FOCUS

ON BRITAIN'S CONSERVATIVE REFORM 1979-

THE FRASER INSTITUTE

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By
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Personal Economic Adviser
to
Prime Minister Thatcher

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PART ONE

AN ADDRESS BY ALAN A. WALTERS

to the

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of

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VANCOUVER, B.C.

INTRODUCTION
BY
DR. MICHAEL A. WALKER
DIRECTOR, THE FRASER INSTITUTE

It is an honour and a privilege for me to have the opportunity today to introduce to you one of the most influential economists of our time. As Personal Economic Adviser to Prime Minister Margaret Thatcher, Professor Alan Walters has made a unique contribution to an epoch-marking reorganization of the economic policy in the United Kingdom.

Alan Walters was born in the United Kingdom in 1926 and was educated at the University of London and Nuffield College, Oxford University. He has held distinguished professorship chairs in the London School of Economics, the University of Birmingham and Johns Hopkins University from which institution he is at present on leave. He has also been a visiting professor at many institutions in North America including the Massachusetts Institute of Technology and the University of British Columbia. He is the author of two widely used textbooks in economics, one in micro-economic theory and the other in econometrics and he has authored an additional nine books in several areas of economic analysis.

It is a mark of Professor Walters' versatility that, at a time when he was occupying a chair in money and banking at the London School of Economics, he was perhaps best known for his seminal work in the area of transportation economics. In fact, it is probably safe to say that Professor Walters is the world's leading expert in the economics of transportation and his advice on these matters has been sought by numerous governments, including the governments of Canada and the United States. He is also currently Economic Adviser to the

World Bank on transportation, telecommunications and urban matters. A former editor of the Journal of the Review of Economic Studies, Professor Walters has contributed articles to no fewer than 25 of the world's leading professional journals.

I said before that Professor Walters has been influential in the epoch-marking experiment in economic policy-making which is underway in the United Kingdom at this very moment. In fact, he has been part of a phenomenon which has occurred in the United Kingdom and is beginning to occur in North America, namely, the greater reliance of political policymakers on advice from market-oriented advisers. For many years Alan Walters was a member of the Editorial Advisory Board of the Institute of Economic Affairs in the United Kingdom and, since 1974, has been on the Editorial Advisory Board of the Fraser Institute. Both of these institutions have in common the objective of changing the basic character of economic policy in these two countries.

Last year at this meeting, Professor Milton Friedman told us that ideas have consequences; that ultimately it is ideas which produce changes in the way in which society organizes its activities. Professor Walters stands before you today as living proof of the way in which ideas have their effect on the practical implementation of policy.

Although I am sure he is probably not aware of it he has had, indirectly, a significant effect on the conduct of economic policy in Canada. In 1969 Professor Walters was a visiting scholar at the Bank of Canada in Ottawa and during his time there he was a member of what was then-called the Subrosa Committee on Monetary Policy. One of Professor Walters' tasks during that period was to introduce to the Bank of Canada research on the monetarist policies advocated by Professor Milton Friedman. As a fresh new Ph.D. graduate in 1969, I arrived at the Bank of Canada just after Professor Walters had departed and had the opportunity to watch, over a period of five years, this germ of an idea develop ultimately into a new methodology for the conduct of monetary policy.

In his many years as an adviser to governments, central banks, special commissions, committees, and research boards, Professor Walters has left a trail of ideas and changes in public policy which I am sure he would be too modest to acknowledge.

Ladies and gentlemen, please join me in welcoming to Vancouver the Personal Economic Adviser to Prime Minister Margaret Thatcher, Alan Walters.

BRITAIN'S CONSERVATIVE REFORM 1979 -

INTRODUCTION

From World War II to Mrs. Thatcher

The year 1979 marked not merely the end of a momentous decade, but also the end of an era. A distinguished British journalist, Brian Walden, has dubbed the years before 1979 as the years Before Thatcher (BT). And the years after, AT. Well, although I do not actually approve of this new method of enumeration, the new way of determining a zero in time, I can at least see his point.

But that watershed must be seen in the whole sweep of Western history since the end of World War II. After the immediate recovery period in the 1940s, the decade of the Fifties saw indeed the golden years of the West. Growth was high, sometimes at miracle rates, and unemployment was virtually unknown.

To a large extent growth was based on the transfer of American technology and management methods to Europe and Japan. In these war-torn countries there were to be found able, educated, disciplined, resourceful, and highly motivated populations. They responded with alacrity to the incentives of the market place. Europe and Japan rapidly began to catch up on the United States.

During these halcyon days, growth was entirely natural. It needed no artificial stimulus from government deficit finance with massive public sector investment programs. Neither was it plotted by planners in accordance with some grand design. No, it was firmly based on individual initiative and private enterprise, it was financed not by state expropriation but by private savers.

The momentum of this great leap forward continued into the early years of the 1960s. And the world financial system that supported it was pivoted on a stable dollar and a low, almost zero, rate of inflation in the United States. The world was on a dollar standard and it prospered well. Then in the mid-1960s the government of the United States markedly changed its policy to one of "go for growth."

Deficit financing -- a new way of life

Of course the United States administration and Presidents Kennedy and Johnson in particular, were sold the proposition that one could increase the rate of growth, or at least the level of output, permanently by expanding government spending. The long-held anathema to deficit financing, which had given rise to such prudence in the United States, just as it had in Japan and Germany, was jettisoned. Deficits were good for growth. The United States then embarked on a monetary expansion -- it metaphorically printed money -- in order to finance the great society, the fight on poverty, and the Vietnam War.

The great inflation conundrum

You all know the sad result. The great inflation started in 1964. It is an inflation with which we are still wrestling today. It has resulted in the disintegration of the dollar standard. It has cast a long shadow over all our lives. It has caused great tensions within the great Western alliance.

The great inflation also ushered in the decade of the debtor. For almost 15 years from 1965-1979 interest rates in the West have been normally, and certainly on the average, below the rate of inflation. The saver has been systematically robbed. Professor George Stigler pointed out that if one had invested in **Standard and Poor's Index** over little more than the last decade, one would get a real rate of return of about -5 per cent. Again we are still wrestling with the debt problem.

It was always clear, at least to monetarists, that the process of reform to an inflation-free world economy would be agonizing and probably long. Inflation had corrupted the context of our lives. Few asked when it would stop; all wondered where it would go to next. In 1971 I ended an article with the following words, "The great inflation (in the UK) will inevitably come. There is nothing we can do to stop it. And God only knows when it will end."

The symptoms of the British Disease

This was the world environment when the Conservatives took office in 1979. But if the world had its problems, then Britain had them in fuller measure.

First, the growth of government had been more rapid in Britain than in most other Western countries. Vast areas of industrial and commercial activity had been invaded and conquered by bureaucracy. Nor was the incursion of the state restricted merely to industrial and commercial life. The creeping controls infiltrated into health insurance, the schools, and the very family itself. The second main effect followed as night must follow day. The state required more and more of the citizens' resources in order to finance its incursions. So, through taxes, through inflation, and through enormous borrowing the state acquired a larger and larger fraction of the fruits of a person's labour or savings. By so doing it exacerbated that tragic divorce between effort and reward. Marginal tax rates soared and were not uncommonly found to be well over 100 per cent. Of course, little or no revenue accrued from such high rates -- but that did not ameliorate the great damage they did in distorting activity and destroying enterprise.

The third form of paralysis was that induced by extensive regulation. Controls on the use one could make of one's assets, regulations on incomes and prices, controls on exchange rates, restrictions on credit, and so on. As Friedrich von Hayek so acutely observed, controls beget, not joy, but more controls.

The fourth persistent problem was that Britain, compared with OECD countries, was always at the top of the inflation league. In the view of learned scholars, who had been so influential during these post-war years, inflation did not harm and was almost certainly good for our society. It expropriated the capitalists, and the small saver in particular, and it provided government effortlessly with funds; they did not need to ask for parliamentary approval. But it also created uncertainty and even fear and alarm. The great institutions of Britain came under increasing strain, and doubts about their durability were rife.

The Thatcher Experiment -- much done, much undone

Well, now four momentous years have passed. Much has been done. Much undone. It is a time to reflect and review.

Let me begin with the great reform towards financial stability. I suspect there is no need to tell anyone of the sad state of the British economy in the latter part of the Seventies (and unless anyone has the remotest suspicion that it is a statement tainted by party political considerations, let me immediately state that the British inflation was, if not generated then certainly secured by the Conservative government under Edward Heath in the first four years of that decade).

It was not simply that inflation was high and rising. There was a hopelessness about it all. Somehow nobody believed that anyone could really conquer the seemingly inevitable rise in the rate of inflation.

The political air had been polluted thick with promises but performance if it were not paltry had been almost perverse. Virtually every policy had been tried e.g. income and price controls by blandishment, threat, and legal enforcement; social compacts and contracts between unions, government, and industry. Interest rates had been controlled and credit rationed. The pound had been pegged at a high rate to induce domestic prices to behave themselves.

All had been tried. All had failed. But it was no mere failure of ability to rein in and reduce the inflation rate. It failed in a more general sense. The economy tended more and more to stagnate. Unemployment which one was taught could be solved by a little turn of the expansionary screw, grew greater and greater along with its seemingly perpetual bedfellow of rising inflation. Here was a good traditional British solution.

MONETARY AND FISCAL POLICY IN THE U.K.

Solving the inflation dilemma?

I am sufficient of a chauvinist to claim that monetary policy as the prime, if not the only, method of controlling inflation was largely invented and developed by distinguished British economists from David Hume to John Maynard Keynes and Denis Robertson.

Monetary restraint was tried -- fitfully -- both in the Sixties and the Seventies. But inevitably it involved painful periods of adjustment. No government had sufficient resolution or political courage to see any such program through. After a year, or perhaps even 18 months, of monetary restraint, the monetary caution was thrown to the winds. Back we were again on the old inflationary cycle but at higher rates.

Monetary policy -- a spoonful of courageous medicine

In the mid-1970s I was quite convinced that no politician, no political party, and no government would have the courage and resolution to carry through a monetary policy for a sufficiently long time so that the increase in inflation would be contained and reversed. Labour Chancellors such as Roy Jenkins in 1968 and Denis Healey in 1976, who tried it even for quite brief periods, later found themselves political pariahs in their own party. And the grand old guard of the Conservative Party were equally fearful of the consequences and of being condemned as heartless capitalists. It seemed to me in 1975 (my paper was **Money and Inflation** published by Aims of Industry) that Britain was drifting into the paralysis of an Argentina or a Uruguay.

The claim of Mrs. Thatcher's government that it was determined to control inflation and to bring about financial stability was understandably greeted with skepticism verging on cynicism. The media and the academicians settled down with their eyes peeled for the first inkling, the first sign of a U-turn. And where there's a newsman there's a story. Tales of U-turns abounded with such profusion that mutual contradictions in the same paragraph or even in the same sentence became common.

The results -- a success story

In fact there has been no U-turn at all. We are still on course. The financial policy that the government was to pursue was set out in a most unprepossessingly titled document called The Medium Term Financial Strategy (MTFS). There the government proposed to reduce gradually the rate of growth of the money supply on one hand and, on the other, to reduce gradually the public sector borrowing requirement -- or roughly speaking, the public sector deficit.

The path of decline in monetary growth was anything but smooth in the first full year of the Tory government. There was a major dilemma. The rate of growth of the money supply in terms of M1 was brought down from 15 per cent in 1979 to less than 5 per cent in 1980. Yet, Sterling M3, the chosen measure in the government's plan, rose from some 12 per cent in 1979 to near 20 per cent by the end of 1980.

Yet throughout 1980 it was absolutely clear that there was a substantial monetary squeeze taking place. All the other indicators -- real interest rates, the monetary base, and the rapidly appreciating exchange rate -- suggested that money was tight and that M1 was telling us the truth of the matter.

Indeed, the evidence suggested that money was perhaps rather too tight in 1980 and there was a relaxation through reductions in interest rates. Monetary growth -- in terms of M1 -- was restored to about 9-10 per cent in 1981. However, by this last year, up to the last statistics, all of the monetary aggregates were growing within the range prescribed in the MTFS. Even the wayward M3 had come back into line. I suspect that this is something of a record.

In retrospect it is fairly easy to account for the wayward growth of M3 in 1980 and 1981. It was connected with the elimination of controls on the banking system which made it both more profitable and efficient for the banks to act as intermediators in credit markets. And, although I remain deeply committed to the pursuit of monetary rules, I think one must interpret them rather carefully, especially when there are substantial changes in regulations taking place (as indeed there are now in the United States).

Our monetary aggregates now are seemingly well under control. The monetary base is growing slowly, only about 3½ per cent per annum and transactions balances (we call them M2) grew by only 6.5 per cent last year. All these indicators suggest that we are near to achieving stable non-inflationary monetary conditions.

Inflation wrestled to the ground

In terms of the reduction in inflation, the result has been far more dramatic than anyone dared hope. The inflation rate which peaked at over 22 per cent in May 1980 has now fallen to less than 5 per cent. And even the most determined cynics cannot see it bouncing back into double digit levels in the next two or three years. Many perceptive observers are convinced that eventually it will go down even further. And I suspect they are right.

This great achievement -- and I think it is quite an astonishing achievement for the United Kingdom -- was not brought about by regulation on wages or prices. Nor was it induced by an artificially high exchange rate. (Indeed the final stages of the reduction in inflation have been associated with a depreciation in sterling.) Nor has it been associated with restricted credit markets, regulations on interest rates, and rationing of funds. All the financial markets have worked with a freedom hitherto unknown in Britain and rarely to be found in the rest of the world.

Furthermore, it has been achieved over a period of only about three years. And, against the background of a recession deeper than any we have experienced since the 1930s. Yet we have come through with our institutions intact, no substantial civil disorder and, strangely enough, a Conservative Party topping the polls. No mean achievement. I believe also that the other essential feature of this reform was a sustained progress in reducing the government deficit or, as we call it, Public Sector Borrowing Requirement. In 1975/76 the deficit was ten per cent of money Gross Domestic Product (GDP), next year it is targeted at about 2.75 per cent of GDP. In practice, that means we are very near to having a balanced budget in the sense used in many other countries. (We include in our deficit the capital programs for the nationalised industries and for public services which would normally be excluded in other countries.)

Towards balancing the budget -- an unpopular policy

That is, I think, quite a substantial achievement, especially under conditions of world recession. It took some doing. The critical budget was in March 1981 when the government found that the deficit was likely to boom. Then occurred one of those odd, but very interesting examples, almost like a controlled experiment, when the government in fact tightened fiscal policy quite dramatically, primarily by raising taxes, but also by cutting expenditure by a net value of £5bn (or five per cent of the public expenditure) and at the same time eased monetary policy by lowering interest rates by two percentage points.

So we had a dramatic tightening of the budget at the same time as a more relaxed monetary policy. The vast majority of economists in the United Kingdom condemned this budgetary policy. Indeed, 364 economists from all universities in the United Kingdom wrote to **The Times** a letter reviling the policy as one which would lead to an ever-deepening slump.

In fact, as everyone now would agree, exactly the opposite effect took place. The economic decline was not merely arrested but by the middle of the year there had been a decisive upturn. For the scholar, however, (and I remain a scholar manque) the interesting feature was that the economy had responded to the monetary stimulus rather than the fiscal squeeze. It demonstrated yet again in modern Britain that the motor of the monetary mechanism was far more powerful than the force of fiscal policy.

However, I do not wish to leave anyone with the impression that I believe that fiscal policy and, in particular, controlling the public sector deficit is a matter of little importance. Persistent deficits incurred year after year, rather like those in the United States, threaten either future increases in tax rates or, more likely, future increases in inflation. It is rare that one can find in history persistent deficits year after year that have not been eventually monetized. The political temptations to overcome these debt problems with a bit more inflation is very beguiling -- as you can see in many, many countries around the world today. In

Britain there has been a bitter experience in the 1970s of the erosion of national debt and many a saver's nest egg by the great inflation. I do not think many would wish to relive that experience yet again.

A PROGRAM OF DE-REGULATION IN THE U.K.

A program of de-control

So much for fiscal and monetary policy. I now turn to the area of deregulation, privatization, and other singularly hideous words to describe a most desired and desirable process. Here again I believe that experience over the past four years has been good.

Regulations and controls have been with us increasingly, certainly since World War II. Labour governments, and indeed many Conservative administrations, have used the whole panoply of controls over prices and wages. And exchange controls, introduced under emergency legislation during World War II, have persisted for 40 years. Britain did not drift into this middle-aged arthritic state overnight.

Exchange controls abolished

In 1979 within a few months of being in office, the new government abolished completely all exchange controls. Shock and horror. Thousands of regulators were rendered redundant. For the first time in 40 years one was free to buy and sell as much sterling as one wished.

Many acknowledged "experts" poured forth their fears that this would result in sterling dropping to unforeseen depths. There was dark talk of uncharted territory and black holes. But in fact the experts were neatly and decisively discredited by events. Instead of sterling falling to embarrassing lows, it scaled new highs. (And this is what one would normally expect as a consequence of a tighter monetary policy pursued after the third quarter of 1979.)

The abolition of exchange controls was the first, the most courageous, and arguably the most successful of the deregulation measures. We all understand now that exchange control, applying only to residents, has the effect of expropriating residents in favour of government, on the one hand, and foreign speculators on the other. There will be no looking back, except by the opposition parties. We have learned an important lesson: if exchange controls are effective they are bad, and if ineffective they are futile.

The elimination of controls has proceeded in many other areas of economic life. For example, there are now no credit controls; they were eliminated in the 1980s. Credit is allocated according to the market mechanism and controls on savings are virtually zero. Again to the surprise of many and the chagrin of a few, the credit markets work very well.

The politically impossible option

There are in some fields one or two significant residual elements of control which are serious and do impede the freedom of the individual and the functioning of the market. Probably the most important are in housing. Although it has been significantly modified, the government has never felt that it would be appropriate to eliminate rent control. For many years the private rented sector has been declining rapidly. At the same time, the public sector has expanded with owner/occupier dwellings. Housing policy has concentrated on enabling the tenants of public sector rental housing to buy their houses. It is aimed at a property-owning democracy. It has enabled a rapidly increasing number of tenants to become owner-occupiers. And it is a monument to what R.A. Butler called "the art of the possible."

Another impediment of some importance is that we still tolerate minimum wage laws in certain trades. These have undoubtedly exacerbated unemployment and have probably inhibited training of the young. It is, however, legally very difficult to get rid of them. The government is bound by an ILO Convention which cannot be renounced until 1985.

Privatization on the move

These are the most important examples of prices and incomes control left in the UK. But what, you may ask, about nationalized industry? That is often said to be a form of price control by any other name. Some commercial discipline and efficiency were very much needed in nationalized industries. Ultimately, many of them were to be privatized. So what is the record of government here?

Of course, privatization has never gone as fast as one would have wished. But it has gone faster than many expected. Britoil is now a private company. Legislation is in place to turn British Airways over to the private sector and largest of all, British Telecom will be sold to the private sector in the next Conservative administration. But apart from these cases, I think it is remarkable how the nationalized industries have been induced to become more efficient. There are some wonder cases such as steel plants that have almost doubled production. But the hard core of nationalized industries remain with problems of low efficiency and high losses. I will return to this question of industrial reform later.

PUBLIC SPENDING AND THE TAX BURDEN

Room for improvement? -- public expenditure and taxes

But I must first talk about the two aspects of reform which have been less successful -- these are reducing public expenditure and the tax burden on the British people. It is perfectly true that in 1979/80 and 1980/81 the fraction of total public spending to GDP increased. This was very largely due to the onset of the world recession. Expenditure on unemployment benefits and supplementary benefits (often a form of unemployment benefit) increased dramatically as the number of unemployed increased. Manufacturing output fell and output in general stagnated.

Public expenditure finally under control

However, since 1981 the tide has turned. Public spending as a percentage of GDP has fallen. From 44.5 per cent in 1981/82 it has fallen to 44 per cent in 1982/83 and is planned to fall to 43.5 per cent in 1983/84. More important, however, there is good reason to believe that those numbers in 1983/84 are likely to be realised. Public spending is now under control. And indeed last year it was slightly less than that which was planned. The new cash method of controlling expenditure has been a success and plans for future expenditure have been substantially reduced (by £1.1 billion 1983/84 and by £1.2 billion in 1984/85) compared with earlier plans.

Although we look forward for three years in our public expenditure program, it would be wrong not to look further ahead. There is a real problem in the automatic nature of the growth of public expenditure. It is somehow like a cancer that destroys healthy tissue and multiplies by cellular division. We in the Western democracies have not really yet come to terms with this phenomenon. All sorts of suggestions have been made. The one that I like best is the constitutional limit proposed by Milton Friedman. But there are many problems with that particular measure. This is still unfinished business.

Tax rates decline

The fruits of this new effective control of public expenditure have been recently transmitted to the long-suffering taxpayer. But in three other respects there have been important changes. First the taxes at envy-and-hate levels of 98 per cent (and effectively over 100 per cent) were reduced to 60 per cent and 75 per cent marginal rates.

Secondly, there has been a laudable attempt to widen the tax base and bring the rates down generally. Thirdly, the government has more than any other previous government in the last ten years, tried to raise its finance **honestly** through the tax system rather than through inflating the currency or by borrowing and taxing future generations.

The government's firm commitment to honest finance is one of the lynchpins of its general policy. I suspect that the people of Britain generally admire this aspect of the government more than any other. Honest finance is a rare flower to bloom in British soil. We cherish it.

THE THATCHER RECORD

Thatcherism — the new spirit

So far I have reviewed the progress of the British economy and the record of government in terms of the classic measures of Conservative criticism. But, important though these measures of public spending, inflation, and so on are, I really do not think they catch the spirit of Mrs. Thatcher's Britain.

I believe the transformation is most easily seen on the shop floor. I am told time and time again that there is a new spirit developing. Restrictive practices hallowed for years are gradually, and in some cases suddenly, disappearing. Managers who had long given their management function over to the Shop Stewards have now discovered the will and ability once more to manage. Pride in the product, attention to detail and quality, and cooperation are all reaching new and hitherto unattainable highs. You have all seen manifest examples -- in, for example, the much improved Jaguar cars now being sold in enormous number in the United States, and produced in Coventry by a reduced labour force. Last year Britain increased its share of world manufactured exports --

certainly against a long-established trend, and against a measured decline in competitiveness.

It is even discernible statistically. Over the past two years productivity in Britain has increased quite dramatically against the normal trend and against cyclical expectation. Indeed, our productivity increase has been higher than any of the OECD countries, higher indeed even than Japan over this period. Similarly, again a most unusual event, the increase in wage costs has been lower than all but two OECD countries.

In conclusion

From all these straws in the wind, can one believe or should one merely hope that this heralds the British renaissance? Has it at long last been turned around? Shall we set in train, not merely that inflation-free growth, but that new spirit of enterprising and energetic Britain?

I do not know. But I am quite convinced that the absolute precondition for that in Britain is another five years for Mrs. Thatcher.

PART TWO

MIKE RYAN INTERVIEW

with

ALAN A. WALTERS

for

"BUSINESSWISE"

CBC TV, Vancouver

THURSDAY, APRIL 7, 1983

Ryan: The economic policies of British Prime Minister Margaret Thatcher have created much controversy over the last few years. She's been condemned in some quarters for being an iron lady who has tried to battle inflation at the expense of the people. Others argue that she's made significant gains. Alan Walters is Prime Minister Margaret Thatcher's Personal Economic Adviser.

The perception over here is that Thatcherism and Reaganomics are quite similar and people are saying that Thatcherism has been a very mixed success so, therefore, Reaganomics is doomed. But we'll get into that. Are they really similar?

Walters: In some respects, yes. I think the only manner in which they were dissimilar originally was that the Reagan administration put a lot more emphasis on the fact that they believed that the enormous increase in output and activity is a consequence of reducing taxes. The so-called supply side. In Britain we were never convinced that that would be a very important factor. We thought it would happen but we didn't believe it was so important that it would give us almost perpetual motion.

Ryan: But was reducing taxes part of Thatcher's theory?

Walters: Oh yes, indeed. Much more important was the reduction, however, in public expenditure.

Ryan: Reduction in public expenditure, reduction in taxes, and reduction of the deficit.

Walters: The key thing is the reduction of public spending.

Ryan: What about the reduction in the money supply, the tightening of money?

Walters: Well, that has been, I think, one of the most successful, in fact even the most obviously successful element of the Conservative government's policy. That really has worked. It has been associated with this dramatic reduction in inflation from well over 22 per cent in May 1980 to about 5 per cent now.

Ryan: Which is still slightly higher than the inflation rate in the United States. Right now they seem to have achieved the same thing. Would you agree with that?

Walters: In the U.S. they didn't start from quite such a high level as we did. I think the achievement in Britain is rather more remarkable than that of the United States. But, they followed a somewhat similar policy. From 1979, onwards they reduced the rate of growth in the money supply. What they did not do, however, (this is where the difference is) they did not set about reducing their budget deficit. We in Britain set about reducing our budget deficit.

Ryan: Did you succeed?

Walters: We succeeded. Yes!

Ryan: Part of Reagan's economic theory is less and less controls from the government. Is this also part of Thatcherism?

Walters: Yes, indeed. The first thing the British government did and one of its major measures was to eliminate exchange controls. They did that very quickly, in fact, overnight.

Ryan: So there is no restriction on someone in Great Britain taking funds out of the country?

Walters: You can take your money where you like and do what you like with it. That is, I believe, a remarkable freedom and it is what we should defend and cherish.

Ryan: We have two very serious problems in North America as a result of restricting the money supply and trying to control inflation. One, of course, is a very high rate of unemployment. Has Great Britain also suffered from that?

Walters: Yes, Great Britain has suffered from a very high rate of unemployment. But I think really no higher than that of Germany or Holland which are comparable countries where exports account for a large portion of Gross Domestic Product. I am rather doubtful about the proposition that much of this unemployment is caused by the fight to reduce inflation because it has occurred in one economy after another where there have been quite different policies pursued. I think the basic thing that caused unemployment is the fact that wages outstripped productivity by a remarkable factor during the 1970s. And it happened in virtually all Western countries.

Ryan: The other major problem Canada suffered from was incredibly high interest rates. What was your experience in Great Britain?

Walters: Well, experience in the 1970s was, of course, that you had high interest rates but they were still lower than the rate of inflation. Now, what we've been doing since 1979 is really recovering from the fact that over the 1970s the saver, especially when you take taxes into account, was essentially expropriated. Now, you always expect overreaction in monetary economics. And that is what we have seen over the past two, maybe two and a half years. We've seen real interest rates, very high rates, even taking into account taxes and you're bound to see an overreaction. Interest rates also in the United States, I believe, reflect that people feel markets are not entirely certain that the battle for inflation is over. They must do; otherwise interest rates would be considerably lower. As I say, it takes a long while to convince people when they are being, as it were, deluded so often. They are looking very carefully; they are behaving very prudently.

Ryan: What do you see for the trend of the U.K. economy in the next short while -- six months to a year?

Walters: Every piece of evidence points to a slow but sustainable, non-inflationary recovery.

Ryan: That would be very healthy. A recovery that might be better than that of North America?

Walters: I hesitate to predict what is going to happen in North America. But it looks as though the United States economy is bouncing back at a rather faster rate than anyone predicted and it looks as though it is probably bouncing back at a faster rate than in Great Britain.