Foreign Exchange by David Goldman

Margaret Thatcher's monetarist fiasco

Will U.S. and other Western worshippers of the Friedman-von Hayek cult draw the obvious conclusions?

In 1980, the British pound was worth $2.80. It now sells for $1.13, and threatened early in the week of Jan. 27 to fall to parity with the dollar. The upshot of this is that every U.S. official remotely connected to economic policy should write on the blackboard one thousand times, "Monetarism stinks."

Margaret Thatcher took office in 1977 with an explicit commitment to "the monetarist experiment," inviting the high priest of the cult, Milton Friedman, to visit 10 Downing Street in order to dispense wisdom to her. London became the new mecca of the Mont Pelerin Society, the cult's worldwide inner circle, over which Milton Friedman, Friedrich von Hayek, and Count Max Thurn preside.

In 1979 Thatcher abolished Britain's longstanding controls on the export of capital, spurring London's further development as the world's capital for loose or dirty money. This succeeded to the point that the leading Swiss banks have bought themselves London brokerage houses during the past several months, a major concession to the City of London's predominance in the nether world.

With the doubling of oil prices in June 1979, coinciding with the peak of North Sea oil production, the British pound reached its highest level in a decade, flying up to $2.80 for a time, as Britain became the world's fourth-largest oil exporter.

Not a nickle of the oil money stayed in Britain: Instead, the City of London bought over $150 billion of foreign stocks, including $100 billion in Wall Street.

The result was the utter, complete, and final ruin of the British economy. Unemployment rose from an (officially counted) 6.1% in 1978, the year after Thatcher came in, to 13.4% currently. Britain's living standards fell to the lowest in the European Community. Industrial output is lower than it was 15 years ago, and British industrial production per capita is lower than that of South Korea.

In 1981, while the pound was still riding high on oil revenues, this writer asked the then chancellor of the exchequer (finance minister) of Britain, Sir Geoffrey Howe, whether he were prepared to declare the monetarist experiment a failure. Howe, now foreign secretary, replied haughtily that Britain's viewpoint had been adopted by the International Monetary Fund, the Federal Reserve System, and, indeed, by most of the industrial nations.

Howe was right, unfortunately. But it follows that Britain's current disaster prefigures what will happen to the United States unless it extirpates monetarism.

Thatcher's supposed great success was the elimination of inflation. The officially calculated inflation rate (for what that might be worth) did, indeed, fall from 18% in 1980 to 5% currently. But why?

Lloyds Bank Review released a study on Jan. 21 by two Oxford economists which demonstrated the obvious, namely that "the slowdown of inflation in the dozen industrialized countries that we have studied can be explained entirely by the sharp deceleration of 'commodity prices,' i.e., the prices of primary products." In other words, the collapse of the terms of trade of developing nations, forced to dump their products in Western markets at a fraction of their cost in order to pay debt service to the banks, lowered the apparent inflation rate in Britain as well as the other industrial nations.

The authors argue that "the basic assumption that the mass unemployment had, in fact, checked the inflation . . . also probably contributed to Mrs. Thatcher's election victory in 1983. It appeared to constitute evidence of determination, competence, and effectiveness."

Nothing of the sort took place, write the Oxford professors. "With a swing in import prices, for the average of 13 advanced OECD countries, of over 20%, which can be entirely accounted for by the swing in commodity prices, and given also that total imports constitute about 16% of the Gross Domestic Product of the OECD [Organization for Economic Cooperation and Development] countries as a whole and 25% of the GDP of the European members of the OECD, one would expect a deceleration of the final prices in the typical advanced OECD country of about 5%. And this is almost precisely what took place."

As one leading British analyst commented, "Once the oil prop was removed, it became clear that the British economy no longer had the capacity to produce wealth." The fall in oil prices is eroding Britain's last, artificial source of earnings, and the pound has crashed as a result.