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When rules started to rule: the IMF, neo-liberal economic ideas and economic policy change in Britain

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ABSTRACT

This article reassesses the neo-liberal shift within British economic policy-making and the international political economy, focusing especially the role of the International Monetary Fund (IMF) in the 1960s. The IMF has always used the conditions attached to its lending to try and shape borrower's policy; here we explore the evolving content of that conditionality and the economic ideas underpinning it. Using recently released IMF records, as well as other archives, we argue that the negotiations between the IMF and the UK Government in the 1960s can be seen as part of the Fund's drive towards a crucial change from discretionary to rules-based approaches to macroeconomic policy making. This drive took place within a struggle over a specific policy instrument, domestic credit expansion (DCE), at that time regarded as an important measure of monetary policy. The article locates the IMF advocacy of DCE within an attempt by the Fund to constrain discretionary policy-making through increasingly specific and binding rules. In response, UK Government officials began to pre-empt and even deceive the Fund to avoid being tied down. Our analysis unpacks *which* neo-liberal economic ideas the Fund embraced, noting its rejection of monetarism. In the period charted here (1965–69), the rules-based regime remained compatible with Keynesianism. However, the UK Government's grudging acceptance of this approach provided a crucial condition of possibility for a significant qualitative shift in macroeconomic policy-making when rules later became infused with an increasingly neo-liberal character.

KEYWORDS

International Monetary Fund (IMF); United Kingdom; Keynesianism; monetarism; rules versus discretion.

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INTRODUCTION

This article reassesses the nature of the neo-liberal shift in the international political economy, and especially the role of the International Monetary Fund (IMF) in that process of ideational change, since the 1960s. Our exploration of the changing content of conditionality within IMF stand-by agreements attached to loans to the United Kingdom addresses the important issue of *which* economic doctrines underpinned IMF conditionality in its relations with the UK, and how these ideas were evolving in the 1960s and 1970s. It further elucidates under what conditions the IMF can influence domestic economic policy ideas.

The 1980s have been seen as the era when market fundamentalists took over the IMF, 'purging' more Keynesian-oriented economic analysis (Stiglitz, 2002; Cox, 1987). Our more fine-grained analysis unpacks *which* economic ideas within the 'neoliberal continuum' (Chwieroth, 2010: 84) were embraced by the Fund, and when this took place. Close inspection of the archival records in Washington, DC, and London concerning UK/IMF relations and negotiations reveals that, contrary to popular mythology (Baer and Kerstenetzky, 1964; Harvey, 2005: 24; Hay, 2001: 209; Taylor, 1987), the IMF did not embrace 'monetarism' in the 1960s and 1970s. We use this UK case study to support the argument that the key shift in the nature of macroeconomic conditionality in the Fund from the 1960s onwards was not about monetarism 'versus' Keynesianism. The more significant, much longer-lasting, though less emphasized neo-liberal shift in economic ideas and policy instrumentation, and the main substantive focus here, is the move from discretionary to rules-based macroeconomic policy-making. The analysis below demonstrates that the IMF surveillance and conditionality regime was moving from accepting vague UK Government pronouncements on policy direction (notably in addressing the payments balance problems central to successive stand-by arrangements in the 1960s) towards tougher negotiating stances insisting upon greater use of increasingly specific, binding rules and trigger clauses (reaching a specified level of, for example, balance of payments deficit or public sector deficit automatically 'triggered' a policy change or response).

Some existing constructivist accounts of economic ideas within the IMF draw on sociological institutionalist insights to explain the dominance of particular ideas via institutional norms (Babb, 2007; Barnett and Finnemore, 1999, 2004; Chwieroth, 2008). As a methodological complement to these, we adopt a political sociology of policy instruments approach (Lascoumbes and Le Galès, 2007), analysing the assumptive foundations of policy instrumentation which facilitates 'seeing like the IMF' (Broome and Seabrooke, 2007; Broome, 2010; also Thirkell-White, 2005). We focus on one specific policy instrument, the monetary aggregate of 'domestic credit expansion' (DCE), which played a crucial role in UK/IMF negotiations in the 1960s. This allows us to drill down into the policy negotiation process to establish an 'endogenous' account (Blyth, 2002: 8) of economic ideas and policy change within UK/IMF negotiations. Such an approach and method helps address key questions facing ideational IPE scholarship – namely *how* and *why* particular economic ideas, and the policy instruments that flow from them, get selected.

Drawing on IMF archival materials only recently made available, and on UK Government sources in the National Archive, this article deploys a close reading of these primary historical sources to analyse UK monetary policy-making and UK/IMF conditionality negotiations. Many scholars highlight crises as key catalysts of transformation, with actors seeking different solutions to problems at times of crisis as extant economic ideas and approaches lose their capacity to explain events (Blyth, 2002: 34–45; Hall, 1993: 280–1; Hay, 2001: 193–218; Broome and Seabrooke, 2007: 596). Recognizing the key role played by crisis in changing attachments to economic ideas, ours is a diachronic research design analysing the UK's two IMF stand-by arrangement negotiations as British economic policy elites navigated the build up to and aftermath of the devaluation crisis of 1967. This detailed study of the UK case is revealing of the intellectual building blocks of the IMF approach, and the core IMF theoretical and operational economic policy ideas 'in play' within those negotiations. Our diachronic account of UK monetary policy-making involves the IMF as key protagonist, and throws into relief its crucial role in instigating change in the UK economic policy regime. In the UK case, the evolution of IMF conditional lending practices involved the introduction of new policy instruments, linked to unfamiliar (in the British context) economic ideas which heralded a new approach to macroeconomic policy. While some underlying doctrinal differences between the IMF and UK remained concerning policy autonomy, the appropriate policy instruments, and the desirability of an increasingly restrictive rules-based approach to managing economic policy, the IMF in the 1960s used advocacy of DCE to attempt to tie the UK Government to a rules-based regime.

The particularities of the British economy, and of sterling's role within the post-war international monetary order, mean that we should be careful not to extrapolate too readily from UK experience.[1] That said, given that DCE was embedded in a set of standard operating procedures of IMF financial programming which were formalized and rolled out to all member countries in the 1968 normalization of IMF conditionality mechanisms and treatment of all its members,[2] these findings are indicative of broader dynamics of IMF influence on economic policy ideas within the world economy.

UK/IMF CONDITIONALITY AND ECONOMIC IDEAS

A body of recent IPE literature, much of it constructivist, focuses on how the IMF can act as a source of economic ideas which shape behaviour and outcomes in the world economy (Babb, 2007; Best, 2005; Chwieroth, 2007, 2010). Our contribution is to offer an in-depth account of which economic ideas became influential in the IMF–UK case from the 1960s onwards. Furthermore, we set out in detail the conditions under which the IMF was able to wield this ideational influence. The economic ideas under discussion here operate at two different levels which Campbell distinguishes as 'programmatic' and 'paradigmatic' economic ideas (Campbell, 1998: 386–92; also Schmidt, 2008: 306–07). Thus, first, there are 'programmatic' or operational economic policy ideas used by the IMF and member country economic policy elites in day-to-day policy-making. Second, there are 'paradigmatic' ideas, rooted in theoretical debates within economics – such as Keynesianism 'versus' monetarism. These are discussed in the next section. In relation to both, this article demonstrates the merits of deploying a political sociology of policy instruments approach in explaining *which* ideas get prioritized, why, when and how?

Some existing studies of economic ideas in the IMF have highlighted the pertinence of sociological institutionalism's emphasis on institutional norms in establishing the parameters of legitimate and appropriate policy-making (Barnett and Finnemore, 1999; Chwieroth, 2008; Lombardi and Woods, 2008). Actors within institutions act on the basis of institutional norms, rules, understandings and routines that 'define appropriate actions' (March and Olsen, 1984: 741; 1989: 21–6; Peters, 1999: 30). Institutions shape their participants, supplying 'systems of meaning' enabling institutions to express a 'logic of appropriateness'. Through processes of socialization, actors come to understand appropriate and inappropriate behaviour within 'the parameters established by the dominant institutional values' (Peters, 1999: 29–30). Compatibility of economic ideas with these established institutional norms and practices explains how and why particular ideas achieve enduring impact. Whilst not adopting the terminology of sociological institutionalism, Broome and Seabrooke think along similar lines highlighting the importance of seeing institutional change 'through the eyes of the IMF' (Broome and Seabrooke, 2007; Broome, 2010) to an adequate grasp of the nature of IMF interactions with member countries.

Inspired by both the above approaches, here we seek to 'drill down' into UK/IMF conditionality negotiations and the policy process they focus on. Blyth notes that an 'endogenous' account must be constructed to establish which ideas get prioritized and why. Such an explanation explores 'how agents redesign and rebuild institutional orders, and the conditions under which these activities take place' (Blyth, 2002: 8). It is the operationalization of this insight which motivates the deployment here of a method complementary to sociological institutionalism, the political sociology of policy instruments approach. This enables us to understand and demonstrate how policy instruments entail particular understandings, consistent with the above institutionalized norms, of policy problems, policy solutions, and the policy process. Policy instruments, Lascoumes and Le Galès argue, 'structure public policy according to their own logic' and constitute a 'condensed form of knowledge about social control and ways of exercising it' (Lascoumbes and Le Galès, 2007: 1); they are 'bearers of values, fuelled by one interpretation of the social and by precise notions of the mode of regulation envisaged' (p. 4). The definition and interpretation of the issue which the policy instrument addresses, shaped by institutional norms, needs to be unpacked in terms of the 'construction of agreed realities' (Lascoumbes and Le Galès, 2007: 10; Callon, 1986).

Methodologically, to grasp the operational policy ideas, and the instruments to operationalize them, it is important to understand their specific policy environment – what these ideas were for and how they were designed. Policy instruments deal with specific policy issues in a very particular manner. Such an 'endogenous account' helps us piece together the IMF's selection process for economic ideas. Often this is because they meet organizational needs (Barnett and Finnemore, 2004: 45–72; Woods, 2006: 69). Crucial to this policy environment, and discussed in a later section, is the conditionality which came to accompany IMF lending.

THE RISE OF NEO-LIBERALISM WITHIN THE IMF – *NOT* FROM KEYNESIANISM TO MONETARISM, BUT FROM DISCRETION TO RULES

The second type of economic ideas 'in play' in IMF interactions with member countries' economic policy elites are 'paradigmatic' economic ideas (Campbell, 1998: 386–92; also Schmidt, 2008: 306–07) rooted in theoretical debates within economics – such as Friedman (1959, 1968, 1969) or Johnson's (1972) monetarist assault on Keynesianism and the neo-classical synthesis. Analysing the policy environment and policy debates within which DCE arose in UK/IMF negotiations unearths important aspects of the origins of the new emphasis on monetary aggregates within IMF Conditionality. In so doing, it refines our understanding of the much discussed neo-liberal shift in dominant political economic orthodoxy within international financial institutions by allowing us to delineate more precisely which neo-liberal economic ideas were adopted.

Best has explored the gradual 'hollowing out' of the Keynesian ideas and norms which had informed the original Bretton Woods agreement, and their replacement with the neoclassical synthesis (Best, 2004: 384; 2005: 87–116). This article both builds on and engages with Best's work, exploring UK/IMF conditionality negotiations to understand one particular significant episode in this 'hollowing out' process in more detail. On the issue of policy autonomy, which we argue below is an absolutely crucial dimension of IMF–UK conditionality and its evolution in this period, our findings align with Best's 'hollowing out' thesis to a significant degree. We note an increased rigidity of mechanisms of adjustment (Best, 2005: 88, 111), and greater reliance on quantitative approaches (Best, 2005: 94) within the IMF's increasing enthusiasm for rules-based adjustment from the late 1960s. We demonstrate below that the IMF was not particularly successful at constraining UK discretionary policy-making in this period. However, over time, the degree of autonomy afforded to governments in pursuit of demand management was eroded. Keynes' emphasis on enabling domestic macroeconomic policy autonomy (reflected in his desire for automaticity of borrowing from the Fund), allowing all governments to pursue their own 'favourite experiments' is clearly at odds with the rules-based shift in IMF policy approach to the UK that this article charts.

Yet we also find areas of disagreement with Best's account. Notably, we reject her notion of a partial embrace of monetarist ideas within the Fund in the 1960s and 1970s, and her claim that, ultimately monetarist ideas were crucial to the defeat of the neo-classical Keynesian synthesis within the IMF (Best, 2005: 92–5). There is no accepted definition of monetarism, but three key elements can usefully be distinguished (Laidler, 1981; Hoover, 1984). First, monetarists stress rules for *sustaining* stability, not restoring the economy to full employment, on the assumption that in a stable, non-inflationary environment, the economy will always tend towards full employment. Second is the monetarist axiom that in the long-run the growth of the money supply is what determines the rate of inflation, and therefore macroeconomic stability. Third is the belief that in pursuing monetary (and other) policies, the authorities should use fixed rules, not exercise discretion. This latter point is today linked with the complex theoretical developments in the 'new-classical economics' which became influential within the Fund in the 1980s (Boughton, 2004: 17; Chwieroth, 2010). However, the idea long predates these developments, resting on 'the much more down-to-earth proposition that we are too ignorant of the structure of the economies we live in and of the manner in which that structure is changing to be able safely to implement activist stabilisation policy' (Laidler, 1981: 19).

It is only on the specific issue of rules based approaches that IMF advocacy of DCE appears similar to monetarist thinking. Yet, on closer inspection even this apparent point of connection is deceptive. The DCE monetary targets were nothing like the fixed policy rules of Friedman's policy engineering approach. DCE and other targets were not fixed and rigid limits, they were estimates or forecasts, and they were renegotiated frequently. Thus, even here, the IMF approach to rules was less rigid than monetarists would have desired. Best's claim that 'the Fund thus developed a particular hybrid of Keynesian neoclassical synthesis and monetarist approaches to payments imbalances, combining demand management with a set of targets that relied on controlling the money supply' (Best, 2005: 95, 95–6, 101–03) mis-specifies the origins of the monetary aggregates within IMF conditionality and overstates the role of monetarism within Fund thinking and practice. Highlighting the insulating role of institutional culture from the evolution of economic ideas within academia, IMF historian James Boughton argues that monetarism 'had less impact on the IMF than on the economics profession at large, and its influence was felt primarily in efforts made to examine and ultimately to reject it' (Boughton, 2004: 15).

Given that DCE is a monetary aggregate, and that these became integral to 'monetarist' policy debates and practices in the 1970s and 1980s, it is tempting to interpret the debate over DCE as representing the struggle between 'monetarism' and 'Keynesianism' (Hall, 1993; Hay, 2001), or as a precursor to that struggle.[3] Yet Boughton terms the IMF in this period 'a Keynesian institution' (Boughton, 1997: 8–9, 2004: 13–16; de Vries, 1987). The Keynesian training of the economists who joined the Fund in the 1940s and 1950s continued to shape IMF approaches until their retirement in the 1980s (Chwieroth, 2007: 14–18; 2010). Accordingly, the emphasis on and use of monetary aggregates in IMF surveillance and conditionality continued to have Keynesian roots in the 'absorption' approach to the balance of payments (Alexander, 1952) and the Polak model (Polak, 1957, 2001).

Best rightly points out that neo-classical synthesis and monetarism were on opposite sides of a battle of economic ideas (Best, 2005: 92–3; Chwieroth, 2010: 74–5; Blyth, 2002: 139–43). We demonstrate below that the Fund's approach to monetary policy remained on the Keynesian as opposed to the monetarist side of that ideational divide (Boughton, 1997, 2004; de Vries 1976: 363–9, 1987: 30). Thus whilst we agree that the economic ideas 'in play' were a Keynesianism influenced by the neo-classical synthesis, IMF and UK policy elites remained Keynesian in their appreciation of inherent market instability, and of the need for state intervention and demand management to secure full employment.

Furthermore, these policy elites had not lost sight of Keynes' insight about the 'intersubjective nature of speculation' (Best, 2005: 111), nor 'Keynes' self-reflexivity about the impact of economic ideas upon market behaviour' (Best, 2005: 93). The 'signalling to an international audience' (Broome and Seabrooke, 2007: 577; Lombardi and Woods, 2008: 733) aspect to UK–IMF relations was crucially important in the 1960s. As the empirical analysis below demonstrates, UK policy elites were Keynesian in their appreciation of the psychology of financial markets regarding IMF seals of approval, and sceptical about the long run perfectibility of market information and indeed markets. For all these reasons, it is certainly necessary to reject any mooted embrace of monetarism. It is also important not to overstate the erosion of Keynesianism in this period. Although a process of 'hollowing out' Keynesian norms had begun in the 1960s (Best, 2004, 2005), the enduring hold of Keynesian thought within the IMF and amongst UK policy elites meant that, in relation to UK–IMF relations and conditionality at least, the process was not very far advanced in the mid-to-late 1960s.

IMF teams advocating DCE in the late 1960s also consistently emphasized the crucial role of statutory incomes policy in containing inflation (de Vries, 1976: 368), a policy reviled by monetarists (Laidler, 1981: 20–1). The broad consensus shared by IMF and UK negotiators in the late 1960s rested decidedly on the Keynesian, rather than the monetarist side of the fence. Both IMF and UK elites shared the view that full employment was still a central policy goal and that demand management and 'activist stabilisation policy', using a wide variety of means, were crucial to achieving it, given the inescapable instabilities of a market economy; in that sense it was anathema to monetarism. We argue that the doctrinal dissonance between UK policy elites and IMF staff detailed below was *not* between the Keynesian approaches of the former and monetarist approaches of the latter. Rather, the crucial disagreements between the IMF and the UK Government were over the extent to which it was appropriate for IMF stand-by agreements to constrain domestic policy autonomy over economic management using economic policy rules.

There were minor disagreements *within* the Keynesian–neo-classical synthesis about the degree of emphasis on maintaining full employment and efforts to keep inflation down. Both sides of the debate – Polak for the IMF, and the UK Chancellor – operated *within* an 'embedded liberal' (Ruggie, 1982) approach to activist macroeconomic policy, demand management, and full employment. Thus the IMF in the 1960s used policy instruments such as DCE to attempt to tie the UK Government to the mast, but that Government was still plotting a Keynesian course of macroeconomic policy. Neo-liberal economic ideas in general became more influential within the Fund, particularly from the 1980s onwards as the generation of post-war Keynesian IMF economists retired (Chwieroth, 2007). However, monetarist ideas specifically were not embraced as part of the IMF's neo-liberal drift (Boughton, 2004: 15–16; de Vries, 1987: 30).

IMF–UK RELATIONS AND THE POLICY ENVIRONMENT OF CONDITIONALITY

Conditionality was a contentious issue at Bretton Woods. Keynes and the British wanted close to automatic access to the Fund's resources, the Americans substantial conditionality. The American viewpoint was not embodied in the original Agreements but was introduced and developed through the 1950s, reflecting the dominance of the USA within the organization (Dell, 1981; Ferguson, 1988: 198–227). In 1952 the stand-by arrangement became the standard form of IMF borrowing, with conditions toughening as the amount borrowed increased, minimal in the first credit tranche, increasing substantially from the second to fourth tranches (Gold, 1970; Ferguson, 1988: 200–01). Such technocratic, operational policy ideas are shaped by the norms and logics of appropriateness outlined above. The IMF developed techniques and frameworks for analysis to perform its surveillance role and to help borrowing countries address balance of payments adjustment issues through stand-by agreements negotiated with Fund staff.

From the late 1950s, with conditionality already being applied to developing countries (the main borrowers in this period), but not yet to developed countries, disquiet about unfair treatment grew. One important innovation was developed by the IMF economist (and negotiator with Britain in the 1960s) Jacques Polak. Polak's key IMF Staff Paper, where the concept of DCE originated, set out the Polak model (Polak, 1957). This was partly designed to facilitate developing 'fair' and 'objective' criteria for implementing conditionality, by ensuring equal application of the Fund's collective will to all member countries (Polak, 1997: 4). It started with the then widely used 'absorption' approach to the balance of payments, which analysed payments surpluses and deficits as the consequence of disparities between income and output in a national economy; current account deficits therefore reflected domestic expenditure exceeding domestic output. To be empirically viable such analyses required reliable National Income data, and in most of the underdeveloped countries with which the IMF dealt, such data was not available in systematic form. Such countries, however, did usually have balance of payments and monetary data. Hence Polak sought to develop a simple way of analysing the payments position of such countries, and came up with DCE, which was defined as the expansion of domestic credit, plus or minus the current account payments position.

DCE was intended to be a simple, summative number which, in Polak's words, could be used 'with pencil and paper' (Polak, 1957: 6). De Vries notes how the emphasis on monetary ceilings reflected 'practical considerations' such as the presence of a credit policy framework in all member countries, and the existence of statistical information on monetary flows (de Vries, 1976: 363). These evolved into standard operating procedures (de Vries, 1987). IMF teams working in Latin America from the 1950s had long deemed it appropriate to deploy monetary aggregates in this way (Babb, 2007: 145–7; de Vries, 1987). These approaches 'became almost standard practice' in relation to stand-by agreements, initially in Latin America, but then for members in all regions (de Vries, 1976: 364, 365). Polak's paper, then, originated as a very specific solution to the Fund's problems in designing policy measures for poor countries. In the mid-to-late 1960s, the techniques for securing balance of payments adjustments in the context of stand-by agreements trialled on Latin American members in 1950s (Babb, 2007; de Vries, 1987) were rolled out for all in the 1968 normalization of IMF treatment of all its members.[4]

Crucial to our 'endogenous' account of economic ideas and policy change is the fact that economic policy flowed from a complex and repeated process of UK/IMF negotiation. Because of regular borrowings, and frequent interactions, UK/IMF relations were a 'repeated game' from the 1950s to the 1970s. UK politicians and officials became very familiar with IMF preferences and opinions in relation to particular policies. This 'feedback loop' makes it difficult to discern the precise degree of Fund influence:

> we knew what policies would be acceptable to [the Fund]; and when framing our policies we knew that we wished to make a drawing from the Fund. In these circumstances the distinction is a little subtle between submitting our policies for the Fund's approval and choosing policies we knew the Fund would approve.[5]

Thus there are 'fund friendly policies' (Broome and Seabrooke, 2007), whose status emerges through mutual learning and socialization *within* successive rounds of consultations and negotiations between IMF and UK policy elites (also Lombardi and Woods, 2008: 718–19; Barnett and Finnemore, 1999).

Another forum for this learning and socialization, which gives a good indication of the economic ideas in play within UK/IMF negotiations, was a one-off joint IMF/Treasury/Bank of England seminar on monetary theory in London in October 1968.[6] The proceedings of the London seminar indicated that a relatively small part of the spectrum of theoretical views about the efficacy of monetary policy covered most British and IMF policy-makers. Most Treasury and Bank speakers showed little hostility to the broad thrust of Polak's case for using DCE as a policy instrument, focussing their comments on more detailed, operational issues.[7] As one UK official put it, if one looked at the 'general arguments about the importance and utility of monetary policy in economic management. On this issue the Fund are by no means extreme'.[8] There was some pragmatic scepticism about DCE in the Bank of England, the Treasury and amongst economists (Artis and Nobay, 1972: 570; Governor of the Bank, cited in Johnson, 1972: 583–4). Overall, though, IMF economists such as Polak on one side, and British government advisers on the other, were part of a professional consensus encouraged by officially sponsored contacts between the IMF and Treasury economists (Cairncross, 1997: 330, 352), which was shifting towards accepting the importance of money in the 1960s.

The economic ideas informing these 'Fund friendly' policies were somewhat insulated – by the nature of consultations, and by the Keynesian institutional culture discussed above (Boughton, 1997: 8–9, 2004: 13–16; de Vries, 1987) – from academic economics debates. Consistent with our political sociology of policy instruments approach, these Keynesian assumptive foundations informed IMF policy instrumentation from the 1950s to the 1970s. The Polak model was grounded in Keynesian economic assumptions about the roots of balance of payments reflecting imbalances in expenditure and output within a national economy. Hence, DCE was rooted in that Keynesian paradigm. Polak's paper, addressing the Fund's problems in designing policy measures for poor countries, was grounded in an attempt to 'internationalize' Keynesian concepts. It was a foundation stone of the IMF's monetary approach to the balance of payments, in turn a key part of the revival of monetary analysis of macroeconomics in the 1960s and 1970s (IMF, 1977). Crucially, though, as Polak later pointed out, there were in fact *two* monetary approaches to the balance of payments – a Keynesian inspired IMF version, and a Chicago School 'revolutionary' approach (Polak, 2001). The Polak model, the IMF monetary approach, and DCE within them, sat on the Keynesian side of the fence dividing economic theory between Keynesian and monetarism.

Accordingly, the financial programming and stabilization approaches bound up with stand-by agreements which grew out of the Polak model retained that same Keynesian character, rooted in those same Keynesian understandings and assumptions about markets and economic policy. DCE evolved out of internal organizational norms, practices and standard operating procedures (the Polak model, and the IMF's monetary approach to the balance of payments), that were largely *unrelated* to external academic economic ideas, and certainly not rooted in monetarism. Whilst DCE entailed a more rigorous and mechanistic control to monetary aggregates, it did so in a manner consistent with a Keynesian approach to monetary policy.

1965: RESISTING 'RULES', AND COOKING THE BOOKS . . .

The background to the 1965 approach to the Fund was an enduring weak British payments position after the 1961 loan. As in 1961 (but unlike 1956), borrowings in 1963 and 1964 were accompanied by Letters of Intent, the formal statement of the 'understanding' reached with the IMF. These two Letters of Intent occasioned little debate in government circles (they were not made public) and included no mention of DCE, though in the drafting of the 1964 letter the IMF raised concerns about inflation and the appropriate monetary policy to combat it.[9] Labour's 1964 election victory was swiftly followed by a payments crisis, and the imposition (after IMF consultation) of a controversial import surcharge. The IMF extended further credit in November 1964, when its concerns focused primarily on the UK balance of payments. In April 1965, Chancellor Callaghan noted 'the aim for the second half of 1966 is a state of balance on the combined current and long-term capital account', and looking ahead, 'in the years after 1966 my aim is a surplus on the overall balance of payments'.[10] This commitment was a central plank of the government programme, with the IMF team recording that the 'program has a good chance of success'.[11] This balance of payments objective was also the centrepiece of the Letter of Intent accompanying the May 1965 Fund borrowing – a much more specific document than its July 1964 predecessor.

Additional possible performance criteria were discussed between the Chancellor and IMF Managing Director Schweitzer in April 1965. DCE was now introduced, seemingly for the first time, into the discussion. The UK Government, preferring discretionary policy-making to a rules-based approach, objected to Polak's plan to insert numerical targets for bank credit as trigger clauses, arguing that

> inclusion in the letter of intent of our tentative estimates in the monetary field would give them a significance which, from the nature of the case, they cannot reasonably bear; and might lead to subsequent misunderstandings, particularly if events diverged from the estimates.[12]

DCE was a bone of contention during talks with Polak and the IMF Team in April 1965. Firstly, there was hostility to *any* quantitative targets, which it was felt would hinder room to manoeuvre excessively. Secondly, at this stage, UK policy-makers were less convinced than IMF Staffers as to the relative import of monetary policy as compared to fiscal policy. As Hubback of the Treasury noted, the idea of a credit ceiling

> is something very dear to the heart of Continental bankers, and the Fund staff, or at any rate Polak and Schweitzer, seem to be of the same school of thought. We are going to have some difficulty in satisfying them on this point.[13]

But in the event the difficulties were small, and the UK successfully avoided quantitative targets on monetary policy. The Letter of Intent referred to 'tight control over bank lending' and 'estimates' for increases in advances to the private sector, but there was no mention of targets or ceilings. Polak retreated from his initial desire for explicit 'arithmetic' targets.[14]

The UK's May 1965 Fund drawing was discussed at two IMF Executive Boards, with some executive directors expressing concern that the

UK Letter of Intent was too loosely worded, and others expressing scepticism at the UK's ability to meet its payments balance objective in 1966.[15] Such concerns, shared by IMF Staff and the Managing Director, led to the scheduling of further consultations. Schweitzer's enduring suspicion about the achievability of overall external balance in 1966, 'unless special measures were taken'[16] was shared by Polak in May 1966.[17] This climate of opinion increased IMF desires for more knave-proofing of the UK economic policy regime, and a greater emphasis on rules at the expense of discretion.

Given the difficulties in achieving the payments balance objective set out in the April/May 1965 Letter of Intent, IMF teams saw further action as necessary. This provoked repeated correspondence between the IMF Managing Director Schweitzer and the UK Chancellor.[18] Concern about the consequences of discretion in policy-making for the stability of the economy could be linked to quite technocratic notions about time lags and ignorance in policy design, but was also part of a wider distrust of political decision-making on the economy. The British authorities found these arguments difficult to counter when the British policy regime was widely held to have 'failed'; the very fact of having to borrow frequently from the IMF seemed to attest to that failure.

Inevitable tensions arose from the IMF's penchant for rules (and quantitative monetary policy commitments), and its incompatibility with the UK Government's desire for discretion. To resolve these, UK officials lied to the Fund, massaging the figures presented to them in 1965. In preparing for an 'informal visit' in December 1965, officials noted that whilst they had 'been *apparently* frank with the IMF' (emphasis added), in fact the 1966 balance of payments forecasts given to the Fund in April 1965 'were not on all fours with our then current working forecasts. For the IMF we wrote in a considerably bigger rise in exports than we in fact thought likely'.[19]

One member of the Treasury team reflected, 'we have learnt a very painful lesson since last April about the practical difficulties of attempting in effect to have two sets of books.'[20] This outright dishonesty 'strategy' was therefore abandoned in November 1965. Officials elected to 'come clean (with figures) about the balance of payments'. In the process, British officials still strongly opposed to specific targets and quantitative indicators decided to take the IMF Mission 'orally through the prospects for 1966 and difficulties of discerning them now in a more or less numberless fashion, but not concealing the possibility of some residual deficit next year', accepting a recent National Institute of Economic and Social Research (NIESR) projected deficit of around £150 million for 1966.[21] UK officials agreed this line 'to avoid deceiving the Fund'.[22]

The Chancellor sought to counter IMF attempts to erode discretion through quantitative targets by pulling Fund officials up when they threatened to overstep their constitutional brief. In May 1966, Polak expressed disappointment at progress towards balance of payments targets, and implied that efforts to restrict demand had been insufficient.

> The Chancellor' officials noted 'took him up sharply on this and drew from him the admission that he (Mr. Polak) thought that the unemployment rate was too low and should be increased. The Chancellor said that in his view he had taken sufficient disinflationary action in the Budget' the Chancellor 'found it disappointing that an official of the I.M.F. should come to him and suggest that H.M.G. should adopt policies designed to create more unemployment. He would report this to his colleagues.[23]

These exchanges are testament to the tensions *within* the Keynesian/neoclassical synthesis professional consensus caused by even the modest shifts towards more specific and quantified conditionality which the 1965 Letter of Intent entailed. Underlying these tensions were different understandings of the 'proper' balance between rules and discretion in economic management. Simply put, rules-based policy-making was anathema to the UK Government. These principled disagreements between the IMF and UK Government and officials did not, however, come to a head *at this stage* because the IMF did not press the point about DCE's inclusion. The UK Government retained its prized discretion, and rule-based policy remained a glint in IMF negotiators' eyes.

Throughout the DCE debates the British authorities endeavoured to avoid any commitment to precise forecasts which the IMF could construe as targets. Thus, in the 1966 Article VIII consultations the Treasury noted 'the written forecast given last year has proved an embarrassment, and our view is that we might avoid some future embarrassment if we do not give the Fund a formal written memorandum embodying quantified forecasts now'. Balance of payments forecasts handed to the IMF were, it was underlined, 'not to be treated as a formal UK forecast but as help to the Fund staff in preparing their report'.[24] Crucial was the resistance to *any* quantified target, regardless of its economic character, in order to preserve policy autonomy. That said, the UK Government's ongoing failure to meet key balance of payments objectives did nothing to allay IMF concerns that too much discretion was being exercised, with adverse economic consequences. This sowed the seeds of increased Fund pressure for greater reliance on more specific rules, quantitative targets, and trigger clauses in subsequent negotiations.

1969: 'RULES RULE' AT LAST ...

The 1967 devaluation cast a shadow over UK/IMF relations in the build up to the 1969 stand-by arrangement. There was a sense of crisis in the UK economy, especially after devaluation initially seemed to have failed to solve the balance of payments problem (Wadsworth, 1973: 82). Beckerman detected within UK Government circles, 'a sense of despair at the apparent failure – up to then – of the standard weapons of economic management to produce "the goods" (a balance of payments surplus)' (Beckerman, 1972: 297). As Cairncross suggests, the mood in Whitehall was 'If fiscal policy was so slow in bringing the economy into balance . . . perhaps it was time to see what tighter money could do' (Cairncross, 1996: 237). Consistent with ideational IPE accounts of *how* and *when* economic ideas underpinning policy regimes change (Blyth, 2002: 8, 34–45; Hall, 1993: 280–1; Hay, 2001: 193–218), this sense of crisis in British economic policy increased the IMF's capacity to secure assent for its specific DCE idea, and more broadly its rules-based approach to economic policy-making.

The IMF teams visiting the UK in the late 1960s continued to favour explicit rules in the form of quantitative targets for monetary aggregates, and 'trigger clauses' in stand-by arrangements tied to them.[25] IMF disquiet in May 1968 discussions centred on the failure of UK Government deflationary policies to deliver significant post-devaluation improvements in the balance of payments. Richard Goode, who led for the IMF, argued forcefully that the unsatisfactory payments position resulted from excessive monetary growth, leading to rapid growth of imports.[26] This increased IMF desires for quantitative targets for monetary expansion. In this context, the Fund's undimmed enthusiasm for DCE derived from two basic observations. First, that post-devaluation, the balance of payments had improved much less than hoped. Second, that the government had been pursuing a tough fiscal policy:

> If it was considered that the fiscal weapon had been used to the limit for the present, it was the more important to consider what credit policy could do to help. The Mission saw this as the key question at issue.[27]

In 1969 public spending and borrowing was not at issue between the British authorities and the IMF. Unlike in 1976 the IMF was quite content with British fiscal policy; their point was its inability to achieve balance of payments required more use of the monetary weapon. Furthermore, the debate with the IMF in 1968 and 1969 was not about whether there was a need for a monetary squeeze. UK and IMF officials alike agreed such a policy was necessary. The dispute was over the means to achieve that objective. Specifically, most officials and Ministers thought DCE did not match British circumstances, and that DCE targets were misleading.[28] More fundamentally, DCE was resisted by UK negotiators because they objected to a rules-based policy approach eroding the scope and limits of discretionary governmental intervention in the economy.

The UK Government rejected the notion that these DCE targets should generate pressure for policy changes if and when the targets were breached.

Within the Treasury, Andrew Graham had attempted to resist IMF insistence on quarterly targets for DCE because of the 'madness' and 'basic stupidity' of 'this emphasis on monetary policy', regarding it as 'essential as a point of principle that a UK Government should not be subject to this extent of external pressure'.[29] The quantified 'trigger' clause was especially contentious. As Chancellor Jenkins had told Schweitzer during the negotiations, as reported to the Prime Minister, 'The concept of domestic credit expansion was almost a totally new one at home, and a policy of publicly declared quarterly objectives would appear to have been dictated to us by the Fund'.[30]

Ongoing IMF concerns about the need for 'knave-proofing' given excessively lax monetary policy fed into Schweitzer's insistence in January 1969 upon additional elements in any future stand-by arrangement. The IMF position had hardened since 1965: 'there would be a requirement for an overall credit ceiling. The Fund regard this as essential'.[31] As the negotiations in 1969 got underway, IMF shock at the rapid money supply growth (DCE rose by £1225 million in 1968/9; Jay, 1969) was grist to the mill of those calling for tighter rules. This raised the tension between the IMF and UK Government to new levels. The Chancellor told the PM, that he had explained to Schweitzer, 'the great political and operational objections we saw to signing a Letter of Intent committing us publicly to quarterly figures for domestic credit expansion which would be used to trigger consultations with the Fund.'[32]

From the beginning of these negotiations, as a result of the 'feedback loop' discussed above, the British were aware that some stated targets for DCE would be at the centre of the IMF's requirements. This recognition led to a great deal of discussion in London about the implications of such a target. An early summary of the British position captures many of the key points.

> We cannot argue that the concept of DCE is inapplicable to the UK, nor indeed that it would be inappropriate as one of a number of indicators of economic progress. We see no reason in principle to suppose that use of this indicator would lead to conclusions about requirements for policy measures which did not equally follow from indicators of domestic economic activity and of the balance of payments.

But, it was argued, DCE assumed British authorities' capacity to control the volume of government debt sales to holders outside the banking system. The British thought no such control existed, due to the unusual scale of outstanding UK debt, and to the impact on financial confidence changes in the target volume of sales might bring about. This complexity seriously inhibited the use of interest rates simply to raise the cost of credit.[33]

Thus, the British bid to retain discretion proceeded via the argument, discussed at length at the 'Theory' seminar in 1968, that this particular rules-based approach was inappropriate to the alleged institutional peculiarity of the British economy which undermined the generality of the IMF's position on monetary control.[34] The Fund thought this distinctiveness was overstated.[35] Jenkins took the view that DCE targets were a major threat to British policy autonomy, and even talked at one stage as if a break with the IMF could be a price worth paying for such autonomy.[36] But ultimately, the UK Government's battle to avoid the inclusion of quantitative targets for DCE was unsuccessful. Schweitzer proved 'unyielding'[37] on this point. The British gave in, and the Letter of Intent included not only a target for DCE (£400 million for 1969/70) but a commitment by the government 'to ensure that the course quarter by quarter of domestic credit expansion as a whole, and of the Central Government borrowing requirement within it, is consistent with the intended result for the year as a whole, and to take action as appropriate to this end' (House of Commons, 23 June 1969, cols 1008–10). Alongside this published document there existed a confidential memorandum of understanding which spelt out the quarterly targets. This was communicated to the IMF Executive, but not published, at the Chancellor's request.[38]

This indicates the political sensitivity of the infringement of government autonomy at the hands of the IMF which DCE targets suggested. No government could admit the existence of IMF determination of British economic policy and not suffer major political criticism. The 1969 package led to accusations of loss of national autonomy from both the Conservative opposition and Labour backbenchers. The Conservatives described the government's policy as one of 'capitulation to the monetary policy doctrines of the IMF' (House of Commons, 23 June 1969, col. 1003; also House of Commons, 25 June 1969, cols 1534–49). Backbench Labour MPs were given a private meeting with the Chairman of the IMF, Schweitzer, to persuade them that he was not responsible for all the aspects of British policy that the MPs disliked (Clarke, 1969).

In the event, the immediate political and economic context sugared the DCE pill. The DCE targets in the Letter of Intent were not difficult to achieve, above all because of the budget surpluses that the post-devaluation squeeze generated. Jenkins defended the policy as fitting with his general strategy of shifting resources from public to private sector (House of Commons, 25 June 1969, cols 1523–4). Jenkins characterized his approach to Schweitzer during the negotiations of the 1969 loan as one of 'We will in fact obey the rules, but, please, don't make them nominally apply to us because we are such an important country' (Jenkins, 1991: 274). But the IMF insisted that the rules had to be applied. Whilst the DCE targets proved easy to meet, the acceptance of DCE targets was pregnant with much greater significance in policy terms, because it embodied the notion that national governments could not be trusted with discretion in policy-making, and that credibility could only be secured through their adherence to rules.

Throughout the late 1960s and early 1970s, UK policy-makers' doubts about the underlying theory and policy efficacy of DCE, expressed in the 1968 seminar, were always combined with policy autonomy issues. The UK Government in the 1960s did not see credibility-centric rules as a necessary condition of effective economic governance. Indeed, UK Ministerial and official resistance to quantitative targets stemmed from the view that credibility was best secured by retaining discretion. In 1974, when contemplating another IMF drawing, a Treasury memo underlined 'the essential need, in conditions of great uncertainty ... that monetary policy should be kept as flexible as possible', and highlighted 'strong grounds for arguing that quantitative monetary targets are inappropriate' because 'any quantitative target could only be set in relation to forecasts for the economy that must in present circumstances be subject to enormous margins for error.' As in earlier Letter of Intent preparations, the UK Government sought to 'avoid quantitative targets if we possibly can', hoping 'to rely instead upon a general statement that the growth of money and credit would be restrained to rates consistent with the Government's general objectives for the economy and for countering inflation'.[39] However, in signing the 1969 stand-by agreement, the UK Government assented to a new set of policy-making parameters wherein discretionary economic policy-making was much more constrained by rules than before. The content of those rules would, in time, evolve in a more neo-liberal direction.

CONCLUSIONS

IMF conditionality on UK borrowing became markedly more exacting from the mid-1960s. Stand-by arrangements between 1964 and 1969 saw a steady ramping up of the specificity of undertakings, performance targets and 'strings' attached to borrowing on the part of an increasingly interventionist Fund. Accordingly, Letters of Intent accompanying stand-by arrangements increasingly emphasized trigger clauses, and more precise performance criteria to increase the specificity of government undertakings. UK Government resistance to IMF insistence on binding rules, ceilings and quantitative targets led government officials to pre-empt and even deceive the Fund to avoid being tied down. DCE sparked off a struggle between IMF and UK negotiators, with the economic ideas about the appropriate scope of rules-based macroeconomic policy-making and policy instruments bound up with IMF conditionality practices being foisted – not always successfully – on British economic policy-makers. The eventual acceptance of a rules-based approach provided a crucial condition of possibility for a significant qualitative shift in macroeconomic policy-making.

In the period charted here (1965–69), the nature of the rules-based regime was compatible with Keynesianism. So, whilst we find a challenge to the general Keynesian attachment to domestic policy autonomy, we find that the extent of 'hollowing out' of Keynesian approaches to macroeconomic policy was quite limited. To explain this enduring power of Keynesianism, and the non-penetration of monetarist thinking, we follow earlier studies of economic ideas within international organizations in highlighting the importance of institutional norms, learning and socialization. As emphasized above, the debate about DCE rested upon substantial convergence between IMF and British economists. There was an 'epistemic community' of economists, economic advisers and policy-makers which to a large extent traversed the boundary between the Fund and Whitehall. DCE fell within the professional consensus of the 'neo-classical synthesis'. Yet operating within that professional consensus, the policy environment of UK policy-makers involved a keen appreciation of the market economy's inherent instability, the key role of state intervention and activist stabilization, and of the inter-subjective nature of financial markets. Crucially, DCE did *not* entail a rejection of Keynesian-inspired approaches to domestic economic management. Its deployment was consistent with demand management in pursuit of full employment. The version of the Keynesian/neoclassical synthesis broadly shared by UK and IMF policy elites in the late 1960s in no way involved an embrace of monetarist economic theory or policy approaches.

The longer-term significance of DCE was not the instrument itself (its import was short-lived, although it played a minor role in the 1976 negotiations), but the qualitative shift in the nature of IMF conditionality, and of British economic policy-making. Returning to the 'political sociology' of policy instruments, different policy instruments entail different understandings of the qualitative nature of the policy process. DCE began a significant modification of the IMF's approach to UK domestic policy autonomy, and its deployment signalled a shift in prevailing understandings of the appropriate balance between rules and discretion in the making of economic policy. This episode began a process whereby the 'knave-proofing' of government economic policy (through increasingly specific quantitative targets and trigger clauses) was becoming legitimized. Rules gained ground at the expense of discretion in the pursuit of crucial economic credibility which was, at the time, negotiated with the IMF.

The acceptance of rules-based approaches provided a conducive environment, in the 1980s, for the introduction of other neo-liberal economic ideas, drawing on public choice theory, time inconsistency theory (Kydland and Prescott 1977) and the new classical economics which became influential in the Fund at the time. Thus, the rules later became infused with an increasingly neo-liberal character. The influence of the intellectual 'fad' of monetarism on macroeconomic policy-making was relatively fleeting. Even ardent early supporters like the Thatcher government had effectively abandoned the monetarist approach of using money supply targets as the centrepiece of economic policy-making by the mid 1980s. However, neo-liberal rules-based approaches to macroeconomic management have become a mainstay of political economic orthodoxy, not least because of how they were prioritized and advocated by international economic institutions such as the IMF. The IMF was thus a key player in and catalyst of the neo-liberal shift from discretionary to rules-based economic policy.

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NOTES

1 Recent historical work has emphasized the enhanced bargaining power the international status of sterling gave British governments in financial discussions with the IMF (and the United States), contrary to an older literature emphasizing the weakness of the British position (Schenk, 2010: 204–05, 414–30).

2 IMF Archives, Staff Memoranda (hereafter SM) 68/128, 'Fund policy with respect to the use of its resources', 23 July 1968.

3 TNA: PRO 326/978 Note of a meeting with the Chancellor of the Exchequer 25 February 1969, where it was argued that DCE had to be made 'intellectually defensible' because of 'the tendency by Keynesian economists to ridicule this type of economic indicator and control'.

4 IMF Archives, SM 68/128, 'Fund policy with respect to the use of its resources', 23 July 1968.

5 TNA: PRO T236/5740 Note to D. Ricketts 8 May 1959.

6 TNA: PRO T326/728 'Monetary seminar (IMF): terms of reference and arrangements for the seminar'.

7 TNA: PRO T326/729 'Monetary seminar (IMF): note of proceedings', 16 Oct 1968, pp. 14–15, 16; ibid., p. 16, and proceedings 18 October 1968.

8 TNA: PRO T326/978 A. Neale 'IMF Standby and overall credit ceiling', 12 February 1969, p. 2.

9 TNA: PRO T311/276 'Mins of meeting 7 May 1964: redraft of statement of Intent'; T311/27 'IMF Standby: notes for Sir Eric Roll 7 July 1964' IMF Exec Minutes 27 July 1964.

10 IMF Archives EBS/65/59. Letter of Intent from Callaghan to Schweitzer, 27 April 1965.

11 IMF Archives SM/65/37, p. 42.

12 TNA: PRO PREM 13/3151 Draft Letter from Chancellor to Schweitzer, 21 April 1965.

13 TNA: PRO T320/70 Hubback to Goldman 'IMF consultations', 8 April 1965.

14 IMF Archives EBS/65/74, pp. 2–3; PRO T312/1392 D. Hubback 'IMF visit', 22 February 1965.

15 IMF Archives EBM/65/25, pp. 23–4; EBM/65/26; also TNA: PRO PREM 13/3151 P. Dean to FO 'IMF UK drawing', 29 April 1965.

16 TNA: PRO T230/800 D. Hubback, note for record, IMF Consultations, 7 December 1965; ibid., Dean to FO, 6 January 1966.

17 TNA: PRO T230/801 'IMF Consultations: Mr Polak's closing remarks', 18 May 1966.

18 TNA: PRO T230/800 Schweitzer to Chancellor, 14 July 1965; and Hubback to Walker 'IMF Informal Consultations', 8 July 1965; also PRO T230/800 D. Hubback, note for record, IMF Consultations, 7 December 1965; ibid., Dean to FO, 6 January 1966.

19 Ibid., P. Brown to Mr Workman 'IMF visit in December', 25 November 1965.

20 Ibid.

21 TNA: PRO T230/800 Workman to Hubback 'IMF Visit: balance of payments', 26 November 1965.

22 TNA: PRO T230/800 Brown to Workman 'IMF Visit in December', 25 November 1965; T230/801 Workman 'IMF Consultations: balance of payments', 4 May 1966.

23 TNA: PRO T230/720 I. Bancroft, 'Note for record of IMF Consultations', 13 May 1966.

24 TNA: PRO T320/720 Workman 'IMF Consultations: balance of payments', 4 May 1966.

25 IMF, UK Country files, 1760, Box # 32, File # 5, David Finch to the Managing Director 'United Kingdom Consultation under stand-by arrangement', 16 July 1968.

26 TNA: PRO T331/121 IMF: UK consultations, 21 and 22 May 22 1968; ibid., 23 May 1968, p. 5.

27 TNA: PRO T326/977 'DCE: discussions with IMF staff mission', 23 April 1969; ibid., 'IMF standby', 3 May 1969, p. 1.

28 TNA: PRO PREM 13/8151 A. Graham 'Monetary Policy and the IMF', 30 April 1969.

29 TNA: PRO PREM13/3151 Note from Andrew Graham to Mr Andrews & Mr Halls on 'Monetary Policy and the IMF', 30 April 1969.

30 Ibid., 'Personal from Chancellor to PM', 9 April 1969.

31 TNA: PRO T326/978 Mr. Figgures 'Another IMF Standby', 31 January 1969.

32 TNA: PRO PREM 13/3151 Telegram 'Personal from Chancellor to PM', 29 April 1969.

33 TNA: PRO T326/978 R. Armstrong 'IMF credit and overall credit ceiling', 7 February 1969.

34 TNA: PRO T326/729 Monetary seminar (IMF) proceedings, 18 October 1968, pp. 19–23.

35 Ibid., pp. 20, 21. IMF Archives Exec Meetings 17 January 1969.

36 Ibid., Jenkins to PM 29 April 1969; T171/845 D. Dowler to E. Figgures, 8 April 1969.

37 Ibid., Telegram 'Personal from Chancellor to PM', 29 April 1969.

38 TNA: PRO PREM 13/3151 'Memorandum of Understanding', 22 May 1969. IMF Archive Country Files: United Kingdom, # 1760, Box 32, 'Memorandum of Understanding', 3 May 1969.

39 TNA: PRO T230/2950 F. Cassell to Mr Downey, 'Possible contents of a Letter of Intent', 2 January 1974.

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