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978-1-107-04293-3 - Expansionary Fiscal Contraction: The Thatcher Government's 1981 Budget in Perspective

Edited by Duncan Needham and Anthony Hotson

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Expansionary Fiscal Contraction

The Thatcher Government's 1981 Budget in Perspective

In its 1981 Budget, the Thatcher government discarded Keynesian counter-cyclical policies and cut Britain's public sector deficit in the depths of the worst UK recession since the 1930s. Controversially, the government argued that fiscal contraction would produce economic growth. In this specially commissioned volume, contributors examine recently released archives alongside first-hand accounts from key players within No. 10 Downing Street, the Treasury and the Bank of England, to provide the first comprehensive treatment of this critical event in British economic history. They assess the empirical and theoretical basis for expansionary fiscal contraction, drawing clear parallels with contemporary debates on austerity in Europe, the United States and Japan in the wake of the recent global financial crisis. This timely and thoughtful book will have broad appeal among economists, political scientists, historians and policy makers.

Duncan Needham is Associate Director of the Centre for Financial History at Newnham College, Cambridge, and a Research Fellow of Darwin College, Cambridge. Before returning to academia, he worked as a credit trader at J.P. Morgan and then as a credit portfolio manager at Cairn Capital. Dr Needham lectures in economic history and teaches undergraduate and graduate courses in history, economics and politics.

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Contributors

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Foreword

Geoffrey Howe

It is striking how much the 1981 Budget continues to fascinate economists and excite historians and political commentators. One cannot but assume that something quite important happened as a result of it! In recent years those interested in reading about it have been offered a great deal of interpretation and second-hand, subjective comment but relatively little history, though I would make exceptions of Nigel Lawson's fascinating autobiographical *The view from No. 11* and the first volume of Charles Moore's *Margaret Thatcher: the authorized biography*. So we should all welcome Cambridge University Press's splendid initiative and the hard work of Duncan Needham and Anthony Hotson in editing this richly informative collection of papers and essays. As a Cambridge man I am not, of course, totally surprised by the origin of this initiative.

Since it is vital to balance the subjective material – of which we already have plenty – with some real facts and an accurate record, I particularly appreciate the careful narrative work of (in alphabetical order) Messrs Budd, Collins, Goodhart and Lankester; and the filling out of the background undertaken by Robert Neild (who led the '364 economists'), Duncan Needham and my Special Adviser at the Treasury, Adam Ridley. I also enjoy the unavoidably arcane debates of the economists, even if their arguments are at times way over the head of a mere ex-Chancellor of the Exchequer.

That said, the book is dealing with some very important questions. This is not the time or place for me to speculate in detail about what went right or wrong; many of my own thoughts are to be found in my memoirs. But there are some points I should like to make now with the advantage of many years of hindsight, enlightened by this stimulating collection.

Today, the Medium-Term Financial Strategy we launched in 1980 may seem rather ephemeral – indeed, pointless, or even perverse. At the time, however, it was invaluable in reorientating radically the broad lines of British economic policy; or perhaps I should say in consolidating

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the earlier reorientation initiated in 1976 in one of his wise phases as the Chancellor of the Exchequer by my friend Denis Healey. Look at what happened to output, inflation and so much else in the fifteen years after 1981.

Some critics try to dismiss all these successful developments by referring to the fact that, after 1981, employment did not recover, or at least unemployment did not fall as quickly or to such low levels as it had done in periods of growths in the 1950s and 1960s. They disregard the sad fact that, by 1981, such an old-style recovery was no longer on offer.

All of which brings me, with a certain smile, to the famous 364 economists who wrote so trenchantly to *The Times* to attack the Budget in March 1981. In its aftermath, they (and many others) were ferocious in their criticism, constant in their predictions of continuing recession and strident in proclaiming that there were better alternatives to the policies we pursued. Looking back, we can be relaxed about the ferocity of their criticism, puzzled at their failure to suggest alternatives and amused at the inaccuracy of their prophesies, which were almost instantly disproved by the performance of the economy from the moment I sat down after my Budget speech. As we know, like the savage 1976 IMF Healey measures and the brutal Jenkins post-devaluation strategy of 1968, the vicious 1981 Budget was followed by years of unusually strong GDP growth.

Today, some thirty years later, there are two features of this period that stand out. As Alan Budd notes, those involved in political life or in 'high policy' are often marked by a 'searing experience'. For older generations, the searing experience was the depression and unemployment of the 1930s. For those active in the 1970s, it was the inflation, depression and unemployment following the first oil crisis. After the banking crisis of 2007–8 it will be the depression and unemployment that it unleashed. Each episode leaves society divided between those desperate not to repeat the mistakes of the previous crisis and those who recognise that we live in new times and must not unthinkingly follow standard orthodoxy.

Finally, I recall a little wistfully that the Conservative government elected in 1979 lived through a great deal of sound and fury. There was an exceptional emotional intensity about our politics at that time. This was as it should have been. There were massive issues at stake. It all made for a splendid spectacle for the historians. But it also made for some erratic history and unreliable memories, in which passions and emotions now need to be matched by a careful examination of the facts. Read on!

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Note on the text

In this volume, '1972/73' means the fiscal year ending April 1973. '1972–73' means the two calendar years 1972 and 1973. This may differ in quotations from primary sources.

Fractions are used to denote a number to the nearest one-quarter, as opposed to decimals, which denote greater precision.

Citations from the Thatcher Foundation website are given in the following format: MTFW [unique document ID]. Documents can be found either by typing this number into the search box on the website or by appending it to the URL margaretthatcher.org/document. For example, MTFW 107590 can be found at www.margaretthatcher.org/document/107590.

Appendices 5.1 and 5.2 to chapter five reproduce Bank of England archive documents in full. We acknowledge the kind permission of The Governor and Company of the Bank of England in including them in this volume.

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Definitions of UK monetary aggregates

- M0 Currency in circulation with the public and held by banks, comprising Bank of England notes, current coin issued by the Royal Mint, and the fiduciary note issue of the Scottish and Northern Irish banks, plus UK banks' deposits with the Bank of England, often referred to as bankers' balances.
- M1 Currency in circulation with the public and UK residents' sight deposits with UK banks.
- M3 Currency in circulation with the public, plus UK residents' sterling and foreign currency deposits with UK banks. Deposits include time deposits and certificates of deposit.
- £M3 Currency in circulation with the public, plus UK residents' sterling deposits with UK banks. Deposits include time deposits and certificates of deposit.
- PSL1 Private Sector Liquidity 1: M1, plus private sector time deposits with a maturity of up to two years, plus private sector holdings of money market instruments.
- PSL2 Private Sector Liquidity 2: PSL1, plus private sector building society deposits, excluding terms shares and Save As You Earn (SAYE) holdings, and National Savings, excluding longer-term savings, minus building society holdings of bank deposits and money market instruments.

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Abbreviations

<i>BEQB</i>	<i>Bank of England Quarterly Bulletin</i>
BOE	Bank of England Archive
BSA	Building Societies Association
CBI	Confederation of British Industry
CCC	Competition and Credit Control
CPRS	Central Policy Review Staff
DCE	domestic credit expansion
EFC	expansionary fiscal contraction
EMS	European Monetary System
ERG	Economic Reconstruction Group
ERM	Exchange Rate Mechanism
<i>FSBR</i>	<i>Financial Statement and Budget Report</i>
GDP	gross domestic product
HMG	Her Majesty's government
HMT	Her Majesty's Treasury
IMF	International Monetary Fund
LIBOR	London Interbank Offered Rate
LBS	London Business School
LTV	loan to value
MBC	monetary base control
MLR	Minimum Lending Rate
MTFS	Medium-Term Financial Strategy
MTFW	Margaret Thatcher Foundation Website
NAFA	net acquisition of financial assets
NHS	National Health Service
NIC	National Insurance Contributions
NIF	national income forecast
OECD	Organisation for Economic Co-operation and Development
ONS	Office for National Statistics
OPEC	Organization of the Petroleum Exporting Countries
PSBR	public sector borrowing requirement
RPI	Retail Price Index

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SAYE	Save As You Earn
SLA	US savings and loan associations
SSD	supplementary special deposits (the 'corset')
TFP	total factor productivity
TNA	the National Archives
TUC	Trades Union Congress
VAT	value added tax