

SAVED BY A WAR

THATCHERISM AND ITS USEFUL ENEMIES

Sovereign is he who decides the state of emergency.

—Carl Schmitt, Nazi lawyer¹

When Friedrich Hayek, patron saint of the Chicago School, returned from a visit to Chile in 1981, he was so impressed by Augusto Pinochet and the Chicago Boys that he sat down and wrote a letter to his friend Margaret Thatcher, prime minister of Britain. He urged her to use the South American country as a model for transforming Britain's Keynesian economy. Thatcher and Pinochet would later become firm friends, with Thatcher famously visiting the aging general under house arrest in England as he faced charges of genocide, torture and terrorism.

The British prime minister was well acquainted with what she called "the remarkable success of the Chilean economy," describing it as "a striking example of economic reform from which we can learn many lessons." Yet despite her admiration for Pinochet, when Hayek first suggested that she emulate his shock therapy policies, Thatcher was far from convinced. In February 1982, the prime minister bluntly explained the problem in a private letter to her intellectual guru: "I am sure you will agree that, in Britain with our democratic institutions and the need for a high degree of consent, some of the measures adopted in Chile are quite unacceptable. Our reform must be in line with our traditions and our Constitution. At times the process may seem painfully slow."²

The bottom line was that Chicago-style shock therapy just wasn't possible in a democracy like the U.K. Thatcher was three years into her first term,

sinking in the polls and not about to guarantee a loss in the next election by doing anything as radical or unpopular as Hayek was suggesting.

For Hayek and the movement he represented, it was a disappointing assessment. The Southern Cone's experiment had generated such spectacular profits, albeit for a small number of players, that there was tremendous appetite from increasingly global multinationals for new frontiers—and not just in developing countries but in rich ones in the West too, where states controlled even more lucrative assets that could be run as for-profit interests: phones, airlines, television airwaves, power companies. If anyone could have championed this agenda in the wealthy world, it would surely have been either Thatcher in England or the American president at the time, Ronald Reagan.

In 1981, *Fortune* magazine ran an article extolling the virtues of “Chile’s Brave New World of Reaganomics.” Praising Santiago’s “glittering, luxury filled shops” and “shiny new Japanese cars,” the article was oblivious to the pervasive repression and the explosion of shantytowns. “What can we learn from Chile’s experiment in economic orthodoxy?” it asked, and quickly provided the correct answer: “If a small undeveloped country can live by the theory of competitive advantage, then surely our infinitely more resourceful economy can.”³

However, as Thatcher’s letter to Hayek made clear, it wasn’t quite as simple as that. Elected leaders have to worry about what voters think of their job performance, which comes up for regular review. And in the early eighties, even with Reagan and Thatcher in power and Hayek and Friedman serving as influential advisers, it was not at all clear that the kind of radical economic agenda that had been imposed with such ferocious violence in the Southern Cone would ever be possible in Britain and the United States.

A decade earlier, Friedman and his movement had faced a great disappointment in the U.S. at the hands of none other than Richard Nixon, one that seemed to confirm this point. Even though Nixon had helped put the Chicago Boys in power in Chile, he had taken a very different route at home—an inconsistency Friedman would never forgive. When Nixon took office in 1969, Friedman thought his time had finally come to lead his domestic counterrevolution against the legacy of the New Deal. “Few presidents have come closer to expressing a philosophy compatible with my own,” Friedman wrote of Nixon.⁴ The two men met regularly in the Oval Office, and Nixon named several of Friedman’s like-minded friends and colleagues to key economics posts. One was the University of Chicago professor

George Shultz, whom Friedman helped recruit to work for Nixon; another was Donald Rumsfeld, then thirty-seven. In the sixties, Rumsfeld used to attend seminars at the University of Chicago, gatherings he later described in reverential terms. Rumsfeld called Friedman and his colleagues “a cluster of geniuses,” while he and other self-described “young pups” would “come in and learn at their feet. . . . I was so privileged.”⁵ With true disciples making policy and a strong personal rapport with the president, Friedman had every reason to believe that his ideas were about to be put into practice in the most powerful economy in the world.

But in 1971, the U.S. economy was in a slump; unemployment was high and inflation was pushing prices way up. Nixon knew that if he followed Friedman’s laissez-faire advice, millions of angry citizens would vote him out of a job. He decided to put caps on the prices of necessities such as rent and oil. Friedman was outraged: of all possible government “distortions,” price controls were the absolute worst. He called them “a cancer that can destroy an economic system’s capacity to function.”⁶

Even more disgraceful, it was his own disciples who were the Keynesian enforcers: Rumsfeld was in charge of the wage-and-price-control program, and he answered to Shultz, who at the time was director of the Office of Management and Budget. At one point, Friedman called Rumsfeld at the White House and berated his former “young pup.” According to Rumsfeld, Friedman instructed him, “You have got to stop doing what you are doing.” The novice bureaucrat replied that it seemed to be working—inflation was going down, the economy was growing. Friedman fired back that that was the greatest crime of all: “People are going to think that you’re doing it . . . they’re going to learn the wrong lesson.”⁷ They did indeed, and they re-elected Nixon with 60 percent of the popular vote the following year. In his second term, the president proceeded to shred even more of Friedman’s orthodoxies, passing a slew of new laws imposing higher environmental and safety standards on industry. “We are all Keynesians now,” Nixon famously proclaimed—the cruelest cut of all.⁸ So deep was this betrayal that Friedman would later describe Nixon as “the most socialist of the presidents of the United States in the 20th century.”⁹

Nixon’s tenure was a stark lesson for Friedman. The University of Chicago professor had built a movement on the equation of capitalism and freedom, yet free people just didn’t seem to vote for politicians who followed his advice. Worse, dictatorships—where freedom was markedly absent—were the only governments who were ready to put pure free-market doctrine

into practice. So while they griped about being betrayed at home, Chicago School luminaries junta-hopped their way through the seventies. Almost everywhere that right-wing military dictatorships were in power, the University of Chicago's presence could be felt. Harberger worked as a consultant to Bolivia's military regime in 1976 and accepted an honorary degree from Argentina's University of Tucuman in 1979, a time when universities were under the control of the junta.¹⁰ And farther afield, he advised Suharto and the Berkeley Mafia in Indonesia. Friedman wrote an economic liberalization program for the repressive Chinese Communist Party when it decided to convert to a market economy.¹¹

Stephen Haggard, a staunch neoliberal political scientist at the University of California, conceded the "sad fact" that "some of the widest-ranging reform efforts in the developing world were undertaken following military coups"—in addition to the Southern Cone and Indonesia, he listed Turkey, South Korea and Ghana. Other success stories took place not after military coups but in one-party states like Mexico, Singapore, Hong Kong and Taiwan. In direct contradiction of Friedman's central claim, Haggard concluded that "good things—such as democracy and market-oriented economic policy—do not always go together."¹² Indeed, in the early eighties, *there was not a single case* of a multiparty democracy going full-tilt free market.

Leftists in the developing world have long argued that genuine democracy, with fair rules preventing corporations from buying elections, would necessarily result in governments committed to the redistribution of wealth. The logic is simple enough: in these countries, there are far more poor people than rich ones. Policies that directly redistribute land and raise wages, not trickle-down economics, are in the clear self-interest of a poor majority. Give all citizens the vote and a reasonably fair process, and they will elect the politicians who appear most likely to deliver jobs and land, not more free-market promises.

For all these reasons, Friedman had spent a fair bit of time staring down an intellectual paradox: as the heir to Adam Smith's mantle, he believed passionately that humans are governed by self-interest and that society works best when self-interest is allowed to govern almost all activities—except when it comes to a little activity called voting. Since most people in the world are either poor or live below the average income in their countries (including in the U.S.), it is in their short-term self-interest to vote for politicians promising to redistribute wealth from the top of the economy down to them.¹³ Friedman's longtime friend Allan Meltzer, a fellow monetarist

economist, put the conundrum this way: "Votes are more equally distributed than income. . . . Voters with incomes at the median or below gain by transferring income to themselves." Meltzer described this reaction as "part of the cost of democratic government and political freedom" but said that "the Friedmans [Milton and his wife, Rose] swam against this strong current. They could not stop or reverse it, but they influenced far more than most the ways in which people and politicians think and act."¹⁴

Across the Atlantic, Thatcher was attempting an English version of Friedmanism by championing what has become known as "the ownership society." The effort centered on Britain's public housing, or council estates, which Thatcher opposed on philosophical grounds, believing that the state had no role to play in the housing market. The council estates were filled with the type of people who wouldn't vote Tory because it wasn't in their economic self-interest; Thatcher was convinced that if they could be brought into the market, they would start to identify with the interests of the wealthier people who opposed redistribution. With that in mind, she offered strong incentives to the residents of public housing to buy their flats at reduced rates. Those who could became homeowners, while those who couldn't faced rents that were almost twice as high as before. It was a divide-and-conquer strategy, and it worked: the renters continued to oppose Thatcher, the streets of Britain's large cities saw a visible increase in homelessness, but polls showed that more than half of the new owners did switch their party affiliation to the Tories.¹⁵

Although the estate sales offered a glimmer of hope for the possibility of hard-right economics in a democracy, Thatcher still looked poised to lose her job after just one term. In 1979, she had run on the slogan "Labor isn't working," but by 1982, the number of unemployed had doubled under her watch, as had the inflation rate.¹⁶ She had tried to take on one of the most powerful unions in the country, the coal miners, and had failed. After three years in office, Thatcher saw her personal approval rating drop to only 25 percent—lower than George W. Bush at his lowest point and lower than any British prime minister in the history of opinion polls. Approval for her government as a whole had sunk to 18 percent.¹⁷ With a general election looming, Thatcherism was about to come to an early and inglorious close, well before the Tories had achieved their most ambitious goals of mass privatization and breaking the blue-collar unions. It was in those trying circumstances that Thatcher wrote to Hayek, politely informing him that a Chilean-style transformation was "quite unacceptable" in the U.K.

Thatcher's catastrophic first term seemed to further confirm the lessons of the Nixon years: that the radical and highly profitable policies of the Chicago School couldn't survive in a democratic system. It seemed clear that the successful imposition of economic shock therapy required some other sort of shock—whether of a coup, or of the torture chamber delivered by a repressive regime.

That was an especially disturbing prospect on Wall Street because, in the early eighties, authoritarian regimes were starting to collapse around the world—Iran, Nicaragua, Ecuador, Peru, Bolivia—and many more would follow in what the conservative political scientist Samuel Huntington would term the “third wave” of democracy.¹⁸ These were worrying developments—what would prevent the emergence of another Allende, winning votes and support with populist policies?

Washington had watched as that very scenario played out in both Iran and Nicaragua in 1979. In Iran, the U.S.-backed shah was overthrown by a coalition of leftists and Islamists. While the stories of hostages and ayatollahs made the news, the economic side of the program was also raising alarms in Washington. The Islamic regime, which had not yet transitioned to full-blown authoritarianism, nationalized the banking sector and then brought in a land redistribution program. It also imposed controls on imports and exports, a reversal of the shah's free-trade policies.¹⁹ Five months later in Nicaragua, the U.S.-backed dictatorship of Anastasio Somoza Dabayle fell to a popular revolt that installed the left-wing Sandinista government. It controlled imports and, like the Iranians, nationalized the banking industry.

It added up to a grim prognosis for the dream of a global free market. By the early eighties, Friedmanites were facing the prospect that their revolution, less than a decade old, could not survive a new populist wave.

War to the Rescue

Six weeks after Thatcher wrote that letter to Hayek, something happened that changed her mind and altered the destiny of the corporatist crusade: on April 2, 1982, Argentina invaded the Falkland Islands, a relic of British colonial rule. The Falklands War, or the Malvinas War if you are Argentine, went down in history as a vicious but fairly minor battle. At the time, the Falklands appeared to have no strategic importance. The cluster of islands off the Argentine coast was thousands of miles from Britain and costly to guard and

maintain. Argentina, too, had little use for them, though having a British outpost in its waters was regarded as an affront to national pride. The legendary Argentine writer Jorge Luis Borges scathingly described the land dispute as “a fight between two bald men over a comb.”²⁰

From a military standpoint, the eleven-week battle appears to have almost no historic significance. Overlooked, however, was the war's impact on the free-market project, which was enormous: it was the Falklands War that gave Thatcher the political cover she needed to bring a program of radical capitalist transformation to a Western liberal democracy for the first time.

Both sides in the conflict had good reasons to want a war. In 1982, Argentina's economy was collapsing under the weight of its debt and corruption, and human rights campaigns were gaining momentum. A new junta government, led by General Leopoldo Galtieri, calculated that the only thing more powerful than the anger at its continued suppression of democracy was anti-imperialist sentiment, which Galtieri expertly unleashed on the British for their refusal to give up the islands. Soon enough, the junta had Argentina's blue-and-white flag planted on that rocky outpost, and the country cheered on cue.

When news arrived that Argentina had laid claim to the Falklands, Thatcher recognized it as a last-ditch hope to turn around her political fortunes and immediately went into Churchillian battle mode. Until this point, she had shown only disdain for the financial burden that the Falklands placed on government coffers. She had cut grants to the islands and announced major cutbacks to the navy, including the armed ships that guarded the Falklands—moves read by the Argentine generals as clear indications that Britain was ready to cede the territory. (One of Thatcher's biographers characterized her Falklands policy as “practically an invitation to Argentina to invade.”)²¹ In the lead-up to the war, critics across the political spectrum accused Thatcher of using the military for her own political goals. The Labour MP Tony Benn said, “It looks more and more as if what is at stake is Mrs. Thatcher's reputation, not the Falkland Islands at all,” while the conservative *Financial Times* noted, “What is deplorable is that the issue is rapidly becoming mixed up with political differences within Britain itself which have nothing to do with the matter in hand. Not only the pride of the Argentine Government is involved. So is the standing, perhaps even the survival, of the Tory Government in Britain.”²²

Yet even with all of this healthy cynicism in the run-up, as soon as troops were deployed, the country was swept up in what a draft Labour Party resolution described as a “jingoistic, militaristic frame of mind,” embracing the

Falkland Islands as a last blast of glory for Britain's faded empire.²³ Thatcher praised the "Falklands spirit" gripping the nation, which in practice meant that shouts of "Ditch the bitch!" subsided while "Up Your Junta!" T-shirts sold briskly.²⁴ Neither London nor Buenos Aires made any serious attempt to avoid a showdown. Thatcher brushed aside the United Nations much as Bush and Blair did in the run-up to the war in Iraq, uninterested in sanctions or negotiations. Glorious victory was the only outcome that either side had any interest in.

Thatcher was fighting for her political future—and she succeeded spectacularly. After the Falklands victory, which took the lives of 255 British soldiers and 655 Argentines, the prime minister was heralded as a war hero, her moniker "Iron Lady" transformed from insult to high praise.²⁵ Her poll numbers were similarly transformed. Thatcher's personal approval rating more than doubled over the course of the battle, from 25 percent at the start to 59 percent at the end, paving the way for a decisive victory in the following year's election.²⁶

The British military's counterinvasion of the Falklands was code-named Operation Corporate, and though it was an odd name for a military campaign, it proved prescient. Thatcher used the enormous popularity afforded her by the victory to launch the very corporatist revolution she had told Hayek was impossible before the war. When the coal miners went on strike in 1984, Thatcher cast the standoff as a continuation of the war with Argentina, calling for similarly brutal resolve. She famously declared, "We had to fight the enemy without in the Falklands and now we have to fight the enemy within, which is much more difficult but just as dangerous to liberty."²⁷ With British workers now categorized as "the enemy within," Thatcher unleashed the full force of the state on the strikers, including, in a single confrontation, eight thousand truncheon-wielding riot police, many on horseback, to storm a plant picket line, leading to roughly seven hundred injuries. Over the course of the long strike, the number of injuries reached into the thousands. As the *Guardian* reporter Seumas Milne documents in his definitive account of the strike, *The Enemy Within: Thatcher's Secret War against the Miners*, the prime minister pressed the security services to intensify surveillance of the union and, in particular, its militant president, Arthur Scargill. What ensued was "the most ambitious counter-surveillance operation ever mounted in Britain." The union was infiltrated by multiple agents and informers, and all its phones were bugged, as were the homes and even the fish-and-chips shop frequented by its leadership.

The chief executive of the union was alleged, on the floor of the House of Commons, to have been an MI5 agent sent in to "destabilize and sabotage the union," though he denied the charge.²⁸

Nigel Lawson, U.K. chancellor of the exchequer during the strike, explained that the Thatcher government considered the union to be its enemy. "It was just like arming to face the threat of Hitler in the late 1930s," Lawson said a decade later. "One had to prepare."²⁹ As in the Falklands, there was little interest in bargaining, just a focused determination to break the union, regardless of the cost (and with three thousand extra police a day, the cost was enormous). Colin Naylor, an acting police sergeant who was on the front lines of the conflict, described it as "a civil war."³⁰

By 1985, Thatcher had won this war too: workers were going hungry and couldn't hold out; in the end 966 people were fired.³¹ It was a devastating setback for Britain's most powerful union, and it sent a clear message to the others: if Thatcher was willing to go to the wall to break the coal miners, on whom the country depended for its lights and warmth, it would be suicide for weaker unions producing less crucial products and services to take on her new economic order. Better just to accept whatever was on offer. It was a message very similar to the one Ronald Reagan had sent a few months after he took office with his response to a strike by the air-traffic controllers. By not showing up to work, they had "forfeited their jobs and will be terminated," Reagan said. Then he fired 11,400 of the country's most essential workers in a single blow—a shock from which the U.S. labor movement has yet to fully recover.³²

In Britain, Thatcher parlayed her victory in the Falklands and over the miners into a major leap forward for her radical economic agenda. Between 1984 and 1988, the government privatized, among others, British Telecom, British Gas, British Airways, British Airport Authority and British Steel, while it sold its shares in British Petroleum.

Much as the terrorist attacks of September 11, 2001, would take an unpopular president and hand him an opportunity to launch a massive privatization initiative (in Bush's case, the privatization of security, warfare and reconstruction), Thatcher used her war to launch the first mass privatization auction in a Western democracy. This was the real Operation Corporate, one with historic implications. Thatcher's successful harnessing of the Falklands War was the first definitive evidence that a Chicago School economic program did not need military dictatorships and torture chambers in order to advance. She had proved that with a large enough political

crisis to rally around, a limited version of shock therapy could be imposed in a democracy.

Still, Thatcher had needed an enemy to unite the country, a set of extraordinary circumstances that justified her use of emergency measures and repression—a crisis that made her look tough and decisive rather than cruel and regressive. The war had served her purpose perfectly, but the Falklands War was an anomaly in the early eighties, a throwback to earlier colonial conflicts. If the eighties were really going to be the dawn of a new age of peace and democracy, as many claimed, then Falklands-type clashes would be far too infrequent to form the basis of a global political project.

It was in 1982 that Milton Friedman wrote the highly influential passage that best summarizes the shock doctrine: “Only a crisis—actual or perceived—produces real change. When that crisis occurs, the actions that are taken depend on the ideas that are lying around. That, I believe, is our basic function: to develop alternatives to existing policies, to keep them alive and available until the politically impossible becomes politically inevitable.”³³ It was to become a kind of mantra for his movement in the new democratic era. Allan Meltzer elaborated on the philosophy: “Ideas are alternatives waiting on a crisis to serve as the catalyst of change. Friedman’s model of influence was to legitimize ideas, to make them bearable, and worth trying when the opportunity comes.”³⁴

The kind of crisis Friedman had in mind was not military but economic. What he understood was that in normal circumstances, economic decisions are made based on the push and pull of competing interests—workers want jobs and raises, owners want low taxes and relaxed regulation, and politicians have to strike a balance between these competing forces. However, if an economic crisis hits and is severe enough—a currency meltdown, a market crash, a major recession—it blows everything else out of the water, and leaders are liberated to do whatever is necessary (or said to be necessary) in the name of responding to a national emergency. Crises are, in a way, democracy-free zones—gaps in politics as usual when the need for consent and consensus do not seem to apply.

The idea that market crashes can act as catalysts for revolutionary change has a long history on the far left, most notably in the Bolshevik theory that hyperinflation, by destroying the value of money, takes the masses one step closer to the destruction of capitalism itself.³⁵ This theory explains why a certain breed of sectarian leftist is forever calculating the exact conditions

under which capitalism will reach “the crisis,” much as evangelical Christians calibrate signs of the coming Rapture. In the mid-eighties, this Communist idea began to experience a powerful revival, picked up by Chicago School economists who argued that just as market crashes could precipitate left-wing revolutions, so too could they be used to spark right-wing counter-revolutions, a theory that became known as “the crisis hypothesis.”³⁶

Friedman’s interest in crisis was also a clear attempt to learn from the victories of the left after the Great Depression: when the market crashed, Keynes and his disciples, previously voices in the wilderness, had been ready and waiting with their ideas, their New Deal solutions. In the seventies and early eighties, Friedman and his corporate underwriters had attempted to mimic this process with their unique brand of intellectual disaster preparedness. They painstakingly built up a new network of right-wing think tanks, including Heritage and Cato, and produced the most significant vehicle to disseminate Friedman’s views, the ten-part PBS miniseries *Free to Choose*—underwritten by some of the largest corporations in the world, including Getty Oil, Firestone Tire & Rubber Co., PepsiCo, General Motors, Bechtel and General Mills.³⁷ When the next crisis hit, Friedman was determined that it would be his Chicago Boys who would be the ones ready with their ideas and their solutions.

At the time he first articulated the crisis theory in the early eighties, the U.S. was in a recession—a double whammy of high inflation and unemployment. And Chicago School policies, now known as Reaganomics, certainly held sway in Washington. But even Reagan didn’t dare implement the kind of sweeping shock therapy that Friedman dreamed of, the kind he had prescribed in Chile.

Once again, it would be a Latin American country that would be the testing ground for Friedman’s crisis theory—and this time, it wouldn’t be a Chicago Boy who would lead the way, but a new breed of shock doctor, one more suited to the new democratic age.