

# Reaganomics and Thatcherism: From Ideas to Policy

by Nigel Ashford

The issue I wish to examine today is the role of ideas in public policy. How do ideas get transmitted from the intellectual realm to the public policy arena? And my focus today is on the determinants of the comparative influence of three schools of thought: monetarism, Austrian economics, and supply-side economics, and their impact on the economic policies of the Reagan and Thatcher Administrations. I am concerned with the policy-making process, not with the policies themselves.

Unfortunately, I don't have time to discuss the differences between these three main schools. That discussion would require a whole lecture in itself. But I hope some of their differences will emerge during the rest of my lecture.

## Economic Policies of Thatcher and Reagan

Before turning to the question of those determinants of influence, I need to say something about the differences between the economic policies of Reagan and Thatcher, because of course they have a great deal in common and are seen as representing a similar point of view, as they do share a free market, limited government perspective on the economy.

Turning first to the Thatcher Administration, we see clearly that the number one priority was fighting inflation. It accepted the monetarists' view that we needed to control the money supply in order to reduce inflation, and we needed to reduce government borrowing, what we in the U.K. call the Public Sector Borrowing Requirement. Thatcher accepted the Milton Friedman argument that trying to reduce inflation would inevitably have some negative side effects on economic growth, and thus on unemployment. But he said we could minimize those negative effects by declaring in advance what our policy was going to be and gradually reducing or controlling the money supply and reducing inflation. In 1979, Thatcher announced the Medium Term Financial Strategy, declaring that this is what the government would be doing in the next few years. So the emphasis there was on reducing inflation through control of the money supply.

**No Supply-Side Assumptions.** The Conservative government in Britain also believed in cutting taxation. But there was none of this emphasis on the supply-side aspect. It was argued that any tax cuts should be paid for either by reductions in public expenditure, which as we know in the United States is something very difficult to achieve, or through an increase in economic growth. There were no supply-side assumptions built into the Thatcher strategy.

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Nigel Ashford is Bradley Resident Scholar at The Heritage Foundation and Senior Lecturer in Politics at Staffordshire Polytechnic, England.

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So in the first budget in 1979, marginal income tax rates were cut from 33 percent to 30 percent, and for higher tax payers from 83 percent to 60 percent. There were even some people paying as high as 98 percent on investment income. So they cut the income tax, but to pay for it they increased what in the U.K. is called the Value Added Tax, a sales tax, from 8 and 12 percent to 15 percent. They were saying that as we're going to lose revenue from the income tax cuts, we must completely make up for it somewhere else by an increase in the sales tax. There was no role here for the arguments about the revenue effects of supply-side economics, no belief here about the counterinflationary effects of supply-side economics which supply-side economists in the United States had noted.

**Significantly Different.** Thatcher's approach was significantly different from Reagan's, with an emphasis on controlling inflation through reducing government debt and an approach to tax cuts which ignored the supply-side effects.

You are more familiar, of course, with Ronald Reagan's position, which placed tax cuts as the number one priority, with a willingness to accept budget deficits if that was necessary in order to keep a low level of taxation. It was the monetarists within the Administration — like Martin Feldstein at the Council of Economic Advisors, or Paul Volcker at the Federal Reserve Board — who were arguing strongly for a tax increase as a way of trying to overcome the budget deficit.

It is the difference between the policies of Reagan and Thatcher that I am interested in explaining. Mrs. Thatcher clearly aligned herself with monetarism, Reagan aligned himself with supply-side economics. Austrian economics is a sort of also-ran in this game. I also want to explain why Austrian economics had very little impact on either of them.

I want to argue that these differences can be explained by five factors. First of all, academic credibility. Secondly, institutional support. Thirdly, media attention. Fourthly, promotion by politicians. And fifthly, evidence of electoral acceptability.

### **Academic Respectability**

The role of academia is to give authority to ideas. Monetarism is positivist in its methodology, empirical in its style, and uses mathematical models to demonstrate and test hypotheses. It thus fits in very well with the whole style of the economics profession here in the United States and in Britain. It conforms to the ethos of the economics profession. And so monetarism has been able to establish itself as a subdiscipline within economics on both sides of the Atlantic. Its influence was recognized by giving Milton Friedman the Nobel Prize in 1976, and electing him president of the American Economic Association in 1977.

By contrast, the Austrians are very critical of positivist economics. They adopt an *a priori* style, based on first principles, rather than on empiricism. They are dismissive of the use of mathematical models. Austrian economics has gained attention primarily among economic historians who are interested in their contribution to the economic calculation debate, and among political philosophers who are interested in Hayek's work as a modern restatement of classical liberalism. Austrian ideas with regard to macro-economic policy or economic policy making had very little influence in academia. It is only in the latter part of the 1980s that one begins to see the emergence of graduate students and younger academics representing the Austrian school.

Supply-side economics has achieved little academic respectability. There are really only two academics associated with this particular approach, at least during the late 1970s and early 1980s. They are Robert Mundell at Columbia University and Arthur Laffer at the University of Southern California. On the whole, the supply-side economics has been dismissed within the economics profession. Paul Samuelson once gave a famous lecture about "Why Everyone is Laughing at Laffer," which summed up the view of the academic establishment towards supply-side economics.

### **Institutional Support**

We turn now to institutional support. The role here is played particularly by think tanks who transmit these academic ideas to the policy makers in a digestible form, in a form that people in policy making may actually read, where the relevance of these ideas to public policy is clear.

The American Enterprise Institute provided an institutional forum in Washington, D.C., for monetarist ideas. The Hoover Institution gave a home to Milton Friedman and appointed him as a senior fellow. Institutional support, however, was less significant in the United States because monetarism already had a degree of respectability within the academic profession.

In Britain that was much less true. The Institute of Economic Affairs, the IEA – not to be confused with your own IEA here in Washington, which plays a somewhat different role – is a small free market think tank. In 1970, it produced a short pamphlet by Milton Friedman called *The Counter-Revolution in Monetary Theory*. It was basically a 20-page summary of Milton Friedman's ideas on monetarism. I think it would just about pass Heritage's briefcase test in terms of its length and people's willingness to read it. This was the first real attempt to give monetarism some coverage in British academic and political debate.

Friedman then attended several conferences at the IEA, which also published several other of his shorter pieces of work, expanding his ideas on monetarism. The IEA also played an interesting role in bringing together Friedman with leading politicians such as Mrs. Thatcher, and leading journalists at IEA lunches. So there was some sort of, what you Americans would call, networking exercise with regard to Milton Friedman's ideas.

**Wide Audience.** In 1975, the Center for Policy Studies was created in Britain, which had as its primary focus explaining monetarism to the British public. It was founded by Sir Keith Joseph and Margaret Thatcher and it produced a series of pamphlets which was extremely widely read for political publications. As you know there are great difficulties in trying to get the mass public to read anything substantial. In fact, they were very successful in reaching a comparatively wide audience with their CPS publications.

The Austrians really only have the Cato Institute as their institution promoting Austrian economic ideas to policy makers. And Cato didn't come to Washington, D.C., until 1981, after the Reagan Administration had already arrived in town. So it was a bit too late for it to have any impact on the basic framework within which the Reagan Administration would operate.

In Britain the IEA also published a series of pamphlets by Hayek, but it tended to emphasize Hayek's interest in microeconomic issues rather than macroeconomic issues. For example, it gave attention to Hayek's views on trade unions, where there was a clear dif-

ference between him and Friedman. While Friedman argues that in the long term trade unions have no significant impact on the level of employment, Hayek says that they do have a significant effect. And this was particularly interesting in the U.K. when it was going through a period of major industrial relations problems, a very high level of strikes. So the IEA introduced Austrian economics, but not on the macroeconomic sort of level which put them in conflict with the traditional monetarists.

The Adam Smith Institute, created in 1981, was another institute which was Austrian in its flavor. It produced a series of introductions to Austrian economics, and also a whole load of policy recommendations. The Adam Smith Institute was very significant, for example, in promoting privatization in the British context. What they didn't do very successfully, though, was to link these principles of Austrian economics with specific policy proposals. And so Austrian economics didn't get very widely accepted within Britain.

For supply-side economics, the American Enterprise Institute gave a home to Jude Wanniski in 1977, which enabled him to write his book, *The Way the World Works*. But most of the AEI economic establishment, including such notables as Herbert Stein, was very hostile to the conclusions of that book, and they made speeches and lectures attacking supply-side economics. So AEI as a whole was not a center of supply-side economics in the late 1970s or in the 1980s.

**Creating Institutions.** So the supply-siders had to create their own institutions. One was the Institute for Research into the Economics of Taxation, formed in 1977 by Norman Ture. But that gained very little attention until The Heritage Foundation took it under its wing in 1981, and then gave its work a much higher profile in Washington. Ture contributed the chapter on the Department of Treasury to the influential *Mandate for Leadership* report of The Heritage Foundation, in which he summed up the case for supply-side tax cuts. He was appointed Undersecretary for Tax and Economic Affairs at Treasury.

Another significant institutional support for supply-side economics was the Manhattan Institute, with George Gilder as the program director, giving a lot of attention to supply-side economics, which eventually led to his best selling book, *Wealth and Poverty*.

In Britain there was no institutional support for supply-side economics. People didn't understand what the term meant. It wasn't used by economists; it wasn't used by politicians. The first conference on supply-side economics in Britain was organized in 1986 by the Manhattan Institute. There was no institutional base for supply-side economics within Britain.

## **Media Attention**

A third factor is that of the media. The media play the role of bringing these ideas to what may be called the attentive public, those people who take some interest in public policy affairs. Monetarists didn't have any problem with the media when they had a spokesman like Milton Friedman who loved publicity, who loved going on television, who loved the combative style that gained media attention, no problems for Friedman having an interview in *Playboy* magazine in 1973, for example. He wrote his regular column in *Newsweek* from 1966. And he produced the popular TV series and book, *Free to Choose*, shown in 1980 in the United States and Britain.

The IEA played a very crucial role in introducing Friedman's ideas to the economic journalists in Britain. The economic editors of the three quality newspapers in Britain all met

Milton Friedman through the IEA, became convinced and converted by his ideas, and gave exposure to those ideas, mentioning his name frequently in their columns and articles in their newspapers. The most significant, I think, was Sam Brittan of the *Financial Times* who made his own interesting theoretical contributions to monetarism. The second was Peter Jay, economics editor of the *Times*, whom you may have known as British Ambassador to the United States when he was appointed by his father-in-law, Prime Minister Jim Callaghan. And thirdly, there was Frances Caincross, economics editor of the *Guardian*. An interesting thing about all three of them is that none supported the Conservative party and yet they played probably the major role in terms of media exposure to monetarist ideas.

The Austrians had virtually no media coverage. By contrast, it sometimes is suggested that supply-side economics is nothing but a media creation. This is a big contrast between the two. Robert Bartley gave a good deal of exposure to supply-side economics on the editorial pages of the *Wall Street Journal*, where Jude Wanniski was employed and first started getting interested in these ideas. Irving Kristol used his column in the *Wall Street Journal* to articulate what he saw as the political benefits of supply-side economics as against traditional Republican economics. And there was a whole series of conservative journalists, like Tom Bethell, Bruce Bartlett, and Warren Brookes, who published articles on these ideas in places like the *New Republic*, *American Spectator*, *Reason*, etc.

By contrast in Britain, there was no media coverage of supply-side economics. No newspaper gave it any serious consideration, and it wasn't until 1986 that the *Sunday Times* in Britain first started to explore and present supply-side economics in its relevance to Britain.

### **Promotion by Politicians**

The fourth factor is the endorsement by politicians. This is the most likely way in which the general public will become familiar with economic ideas.

With regard to monetarism in Britain, it was very much picked up by and associated with Sir Keith Joseph. He had been a minister in the Heath government from 1970 to 1974. The Heath Conservative government was widely felt to have been a total disaster and failure. So Joseph asked himself this question, why was it? Why did we make such a mess of the economy when we were in power and able to do something about it? He went away on a summer holiday with a suitcase of books by Friedman and Hayek, read them on that holiday in Scotland, and then said, this is the answer — these are the ideas which explain why we made a mistake and what we need to do.

Then he made a whole series of speeches, speaking at over a hundred meetings in three years, basically trying to explain monetarism in simple terms that people could understand. Those speeches gained a considerable degree of media coverage, because part of his argument was attacking the government of which he had been a member, and it's always good for news when people are fighting inside their own political party. It was Joseph who popularized the term monetarism. He made it almost a household word within the British context so that everybody had heard of monetarism even if he didn't always understand it.

At that time in the mid 1970s Margaret Thatcher was Joseph's lieutenant, his number two, if one can imagine Mrs. Thatcher being number two to anyone. At that time it was Joseph who was being seen as the possible leader of the Conservative party. It was Thatcher

who learnt these ideas largely from Joseph, but what she did was to integrate monetarism into a broader framework of values such as thrift and hard work. And then she tied this up with trying to make it electorally popular after her success in winning the leadership of the Conservative party in 1975.

**Too Abstract for Americans.** In the United States politicians did not try to explain monetarism to the American public. They thought it was much too abstract an idea for Americans to grasp. I won't say anything about the relative qualities of education, but it was assumed that in Britain you could explain monetarism to the general public, whereas in the United States it was felt impossible to do so. But the point is that no American politician attempted it.

On Austrian economics, no politician really picked up and tried to use these ideas. Mrs. Thatcher did read Hayek. She was very impressed by his philosophical work on *The Constitution of Liberty*. She took on board some of his arguments on the trade unions, but she never tried to explain Austrian economics to any sort of wider audience, and neither did any American politician.

With supply-side economics, with which you are probably most familiar, you will know that it was Jack Kemp, then the Congressman from Buffalo, who was the first politician to try and spread the supply-side message, influenced by his conversations with people like Jude Wanniski and Arthur Laffer. In 1977 he introduced his Kemp-Roth Bill calling for income tax cuts as an alternative to the Democrat budget.

Reagan's initial reaction was somewhat skeptical about these arguments. He was not an early supporter of this point of view. I know there has been some attempt by Martin Anderson to go back and say that Reagan did mention tax cuts and the revenue effect of tax cuts in a rather obscure newspaper column, but there was never an attempt in the 1976 campaign – in Reagan's campaign against President Ford – to place supply-side economics in any significant role.

**Convincing Reagan.** Laffer accused Reagan of being too interested in what he called "deep root canal theory." What he meant by that is that somehow we can't cure America's problems without going through a difficult and painful process. As Americans might say, no pain, no gain. So Reagan wasn't entirely happy with this argument that tax cuts could be the solution to America's economic problems.

Eventually, though, he became convinced. First of all because it fitted in with his own optimistic upbeat view of America – if only the energies of the ordinary American people would be released, then they could come to grips with the problems that the United States faced. Secondly, he was impressed that most of the conservative journals that he read – such as *National Review* or *Human Events* – were endorsing these ideas. And thirdly, it was becoming increasingly clear that these were popular ideas with the electorate, which would gain him votes in his campaign for the presidency. And once he had sort of grabbed this idea, he then became the Great Communicator of supply-side economics to a wider audience.

Contrast this with Thatcher, who never really picked up on supply-side economics as a position. She did have a serious look at it in 1979 after the election victory. But she looked at it, and in the end it was disregarded. First of all, she asked Sir Alan Walters, her

economic advisor with whom you are now familiar after recent events, to investigate these ideas; and he came back and said, in effect, you can ignore them.

Secondly, they were still very controversial. In America there wasn't a great deal of academic and intellectual support for these ideas, and there was virtually no one in Britain supporting them.

And thirdly, I think the same thing that was true of Reagan was also true of Thatcher. She felt it was a soft option, that we need to go through a difficult period to wring out inflation from the British economy before we could do anything like tax cuts.

Here is an example of the extent to which the British Conservatives ignored supply-side effects. In 1986 we discovered that the revenue from the highest marginal rates of taxation — that had been cut from 83 percent to 60 percent — had increased. No great surprise now, but it was a big surprise in Britain, because the government never mentioned that fact. We only discovered that revenue had increased because of a question posed by a British opposition Labor Member of Parliament who thought that the figures would reveal the opposite: how much seriously revenue had declined as a result of this tax cut. The Treasury did not have that information. They had to go and conduct the research to find out the evidence for it. So it was certainly not seen as being an important part of the Conservative case for tax reduction.

### **Electoral Acceptability**

Now then to the fifth factor explaining the differences. This is the question of electoral acceptability. I don't mean by this that the electorate have a firm grasp of economic theories, only that they are willing to allow certain ideas to be tried, to be attempted. The ideas are not simply dismissed as being totally off the wall.

In Britain, inflation was seen as the greatest problem in 1979, running at about 25 percent and rising. The only serious attempt that had been made to try and reduce inflation had been by the imposition of prices and incomes policies, which had been attempted both by Labor and Conservative governments. And the one thing that they had in common was that they had all failed. People were looking for some way of dealing with inflation, and the only people who were coming up with a proposal were those supporting a monetarist point of view that Thatcher was articulating.

In the United States the popularity of supply-side economics was probably first demonstrated with the success of Proposition 13 in California, the spreading tax revolt, the success that Republican candidates found they had using the tax issue in 1978 and 1980. One of the crucial events for Reagan occurred in 1980 when he was running for the presidency. He did very poorly in the Iowa caucuses. The campaign was convinced to put on a TV blitz emphasizing tax cuts in the New Hampshire primary, which swept him to victory. That encouraged the campaign to make supply-side cuts a central theme of the 1980 elections.

### **The Determinants of Economic Policy**

To sum up, there were three different schools of economic thought trying to compete for the conservative economic agenda. I have suggested that there were five factors which you can identify as significant in determining which of those schools was successful in Britain

and in the United States. First of all, academic respectability. Secondly, institutional support. Thirdly, media coverage. Fourthly, endorsement by politicians. Fifthly, an appearance of electoral acceptability. It is the differences in these factors which I think help to explain the different policies of the Reagan and Thatcher Administrations.

What I am arguing here is that ideas do affect public policy, though they rarely do it directly. They affect public policy through their interaction with interests, with institutions, and with personalities. But we need to understand the role of ideas if we are to explain the differences between politicians who are normally seen as ideologically close, Ronald Reagan and Margaret Thatcher.

