The Actuary

February 1982 – Volume 16, No. 2

The Actuary
The Newsletter of the Society of Actuaries
VOLUME 16, No. 2 FEBRUARY, 1982

UNITED KINGDOM RESPONSE TO INFLATION

by William Vickers, B. Comm., Toronto

Ed. Note: Mr. Vickers, Senior Compliance Officer of Manufacturers Life Insurance Company, kindly contributed this at the invitation of our Economics & Finance (Continuing Education) Committee.

How to deflate overheated economies, and at the same time to stimulate productivity and maintain high employment, are difficult challenges facing many governments. The results of Prime Minister Margaret Thatcher's monetary and fiscal policies to achieve these goals are therefore of no little interest abroad.

Inflation's Perceived Roots

It is widely accepted that inflation is sparked by excessive growth in the money supply at a point (called the "inflationary gap") where there already is full employment, i.e., no excess productive capacity. Such growth, which may arise from government spending, new investment, or consumption, is deemed inflationary because it increases aggregate demand without increasing production. Labour cost-push and monopolist price-push theorists attribute inflation to excessive wage and price increases created by union and monopolistic power, respectively. Structural-rigidity theorists consider that prices can increase but never decrease, because prices in contracting sectors of the economy stay the same because of economic structural rigidities, and prices in expanding sectors rise. Many attribute inflation's persistency to expectations that it won't be stopped; hence wage and price contracts reflect inflation that has not yet happened.

(Continued on page 4)

NEWSLETTER NEWS

Among actuarial newsletters these days, we have one that's new; one that's using a computer; one that sports a new editor; and one that has both a new editor and an increased issue frequency.

FRESH AIR—AIR stands for Actuaries In Regulation—has been launched. Its Editor, R. Michael Lamb of Salem, Oregon, tells us that it's intended to appeal to casualty people, but an occasional item may merit attention of life and pension actuaries. He cheerfully permits us to relay such pieces.

The October 1981 issue of John H. Miller's DISABILITY NEWSLETTER was produced on their newly acquired equipment, consisting of a TRS-80 II computer, TRS-80 Daisy Wheel Printer II, and Scripsit Word Processing, Model II. As well as meriting our respect, this gives food for thought for this journal which is edited in North Carolina, produced in New York, and distributed from Chicago. Comments from readers on what you might do if you were in our shoes will be welcomed.

FIASCO in London, skillfully edited these past two years by Peter J. Turvey, advertised in its October 1981 issue for a successor, and promptly announced appointment of R. David Campbell of Epsom, Surrey. We count upon enjoying the same reciprocity with him as with his genial predecessor.

The ACADEMY NEWSLETTER now has Mary H. Adams at its editorial helm, and will have twelve issues in 1982. We expect this latter to result in rather less duplicating of articles and announcements between us than in the past.

E.J.M.

SCOPE OF SOCIETY RESEARCH

Ed. Note: This is little more than a teaser excerpted from a three-page statement of policy adopted by our Executive Committee in September 1981. Interested readers are invited to obtain the full text from James L. Cowen, Director of Research at the Society Office, and to direct comments and questions to him or to Dwight K. Bartlett, III, c/o National Health & Welfare Mutual Life Assn., 666 Fifth Avenue, NYC 10103.

Actuarial research efforts of Society members may be classified generally into three categories as follows:

Experience:

Collection, analysis and reporting of . . . data pertaining to actuarial science . . . including preparation and graduation of experience tables, and development of projection factors.

Theory:

Discovery and refinement of mathematical and statistical theories and techniques . . .

Practice:

Research and development relating to actuarial principles and business practices affecting . . . insurance companies, employee benefit plans and government programs.

. . . .

The Practice category includes much of the work of the various committees on dividend practices, valuation principles, and pensions, as well as much of the research of individual Society members. It is important to distinguish between two phases of Practice category projects as follows:

(Continued on page 5)

New Model Valuation

(*Continued from page 3*)

some minimum paid-up values and extended term periods higher than those now required. To keep the resulting filing of new forms to a minimum, companies may resort to policy forms under which only the rate and value pages need to be revised as the requirements change.

* * * *

To sum up the three articles on this subject: I believe that these new laws will be found to serve the public effectively in their flexibility and in their safeguarding of company solvency, and likewise in the reasonableness of the withdrawal benefits whose minimums they prescribe. □

A Chance To Acquaint Yourself With Modern Risk Theory

Any member who wants a two-day course built upon the recently announced text material on Risk Theory — see "New Risk Theory Study Note Signals Change," front page of our December 1981 issue—is invited to enroll, while space is available, in one of several seminars to be held in March.

Response by Part 5A students has been so strong that sessions are scheduled for numerous cities, probably in one convenient to you. If this may interest you, ask Linden N. Cole at the Society office for particulars.

Response to Inflation

(*Continued from page 1*)

Current persistent inflation in the U.K. is peculiar to this era in British history. During John Maynard Keynes' heyday (1919-46) Britain had experienced remarkably stable prices amidst generally high unemployment; hence controlling unemployment was his primary concern. He thought employment would respond to government taxation and expenditure policies; probably he was unaware that inflationary gaps might simultaneously cause unemployment, productive stagnancy and price increases.

Inflation's most damaging effect is that it redistributes income haphazardly, taking it from those who can't protect themselves from price increases and giving it to those who can.

Many economists have expected persistently low unemployment to go along with high inflation and rapid growth in the money supply. But today's experience having shown the reverse to be usually true, the conclusion often reached is that the money supply must be reduced to cure inflation; slowing its growth results in higher unemployment unless the private sector reacts by promptly moderating wage demands and price increases.

British price levels increased explosively in 1972 following one of the highest fiscal deficits in its history occurring at an "inflationary gap" point. Blaming this on high wage settlements, the government imposed strict wage and price controls. Unions reacted with demands aimed at restoring wages to their previous level in real terms; the results were crippling strikes in key industries, power cuts, social unrest, the calling of a general election and the government's fall. The incoming Labour government surrender to the strikers' demands; the income policy collapsed; lost output and social stress were enormous, yet inflation was not controlled.

The Prime Minister's View

Mrs. Thatcher, coming to power in 1979, adopted a different economic strategy. She may have assumed that because wage and price controls had failed before, they would be expected not to work, hence inflation would resume as soon as they were lifted. Her approach was to reduce aggregate demand by contracting the money supply and by other monetary and fiscal measures.

She said she was committed—to reducing the rate of growth of the money supply—to creating conditions for a sustainable economic growth—to strengthening incentives by allowing people to keep more of what they earn—to enlarging individual freedom of choice by reducing the role of the State—to reducing the burden of financing the public sector so as to leave room for commerce and industry to prosper—and to promoting a proper sense of responsibility in those who take part in collective bargaining.

Her primary initial monetary measure was to keep high the interest rate at which the (Central) Bank of England makes advances to the chartered banks, with the twin objectives of discouraging borrowing by businesses and individuals and reducing profits so that management would surrender less easily to unreasonable wage demands. Her fiscal measure was to reduce income taxes, making up the resulting loss in tax revenue by increasing the rate for the national sales tax (VAT) and employers' social security contributions; her hope here was to confront taxpayers with the choice between contributing via VAT in spending their tax savings or else increasing their own savings. And she undertook to reduce public expenditures wherever possible.

The Story So Far

Up to her announcement of the 1981-82 budget in March 1981 the effects of Mrs. Thatcher's policies were:

- unemployment at an unusually high level and still growing;
- increases in business bankruptcies and near bankruptcies, which she has alleviated in a small way by reducing the minimum lending rate from 14% to 12% and granting enormous subsidies to several essential industries;
- moderation in wage settlements as labour and management both realized that profit margins were too slim to risk unreasonable increases;
- inflation rate moving from 12% when she took office to 23% in April 1980, then down to 13% in March 1981;
- 20% 1980-81 growth in the money supply, much higher than the 13% when she took office and than her 7% to 11% goal (which has caused her to impose tax increases whose burden will be mainly on the consumer rather than on the generally financially weak industry);
- and a strong pound sterling, attributable partly to self-sufficiency in oil.

It will be interesting to see whether, until election day in 1984, the Iron Lady can continue to convince a growingly rebellious cabinet and hundreds of leading British economists that her austerity program will achieve her goals, and what further pragmatic strategy changes, if any, she will make. □