put a key element of economic policy into the hands of neutral experts who would not be influenced by short-term political considerations.

The immediate reaction among Conservatives was to oppose the introduction of the MPC. Very quickly, however, they came to see the sense of it and finance spokesman, Michael Portillo, soon accepted it. However, as we saw above, the Conservatives remain concerned that the MPC has too narrow a role, and should take factors other than inflation into consideration. Opposition was futile, in any case, when the operation of the committee proved successful, with inflation remaining within target throughout New Labour's first term.

Fiscal policy

Gordon Brown had gone halfway towards removing macro-economic policy making from political hands with the introduction of the MPC. But this was not enough for him. He also wished to see an end to governments' tendency to run up huge borrowing during recessions (by reducing taxes and raising public expenditure). He wanted a straitjacket placed around fiscal policy. He was influenced heavily by the fact that he had inherited a huge burden of public debt from the previous government. His response was the so-called 'golden rule'.

The golden rule, whose official name is the 'Code for Fiscal Stability', states that a government should not borrow money for the purpose of simply spending more than it is raising in taxes (i.e. for current account debt). Rather, there can be borrowing only to finance investment, that is, projects which will have lasting benefit such as roads, schools or hospitals. What this effectively means is that a government cannot simply spend and borrow its way out of a recession without breaking the rule.

To demonstrate his determination, Brown risked unpopularity by tightening public spending for the first three years of the new government's term. Public spending as a proportion of national income (i.e. the economy's total output) fell from 41.2 per cent in 1996 to 38.9 per cent in 1999. At a time when the government as a whole was promising improvements in public services, he was actually reducing public expenditure from £343 billion to £340 billion! As a result, the government finances moved from a deficit (i.e. government borrowing) of 3.6 per cent of national income in 1997 to a surplus (i.e. repayment of government debt) of 2 per cent of national income in 2000 – an improvement over three years of £40 billion.

This responsible attitude to government budgeting was underpinned by a cautious stance on taxes. Brown also refused to court political popularity by reducing the tax burden. But the Labour government's policy on taxation as a whole proved to be less coherent than its stance on macro-economics.

Taxation

The overall effects of tax policy after 1997 were largely neutral. There was a small rise in the burden of taxation from about 36 per cent of national income in 1997 to 38 per cent in 2000. However, most of this was caused by 'fiscal drag' rather than policy changes. Fiscal drag refers to a natural process whereby, as prosperity rises, which it did fairly rapidly between 1997 and

2001, the *proportion* of National Income taken in tax is bound to rise as individuals and companies move into higher tax brackets. Increased spending by consumers also raises more in VAT and various duties.

Having said that, Gordon Brown did make some important decisions. These added up to a sizeable shift in the emphasis on taxes away from income tax towards indirect taxes and other subtle or 'hidden' tax changes. A new income tax bracket was introduced at 10 per cent instead of 20 per cent for many of the low paid. Several million were also taken out of taxation at the bottom end of the earnings scale. Tax credits (i.e. benefits paid through the tax system) were made available for poorer families and there were reductions in the tax burdens on businesses, especially small ones.

To pay for these reductions the government increased a wide range of other taxes which became known by the Opposition as 'stealth taxes'. This was because most payers were not fully aware that there had been an increase. A typical example was the loss of tax relief on many private pension schemes. Tobacco and petrol duties also rose sharply and the married couples' tax allowance was abolished.

The general direction of Gordon Brown's tax policies has been mildly socialist. There has been a reduction in the burden of taxation on the low paid and working families with children, including lone parents, have all done well. However, he has resisted the temptation to raise the top rate of income tax above 40 per cent or to introduce greater tax burdens on high levels of business profits. But Brown had plenty of room to relieve tax burdens even more on the low paid after 1999. Instead, he has chosen to pay off chunks of the national debt and raise levels of expenditure on public services.

Micro-economic policy

As we saw above, New Labour moved supply-side economics a stage further than the Conservatives by taking a number of direct, positive measures to improve the efficiency and productivity of British commerce and industry.

As with the Conservatives, the Labour government laid great stress on the effectiveness of competition in promoting efficiency and there has been a sustained drive to introduce market forces into such industries as telecommunications, transport, electricity, retailing and the car industry. At the same time the Office of Fair Trading was given increased powers in 1999 to outlaw uncompetitive practices by large manufacturers who were attempting to exert too much control over retail distribution.

Persistent problems in depressed areas such as the north east, south west and north west were a further concern. Twelve Regional Development Agencies were set up in 1998 to distribute public funds for regeneration of existing industry and to attract new investment into these areas. Although this has not solved long-term unemployment in the regions, it has contributed to a steady reduction in overall unemployment.

But the main thrust of micro economic policy fell on labour markets. Union powers were not, on the whole, restored in spite of intense pressure from the left wing of the party. Although the national minimum wage was introduced it was set at such a low level (£3.80 per hour), that employment was little affected. Thus the downward trend in level of industrial unrest was maintained and wage costs fell to be increasingly in line with the rest of Europe.

In the longer term, Tony Blair continually stressed the need for a more highly trained and educated workforce. His clarion call for ‘education, education, education’ in 1997 was not just for social reasons. He recognised that a higher-quality labour force would be more able to compete and to handle new technologies. So the drive for higher standards from pre-school to university was as much about economics as it was about education. A Training and Skills Council was also set up to organise more training on an industry-by-industry basis.

In common with his Conservative predecessor, John Major, Blair also saw small businesses as the driving force of economic growth, so they were granted substantial concessions on taxes and employment.

These micro-economic measures represented a continuation of Conservative policies in the 1990s. However, they were now being conducted within a stable macro-economic environment. Progress along these lines had been thwarted in the past by the uneven nature of economic growth, Blair’s government hoped that the healthier climate would enable Britain to compete in the long term.

EUROPE AND THE ECONOMY

The impact of the European Union on Britain is considered later in this book. But some mention of Europe must be made here as British involvement has had a growing effect on the conduct of economic policy making, especially since the Single European Act came into force in 1987. This finalised the creation of a single market in Europe. In other words the British economy was thereafter strongly influenced by European events. The main effects on policy can be summarised as follows:

- British interest rates are affected by the level of European rates which are determined by the European Central Bank. The Monetary Policy Committee of the Bank of England does not have to follow European rates, but recognises that there may be an impact on British inflation.

- The Labour government after 1997 has been committed to creating favourable conditions for entry into the single European currency. These are known as the 'convergence criteria', a set of conditions which will bring Britain's economy into line with that of the rest of the EU. They include low inflation and interest rates, controlled levels of public debt and low unemployment. Britain has moved steadily towards the criteria and had achieved them by the end of 2000. In the event, the government would probably have worked towards similar objectives, single currency or not, but it has been a factor in the background of policy consideration.
- The exchange rate between sterling and the euro has been significant. The weakness of the euro (and therefore the relative strength of sterling) during 2000–1 made British exports to Europe expensive (but imports have also been cheap – a great help with inflation control). The government was able to do little to counteract this trend, but it has made the competitiveness of British industry an even more pressing problem.
- Competition policy must conform to European rules. In fact this has speeded the process as controls in Europe have traditionally been tighter than in Britain. European policy has therefore suited the supply side stance of New Labour.

Labour's 'third way' economic policies since 1997 summarised

- Transferring control over interest rates to the Monetary Policy Committee of the Bank of England.
- Introducing the 'golden rule' establishing fiscal responsibility – no public borrowing other than for investment.
- Making labour markets more flexible at the lower end through low tax bands and welfare benefits for poorer families.
- Raising indirect taxes to fund spending on improved public services, but not direct taxation.
- Encouraging partnerships between public and private sector enterprises to fund investment in public services such as health, education and transport.
- Preparing the British economy to enter the euro-zone in due course.
- Increased spending for regional industrial development.

SUMMARY: SOME THEMES

We can identify several important features of economic policy in the period since the 1960s.

1 The existence of a conflict and consensus on economic policy has ebbed and flowed. There was a strong consensus in the 1950s, 1960s and most of the

1970s. This collapsed in the late 1970s, culminating in an extreme schism in the mid-1980s as the Conservative party moved to a right-wing, neo-liberal position and Labour shifted dramatically to a left-wing, socialist position. During the 1990s the two main parties, supported by the Liberal democrats moved slowly back towards consensus. This was based on the success of New Labour's third way policies. In the early years of the twenty-first century, however, this new consensus was threatened by divisions over the future of Britain's involvement with the European Union.

2 British economic policy making has been characterised by periodic recessions, followed by rather shorter intervals of growing prosperity. Policy has, therefore, usually been dominated by the need to combat the existing recession or avoiding the next one. Recession policies are, ironically, rather easier to develop than the decisions which have to be made when economic growth is healthy. In times of economic slowdown, inflation has been low, interest rates have fallen and the exchange rate of sterling drops, making it easier for industry to export. The problems for policy makers are, therefore, how to deal with unemployment and how to finance the public debt which inevitably mounts up in a recession. It was also normal to reduce taxation at such times to try to boost consumption, so governments were able to make decisions which enjoyed short-term popularity.

3 Governments have conspicuously failed to maintain sustained periods of economic growth, at least until after 1995. Tempted by the availability of increased funds governments have tended to raise public expenditure and reduce taxation dramatically in the good times. However, such measures have typically created rapid inflation and have simply forced a clampdown in the following years. This kind of cycle became known as 'stop–go' policy. This was certainly the experience in the late 1960s, late1970s and late 1980s.

4 Faced by an unusually long period of sustained economic growth between 1995 and 2001 governments have found new problems in prosperity. Various groups, for example demanded tax cuts, from poor families to motorists to businesses. At the same time, calls on the public finances grew from different groups who wanted their fair share of the prosperity. The obvious examples are the health, education, law and order and transport authorities. But other groups want some of the action too. Farmers, small businesses, local authorities and cultural or sporting bodies have demanded a bigger share. The more cautious chancellors in this period – Ken Clarke and Gordon Brown – have avoided the sins of their predecessors by keeping public expenditure under control and maintaining tax levels, but have paid a high political price for doing so.

5 The growing importance of Europe and the global economy will bring new, longer-term pressures on economic policy makers. Certainly there is bound to

be a loss of flexibility and independence as international forces exert an increasing influence on the British economy.

SAMPLE QUESTIONS

1 To what extent have New Labour's economic policies been different from those of other governments since 1979?

2 What was meant by Gordon Brown's claim to have established 'prudence with a purpose'? How has he sought to achieve it.

3 What have been the differing attitudes towards taxation and welfare demonstrated by Conservative and Labour governments since 1979?

4 Has a new economic consensus emerged since 1992?