What can we learn from Thatcher?

On April 8th Britain's most divisive political figure of the past 50 years passed away. A flood of malice swept "Ding Dong The Witch Is Dead" to number 1 on iTunes while at the same time world leaders from all corners of the globe rushed to praise her principles, contributions, and leadership. Even 20 years after her own political party ousted her from office, Margaret Thatcher still brings out strong emotions amongst both friends and foes; in Britain and abroad. But who was Margaret Thatcher and what lessons – if any– does the British experience during her tenure bring for us today?

The Lady of Free Markets

When the future prime minister became a Tory member of parliament in 1959 she found herself submerged in a political climate so deeply scared by the unemployment of the Great Depression that ensuring full employment was the overarching goal of government. With a nearly universal mindset of activist Keynesianism this was done through a level of government micromanagement scarcely imaginable today. Subsidies, price controls, and government ownership in industry were ubiquitous. Similar policies were in place in most European countries as well as the United States.

Though the reduction of government's role in the economy is perhaps what Thatcher is most (in-)famous for, when she became prime minister in 1979 her focus was on inflation. A text book example of an overeager central bank had pushed British inflation rates past 20 per cent in the late 1970s and the first thing she did was to increase interest rates, reduce public spending, and transfers. A drastic permanent reduction in inflation – as well as a temporary recession – followed (see figure 1). Almost simultaneously, Chairman Volcker at the Federal Reserve in the United States pursued a similar monetary policy, with the same results. Though the number of unemployed people passed two million in a few years the prime minister replied only with a "You turn if you want to. The lady's not for turning!", one of her many memorable quotes.

Figure 1. UK inflation (CPI), Unemployment Rate and Real GDP Growth (Thatcher years: 1979:1990). Souce. OECD Statistics

Though the macroeconomic policies that brought down inflation are no longer a source of heated debate, her microeconomic policies of deregulating industries, privatizing state-owned companies, and curbing – some would say dismantling – unions' influence can still bring heated debate throughout the British isles. In particular the miners' strike following the government's refusal to continue operating unprofitable public coal mines. The Thatcher government's win against the striking miners stands as a pivotal moment. However, the unemployment rate remained stubbornly high throughout the 80s as many who lost their jobs either directly from privatization or from the Thatcher government's refusal to stop the decline of manufacturing never found new employment. Hence, though the 1980s saw productivity increasing considerably faster than in the 1970s (around 2 per cent annually versus 1 per cent) overall GDP grew at only a slightly higher pace (though, still outpacing that of Continental Europe).[1] Regions previously heavily dependent on industry never recovered. This, coupled with the liberalizations of the financial markets and the resulting growth in the financial industry, meant inequality increased in Britain.

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1 See "Seeking a Premier Economy: The Economic Effects of British Economic Reforms, 1980-2000" (editors Card, Blundell and Freeman) for an extensive survey of the reforms.

Toward the end of her tenure the debate over Britain's role in the European Community was central. Though she was an early proponent of the common market she was very suspicious of the common currency. Her refusal to set up a timetable for Britain's inclusion in the project contributed to the discontent within her own party that finally forced her to step down as prime minister and leader of the conservative party in 1990.

Thatcherism today

What lessons from Thatcher's tenure can we draw for our world of financial crises, sky-high unemployment in Southern Europe and increasing skepticism of free markets and capitalism?

Perhaps most contentious is the issue of fiscal discipline. Thatcher rejected the notion of Keynesian fiscal stimulus and was a staunch believer in balancing the books and strove to meet this goal from her first day in office. The choice between Keynesianism and monetarism is again at the forefront of the European debate which is split between those who see fiscal austerity as a necessary path to calm the markets and those who see the problem as insufficient demand which only greater government spending can remedy. This might seem like a repeat of the fiscal austerity implemented in the early 80s by the Thatcher government, but the two are only superficially similar. Whereas the Thatcher government implemented a number of reforms from tighter monetary policy and fiscal tightening to deregulation and privatization, the current policies of Southern Europe are almost exclusively those of fiscal tightening. Today the list of desperately needed measures includes privatizations (Greece), competition-improving policies (Italy) and labor market reforms (Spain) as well as general improvements in the efficiency of the state throughout the periphery.

Figure 2.Support for Free Markets (%Completely/mostly agree that people are better off with free markets). Source: www.pewglobal.org

But a deeper issue is a change in the underlying belief in free markets and capitalism. Thatcher herself has been quoted as saying that the change in the political platform of (New) Labor was her biggest achievement. There has been such a complete change in political discourse that it is now hard for us to imagine that throughout Europe only 30 years ago the inflation rate was double digits, governments had a say in the pricing of hot dogs, and monopolies were handed out to favored interest groups. Regrettably, the financial crisis has pushed public opinion in the opposite direction and perhaps this drift is the biggest threat of the current crisis (see Figure 2). In particular France has seen a shift in public policy with an extractionary tax on high-income earners and a strong push – along with 10 other member states of the European Union – for a financial transaction tax.

It is crucial to prevent a shift toward the economic systems of the post-war era. A modern market economy is the only way humans have discovered to ensure prosperity for all and we must keep it. But in order to do that, leaders must learn something that Margaret Thatcher never quite appreciated. It is not enough to swing your handbag and bend all to your iron will. If today's politicians want to ensure that public opinion is on their side through tough reforms, they must explain clearly why reforms are needed and show compassion for those most affected.