The failed economics of Thatcherism

Behind the public relations hype, British industry is rusting and infrastructure has collapsed. Part II of a series by William Engdahl.

For more than a decade the "Thatcher economic miracle" myth has been hailed worldwide. With apropriate irony, the media public relations and advertising firm that was largely responsible for packaging and publicizing the Thatcher era, Saatchi and Saatchi, is teetering on the edge of bankruptcy. The best demonstration of the bankruptcy of the Thatcher economic policies, however, is in the vital area of British industrial and infrastructural capabilities.

Over the decade since Prime Minister Margaret Thatcher took office in 1979, the British economy has failed to make the promised renaissance in competitiveness and technological modernization. More alarming, as recent prison riots, hospital worker strikes, subway disasters, and food poisonings attest, the quality of living of the average Briton has deteriorated dramatically.

In its latest "World Economic Outlook" review of the British economy, the International Monetary Fund noted that this year Britain will have the lowest growth, highest inflation, and the greatest current account deficit of any of the world's seven top industrial countries. For the year to date through April, the official Retail Prices Index of inflation rose at an abysmal 9.4% annualized. Bank Base Rates have doubled from 7.5% in mid-1988 to 15% today, as part of the Thatcher program to "squeeze inflation out" of the economy. In April, Britain had another month of huge trade deficit, as exports stagnated. Let's look more closely into the content of Thatcher economic policy, to get at the roots of this debacle of what is sometimes called the Anglo-Saxon economic model.

'Investment'—in what?

Thatcherite advocates, a rare species in today's Britain, point to what they claim is an unprecedented national investment boom since the early 1980s, as proof that Thatcherite *laissez-faire* or free market policies, and a bent to "privatization" and cutting state budget spending, have indeed worked.

So we must note that since 1981, real "business investment," adjusted for inflation, has grown by an impressive 7% per annum. Even if we go back to the depression year of 1979, it has averaged 4% per annum. This is still double the growth rate of the dismal 1970s before Thatcher assumed office. But, like many isolated "facts," this one is very misleading. It is necessary to look more closely at the components of this "business investment."

If we separate out investment related to manufacture and agriculture or the production of the physical economy from that related to "services," we get a dramatic and revealing contrast. According to official government data taken from the 1989 United Kingdom National Accounts, whereas in the 10 years from 1979 through 1988, British gross investment for all business increased some 37.4%, this is entirely due to the services sector, where investment in such things as new bank headquarters following the Oct. 27, 1986 "Big Bang" financial market deregulation, or new stock market computerization, led to an impressive 93.1% investment increase for service businesses. Investment over the same decade for agriculture and manufacturing dropped 8.4%! The sharpest drop was in oil and gas investment, which fell by more than 38% over the period, and construction, which fell by 23%. In the critical manufacturing sector, British companies were absolutely stagnant during the term of the "Thatcher revolution," with a net real investment of less than 1% over a decade!

By comparison, if we look at investment in manufacturing capital stock, e.g., plant and equipment, for the 1979-88 period, and compare it with continental Europe or Japan, we find an even more dramatic contrast. Prof. Andrew Glyn, an economist at Oxford's Corpus Christi College, showed that Britain's investment of this type was less than half that of the economies of continental Europe, and a mere one-fifth the capital stock growth of Japan for the period.

According to the Confederation of British Industries (CBI), most of this "investment" by manufacturing companies, from 1979 until quite recently, went into paying the costs of "rationalizing" their work forces, one reason Thatcher's economics led to a staggering 1930s level of more than 3 million unemployed by 1983. Granted, official unemployment is down now from those levels—partly aided by changes in statistical accounting—to a level of 1.65 million this past March; but unemployment in the industrial north still ranges from 7.5% in the northwest to 14% in Northern Ireland. With the growing problems of the economy, unemployment will rise again in the coming months.

The U.K. companies which have held large cash from profits in the recent several years, usually multinational firms like GEC, have invested profits into financial assets rather than long-term plant improvement. Other firms have been forced by Britain's liberal New York-style corporate take-

TABLE 1
U.K. business investment

	Gross investment % change 1979-88	Growth of Gross Fixed Capital stock, 1987-88 (%)
Total business	37.4	3.1
Industry and agriculture	−8.4	0.6
Services	93.1	6.9

TABLE 2
U.K. material goods investment

	Gross investment % change 1970-88	Growth of Gross Fixed Capital stock, 1987-88 (%)
Agriculture	− 7.2	−0.7
Oil and gas	−38.5	0.0
Energy and water	− 1.5	0.3
Manufacturing	0.6	1.1
Construction	−23.5	0.0

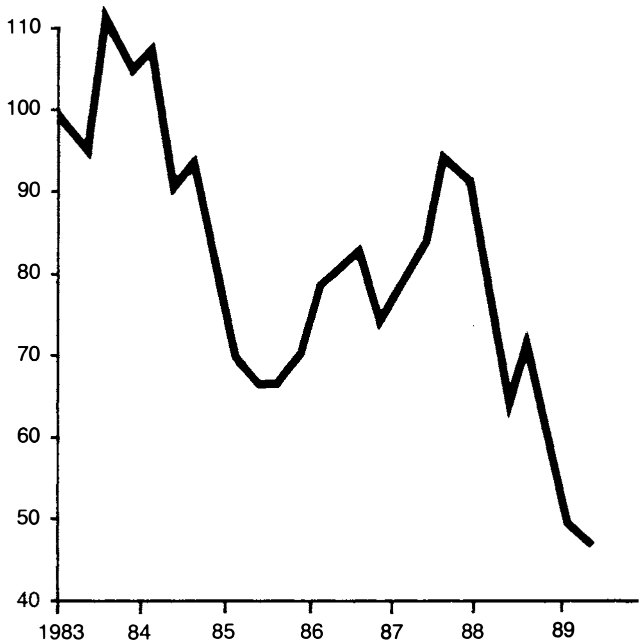
TABLE 3
U.K. services investment

	Gross investment % change 1970-87	Growth of Gross Fixed Capital stock, 1986-87 (%)
Distribution and catering	43.9	5.3
Transport	−17.4	−2.3
Communication	51.6	2.6
Banking and finance	125.5	} 9.1
Business services	148.4	

Source: *U.K. National Accounts*, 1989 edition

FIGURE 1
Liquidity ratio plunged under Thatcher

British manufacturing companies (%)



Total current assets as a percentage of current liabilities

over climate, to invest in debt to fend off attack, or to borrow in order to buy, often at inflated prices, existing production capacities from other companies. This has resulted in an alarming growth of corporate debt.

According to the Bank of England, for the 12-month period up to December 1988, U.K. corporate "interest-bearing liabilities" almost doubled from some $45 billion to $79 billion. Since then, bank rates have been forced to the present 15% levels, and the debt burden for manufacturing companies is the worst in 15 years, since the depression of the mid-1970s. According to a CBI study, the ratio of manufacturers' short-term assets to short-term debt fell by June 1989 to the lowest level since 1975. As a result of Thatcher's interest rate policy, itself a bow to the monetarist dogma that money is more "valuable" than creation of real industrial and agriculture wealth, U.K. companies ran up a financial deficit of more than $10 billion by 1988. In recent history, there have been only two times when British companies slipped into net deficit, 1974 and 1979, both a year before the overall economy went into severe depression.

Poor in international competition

In a speech in March to a group of U.K. manufacturers at the JIT Club in Renfrew, Scotland, Hashime Yamashina of Japan's Kyoto University warned that British manufacturing will be "finished" before the next decade if it refuses to adopt modern production and inventory control methods, such as computerized flexible manufacturing methods and computer-controlled just-in-time inventory control.

Professor Yamashina hit a raw nerve, noting the problem that investment in state-of-the-art manufacturing technology requires a workforce educated and skilled to the modern requirements. "Japan has proportionally twice as many qualified engineers as the U.K.," he noted, adding with irony that, on the other hand, the U.K. has 10 times as many accountants. "In the Japanese manufacturing organization, in addition to research and design engineers, there are two categories of engineer directly involved in production: one in systems and the other in on-line production. And the more of these you have, the better the product."

Not surprisingly, British exports have performed dismally in competition with German, Japanese, or even French or Italian companies in recent years. A March 1990 study

FIGURE 2
British current account balance
Billion £ (quarterly)

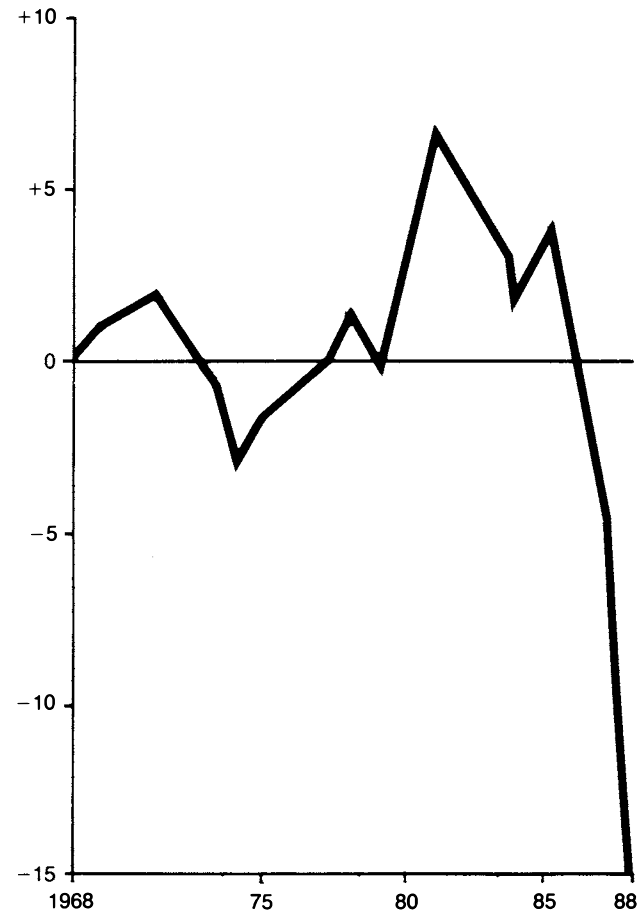
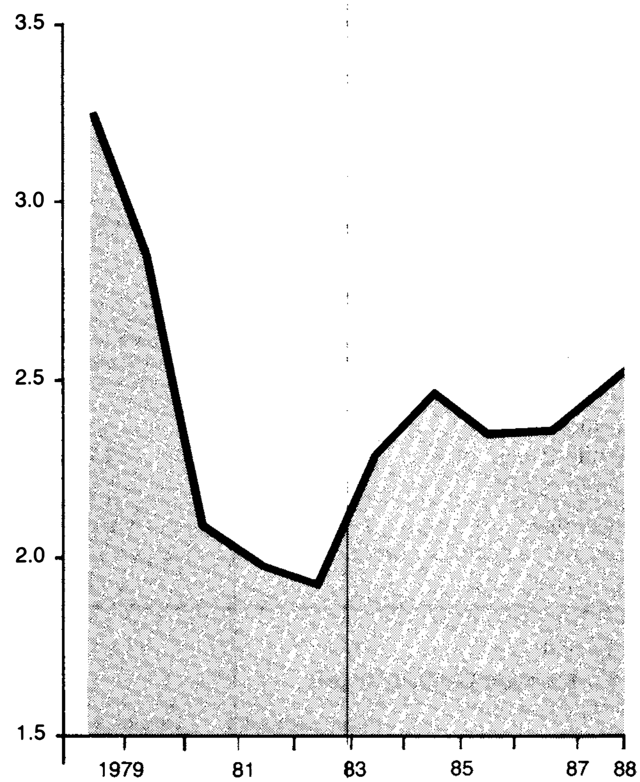


FIGURE 3
British manufacturing investment as % of GDP
Gross fixed capital formation



Source: OECD, CSO

released by Britain's National Economic Development Office (NEDO) revealed that British industry, like that in the United States, is withdrawing from sector after sector in competition for exports, "not because domestic prices are unduly high, but because Britain is out of line on quality."

The NEDO study found that the fundamental problem of British industry's slipping markets is due to its "specialization in inferior products." British companies tend to export low-value products and import high-value ones, such as German or Italian machine tools. In a survey of British manufacturing industry for the decade through 1987, NEDO revealed that the Thatcher revolution did not improve the quality of manufacture. In the important capital goods industries such as machine tools, pumps, and agricultural machinery, after a decade of Thatcherism, Britain continues to export lower quality goods than Germany, France, or Japan. In short, Britain "exports cheap and imports dear."

British industry is now faced with a devastating competitive challenge, as continental Europe opens its borders under the European Community's (EC) 1992 Single Europe Act. In addition, the opening of Eastern European economies will now threaten those very cheap markets that British industry now holds. As of early this year, for every dollar British companies have invested to prepare for the challenges of Europe's 1992 market openings, it has spent $5 on investment in the U.S. market—ironically, the one which faces the worst economic downturn of all industrial economies. As one commentator, John Edmonds, put it, "British industry repeatedly gets the answer wrong on all the tough questions."

But industry has had worse than no help from the "malign neglect" industrial policy of the Thatcher government.

The infrastructure debacle

A recent study by Britain's private Employment Institute insists that government spending for education, research and development, and infrastructure must be significantly increased, if Britain is not to be relegated to the bottom tier of European Community low-wage and low-quality producers after 1992, along with Greece, Portugal, and a handful of others. Nowhere is the bankruptcy of Thatcherite economics more stark than in the government's record on state infrastructure investment, that is, the basic public rail, road, airport, and electric power grid without which the national economy ceases to function. Among the seven industrial nations, only the United States ranks lower than Britain in terms of public core infrastructure investment.

Present conditions of the road network are bad to dismal, according to a 1989 report of the Confederation of British Industry. The main highway routes are twice as congested in terms of vehicles per kilometer as those of the efficient West German Autobahns, and three times as congested as those of France. The CBI estimates that this overcrowding alone costs British industry $24 billion annually, added to the costs of delivering its products. The situation is worst in the large cities. Since 1982, costs of U.K. road transport have risen by 36%, more than for any of the other EC major industrial countries.

In the Thatcher government's National Transportation "White Paper" of May 1989, a proposal is made to double current road investment, but almost all for simple repair and widening of existing roads. No new lines are proposed, and two routes which are desperately needed along the south and east coasts, to link the ports that give access to continental Europe, are simply not mentioned. In comparison, between 1982 and 1985, West Germany invested 130% more in its road infrastructure than Britain, and France invested two-thirds again as much as the United Kingdom. While Britain plans virtually no net increase in road network, France's current national transportation plan will increase the nation's highway network by 250% by 1997. Further, under the Thatcherite dogma, the Government Transport Ministry is trying to stimulate private investment to pay the costs of the road program in key areas so as to keep taxes low, along the lines of the Bush administration proposals from Transportation Secretary Samuel Skinner.

One of the largest construction projects under way in Europe is the Channel Tunnel ("Chunnel"), a long-delayed link across the English Channel between Britain and the continent. Here as well, while the French terminus of the tunnel already has three modern highways linking it to the national road grid, as well as a new high-speed TGV high-speed train link, the British side, to be complete in 1993, has only one connection, M-20, not yet complete.

Road transport, as bad as it is in the U.K., carries 81% of all transport, simply because of the decrepit state of the national British Rail system. But little is being done to improve the rail grid. France spends two-thirds more than Britain does on its rail infrastructure, which is today the most advanced in any industrial country. West Germany is engaged in a large-scale rail modernization project, where its version of a high-speed rail, the Inter-City Express, similar to France's TGV, is nearing completion in some areas. Britain has scarcely discussed the possibility of high-speed rail.

But the British rail infrastructure dilemma is even more pathetic. In a policy Britain has stubbornly held to since her rail grid was laid early in the 19th century, Britain today still uses a special narrow "loading gauge," which determines the clearances of width and height for train tunnels, bridges, and loading platforms at stations. This loading gauge, W5 as it is called, is narrower than continental Europe's Berne gauge. Because of this, wider and higher rail cars used on the continent carry up to 60% more volume than British railcars, with staggering transport cost implications.


Stuart Lewis

Margaret Thatcher's "economic miracle" is bankrupt.

Conversion of the existing British Rail loading gauge to the Berne standard would open U.K. transport to some 200,000 continental railcars. Obviously, such conversion could have been accomplished far more cheaply at any time in the past century. Today, with a government that has an ideological adherence to cutting government spending in all respects, such a simple modernization is hardly at the top of the British Rail agenda. Costs of total conversion are estimated to be as little as $340 million, and the move would eliminate the need for costly transshipment at the Channel Tunnel or the use of overloaded highways. As yet, British Rail has nothing more than piecemeal plans to modify a short rail stretch from the tunnel to a central marshaling yard.

But, despite issuance of the Transport White Paper a year ago, the entire transportation plan is stalled, because of the unwillingness of the government to spend public funds. A group of leading British industrialists has issued a private estimate that at least $14 billion over the next nine years will be needed merely to patch up London's subway and road transportation system. In response to the "free market" ploy by Transportation Secretary Cecil Parkinson, of calling for private funds to build the infrastructure, the London Planning Advisory Committee has bluntly told the government that there is no possibility of sufficient private funds, demanding that the government reverse policy and invest in infrastructure. So far little has been done. A report from the British

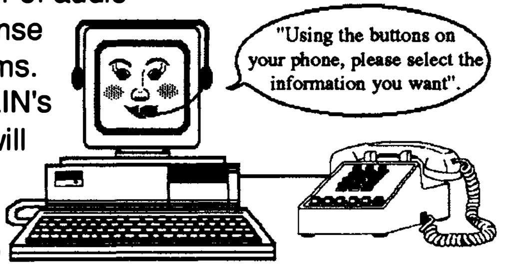
Property Federation states, "The Government has now rejected a program of major road building for London. Unfortunately, there is as yet little indication of what alternative transportation policy the government is to pursue."

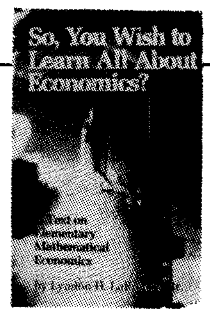
Privatization of formerly state-owned companies, such as British Gas and British Petroleum, has brought relatively little new revenue into the Treasury, since it became the centerpiece of the Thatcher economic model over a decade ago. Privatization has enriched a number of City of London merchant banks which have advised the government on the sales, such as N.M. Rothschilds and Kleinwort Benson, however. The most ambitious privatization to date, a potential $32 billion selloff of the Central Electricity Generating Board (CEGB) into 12 regional private boards, is due to be finalized by November.

According to industry estimates, the costs of this privatization of electricity will be immense and potentially fatal to what remains of competitive British industry. After a one-year price freeze, electric power costs to heavy industrial users are estimated to rise by 40% over the coming two years, according to Energy Department estimates, as price concessions for heavy industry are removed. This will hit electricity-intensive industries such as chemicals, glass, and steel, whose electric power costs already are among the highest in the European Community, forcing the closing of factories or transfer abroad. But N.M. Rothschilds and Kleinwort Benson downplay this aspect in their advice to the government. Further, in order to make the privatization package "saleable," the Thatcher government in effect decided to kill the future nuclear power investment program, by splitting it from the privatization. Lord Marshall, the widely respected head of the CEGB, resigned last year in protest over this short-sighted decision.

Perhaps most damaging of all has been the immense social toll of the Thatcherite "free market" economics. Aside from the teams of high-paid City of London financial center brokers and bankers who have benefited from market deregulation, the real cost of Thatcher's economics has been devastating.

One of Thatcher's prime claims is that her ruthless economic policies since 1979 have successfully "squeezed inflation out" of the economy. Granted, in 1980 inflation was at 20% and had dropped to 3.7% by summer 1983; but when Thatcher first won office pledging to halt inflation, it was running at 10%. Now, 11 years of Thatcher economic "squeeze" later, in April 1990, retail price inflation is 9.4%. Much to the prime minister's embarrassment, 10 years after her brand of radical monetarism began, bank base interest rates today stand exactly where they were, at the prohibitively high level of 15%—the highest in the OECD. Even the governor of the Bank of England, Robin Leigh-Pemberton,





was forced to admit in April that there might be a flaw in the government's economic battle strategy.

Living costs have soared. Shoes are 226% more expensive than in 1980, while private medical insurance has risen 265%. The average water bill to households has risen 160%, in another privatized area. Milk is 89% higher, and the famous fish 'n' chips 170% more expensive than in 1980. British Rail ticket fees have risen by 130-170%, while service has deteriorated.

Thatcher's tax policy has selectively reduced taxes on the highest income earners, while recovering revenues via indirect regressive taxes such as the Value Added Tax or the new controversial head tax known as the "poll tax."

Widespread public walkouts last year by nurses and hospital employees dramatized the crisis of government-funded health care, but little has been done since to change things. In May, John Major, Thatcher's Chancellor of the Exchequer, the man who controls the purse strings, told cabinet ministers to control government spending in order to combat inflation. Earlier gimmicks to patch up the National Health Service by sale of some of its real estate were a failure, because of the government's prohibitively high 15% bank interest rate levels, blocking funds for urgently needed new hospital construction.

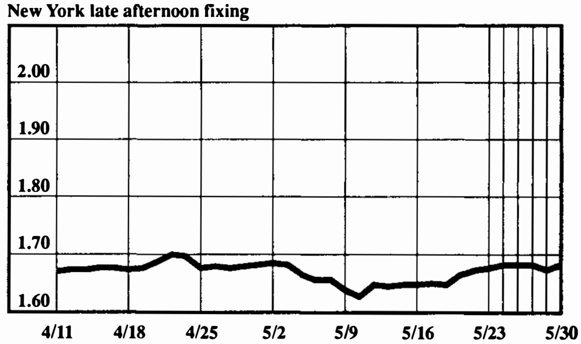
In the area of livestock and food quality standards and government regulation of this, Britain is perhaps below the level of the poorest EC countries, as a result of its *laissez-faire* approach. One result is a current panic spreading over outbreak of a dangerous cattle disease, bovine spongiform encephalopathy (BSE or "mad cow disease" as the popular press dubs it). It comes from the government's lax controls on cattle feed, which have allowed sheep that have a virulent brain disease known as "scrapie," to be slaughtered and processed for cattle feed. According to an expert on the disease, Albert Roux, master chef in London's only three-star restaurant, Le Gavroche, "This country has become the laughingstock of Europe over the quality of its food." Roux is also one of Britain's leading experts in the microbiology of food preparation. Only after a loud outcry and the slaughter of thousands of infected cattle, did the Thatcher government reluctantly take any steps to control the problem.

Last December, Prof. Richard Lacey resigned as adviser to the government's Veterinary Products Committee on Health and Microbiology, in protest against the government's failure to heed warnings of risks of salmonella-contaminated eggs. He now demands that 6 million cattle be slaughtered to stop the spread of "mad cow disease." West Germany and several other EC countries with high animal health standards now refuse to import any British beef.

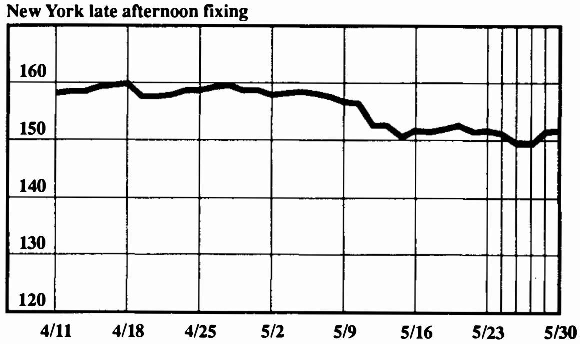
The list is unfortunately endless of such incidents of malign neglect, spawned by the credo of Thatcher's brand of Friedrich von Hayek's radical monetarism. It can be said that the "Thatcher experiment" is still on course, but the course is leading Britain directly into catastrophe.

Currency Rates

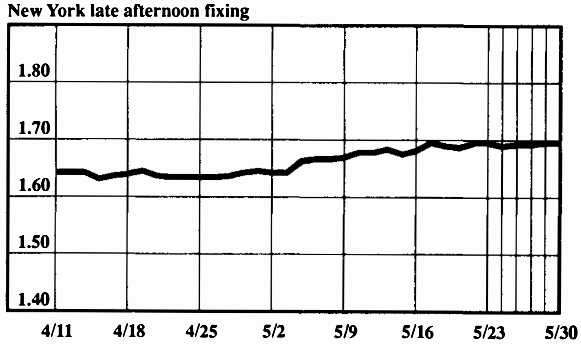
The dollar in deutschemarks
New York late afternoon fixing



The dollar in yen
New York late afternoon fixing



The British pound in dollars
New York late afternoon fixing



The dollar in Swiss franks
New York late afternoon fixing