UNIVERSITY OF OXFORD

Discussion Papers in Economic and Social History

Number 104, October 2012

THE EVOLUTION OF BRITISH MONETARISM: 1968-1979

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Abstract: *How far were monetary targets imposed on the post-1974 Labour Government by international and domestic financial markets enthused with the doctrines of 'monetarism'? The following paper attempts to answer this question by demonstrating the complex and contingent nature of the ascent of British 'monetarism' after 1968. It describes the post-devaluation valorisation of the 'money supply' which led investors to realign their expectations with the behaviour of the monetary aggregates. The collapse of the global fixed-exchange rate regime, coupled with vast domestic inflationary pressures after 1973, determined that investors came to employ the 'money supply' as a convenient new measure with which to assess the 'soundness' of British economic management. The critical juncture of the 1976 Sterling crisis forced the Labour Government into a reluctant adoption of monetary targets as part of a desperate attempt to regain market confidence. The result was to impose significant constraints on the Government's economic policymaking freedom, as attempts were made to retain favourable money supply figures exposed to the short-term volatility of increasingly-globalised and highly-capitalized financial markets.*

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* The author is grateful to Ben Jackson for his support in the preparation of the paper. This paper has been written with the generous financial support of the Winton Institute for Financial and Monetary History, as well as the Arts and Humanities Research Council. The author would like to thank Nick Mayhew, Anthony Hotson, and Luke Samy at the Winton Institute for their support. Thanks also to Harold Carter, Nicholas Dimsdale, Rui Esteves, Peter Hall, Jane Humphries, Eric Monnet, Duncan Needham, Avner Offer, Michael J. Oliver, Gordon Pepper, Florian Ploeckl, and to the attendees of the Economic and Social History seminar held at Nuffield College, the Economic History seminar at the Paris School of Economics, and the Winton Institute Seminar at the Ashmolean Museum for their comments.

The Medium Term Financial Strategy (MTFS), launched in March 1980, was the apotheosis of the British monetarist experiment. A 'target for a steadily declining growth of the money supply' was set over four years, with £M3 to be reduced from a target of 7-11 per cent in 1980/81 to 4-8 per cent in 1983/4.[1] The Public Sector Borrowing Requirement (PSBR) was to be reduced from 3.75 per cent of GDP in 1980/81 to 1.5 per cent by 1983/4.[2] This 'monetarist' moment is often presented as a rupture in the norms of economic management which had defined the post-war era. The 'Keynesian' consensus of attempting to maintain full employment was abandoned and price stability became the primary goal of economic policy. Where monetary policy had previously been subservient to the strategies of demand management, it was now enshrined as the key control lever of economic growth and stability.

The popular view of the monetarist experiment ultimately tends to emphasize its 'idealist' or 'ideological' nature. This perspective emphasizes the spread of Milton Friedman's economic theories (alongside other elements of 'New Right' thought) and their adoption by the right-wing of the Conservative Party during the 1970s – influenced by journalists, think-tanks, and a minority of British economists.[3] It is argued that monetarist doctrine rationalised the Tory desire to overcome inflation through reductions to public expenditure and abandon trade union-negotiated incomes policies.[4] Yet while the radicalism of the MTFS is certain, it is possible to argue that the shift from nominal 'Kenyesianism' to 'monetarism' was actually an evolutionary

[1] Parliamentary Debates (Commons), 981, 26 March 1980, 1443; £M3 = currency in public circulation and sterling bank deposits of UK residents.
[2] Smith, *Rise and Fall*, 93.
[3] Cockett, *Thinking the Unthinkable*; Desai, 'Second-hand dealers in ideas…'; Harrison, 'Mrs Thatcher and the intellectuals'; Middleton, 'Brittan on Britain'; Parsons, *Power of the Financial Press*.
[4] Bulpitt, 'The Discipline of the New Democracy', 32.

change which took place in the decade prior to Thatcher's election victory in 1979. This is most significantly asserted in the work of Peter A. Hall, who has interpreted the ascent of 'monetarism' as a 'paradigm shift' in economic policy norms during the 1970s. As economic contradictions proliferated (notably the concurrent increase in inflation and unemployment) the established 'Keynesian' paradigm was exposed to an accumulation of anomalies which challenged its basic assumptions. The failure of the post-war economic framework to effectively solve the strife which tormented the British economy during this period instigated a demand for a new, ultimately 'monetarist', economic model.[5]

Jim Callaghan's speech to the 1976 Labour Party conference is often referred to as a critical moment in this evolution. His rejection of inflationary fiscal stimuli to overcome unemployment echoed the monetarist critique of full-employment goals. Yet it was the adoption of domestic monetary targets in 1976 by the Chancellor, Denis Healey, that provided the practical adjustment to notional monetarism which was to provide the basis for the post-1979 Government's attempted monetary control. Why did the Labour Government, social-democratic supporters of the post-war consensus, commit itself to monetary targets after 1976? The purpose of this article is to identify the pressures and influences on economic policymaking during the 1970s which can account for the evolution of monetary targets as the principal mechanism employed in managing the British economy. In attempting to answer this question, the article places particular emphasis on the relationship between financial markets and economic policymakers after 1968. Previous studies of the rise of 'British monetarism' have often stressed the key importance of 'the City' (a slightly erroneous

[5] Hall, 'Policy Paradigms, Social Learning, and the State'; Oliver & Pemberton, 'Learning and Change in 20th Century British Economic Policy', 428 – 432.

short-hand term for the markets in Government debt and foreign exchange) in developing, promoting, and ensuring the success of the British monetarism.[6] Writing in 1978 for the *Centre for Policy Studies*, the journalist-turned-stockbroker, Tim Congdon, proclaimed that the City was ‘the spiritual home of British monetarism.’[7] This was echoed in Nicholas Kaldor’s scathing 1982 denunciation of ‘a new epidemic of monetarism’ promoted by financial journalists and stockbrokers.[8] Peter Hall’s model of a paradigm shift relies on the importance of the ‘marketplace for ideas’ in providing policymakers with a new economic framework to replace the failed ‘Keynesianism’. For Hall, the City was vitally important in constructing and contributing to this marketplace, arguing that the increased prevalence of monetarist ideas within the City coincided with institutional changes which ensured their ascendance. He argues that following the expansionary policies of the early 1970s the Government was increasingly exposed to the demands of its creditors. Simultaneously, the policy of ‘Competition and Credit Control’ adopted in 1971, in which quantitative controls on bank lending were removed and credit was managed according to variations in interest rates (originally ‘Bank Rate’, and then ‘Minimum Lending Rate’ [MLR] after 1972) created a number of structural changes. Firstly, it vastly increased the behavioural cohesiveness of the gilt-edged market, with investors acting en masse to changes (predicted and actual) in interest rates. Secondly, it stressed to investors the vital need to anticipate interest rate changes – which encouraged financial institutions to employ economists to make predictions of future economic trends and policies. These economists became increasingly influenced by ‘monetarist’ thought and concerned with the behaviour of the money supply, and

[6] Coakley and Harris, *City of Capital*, 190 – 214.
[7] Congdon, *Monetarism*, 29.
[8] Kaldor, *Scourge of Monetarism*, xi.

shared their interpretations in client circulars (e.g. Greenwell's *Monetary Bulletin*.)[9] His account of these changes has led Hall to conclude that

'many of the ad hoc adjustments towards monetarism made by the 1974-79 Labour Government were forced on it by the behavior of the financial markets, and the popularity of monetarist doctrine in these markets influenced both the Bank of England and the Government.'[10]

The following sections support and develop Hall's general account of the ascent of monetarism. By analyzing the relationship between the financial markets and policymaking authorities at the Treasury and Bank of England using previously unemployed archival documents, this article aims to deepen our understanding of the evolution of British monetarism in the decade prior to the MTFS. It ultimately argues that monetary targets were the product of interests, ideas, and expectations operating within the changing global and domestic structures which governed the relationship between the Government and financial markets during the 1970s. These structural changes created the conditions out of which the Conservative Government's monetarist strategy would later emerge.

I

In March 1968 Milton Friedman gave his Presidential address to the *American Economic Association*. His speech, on the role of monetary policy, received wide coverage in the British financial press.[11] Samuel Brittan, economics editor of the *Financial Times*, published an article in October entitled 'Money Supply: the great

[9] Hall, 'The movement from Keynesianism to monetarism', 100 – 103.
[10] Hall, 'Policy Paradigms, Social Learning and the State', 288.
[11] Friedman, 'The Role of Monetary Policy'.

debate' which received a large response from the readership.[12] The debate ensued in the letters pages of the paper until January 1969, with contributions which deliberated over the definition, size, and means of controlling the supply of money.[13] Meanwhile, the December 1968 issue of *The Banker* magazine dedicated a special issue to 'The Money Supply Debate' which included a contribution from Friedman himself.[14] To a degree this newfound interest was due to an intellectual curiosity which demanded new ideas which might engage an informed readership. However, this intense focus had a greater imperative. *The Banker* noted that the concept of the money supply was becoming a topic of debate that was 'by no means academic.' 'Money' appeared to be taken seriously by many of the key economic bodies which influenced and directed British economic policy. The magazine cited a September meeting of the OECD which had been set up to discuss Britain's post-devaluation strategy; a meeting between the IMF and the 'UK monetary authorities' which had focussed solely on the issue of monetary theory; and a recent speech by the Governor of the Bank of England in which he had stressed the need for greater attention being paid to the money supply.[15] In addition, the US Government and the IMF were seen to be increasingly dissatisfied with the 'rather old-fashioned' rejection of exogenous monetary theories embodied in the 1959 Radcliffe 'Committee on the Working of the Monetary System'.[16] This perceived influence of 'monetarist' theory emerged at a time, post-devaluation, in which the British economy was particularly susceptible to the institutional opinions of global economic bodies.

[12] Samuel Brittan, 'The Money Supply: the great debate', *Financial Times*, 25 Oct. 1968.
[13] For example – Letter from E.B. Chalmers, 'Money Supply', *Financial Times*, 29 Oct. 1968.
[14] 'The Money Supply Debate', *The Banker*, 118: 514, (1968), 1094 – 1116.
[15] 'The Supply of Money', *The Banker*, 118: 513, (1968), 971.
[16] Ibid.; Dimsdale, 'British Monetary Policy Since 1945', 108.

The gilt-edged stockbrokers *W. Greenwell & Co.* sent a letter to their clients in October 1968 which asserted that it was vital to understand the money supply because 'the Basle bankers and the I.M.F. attach[ed] considerable importance to the subject.'[17] This justified the firm's decision to undertake research into the influence of monetary aggregates on the gilt-edged market, and provoked the firm to send a detailed memorandum explaining how monetary aggregates were calculated. The belief that the authorities were concerned with the money supply was made concrete in May 1969 when the British Government's 'Letter of Intent' in exchange for IMF financial assistance established a commitment to restraining the IMF's favoured monetary aggregate - 'Domestic Credit Expansion' (DCE) (a measure of broad domestic money adjusted for the balance of payments).[18] The formalisation of DCE as a key component of the authorities' economic objectives, whilst in no way a firm assertion of the utmost centrality of money to the management of the economy (and certainly bearing no relation to the Friedmanite proposition of ensuring a stable growth of the money stock), served to valorise the monetary aggregate as a key component in the control of the British economy. Simultaneously, beginning in December 1968, the *Bank of England Quarterly Bulletin* had begun to publish data and accompanying comments on the money supply alongside a formalised definition of M3 based on the 'counterparts' approach.[19] The 'counterparts'-derived definition of the money supply explicitly linked the budget-deficit (PSBR) to monetary growth (alongside private bank lending) – a relationship which was to become central to the MTFS.

[17] Letter from W. Greenwell & Co., 'The Money Supply', 18 Oct. 1968 (digital copies of W. Greenwell materials available on request).

[18] Capie, *The Bank of England*, 396; Oliver, 'Whatever happened to monetarism?', 52; 'Domestic Credit Expansion', *Bank of England Quarterly Bulletin*, 9: 3, (1969), 363.

[19] 'Money Supply: April-September 1968', *Bank of England Quarterly Bulletin*, 8: 4, (Dec. 1968), 370; M3 = currency in public circulation and deposits (foreign and sterling) in UK banks. 'Credit counterparts' approach defines M3 as PSBR, less gilt-sales to non-bank private-sector, plus bank lending, plus foreign inflows.

What emerged after 1968 was a widely held view that international and domestic authorities were increasingly influenced by new theoretical ideas regarding the role of the money supply. It appeared to observers that these various authorities attached considerable importance to the money supply, and were thus liable to shape their policies in accordance with a strategy to control monetary growth. The academic development of Chicago monetarism created a new intellectual climate which, whilst being conceptually stimulating for some, was more notable for its *perceived* influence on key economic institutions. This ensured that for those involved in monitoring and assessing the activities of the Government, such as the gilt-edged brokers at *Greenwell's*, it was imperative that they were able to explain changes in the 'money supply' in order to provide high quality investment advice to their clients. This resulted in the dislocation of the simplistic aggregate of monetary growth from the wider intellectual debates and disagreements in the academic community, ensuring that the importance of money did not rely on a scientifically agreed certainty about the role of money, but simply on a shared belief that the monetary indicators were important.

Though the abandonment of DCE targets in 1971 nominally 'de-formalised' the monetary aggregates, the intense focus on their role had forced the authorities at the Bank of England to take the money supply seriously.[20] The extent to which the authorities were converted to 'monetarist' prescriptions during this period is debateable. Forrest Capie has argued that the Bank experienced no intellectual conversion, yet Duncan Needham has claimed that the UK authorities were engaged

[20]Charles Goodhart, 'The Importance of Money', *Bank of England Quarterly Bulletin*, 10: 2, (1970), 159 – 198; Capie, *The Bank of England*, 452.

in a ‘money supply experiment’ after 1971, operating according to an unpublished ‘monetary objective’.[21] Regardless of these competing accounts, to external observers in the financial markets the Bank appeared publically committed to a practical and moderate belief in the necessity of monitoring and controlling monetary growth. In October 1972 Pepper noted that the Governor had stated:

‘I accept, as most central bankers would, the control of the money supply is my principal, if not my most important, concern.’[22]

This valorisation had the effect of changing market behaviour. Financial markets began to shift their interpretative framework and align their investment expectations with changes in the monetary aggregates. In response to the official assertions of the importance of the money supply, investors altered their conception of the economy and thus changed the way in which they behaved as market participants. This was especially important in the market for Government debt. Jeremey Wormell has argued that the gilt-edged market was one in which ‘practice and commercial greed meet theory and the academic.’ [23] As described by Hall, it was realised in the wake of ‘Competition and Credit Control’ that by monitoring the monetary aggregates it was possible to anticipate future changes in interest rates.[24] The authors of *Greenwell’s Monetary Bulletin* identified that if the authorities were ‘operating a money supply policy’ (i.e. attempting to prevent excessive monetary growth) and the monetary aggregates were seen to increase beyond a desirable range, then it was the case that

[21] Ibid., 460; Duncan Needham, ‘Unhappy Monetary Policy: Britain’s Money Supply Experiment, 1971 – 1973’, *Unpublished Paper*, (2012).
[22] Gordon Pepper (W. Greenwell & Co.), ‘Investment Analysts Meeting. Gilt-edged: The Future Outlook’, 25 January 1973.
[23] Wormell, *The Gilt-Edged Market*, xiii.
[24] Hall, ‘From Keynesianism to Monetarism’, 101 – 102; Gowland, *Controlling the Money Supply*, 101.

long interest rates would inevitably rise in the near future.[25] This dynamic enabled *Greenwell's*, drawing on the counterparts accounting identity, to provide investment advice to their clients. For example, in April 1973 the bulletin stated that

> 'the authorities will not be able to finance sufficiently the public sector borrowing requirement from the non-bank private sector and, therefore, the money supply will continue to grow excessively. Upwards pressure on interest rates will occur as the authorities battle unsuccessfully to control the money supply.'[26]

Alongside this practical usage, monetarist interpretations began to proliferate more generally within the financial markets, providing clues to future economic growth and inflationary pressures likely to emerge. This was led by circulars and bulletins such as those published by *W. Greenwell & Co.*, *Pember & Boyle* (written by Brian Griffiths), and *Joseph Sebag & Co.* (Alan Walters).[27] The writers of these circulars demonstrate the significant personal and conceptual overlap between academic-, City-, and political-monetarism. Brian Griffiths was a lecturer in Economics at the LSE (1968-76) and Professor of 'Banking and International Finance' at City University (1977-85). Alan Walters was a Professor of Economics at the LSE (1968-76). Both of these, alongside Gordon Pepper, were senior advisors to the Conservative Party in opposition and in Government. *Greenwell's* was the most influential circular, as evidenced in a survey conducted amongst UK investment managers in 1975 by *Continental Illinois* which ranked it as providing the best 'Fixed Interest Stock (Primarily gilt-edged market)' investment analysis, and the second best analysis of

[25] W. Greenwell & Co., 'Monetary Bulletins: An Explanation', October 1972.
[26] Ibid., 'The Financing of the Public Sector Borrowing Requirement in 1973/4', April 1973.
[27] Hall, 'The movement from Keynesianism to monetarism',102; David Smith, *The Rise and Fall of Monetarism*, 82.

'General Economic Trends.'[28] Pepper explained to *Greenwell's* clients in October 1973 that the purpose of monitoring monetary aggregates was to 'detect accelerations and decelerations in the economy' and used the firm's bulletin as a means of explaining and predicting the course of monetary change during the post-DCE years.[29]

The strength of the monetarist interpretation of the economy gained a significant degree of validation with the onset of rapid inflationary growth after 1973. Commentators coherently explained the rapid hike in the rate of inflation from a monetarist point-of-view, and popularized the interpretation through market circulars, in the press, and in direct communication with political parties. Pepper strongly criticised the 'explosion in M3' which began at the end of 1971 and grew by 60 per cent in the next two years. The origins of this rapid expansion could be primarily attributed to the Bank of England's failure to control bank lending, which was further exacerbated by the vastly expanding public sector deficit. This interpretation placed the interventionist Heath Government, under the Chancellorship of Anthony Barber, at the root of the rapid growth of the money supply.[30] In a speech dramatically entitled 'An Economic Threat to Democracy' given to the Conservative Bow Group in March 1974, Pepper chastised the Heath Government for its 'growth at all costs' policy, informing the Conservative 'House of Commons Finance Committee' later

[28] Conservative Party Archive, Bodleian Library, Oxford [henceforward CPA]: KJ 10/5, ''Stockbrokers' research: the best of 1975', *Investors Chronicle*, 24 October 1965', 6 November 1975.

[29] W. Greenwell & Co., 'Monetary Bulletin No. 17', October 1973; Pepper, *Inside Thatcher's Monetarist Revolution*.

[30] Gordon Pepper, 'Competition by Lack of Credit Control – A Paper given to the Money Study Group at a Monetary Policy Symposium held at the London School of Economics', 28 November 1973.

that year that 'the economic record of the last Conservative Government was almost unbelievably bad.'[31]

As inflation soared throughout 1974 and 1975 (and PSBR growth continued apace), this broad 'monetarist' interpretation of events gained a strong impetus. The modest cadre of British monetarist economists became particularly vocal, expressing their concerns in increasingly pessimistic terms. In an open letter to Harold Wilson in July 1974, Alan Walters and Harry Johnson urged the Prime Minister to take urgent action to ensure a gradual reduction in the rate of money supply growth with a return to a balanced-budget. They warned:

> 'Every week you…postpone the necessary action the more difficult the task and the nearer we approach the abyss of hyperinflation…If you do not act speedily on the lines that we have urged, we are convinced that both inflation and unemployment will be massive, ugly, and cruel.'[32]

These attacks popularised and politicised monetarism as it became increasingly favoured by Conservative MPs. Yet it was the Labour Chancellor who did most to further the 'monetarist' cause in British public discourse. The questions and proclamations of backbench Conservatives in the Commons regarding the state of the money supply handed Denis Healey a useful political stick with which to beat the opposition. Drawing on the monetarist critique of the Heath administration, Healey regularly responded to challenges in the Commons regarding the rate of monetary

[31] Gordon Pepper, 'An Economic Threat to Democracy – Annual Conference of the Bow Group at Magdalen College, Oxford', 31 March 1974; Gordon Pepper, 'Address to the House of Commons Finance Committee of the Conservative Party', 25 November 1974.

[32] W. Greenwell & Co., 'Monetary Bulletin No. 26', July 1974.

growth by comparing the Labour Government's record with their predecessors. Healey told the House in March 1975:

'I think that there is now general agreement on both sides of the House that the major cause of the inflation now racking Britain is the excessive increase in the money supply which took place in the last year of the previous Conservative Government.'[33]

In early 1976 he was quick to note that his record on controlling the money supply was 'four times superior' to that of the previous Government, and that this was largely due to the Labour Government's 'superior fiscal probity.'[34] In continuing to stress success in preventing excessive monetary growth, and consistently wielding monetary growth under Heath as a political weapon to rile the opposition benches, Healey further legitimized the importance of the 'money supply' as a key economic indicator and gave the distinct impression that the Government was making every effort to prevent its expansion. This was not a 'monetarist' approach to economic policy in any sense. Healey stressed:

'I think it is important to keep the matter under control and I have done so. However, I do not think that that aspect is as important as many honourable Members believe.'[35]

Yet it is clear that by proclaiming successful control of the money supply as one of his Government's achievements, the Chancellor served to cement a widespread belief within financial markets that the Government did attach importance to the monetary aggregates and was operating a strict monetary policy. The result was to establish a situation in which the success or failure of the Government's counter-inflationary

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[33] Parliamentary Debates (Commons), 889, 27 March 1975, 667-73.
[34] Ibid., 904, 5 February 1976, 1396-8.
[35] Ibid.

policies could be easily measured according to the behaviour of the monetary indicators.

II

Against the backdrop of vast inflationary pressures in 1975, it became increasingly evident within the Treasury and Bank of England that a greater degree of importance and value was being assigned, in both domestic and overseas financial markets, to the rate of monetary growth as an indicator of macroeconomic behaviour. The formalised focus on monetary aggregates in the late 1960s, coupled with the popular critique of the deleterious effects of the expansionary Heath Government, had ensured that investors and brokers in the gilt-edged and foreign exchange markets were heavily influenced by the behaviour of the money supply. It appeared that financial markets were employing the domestic 'money supply' as a yardstick with which to measure confidence in the Government's economic policies, and its credibility in being able to bring inflationary pressures under control.

In October 1975, a paper was presented to a sub-committee of the joint *Treasury/Bank of England* group undertaking a review of monetary policy. Produced by unnamed Bank officials, the brief stated that the Bank was becoming increasingly anxious about 'prospective monetary developments' – namely that an expanding PSBR was contributing to an upcoming rapid growth of the money supply. The paper stressed the importance of 'the climate of opinion, expectations and attitudes' and argued that there was a need to present a public display of commitment to controlling the monetary aggregates as a means of ensuring confidence within the financial markets. In attempting to achieve this it was suggested that it might be useful to discuss establishing publicly announced monetary targets.[36] A responding note was prepared for discussion on the possible role which could be played in the adoption of the 'monetarist prescription' of setting a target for the growth of the money supply and holding to it 'irrespective of what was happening in the economy.'[37] The following week a brief was sent to Healey from the Bank which stressed the importance of publically controlling the money supply in order to maintain the confidence of investors and assert the Government's anti-inflation credibility. The brief argued that sharp rises in the money stock would be simplistically interpreted by monetarist commentators as evidence that the Government had 'given up the fight against inflation' – and so to ensure that market confidence was retained strong action on the monetary aggregates was required.[38]

This was a view supported in a draft of the Working Group's paper on 'The Review of Monetary Policy', arguing that it was not necessary to 'subscribe completely to monetarist arguments' to agree that monetary policy could produce inflationary pressure through the real economy and 'via its effect on confidence and expectations.' High money supply figures were clearly damaging to market confidence – made worse by financial commentators and much of the editorial comment in the press which was 'overwhelmingly monetarist in a crude way.' In light of this, the report stated that the Working Party had 'little doubt that a policy based on a declining monetary aggregate should be adopted and publicly stated' to demonstrate the Government's commitment to reducing the money supply. However, the report expressed caution that strict monetary targets would undermine the authorities'

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[36] The National Archive, Public Record Office, Kew [Henceforward TNA]: T 364/274, 'Monetary Policy', October 1975.
[37] Ibid., Letter from Middleton to Bridgeman, 'Review of Monetary Policy', 31 October 1975.
[38] Ibid., Letter from Elstan to France, 'Monetary Implications of Fiscal Policy: A Holding Brief', 7 November 1975.

discretion over interest rates. Furthermore, there was doubt that the authorities had sufficient ability to actually control the money supply.[39]

A submission on monetary policy formulated by Treasury officials J.M. Bridgeman and Kenneth Couzens argued that the 'monetarist approach' was 'neither proven empirically nor intellectually convincing.' However, the authors supported the development of an internal monetary target which would be used as a yardstick with which to measure deviations in monetary growth that might signal a need for 'a reappraisal of macro-economic policy.' It was stressed that the target should not be fixed indefinitely but merely employed as a guideline which would prove particularly useful to the Bank of England in providing a 'clearer frame of reference' in its market operations, and was certainly not designed for publication.[40] A published target was strongly resisted in a paper written a few days later by Frank Cassell which stated that, despite the ability of a published target to generate confidence in the markets (especially amongst the 'monetarists who have a significant influence on market attitudes'), an explicit public target would too rigidly commit the Government to corrective actions. Furthermore, if it appeared that the targets were not likely to be met, market reactions would actually amplify the deviation from the target as gilt-edged investors would force the authorities to borrow more from the banking sector – thus increasing the rate of monetary growth.[41]

The authorities' perception of the markets was that they had become strongly influenced by monetarist ideas – or at the very least had begun to associate money

[39] TNA: T 386/122, 'Review of Monetary Policy', 17 December 1975.
[40] Ibid., Letter from Bridgeman to Wass, 'Draft Outline of Submission on Monetary Policy', 27 January 1976.
[41] Ibid., Letter from Cassell to Wass, 'Targets for Monetary Policy', 6 February 1976.

supply figures with inflationary pressures. Civil servants and Bank officials consciously expressed the view that the influence of 'monetarist' ideas amongst investors were a significant limitation on the Government's policies. In a note from the Downing Street Policy Unit in January 1976 the Prime Minister was informed that 'some people in the City…(whether correctly or incorrectly does not matter) believe that a rising money supply leads to inflation.'[42] Gordon Pepper embodied what the authorities were 'up against from large sections of the City and external opinion.'[43] Yet there remained strong resistance to the constraints which would be imposed by a public monetary target.

The role of the 'money supply' as a key indicator of market confidence in the Government was particularly influential as it had emerged within the vacuum left in the wake of the collapse of the Bretton Woods system of fixed-exchange rates at the start of the decade. The break-down had generated the problem of how to monitor the performance of the Government without a clear anchor, and how to ensure that responsible (non-inflationary) policies were undertaken.[44] As Pepper noted in 1971 –

> '…the discipline of a fixed rate of exchange is one of the few factors which ensure that Governments react to excessive inflation. A Government may be reluctant to take unpopular measures to control excessive inflation. A deterioration in the balance of payments and foreign exchange pressures often force a Government to take early action. A movement towards either floating exchange rates or more flexible fixed exchange rates relaxes this most important discipline on Governments.'[45]

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[42] TNA: T 386/115, Letter from Wicks to Robson, 'Monetary Policy – A Note by the Policy Unit', 5 January 1976.

[43] Ibid., Letter from Posner to Wass, 'Mr. Gordon Pepper', 22 April 1976; Letter from Wass to Posner, 'Mr. Gordon Pepper', 26 April 1976; Letter from Middleton to Couzens, 7 May 1976.

[44] Oliver & Pemberton, 'Learning and Change in 20th Century British Economic Policy', 428.

[45] Gordon Pepper, 'Is the long term bear market in gilts ending?', November 1971.

In 1977, Paul Volcker described this 'radical change in the game' and identified the value of monitoring the money supply for policymakers and investors in the new era of floating rates. He told the *Toronto Bond Traders Association* –

'…the new focus on containing monetary growth can fill some of [the] void…It embodies an essential truth in a manner that can be clearly communicated. Performance can be readily monitored.'[46]

This structural change to the international monetary system coincided with the emergence of vast sums of 'highly mobile private money' in the form of institutional investments (pension, insurance, and trust funds) and the international Euromarkets (based in London) during the late 1960s and 1970s.[47] Between 1957 – 1981 the total assets of institutional funds grew by a factor of nineteen to £154.2bn. (equal to 62 per cent of GDP in 1981).[48] The gross size of the unregulated Eurocurrency market increased from $110 billion in 1970 to $2015 billion by 1982, spurred by the recycling of 'petrodollars' after 1973.[49] The size, speed, and concentration of this 'atomic cloud of footloose funds' overwhelmed the capacity for the government to intervene in the operation of the financial markets (primarily to influence exchange rates) and placed a greater onus on the State to meet the demands of its creditors.[50]

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[46] W. Greenwell & Co., 'Mr. Volcker's Speech to the Toronto Bond Traders' Association – 22nd Feb. 1977 – Monetary Bulletin No. 66', May 1977.

[47] Coakley and Harris, *City of Capital*, 206 – 208; Burn, 'The State, the City and the Euromarkets', 226 – 227.

[48] Coakley and Harris, *City of Capital*, 95

[49] Ibid., Table 3.1, 51.

[50] Healey, *Time of my Life*, 412.

III

The Sterling crisis began in April 1976, and market confidence in the Government began to evaporate.[51] It is widely noted in the extensive literature on this episode that during this crisis the decision was made, by Denis Healey, to adopt a monetary target as an attempt to halt the descent.[52] Yet this decision was not so straight-forward. On 5 July a meeting of senior Treasury figures was held by Douglas Wass to discuss 'the desirability of setting targets for the monetary aggregates.' In the meeting the Chief advisor to the Treasury, Sir Bryan Hopkin, explained how a published target could influence market behaviour in such a way as to actually fulfil the target, arguing that if the Government committed to a combined PSBR and monetary target, demand for gilt-edged stock would increase (thus reducing the amount that needed to be borrowed from the banking system). However, if it appeared that the monetary target was going to be surpassed and the markets expected the Government to raise interest rates, meeting the money supply target would be made more difficult. Kenneth Couzens also expressed concern that the adoption of a money supply target would cause political difficulties for the Chancellor as the trade unions were likely to be suspicious of a policy 'propounded by the right wing of the Opposition.' It was agreed that there was a danger setting a target which would be deemed too high, with Bridgeman stating that a target greater than ten per cent growth would be viewed as being too lenient. Treasury officials were broadly opposed to public targets, with Wass expressing hope that the contents of the existing plans for the 'July Package' would

[51] Kynaston, *The City of London*, 529 – 531.
[52] Healey, *Time of my Life*, 432; Burk and Cairncross, '*Goodbye, Great Britain'*, 161; Harmon, *The British Labour Government and the 1976 IMF Crisis*, 155; Wass, *Decline to Fall*, 212 – 213.

impress the markets sufficiently to encourage the sale of gilts.[53] Yet on 12 July Wass told the 'Second Secretaries Meeting' that the Chancellor wanted 'to incorporate a monetary target in his forthcoming statement.'[54] Treasury staff, alongside colleagues at the Bank of England, were charged with formulating this – with the Bank proposing a target range of 8-12 per cent for 1976/77.[55] Hopkin argued that a monetary target would 'add materially to the confidence-generating effect of the package' – despite acknowledging the future difficulties it might cause in constraining policy. However, Hopkin informed Wass that he was against the Bank's suggested target range, and preferred instead a single figure commitment of 'about 12%', which would decline to '"less" or "about 10%"'.[56]

A deep Treasury resistance to monetary targets remained in principle, which Wass has emphasised in his recent historical-memoir of the crisis. In a letter to the Chancellor's PPS on 16 July the Permanent Secretary asserted his strong dissatisfaction with the idea of publishing a target. He felt that the Government had 'come very close to overdoing the targetry business', and that there was a danger of producing an impossible target which lacked credibility. He also repeated the self-fulfilling nature of the monetary target which, if appearing to be overshot, could generate an expansion in monetary aggregates as a result of reduced confidence in the gilt-edged market. Despite these objections Wass simply concluded that

'Since we cannot afford failure we must have the target.'[57]

[53] TNA: T 386/116, Wood, 'Note for the Record', 5 July 1976.
[54] Wass, *Decline to Fall*, 212.
[55] TNA: T 386/16, 'Speaking Note on Monetary Targets', 14 July 1976.
[56] TNA: T 386/116, Letter from Hopkins to Wass, 'Monetary Targets', 15 July 1976.
[57] TNA: T 386/16, Letter from Wass to PPS, 'Monetary Targets', 16 July 1976.

The absolute necessity of regaining the confidence of the financial markets made the adoption of a monetary target seemingly essential – regardless of the intellectual justifications or Treasury preferences. The Bank of England was generally more proactive in asserting a targets policy – aware that a public monetary restraint would place ‘a tighter rope around the Chancellor’s neck’ to restrain public expenditure.[58] In a meeting held in the Chancellor’s room at the Treasury on 20 July, Gordon Richardson argued strongly that adopting a target, alongside a firm commitment to a ‘progressive reduction of inflation’, would help confidence.[59] Reviewing the Chancellor’s proposed statement the following day, Richardson stressed that the target must not exceed 12 per cent and that, ‘consistent with your objective of lowering the rate of inflation’, should be lower the following year.[60] On 22 July Healey made his statement to the House of Commons, stating simply that

> ‘…monetary growth *should* amount to about 12 per cent. Such an outcome would be fully consistent with our objectives for reducing inflation. I repeat the assurances I have given that I do not intend to allow the growth of the money supply to fuel inflation either this year or next. If inflation and output move as now forecast I would expect the growth in money supply to be lower next year than this. [Emphasis added]’[61]

The Chancellor justified his phraseology to Richardson by arguing that he felt he had gone ‘a considerable way towards what [the Governor] wanted.’ His reasoning for not going further was that he

> ‘did not want to enter into commitments without being clear about the policy measures needed to meet them, and our ability to deliver them.’

[58] BOE: EID 4/700, C.W. McMahon, ‘Monetary Policy’, 26 September 1975; quoted in Needham, ‘Unhappy monetary policy’, 25.
[59] Ibid., Monck, ‘Note of a Meeting: A Monetary Target in the Package?’, 20 July 1976.
[60] TNA: T 386/116, Letter from Richardson to Healey, 21 July 1976.
[61] Parliamentary Debates (Commons), 915, 22 July 1976, 2010 – 2036.

The use of the word 'should' was a deliberate attempt to provide manoeuvrability and to prevent being forced into automatic corrective action if aggregates appeared to be deviating from the target.[62] The vagueness of Healey's announcement, with its lack of rigid commitment, had a double effect. Whilst serving to further valorise the 'money supply' as an aggregate which the authorities were attempting to control, the statement did not convince investors that the commitment was serious. Writing in the *Phillips and Drew Market Review* for August, Chris Anthony described how the fiscal promises of the 'July Package' were met with 'scant enthusiasm in both the gilt-edged and foreign exchange markets.' The market had calculated that with an estimated borrowing requirement of £9 billion, the money supply was certain to grow at a rate 'inconsistent with the Chancellor's aim of a sustained fall in the rate of inflation.' Confidence had not been restored by the package as a whole, with the money supply commitment providing little relief for the Government.[63] Furthermore, the Government's commitment to controlling the money supply was decidedly unconvincing in global markets. A letter sent from S.H. Broadbent at the 'United Kingdom Treasury and Supply Delegation' in Washington to Frank Cassell described the view:

'The Chancellor's public statements lay increasing emphasis on a 12% *target*, but amongst those who take an interest in these matters (ie the Wall Street Journal, a good deal of the foreign exchange market, and, to varying degrees a majority of the bank and business economists) our enthusiasm for targets is seen as lukewarm, our willingness to stick with them as slight, and the targets themselves as too high. [Emphasis added]'

[62] TNA: T 386/116, Letter from Healey to Richardson, 22 July 1976.
[63] Chris Anthony, 'Spending Cuts and the Money Supply', *Phillips and Drew Market Review*, (1976).

Broadbent stated that, regardless of the ‘intellectual basis of monetarist arguments’

‘…the fact remains that there seems to be some yearning for a clear, and probably too low, set of monetary targets as an element of our policies – coupled, of course, with some evidence that we will actually follow them.’[64]

In the following months it was acknowledged within the Treasury that the hoped-for 12 per cent growth in money supply had actually ‘assumed the properties of a target’, and that market expectations were aligned to the notion that the Government was attempting to achieve the 12 per cent rate or lower.[65] This was despite a deliberate effort on the part of the Chancellor to not commit to a rigid target. Failure to meet the 12 per cent figure would indicate to investors that the Government was failing to get a grip of the economic situation, and thus the authorities were required to operate as if the figure described was actually a fixed target. Treasury officials realised that in the financial markets the behaviour of the monetary aggregates, in relation to the nominal target, had come to be regarded as ‘an index of the “responsibility” of Government policy and hence ultimately of its credit-worthiness.’[66]

As the crisis continued throughout the remaining months of 1976 preparations got underway to secure an eventual $3.9 billion support package from the IMF. The painful wrangling over the terms of the loan primarily revolved around the extent of public expenditure cuts, with the Labour Cabinet deeply divided over the necessity,

[64] TNA: T 386/116, Letter from Broadbent to Cassell, ‘Monetary Targets’, 28 September 1976.

[65] H.M. Treasury Freedom of Information Disclosures <http://www.hm-treasury.gov.uk/foi_sterling_imf_2006.htm> [Henceforward HMT FOI]: File 60, Letter from Wiggins to Heigham, ‘Briefing for Chancellor’s Statement’, 14 December 1976.

[66] TNA: T 386/117, Letter from Britton to Hopkin, ‘Objectives for the Money Supply’, 17 November 1976; Letter from Hopkin to Britton, ‘Objectives for the Money Supply, 23 November 1976.

viability, and desirability of the deflationary measures being proposed. Yet a core component of the measures put in place by the Government securing the loan was a commitment – as in 1969 – to establishing a DCE target. It is widely asserted that the Government's IMF Letter of Intent established a commitment to a target for domestic monetary growth (£M3), yet this was not the case.[67] Healey announced in the Commons that

> 'the growth of sterling M3 is likely to be between 9 per cent and 13 per cent. It is too early to give an estimate for 1977–78. But our target will now be in terms of DCE, not M3.'[68]

Indeed, a note prepared for Healey's attendance at Cabinet in advance of his Commons announcement described how the IMF team was persuaded that an M3 target was not needed in addition to DCE, on the basis that having to observe two targets would be problematic.[69] However, in announcing a 'likely outcome' for £M3 Healey essentially reaffirmed the monetary 'target' set in July (DCE was simply derived from £M3 anyway). The Government had avoided committing themselves to a formal monetary target with the IMF, but Healey gave legitimacy to what was interpreted and expected by the financial markets to be a treated as a formal target range. In March 1977 the Governor informed the Chancellor that, despite the latter's continued reluctance to announce any formal commitment to £M3 growth, the constraint was already in place because the financial markets would react badly to growth above the 'likely' growth of 9-13 per cent – even if the formal DCE target was

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[67] Bank of England Freedom of Information Disclosures <http://www.bankofengland.co.uk/publications/foi/disc060519.htm> [Henceforward BOE FOI]: Document 4, Denis Healey, 'Letter of Intent', 15 December 1976.

[68] Parliamentary Debates (Commons), 922, 15 December 1976, 1534; Sterling M3 (£M3) is equal to M3 minus foreign currency deposits of UK residents with UK banks.

[69] HMT FOI: File 65, Letter from Bridgeman to Isaac, 'Cabinet 14 December: Monetary Policy', 13 December 1976.

being fulfilled.[70] In his memoirs, Healey described the deliberate decision to publish monetary forecasts and describe them as targets in order to 'satisfy the markets.'[71] In reality the emergence of targets was, as Bryan Hopkin has asserted, 'mostly luck.'[72]

With the established constraint of a fixed-exchange regime no longer in place, financial markets looked to the money supply as a measure for indicating the anti-inflationary, 'sound' policies of the Government. The Sterling crisis of 1976 was a critical juncture in which the newly formed market metric for measuring confidence compelled the resistant Chancellor towards moderate concessions, which were translated into formal targets by the rational and inevitable market response.

IV

The effect of having unwillingly established fixed monetary targets, which were given validity by the behaviour and expectations of the financial markets, was that the Government was required to publically demonstrate its long-term commitment to the targets. It became impossible for the authorities to cease operating according to targets because any attempt to abandon them would be seen by the markets as failure to commit to the action markets believed was required to control inflation. The Governor informed Healey in October 1977 that 'any appearance of resiling' from holding to monetary targets would cause serious damage to confidence.[73] Wass also conceded that 'it was no longer practical politics to contemplate abandoning monetary

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[70] TNA: T 386/118, 'Note of a meeting held in the Chancellor of the Exchequer's room, Treasury Chambers', 16 March 1977.
[71] Healey, *Time of my life*, 434.
[72] Hopkin, 'Freedom and Neccessity', 312.
[73] TNA: T 386/120, 'Note of a meeting held at 11 Downing Street – "Money supply, Exchange Rate Policies and Exchange Controls"', 11 October 1977.

targets.'[74] Targets were now 'locked-in' and irreversible. Furthermore, in line with the Chancellor's promise to eradicate inflationary pressures, it was thought that the markets were expecting the Government to set progressively lower yearly target ranges – regardless of other policy demands. The Governor was particularly keen, as in 1976, and attempted to persuade the Chancellor to commit to a percentage reduction on the previous 9-13 per cent target range for the financial year 1977/78.[75] Any attempt to *increase* the target range, regardless of any broader economic objectives, would send a damaging signal to the markets that the Government was uncommitted to a convincing anti-inflationary strategy.[76]

Yet the obligation to continue publically announcing nominal targets was significantly less onerous than the requirements of actually meeting them. By agreeing to adhere to the targets the Government accepted that action would be taken to ensure that they were not breached. From August until October of 1977, the success of the Government's attempts to maintain the stability of Sterling by signaling a domestic monetary squeeze had the unintended outcome of generating significant foreign inflows. As the inflows of foreign funds into the UK increased, so in turn did the rate of monetary growth.[77] The effect of the increase in £M3 was to shake confidence in the gilt-edged market as it seemed to signal that the authorities had been overwhelmed, giving the impression that the Government lacked the ability and will to take the necessary steps to fulfill its promised anti-inflationary agenda. There was

[74] TNA: T 286/271, 'Note of a meeting held in Sir Douglas Wass' room – Monetary Policy', 9 November 1977.
[75] TNA: T 386/118, 'Note of a meeting held in the Chancellor of the Exchequer's room, Treasury Chambers', 16 March 1977.
[76] TNA: T 386/119, Letter from Bridgeman to Isaac, 'Market Reaction to Package', 20 September 1977.
[77] Peter Riddell, 'Sterling policy threatening monetary target, say brokers', *Financial Times*, 28 October 1977; W. Greenwell & Co., 'Monetary Bulletin No. 69', August 1977.

evident frustration within the Labour Government as the markets were perceived to be over-reacting and misunderstanding the difference between domestic and 'inflow' generated monetary growth. Yet they were constrained by the targets. In a letter to the Chancellor, the Treasury Minster Denzil Davies expressed the view that

> 'we should do all we can do to keep M3 within the announced target during this financial year. It matters not, it seems to me, that the definition of M3 is arbitrary; that the commitment to the IMF is in terms of Domestic Credit Expansion (although everyone knows that DCE is irrelevant when a country is in a balance of payments surplus); and that an increase in the money supply caused by "printing money" may be of a different nature to an increase caused by inflows. All this, no doubt, is good stuff for a seminar. Unfortunately, those people who have the power to move large sums of money across the international exchanges believe, on the whole, that "money counts". The fact that it may not count as much as they think it does, seems to me to be somewhat irrelevant.'[78]

As described earlier, gilt-edged investors understood the practical use of monetary theory in an environment in which the authorities were seen to be acting to restrain monetary growth, allowing investors to predict the future course of interest rates. Essentially, if monetary aggregates were seen to be increasing beyond the Government's stated objectives investors could be sure that interest rates were likely to rise. In the wake of the failure of 'Competition and Credit Control' the authorities had developed the 'Duke of York Strategy', which acknowledged that the demand for gilts peaked when long-term interest rates were believed to be at their highest – meaning that the price of the stock was at its lowest and could only increase as long interest rates were inevitably reduced over the medium-term. If the authorities could engineer a situation of this kind they would be able to ensure a successful sale of

[78] TNA: T 386/120, Letter from Davies to Healey, 'Monetary Prospects', 27 October 1977.

Government debt.[79] The task of investors and their brokers was to predict when interest rates were at their peak in order to ensure the greatest capital return on their investment. 'The Duke of York Strategy' gives the appearance that the authorities were able to establish a situation amenable to their funding programme, and thus investors were simply following the authorities' lead. Yet there was a fundamental communication problem in this strategy which meant that the authorities were unable to freely announce when long-term interest rates were at their peak, because under a system of monetary targeting it remained up to gilt-edged brokers, looking after the interests of their clients, to decide when they have peaked. As a result, the behaviour of gilt-edged investors could force interest rate changes on the Government by refusing to purchase stock until they believed that rates were actually at their highest.[80] Hall has described this as holding Government 'to ransom.'[81]

This process regularly took place under the post-1976 system of monetary targets. In late 1977, as £M3 grew beyond the intended 9-13 per cent annual rate, gilt-edged investors predicted that interest rates would have to increase to halt monetary expansion, and given that an interest rate hike was inevitable, the rational investment decision would be to hold-off from buying gilt-edged securities until rates peaked. The result was that market demand dried-up completely, establishing a situation which forced the Government to borrow directly from the banking system. In response the Government was forced to raise MLR from 5 per cent to 7 per cent in order to meet the expectations that rates would go up – resulting in a large scale

[79] Hall, 'From Keynesianism to Monetarism', 101 – 102; TNA: T 386/406, 'Transcript from BBC2, The Money Programme', 28 February 1979.
[80] Bank of England Archive <http://www.bankofengland.co.uk/about/Pages/history/bank_history.aspx>: Letter from Fforde to Governors, 'Some Obiter Dicta, Old and New, on the Gilt-edged Market', 13 June 1978.
[81] Hall, 'Policy Paradigms…', 285; Ibid., 'From Keynesianism to Monetarism', 102.

selling operation.[82] This was accompanied by an ‘uncapping’ of the exchange rate.[83] In other words, the market had collectively decided (not through conspiracy, but in accordance with rational investor behaviour guided by the influential advice of a handful of brokers) to not purchase gilt-edged stock until rates reached a certain level, thus forcing-up interest rates regardless of whether the Government had intended to do so in the first place. The result was a system in which gilt-edged investors, acting rationally, could impose favourable investment conditions on the authorities. Under the post-1976 system of monetary targeting this process of pushing up interest rates to ensure that the PSBR could be met became endemic.[84]

In July 1977 the Labour minister Harold Lever had identified that gilt-edged strikes would become a protracted problem under monetary targets, and that interest rate volatility would wreak havoc on the real economy. In a note sent to Callaghan, Lever acknowledged that

> ‘when we commit ourselves to fixed monetary targets, we commit ourselves to accepting the rates of interest determined by the market in absorbing the required amount of gilt-edged stock. These rates depend crucially on market expectations and the only control we have over them arises from any ability we have to affect these expectations. Without such ability we would be obliged to accept interest rates however high or unstable and whatever their consequences for exports, unemployment, finance for industry and housing costs.’[85]

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[82] ‘The Monetary Targets’, *Financial Times*, 23 December 1977; Chris Anthony, ‘Gilt-edged’, *Phillips and Drew Market Review*, December 1977.

[83] TNA: T386/270, Letter from King to Odling-Smee, ‘Study of Macroeconomic Problems and Policies: Monetary Policy’, 5 May 1978.

[84] Healey, *Time of my Life*, 397; Capie, *Bank of England*, 670; Keegan and Pennant-Rea, *Who Runs the Economy*, 133.

[85] TNA: T 386/118, Letter from Lever to Callaghan, ‘Interest Rates and the Money Supply’, 22 July 1977.

He argued that the solution was to establish a formal interest rate policy which would clearly and unequivocally inform the markets when interest rates were at their peak, handing the initiative back to the Government. This would serve to align correctly investor expectations with the Government's aims, rather than allowing the gilt-edged market to determine rates.[86] This proposal fell on deaf ears, largely because it was incompatible with the logic of monetary targets.

In early 1978 the process re-ignited as gilt-edged demand dried up once more. Callaghan confided in Tony Benn, then Secretary of State for Energy, that there was 'a lot of funny business going on between the City of London and the Government over the gilt-edged market. The City are not buying gilts in an effort to force us to push up interest rates'.[87] The response of the Governor was to press for an increase in MLR up to 10 per cent, though Wass and Couzens at the Treasury were doubtful that such an increase would be sufficient.[88] By early June, as high money supply figures fed on themselves through depressed gilt-edged demand, Richardson became equally pessimistic that monetary policy alone could revive confidence. Only monetary measures of 'exceptional severity' could be relied upon – a prospect which encouraged Healey to look into taxation measures and the re-imposition of the corset on bank lending as means of bringing monetary growth under control.[89] Despite exhortations not to increase rates, nor to impose a strict 'corset' from Lever – favouring instead an attempt to communicate directly with investing institutions – it was emphasized by Richardson that there were 'greater risks to activity and

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[86] Ibid.
[87] Benn, 'Tuesday 23rd May 1978', *Conflicts of Interest*, 305.
[88] TNA: T 386/270, 'Note of a meeting held at No. 11 Downing Street – Financial Markets', 17 May 1978.
[89] TNA: T 386/280, Letter from Lever to Healey, 'The meaning of 27 per cent annualised growth of £M3', 25 May 1978.

employment if confidence was not restored.'[90] Once MLR was eventually raised to 10 per cent, and the 'corset' on bank lending reintroduced, *Rowe & Pitman* chronicled an 'immediate euphoric response' in the City which 'enabled the Government broker to enjoy a concentrated spell of substantial funding sales.'[91] The process occurred yet again in November 1979 when, under the new Conservative Chancellor Sir Geoffrey Howe, MLR was increased to 17 per cent in what Kit McMahon described as going 'for overkill in interest rate terms' in order to sell-gilt edged stock.[92]

Writing in the *Phillips and Drew 'Market Review'* in February 1979, the analyst Chris Anthony described the gilt-edged 'stop-go cycles' which had been taking place since 1976:

'In recent years it has become a feature of the UK financial system that market pressures have at times persuaded the authorities to introduce measures of either a fiscal or monetary nature, whether or not strict economic considerations initially dictated such moves. What might start out as a pessimistic view held by only a small minority on, for example, the outlook for the money supply may eventually develop into a majority opinion causing a 'funding deadlock' in the gilt-edged market. Consequently, a market faced with reasonably favourable medium-term prospects shifts rapidly into one locked in a self-perpetuating downward spiral where a decline in the level of official stock purchases by the non-bank private sector leads to a deterioration in the monetary background and heightens further the general degree of pessimism. As a result the authorities are forced to introduce measures, often containing a significant degree of 'overkill', to break the funding impasse.'[93]

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[90] TNA: T 286/270, 'Note of a meeting held at No. 11 Downing Street – Monetary Situation', 6 June 1978.
[91] Quoted in Kynaston, *The City of London*, 555; Grant, *Business and Politics*, 78; Chris Anthony, 'Gilt Edged', *Phillips and Drew Market Review*, June 1978.
[92] Capie, *The Bank of England*, 701.
[93] Chris Anthony, 'Gilt-Edged Stop-Go Cycles', *Phillips and Drew Market Review*, February 1979.

Throughout the remaining years of the Labour Government perennial attempts were made to try to extricate the Government from the bind imposed on it by this process. In his February 1978 speech to the 'Johnian Society' Douglas Wass publically pleaded with the financial markets, stressing that investors should not overemphasize the monetary targets – placing them instead within the context of the Government's wider economic strategy.[94] Interestingly, Wass' speech was delivered less than a week after the Governor's 'Mais Lecture' which had extolled the virtues of 'practical monetarism' in providing 'one element of stability in a turbulent world.'[95] Meanwhile, within the Downing Street Policy Unit, Bernard Donoughue promoted new methods of gilt-edged market management which might produce 'a more even flow of gilt sales' – such as index-linked gilts and tender selling. These were rejected by the Bank on the basis that they could signal a lack of commitment on the part of the Government to controlling inflation, and that the market might be disturbed by any changes to the current structure.[96] The failure to overcome the problem ensured that the Labour Government was exposed to recurrent gilt-edged crises throughout its remaining period in office.

V

The decade prior to the election of the 1979 Conservative Government saw significant adjustments towards a form of British 'monetarism' embodied in the evolution of monetary targeting. This process of change was not the product of an intellectual conversion, nor was it a coherent package forced upon the Labour Government by monetarist ideological fervour within financial markets. Instead we see that after 1968

[94] 'Governor's philosophy', *Financial Times*, 10 February 1977, 16.
[95] Peter Riddell, 'Treasury head's plea on money supply targets', *Financial Times*, 15 February 1977.
[96] Kynaston, *The City of London: IV*, 555.

financial markets came to believe, understandably, that the Government was operating a ‘money supply’ policy, which ensured that investors started to align their investment decisions and expectations with the behaviour of the ‘money supply’. Furthermore, set against the background of vast inflationary pressures and the collapse of the global fixed-exchange rate regime after 1973, financial markets came to attach considerable value to the ‘money supply’ in employing it as a yardstick with which to measure the Government’s commitment to counter-inflationary action. This was bolstered by the eagerness of the post-1974 Labour Chancellor to use the ‘monetarist’ interpretation of the ‘great inflation’ for political and rhetorical purposes.

As confidence in the Government waned during 1976 the pressure for a public monetary target to demonstrate fiscal and monetary integrity proliferated. In an attempt to retain policy autonomy Denis Healey resisted these formally-announced targets, yet in announcing intended monetary outcomes he unintentionally provided figures which the markets adopted and interpreted as if they were targets. The result of this market-formalization was to impose significant constraints on the Government’s economic policy, through fears of losing confidence in the foreign exchange markets; and by allowing gilt-edged investors the liberty to determine interest rates. By 1979 the Government had ceded a large degree of its macroeconomic policy autonomy to the dominance of financial indicators centred on the monetary aggregates. In an attempt to retain favourable money supply figures the Government was left exposed to the short-term volatility of domestic and international investors, which in turn ensured that macroeconomic management became increasingly problematic.

This account highlights the contingent and often-unintended nature of the macroeconomic policy changes which took place during the 1970s, which were the product of interests, ideas, and market expectations operating within the changing global and domestic structures which governed the relationship between the authorities and the markets. It poses a strong challenge to notions of intentionality in economic policy-making, and undermines the simplistic ideological accounts which have tended to dominate popular interpretations of the British ‘monetarist’ moment. However, the fundamental dynamic which underpinned this process was the emergence and imposition of a new financial discipline on the State which served to replace the collapsed strictures of the fixed-exchange rate regime. This new framework was not designed as a coherent strategy for maintaining exchange rate stability and insulating national economies from uncontrolled international capital movements, but was chaotically imposed by the behaviour of increasingly globalized, liberalized and highly-capitalized financial markets seeking a new metric of Government ‘performance’ and ‘credibility’.

What can this account tell us about the ‘Thatcherite monetarism’ which was to follow? The influence of ideological monetarism on senior Conservative politicians (e.g Sir Keith Joseph) is certain. Furthermore, the convenient relationship between the PSBR and the money supply which justified radical curtailments to government expenditure (whilst also to abandoning controls on bank lending) was undoubtedly influenced by a free-market intellectual tradition within the Tory Party. Yet one must be conscious that when the Conservatives entered Government in 1979 they faced the intractable problem of managing a large budget deficit within volatile markets reacting to short-term economic data and short-term monetary targets. In this context, it is possible to interpret the 'Medium Term Financial Strategy' after 1980 as a strong signal designed to assure investors in the financial markets of the Government's medium-to-long-term commitment to constraining monetary growth (and hence inflation), whilst also serving to re-structure the time horizon of policy to force investors to assess successful monetary control in the long- rather than the short-term.

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