A brief economic history of England

Part 2

The long unwinding road

In the early 1970s and possibly even sooner, it became apparent that the accepted 'model' of post war growth had within it a fundamental problem. This rested on what some of you will know as the Phillip's Curve, which had allowed politicians and planners to target a specific level of price inflation against an accepted level of unemployment. In doing so, those in power were able to 'manufacture' socially agreeable levels of macro success whilst delivering economic stability. However, the approximately four yearly business cycles began to show a worrying trend, namely that with each down turn the level of recorded unemployment became greater and with the subsequent upturn came higher and higher levels of price inflation. The impact of these trends affected some economies more harshly than others.

Alas, post-colonial Britain was shown to be very vulnerable to the impact of this new reality, whilst both Japan and West Germany managed to disguise many of the ill effects. In their case it was probably the benefits of re-building their war damaged economies that postponed the onset of a new way of thinking about how to manage the quest for economic growth. Another feature of the Japanese economy was its high dependence on exports. It also supported a social system that bore little resemblance to those of the 'West' and much of its export trade and the subsequent capital generated by the successful harnessing of modern technology was transferred to the US. Over one-third of all Japanese exports are destined for the US market. In Europe both France and West Germany experienced rapid export-led growth and the subsequent problems of an over valued currency.

Students of current economic worries might be seeing some of the early signs of what was to manifest itself as the need for a single currency, following the inevitable ending of the fixed exchange rate era and the emergence of the much used words productivity, efficiency and value added! In 1971 the US devalued the dollar (at what became known as The Smithsonian Agreement) and set about making its own goods more competitive in the world markets. With this monumental change in how the US saw its role in international economics came the end of the Bretton Woods acceptance that the US would run sufficiently high trade deficits to accommodate the surpluses of the other major economies.

Economists who followed the writings of Milton Friedman, Harry Johnson and others of the 'Chicago School' began to put forward the fact that high unemployment could not be brought down by expansionary fiscal and monetary policy. Indeed, they prophesised that such policies would merely result in sustained price inflation. As this debate raged in the Treasuries of the western economies, one final fact of life in the new economic order emerged, namely the power of those who owned oil to upset market stability with alarming speed. OPEC reacted to the Yom Kippur war in the Middle East in 1973 by quadrupling the price of a barrel of oil. The shocks of this single act were to have enormous repercussions. In Britain the Prime Minister, James Callaghan, pronounced in 1976 that full employment was no longer possible (a statement that both angered the Trade Unions, who were the traditional purse holders of the Labour Party and allowed the newly appointed Conservative Leader Margaret Thatcher to quietly change the economic policy of her party). The so-called era of

Butskellism (where the two major political parties agreed to run broadly similar economic policies and goals) in the UK was over and the dawn of a greater emphasis on free enterprise economics was upon us.
Meanwhile in the US president Jimmy Carter (a Democrat) appointed Paul Volcker as chairman of the Federal Reserve (their Central Bank) with the express command of stabilising prices by the use of monetary policy. Price stability and not full employment became the most important goal of economic policy. Macro targets were replaced by a fascination with micro objectives. The role now of fiscal policy, was thought to be that of assisting in the quest to 'balance the budget' and to oversee a reduction in the size and power of the State sector in an economy.
As all students of economics appreciate we cannot ignore the influence that politicians had on the behaviour of our subject and two who came into office at this time had notable influence on the directions economic history took. One was Ronald Reagan, who despite having been a B feature movie star was swept into the White House in 1980. He brought with him what are often known as 'homespun' philosophies or beliefs and a foreign policy based largely on the need to defeat the perceived threat of Communism. To enforce this, he and his advisers devised a 'Star Wars' defence policy, which attempted to build a nuclear missile shield around the US (and possibly its closest allies). This laser age dream was to cost billions of dollars and did not materialise. However, his deepening of the arms race came to be accepted by many as the largest single influence on the demise of the Soviet Union.
The cost of matching the levels of expenditure passed by Congress imposed an enormous strain on the USSR and by 1985 Gorbechov was introducing radical reforms to the once mighty superpower. Whatever one's opinions of someone alas now suffering the agonies of Alzheimer's disease, Reagan did re-focus US foreign policy, which had suffered traumas post Vietnam and introduced us to what economists call the Radical Right. The latter were to unleash supply side economics on an unsuspecting world.
In Britain Reagan's close ally was Margaret Thatcher, who came to embrace (some have said somewhat reluctantly) privatisation and de-regulation. She supported the US in all of its overseas exploits and carried on her own war against many sacred cows of the establishment, including organised labour. Market forces came to reign supreme and only after some noticeable social unrest in the cities of Birmingham, Bristol, Liverpool and London was the 'Iron Lady' persuaded that mass unemployment in a democracy was not a recipe for peace and tranquillity. Historians are yet to formalise their opinions on what became known as Thatcherism but she left office in 1990.She left many of the bricks firmly in place that Tony Blair (1997 to present time) used to build his own economic order. Students of politics might like to read Hugh Stephenson's account of the rise of the Social Democratic Party in the UK called 'Claret and Chips'. It describes the split that arose in the Labour Party in the early 1980s and how Europe emerged as a major political topic that continues to dominate the politics of this century. However, enough of the present, let's return to the 1970's and the demise of the post war Keynesian demand management era and in the eyes of some the consensus politics that had been the mainstay of post war UK political life.
In the US any form of consensus in the world of politics was reduced as the Democrats and Republicans moved further apart in their ideas as to how to manage the largest economy on the planet. Elsewhere in Europe conviction politics began its final period of life in France, West Germany and even Italy. Those interested in affairs European might like to take a closer look at the final experiment in wide scale

change that followed the election of Mitterand (whose first cabinet contained Communists, as they had polled almost 15% of the vote) in 1980. Or the re-thinking of the Social Democrats in Germany as they lost both office and the support of their coalition partners the Liberals and the dying pains of radical swings and roundabouts of the constantly changing colours of Italian political life. You might also like to reflect on how the growing domination of global corporations came to set the ground for the emergence of both a business dominated European Union and the birth of political parties in Europe that produced a business friendly approach to economic management.

The 1970s saw deeper recessions, higher unemployment and higher price rises and the race was on for a new way to manage economic affairs. At the same time the newly independent economies of Africa and elsewhere in the developing world remained convinced that planning was the model for their economic development. In many of these new economies, and India was a prime example; five-year plans became the order of the day. Protectionism and the need to develop import substitution industries coloured many of the schemes to bring these nations inline with their western counterparts.

The potential of these resource rich economies did not go unnoticed by the developed economies. Bankers and others from the financial sectors began to make their way to such places as Lagos, Kinshasa and other old colonial outposts. Some merely wanted the right to mine the minerals e.g. Lonhro but most wanted to lend money to these infant administrations. This was not reserved for the private sector banks and entrepreneurs, the large multilateral organisations, such as the World Bank, and the International Monetary Fund also lent vast sums of money on what are now considered to be less than secure terms. The birth of foreign direct investment to previously unknown recipients such as Zaire, Peru or Mexico was to pave the way for serious debt repayment problems and a complete re-thinking of how post colonial economies should be encouraged to develop. Some of you may have heard of such phrases as structural adjustment programmes and other ways of introducing to the developing world the essentials of monetary and fiscal discipline.

In the 'West' strict monetarist policies had caused hardship to both industries and individuals and in the developing world, which possessed little, if any social welfare provision the results were very painful for the most vulnerable. Once again someone from my generation, with its hopes and beliefs, had to sit and watch as poverty levels increased. It is too early to tell, but some of the hideous conflicts that have ravaged Africa throughout the 1990s and continue now in the twenty first century, probably had their beginnings in the greed and corruption that was started by the desire to exploit the riches of the newly developed economies in the 1970s.

In the 1970s the free market economies of the 'West' were characterised by a decline in State intervention, whilst those in the Command or Soviet influenced bloc spent much of this era trying to match the development of the US and its sister economies. They had received a body blow as early as 1947 when the monies thought to be destined for them under the Marshall Aid programme were removed. This left what we now know as the economies of 'Eastern Europe' with no alternative but to accept the rule of Moscow and work as part of COMECON. There followed in 1948 the problems associated with the 'Berlin Blockade' and the various difficulties imposed by the costs of wars between the two superpowers in such far off lands as Angola and Mozambique.

It is difficult, if not impossible to actually determine whether the experiment in central planning was a success or not. Obviously, by the mid 1980s it faced virtual collapse.

The problems exposed by the Chernobyl disaster only served to prove what many had believed for years, namely that with little real use of information, incentives, investment and innovation the USSR held its empire together by fear based on the might of the Red Army. In its favour the early post war days had seen the Stalin led economy rebuild itself from the war-damaged position. By the early 1960s the Space Race saw the USSR in the lead and amongst the better off much of the materialism of the 'West' was also part of their life style. For the masses the evils of unemployment and inflation were kept at bay by direct intervention. So, to the average Muscovite life was good. Queues were accepted in the name of the people fighting against the evils of the imperialist, capitalist world.

However, even with the apparent advantages of the post OPEC inspired hike in oil prices by 1973 the Soviet Union could only maintain its quality of life by massive exports of its natural resources. Unlike its export mix of the pre Bolshevik era it no longer produced a grain surplus. Successive leaders made certain that investment in consumer durables kept pace with consumer expectations but they could not ignore the technology gap that was emerging. It was soon reflected in both the quality and quantity of the output coming from the State-owned enterprises. To this must be added the Soviet Unions' version of Vietnam, which took place in Afghanistan. This long and costly confrontation showed once more that determined groups of individuals, however poorly equipped they might be, can take-on and defeat the total strength of a superpower. To the rest of the world it further re-enforced a growing awareness that fundamentalism was a force that would dominate both the 1980s and 1990s.

The arrival of Gorbachev in 1985 and his introduction of perestroika merely served to underpin an already corrupt and inefficient system. Despite has apparent powers of statesmanship he was toppled in the coup of 1991 and the more 'down to earth' figure of Yeltsin emerged as the new leader of Russia. Despite all of Gorbachev's efforts to maintain the old style Soviet Union it became a set of loosely connected economies that agreed to trade but from behind the safety of their own national governments and characteristics. The transition from command to free market economies had been a long and painful one. Indeed, in many ways it has not yet finished. For some, especially amongst the more elderly sections of the population, the days of the command economy were looked upon with considerable affection. But amongst the younger and more affluent sections of society a return to the old ways of doing things was not on the agenda. They feared anything that remotely resembled a return to supply and demand being signalled not by prices but by political ambitions and investment channelled by dogma. They also rejected in successive elections for the parliament any return to a lack of financial incentives set against clear production targets and any apparent fear of innovation. The latter had always been considered as an invasion from an evil force beyond the Berlin Wall.

Alas, it was the lot of those eastern European states rescued from Nazism to remain firmly within the control of Moscow until the final decade of the twentieth century. They had to accept that investment went mainly to heavy industry and that the amounts involved were normally allocated with no official 'return' in financial terms attached. In fairness to those who worked for an ideal that was designed to liberate the workers, they appear to have recorded exceptional growth figures. These may have been an over estimation but they did show that central planning was a force for welding together human effort in the pursuit of some common goals. As time went by, so the lack of clear consumer led messages meant that the allocation of resources became more and more suspect. The Soviet Union, in stopping COMECOM countries

from engaging in the more lucrative markets of international trade, swallowed up too much output from the satellite states.
We all know of crude examples of the might of Moscow dictating what should be done and the first of these, which followed the uprising in Hungary in 1956 cost communism dear in the 'West' as many card carrying members cancelled their membership. By 1968 and Prague most of the 'free' world was opposed to the might of the Red Army being used to crush popular public opinion. When the dictators did start to fall they mostly gave way in relatively peaceful rebellions. Only in Romania was force used on a wide scale to rid the country of the powerful elite. Alas, the fall of communism in the former Yugoslavia gave way to the smouldering forces of nationalism, which was only beginning to be extinguished as the twentieth century grew to its close. The former 'eastern block' spent the final years of the second millennium in 'transition'. Some, such as Hungary and Poland entered the market economy more easily but for others it was a very painful experience. Crime, corruption and organised underworld activities accompanied their entry to the free market system.
So, this second part of our brief journey through economic time together ends with some interesting situations still to be resolved. A convenient stopping place is the early 1990s. Let's think for a moment how the world looked when you first began to realise that school was a permanent part of your life and maybe even the occasional teacher began to talk of tests!

- The western world was again experiencing some cyclical trends of quite severe intensity
- The newest experiment with 'fixed' exchange rates, the ill fated European Exchange Rate Mechanism was moving towards its inevitable death
- The Single European Act had been signed in 1986 and Maastrich was soon to be the scene of the Act that gave birth to the single currency
- The North American Free Trade Association (NAFTA) had been formed and its close cousin the Association of South East Asian States (ASEAN) was emerging, so setting the ground rules for a world trading system that would be based on just three main trading blocks
- Inflation was beginning to move back towards low, single figure numbers
- Politicians were beginning to rediscover macro economics but not in the same depth and level of belief they had once shown
- Supply side economics had taught us all to live with downsizing, de-layering, multi-skilling, flexibility and the need to be efficient, competitive and add as much value as possible. Competition was not based basely solely on prices but on the loser term of non-price factors
- The world had literally shrunk with the introduction of the information superhighway and cost centres, outsourcing and supply chains had become the jargon of the multinational corporations
- The final vestige of colonialism had gone with the return of Hong Kong to The Peoples Republic of China
- ·The third world had continued to get poorer and was riddled with war, famine and human tragedy on scale not previously known to a species now always in touch with reality through mass communications

There are others, which you may care to think over for a few minutes but as we close Part 2 it is difficult to sound very optimistic. The prophets of doom, now collectively known as the 'Green Movement' moved into a more mainstream position in both the business and political worlds. So, let's close now and get ready to turn our attention to the arrival of new giants - many of whom come from the little known areas of South East Asia.