

The failed economics of Thatcherism

The world's banker is bankrupt, as the English-speaking world harvests the fruits of its policy disasters. Part I of a series by William Engdahl.

The Interim Committee meeting of the International Monetary Fund in Washington, D.C. on May 7 approved a proposal to downgrade Great Britain from its 45-year-long position as the world's second most powerful financial power. According to the rules of the Anglo-Saxon game, established at Bretton Woods in 1944 by Maynard Lord Keynes and his American counterpart, Treasury Undersecretary Harry Dexter White, Britain would be given voting power second only to the United States in setting terms of world trade and currency parities for the postwar world.

The demotion of Britain has been acknowledged formally more than 20 years after it had obviously become an economic "basket case" compared with the booming industrial economies of France, West Germany, and later Japan. In November 1967, a Labour government devalued the pound sterling by 14% to reflect the sick industrial realities of Britain of that day.

Today, following a much-touted 11 years of conservative "Thatcher revolution" policies, Britain is, perhaps even more alarmingly, in economic crisis and, most recently, sinking into one of the most serious financial, real estate, and banking crises in its history. Ironically, at the time Thatcherite free-market economics is being exported to unwitting emerging East European nations as the "antidote" to 45 years of communist centralism, Thatcher's economic strategy has ensured that Britain, potentially a dynamic industrial economy of 55 million people, has allowed its national transport and electric infrastructure to rot, and its industry to fall far behind continental Europe in technology levels.

But most telling is the spreading rot in the one area which Thatcher pointed to with pride as her crowning accomplishment during the last national election: the rebuilding of the City of London as the world's preeminent financial and banking center. By 1984, London had retaken its 19th-century role as the world's largest international banking center, more from its dealings in others' "offshore" Eurodollar transactions than from any healthy profits from British industry.

Guided by Thatcherite "free market" reforms, Britain has auctioned off some of its most precious state companies in a series of "privatizations" which benefited no one but the financial advisers such as N.M. Rothschild. In tax policy, it has successively lowered corporate tax rates to one of the lowest in the industrial world, at a par with the United States at 35%. This corporate "tax haven" policy has been complemented with Thatcher's increasing use of direct consumer

taxes—the Value Added Tax (VAT) and now the hated "poll tax."

In the financial markets, Thatcher's government opened the floodgates of financial market deregulation with its ill-fated October 1986 City of London "Big Bang." It was deliberately modeled on the revolution of the late 1970s which made Wall Street into one of the world's largest speculative casinos. Since "Big Bang," in addition to a few publicized "insider trading" cases, unbridled speculative excesses continue virtually unchecked, according to informed reports.

Today, British stock brokerages and merchant banks are in their worst crisis since the crash of 1974. Real estate prices are plummeting. Inflation is soaring again to 10% levels not seen since 1981. Trade is collapsing and imports soaring. U.S. economist David Hale refers to the present situation as a crisis of the past decade's "leveraging process which occurred in all the English-speaking nations," including the United States, United Kingdom, Australia, and New Zealand. He is correct in that the exact same policy advisers launched the most unprecedented binge of "free-market" reforms, in a daring bid to force similar change throughout the industrial world. But the cancer of Anglo-Saxon free-market economics has remained concentrated in the "English-speaking region."

In a rare and candid "Lombard" column in London's influential *Financial Times* on Dec. 18 of last year, editorialist John Plender noted this reality. Plender looked at the consequences of the wave of 1980s liberalizations in financial and foreign exchange markets, the heart of the Thatcher "revolution." His verdict is black. Noting that financial market liberalization has so far been largely confined to the Anglo-Saxon countries, he reports that "this has not deterred the Anglo-Saxons from ill-considered attempts to impose deregulation on their trading partners. Now we have Mrs. Thatcher urging liberalization on the continental Europeans as a condition of British entry into the exchange rate mechanism." Plender correctly notes, "Britain's over-sized financial sector derives much of its competitive advantage from being less heavily regulated than its continental equivalents." He contrasts such "Anglo-Saxon policy chaos" to the largely healthy industrial policies of Japan and continental Europe, especially Germany.

Let's look briefly at the current dimensions of Britain's real estate situation, and how this is threatening the most severe banking crisis in postwar British history.

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Thatcher's real estate bubble

Largely in order to maintain the position of the City of London as a banking power and to ensure that eventual British entry into the continental European currency zone would make London the world's financial "entrepôt" for recycling world capital, as Bank of England Governor Robin Leigh-Pemberton put it, the British government began to raise interest rates to the point that bank "base rates" hit a staggering 15% last October, where they have remained ever since—the highest level since the all-time high of 17% back in 1981.

Predictably, such absurd costs of money have done little to help the real economy. Most directly hit to date, however, has been a recent binge of speculative real estate lending. On April 27, a large U.K. property development and construction, Rush and Tompkins, went into bankruptcy. The group had operations across the U.K. and in the U.S. and Bahamas as well, employing 2,000 at its peak. It has debts of some \$450 million and got smashed by soaring interest costs on its debt. It has been the first failure of a publicly quoted commercial real estate developed in years. The stock market in London immediately fell on the news.

But Rush and Tompkins has not been the only hint of troubles. Only days before, the Bank of England made an unprecedented intervention to attempt to rescue British and Commonwealth, a financial and real estate conglomerate with debts of more than \$1 billion. Many smaller companies are either bankrupt or on the verge. But the most dramatic shock, according to London property experts, has not yet become public. They report that the world's largest private real estate conglomerate, the Toronto-based Olympia and York, is having serious financial problems. The secretive Reichmann brothers, who hold Olympia and York, not only hold the largest single share of New York City commercial real estate; they are now the largest shareowner of the crisis-ridden Campeau Corp. of Canadian financier Robert Campeau. But most recently, in order to "diversify" risk, Olympia and York went into London real estate. It is now the key promoter of the largest commercial real estate development in Britain, the ill-

fated London "Canary Wharf" \$4.5 billion Docklands office project. Office space is vacant, developers are going bankrupt, and construction is years behind schedule.

London became the centerpiece of Britain's latest real estate bubble, when banks and financial companies launched a spending spree in anticipation of Thatcher's financial "Big Bang." As a result of lax government development policies and a plenitude of speculative funds, an unprecedented construction boom took place in the environs of London over the past five years. By 1992, if all buildings are completed—a highly dubious prospect—London will have 35 million new square feet of office space, equal to one-half of present City of London total space. Already, with tens of thousands of layoffs following the October 1987 London stock market crash, office vacancy rates have doubled to 10% from the level of mid-1988. In the Reichmanns' Docklands, the vacancy rate is an alarming 42%.

Hitting the banks

The speculative real estate boom in many respects is parallel to the real estate speculation that took hold during the 1980s in the United States. Major U.K. banks trying to find new sources of profit to compensate for their devastating losses from the Third World debt crisis of the 1980s turned to a classic speculative bubble. Banks have gone into real estate lending in a manner never before seen in the United Kingdom. "This crisis is in a certain sense far more dangerous than the last major one in 1974," stressed City of London economist Stephen Lewis. "This time, unlike in 1974, the big banks are directly exposed as real estate lenders." This was the reason for an unusual warning issued by the Bank of England's Leigh-Pemberton last October, that bank real estate loans had soared by a staggering 50% in value in the 12 months ending last August.

Total U.K. bank lending to real estate as of this March was estimated at \$48 billion. And most of this is extended in a pyramid of loans to over-leveraged developers or projects. Lloyds Bank, the British bank with the largest Third World

debt burden, had gone into real estate to compensate. It is now holding the bag for the bankrupt Rush and Tompkins. Total bank exposure to real estate has soared. From less than \$15 billion in early 1987, it is now just below \$50 billion. By the final quarter of 1989, British property values actually began to drop. A survey by the Investment Property database noted an alarming 1.8% drop in prices. In home prices the drop is even more severe, with estate auctions in the last weeks reporting prices down 20% from their 1987 peaks. The problem is that banks have bet billions of their scarce assets on the idea that assets and prices would continue to rise. The house of cards is now crashing down about them.

This new reality was hinted in a statement in April to the annual meeting of Britain's Midland Bank by chairman Sir Kit McMahon. McMahon warned stockholders, "The impact of high interest rates is also reflected in a worsening of the bad debt position across our U.K. loan portfolio." The depressed market for home mortgages in Britain and the collapsing real estate picture were the primary reasons for Midland's sharp losses. But only two days after Sir Kit rattled the London stock market with his dismal report, Sir Martin Jacomb, deputy chairman of Barclays Bank, warned that "the current economic situation in the U.K. is beginning to have an adverse effect on some of our customers." Stock share prices for Midland Bank are down 31% over their high this year as

a result, with Barclays down 17% and Lloyds down 19%.

All this doesn't help the other part of the London financial community, the merchant bankers, who finance corporate takeovers or trade in stocks and bonds. Lewis estimates that by the end of next year, 50,000 financial jobs will have been lost as result of the post-1987 depression in financial trading profits, since Thatcher's Big Bang allowed banks and brokerages to be under one owner. Commission income on London's stock trading is down by 25% from last year, as merger activity has ground to a virtual halt in the nervous high interest rate climate. Volume of takeover business is also down this year to only one-third what it was a year ago. This is hitting such names as S.G. Warburg, Schroder, and Lazard Brothers.

All these problems have a common root. Under the "free-market" Thatcher economic dogma—actually a poorly rehashed version of Adam Smith's "magic of the marketplace"—unbridled competition reigned, while sensible national investment and development policy was given last priority. Like the blind man falling from a 20-story building, it all seemed to be going smoothly until that last floor. Today, Britain's major banking and financial institutions are close to that last floor. Their incestuous ties into U.S. real estate problems will only compound what Hale accurately terms the crisis of the English-speaking world.

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