The gall of Maggie Thatcher

She demands that the U.S. adopt her disastrous policies, only more so; Richard Freeman documents Britain's two-year economic extinction.

When British Prime Minister Margaret Thatcher meets with President Ronald Reagan, she will attempt to sell him on the "British experiment." Thatcher comes to the U.S. with an economy that is worse off in every respect than when she took office 21 months ago, and has no sign of any recovery.

Thatcher's experiment is nothing less than the biggest failure since John Law's South Sea bubble. Since she took office, unemployment has almost doubled to its highest level since the 1930s depression; as a result, the budge deficit for fiscal 1980-81 has swollen by 50 percent. Production crashed in this period by 21 percent. The inflation rate, down from its 22 percent peak, has run at 14.5 percent for the last three months, twice its level when Thatcher took office. The money supply has been clocked for most of 1980 at greater than 20 percent.

Nothing has worked; everything has gone wrong. But Thatcher will tell Reagan that the only reason her experiment did not succeed is that she did have enough time, and she didn't apply her program hard enough. She will tell Reagan point blank that he must push harder than she did.

What Thatcher did only too fully is apply every disastrous scheme that monetarist adviser Milton Friedman urged. Friedman's form of cult, called monetarism, says that applying shock therapy to an economy should result in restoring it to health, and that money supply, a thrice-removed measure of the economy, is more important than production.

Clockwork Orange

Beginning in May 1979 when she took office, Thatcher and the governor of the Bank of England, Gordon Richardson, began pushing the Minimum Lending Rate (MLR) into the stratosphere, just as Volcker has done. She and Richardson slashed money supply, applied fiscal restraint, and cut out all government investments in high technology. If Friedman's theory held true, the rate of inflation should fall precipitously six to nine months after this package of "reforms" was applied to the economy.

In late 1979, Thatcher announced the lifting of exchange controls, permitting hot-money flows to enter London that previously had only partial access. The exchange-control abolition, combined with the higher revenues from the flow of British-owned North Sea oil gave Britain a current-account surplus for the first time in years.

The combination of high interest rates, current-account surplus, and exchange liberalization in turn delivered an artificial boost to the pound sterling. It rose from a level of a $1.90 to the pound in late 1979 to a current level of $2.35 to the pound today. This reinforced the flow of money into the speculative side of Britain's economy.

Thatcher cut spending in the areas of foreign aid, education, housing, and municipal services; housing alone was reduced $3.5 billion. She jiggled the tax structure, lowering the maximum rate of taxes from 83 to 60 percent while imposing a value-added tax on all but the most essential household commodities, which deeply slashed the incomes of low- and middle-income wage earners. Then Thatcher sat back. What she got was not only the destruction of the physical economy. Inflation went wild.

Thatcher and Richardson indeed massively gouged the money supply. At one point in late 1979, it was falling at a negative 15 percent rate and was down sharply for the last six months of 1979. Six months after the application of this policy, inflation should have fallen, were Friedman right. But because interest rates were high, and speculative currency arbitrage and real-estate ventures flourished under such conditions, they pushed inflation up. By mid-1980, inflation was spiraling out of control at a 22 percent rate, more than triple the rate when she took office.

Production savaged

President Reagan should pay very close attention to what happened to the British economy, for this is the guts of the Thatcher-Friedman "experiment."

The bottom fell out of the economy starting in 1979, and accelerated in 1980. British industrial production dropped more last year than in any year since the 1930s. And there is no indication of a turnaround.

Overall all industrial production fell by 10.7 percent in the course of 1980, worsening as the year went on. During the fourth quarter of 1980, industrial production was down 13.8 percent from the corresponding period in 1979. The drop in the manufacturing portion of industrial output was even sharper: it fell 1.2 percent in December, or a 14.4 percent annual rate. Entire industries were gutted, creating disgraceful unemployment and tens of billions of dollars in lost output. For example, in the fourth quarter of 1980, the metal industries' output fell by 32 percent from the same three month period of 1979.

Unemployment climbed at a staggering 66 percent in 1980 or more than 50,000 new unemployed per month. It has nearly doubled since May 1980, going from 1.29 million to 2.4 million, which now represents nearly 10 percent of the labor force. To evaluate the shake-out in industry and resulting unemployment, consider the following:

- **Textiles:** Nearly 200 medium-to-large-sized clothing factories closed during 1980, and unemployment, which rose by other 100,000 last year, nearly doubled. One in two clothing workers in the course of 1980, faced either redundancy (layoffs) or short-time.
- **Steel:** In 1979, steel output was 21 million tons per year. Under the direction of British Steel Chairman Ian McGregor, a former Lazard Frères investment banker, British steel output for 1980 was 11.2 million tons. One example illustrates the unemployment situation: in Wales, British Steel Company employed 46,000 workers in 1979. By early this year, the number is projected to sink to 16,000, a one-third drop.
- **Housing:** In the public-sector housing industry—which produces two-fifths of Britain's homes annually—the Thatcher government itself projects that housing completions will fall from 102,000 in 1979 to a level of 50,000 by 1982. During 1980, the number of construction workers on unemployment benefits rose by 70 percent from 157,000 to 280,000. The employers estimate that this idle construction manpower alone is costing the British Exchequer $1.32 billion per year in lost revenue and state benefits.
- **Coal:** This is one of Britain's major industries. Thatcher announced this week, and then had to withdraw temporarily, a decision to close down 20 mines and 10 million tons of annual coal output from the nationalized coal industry. With the steel industry, power stations, and the like producing less, and therefore using less coal, Britain now has stocks of 36 million tons of unused coal, which are growing, meaning new layoffs.

In short, there is not a sector of the British economy—except certain technetronic and service industries—which doesn't have plummeting output and rising unemployment. In a Feb. 15 article entitled "Has Industry Lost Its Heart to Fight," Britain's *Sunday Times* wrote, "Even the West Midlands—the heartland of Britain's engineering excellence and once the place where recession was something other people suffered—is reeling." Unemployment in this high technology zone is 15 percent.

Friedmanism shattered

Just as in Argentina and Israel—two other nations which have subjected themselves to Milton Friedman's advice and which had 1980 inflation rates of 87 percent and 122 percent respectively—in Britain, the collapse of production has shattered even the monetary and fiscal targets that Thatcher set.

The budget deficit for fiscal 1980-81 was first forecast at $20 billion, then revised last November to $27 billion. Now government sources expect that deficit to exceed $30 billion. In the U.S. economy, Britain's deficit would be the proportional equivalent of $120 billion. Most of this $10 billion increase in the budget deficit is due to the record unemployment and paid out benefits.

The monetary aggregates, which were supposed to be in the 7 to 11 percent growth range, zoomed out of control. M3 sterling rose at a 22 percent rate in 1980. The Bank of England and British banks were heavily lending to business to prevent bankruptcies, which greatly swelled the money supply. Despite this, a record 10,000 businesses went under. According to one economist, "some companies are borrowing with the benign consent of the Bank of England . . . *just to pay the interest on their bank loans* [emphasis in the original]."

Inflation over the past three months is still at 14.5 percent. The only reason it came down from the 20 percent range is not that domestic prices aren't rising fast. The overvalued pound sterling has depressed the cost of imports, tending to lower inflation. Of course, exports, denominated in pounds, are tumbling, leading to a further shutdown of production.

Too lax?

Anyone who concludes that Thatcher "hasn't gone far enough" needs his head examined. The Thatcher "experiment" has been under way for just short of two years. Thatcher is predicting 3 million unemployed soon and more production losses. She admits, for what it's worth, that the recession is twice as bad as the Friedmanite model had predicted it would be!

Yet Thatcher will now attempt to force this "experiment" onto Reagan. According to Penelope Hartland-Thunberg, former economics expert at the Central Intelligence Agency and now a Britain expert at the Georgetown Center for Strategic International Studies, "Thatcher will certainly talk to Reagan when she arrives in the U.S. about her British economic policies. Thatcher is a firm believer in the sunrise-sunset distinction, in which older industries are phased out. Steel, auto, and other industries are not of strategic importance for either the British or American economies."