Margaret Thatcher's monetarism and the challenge of disinflation

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Abstract

To reduce the rate of inflation, Margaret Thatcher followed the monetarist theory that inflation is a monetary phenomenon. The creator of monetarism, Milton Friedman, predicted that the cost of Thatcher's monetarist policy would be modest. Friedman's theory was flawed: disinflation stopped even when unemployment was persistently high. A high rate of unemployment does not cause a persistently decreasing rate of inflation. Furthermore, according to monetarist theory, a leftward shift in the IS curve due to a world recession would not cause much unemployment. A cost push increase due to a substantial increase in the wage aspirations of trade unions or oil prices should also have a limited and temporary effect on inflation according to the demand/supply basis of monetarism. Monetarism may have had political value in allowing Thatcher to articulate simple slogans, to appear as a strong leader or to blame unemployment on trade unions rather than on aggregate demand. An interesting question is whether her monetarist approach would have been adopted had she recognised in advance this flaw in monetarism. Thatcher's university scientific training in chemistry and her involvement with the ideology of the Centre for Policy Studies was of little help in fostering her understanding of disinflation and her readiness to reject a theory contradicted by the facts. For Thatcher, in her words, the decisive influence on her views on economics, was her "experience of life in the Roberts household" [ie her childhood], Thatcher (1995, p.565), hardly a scientific basis.

Key words: Thatcher; monetarism; disinflation

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