Finance and Economics Discussion Series
Divisions of Research & Statistics and Monetary Affairs
Federal Reserve Board, Washington, D.C.

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2017-096

Please cite this paper as:
Nelson, Edward (2017). "Reaffirming the Influence of Milton Friedman on U.K. Economic Policy," Finance and Economics Discussion Series 2017-096. Washington: Board of Governors of the Federal Reserve System, https://doi.org/10.17016/FEDS.2017.096.

Reaffirming the Influence of Milton Friedman on U.K. Economic Policy

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August 22, 2017

Abstract

This paper finds a significant influence of Milton Friedman on U.K. economic policy from the 1970s onward, and especially during the period of the Thatcher Government. The finding is based on a consideration of statements by policymakers and key economic advisers, as well as an analysis of Friedman's commentary in the 1970s, 1980s, and 1990s on U.K. economic developments. Explicit, public acknowledgments of Friedman's influence were given by Margaret Thatcher, Chancellor of the Exchequer Geoffrey Howe, Bank of England officials, and others in policy circles. Examples of Friedman's influence include the absorption into U.K. policy doctrine of the permanent income hypothesis and the natural rate hypothesis, the rejection from 1979 onward of incomes policy as a weapon against inflation, and U.K. officials' repeated appeals to monetary sovereignty when arguing against monetary union or a sterling peg. Evidence of influence by Friedman on privatization policy and on the official perspective on the current account deficit can also be discerned. Although he had only limited interaction with U.K. policymakers, Friedman had a major influence, reflected in the adoption into actual U.K. policymaking of recommendations made in his writings and in the fact that those writings—which were studied closely by a number of senior U.K. economic advisers—helped alter U.K. economists' conceptual framework and thereby fostered doctrinal changes in U.K. economic policy. This paper's analysis also shows that two prominent critics of the Thatcher economic policy—Labour's Harold Wilson and the Conservatives' Edward Heath—saw this policy as partly due to the influence of Friedman, whom each of them had met before the Thatcher era.

Key Words: Milton Friedman, U.K. economic policy, incomes policy, monetarism.

* Email: edward.m.nelson@frb.gov. The author is grateful to Alan Budd, Tim Congdon, Charles Goodhart, Brian Griffiths, Harold James, Mervyn King, David Laidler, William Poole, and Tony Thirlwall for very useful comments on an earlier version of this paper, to Oliver Bush and David Shiels for help in accessing archival items, and to Carter Bryson for research assistance. The views expressed in this paper should not be taken as those of the Federal Reserve or the Board of Governors.

1. Introduction

In mid-1979, soon after the Thatcher Government took office in the United Kingdom, Milton Friedman used his *Newsweek* column to suggest an economic program to the U.S. president. Friedman added that the president "might ask Margaret Thatcher" whether that program could be sold to the voters (*Newsweek*, June 18, 1979). This reference to Thatcher amounted to an acknowledgment on Friedman's part that the economic program of the recently-elected U.K. government had been importantly influenced by his work. Friedman's economics continued to be linked with the Thatcher Government, especially during its first term (May 1979 to June 1983), and a retrospective by the London newspaper *Independent on Sunday* (July 26, 1992) noted that Friedman was "unfailingly associated with the early Thatcher years." [1]

In important respects, the influence of Friedman's economics on U.K. government policy endured beyond 1990, the year in which Thatcher left office, and has continued to the modern day. One official acknowledgment of this came in the early 2000s with the appearance of the U.K. Treasury's book *Reforming Britain's Economic and Financial Policy*, which stated that "the economics profession owes a debt of gratitude towards Milton Friedman, one of the great U.S. postwar economists" (HM Treasury, 2002, p. 30). This Treasury discussion specifically credited to Friedman two concepts that are embedded in the formation of modern U.K. economic policymaking: the permanent income hypothesis and the proposition that there is no long-run tradeoff between inflation and unemployment. In addition to these items, other features of modern U.K. official thinking on the economy that many would closely associate with Friedman—on account of his advocacy of these features in his writings and other statements—include the merits of floating exchange rates, the importance of the distinction between nominal and real interest rates, and the conviction that inflation is a monetary phenomenon. These examples buttress Bernanke's (2004, p. 209) observation that a good number of Friedman's propositions concerning macroeconomics "would be viewed by most policymakers and economists today as being, as the British would put it, 'spot on.'"

On the interpretation sketched above, Friedman's economic analysis has proved influential in U.K. economic-policy formation, with several elements of it continuing to have influence today. Nevertheless, as already indicated, Friedman's influence is also regarded as having been

[1] In what follows, media quotations that appeared in the author's prior papers on Friedman and on U.K. economic policy, including Nelson (2005, 2009a, 2009b), are referenced by citing those papers, which contain detailed bibliographical listings for the media items. Bibliographical details for the remaining media items quoted below are listed in Section A of the bibliography of this paper.

particularly strong during the era of the Thatcher Government (1979 to 1990). With regard to the issues of the role of government in the economy and of microeconomic policy, many of the initiatives taken by the Thatcher Government had parallels with specific positions Friedman had taken. But it is in the area of *macroeconomic* policy that Friedman's imprint on the Thatcher Government might well be regarded as especially important. It is on this area that the present paper focuses.[2]

The procedure of announced targets for the growth rate of a monetary aggregate was begun by the Callaghan Labour Government in 1976. Furthermore, neither the Callaghan Government nor the Thatcher Government embraced the monetary-base-control method that Friedman advocated for the pursuit of monetary targets. But, unlike the Callaghan Government, the Thatcher Government pursued monetary targets (initially for the growth in broad money, with the emphasis shifting to base-money-growth targets in its second term), *not* in conjunction with attempts to influence wages and prices directly, but as the *key* means of achieving disinflation. The Thatcher Government's embrace of the notion that monetary policy could serve as a sufficient device for the control of inflation marked that government out from its predecessors and also constituted an area of alignment with Friedman's framework. Furthermore, this is a notion to which U.K. policymakers have continued to subscribe in the past three decades even as they have departed from Friedman's prescription of monetary targeting.

In light of the Thatcher Government's endorsement of this notion, and the same government's strong emphasis in its early years on monetary targeting, it is not surprising that many U.K. commentators have linked Friedman and the Thatcher Government. This perception was reflected in media commentary that appeared during the Thatcher era. For example, an article on Friedman that appeared in the London *Daily Express* newspaper (August 6, 1980) stated that he had "exerted an enormous influence on the policies of the Thatcher Government." And a columnist in the London *Sunday Telegraph* (March 11, 1984) observed with regard to economic matters: "Nobody can possibly deny the vast debt Mrs. Thatcher owes to Milton Friedman…"

In the same vein, many economic researchers based in the United Kingdom have traced the positions of the Thatcher Government or of Prime Minister Thatcher herself to Friedman's work. For example, Bean and Symons (1989, p. 13) observed with regard to Thatcher: "Her favorite economist was Adam Smith with a respectful nod to Milton Friedman..." A number of

[2] The principal exception made will be in the case of privatization (covered in Section 6.4 below). The Thatcher Government's privatization program would likely be regarded as a microeconomic reform or one at the intersection of microeconomics and macroeconomics.

biographies of Thatcher have likewise endorsed the assessment that Friedman was an important influence on her economic views.[3] Numerous U.S.-based economic researchers have also characterized Thatcher or key personnel of her government (in the ministry or in senior advisory positions) as having been influenced to a significant degree by Friedman's work. For example, Krugman (1994, p. 173) stated that "Margaret Thatcher… was surrounded by men who had really been convinced by Milton Friedman…" And Shleifer (2009, p. 123) included Thatcher among a number of heads of government coming on the scene in the late 1970s and early 1980s who "professed inspiration from the work of Milton Friedman."

The suggestion of a considerable influence of Friedman on U.K. economic policy has also received support in the present author's work both on Friedman's economic framework and on U.K. economic policy. To be sure, a rigid mapping between Friedman's views and U.K. economic policy was never present; and his personal role in, and knowledge of, U.K. economic policy were never very extensive. But several Friedman tenets have found their way into U.K. economic policymaking. Most important of them is that already mentioned: the eschewing of incomes policy as a tool against inflation and its replacement by an approach that made monetary policy the key means of controlling inflation. The transformation of U.K. economic policy implied by this change has been analyzed in detail in Nelson and Nikolov (2004), Nelson (2005, 2009b) and Batini and Nelson (2005), and its link with Friedman's work has been stressed particularly by Nelson and Schwartz (2008) and Nelson (2009a, 2009c)—with additional evidence on this score appearing later in the present paper. Further enduring instances of Friedman's influence were also given earlier, among them the rejection of a long-run Phillips-curve tradeoff and the emphasis on the real/nominal interest-rate distinction.[4] In addition, Batini and Nelson (2001) have noted that the proposition that monetary policy exerts its main effect on inflation with a lag of about two years—a rule of thumb prevalent in policy circles in the United Kingdom under both monetary targeting and inflation targeting—can be traced to Friedman's (1972a) work. Evidence provided in Nelson (2009a, 2009b) has also been supportive of the notion that the Thatcher Government in particular was influenced by Friedman's work.

In sum, there is a considerable body of work in favor of the contention that Friedman was influential on U.K. economic policy.

[3] For example, Campbell (2000, p. 374) credited Friedman with having "influenced Mrs. Thatcher far more powerfully" than some other figures cited as influential on her.
[4] Although it is now regarded as commonplace, the Fisherian distinction between real and nominal interest rates really only became standard in postwar monetary analysis after it was stressed by Friedman and his students and coauthors. See Nelson (2017, Chapters 6 and 12) for a detailed discussion.

A contrary position has, however, been taken in retrospectives by Nigel Lawson—a key figure in economic policy during the Thatcher Government—and by Forder (2016). In a 2011 discussion, Lawson stated that "Friedman really had very little impact or influence on any of the policies that we were pursuing."[5] In a similar vein, Forder has contended that Friedman "had no special influence" on U.K. economic policy (Forder, 2016, p. 1). Forder applies this claim to the Thatcher years—contending that there was no "specific influence from Friedman on Thatcher" (Forder, 2016, p. 2)—and to other periods, such as that of the Callaghan Government. In light of these challenges to the conventional wisdom, it is of interest to ascertain whether there was a significant influence of Milton Friedman on U.K. economic policy, especially during the period of the Thatcher Government.

The present paper carries out an analysis of this matter. The analysis, which extends Nelson (2009a) to the post-1979 period (both the Thatcher years and the post-1990 period), confirms a significant influence of Friedman on U.K. economic policy—an influence that started in earnest in the 1970s (after a brief prior period of influence in the late 1950s) and that endures in a number of features of modern U.K. economic-policy doctrine, and an influence that was especially large during the Thatcher years. This finding is based on a consideration of statements by policymakers and key economic advisers, as well as an analysis of Friedman's commentary in the 1970s, 1980s, and 1990s on U.K. economic developments.

It is found that several aspects of Friedman's influence on U.K. economic policy transcended both the early Thatcher years and the era of monetary targeting. These included his cases for privatization and floating exchange rates, his perspective on the current account deficit, and a number of elements of his monetary analysis given above, most centrally his insistence that monetary policy is at the heart of the analysis and control of inflation.

Documentation will be provided in the discussion below of specific acknowledgments by key U.K. policymakers of Friedman's influence to this statement—including Thatcher's remark, "We had learned at Milton Friedman's knee that inflation is a monetary phenomenon," and Geoffrey Howe (her first Chancellor of the Exchequer) observing of Friedman that "I admire him enormously" and stating that "I'm a man of commonsense and reasonable determination taking advice, a great deal of it from Professor Friedman." The important influence of Friedman's work on the monetary thinking of key economic advisers in the Thatcher era—especially Alan Walters and Brian Griffiths—is also documented below.

[5] As quoted in Needham, Oliver, and Riley (2011, p. 24).

The rest of this paper is organized as follows. Section 2 lays out five basic points on the connection between Friedman and U.K. economic policy. In Section 3, the acknowledgments of Friedman's influence by key ministers and economic advisers are presented. In Section 4, Friedman's influence on pre-1979 U.K. economic policy is analyzed. Sections 5 and 6 then revisit post-1979 developments: Section 5 considers Friedman's largest impact on post-1979 economic policy—which was the permanent shift to the use of monetary policy as the key anti-inflation weapon—while Section 6 considers the Thatcher years in detail and their connections to Friedman's economics. Section 7 contrasts the finding of a Friedman influence in this paper with the claims of a lack of influence. Section 8 provides some concluding remarks.

Before proceeding, it is useful to make two clarifications. First, several U.K. politicians who featured prominently in economic-policy debates during the 1970s and 1980s are listed in Table 1, together with some major positions that they held.[6] Second, "monetarism" will be used below to refer to propositions about the relationships between the money stock and key economic aggregates as well as those propositions' implications for the role of monetary policy. It will not be used to refer to Friedman's views on the desirability of free-market arrangements.[7] There will be some mention of these latter views below, but they will not be treated as part of monetarism.

2. Friedman and U.K. economic policy: five major points

In this section, five major points concerning the analysis of Friedman and U.K. economic policy are set out. An appreciation of these points provides an understanding of the way in which Friedman's influence can be ascertained.

The first point is that, as stressed at the outset in Nelson (2009a, p. 1), Friedman was not an expert on the U.K. economy. Nor did he claim to be; on the contrary, he was explicit that he was not. Friedman did not follow developments in U.K. economic data on a close and regular basis, and he provided commentary on U.K. economic developments only sporadically.

Second, although, as discussed in Nelson (2017, Chapter 14), Friedman paid more attention to developments in the United Kingdom than to those in many other parts of the world (such as

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[6] For tenures as Shadow Chancellor (that is, the opposition party's head spokesperson on economic-policy matters), only those of Healey and Howe are given in Table 1. But all the figures in the table held various economics-related posts over some periods in which their parties were in opposition.

[7] The permanent income hypothesis, although it was an essential part of Friedman's macroeconomic framework, will be identified specifically in the discussion below rather than being considered to be automatically under the heading of monetarism. Likewise, rather than taking the natural rate hypothesis as automatically part of monetarism, the analysis that follows will explicitly indicate when that hypothesis is being considered.

Table 1. Selected leading figures in U.K. economic policy in the 1970s and 1980s	
Individual	Selected positions
James Callaghan (1912–2005)	Chancellor of the Exchequer, 1964–1967; Prime Minister, 1976–1979; Leader of the Opposition, 1979–1980; leader of the Labour party, 1976–1980
Denis Healey (1917–2015)	Shadow Chancellor of the Exchequer, 1972–1974 and 1979–1980; Chancellor of the Exchequer, 1974–1979
Edward Heath (1916–2005)	Leader of the Opposition, 1965–1970 and 1974–1975; Prime Minister, 1970–1974; leader of the Conservative party, 1965–1975
Geoffrey Howe (1926–2015)	Shadow Chancellor of the Exchequer, 1975–1979; Chancellor of the Exchequer, 1979–1983
Nigel Lawson (born 1932)	Financial Secretary to the Treasury, 1979–1981; Chancellor of the Exchequer, 1983–1989
Margaret Thatcher (1925–2013)	Leader of the Opposition, 1975–1979; Prime Minister, 1979–1990; leader of the Conservative party, 1975–1990
Harold Wilson (1916–1995)	Leader of the Opposition, 1963–1964 and 1970–1974; Prime Minister, 1964–1970 and 1974–1976; leader of the Labour party, 1963–1976

Continental Europe), and he described himself as "very greatly interested in what happens in Great Britain" (Friedman, 1983a, p. 15), he devoted little of his own research time to the U.K. experience. The major exception to this pattern was found in his and Anna Schwartz's inclusion of U.K. data in their 1982 study *Monetary Trends* (Friedman and Schwartz, 1982). Friedman occasionally referred during the 1960s and 1970s to results flowing from the ongoing *Monetary Trends* project, and he used the then-nearly-complete *Monetary Trends* as part of the basis for policy prescriptions that he made for the United Kingdom in Friedman (1980).[8] It is nevertheless the case that Friedman did not personally participate very heavily in the discussions of U.K. monetary relations that took place in research journals and conferences in the 1960s and 1970s. But he nevertheless figured heavily in those discussions. For, very importantly, his work on the United States inspired others in these decades to conduct parallel studies using U.K. data—including a key figure at the intersection of policy and research, Alan Walters, whose role will be considered at several later stages of the discussion.

[8] On these pre-1982 discussions, see Nelson (2009a, pp. 63, 87; 2017, Chapter 2, Section III).

Third, Samuel Brittan (for example, in *Financial Times*, March 11, 1982, and in Brittan, 2005, p. 298) has validly observed that the connection between Friedman and Margaret Thatcher was often exaggerated by commentators, and that it is not correct to suppose that they had heavy personal interaction or that there was a very rigid connection between Thatcher's policies and Friedman's views. Friedman himself alluded to both these mischaracterizations when in 1981 he remarked on the incongruity of being held "responsible for the serious problems of Thatcher's government because I once had dinner with Mrs. Thatcher."[9] It is well established that Friedman's meetings with Thatcher during her time as a politician were few. Their meetings included one in London in 1978, while Thatcher was Leader of the Opposition.[10] Although several accounts (including Moore, 2013, p. 351) have focused on the coverage of the foreign-exchange market in their conversation, the same conversation, by Friedman's own account, also covered domestic monetary-policy issues, including the link between monetary growth and inflation (Stephenson, 1980, p. 45; Whitehead, 1985, p. 331). Friedman subsequently visited her as Prime Minister at 10 Downing Street on February 27, 1980. In the considerable media coverage that this meeting received, it was initially given as being an hour in length (*The Times*, February 28, 1980), but in actuality Thatcher's attendance was limited to listening to, and endorsing, Friedman's opening remarks (Moore, 2013, p. 523).[11] In another trip to London during Thatcher's first term, Friedman did not see Thatcher, who was visiting the Far East, but he did meet with her economic adviser, Alan Walters (*The Observer*, September 26, 1982).[12]

The mentions of Walters in the preceding two points brings us to the fourth point: the influence of Friedman on U.K. economic policy was predominantly indirect in nature—one that occurred via the influence his writings had on politicians and, especially, on their advisers, rather than in the form of direct personal advice from Friedman to U.K. officials. It is not, in fact, a matter of dispute that Margaret Thatcher read works by Friedman: that fact—already hinted at in her 1977 remark (see Section 7 below) that she would like to talk to Friedman—was confirmed in

[9] In Friedman, Porter, Gruen, and Stammer (1981, p. 23).

[10] This meeting (which corresponded to the dinner mentioned in the 1981 Friedman remark quoted above) was referred to in Nelson (2009a, p. 103) on the basis of the account in Campbell's (2000, p. 372) biography of Thatcher. Campbell suggested that the meeting was around 1978. The account in Thatcher's authorized biography, Moore (2013, p. 351), confirmed the date of the meeting as 1978 (albeit taking place around November, not the April date suggested in Nelson, 2009a).

[11] In a parliamentary debate the day after the meeting, Leader of the Opposition James Callaghan commented mockingly that he was "thankful that the Prime Minister was able to spend only a short time yesterday with Professor Milton Friedman." (*House of Commons Debates*, February 28, 1980, p. 1587.) The fact that the meeting included her endorsement of Friedman's remarks does support the association between Friedman's and Thatcher's views that Callaghan stressed.

[12] Their meetings during this visit included a lunch on September 20, 1982. See Walters' record of the meeting at: *http://www.margaretthatcher.org/document/144366*

Thatcher (1995, p. 567) as well as by Moore's (2013, pp. 254, 343) examination of her annotated papers. In addition, those close to Thatcher during her time as Leader of the Opposition in the 1970s confirmed her interest in Friedman's writings. Specifically, Alfred Sherman of the Centre for Policy Studies stated that "Margaret turned to Hayek and Friedman" (quoted in Ranelagh, 1991, p. 182) and Christopher Patten, who was a Conservative party staffer during the 1970s, recalled that she would keep quotations from Friedman and other writers in her handbag (Maddox, 2003, p. 174). However, academic economists involved in U.K. economic-policy advice, such as Alan Walters and Brian Griffiths in the Thatcher era, and Lionel Robbins in an earlier era, were far more steeped in Friedman's writings.[13] And it is the channel running from Friedman's writings to these advisers' positions to actual policy that provides an important indirect influence of Friedman on U.K. economic policy, one documented extensively below.

Fifth, on key dimensions, Thatcher Government economic policy did line up with Friedman's views. As indicated in the Brittan writings mentioned above, there were certainly numerous differences between the Thatcher Government's policies and Friedman's recommendations. These were apparent almost from the outset with Friedman's public criticism (in *Newsweek*, July 9, 1979) of the Thatcher Government's increase in Value Added Tax (VAT). Consequently, within six months of Thatcher taking office, the London *Daily Telegraph* could editorialize (October 12, 1979): "As for compromise, ask any disciple of Milton Friedman how much of the government economic policy is in line with the pure word of monetarism." In 1980, the differences became manifest again in Friedman's public criticism (especially in Friedman, 1980) of the government's continued adherence to interest-rate- and fiscal-policy-based methods of monetary-aggregate targeting, instead of his preferred method of monetary base control. Indeed, the Friedman (1980) critique—first made public in *The Observer* of July 6, 1980—would be repeatedly noted in the monetary-policy literature of the 1980s and 1990s (see, for example, Bean and Symons, 1989, p. 18; Congdon, 1992, p. 215).[14]

But these differences should not obscure important areas of agreement. Friedman himself observed: "Obviously I'm in no position over here to follow the day-to-day details of [U.K.] government policy. But I do applaud wholeheartedly the main lines of that policy." (*David*

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[13] For the period from 1997 onward, when several officials at the Bank of England formally became policymakers owing to their membership in the Monetary Policy Committee (MPC) and the advent of Bank of England independence, it becomes more legitimate to see, in some cases, a direct influence of Friedman's work on policymakers' views, instead of an influence operating indirectly via advisers.

[14] It has also been mentioned in many books on Thatcher and the Thatcher Government—although some of these (such as Moore, 2013, p. 523) incorrectly suggested that Friedman testified in person to a parliamentary committee. In fact, his evidence was wholly a written submission.

Frost's New Year Special, We've Seen the Future, Yorkshire Television, January 1, 1980.) Indeed, an important reason why the U.K. media and the research literature found the differences between Friedman and the Thatcher Government worth discussing was the very fact that his views had played an important role in the formation of the Thatcher Government's conceptual framework. These views included microeconomic positions on the connection between regulation and national economic performance. But they also included the crucial conclusion advanced by Friedman, already mentioned in Section 1 and discussed in detail in Sections 3 and 5 below, that inflation was a monetary phenomenon whose control was to be found in monetary-policy measures and not in direct intervention in the wage- and price-setting process.

The above are the five key points that need to be kept in mind when considering Friedman's influence. The third and fourth points underpin the conclusion documented below that Friedman was an influence on Margaret Thatcher and her government.

Prior to turning to direct evidence on this matter, it is worth considering the position taken by Sir Keith Joseph. Joseph, like Thatcher, served in the 1970–1974 Heath Conservative government. After that government left office, Joseph became a critic of its economic policy, making use of monetarist arguments in doing so. Yet Joseph stated in September 1974 of Friedman: "the evolution of my views owes little to him" (quoted in Nelson, 2009a, p. 102). This statement cannot, however, be validly taken at face value. For one thing, Joseph did acknowledge that the interaction he had with Alan Walters during the mid-1970s was part of the process by which Joseph became a monetarist (*Pandora's Box*, BBC2, June 25, 1992, p. 27 of transcript). As Walters was heavily influenced by Friedman, Joseph's change of views on monetary matters certainly involved indirect influence on Joseph from Friedman. For another thing, Joseph's claim of little influence from Friedman is belied by other indications that Joseph gave during 1974. For example, Joseph (1974) cited Friedman (1974)—a piece in which, in the course of advocating indexation schemes, Friedman had espoused both the natural rate hypothesis and the view that inflation was a monetary phenomenon. In addition, in defending the monetarist position, Joseph referred (in *The Times*, September 9, 1974) to the "well-attested time lags" between money and the economy—thereby invoking studies that either were by Friedman himself or were applications of Friedman's work to U.K. data. A short time later, Joseph wrote (*Sunday Times*, September 22, 1974) that "to hold registered unemployment down artificially by means of demand management, an accelerated rate of inflation is required"—a conclusion so close to Friedman's prior writings (including the 1974 Friedman piece that Joseph had already publicly cited) that it is untenable to regard it as made independently of those writings.

Joseph's claim to have arrived at a monetarist framework without influence from Friedman is, therefore, implausible. Why might he have made this claim? One reason suggested above is that Joseph may have been unaware of the extent to which the U.K. monetarist economists upon whom he drew were themselves influenced by Friedman's work. But another possibility is that U.K. politicians are naturally reluctant to acknowledge that they are drawing upon the views of intellectuals unless (like Adam Smith, for example) those intellectuals are long dead. Bale (2010, p. 10) notes that the Conservative party has traditionally taken a suspicious attitude toward abstract solutions, all the more so if they come from outside the United Kingdom. Friedman in particular was a living, American academic. Admission by a U.K. politician to being influenced by the work of a U.S. academic economist might go against being perceived as a practical politician who was focused on the United Kingdom's problems and whose views were developed from their own reading of the facts. And, whereas acknowledgments of influence are routine in the research world, they carry risk in the political world. For a politician, to indicate that one has been influenced by Friedman might risk being misinterpreted as taking a sycophantic, uncritical attitude toward Friedman and his writings—as opposed to digesting, and learning from, those writings as part the formation of one's own viewpoint. In this connection, it is notable that in his 1974 denial of influence from Friedman, the description of himself to which Joseph particularly took exception was as a "follower" of Friedman.

In view of this record, what is striking is not how little Thatcher herself acknowledged Friedman's influence, but how much she *did* do so. Her 1993 volume of memoirs provides an example: Thatcher (1993, p. 710) both endorsed the idea of a roughly eighteen-month lag from monetary growth to inflation and associated this idea with Friedman. And as discussed in the next section, she explicitly acknowledged Friedman's influence on her perspective on inflation both in the next installment of her memoirs and in an important companion volume to her memoirs.

3. Acknowledgments of Friedman by key figures

In this section, the acknowledgments of Friedman's influence by key figures in policy circles during the Thatcher era are documented and analyzed. Section 3.1 considers Thatcher and Geoffrey Howe, and Section 3.2 considers some advisers who served in the executive branch of government or at the Bank of England during the Thatcher period.

3.1 Margaret Thatcher and Geoffrey Howe

As indicated above, it is not in question that Thatcher read articles by Friedman during the 1970s. However, Jenkins (1989, p. 81) argued that Thatcher's upbringing had already given her a belief in sound money prior to reading Friedman's work. What this interpretation overlooks is that monetarism as advanced by Friedman went beyond observations about the desirability of monetary discipline to the position that "[r]estraint in the rate of monetary growth is both a necessary and a sufficient condition for controlling inflation" (Friedman, 1980, p. 56). In particular, in the monetarist view, it was not only the case that excessive issuance of money could create inflation but also that absence of money creation—a non-accommodative monetary policy—was sufficient to prevent other factors often cited as sources of inflation, such as union wage-push, from actually leading to inflation.

It was this aspect of Friedman's views that Thatcher did not appreciate or share before the mid-1970s. In two crucial passages of her 1995 memoir *The Path to Power*, she acknowledged that her understanding of the monetary nature of inflation was not well developed during the 1960s. In Thatcher (1995, p. 115), she stated that in the 1960s she was not among the handful of U.K. parliamentarians who "were prepared to argue the case against incomes policy and for monetary control of inflation." In Thatcher (1995, p. 141), she granted that, while she opposed the mandatory wage and price controls imposed by the Wilson Government in 1966, her opposition was *not* based on rejection of wage-push accounts of inflation and on the acceptance that (in the absence of wage and price controls) inflation's behavior reflected the authorities' monetary policy. In this discussion, she also indicated that she did not embrace the monetarist view of inflation until the 1970s.

Thatcher's recollection receives support when one considers her statements from the late 1960s through the mid-1970s. In these statements, while noting that an appropriate money-supply choice was *necessary* to prevent inflation, she did not treat monetary control as sufficient for inflation control.[15] Instead, in Thatcher (1968, 1974) she supported the notion that union wage-push was a possible separate source of inflation. This perspective was brought out in these speeches' endorsements of the existence of a rigid link between nominal wage growth and inflation, and in her favorable outlook toward the notion that price stability should be secured by policies that sought by direct means to keep nominal wage growth in line with productivity

[15] See the discussion of Thatcher (1968) in Nelson (2009a, p. 102). See also Thatcher's (1995, p. 149) acknowledgment that the views she articulated in Thatcher (1968) were far from the monetarist positions on incomes policy, monetary policy, aggregate demand, and inflation that she would later embrace.

growth, as had been claimed in the 1944 White Paper on Employment Policy (Ministry of Reconstruction, 1944) that she cited.[16]

Also consistent with the fact that Thatcher did not comprehend and embrace the monetarist view of inflation until the mid-1970s was the recollection of Alan Walters and Peter Jay, two figures to whom she spoke on economic matters at the time (the latter being the *Times*' economics editor and someone of whom she would say, "I've been an economic disciple of his for years"—see Nelson, 2009a, p. 103). Both Walters (in *A Conversation With Sir Alan Walters*, 2002) and Jay (in *Financial Times*, June 8, 1985) recalled Thatcher as still learning about monetarism during the 1974–1975 period in which she transitioned from being a member of Edward Heath's Shadow Cabinet to Conservative party leader.

Following the publication in 1993 and 1995 of Thatcher's memoirs, there appeared a third book, *The Collected Speeches of Margaret Thatcher* (Harris, 1997), which was explicitly offered as a companion volume to Thatcher's memoirs.[17] The speeches in this volume included one in 1992 in which Thatcher was unambiguous about Friedman's influence on her thinking about monetary policy and inflation: "We had learned at Milton Friedman's knee that inflation is a monetary phenomenon…"[18] Evidently, this learning consisted largely of coming to appreciate, over the course of the mid-1970s, Friedman's ideas, via greater exposure to his writings and via discussion of his ideas with her advisers and other interlocutors. She also evidently reached an assessment that the U.K.'s inflation experience validated those ideas. For by the time she met Friedman in 1978, she had grasped the monetary nature of inflation. In Friedman's recollection of that meeting (given in Whitehead, 1985, p. 331): "I was enormously impressed with her understanding of the economic situation, and the extent to which she recognized very clearly the relationship between monetary policy on the one hand and inflation on the other."

Thatcher's familiarity with and sympathy with *free-market ideas*—in contrast to her embrace of the monetarist view of inflation—long preceded the 1970s, and that it partly involved reading the work of figures other than Friedman (such as Hayek). However, notwithstanding her preexisting familiarity with free-market ideas, Thatcher in the 1970s and beyond recognized that Friedman was a leading exponent of those ideas, and one on whose views she and other economically

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[16] In addition, Thatcher (1968) suggested that greater competition could be an effective weapon against inflation. This echoed the position of Edward Heath, who in the 1960s saw the abolition of resale price maintenance (implemented by him in 1964) as an anti-inflation measure.
[17] The publishers, HarperCollins, described the *Collected Speeches* as a "companion volume to the two books of Margaret Thatcher's memoirs."
[18] Thatcher (1992), as given in Harris (1997, p. 543).

liberal politicians could draw. For example, late in her tenure Thatcher indicated that she had discussed Friedman's ideas with leading figures in the Soviet Union who were concerned with economic reform (*House of Commons Debates*, June 12, 1990, p. 143).

An influence of Friedman's monetarist economics was also acknowledged by Thatcher's first Chancellor of the Exchequer, Geoffrey Howe. In an interview shortly after taking office, Howe said of himself and Thatcher: "I don't think that either of us would claim to have been monetarists from the beginning of time—I certainly wouldn't. We were both members of the 1970−74 government, which didn't take monetary policy as seriously as we do now, but then nor did anybody else." With regard to Friedman, Howe affirmed: "Oh yes, I admire him enormously!"[19]

In a television appearance alongside Friedman in early 1980, Howe said: "Because if I were a Friedmanite—and I don't think I'm an anything-ite, I'm a man of commonsense and reasonable determination taking advice, a great deal of it from Professor Friedman." (*Free To Choose*, BBC2, March 22, 1980 p. 9 of transcript.) In 1981, Howe implied that Friedman's writings were among the places in which there could be found the principles governing monetarist policies in the world (*House of Commons Debates*, January 15, 1981, p. 1159). In 1982, former Prime Minister Heath claimed that the government had parted ways with Friedman's macroeconomic views.[20] Against this background, Howe stated: "It remains absolutely central to the fight against inflation to secure corresponding reductions in the rate of monetary growth… [T]hose who talk about the death of monetarism never wished monetarism well in the first place." (*Newsweek International*, March 29, 1982.)

3.2 Economic advisers

Alan Walters served at 10 Downing Street as Thatcher's chief economic adviser during the 1981−1983 period. He continued to serve as her economic adviser, usually on a part-time basis, for much of the rest of the 1980s. Prior to his service in government, he had done research in monetary economics, mainly in the 1960s, and had also, as noted, interacted with Conservative politicians in the first half of the 1970s, including at a Shadow Cabinet meeting in 1974 after Edward Heath's second election defeat of that year (Heath, 1998, p. 521). Although Walters was based in the United Kingdom in the years of his monetary research, he clearly saw monetarism

[19] From Murray (1980, p. 163).
[20] Heath's 1982 remarks are discussed in Section 5 below.

as having been launched in the United States, principally by Friedman. This view was evident in Walters' later reference to the "quantity theory in its new reborn Chicago form" (Walters, 1987, p. 425). Indeed, Walters' 1960s studies had in large part been applications to U.K. data of Friedman's work: for example, Walters' (1966) U.K. version of Friedman and Meiselman (1963), and a study (Walters, 1971) of U.K. historical monetary relations partly inspired by, but on a smaller scale than, Friedman and Schwartz (1963a, 1963b).

There was a close correspondence of views between Friedman and Walters. Walters' acceptance of the validity of much of Friedman's monetarism was evident in Walters' (1973, p. 14) observation: "In my view, the Friedman and Schwartz [1963b] paper does establish the proposition that 'money matters.'" The closeness of Friedman's and Walters' versions of monetarism was underlined by Friedman's own remark (*Sunday Telegraph*, October 15, 1989) that he had not been following U.K. developments in detail, "but you can take the views of Sir Alan Walters as a proxy for my views."

Walters' affinity for Friedman's work was also manifested in the fact that, after he had completed his first spell as a full-time adviser to Thatcher, Walters was assigned by the editors of the *New Palgrave* dictionary of economics to write the entry on Milton Friedman. In that entry, Walters (1987, p. 426) made clear that he believed Friedman had been influential on economic policy, with Friedman's macroeconomic research ranking among "the very few contributions that changed both the approach of professional economists and the policies adopted by finance ministers… Every economist, finance minister and banker felt his influence."

Another key adviser on economic matters during the Thatcher years was Brian Griffiths. Griffiths had been providing input to Conservative politicians even before Thatcher became party leader: Howe (1994, p. 100) noted that an early speech of his that was monetarist in content was one on the role of monetary policy in a disinflationary strategy, given in January 1975 and written with Griffiths. Later, in 1985, Griffiths, who had publicly defended the Thatcher Government's monetarist policies (see Griffiths, 1985), left his academic position to become head of Thatcher's Policy Unit at 10 Downing Street.

Like Walters, Griffiths clearly saw monetarism as coming from the United States and as led by Friedman. In a 1968 newspaper article coauthored with Harry Johnson, Griffiths portrayed the postwar monetarist movement as one that began with "Friedman's challenge to the American Keynesians" and had spread to a "growing number of academic monetary specialists in North America and elsewhere" (*The Times*, October 29, 1968). In *Business Week* (February 19, 1972), Griffiths wrote: "over the last 15 years or so, a counterrevolution has been taking place, spearheaded by Milton Friedman of the University of Chicago, Karl Brunner and Allan Meltzer, formerly of UCLA, and Leonall Andersen and Jerry Jordan of the Federal Reserve Bank of St. Louis." In Griffiths' (1970) monograph on monetary reform, Friedman was the most-cited author, with four of the latter's monetary writings in the bibliography. A 1972 Griffiths article on inflation cited Friedman (1968, 1970). In a book on inflation, Griffiths (1976, p. 30) identified Friedman and Schwartz (1963a) as a classic that "showed money performing a crucial role in the business cycle." And Griffiths (1985) noted that the government's Medium Term Financial Strategy (MTFS) partly reflected the influence of Friedman's work on monetary-policy rules—an issue discussed further in Section 6 below.

It also deserves mention that both Walters and Griffiths endorsed the natural rate hypothesis.[21] The importance of the natural rate hypothesis, as well as its acceptance at the official level in the United Kingdom in the Thatcher era and afterward, was further emphasized by Charles Goodhart, who served in important roles at the Bank of England from the late 1960s through 1985, including that of chief monetary adviser from 1980 to 1985. Goodhart (1992, p. 315) observed: "the core of the monetarist position remains untouched, or has even strengthened. There has been no serious challenge to the claim that the medium- and longer-term Phillips curve is vertical, and hence that monetary policy should focus, primarily, if not solely, on controlling the level of some intermediate nominal variable, so as to anchor the rate of inflation at zero, or some very small positive number." Earlier, Goodhart (1983, p. 219) had remarked that, as between Friedman's view of the Phillips curve and the more flexible-price versions of the Phillips curve then on offer from the rational expectations literature, the U.K. authorities had been "swayed by the more pragmatic monetarism of Friedman."

In sum, as was the case with key ministers during the Thatcher era, a number of individuals who served as senior economic advisers to the U.K. government in that era were importantly influenced by Friedman's work and also noted the influence of that work on the Thatcher Government's economic policy. More discussion of the interaction between Friedman's perspective and that of the Thatcher Government will follow in Section 6. In the meantime, the analysis will turn back to the pre-1979 period, in order to consider a number of influences that Friedman had on U.K. economic policy prior to the Thatcher years.

[21] For Walters, see for example *Financial Times* (January 1, 1972) and *The Spectator* (November 2, 1974); for Griffiths, see for example Griffiths (1972, pp. 16–18; 1976, p. 255).

4. Friedman's influence on pre-1979 U.K. economic policy

This section considers the influence that Friedman had on three policy changes instituted prior to 1979: the United Kingdom's earlier short-lived focus, initiated in 1957, on using monetary policy as the main weapon against inflation (Section 4.1); the adoption of monetary targeting in 1976 (Section 4.2); and the introduction of a floating exchange rate in 1972 and the continuation of a float for much of the subsequent period (Section 4.3).

4.1 The 1957 tightening of monetary policy

The 1957 tightening of monetary policy by the Macmillan Government was explicitly justified by Treasury policymakers in terms of the link between the stock of money and the price level. It consequently was a significant early postwar episode in which monetarist ideas shaped U.K. monetary-policy decisions. The episode, begun in September 1957, is widely considered to have ended when the government's Treasury ministers—Peter Thorneycroft, Enoch Powell, and Nigel Birch—resigned in January 1958 after not being supported by the Prime Minister.

These developments formed an early example of the influence on U.K. economic policy of Friedman's monetary work. Lionel Robbins has long been identified as an influential adviser concerning the 1957 tightening (see, for example, Dell, 1996, pp. 229−233). And, as discussed in Nelson (2009a, pp. 53−54), Robbins was a close watcher and admirer of Friedman's work on money. He parted company with Friedman on some monetary matters. This was especially so with regard to external arrangements, for which Robbins favored exchange-rate management (see Dellas and Tavlas, 2009). But, on the issue of the connection between the money stock and economic aggregates, Robbins was largely in agreement with Friedman, and he viewed Friedman as an expert to whose work he deferred.

This state of affairs became apparent on multiple occasions. Robbins (1961) referred to Friedman's research in laying out a case against the Radcliffe Report.[22] Robbins (1970) provided a written introduction, very largely favorable (albeit with reservations expressed about a fixed-monetary-growth rule) to Friedman's (1970) lecture in London on monetarism, and earlier Robbins declared in the House of Lords: "I am far from contending that the quantity theory of money is the last word in wisdom in matters of this sort, but if we look at what is happening

[22] That is, against the conclusions of the Committee on the Working of the Monetary System (1959). For a recent examination of the U.K. monetary and financial arrangements that emerged in the wake of the Radcliffe Report, see Aikman, Bush, and Taylor (2016).

among some of the most advanced thinkers on these subjects in other parts of the world, it must be said at least that it takes a very long time dying, and that sometimes it shows signs of reviving." (*House of Lords Debates*, April 10, 1968, p. 399.) These public endorsements were preceded by Friedman-Robbins meetings going back to 1947 (Friedman, 1988, pp. 185−189). In this interaction, as well as in correspondence, Robbins was by the early 1950s acknowledging Friedman as a leading exponent of the quantity theory (see Nelson, 2009a, p. 42).

Robbins' role in providing advice in 1957 casts serious doubt on the validity of Enoch Powell's oft-repeated claims to have invented monetarism, or to have arrived at monetarism independently of Friedman and his work. Powell expressed resentment that Friedman had won the Nobel prize in economics, Powell's grounds being that monetarism had been invented by the U.K. Treasury ministers in 1957.[23] But because Robbins was a catalyst for the 1957 policy measures, and because Robbins was from the early 1950s onward favorably struck by Friedman's monetary work, Powell's becoming a monetarist was not in fact independent of Friedman's research—although Powell may well have believed that it was.[24]

4.2 Monetary targeting

As indicated in the introduction, formal, publicly announced targets for monetary growth in the United Kingdom were begun by the Callaghan Government in 1976. Monetary targeting should be regarded as an influence of Milton Friedman's thinking on U.K. economic policy; this was acknowledged by policymakers at the time.

Internal targets for broad money (M3) growth were already being used by the U.K. authorities in the years immediately prior to 1976 (Goodhart, 1984, p. 122). Consistent with this situation, Denis Healey would testify about his period as Chancellor of the Exchequer: "We had monetary targets from the word 'go' and the question arose in 1976 as to whether we should publish them."[25] As for the public announcement of M3 growth targets, this indeed occurred in 1976, but *before* the September-December 1976 period over which the U.K. government worked out an agreement with the IMF concerning the direction of economic policy. The M3 growth target was announced in terse terms in the April 1976 Budget (*Financial Times*, April 7, 1976; *Midland*

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[23] For his statements to this effect, see for example Nelson (2009a, p. 73), and Ranelagh (1991, pp. 79, 183).
[24] It may well be that Robbins articulated the case for a quantity-theory approach to the Treasury without explicitly indicating that his advocacy of it was informed by Friedman's research. Budd (1987, p. 189) cautioned: "In Whitehall it is never a good argument to claim that a particular policy has already been adopted abroad." It would likely be even less palatable to appeal to research done abroad as the basis for a U.K. policy initiative.
[25] From Healey testimony of July 7, 1993 (House of Commons Treasury and Civil Service Committee, 1993, p. 51).

Bank Review, May 1976). This new policy was then fleshed out during June-July 1976 through further public statements by the authorities, whose clarifications included confirmation of the target rate (Gowland, 1979, p. 24; Congdon, 1982, pp. 4, 93).

The adoption of monetary targets stemmed in large part from growing acceptance in the United Kingdom of the relationship between monetary-policy actions and aggregate demand and of monetary aggregates as a measure of monetary-policy stance. Such acceptance partly reflected the influence of Friedman's research (and, as an element of that influence, the appearance of studies modeled after Friedman's but applied to U.K. data): for example, Bank of England Governor Gordon Richardson (1978, p. 32) mentioned Friedman's work on the demand for money. To be sure, another important aspect of Friedman's framework—the position that inflation is a monetary phenomenon (so that monetary-policy actions were necessary and sufficient for inflation control)—was not yet, in 1976, something that U.K. policymakers accepted; the period (1979 onward) in which it was accepted is discussed separately below.[26] But the adoption of monetary targeting in the United Kingdom did to an important degree reflect the influence of Friedman's research on aggregate demand (such as his studies of the relative importance of fiscal policy and monetary policy, and his emphasis on the Fisher effect) and, as already indicated, on the demand for money. [27]

The consonance of monetary targets with Friedman's prescriptions was emphasized in retrospectives by successive economic advisers to the Wilson-Callaghan and Thatcher administrations. Peter Jay, who was an informal adviser to the 1974−1979 Labour Government in its first three years, noted concerning Healey's tenure that it was the case that from 1975 onward: "The Chancellor sat on the money supply, which followed a course of steady disinflation that Professor Milton Friedman himself might have charted."[28] And Alan Walters, in looking back on a year (1982/1983) in which the official Sterling M3 growth-rate target was met

[26] In particular, as stressed in Fischer (1987, p. 13) and Batini and Nelson (2005, pp. 26–29), those in policy circles who were not persuaded by monetarist arguments could reconcile themselves to broad-money targeting by viewing it as an indirect means of imposing targets for aggregate bank credit or the fiscal balance. Fforde (1982, p. 53) confirmed that such nonmonetarist arguments played a role in the acceptance of monetary targeting in officialdom, although he added that "the quantity theory itself" was part of the rationalization for monetary targets in the United Kingdom.

[27] One of the core studies published by the Bank of England in the area—important not only for studying the demand for money but also, as Goodhart (1984, p. 11) stressed, for endorsing the nominal interest-rate/real interest-rate distinction and associating that distinction with the monetarist literature—was Goodhart and Crockett (1970). In addition, Fforde (1982, p. 53) noted that, alongside money demand studies, the finding of a "reliable relationship between M3 and nominal incomes" was influential on the authorities. This suggests that U.K. versions of the reduced-form study of Friedman and Meiselman (1963) played a role in the authorities' interest in broad money.

[28] Jay (1984, p. 162).

(and in which his favored U.K. monetary aggregate, the monetary base, was also growing moderately), observed: "Britain was on a Friedmanian path of stable monetary expansion."[29]

For his part, Friedman—who in his 1970 visit to the United Kingdom had affirmed that he regarded his prescription of steady monetary growth as appropriate for that country (*Financial Times*, September 18, 1970)—saw the adoption of monetary targeting in the United Kingdom as a case of policymakers accepting his advice. In a 1980 television appearance with Denis Healey, Friedman said: "Well, first of all, I might give credit to Denis Healey; he was the first one who followed the gospel, [as] to the best of my knowledge he was the first one in Britain who introduced monetary targets." (*Free To Choose*, BBC2, March 22, 1980 p. 8 of transcript.)[30]

4.3 Floating exchange rates

The Heath Government floated the pound sterling in June 1972 after a brief attempt to include it in a European fixed-exchange-rate arrangement (the "snake"). As will be seen, the embrace of floating exchange rates in the United Kingdom is one testament to Friedman's influence. True, in the 1970s that Friedman noted that countries had initiated floating exchange rates because of the pressure of events (see Nelson, 2009a, p. 77). However, a distinction must be made between the *circumstances forcing the adoption of floating rates* and the *decision to maintain a floating-rate arrangement*. The latter refers to the matter of whether, in calmer conditions well after an emergency-driven move to floating exchange rates, a country chooses to resume a fixed-exchange-rate arrangement. It is on this matter that the absorption of Friedman's (1953) arguments was very important; and Friedman (in Taylor, 2001, p. 129) did indeed take the view that his paper on floating rates was influential.

With regard to the United Kingdom specifically, Heath (1998, p. 410) observed: "We intended this [the float] to be a temporary move, but as it turned out the arrangement stayed in place until 1990." Despite having been forced into a float at first, the U.K. authorities over much of the 1970s and 1980s looked favorably on the floating-exchange-rate arrangement. Monetary-sovereignty arguments (which stressed that monetary policy should be guided by domestic economic stabilization rather than exchange-rate management), of the kind in Friedman (1953), figured heavily when, on several occasions after 1972, the U.K. government rejected fixed exchange rates: for example, in late 1977 when the authorities uncapped sterling, and in late

[29] Walters (1990, p. 91).
[30] In addition, Friedman (1987, p. 18) gave as an "element of the quantity theory approach that has had considerable influence" the pursuit of monetary-aggregate targets, including in the United Kingdom.

1978 when they turned down the opportunity of participation in the Exchange Rate Mechanism (ERM). After sterling left the ERM in 1992, the monetary-sovereignty rationale formed an important part of the Blair Government's decision in 1997 not to be part of the euro area. Monetary-sovereignty arguments were also a prominent element in the (ultimately, losing) pro-float side of the argument taking place in U.K. policy circles during the 1985−1990 period, when ERM membership was being contemplated very seriously (see Section 6.3 below).

Both sides of the U.K. debate on exchange rates in the early 1970s saw Friedman's paper as a benchmark reference. An advocate of fixed exchange rates (in *International Currency Review*, September/October 1970, p. 8) granted that Friedman's 1953 paper was "frequently described nowadays as a 'classic.'" On the side of exchange-rate flexibility, Brittan (1970, p. 96) described Friedman (1953) as the "classic statement of the case for floating rates." In U.K. discussions during the 1980s of exchange-rate policy, Friedman continued to be invoked as the leading representative of the pro-float case. This fact is evident in accounts of that decade's debates on pegging sterling and ERM membership: for example, Lawson (1992, p. 468) named Friedman as an advocate of floating.

Friedman himself participated in the U.K. debate on exchange rates when he visited the United Kingdom in 1970. He publicly advocated that the pound be floated (*Financial Times*, September 18, 1970) and also urged this in a meeting with Prime Minister Heath (Oliver and Pemberton, 2006). Friedman's activism in the later ERM debate is discussed in Section 6.

5. Friedman's biggest influence: the permanent change in the role of monetary policy

Friedman's largest influence on U.K. economic policy pertained not just to the Thatcher era but to the whole post-1979 period: acceptance of his point that inflation was susceptible to control only by monetary policy and not by incomes policy. That change is the focus of this section.

5.1 Official acceptance of Friedman's position on inflation

As Chrystal (1984, p. 31) observed: "The intention of eliminating inflation solely by monetary policy rather than incomes policies was one reason why Mrs. Thatcher earned the monetarist label." In the same vein, a Bank of England official would note of U.K. governments' position (Coleby, 1993, p. 126): "By the end of that decade [the 1970s], we had therefore reached the position of orthodoxy…. We recognized inflation as a monetary phenomenon." The implication of this doctrinal change in U.K. policy circles was the abandonment of the pursuit—carried out by the Callaghan Government and its predecessors—of compulsory wage and price controls (or voluntary, but formal, wage agreements), against inflation. The momentous nature of this change in policy strategy was noted by an adviser during the Callaghan tenure who had worked closely with the Prime Minister on economic policy: "Above all, the government's then obsession with reducing the rate of inflation through direct state intervention in the intricate processes of wage negotiations… [now] seems from a different age." (Donoughue, 2008, p. 6.)

Friedman's importance in providing a monetary perspective on inflation was acknowledged on the record by such U.K. figures as Thatcher (see Section 3 above) and Nigel Lawson (see Section 7 below). Friedman's opposition to incomes policy and his critique of cost-push views pervaded his work and his public statements. He was already an outspoken critic of incomes policy in U.S. public debate in the 1940s and 1950s (see Nelson, 2017, Chapters 3 and 10).[31] He was identified, thanks to writings such as Friedman (1951, 1959), as a critic of cost-push views of inflation in such pre-1966 references as Schultze (1959). And in the *Newsweek* column that Friedman had from 1966 onward, he criticized incomes policy repeatedly, including in indictments of the incomes policies that had been attempted by the 1964−1970 Wilson government (*Newsweek*, January 11, 1971), the wage and price controls imposed by the Heath Government (*Newsweek*, November 27, 1972), and the Social Contract maintained by the Callaghan Government (*Newsweek*, September 20, 1976). He made similar criticisms in interviews given to the U.K. media in the 1970s (see Nelson, 2009a, p. 79) and in Friedman (1975).

Friedman's critique of President Nixon's imposition of wage and price controls in the United States was also well known in the United Kingdom, and he was mentioned in this connection in the U.K. press around the time that Edward Heath reintroduced U.K. wage and price controls in 1972 (for example, *Daily Mail*, October 31, 1972; *The Guardian*, November 11, 1972). Thus Friedman was a very prominent critic of incomes policy in the United Kingdom, and (in contrast to some critics of incomes policy) was making this argument in conjunction with a critique of cost-push theories of inflation.

U.K. officialdom's rejection from 1979 onward of incomes policy and of cost-push views of inflation, and its acceptance of a monetary view of inflation, consequently reflected an influence from Friedman. A further Friedman influence on policy from 1979 onward was clear in the

[31] See also the criticisms of price controls, and the skepticism about cost-push arguments, in Friedman and Schwartz (1963a, pp. 497–498, 557–558).

specific monetary view of inflation that U.K. policymakers adopted—which was the outlook associated with the natural rate hypothesis.[32] Some statements by U.K. policymakers in this area were virtual paraphrases of propositions associated with Friedman. These included Margaret Thatcher's remark that the prior Labour government had "brought down unemployment temporarily at the cost of reflation, which increased unemployment later" (*House of Commons Debates*, January 26, 1982, p. 745) and Nigel Lawson's observation that "the government cannot, other than in the very short term, directly increase the level of real demand in the economy" (*House of Commons Debates*, March 25, 1985, p. 107).

Also indicative of the U.K. government's acceptance of the natural rate hypothesis was Chancellor Lawson's Mais lecture (Lawson, 1984). In this lecture, Lawson cast the new policymaking framework as one in which control of inflation had been reallocated from microeconomic to macroeconomic tools, and influence on unemployment from macroeconomic to microeconomic tools. Subsequent generations of policymakers have largely endorsed this interpretation of the modern U.K. policymaking framework (see, for example, King, 2005). It clearly owed heavily to Friedman (1968). Indeed, Lawson's division of responsibilities between macroeconomic policy and microeconomic policy resembled Friedman's own policy recommendations for the United States, such as in Friedman (1972b, p. xv). In that 1972 discussion, Friedman urged labor-market reform to get (the natural rate of) unemployment down, stated that policymakers should not have a numerical goal for the unemployment rate, and recommended fighting inflation with monetary policy.

5.2 Harold Wilson and Edward Heath

It was concluded at an early stage that Friedman's position on how to control inflation was influential on the Thatcher team. The increasing acceptance of Friedman's view of inflation among some leading Conservatives was well known by early 1975: for example, one interviewer introduced Friedman by stating: "Professor Friedman's views have recently been winning some influential converts among politicians as well as among economists." (*Controversy*, BBC2, September 23 1974, p. 1 of transcript.) And soon after Thatcher became Conservative party leader, a newspaper article stated that her positions on inflation were "following closely the arguments of Professor Milton Friedman" (*Sunday Times*, February 16, 1975). As will now be

[32] As discussed in Nelson (2009b, p. F359), Thatcher's own dislike for the "natural rate of unemployment" terminology did not imply that her policymaking framework rejected the natural rate hypothesis.

discussed, this perspective on the origins of the Thatcher economic policy was shared by two key political figures: Labour's Harold Wilson and the Conservatives' Edward Heath.

As already indicated, by the early 1970s Friedman was known in both the United States and the United Kingdom as the advocate of the view that inflation was a monetary phenomenon that could not be meaningfully reduced by incomes policy and for which restriction of aggregate demand was the only effective remedy. The Wilson Government in 1975 adamantly took the opposite view. For example, its White Paper on inflation stated that "there can be no solution to the problem of inflation which relies on… under-utilization… The direct and sensible solution is to reduce our rate of increase in wages and salaries…" (quoted in Nelson, 2005). Chancellor of the Exchequer Healey denounced the approach of using aggregate-demand restriction to fight inflation as derived from "Friedmanite theory" (*Washington Post*, June 22, 1975).

Against this background, Prime Minister Wilson observed early in Thatcher's period as Conservative party leader: "The answer certainly is that we can and shall bring down the rate of inflation without economic disaster. However, we reject the policies advanced by leading Conservatives who say that it can be done by monetarist means, producing more unemployment." (*House of Commons Debates*, March 20, 1975, p. 1850.)

Wilson had a basis in his own experience to associate the demand-restriction policies embraced by the Conservative leadership in 1975 with monetarism and with Friedman. He had met, and found himself in an impromptu public debate with, Friedman in the early 1960s, at a time when Wilson had a visiting arrangement with the University of Chicago (Wilson, 1986, p. 190). This was a point at which Wilson had already established himself as a critic of monetary policy's role, via statements such as: "Have we forgotten the devastating analysis of the Radcliffe Report about overreliance on monetary policy?" (*House of Commons Debates*, July 26, 1961, p. 445.) As Prime Minister in 1975, Wilson was dismayed by the high esteem in which Friedman's economics was held by policymakers in other countries (Wilson, 1979, p. 110).

Wilson reaffirmed his belief in the connections between the Conservatives' economic policy and Friedman's views in the years after he was Prime Minister. For example, in 1978 he referred to Friedman as the Conservatives' "adopted guru" (*Irish Times*, May 2, 1978). This remark was made in the partisan context of a Labour party rally, but Wilson linked Thatcher and Friedman in other, less heated contexts. Indeed, for much of 1978–1979, members of Prime Minister Callaghan's inner circle were concerned that Wilson was adopting too neutral a position in the contest between Callaghan and Thatcher, and that his public criticism of Callaghan and praise for

Thatcher might reflect a wish on Wilson's part that Callaghan suffer defeat to Thatcher at the next election.[33] This non-adversarial posture taken by Wilson toward Thatcher was also reflected in his 1978 remark, published in Murray (1980, p. 94), "I've no doubt at all that Margaret was elected [leader] because of her courage." In the same interview, Wilson matter-of-factly voiced his belief in an influence of Friedman on Thatcher: "As far as general economics are concerned, I think for her it's more theoretical but she certainly knows a good deal about the kind of economic philosophy she likes. I should imagine she knows her Friedman very well but, needless to say, my views on the subject do not coincide with hers." (Murray, 1980, p. 98.)

In short, Harold Wilson, a figure greatly familiar with debates on U.K. monetary policy and inflation, and who had himself met Friedman, reached the judgment early that Friedman's economics was an influence on Thatcher. He reaffirmed his judgment in subsequent years.

Edward Heath, whom Thatcher replaced as leader of the Conservative party, likewise viewed Friedman as having been an influence on the shaping of the Conservative party's economic policy in the period after he left the leadership. For example, in 1982 Heath stated that Thatcher's government had been influenced by the "alien doctrines of Friedman and Hayek" (*House of Commons Debates*, March 15, 1982, p. 37; also quoted in Campbell, 1993, p. 732).

This characterization echoed others Heath had made since losing the Conservative leadership in 1975. He viewed the monetarist position taken by Thatcher as having two important, and undesirable, features: it was academic in origin and it originated outside the United Kingdom. Its academic origin was alluded to by Heath soon after he left the leadership when he suggested that the party was embracing a "soulless textbook theory" (quoted in *The Sun*, June 17, 1975). Its overseas, specifically U.S., origin, was hinted at in a play on words that Heath made in November 1975, when he criticized his opponents in the party for having "tried to import a strong ideological content into their argument" (quoted in *Glasgow Herald*, November 22, 1975).

Heath's position on U.K. inflation was that it reflected domestic wage-push forces whose strength was magnified by the country's special institutions and geography (see Nelson, 2009b, p. F351). He regarded monetarism as a doctrine developed without regard to U.K. institutions—a position reflected in a private remark Heath made in 1977 that monetarist policies would not work in a country like the United Kingdom (Young, 2008, p. 109). In early 1979, Heath publicly

[33] See Donoughue (2008, pp. 446, 493).

declared monetarism to be "intellectually bogus," and he characterized the Conservatives as having adopted the views of "a school of Milton Friedman" (*Toronto Star*, April 8, 1979).

As with Wilson, Heath's exposure to Friedman's views partly reflected direct interaction with Friedman. During Heath's premiership, Heath and Friedman met twice. As already mentioned, the two met in London in September 1970. At that meeting, Heath and Friedman discussed not only exchange-rate policy (as noted above) but also domestic U.K. economic issues (Ziegler, 2010, pp. 333–334). They met again at a White House dinner for Heath in December 1970.[34] Thus Heath, like Wilson, met Friedman before the Thatcher era and formed the view early in Thatcher's time as leader that Friedman's economics was an influence on Thatcher. As stressed in this section, the most important such influence concerned a belief to which Heath and Wilson were united in their opposition: the belief in the need for a monetary approach to the analysis and control of inflation.

6. Friedman and U.K. economic-policy developments, 1979–1990

This section considers more of the intersections between Friedman and the Thatcher Government's economic policy. Sections 6.1 to 6.3 consider developments in macroeconomic policy chronologically, before a consideration of privatization (Section 6.4), and the current account deficit (Section 6.5).

6.1 Early decisions

In the early months of its tenure, the Thatcher Government made a number of important economic initiatives—including Geoffrey Howe's announcement in June 1979 that foreign-exchange controls would end. In his magazine column (*Newsweek*, July 9, 1979), Friedman applauded the exchange-control announcement. Since the early 1950s, he had been a prominent advocate of abolition of the United Kingdom's exchange controls (see Friedman, 1953).

Another development during 1979–1980 was the development of the Thatcher Government's MTFS. For the purposes of this paper, two important features characterized the making of the MTFS.

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[34] The dinner for Heath was on December 17, 1970 (Haldeman, 1994, p. 264). In Friedman and Friedman (1998, p. 390), Friedman incorrectly recalled their London meeting as being after their White House meeting. That Friedman discussion focused upon a 1980 radio forum in which both he and Heath participated (without meeting in person). In this heated exchange, Heath again associated Friedman with Thatcher's policies (see Campbell, 1993, p. 723).

First, this plan—which consisted of a laying-out of the government's successive intended reductions in the Public Sector Borrowing Requirement (PSBR) and Sterling M3 growth—was announced with the March 1980 Budget, but it had long been foreshadowed by key figures in the Thatcher economic team. An economic commentary that appeared a month after the government took office stated: "The government is almost certain to adopt a medium-term financial plan for the economy before the end of the year." (*Daily Telegraph*, June 4, 1979.) Just prior to the 1979 election, Howe had indicated he intended to seek a lower PSBR in the current fiscal year (1979/1980), adding: "Further progressive reductions will enable monetary targets to be similarly reduced." (*Daily Telegraph*, April 30, 1979.)

Second, and as already suggested, the MTFS reflected the influence of Friedman's work on monetary-policy rules.[35] The idea of carrying out a program of gradual disinflation and doing so via an announced plan for multi-year reductions in monetary growth matched Friedman's prescriptions. For example, the 1-percent-per-year reduction in monetary growth from 1980/1981 to 1983/1984 for the United Kingdom envisioned in the original MTFS mirrored Friedman's recommendation (in *Newsweek*, April 24, 1978) that the U.S. monetary authorities announce that they would reduce monetary growth by 1 percent per year from 1978 to 1982. To be sure, the inclusion of PSBR targets in the MTFS jarred with Friedman's prescriptions. Indeed, that inclusion was criticized by Friedman (1980) on several grounds, including the contention that fiscal deficits and monetary growth had no necessary relationship. It is clear, however, that the monetary-growth part of the MTFS was the element on which its designers put greatest emphasis.[36]

6.2 Developments in U.K. monetary and fiscal policy, 1979–1987

The path of declining rates of growth of Sterling M3 envisioned in the original MTFS—with the target range for monetary growth being 7–11 percent for 1980/1981—rapidly became superseded by events, with high double-digit growth of the aggregate recorded in the course of 1980. Friedman's initial reaction was to take the severe overshoot of the monetary target as implying an unintended easing of monetary policy and as a frustration of the Thatcher Government's intention to restrict aggregate demand. Taking this perspective, he judged in October 1980 that the government's "first year and a half have in large part been wasted"

[35] As indicated in Section 3, this was the judgment of Griffiths (1985). Similar interpretations were offered by Brittan (2005, p. 298), and Minford (2005, p. 52)

[36] For example, in his 1980 Budget speech, Chancellor Howe said of the MTFS: "At its heart is a target for a steadily declining growth of the money supply." (*House of Commons Debates*, March 26, 1980, p. 1443.)

(Friedman, 1981a, p. 17). Friedman attributed the overshoot to the authorities' existing monetary-policy operating procedures, which he had already criticized in Friedman (1980). Friedman recommended sweeping changes in procedures and personnel at the Bank of England: the Thatcher Government, he said, should "kick out the people who have been running the money supply and replace them with people who know how to do it." (*Newsweek*, November 24, 1980.)

What followed instead was a change in personnel at 10 Downing Street: Alan Walters' arrival as an adviser. This development helped prompt a reassessment by Friedman of the monetary-policy stance that had prevailed during Thatcher's first eighteen months in office. The view that monetary policy was loose in 1980 was already at variance with other indications of tightness, including pronounced declines in real GDP and large increases in the unemployment rate. But, as Alan Walters would emphasize when making his own diagnosis in late 1980 prior to taking up his position as Thatcher's adviser, even monetary aggregates suggested tightness when series other than Sterling M3—notably M1 and M0 (the monetary base)—were considered.[37] Friedman himself had come round to this diagnosis by April 1981, when he observed: "With respect to monetary growth, the Thatcher Government has achieved a slowdown, if you look at the appropriate magnitudes, and that slowdown has produced a sharp decline in the rate of inflation." (Friedman, 1981b, p. 6.)

As he now conceded that monetary policy had been tight and monetary growth reduced, Friedman also viewed the U.K. recession as also partly due to the monetary tightening. But, on multiple occasions, he cited as a factor making the recession worse than otherwise the erratic pattern of monetary growth under the Thatcher Government.[38] It is the case, however, that the declining path of nominal income growth in the United Kingdom over the early 1980s was much as the authorities had privately forecast; it was, instead, the split during 1979−1981 between inflation and real output growth that was much worse than expected (Bean and Symons, 1989, p. 16). Under these circumstances, the variability of monetary growth that Friedman cited was unlikely to have been a prime factor making the recession more severe than expected. Variability in monetary growth, insofar as it was a factor raising uncertainty, likely would have been associated with lower nominal income growth than otherwise; but the slowdown in nominal income growth was, as noted above, not really much sharper than the authorities planned.

[37] See, for example, Walters (1986, pp. 140−145).
[38] See, for example, his remarks in Friedman (1983a, p. 14; 1983b, p. 13) and Friedman and Friedman (1985, p. 105).

However, another measure that Friedman criticized from an early stage—the VAT increase—likely *did* play a notable role in worsening the early-1980s U.K. recession.

Notwithstanding his criticism on the count of monetary variability, Friedman was prepared to describe the Thatcher Government as having followed a monetarist policy partially, because it had delivered a reduction in monetary growth (*American Attitudes*, BBC1, February 16, 1982, p. 2 of transcript; Friedman, 1983b, p. 1). With inflation coming down further in 1982, and with real output growth having turned positive, Friedman suggested, "[i]n that sense monetarism has worked and done everything that was promised for it" (Friedman, 1983a, p. 13). In a still more upbeat assessment after Thatcher's reelection in 1983, Friedman noted that in achieving a decline in inflation to 4 percent (from a peak of around 22 percent in early 1980), the Prime Minister had met a major promise she had given in the 1979 election campaign. He also praised Thatcher for "persistence in the main lines of her policy" instead of giving into pressure, especially during 1981, to embark on a major stimulus to aggregate demand (*Newsweek*, July 4, 1983).

In addition to not introducing an expansionary package, the Thatcher Government did not reinstitute an incomes policy in the United Kingdom. Prior to the 1979 election, Edward Heath had predicted privately that Thatcher, if elected to government, would have to impose an incomes policy (Young, 2008, p. 109), and shortly after her election victory Harold Wilson had suggested that it was likely a question of when, not if, Thatcher would adopt an incomes policy (*Financial Weekly*, June 29, 1979). Friedman applauded Thatcher for not, in fact, doing so (*The Observer*, September 26, 1982). At the time of her first reelection, this was an aspect of her economic record that Thatcher herself underlined when she observed: "The achievement in inflation is not just that it has come down to 4 percent from 21 percent, but that it has been done without the panoply of prices and incomes or exchange controls. Freedom is working." (*Time*, June 20, 1983.)

As the second sentence in the 1983 Thatcher quotation indicates, the rejection of incomes policy amounted not only to an acceptance of the monetarist view of inflation but also to a decision that was in the direction of promoting free markets. Friedman, however, was already disturbed at this point by the extent to which monetarist policies and free-market policies—even though he advocated both—were taken as synonymous. This was, he found, especially so in the U.K. context. He complained in *The Observer* (September 26, 1982) that the U.K. media took the term "monetarism" as "cover[ing] anything that Margaret Thatcher at any time expressed as a desirable object of policy." He elaborated in Friedman (1984, p. 3) that, in much U.K. discourse, "monetarism is everything that Margaret Thatcher has proposed, whatever it may be. If

Margaret Thatcher proposed that taxes be lowered, that's monetarism. If Margaret Thatcher proposed that some of the nationalized industries be privatized, that's monetarism."[39]

For Friedman, a monetarist policy did not itself include policies of restraint or reductions in regulation, public ownership, taxes, and public spending. He nevertheless was a major advocate of these latter policies, and in the last-mentioned area of public spending he was initially very critical of the Thatcher Government's record. In April 1981 he suggested that a "great failure" was that the share of government spending in output had risen under Thatcher (Friedman, 1981b, p. 7). He believed that this development was bad for supply-side reasons, and that it also put the burden of adjustment to aggregate-demand restriction on the private sector (*Panorama*, BBC1, March 9, 1981, p. 19 of transcript).

Friedman had earlier suggested that the Thatcher Government would, thanks to the Labour party's disunity, likely have a long time in office, and that it would achieve government-spending restraint over a longer period of years (Friedman, 1981a, p. 17). This scenario largely would come to pass. In 1986, Friedman implied that it had not, in fact, materialized, when he complained that, other than in areas such as privatization and the foreign-exchange market, the Thatcher record had "consisted of little more than a mere deceleration rather than a *reversal* of the growth of government" and that his "high hopes" on this matter had been disappointed (Friedman, 1986, pp. 135, 138). However, the government-spending share of national income in the United Kingdom, having reached about 47 percent in 1982/1983, fell over the following six years by an amount exceeding 7 percentage points (Thatcher, 1995, p. 572). Over the 1987−1988 period, Friedman evidently absorbed news of this kind, and he changed his position on the Thatcher Government's public-spending record. He affirmed in 1987 that he remained one of Thatcher's "long-time admirers and supporters" (*Financial Times*, December 4, 1987), and Friedman and Friedman (1988, p. 466) judged that, in reducing the role of government in the economy, "Britain has made more progress under Margaret Thatcher than the United States has under Ronald Reagan."

One fiscal-policy issue on which Friedman continued to take Thatcher to task was the priority to be given to tax cuts. From the earliest months of the Thatcher Government, Friedman had been critical of its use of tax increases to limit budget deficits. This position largely reflected Friedman's starve-the-beast perspective, according to which sizable budget deficits can lead to downward pressure on public spending. It was from this perspective that Friedman in late 1987

[39] Friedman made similar complaints in Friedman (1983a, p. 1) and in *Independent on Sunday*, July 26, 1992.

wrote an open letter to Thatcher, criticizing her support for proposals for an increase in federal taxes in the United States. The proposed tax rise, Friedman argued, would ultimately lead to a permanent increase in U.S. government spending rather than a lower budget deficit (*Financial Times*, December 4, 1987). It is unlikely that this letter made a favorable impression on Thatcher. Thatcher was one of a succession of senior figures in UK policymaking who rejected the starve-the-beast approach to the analysis and control of the national budget (see Nelson, 2009a, pp 65–66).

With regard to monetary policy in much of Thatcher's second term, Friedman's assessment was predominantly favorable. In May 1985 he observed that the U.K. authorities had been prepared in the face of large and prolonged unemployment to pursue policies that had had ended double-digit inflation (Friedman, 1985, p. 18).[40] An event the following October must have given Friedman some pause: Chancellor Lawson suspended the target for Sterling M3 growth after seriously overshooting the target for several months. Congdon (1992) has argued that the abandonment of the broad-money target ushered in the United Kingdom's inflationary boom of the late 1980s. Friedman, however, came out against this interpretation. The government had since 1984 been targeting growth in both M0 and Sterling M3—and from October 1985 it kept, and for a while thereafter continued to meet, the M0 targets. Friedman preferred one monetary target to two, and he was already suspicious of Sterling M3—a suspicion that would have been reinforced by the criticism of that aggregate, and support for M0, in Walters (1986). With M0 still being targeted by the authorities, Friedman had grounds for continuing to regard the United Kingdom as a monetary-aggregate-targeting country, and he so characterized it in Friedman (1987, p. 18). Furthermore, he would look back on the mid-1980s period, which featured contained and stable M0 growth alongside low inflation, as that in which the United Kingdom's monetary policy comprised "strict monetarism" (*Sunday Telegraph*, October 29, 1989). The Thatcher period, Friedman observed in late 1987, had "proceeded on the basis of more stringent monetary and budgetary policies… Great Britain has had some transitional difficulties, but it's now emerging from that. Inflation has come way down and the British economy has been growing at a more rapid rate than any economy in Europe." (*Jerusalem Post*, November 6, 1987.) However, Friedman's high regard for monetary policy under Nigel Lawson would change in response to the policies that Chancellor Lawson pursued from early 1987 onward.

[40] Friedman also noted and applauded the U.K. government's issuance of indexed long-term bonds. He observed that this innovation would reduce government revenue from inflation (Friedman, 1985, p. 17). However, his implication that the revenue-raising motivation helped explain prior periods of high inflation in the United Kingdom clashed with the U.K. postwar policy record, as discussed in Nelson (2009a, pp. 80–81).

6.3 The ERM debate

Chancellor Lawson pursued an unannounced peg of the sterling exchange rate against the mark in the 1987−1988 period. Even after this policy was abandoned, he and many other government figures favored a fixed-exchange-rate policy in the form of U.K. membership of the Exchange Rate Mechanism of the European Monetary System (EMS), and debate on this matter inside and outside the government was intense in the late 1980s and into 1990.

In the wake of Lawson's experiment with pegging sterling and the emergence of a revival of inflation in the United Kingdom, Friedman wrote in the *Wall Street Journal* (April 19, 1989): "Nigel Lawson chose to stabilize the exchange rate and hence lost control of the price level." It was likely in light of this letter (perhaps as reprinted in London's *Wall Street Journal Europe*) that *The Scotsman* newspaper (May 30, 1989) noted that, in the "simmering row" over the United Kingdom and the ERM, "Milton Friedman, the arch monetarist, is airing his views." Later in the year, Friedman went further and penned an article for the *Financial Times* (December 18, 1989) reaffirming the case for floating exchange rates.[41] Elaborating on this theme in *National Review* (June 11, 1990), Friedman suggested that Lawson's 1987−1988 pegging experiment had led to "a sharp rise in monetary growth that… left a legacy of inflation and high interest rates that Britain is still struggling to overcome."

Not only did Friedman participate in the public debate on the ERM; it was also the case that his views on exchange rates informed the anti-membership group within the government. The group included Margaret Thatcher and her adviser Alan Walters. Walters made his stand against the ERM in prominent public forums in 1986 (Walters, 1986, Chapter 7; *Financial Times*, April 28, 1986). The following year, his *New Palgrave* entry on Friedman appeared, and it credited Friedman (1953) with the monetary-sovereignty case for floating exchange rates and with an emphasis on the consistency of floating exchange rates with free markets (Walters, 1987, p. 425). Both these aspects of the case for floating appealed to Thatcher.[42] After Walters ceased being an adviser to the government, he published a book against ERM entry, in which he cited Friedman's 1953 paper for its analysis of exchange-rate behavior under a float (Walters, 1990, p. 127).
The United Kingdom joined the ERM in October 1990, the month before Thatcher left office. It was in the aftermath of these events that Friedman observed in 1992 of Thatcher: "I think she

[41] See also Nelson (2009a, p. 15), which mentions this article and its revised version in Friedman (1992).
[42] For Thatcher's endorsements of these arguments, see for example Thatcher (1993, pp. 689−690, 726; 1995, pp. 479, 597).

was a godsend for the British. I just wish she had exercised a little better control of her government." (*Independent on Sunday*, July 26, 1992.)

A couple of months after Friedman made these remarks, the United Kingdom was forced out of the ERM. In 1994, after the United Kingdom's and other countries' recent problems with pegged-exchange-rate systems, Friedman wrote a new piece on fixed exchange rates in which he argued that even the Bretton Woods system was overrated (*National Review*, September 12, 1994). This 1994 Friedman article would be cited favorably in Thatcher (1995, p. 596).

6.4 Privatization

Ahead of the Thatcher years, Friedman was one of the most prominent advocates of the position that U.K. industries be privatized.

As Friedman (1986, p. 135) noted, the issue of privatization was vastly more pertinent for the United Kingdom than for the United States, owing to the extensive government ownership of industrial enterprises in the former country. Friedman, in fact, wrote at length during the 1970s on the case for privatization of U.K.-government-owned industries. His *Newsweek* column, "How to Denationalize" (December 27, 1976), specifically made this case. In addition, in talks given in London a few months earlier, Friedman had publicly advocated large-scale privatization of U.K. enterprises; in doing so, he employed the then-little-used "privatize" term.[43] When these talks entered print in the United Kingdom in early 1977, Friedman's advocacy of U.K. privatization received wide attention and prompted a hostile editorial in the *Daily Express* (February 1, 1977). The editorial line of the *Express* was pro-Conservative party, but privatization was at this point liable to be resisted by many Conservatives as well as Labour figures.

Friedman again pushed for privatization during a visit to the United Kingdom in 1980, including in his joint television appearance with Geoffrey Howe (*Free To Choose*, BBC2, March 22, 1980 p. 23 of transcript). The absence of comprehensive industrial privatization was one basis on which Friedman criticized the early years of Thatcher's record. He felt that the lack of privatization had blown up public spending, in part because the Thatcher Government had committed itself to public-sector pay rises of a magnitude greater than would have been granted by private firms (Committee for Economic Development of Australia, 1981, p. 7).

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[43] See Friedman (1977, pp. 51–53). In this discussion, the word "privatize" appeared on page 51.

The Thatcher Government's privatization of industrial enterprises featured heavily in its second and third terms, and these privatization programs received some praise from Friedman (for example, in Friedman, 1989, p. 569). However, he complained that the form in which privatization had proceeded had not been the one he had advocated in his 1976 contributions. Friedman wanted the transfer of ownership of enterprises to consist of a process in which the government ended its participation by giving ownership claims to every member of the citizenry. He insisted that this method was "the policy of privatization that makes the most sense" (*Jerusalem Post*, November 12, 1987). This method clearly diverged from the U.K. privatization process, in which government enterprises were sold by selling equity claims on the stock market. It is perhaps testimony to the prominence that Friedman conferred upon his own preferred variant of privatization that Lawson's (1992, p. 217) account of the Thatcher Government's privatization program have contained a defense of the selling-shares method against the giving-away method.

6.5 Current account of the balance of payments

An overlooked aspect of Friedman's influence on U.K. economic policy is the way his work had an impact on thinking in the United Kingdom about the balance of payments and specifically on judgments on whether current account deficits were a problem.

Lawson (1992, p. 856) quoted one of his own talks on the balance of payments, given in July 1988, in which he observed that "a country whose investment opportunities are sufficiently attractive to generate a net capital inflow will by definition have a current account deficit." This perspective matched very closely the one Friedman had been offering for many years. Friedman (1969b, p. 2) had observed: "You can have a capital inflow only by accommodating it on current account." Along the same lines, Friedman and Friedman (1985, pp. 120–123) had viewed the recent enlargement of the U.S. current account deficit as a by-product of the increasing attractiveness to foreigners of making investments in the United States, and they stressed that efforts to reduce the current account deficit by trade-policy measures were undesirable and would only actually lower the deficit insofar as they deterred capital inflow.[44]

The starting point for this perspective was that, under a floating exchange rate, the overall balance of payments had to be in equilibrium. The issue then arose of whether it was a cause for

[44] An older example Friedman gave was of U.S. current account deficits in the nineteenth century, which he viewed as a counterpart to the investment flows coming from the United Kingdom to the United States during that period (Friedman and Friedman, 1980, p. 43).

concern if, within the overall zero balance, a current account deficit was being registered, equal in absolute magnitude to the capital account surplus (a net capital inflow). According to the perspective Friedman (and later Lawson) took, if a capital inflow reflected large-scale government borrowing from overseas, the associated current account deficit might be a symptom of problems; but if the borrowing was by the private sector, it might reflect the appropriate operation of intertemporal behavior on the part of households and firms. "If individual Britons want to borrow from abroad, that's their business," Friedman remarked in a 1976 U.K. television interview (*Newsday*, BBC2, November 9, 1976, p. 8 of transcript). "There's nothing wrong with being a debtor nation... if the debt has been accumulated to get assets," he observed on a later occasion (*The Commonwealth*, August 24, 1987, p. 361).

Friedman stressed that the function of floating exchange rates was not to eliminate a trade or current account deficit, but to give a country the ability to operate its own monetary policy (*Wall Street Journal*, June 30, 1975). In that context, it could be part of the normal operation of floating exchange rates for an increased capital inflow to provoke an exchange-rate reaction that generated a larger current account deficit (Friedman and Schwartz, 1982, p. 335).

It is clear from the above that Friedman was an exponent, in public statements since at least the 1960s, of what has come to be called the intertemporal approach to the current account. Although the discussion of this approach by Obstfeld and Rogoff (1995) did not cite Friedman's work, they did describe the approach as derived from "forward-looking consumption theories" (p. 1776)—implying that it was descended from the permanent income hypothesis of Friedman (1957). The permanent-income aspect of the intertemporal approach to the current account is brought out most clearly by considering the fact that a current account deficit involves consumption spending that is likely high in relation to current income. The intertemporal approach can rationalize such behavior if current income is low in relation to permanent income.

Lawson had evidently reached a similar perspective on the current account deficit. Lawson recognized Friedman (1957) as a pioneering work (see below), and Lawson's 1988 thinking on the current account deficit flowed naturally from the permanent-income view of agents' behavior propounded in *A Theory of the Consumption Function*. Furthermore, as indicated in Section 1 above, the permanent income hypothesis has continued to be embraced as a key analytical tool in U.K. policy circles in the period beyond Lawson's time as Chancellor of the Exchequer.

7. Two retrospectives on Friedman's influence reconsidered

In view of the evidence in this paper that Friedman significantly influenced U.K. economic policy on a variety of fronts, it is appropriate now to consider the contentions to the contrary of Nigel Lawson and of Forder (2016).

Nigel Lawson. Lawson, as already indicated, stated in 2011 that Friedman had not been influential on the Thatcher Government's policies. However, as discussed by Budd (2014), Lawson, in the years after he left office, has not been well disposed toward the practice of tracing the Thatcher Government's economic policy to academics' ideas. Examination of earlier Lawson writings does reveal significant acknowledgments of Friedman's work. In September 1970, Lawson wrote of Friedman, "as an economist, he stands second to none in the world today," and called on Heath Government members to meet Friedman during his forthcoming visit to London (*Sunday Times*, September 6, 1970).[45] In the same period, Lawson described the "non-union diagnosis" of inflation as comprising the "idea... that inflation will be brought under control by keeping a tight rein on the growth of the supply of money (as recommended by Professor Milton Friedman)" (*Evening Standard*, September 30, 1970).

In his memoirs (Lawson, 1992), Lawson referred to and endorsed the *Monetary History*'s analysis of the U.S. Great Depression (p. 1048). Lawson described Friedman's work on the permanent income hypothesis as "pioneering" (p. 632) and also (p. 1089) cited Friedman's book *The Optimum Quantity of Money and Other Essays* (Friedman, 1969a)—a book that contained a reprint of Friedman's (1968) celebrated outline of the natural rate hypothesis. More evidence of the influence of the natural rate hypothesis and permanent income hypothesis on Lawson's thinking was provided above in Sections 5 and 6, respectively.

Forder (2016). A number of the arguments in Forder (2016) for Friedman's "lack of influence" on U.K. economic policy are now considered and found to lack validity.

Forder (2016, p. 10) states that Thatcher's memoirs did not make any specific acknowledgment of ideas she owed to Friedman. This is incorrect, as Thatcher (1993) acknowledged Friedman's work on the lag between monetary growth and inflation. In addition, as noted in Section 3 above, in the companion volume to her memoirs Thatcher acknowledged that she owed the

[45] In fact, as discussed below, Heath himself met Friedman during this visit.

realization that inflation was a monetary phenomenon to Friedman. Indeed, as observed above, Thatcher (1995) admitted that she did not grasp this point until the mid-1970s.[46]

Forder (2016, p. 8) conjectures that Friedman in his U.K. press interviews "does not seem anywhere to have claimed influence" on the Thatcher Government. In fact, Friedman did do so, such as when he stated in 1982: "You're doing one of the things I'm advocating, which is slowing monetary growth…" (*The Observer*, September 26, 1982.).[47]

It is also incorrect to suggest, as Forder (2016, p. 22) does, that the idea that Thatcher and her economic team were influenced by Friedman was a misconception spread after March 1975 and launched by Labour party figures who were members of parliament but outside the ministry. On the contrary, we have seen that this idea—which was valid—was articulated publicly during the September 1974-February 1975 period and that it was subsequently affirmed by prominent opponents of Thatcher (such as senior Labour ministers Harold Wilson and Denis Healey, and Conservative Edward Heath) who were in a good position to ascertain Friedman's influence, and by figures in Thatcher's team (such as Geoffrey Howe).

With regard to monetary targeting, Forder (2016, p. 3) contends that its 1976 introduction was "at the urging of the IMF." If accurate, this claim might remove the possibility that monetary targeting signified the influence of Milton Friedman's thinking on U.K. economic policy. Forder's claim, however, is incorrect. As already indicated, public monetary targeting was introduced in the United Kingdom during the April-July 1976 period. In contrast, the agreement between the Callaghan Government and the IMF concerning forthcoming U.K. economic-policy measures was not hammered out until later in 1976. The agreed measures did not include an M3 target but instead comprised (as well as fiscal-policy targets) limits on domestic credit expansion (DCE). The IMF did participate in the government's refinement of the broad-money definition—a process that resulted in the creation of Sterling M3, which became the targeted

[46] Forder (2016, p. 10), in claiming that Thatcher was a monetarist by the late 1960s, neglects the crucial passages of Thatcher (1995) highlighted in Section 3 above, as well as the distinction between sound-money and monetarist views stressed in that section. Forder (2016, p. 21) further suggests that "[a]fter 1976, hardly anyone in Britain had a good word to say about him [Friedman]" and implies that Thatcher's 1978 meeting with Friedman occurred only with reluctance on her part (p. 7). In fact, however, Thatcher had publicly stated in 1977 that she would like to meet Friedman (*Firing Line*, PBS, August 19, 1977).

[47] Recall also from Section I above that in 1979, in his *Newsweek* column, Friedman implied that the economic program on which Thatcher had been elected was one that largely matched his own prescriptions. This reference to Thatcher in Friedman's *Newsweek* column is not included in Forder's (2016, p. 8) listing, apparently intended to be exhaustive, of the Friedman columns' references to Thatcher.

monetary aggregate in place of M3 (Gowland, 1979, p. 25). Even after this change, it remained the case that the IMF conditions concerned DCE, not M3 or Sterling M3.

It was U.K. policymakers—not the IMF—who emphasized M3 (and then Sterling M3), and it was the behavior of the broad-money aggregate that guided policy decisions such as the renewed floating of the exchange rate in late 1977. It turned out that the DCE ceilings were reached easily in 1976–1978 and that it was targeting broad money that formed more of a constraint on policy decisions (Congdon, 1982, p. 5). Therefore, broad money targeting, introduced by the U.K. government well ahead of the IMF negotiations, continued after those negotiations.

With regard to monetary targeting during the Thatcher years, Forder (2016, p. 9) implies that Friedman was very distant from matters by suggesting that he was ill-informed about the creation of the MTFS. Forder points to Friedman and Friedman's (1985, p. 12) statement that the MTFS was introduced in the Thatcher Government's early months—a statement that he considers an error, in view of the March 1980 announcement of the MTFS. But the Friedmans' suggestion that the MTFS was introduced during 1979 is sound. As already noted, the 1980 MTFS announcement made formal and numerically precise a plan that the Thatcher team had already indicated it intended to carry out; much of the development of the plan had taken place in 1979. Consistent with this, one retrospective contained the heading: "1979 to 1980: the development of the Medium Term Financial Strategy" (Temperton, 1991, p. 8).[48]

One can therefore conclude—in line with the discussions in Sections 4.2 and 6.1 above—that in both the Callaghan and the Thatcher years, U.K. monetary targeting reflected the influence of Friedman's work. This influence was consolidated in 1979–1980 by the MTFS, which cast the monetary targets in multi-year form, as per Friedman's prior suggestion.

With regard to the introduction in the United Kingdom of privatization and the abandonment of incomes policy, Forder denies an important role for Friedman. But it was shown above that Friedman intervened on these issues prominently and early in the U.K. debate. Furthermore, he

[48] Forder (2016, p. 9) also takes Friedman and Friedman's (1985, p. 12) statement that in 1979 Thatcher reduced "the top income tax rate from 90 to 60 percent" as wrong on the grounds that the pre-Thatcher top marginal rate was 83 percent. This specific criticism is incorrect. Until 1979, the top U.K. marginal rates on investment income and labor income were respectively 83 and 98 percent, and the average of these rates is close to the Friedmans' 90 percent number. Where the Friedmans erred, instead, was in taking the top rate on both investment and labor income from 1979 onward to be 60 percent. In fact, while the top rate on labor income was indeed 60 percent starting in 1979, that on investment income was not brought down to this level until 1984. From 1979 to 1984, it was 75 percent, so the Friedmans should have given the new top income tax rate in 1979 as 67.5 percent.

was cited on these issues in public discussions by numerous figures, including several who had advisory or policymaking roles in the U.K. government during the 1980s.

Finally, Forder (2016, p. 5) asserts that Friedman "made no contribution to the British debate about the EMS…" This statement is not correct, as the account in Section 6.3 above established.

8. Conclusions

This paper has found a significant influence of Milton Friedman on U.K. economic policy from the 1970s onward, and especially during the period of the Thatcher Government. Examples of Friedman's influence include the absorption into U.K. economic-policy doctrine of the permanent income hypothesis and the natural rate hypothesis, the official rejection from 1979 onward of incomes policy as a weapon against inflation, and successive decisions by U.K. policymakers to maintain floating exchange rates when other options were being mooted. Evidence of Friedman's influence on privatization policy and on the official perspective on the current account deficit can also be discerned. Important acknowledgments of Friedman's work appeared on the record: for example, in officials' explanations for the introduction of monetary targeting in the United Kingdom, in Margaret Thatcher's crediting to Friedman the insight that inflation was a monetary phenomenon and her mention of his work on lags, and in praise from Geoffrey Howe and Nigel Lawson for Friedman's contributions to economics. The familiarity with Friedman's work that key economic advisers such as Alan Walters possessed was also an important route by which Friedman's influence on U.K. economic policy was felt.

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