THE POLITICAL ECONOMY OF MRS THATCHER'S MONETARISM

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1. INTRODUCTION

During the past few weeks we have witnessed another round of deflationary policy in the UK. Even a three million unemployment figure did not stop the Government from raising interest rates significantly. The pretext for this severe monetary action was that increased bank lending threatened to raise monetary growth and cause inflation.[1] On the face of it, this is a monetarist justification. However, a cursory glance at recent monetarist thought yields the view that interest rates should be freely determined in financial markets and that the Government should use other policy instruments to control the money supply.[2]

The real reason for raising interest rates is quite non-monetarist. Sterling had to be defended against a strong dollar, backed by very high US interest rates, because of fears in the City that devaluation would cause cost inflation. The short-term 'gut reactions' of the City were preferred to the longer-term predictions of monetarist theory. Geoffrey Howe was quick to blame the United States for the increases, but he had a much greater degree of discretion than he implied, as any examination of the reactions of other countries demonstrates.[3]

It is no longer even clear that raising interest rates in the depths of a recession will succeed in curbing monetary growth. The lesson of 1980 was that higher interest rates tended to increase 'distress borrowing' as firms, which were already financing their liquidity position on a substantial overdraft, had to increase their borrowing to pay the extra interest. Furthermore, in the case of very large firms, the extra interest is regarded as a rising cost and may even contribute to cost inflation. It is the small business with limited credit lines and facing market competition that is hardest hit. Paradoxically, this is the kind of business that the present Government looks to for future economic growth in Britain!

The Government asserts its belief in a monetarist theory of inflation then designs policies to fight **cost** inflation. It places its faith in the potential of small business then that potential. In the end, it is not higher interest rates that have lowered business confidence, but the growing realisation that the Government cannot be trusted to practice what it preaches. One of the original attractions of the Thatcher Government to business was the promise of strong, consistent policies in contrast to the double-talk pragmatism of the previous Labour Government. However, just as the Trade Unions came to realise that Labour's lip-service to socialism did not match its political compromises, so businessmen have begun to tire of the contradictions inherent in the present Government's policymaking.

The currently fashionable 'rational expectations' theory held by some monetarists emphasises the view that economic agents pay attention to economic policy in forming their expectations and making decisions.[4] It is also very plausible to argue that the same agents will react to the increased uncertainty that accompanies contradictory policymaking. In

particular, they are likely to take fewer investment risks. The poor record of manufacturing investment in the UK over the past 15 years, in contrast to other countries such as Japan where there has been a much greater degree of consistency in government policy, may well be associated with this recurring problem.[5]

The purpose of this paper is to focus on the contradictions in policymaking that have been observed over time in the actions of successive Governments. Attention is on the present Government simply because its contradictions are of immediate and urgent concern. A similar historical exercise could be conducted on the last Labour Government with similar conclusions, but from a different political standpoint. The spirit of the paper is that the extent to which a government remains consistent in its policymaking may be as important as the policies themselves. Furthermore, the longer Governments sacrifice consistency for short-term political expediency the more likely it is that support will be forthcoming for totalitarianism of the far right or the far left.[6]

The structure of the paper is as follows. First, several of the contradictions in present government policy are isolated. Second, a detailed discussion of the policy contradiction that exists in the area of government subsidies to persons is presented. Third, the reasons why contradictions develop between the theory of economic policy and political decisions are discussed. Fourth, some suggestions are offered on ways in which the links between economics and politics could be changed.

2. THE MONETARIST EXPERIMENT

The image that the Thatcher Cabinet has attempted to project is one of unbending determination to pursue policies which are firmly founded on monetarist/libertarian doctrine. Protests concerning the effects of these policies, even from within the Conservative party, have been ignored irrespective of their logical basis. The Governmnent's view of these protests is political; as are complaints made by patients who have to take unpleasant medicine. Appeals that policies are too crude and simple to cope with the complex feedback mechanisms in the real economy are regarded as obfuscation. The passage of time will overcome all these transient complexities and the policies will be effective. If not, monetarism will have failed, not the Government.

However, is it accurate to state that we have been experiencing a genuine 'monetarist experiment'? In setting up and running any scientific experiment at least three preconditions are essential:

i. The initial conditions or starting assumptions, under which the theory or hypothesis is supposed to work, should exist or be operationalised.

ii. The pattern of actual causal impulses should be as close as possible to its theoretical counterpart. In particular theoretical and operational consistency between different impulses should be maintained.

iii. In the course of the experiment, the pattern of impulses. should remain unchanged, otherwise the validity of the results will be lost.

Experiments in economics are notoriously difficult to conduct because of the absence of laboratory conditions. However, in the case of the 'monetarist experiment' we would expect to observe some minimal adherence to the above preconditions:

i. The transmission mechanism between money supply and inflation should be clearly understood and operational definitions of the money supply and other key variables should be selected accordingly.

ii. Monetarism and a general belief in free markets are inseparable. In a world where markets are believed to have become highly imperfect, particularly in the short-run, any test of monetarism should include an extensive package of complimentary policies designed to liberalise markets. If this is not done, monetary policy is inappropriate to the market structure to which it is applied unless the policymaker falls back on the untested assertion that in the long-run market forces will finally operate. Most monetarist/libertarian thinkers advocate the parallel introduction of policies to break up the power of monopolistic firms and trade unions, to reduce the amount of market intervention by government, to reduce the size of the inefficient government bureaucracy and to remove non-market systems of patronage and priviledge in society.[7] Even though such policies cannot be implemented quickly, their implementation offers the advantage of creating a heightened expectation that market solutions will occur in the future adding considerable weight to belief in monetary control.

iii. The monetary and other policy rules should be strictly adhered to so that the authorities become trusted and individual responses to economic policy become stable over time.

Having translated the preconditions of scientific experiments into a form suitable for a 'monetarist experiment', let us examine the Government's record on each count:

(i) **The Theoretical Basis**

Monetarism tends to be a body of economic theory which is preoccupied with the tendency of the economic system to move to positions of static equilibrium or dynamic steady states. In general, the theory has little to say about disequilibrium dynamics between different equilibria.[8] Consequently, the transmission mechanism between money supply and inflation is often obscure and monetarists are usually forced to rely on some very

speculative statistical analysis of time-lags to support their view on direction of causation and length of time before monetary control is completely effective.

Recurring disputes rage between monetarists about time-lags, which range from under 1 year to 5 years in the existing literature on the subject. It is remarkable how the monetarist theory has become an article of faith on such a scant and unreliable theoretical and empirical base.[9] In addition, there has been much dispute over the choice of an appropriate definition of the money supply to control. It is ironical that Friedman has always been one of the strongest proponents of the view that a theory which cannot operationalise its variables is not a very useful theory.[10]

It would appear that the first precondition of the 'monetarist experiment' has not been met. The mechanism through which the policy is supposed to operate is unclear. The implications of the existence of a real world economic system which differs from the theoretical system have been ignored. The starting assumptions have not been operationalised.

(ii) **Implementation Consistency**

The Government has paid a great deal of lipservice to the ideals of libertarian thought necessarily bound up with monetarism but have backed it with little concrete action. In many cases the Government's pursuance of only one part of monetarist policy has led to repercussions which have militated **against** libertarian ideals.

For example, to what extent has the Government taken action to break up monopolistic firms and trade unions and promote the interest of the small business sector? Despite some window-dressing aid to the latter sector, the reverse has occurred. Recessionary policy has hit smaller businesses much harder than larger businesses. VAT increases caused more difficulties for the former than the latter. Deregulation of prices in the name of competition has had the effect of pushing many small firms out of business, increasing monopolistic concentration. It is argued that this increases efficiency but this is frequently at the expense of the qualitative diversity offered by a large number of small firms. Such effects could have been offset by a parallel policy of breaking up the resultant monopolistic structures but such a policy has been completely lacking.

Similar inaction has taken place in the area of industrial relations. The pretence that the economy is competitive "in the long-run" is carried over to the labour market in the monetarist slogan that "trade unions do not cause inflation". This neatly avoids the grave political difficulties inherent in any attempt to reform industrial relations without also tackling the problem of monopolistic firms. The Government's stance that free-collective bargaining should thus prevail is contradicted by the imposition of public sector pay norms.

To what extent has the Government reduced interference in the economy and cut government bureacracy? The government preaches non-interference then interferes. In the days of Keynesian policy the intervention was expansionary to offset inflationary tendencies, now the intervention is contractionary to offset inflationary tendencies. Monetarist 'neutrality' maxims are not adhered to. The main vehicle for contractionary policy has been cuts in the public sector. However, these cuts have taken place, not with waste and inefficiency in mind, but in terms of achieving a short-term PSBR target in the most politically convenient way. Instead of cutting into the bureaucratic soft-centre, essential public services have been cut on the periphery. In the nationalised industries, investment is cut much more than consumption, guaranteeing a slow death from obsolescence and **increased** inefficiency. At the same time, these industries are forced to make a profit, which is frequently achieved by intensified monopoly pricing, resulting in the underutilisation of a depreciating capital stock. The public pay more for a poorer service.

In sum, there is little evidence that the Government has succeeded in implementing the libertarian dimension of monetarist policy. The actions taken reflect short-term political expediency designed to make the economies necessary to reach a monetary target rather than measures to improve resource allocation and efficiency. It may be the case that, in fact, the Government never had any serious libertarian plans and that their actions can be interpreted as much more political than economic. The Government's attitude to the last tenent of libertarian monetarism, concerning privilege and patronage, is revealing in this regard and will be discussed in section 3.

(iii) **Policy Invariance**

To what extent has the Government adhered to its policy? It is here that the Government has fallen down most dramatically in its 'monetarist experiment'. The centre-piece of its strategy - monetary control - has been in a constant state of flux. Techniques have been changed as targets have not been met and other policy instruments have been added to deal with situations beyond monetarist thinking. Public sector pay norms and interest rate policy have already been mentioned in this regard. The Government has repeatedly acted in contradiction to the advice of Friedman and other monetarists.[11]

These central alterations of government policy, added to the policy inaction in other areas, guarantees that we cannot say that the effects we observe tell us anything about monetarism. Instead of a 'monetarist experiment' we have a 'rule of thumb' exercise which is concerned with applying deflationary policy at the first sign of rising inflation, for whatever reason, plus an objective of gaining control of a monetary magnitude using whatever means are at the Government's disposal. It is certainly the case that the Government has done the monetarist/libertarian case considerable damage in associating it with recession economics and monetary target fanaticism.[12] Many economists in this school of thought are aware that the market system is highly imperfect and that deflationary policy will not lower prices, but generate unemployment. Also they are aware that the forces of competition tend to work poorly when unemployment is high and investment is low but well when the economy is growing. To them, monetary control is not a meaningful policy by itself but only part of a programme that attempts primarily to increase the scale of market competition and allow growth to be generated in the private rather than the public sector.[13]

It is hard to recognise any elements of this view in the Government's present policy. Simple political dogma has superceded economic theory in policymaking. So let us move on to see whether there is any evidence to suggest that it was the Government's prior commitment to political interest groups that determined its policies rather than any real commitment to a 'monetarist experiment'.

3. THE POLITICS OF PRIVILEGE AND PATRONAGE

To what extent do the policies of the Government reflect an attempt to redistribute income, absolute and relative, from poorer to richer? Is its claim to be adhering to monetarist/libertarian theory merely an excuse for the introduction of redistributive devices? It would be going too far to argue that there was some simple socio-political conspiracy theory in operation - too many of the effects of the present Government's policies are affecting traditional Conservative supporters. However, there is plenty of evidence in the class divided political history of the UK that sectional interests have been reflected in economic policies.

If we examine the Government's policies with regard to preferred treatment of one group at the expense of another, the discussion always comes round to the issue of support for the unemployed. In recent years this subsidy has been substantial as the Government has implemented policies which stimulate unemployment. There have been several attempts to reduce unemployment benefits and raise National Insurance Contributions. The justification for these measures is usually one concerning the size of the PSBR following the realisation that deflationary cuts in public expenditure are offset by a rise in public transfers to the unemployed. However, in addition to the discovery of this policy dilemma, there has been a longstanding Conservative policy to lower unemployment benefits.

This policy is based on the view that unemployment benefits encourage people to choose leisure rather than work. A significant proportion of the unemployed are viewed as 'scroungers' on the rest of society. As for people who have become unemployed as a direct result of the Government's recessionary policy, it is felt that lower benefits will increase their incentive to accept low-paid employment when the economy turns up and firms require more labour. Thus, in theory, the measures have two libertarian objectives: firstly, to reduce society's handouts to the 'undeserving' and secondly, to increase incentive.

The popular view that favourable benefits, particularly earnings related benefits (ERB), have led to subsidisation of leisure has been widely supported in sensationalistic newspaper articles which concentrate on isolated cases of serious abuse. The body of evidence on the matter offered by Britain's economists receives scant attention.[14]

A recent survey of this evidence by Atkinson (1981) concluded that the main impact of ERB was to extend the **duration** of unemployment spells by two to three weeks. When this is translated into numbers unemployed at a point in

time it becomes a very small effect. Furthermore, inasmuch as ERB simply encourages the unemployed to look more carefully for new jobs then it can be argued that there may be benefits to society in the form of a better matching of skills with jobs.

So it is hard to argue that ERB has had much effect on the incentive to work but only on the incentive to take any old job that comes along. It is also difficult to look on this as 'scrounging' particularly when the evidence also shows that ERB has no significant effect on longer-term unemployment. One study surveyed by Atkinson even found that the correlation went the other way with lower ERB being associated with longer spells of unemployment. This is not a surprising result when it is appreciated that it is people with few skills to offer that tend to be in least demand by employers.

'Unemployables' tend to exist mainly on supplementary benefit (SB) rather than unemployment benefits. Those dependent on SB can be split into two groups: those who have never had a job, mainly young people, and those who have been unemployed for a long time. To what extent has SB reduced the incentive to find a job? If we select the years 1966, 1976 and 1978 we discover that SB paid to the unemployed as a percentage of average male earnings was 63.9%, 61.1% and 56.4%, respectively. In other words there has been a steady decline in the attractiveness of living on SB relative to working.

The rise in numbers depending on SB is easy to explain. Low investment in the UK has meant that the working population has grown faster than the number of jobs. Timbrell (1980) has estimated that in the period 1967-78 the working population grew by between 3% and 4% and growth in jobs was roughly zero. As might be expected, the shortfall was eventually reflected in the numbers dependent on SB, despite its declining attractiveness. It is also inevitable that this residual will contain the least-qualified and unskilled who are offered the worst job opportunities, if they get any offers at all.

So the available evidence tells us that very little of the observed rise in unemployment can be attributed to more attractive handouts to the unemployed. Of course, the Conservative Government can still maintain that the incentive to work can be raised by cutting this handout, even though the 'scrounger' view is invalid, and that firms will be able to hire workers at lower wages.[15] Politically, this is a popular position in the sense that it is supported by largely employed, middle-class voters and is directed towards unemployed, largely working class Labour voters.

However, because of the high level of unemployment, it has not been possible for the Government to penalise the unemployed as much as it would like and it remains an open question as to whether their motivations are economic or political. The best way to answer the question is to turn to other kinds of subsidies to examine whether or not the position is the same. Is it generally true that the Government is attempting to lower all undeserved subsidies and raise incentives in every area?

If we examine the official statistics on State handouts to persons, we find that they fall into two distinct categories. Firstly, there are the direct handouts in the form of various types of benefits, supports and pensions. The National Insurance Fund, for example, tries to raise revenue from the public to pay for these handouts. Secondly, there are the indirect benefits in terms of tax reliefs for people in various categories. These are paid for in terms of higher taxes levied on everyone else.

An examination of both categories reveals that the bulk of direct benefits not associated with ill-health and old age indeed turn out to be unemployment benefits and supplementary benefits to the unemployed. If we then turn our attention to the indirect benefits we discover that by far the largest component of tax relief not due to individual or family characteristics is mortgage interest relief (MIR).

The Inland Revenue has estimated that in tax year 1979-80, MIR amounted to as much as £1,450m. If we compare MIR with unemployment benefits (UEB) over the previous four years we discover that MIR has been almost double UEB. If we add on SB to UEB we find that the total comes to roughly the same as MIR. The Inland Revenue have also estimated that in 1979-80 about £2,000m was given in tax relief on capital gains accruing to property sellers. Also, the imputed income from property is not taxed in Britain as it used to be and still is in other countries. The Inland Revenue offers us no estimate but this relief must be very substantial indeed.

A great deal of time and energy has been devoted to the issue of handouts to the unemployed, but what about MIR? Prior to the last General Election, the Conservatives did express some concern about the size of MIR, but, in power, this concern has not materialised in policy. To what extent, therefore, are these handouts deserved and what effect do they have on incentives?

MIR was originally introduced for the best of intentions, namely, to facilitate the purchase of owner-occupied housing by first-time buyers. However, it is now widely accepted by economists that subsidising demand to increase supply is a highly inefficient and expensive policy. It encourages house price increases, which makes it harder for first-time buyers and the bulk of the relief accrues to people who already own their houses. All this amounts to is a transfer of income from people who are not owner-occupiers to house-owners.

It is difficult to think of a social justification for such a large transfer. In general, unlike most of the working-class recipients of unemployment handouts, which they partly pay for through national insurance contributions, most middle-class recipients of MIR do not suffer any serious hardship. The room for manoeuvre in cutting unemployment benefits is very narrow, whereas MIR could be cut fully without significant hardship.

The abolition of MIR would be entirely consistent with monetarist policy. An extra £1,500m in tax revenue could be employed in two ways in addition to a straight reduction in the PSBR. Firstly, the size of government spending cuts would be reduced dramatically, given the PSBR and monetary growth targets. Although total income in the economy would be unchanged, the redistribution of income from middle-class homeowners to working-class non-

homeowners would stimulate the level of economic activity. This is because of the well-known economic fact that lower income earners spend a higher proportion of their income than higher income earners. This beneficial effect on employment would also slow the upward pressure on the PSBR because of rising unemployment benefit payments as a recession worsens.

The second way the Government could utilise the £1,500 million tax revenue would be to lower the standard rate of income tax, keeping tax revenue at its old level. The standard rate could be lowered by between 3 to 4 pence in the pound in this way. Such a reduction would be in line with the Government's desire to increase incentives. What would happen would be that **both** the incentive of home-owners and non-homeowners would be increased, despite the fact that the former would have experienced a rise in their income taxation. This is because MIR is a tax allowance and has no effect on the additional pound earned. Abolition of MIR would cause a once-and-for-all jump in income tax but the incentive to earn additional pounds would increase because of the lower marginal tax rate.

Consequently, abolition of MIR would seem an ideal policy change. It would work towards all the government's stated objectives and would also make the economy fairer by removing some genuine 'scrounging' from the State by the undeserving. Why have steps not been taken to implement a change which is so complementary with Government policy? Political motives must account for this inertia. It would be against the interest of the social group which the government represents and might even alienate marginal middle-class voters. As soon as we accept this proposition then the idea that the Government is interested in operating a monetarist/libertarian policy becomes an illusion - political priorities are more important than any economic theory. The latter is a convenient excuse for implementing policies to redistribute income through recession and for the re-establishment of a more inegalitarian society. Such a stance is thoroughly anti-libertarian and it is curious that monetarist economists should have been so willing to help a Government with intentions so contrary to their theoretical position. Clearly, it is necessary to explore the manner in which economics interacts with politics in more detail.

4. THE RISE OF MONETARISM

It is now fashionable to blame economists for the state of the economy. The prevailing view is that economic experts work out economic strategies, based on theories and evidence, which are then adopted by governments in policy formulation. This conventional view is based on the presumption that economics is an objective science which, like any other science, advances through the discovery of new theories and the establishment of laws. This positivist view of economics has enabled economists to become forecasters and advisers to business and Government. Furthermore, other scientists have tended to accept this view of economics since it is quite appealing to suppose that optimisation techniques and statistical analysis can be scientifically applied to economic problems.

There is little doubt that this is true of microeconomics - operations research and statistical forecasting are a very useful aid to management but what about macroeconomics, which is the kind of economics used to guide Government policy? In fact, the whole structure of macroeconomics is specifically designed to be complementary to policymaking, focusing on

observable aggregates which can be controlled by Government. Keynes' **General Theory,** the mainspring of modern macroeconomics was directed specifically at offering a structure for policy and demonstrating the various transmission mechanisms between instruments and targets. On the face of it Keynes offered the basis for a science of Government policymaking.

However, the **General Theory** as 'objective science' has three critical weaknesses:

1. To keep the system manageable, it focuses on important mechanisms and neglects mechanisms which are unimportant for short-term policymaking.

2. The statistical evidence used to support the important mechanisms is incomplete, leaving several vital mechanisms with only 'armchair speculations' to support them. The determination of investment expenditure is the clearest example.

3. The problem of aggregation is ignored, casting doubt on the scientific relevance of both the theories and evidence offered in their support.

The idea that the **General Theory** is scientific is dubious - there is enough evidence in Keynes' other writings to suggest that the book was designed to offer polemical support to the growing political demands in the 1930's for government intervention to raise effective demand and alleviate unemployment in a stagnating economy. The **General Theory** was not a stimulus to government intervention but a response by Keynes to offer an economic framework for its application. The book's suitability for this task, both through its academic quality and the prestige of Keynes himself, resulted in its promotion in the political arena as the main economic guide to government intervention in a mixed economy.

Not only does this push the **General Theory** into the category of political economy but also most of the macroeconomics that followed. The incompleteness of the **General Theory** was gradually disguised in "IS-LM" refinements and a mountain of econometric evidence. Again, these developments were political in origin. The ideology of the mixed economy demanded a theory which was extremely simple to understand by everyone backed up by a vast complexity of theory and evidence, which provided the simple theory with intellectual respectability.

However, because of the underlying incompleteness, macroeconomics is a subject where almost any theory can be justified. A whole range of theories exist, the critical factor is whether or not a theory is promoted as part of a political ideology. Thus, when the mixed economy ran into inflationary troubles, unexplained by the Keynesian orthodoxy, the transition to Monetarist Economics was achieved without difficulty. Furthermore, this idea that macroeconomics is unscientific in its evolution receives support for investigators of the evolution of science such as Ward

(1972) who could not find key elements in the rise of Keynesianism which characterise other scientific revolutions.[16] The manner in which monetarism has grown in importance despite valid objections to its theories and evidence further suggests that the process has little to do with scientific progress.[17]

Which political ideology required monetarism for economic support? It has already been observed that there is ample evidence to suggest that monetarism has been utilised as a justification by right-wing politicians in the implementation of redistributive policies. However, that is clearly an oversimplified view since a significant proportion of the Conservative party are opposed to the present Government's policies and, also, monetary control was first implemented by a Labour Government. Disentanglement of these complexities is a more appropriate task for a political scientist than an economist. However, it is possible to offer a rough historical sketch of events.

Support for monetarism in the late 1960's did not develop from the writings of monetary economists such as Johnson and Laidler. At that time both could be classified as 'Keynesians who felt money was important'. The first group to take up monetarism seriously was several financial institutions and stock-broking firms in the City. Their espousal of monetarism did not arise because of academic interest but because the mixed economy strategies in the UK and the US had begun to lower yields on financial assets.

Throughout the 1960's, firms had financed their investment through retained earnings rather than new issues, to a growing extent. This resulted in controlled dividend yields and also forced new funds into new issues of Government bonds. However, these were fixed interest and persistent inflation lowered real yields. In turn, these unattractive yields led to funds being chanelled away from the stock exchange into property development and speculation. The call for monetarist policies in the City was a rational response. Their adoption would result in an escalation in interest rates and yields on financial assets, a reversion away from property speculation outside the stock exchange to financial asset speculation inside it and inhibition of the process of Government expansion which was at the root of the City's declining fortunes.

However, 'Keynesianism where money was important' was hardly strong enough to back the City's monetarist campaign. Instead, the development of 'rational expectation' monetarism was promoted through the 1970's. Basically, the 'efficient market hypothesis', concerning the functioning of financial markets, was generalised to macroeconomics, building on the inflationary expectations theory of Friedman and other monetarists. Ultimately, monetarist theory was tailored to offer powerful, simple statements concerning the inefficacy of macroeconomic policy backed up highly complex theory and evidence. The ideological mix of simplicity and complexity observed under Keynesianism was repeated but with much greater intensity.

On the political front, the spread of monetarism from the City was inevitable. Successive Governments, whose answer to most economic problems was increased Government expenditure, were incapable of implementing the fundamental changes necessary to prevent inflation from developing from the

chaotic mixed economy that had evolved. By the early 1970's monetarism had spread to the Bank of England, although it still had little foothold in Government as the Heath Government gave us the Barber boom. Monetary control finally became an effective government policy under the Labour Government of the mid-1970's, under severe pressure from the IMF.[18] Meanwhile, the dismal failure of the Heath Government opened the way for the monetarist faction in the Conservative party. City interests were poised to expand the limited monetary control of the Labour Government into a full set of recessionary policies under Margaret Thatcher.

There is little doubt that the use of monetarist analysis to justify policy in recent years is a political strategy. There has been little support for monetarism amongst the bulk of British economists in recent times.[19] The general view of the economists selected by the Government to advise them is that they are excessively ambitious, slightly mad or both. In addition, the position of many monetary economists has been very ambiguous. Instead of protest, we observe such economists either absorbed in the tautologies of rational expectations or buried in the technicalities of money definition and targets.

This imbalance between the views of economists as a group and the small number who advise the Government, directly or indirectly, further supports the hypothesis that Governments simply use economic theories for political ends. Financial inducements in the form of consultation fees, research grants and positions as economic advisers are all offered as inducements to economists to accept and work within a particular set of economic premises. This form of bribery is not restricted to economists working directly for the Government but also applies to economists who would not regard themselves as monetarists, but are prepared to 'play the game' and conduct a dialogue with pro-monetarist factions. For example, the National Institute will debate with the London Business School about technicalities such as the relative size of estimated elasticities in econometric models. There is an unwillingness to admit that a model is invalid in its assumptions, non-scientific in its empirical estimation and political in its intention. In London, monetarism depends as much on its opponents taking it seriously as it does on its proponents. Meanwhile, economists who dismiss the whole pseudo-scientific approach have little influence on policy but can only stand back and watch those, who have compromised on their academic standards, inflict significant damage on the economics profession.

In summary, it appears to be the case that the roots of current economic policy lie in the political motivations. It follows that a broad range of economic expertise cannot be influential on policy-making without fundamental political change. Furthermore, economists need to acknowledge the links between politics and economics, all too frequently assumed away, if they are to identify instances where their discipline is being exploited for political gain.

5. SUMMARY AND CONCLUSIONS

In this paper it has been argued that the macroeconomic policies of the present Government cannot be regarded as a test of monetarism. They are based on the political interests of the City and are an attempt to strengthen the position of financial capital relative to other income and wealth categories in the economy. Furthermore, the macroeconomics which is

used to defend these policies is unscientific and unrepresentative of current economic thinking. The minority of economists who provide support for these policies are either political supporters of the Government or mercenaries prepared to sell their technical skill for financial gain.

Many economists have already protested openly at the Government's policies with little effect given that these policies are determined politically. Much more of their attention should be directed at attacking the economists who provide credibility for such policies, not through academic debating but through a direct personal challenge of academic integrity. For example, should economists be allowed to earn substantial fees from political consultancy while also holding a University post? Should clear lines be drawn between academic research and advising?

There has always been a valid demand by taxpayers that academics should address themselves to practically relevant questions and to pursue research that provides knowledge which is as close to the truth as possible. Thus, the tendency of academic economists to become advisers has been welcomed. However, it is also true that financial inducements to advise lead to moral hazards and require the application of much stronger standards of conduct.

Questioning of the motivations of economists who provide intellectual support for political parties is an important but secondary question. The primary question remains a political one; why is it the case that minority interest groups are allowed total control once their political party has been elected to Government? This raises questions about the extent of democracy within these parties and in the nation as a whole. Margaret Thatcher dismisses democratic consensus as the route to weak government, a sentiment shared by many left-wing members of the Labour party. Justification for such a view is that democracy has failed in the past - but has democracy been adequately tested?

In fact democracy is so limited as to barely exist and has become relatively more limited as time has passed. Democracy consists of placing a cross against a barely known political candidate who belongs to a party with a complex range of policies which are imprecise and rarely adhered to. This happens at least every five years. Democracy has become more limited because the decisions voted on have become more and more extensive as time has passed. Our present voting system was much closer to democracy in the days of **laissez-faire**, when government intervention was minimal, than it is today. So democracy remains untested except in the indirect sense that we know what complete lack of democracy was like in Hitler's Germany and is like in the Soviet Union. We also have some evidence from comparisons of relative degrees of democracy across countries. For example, the success of external imposition of democracy in West Germany after the Second World War and the success of extensive democracy in countries like Switzerland.

The rise of the SDP offers the prospect that democracy might be extended in various ways. Decentralisation, the harnessing of new technology to facilitate rapid consultation and the alteration of voting methods all offer the prospect of a period where increased democracy could be put to the test. However, it remains to be seen whether we are witnessing another lip-service exercise designed to disguise the pursuit of the political interests of a particular group, Perhaps the SDP leadership struggle already confirms Tony Benn's scepticism that 'democracy' is merely window-dressing.

Hopefully, this is not the case for lack of democracy tends to develop a vicious circularity so well observed by Hannah Arendt in Germany during the 1920s. Lack of democracy and the domination of political conflict in Government leads to the belief that elected Government is contradictory and weak. This produces a growing alienated group who seek a strong alternative to bankrupt consensus. The idea that co-operation can lead to mutual benefit is replaced by a belief that gains can only be made by dispossession of another group. The 'mob' will eagerly support any strong group of political extremists who promise them benefits as members. In the words of Hannah Arendt.....

> "Practically speaking, it will make little difference whether totalitarian movements adopt the pattern of Nazism or Bolshevism, organise the masses in the name of race or class, pretend to follow the laws of life and nature or of dialectics and economics".

Such a warning seems particularly appropriate at the present time when we look back on a visible strengthening of support for political extremism. It is easy for 'moderate' politicians to attack such extremism but are they also willing to attack their own past political history? It is nonsense to suggest that the present economic position of the UK is due entirely to the present Government's policies. The current economic position is a product of a succession of Governments with different ideologies but similar political and economic packages. These Governments were unable to cope with various structural changes in the economy and are unlikely to do so in the future in the absence of fundamental democratic reform. Such a failure would further strengthen the support from political extremism, just as it has done in the past.

Footnotes

1. It is well established that at the beginning of a cyclical upturn there will be an increase in bank lending to finance liquidity. This is not evidence of inflation but the beginnings of economic growth.

2. See Friedman (1980) for a typical statement.

3. See **The Economist** vol 281, No 7205, pp13-15 October, 1981.

4. See Minford and Peel (1981) for a recent example of this view.

5. It is very difficult to test this hypothesis using conventional econometric techniques since we are dealing with a qualitative rather than a quantitative phenomenon. However, there is evidence to suggest that 'stop-go' policy has had adverse effects on investment. Also the Wilson Committee (1980) argued that such factors may be of some importance.

6. The most graphic example of these dynamics at work is provided by Germany in the 1920s when policy contradictions by political coalitions finally gave way to open conflict between Communists and Nazis, as

economic decline proceeded. See Arendt (1973) for an extended discussion of this period.

7. For a more extended discussion of monetarist/libertarian thought and policy recommendations, see Hayek (1976) and Brennan and Buchanan (1980).

8. See Buiter (1980) and Casson (1981) for discussion of this issue.

9. Kaldor and Trevithick (1981) concluded that monetarism was founded in 'metaphysics' rather than in any analysis of the real world.

10. See Friedman and Meiselman (1963) for a statement of this position in their attack on Keynesian reduced-form studies of the determination of National Income.

11. See Friedman (1980).

12. See Laidler (1981) for discussion of this political damange.

13. See Laidler (1981).

14. Much more attention has been paid to studies such as that conducted by Benjamin and Kochin (1979) which produced evidence that unemployment in the Great Depression was voluntary and a response to high unemployment benefits. Like the bulk of empirical evidence produced by neo-classical monetarists it has proved to be misleading - Hatton (1980) shows that their results are a product of a statistical detrending error.

15. This kind of 'bulldozer approach' to solving complex problems has characterised much of current Government policy. The 'Keynes effect' whereby resultant income cuts lower aggregate demand and labour demand are ignored or dismissed as a transitional problem.

16. Ward applied the methods used by Kuhn (1970) to investigate the structure of scientific revolutions.

17. Theoretical and empirical objections to monetarist analysis of the real world have grown in volume during the 1970s. Again see Casson (1981) and Buiter (1980) plus Akerloff (1980) and Hahn (1980). However, these are only a few examples representing a broad literature which has done little to halt the progress of monetarism as a politically important theory.

18. Admittedly, the Labour Government did not adhere to the methods laid down in "Competition and Credit Control" but preferred to operate liability ceilings. Such interference with the market was unpopular in the City given that it interfered with 'free market' forces in the determination of interest rates.

19. Lack of support was reflected in the unprecedented 'group of 364 letter' to the Government.

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