The politics of economic policy-making in Britain: a re-assessment of the 1976 IMF crisis

Abstract

Many existing accounts of the IMF crisis have argued that British policy was determined either by the exercise of structural power by markets through the creation of currency instability and the application of loan conditionality, or by demonstrating that only policies of a broadly monetarist persuasion would be sufficient to sustain confidence, a recognition which was reached through a process of policy learning. This paper offers a re-assessment of economic policy-making in Britain during the 1976 IMF crisis to show that policy change did not occur as a result of disciplinary market pressure or a process of social learning. It argues that state managers have to manage the contradictions between the imperatives of accumulation and legitimation, and can do so through the politics of depoliticisation. It then uses archival sources to show how significant elements of the core-executive had established preferences for deflationary policies, which were implemented in 1976 by using market rhetoric and Fund conditionality to shape perceptions about the range of issues within the government's scope for discretionary control.

Key Words: Depoliticisation; IMF Crisis; Labour Government; economic policy-making; social democracy

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Introduction

The economic policy autonomy of states is a salient issue in light of discourses on globalisation, capital mobility and the embedded nature of agreed principles in international economic regimes, which all suggest to varying degrees, that power has shifted away from the national state. Reflecting these positions, many existing accounts of the 1976 IMF crisis emphasise the role it played in determining policy British outputs, either through the disciplinary potential of markets, or the potential for crisis to act as a catalyst for policy learning. This paper begins by outlining an alternative framework for understanding the politics of economic policy-making. It suggests that the general imperatives of accumulation and legitimation are constraints faced by state managers that play a role in determining the broad objectives of governments, but cannot determine specific policy outcomes at times of crisis. It also argues that these imperatives are contradictory, and that these contradictions often make it beneficial for governments to invoke market rules and market rhetoric as part of a strategy of depoliticisation in order to create the necessary political space to achieve both its accumulation and legitimation imperatives simultaneously. The paper then critically reviews existing accounts of the crisis. It shows how the majority of the literature has emphasised the role of crisis in determining policy outputs, and that whilst some empirical accounts have shown that policy changes began to take place before the IMF crisis, thereby 'plausibilising' the depoliticisation thesis, they fail to recognise the strategic element to policy-making and therefore contribute to the impression that this was a period characterised by uncertainty and indecision in policy-making.

The article then offers an extensive archive based account of events that shows how the principles of depoliticisation were used in order to pursue preferences for deflationary policies, which had been established within the Treasury[i] since 1974. It demonstrates how cuts in July were achieved through a strategy of *preference shaping depoliticisation* by encouraging perceptions of crisis in the foreign exchange markets despite preferences for depreciation, and that the IMF settlement was broadly in line with fiscal cuts the Treasury believed necessary. It also demonstrates that this action had been deferred in anticipation of conditionality for political reasons. This can therefore be characterised as an instance of *rules based depoliticisation*. Far from acting as a disciplinary constraint or a catalyst for learning as existing accounts have argued therefore, the 1976 IMF crisis provided the government with the room for manoeuvre to implement its established preferences by altering perceptions about the range of policies effectively within its scope for discretionary action. Finally, the paper reflects on what the events of 1976 may tell us about the limits of social democratic politics, and suggests that it is necessary to consider the possibility that these limits lie not in the market, but are a reflection of the contradictions between accumulation and legitimation inherent in the capitalist state form, and that it is these contradictions that have made depoliticisation such an attractive and widely deployed governing strategy.

The politics of economic policy-making

It has frequently been asserted that the imperatives of globalisation, capital mobility, and the embedded principles of international regimes, mean that an increasing number of actors are able to limit the range of policy choices available to state managers by causing currency instability, capital flight, and denying access to credit when they do not approve of domestic economic policies (see *inter alia* Helleiner, 1992; Andrews, 1994; Cohen, 1998). However, the assumption that political agency is effectively determined by the logic of market forces and their disciplinary potential is problematic, and as Watson (2006, 21) notes, the identification of 'the constraints that the logic emanating from one sphere imposes upon those who seek to act in the other', represents an artificial division between 'the rule of law and systems of exchange […] experienced as a totality within everyday life' (ibid, 21).

By recognising the artificial nature of this distinction, it is possible to see that the state has clear and apparently contradictory roles to play in terms of its management of the economy and the preservation of the incumbent government's legitimacy, which in combination can be understood to broadly determine state-managers objectives and their limits, but not specific policies. Firstly, accumulation represents a constraint for state managers in so far as the stability of capitalist social relations requires sustainable arrangements for production and exchange. Secondly, governments must maintain popular domestic support in order to ensure their re-election and preserve the legitimacy of the state's institutions. However, because the creation of favourable conditions for accumulation require the adoption of policies likely to have social consequences for the labour movement – most obviously lower wages (Kettell, 2004, 19) – and because, where 'the political legitimacy of government derives from the pursuit of the "national interest" […] policy-making must […] display at least a semblant of a connection to the views and wishes of the electorate' (Kettell, 2008, 631), there is a clear contradiction between two of the state's principal functions.

Whilst at times governments may be able to reconcile these contradictions by taking responsibility for a broad range of economic and social issues, it is often beneficial for core-executives to depoliticise difficult aspects of policy in order to shift any blame for their social consequences, by 'placing at one remove the political character of decision making' (Burnham, 1999, 45; 2001, 128), or rather, by employing '*the range of tools, mechanisms and institutions through which politicians can attempt to move to an indirect governing relationship and/or seek to persuade the demos that they can no longer be reasonably held responsible for a certain issue, policy field or specific decision*' (Flinders and Buller, 2006, 295-6). The use of such strategies describe what Hay (1998, 529 original emphasis) refers to as 'the extent to which the parameters of the politically possible are circumscribed *not* by the "harsh economic realities" and "inexorable logics" of competitiveness and globalisation, but by *perceptions* of such logics and realities and by what they are *held to entail*.' It is therefore argued that the invocation of 'globalisation as an exogenous economic constraint' can serve to 'render the otherwise contingent necessary' (Watson and Hay, 2003, 290), which for Watson (2006, 197), is part of the socialisation of beliefs associating legitimacy with accumulation through the use of rhetoric 'which equates globalization with a market-based logic of no alternative.'

There are three principle ways in which governments are able to depoliticise difficult aspects of policy in this way. The first of these is *institutional depoliticisation,* which occurs when the government sets the broad objectives of policy but hands responsibility for the day-to-day management of policy to an appointed administrator' (Flinders and Buller, 2006, 298). The second is *rules-based depoliticisation*, which involves the incorporation of explicit and binding rules into the policy making process that appear to limit the government's ability to exercise its own discretion (ibid, 303-4). The final way in which governments can depoliticise policy making is by *preference shaping*, which involves 'recourse to ideological, discursive or rhetorical claims in order to justify a political position that a certain issue of focus does, or should, lie beyond the scope of politics or the capacity for state control' (ibid, 307).

It comes as no surprise historically that the Treasury and the Bank of England have used or attempted to use market forces in order to alter perceptions about the politically feasible,[ii] but despite an awareness of this *modus operandi*, none of the existing accounts of the 1976 IMF crisis explicitly makes this case. Rather, a substantial body of the literature argues that the Fund had a decisive influence over British economic policy-making through the application of conditionality, or that crisis acted as a catalyst for policy-learning by undermining the Keynesian paradigm and creating a realisation amongst political elites that only policies of a broadly monetarist persuasion would be sufficient to sustain confidence. The next section of the paper offers a review of existing accounts of the crisis.

Decisive influence and social learning

Mark Harmon (1997, 60) develops the 'decisive influence' argument by equating the Labour Government's preferences with commitments made by the Labour Party in opposition, noting that there was a 'leftward tilt [in] policy areas upon which the party, including the parliamentary leadership, was publicly agreed.' On the basis that it 'was only with the explicit binding of the British economic authorities that the economic and political crises in Britain in 1976 were resolved', he concludes that 'economic policy retrenchment in Britain […] was largely the product of coercive external pressures exerted at multiple levels' (ibid, 228-9). This argument is developed from the perspective of regime theory, which, he argues, contains an inherent tendency to 'confuse international "cooperation" with what might be more appropriately characterized as manipulative coercion,' and ultimately confuses what at first appear to be cooperative structures, with instruments that have to ability to play a significant role in disciplining governments by making financial assistance available only with conditions attached (ibid, 15-6).

Unlike Harmon, Bernstein (1983, 147) includes the Treasury in her analysis in so far as is possible without reference to primary documents, but the lack of reference to a broad range of official sources conceals the extent to which there were entrenched preferences for deflation within key institutions of the policy-making apparatus, and leads to the conclusion that 'it would be difficult to argue that [IMF cuts] were desired by the government as a whole.' As such, she also suggests that market pressure played a decisive role in shaping policy outputs, principally because it played an 'important role both in precipitating crises and in the stringency of the measures necessary to end them' (ibid, 658). Bernstein (ibid, 657) argues that the most important constraint acting on government policy was an 'international hierarchy of lending' that operates as 'the framework for international influence', the pinnacle of which, after the exhaustion of other borrowing possibilities, is the IMF, because the Fund is able to 'fulfil a set of functions which other creditors are reluctant or unable to perform' (ibid, 50).

A second strand of literature on the IMF crisis focuses on policy learning. Peter A. Hall suggests it is not appropriate to conceive of policy-making in terms of responses to various pressures applied to the state, but that it is a 'deliberate attempt to adjust the goals or techniques of policy in response to past experience' (Hall, 1992, 277). As such, policy is understood as a learning response to economic and political circumstances, and that change from one discourse of policy-making to another is determined by policy experimentation and policy failure (ibid, 280). This can contribute to explaining change under the 1974-79 Labour

Government by suggesting that the introduction of the system of Cash Limits in 1975 was a response to the failure of the Public Expenditure Survey Committee system of planning (ibid, 283), and that the economic policy retrenchment associated with the IMF loan was the product of the Keynesian paradigm's failure to explain or address the problem of stagflation, which required political elites to examine credible alternatives such as the monetarist proposals of groups such as the Institute for Economic Affairs (IEA) (ibid, 285-6).

Kevin Hickson likewise notes that during the IMF crisis the ideas of monetarists and economic liberals grew in appeal (Hickson, 2005, 188). He suggests that the most important of these ideas were the work of Friedrich von Hayek, supply-side emphasis, the 'crowding-out' thesis of Bacon and Elits, and the rejection of the Philips Curve relationship between inflation and unemployment (ibid, 181-5). Burk and Cairncross (1992, ch. 5) also identify a movement of opinion away from Keynesian approaches to policy-making in the context of its apparent failure to either account for or respond to economic conditions in Britain, and note that the views of monetarists, the 'New Cambridge School', and protectionists, gained increasing credence in 1976. It is therefore the contention of these accounts, that the failure of established modes of economic governance to produce solutions to economic crises was the catalyst for the adoption of new ideas in the policy-making arena.

More recently, an extended empirical account of the crisis has been provided by then Permanent Secretary to the Treasury, Sir Douglas Wass (2008), which has contributed to the study of British economic policy-making in this period by providing an extensive administrative history of the period. This has cast considerable doubt on the extent to which economic crisis and Fund conditionality played a decisive role in determining policy outputs, however the most important contribution to de-mystifying commonly understood perceptions of the IMF crisis is that of Ludlam. He identifies 'four myths' of the crisis, noting that Healey had introduced substantial cuts in the April 1975 Budget and February 1976

Public Expenditure white paper, that cash limits were in place on three-quarters of voted government expenditure by April 1975, that monetary targets had been set in July 1976 as significant but not critical targets, and that the commitment to full employment had effectively been abandoned as a primary aim of policy at the time of the government's mildly deflationary first budget (Ludlam, 1992 716-24). He therefore concludes that 'the IMF deal merely codified a change of political course already well underway and proceeding under the stewardship of British social democracy' (ibid, 727).

By presenting an accurate timeline of events, these accounts have played a significant role in 'plausibilising' the depoliticisation thesis, however neither account acknowledges the strategic element to economic policy-making in this period. Indeed, Wass (2008, 345) argues that the fact 'that there was no specific contingency plan for the events of 1976 is clear from the documents'. Ludlam (1992, 723) offers the closest suggestion that the government aimed to depoliticise policy with his assertion that the adoption of broadly monetarist policies was geared principally at forming public opinion, however he stops short of suggesting that this was part of a fully formed governing strategy, and the absence of the explicit recognition of a strategic element to policy is significant because it does nothing to rebuff characterisations of this period as one of uncertainty and indecision in policy-making.

The rest of this paper is dedicated to presenting an empirical account of events in 1976, which builds on the observations of Ludlam, but demonstrates the way in which the Treasury and the Labour Government used market rhetoric and IMF conditionality in order to depoliticise the consequences of retrenchment in a strategic way. It begins by identifying the broad preferences of the Treasury, the Labour Movement and the Labour Party, and shows that despite commitments under the Social Contract, significant elements in the higher echelons of the Treasury and elements of the government had strong preferences for deflation. As these preferences pre-date the onset of crisis, policy change should be understood to reflect the established preferences of British policy-makers and not the disciplinary potential of markets or a process of policy learning based on policy experimentation and policy failure. The paper then shows how these preferences for deflationary policies became more widely accepted at the political level and were implemented by invoking exchange rate and external financing constraints in the first half of the year (broadly *preference shaping depoliticisation*), and by associating policy change with IMF conditionality at the end of the year (broadly *rules based depoliticisation*). The paper concludes with some reflections about what the use of strategies of depoliticisation by a government elected on a progressive social-democratic platform in order to pursue established preferences for deflation can tell us about the limits of social-democracy, and the realities of market based 'logics of no alternative'.

The TUC, The Labour Party and the Treasury, 1974-76

The preferences of both the Trade Union movement and the Labour Party after the 1974 general elections are adequately captured by both the February and October manifestos, which were strongly based in a 1973 TUC/Labour Party Liaison Committee document calling for the implementation of an 'alternative strategy', which advocated a 'large-scale *redistribution of income and wealth*' (TUC /Labour Party Liaison Committee, 1973, 313). On investment, employment and growth, the document called for the expansion and investment and the control of capital administered through 'effective public supervision of the investment of large private corporations' (ibid, 314), in addition to greater industrial and economic democracy based on 'agreement and not on compulsion'. It furthermore noted that whilst 'there is great scope for seeking to reach recommendations through tripartite machinery […]

in the field of collective bargaining, such recommendations can only be incorporated in collective agreements voluntarily reached by the process of negotiation' (ibid, 315).

The Party (1974a, 192; 1974b, 213) had campaigned on the promise to bring about 'a fundamental and irreversible shift in the balance of power and wealth in favour of the working people and their families' in the general elections of both February and October 1974, and this 'Social Contract' between the Labour Party and the TUC has been perceived as the key in 'establishing a deal in which the unions would support the government's attempts to fight inflation by curbing their wage demands [in return for] favourable industrial policy, unemployment relief and structural modernization' (Koelble, 1987, 257). However, such interpretations are somewhat caricatured, and Taylor (2000, 210) has noted that 'the 1973 Liaison Committee document was little more than a shopping list of TUC demands.' Although the 1974 manifesto commitments closely reflected the 1973 liaison committee document, as Wickham-Jones (1996, 31-2) notes, within the Labour Party the National Executive Committee controls medium-term policy-making whilst in opposition, and the Parliamentary Labour Party is able to reassert control whilst in government. This means that it is by no means certain that policy documents disseminated whilst in opposition have any real reflection on the views of those at the sharp end of government, which become increasingly apparent whilst in office.

The Treasury also had strong preferences for economic policy. These were shaped by the view that systemic stability was dependent on reversing Britain's relative economic decline, and recognised that the potential for these policies to create political unrest because of their impact on general standards of living would mean the successful realisation of these policies would involve altering the expectations of the British people and those on the left of the Labour Party. These preferences became demonstrably apparent at the end of the 1974, as officials 'had at last concluded that existing policies were not sustainable' (Dell, 1996, 410).

The official position was presented to the Chancellor in December, when the Permanent Secretary, Sir Douglas Wass, authored a paper on the broad priorities for British economic policy, arguing that situation was serious in three respects. Firstly, the rate of pay increases was inconsistent with a reduction in the rate of inflation. Secondly, the balance of payments was forecast to be up to £1 billion worse in 1975 than in 1974. Finally, and contingent on this position, it was argued that the prospective public sector deficit would be unsustainable on confidence grounds (The National Archives [TNA] T 277/3053, PCC (74) 4, 20 December 1974, 1-2). Wass therefore advocated direct intervention in the wage determination process and a reduction in the public sector's financial deficit through increases in taxation and reductions in expenditure (ibid, 3).

When Wass suggested this course he noted that it 'may well be that the Chancellor will feel that it is politically out of the question for him to embrace the recommendations […] put forward', but qualified this statement, noting that this may only be the case 'without the external crisis which would justify it' (TNA T 277/3053, PCC (74) 4, 20 December 1974, 5). The potential for market logic to alter expectations about what could be expected from economic policy-making was therefore clearly recognised within the Treasury, and throughout 1975 and 1976 the use of market rhetoric in the context of the prevailing exchange rate strategy afforded the government considerable room for manoeuvre.

The exchange rate, the June stand-by and the July measures

It had been a long-standing objective of the Treasury to secure depreciation of sterling in order to help improve the competitive position of British industry. When sterling had come under pressure in early 1975, a review of the Bank of England's intervention strategy concluded that because it was the Treasury's 'intention to get the rate down […] we ought not to slog away spending money to try and stop this happening' (TNA T 358/207, Barratt to Wass, 22 April 1975, 1). It was an established intention of the government therefore, to allow depreciation which relied 'to the maximum extent possible on autonomous factors [...] so that the main responsibility for depreciation is seen to lie elsewhere than with HMG' (TNA T 358/207, Walker to Mitchell, 11 April 1975, 1). This remained the official view at the beginning of 1976.

In February it was noted that achieving the necessary improvement in competitiveness without undue costs in terms of unemployment would require 'depreciation of about 20 [per cent]' (TNA T 277/3175, PCC (76) 6th Meeting, 16 February 1976, 1), implying a preference to see the pound fall from \$2.02 (Bank of England, 1976, table 29) to around \$1.60. However, the size of the desired depreciation created difficulties, because under the floating rate system there was no mechanism by which it could be achieved in an orderly way. As a result the Treasury's view was that only depreciation of 10 per cent within the year would be possible (TNA T 277/3175, PCC (76) 7th Meeting, 18 February 1976, 2). This was seen to have potential domestic political benefits in so far as it would be possible to rally the support of the trade unions in the event of a slide in the pound, and that 'they would welcome a reduction in interest rates designed to achieve a slide on grounds of domestic policy' (ibid, 4).

In light of these assessments, the Minimum Lending Rate was cut by a quarter of one percent on 5 March. This occurred in the wake of a short-lived demand for sterling the previous morning, which had prompted the Bank to intervene in the markets to cream off dollars and prevent a rise in the rate, but created a view in the market that the Bank had been selling on a falling market. As such, the rate fell to \$1.91 (TNA T 277/3175, PCC (76) 14th Meeting, 11 March 1976, 1), and it has been noted of the subsequent fall in the pound that, 'the impression was given, and remains, that the Bank of England and the Treasury between them could have handled the affair better' (Browning, 1986, 72). However, neither British officials nor ministers were concerned by the fall in the rate. At the Treasury Policy Co-ordinating Committee (PCC) it was noted that 'it was important to hold onto the present advantages and not allow the rate to creep up' (TNA T 277/3175, PCC (76) 14th Meeting, 11 March 1976, 2), whilst the Chancellor informed the Ministerial Committee on Economic Strategy on 17 March that 'it would for the present be wise to take any opportunity to let the pound float downward' (TNA CAB 134/4048, MES (76) 6th Meeting, 17 March 1976, 3). This view was advanced on the basis of the claim that the 4.5 per cent depreciation that this represented was nearly half of what the Treasury deemed appropriate for the year, however as shown above, it is more accurate to view the slide as 25 per cent of what the Treasury had deemed *desirable*, but 50 per cent of what had been deemed *feasible*. The fall in the rate however, presented the opportunity for the Treasury to argue that the lack of confidence in sterling was placing the reserves in jeopardy, and that action was necessary in order to reverse it, despite the fact that it was in favour of the pound's decline.

The argument for a fiscal reduction began to emerge significantly at the end of April in light of concerns about additional claims being made on the contingency reserve. At Cabinet on 29 April, the Chancellor informed his colleagues that high levels of public expenditure were the cause of problems in the market, and that 'there was a serious danger that foreign confidence would collapse' (TNA CAB 128/59, CM (76) 2nd Conclusions, 29 April 1976, 8). This hostility to public expenditure was confirmed in an inter-departmental meeting of public finance officials on 4 May, which recognised that 'no programmes could be sacrosanct in these circumstances (TNA T 371/87, Jones to Pliatzky, 4 May 1976, 1), and significantly, it was noted that officials 'did not want to rule out savings that would require legislation and there was even a willingness to recognise that transfer payments […] might have to be cut in real terms as part of a general reduction in living standards' (ibid, 1). As a result, the Chancellor argued that 'a considerable body of opinion […] believes we ought to be cutting public expenditure this year; and that if we fail to do this of our own free will, we will sooner or later be compelled to do so' (TNA CAB 129/189, CP (76) 15, 14 May 1976, 1).

At the beginning of June, Britain and the G10 negotiated agreement of a $5.3 billion stand-by in order to bolster the reserves, which would be available for six months, whilst within the Treasury, attention turned to making the case for public expenditure cuts. On 21 June Wass said that the first argument for cuts 'was that our creditors would demand a cut in the borrowing requirement and they had a strong preference for seeing this achieved through public expenditure', and the second was that 'there could well be pressure on resources in the manufacturing sector next year' (TNA T 277/3175, PCC (76) 24th Meeting, 21 June 1976, 3). However, it was also noted that the Chancellor required a case that 'went beyond merely asserting that our creditors would demand it' (ibid, 3). At the following meeting of PCC therefore, it was argued that 'for the Government to take visible action to reduce the fiscal deficit would improve confidence' and that 'the market would judge that it would ease the UK's difficulty of financing so large a PSBR in 1977/78' (TNA T 277/3175, (PCC) 76 25th Meeting, 23 June 1976, 1), which had, in the first instance, been amplified by sterling's weakness and the Treasury's approach to exchange rate management.

The Overseas Finance Division believed cuts required were in the order of £2 billion (ibid, 2). Lord Kaldor went further than this, arguing that any potential package should 'raise the total [reduction in the PSBR] to the rage of *£3 billion* for 1977/78' (TNA T 364/17, Kaldor to Healey, 1 July 1976, 8), however calls for cuts of this size faced a considerable degree of political hostility from the Labour left. On 2 July it was argued at a meeting of the Ministerial Committee on Economic Strategy there was unlikely to be pressure on resources in 1977, meaning the government would have to square a circle with the TUC if it was to avoid being accused of cutting expenditure for invalid reasons (TNA CAB 134/4025, EY (76) 9th Meeting, 2 July 1976, 5), but despite these objections and in light of the view that 'the financial case [for cuts] was overwhelming' (ibid, 7), the matter was referred to full Cabinet so that decisions could be made.

When the matter went to full Cabinet, Tony Benn put his alternative strategy forward. He proposed that the government introduce measures to restrict non-essential imports, increase taxation on imported goods, take direct measures to increase home production, and attempt to reconcile the international community with these policies (TNA CAB 129/190, CP (76) 43, 2 July 1976, 1-4). However, there was no substantive discussion of such a strategy at Cabinet, on the basis of objections raised earlier in the year. It had been noted that there was no guarantee that import controls would aid the efficiency of British industry, and that there would be implications for the British standard of living caused by supply shortages that would contribute to creating 'a psychology of shortage' (TNA CAB 134/4025, EY (76) 19, 27 May 1976, 32). In contrast, the Chancellor put the case that the G10 stand-by had only bought time and that because a substantial amount had been drawn it was necessary to implement 'a package which will re-establish confidence in our economic policies to a degree which enables us to rebuild our reserves and avoid being forced to the International Monetary Fund to repay our drawings on the $5.3 billion stand-by' (TNA CAB 129/191, CP (76) 52, 13 July 1976, 2), and on the basis of this established view[iii] that alternative strategies would have worse prospects than retrenchment, Cabinet majority concluded that there was an urgent need to cut the PSBR (see TNA CAB 128/59, CM (76) 13th Conclusions, 6 July 1976).

Subsequently, preparations of a package to reduce the PSBR to £9 billion began, and cuts were announced to the House of Commons on 22 July. The slide in the rate that the Treasury favoured had allowed officials to begin making the argument in favour of the cuts it desired to restore confidence, take pressure off of the reserves, and assist with external financing difficulties. The G10 stand-by reinforced this view, and despite Wass' (2008, 350-1) assertion that the loan 'had no confidence or operational value', the Chancellor's reference to

Britain's repayment obligation in support of cuts shows that it had value in terms of winning the political argument over the July measures by shaping views about what the government could feasibly achieve. Market rhetoric and market rules continued to be used in this way during the 1976 IMF crisis.

The 1976 IMF crisis

It is useful to look at the IMF crisis in three phases in order to demonstrate the extent to which policy outcomes were in accord with the established preferences of the Treasury and the Chancellor of Exchequer, and how other opinions were reconciled with these views through the politics of depoliticisation. The first phase involves the period during which the case for going to the Fund was made, by arguing that market forces would otherwise make Britain's external financing gap unbridgeable. During the second phase, negotiations with the Fund were delayed by the limited negotiating brief given to Treasury officials and disagreements over forecasts, which was beneficial in creating an impression that Britain had not simply acquiesced in Fund conditionality, even though there was considerable overlap between the views of the Treasury and the IMF teams. Finally, it was necessary to win the political argument, which was achieved by noting that the IMF conditions meant retrenchment must occur, and that the issue of confidence meant that any alternative course would involve even greater sacrifices.

The first phase of the IMF crisis began in September, when despite the fact that sterling had remained stable throughout July and August in a band between $1.76 and $1.80, a paper was circulated to PCC arguing that there was no alternative to an application to the IMF because the current deficit was forecast at £1.5 billion for the second half of 1976 and £3 billion for 1977 (TNA T 277/3178, PCC (76) 53, 3 September 1976, 1). It went on to argue that despite current large interest rate differentials in Britain's favour, it was unrealistic to expect a large-scale sterling in-flow and that despite limited possibilities for public sector borrowing 'there is still a substantial gap in each period to be met by recourse to multilateral facilities or the reserves' (ibid, 1). As sterling weakness persisted, Callaghan decided that 'he did not favour continued heavy spending to support the rate', and as such, on 9 September the Bank of England withdrew from the foreign exchange market (TNA T 277/3175, PCC (76) 31st Meeting, 9 September 1976, 1).

At the following PCC meeting, Douglass Wass noted that the situation demonstrated that securing adequate interim finance was the overriding objective of economic strategy, and that in light of this, the 'need to reduce unemployment and the industrial strategy would have to be put on the back burner' (TNA T 277/3175, PCC (76) 32nd Meeting, 14 September 1976, 1). Leo Pliatzky, head of the public sector side of the Treasury, also made the case that 'economically there could be no doubt that a major downward adjustment was still needed, including further reductions in public expenditure', despite the fact that this would pose political problems (ibid, 2), and the Overseas Finance Division noted that 'plainly further unequivocal deflation would be helpful' (ibid, 2-3). In light of the fact that the Treasury had not been able to achieve a cut of the size desired in July therefore, a weight of official opinion believed that an agreement with the Fund that included a fiscal reduction was desirable.

On the basis of these recommendations, Healey put the case for a Fund drawing to the Economic Strategy committee on 23 September, and it was agreed that officials should open negotiations with the IMF on the basis of existing policies (see TNA CAB 134/4025, EY (76) 13th Meeting, 23 September 1976) on the grounds that Britain needed to repay the G10 stand-by, and the level of the reserves was 'not even the equivalent to two months' imports' (TNA CAB 134/4026, EY (76) 41, 23 September 1976, 4). However, if 'existing policies' were thought to be a plausible basis for agreement, it demonstrated a degree of naivety on the part of ministers, as officials were acutely aware of the extent to which agreement to draw from the Fund would involve the kind of deflationary action they believed necessary in order to solve long-term external financing difficulties. Indeed, Overseas Finance had written to the Chancellor's Principal Private Secretary advising that a negotiation with the Fund 'is a real one and cannot be turned into a mere charade' because 'the programme we present must be defensible' (TNA T 381/15, Littler to Monck, 23 July 1976, 1).

In the wake of a *Sunday Times* article at the end of October suggesting the UK and the IMF had agreed that sterling should settle at $1.50, which created further sterling weakness, the recognition of the ability for the IMF to act as a buttress between the government and the consequences of deflationary policies was most clearly recognised. The Governor of the Bank, Gordon Richardson, noted that any intervention in the exchange markets to stabilise the rate should be 'preceded by an announcement of a comprehensive package [...] with a large public expenditure element' before the IMF negotiations (TNA T 378/22, Note of a Meeting, 25 October 1976, 2), a view shared by the head of Overseas Finance, Derek Mitchell, who thought a further cut of £2 billion would be appropriate (ibid, 2). However, because of the political implications of making such a sizeable cut, and the fact that it was widely known that 'those who would lend us the large sums required would insist on policy measures', the Chancellor accepted a 'majority view that we should [defer] announcement of fiscal action until after the IMF negotiations' (ibid, 2-3).

Application to the Fund was therefore made on the basis that agreement with the IMF was essential if Britain were to bridge its external financing gap, and whilst it was recognised that borrowing from the Fund would involve cuts, officials were in favour of them. As such, and in recognition of widespread expectation of conditionality, the Chancellor decided to delay the desired fiscal action until the Fund arrived. The second phase of the IMF crisis began with the arrival of the Fund team on November 1, however substantive discussion was considerably delayed by the limited negotiating mandate of the Treasury team, and the extent of substantive differences between the two groups was greatly amplified by the wide margins of error to which the National Income Forecast (NIF) was subject.

The NIF suggested that slack in the world economy had required an upward revision of the PSBR from £9 billion to £11 billion. On this basis the Chancellor argued that 'faced with this prospect, I do not think it would be right to take no action, even if our creditors would allow us' (TNA CAB 134/4026, EY (76) 54, 2 November 1976, 3-4), and Kenneth Berrill of the Central Policy Review Staff (CPRS), noted that there was 'clearly a great deal to be said for taking further deflationary action' (TNA PREM 16/836, Berrill to Callaghan, 2 November 1976, 4). Derek Mitchell went so far as to suggest that the PSBR should be closer to £8 billion than £9 billion, with the majority of the reduction coming from public expenditure (TNA T 381/17, Mitchell to Monck, 4 November 1976, 1-2).

Despite the clear view amongst officials that a substantial fiscal reduction was required, Wass informed PCC that in negotiations with the Fund, 'on no account should officials express any view, except on his specific authority, about what policy changes were desirable. The discussion should be entirely technical and exploratory' (TNA T 277/3175, PCC (76) 38th Meeting, 2 November 1976, 3). This approach was beneficial in terms of the presentational advantages that would come from the appearance that officials had strongly resisted cuts, which were enhanced by the Fund's disagreement with the NIF. After the opening presentation on 8 November, the leader of the Fund team, Alan Whittome, noted that 'the forecasts simply did not add up' (TNA PREM 16/800, Littler to Wass, 8 November 1976, 1), and on the following day said 'he had detected that everyone in the Treasury had clammed up on discussion of policy changes' (TNA T 364/50, Mitchell to Wass, 9 November

1976, 1). Whilst this indicates that negotiations had stalled, it was in relation to issues of procedure, not of principle.

When Healey met Whittome on 11 November, he indicated that it would not be possible to secure a PSBR reduction in the region of £3-5 billion, and that it would be easier to get a broader negotiating mandate if the Fund gave 'some idea of the changes they thought would be desirable' (TNA T 364/50, Note of a Meeting, 11 November 1976, 3). Whittome seems to have interpreted this suggestion as an attempt by Chancellor to set the Fund up as the architect of deflation in the UK, and agreed to this only 'provided the Chancellor could give a personal assurance that this procedure would not lead to a pillorying of the Fund team for attempting to impose policies on the British Government' (ibid, 4).

When Whittome returned with his suggestions on 16 November, he qualified the Fund's position by noting that the PSBR forecast it had applied was nearly £1 billion lower than the Treasury's. He also noted that because it was the outturn figure that was of critical importance, it would be appropriate to think of the Fund's lower forecast as the figure from which a reduction needed to be made (TNA T 381/17, Note of a Meeting, 16 November 1976, 2). Therefore, despite the appearance of an impasse, the negotiating position between the two sides was reduced by £1 billion without any substantive discussion of a fiscal adjustment.

On 17 November Treasury officials were given a broadened mandate to explore a 'PSBR in 1977-78 lower than the £10.9 billion in the October forecast […] but they should refuse to discuss anything lower than £9 billion (TNA CAB 134/4025, EY (76) 19th Meeting, 17 November 1976, 5). Nevertheless, negotiations continued to be frustrated by the team's inability to discuss actual policy changes. This became particularly apparent on 19 November, when Pliatzky informed Whittome that he had no authority to discuss what would have to occur to reduce the PSBR by £3-4 billion for 1978/79, who responded by saying he 'wanted to see "serious figures" of what could be obtained' (TNA T 371/25, Note of a Meeting, 19 November 1976, 5). On the same day however, in response to Whittome's view that the PSBR for 1977/78 should be in the range of £8-8.5 billion and for 1978/79 should be around £6.5 billion, Wass 'accepted that, in principle, a two year programme of the type they envisaged was a reasonable proposition' (TNA T 371/25, Wass to Monck, 19 November 1976, 1-2), and with the clear demonstration that the Treasury and the Fund were in agreement, it became necessary to negotiate political objections to cuts.

The beginning of Cabinet discussions marks the beginning of the final phase of the crisis. However, the case for agreement and the cuts this involved had to be made beyond doubt, which involved convincing the Labour left that the approach proposed by the Chancellor, the Treasury and the Fund was correct. Once again, it was made with reference to the logic of market forces based on the notion that there was no alternative to a large downward fiscal adjustment if British economic strategy was to be sustainable over the long-term. This process began with the Chancellor's paper of 22 November, which associated current stability with expectations of a credible IMF package, noted that the Fund's aim of a PSBR of around £8.5 billion in 1977/78 was about right (TNA CAB 129/193, CP (76) 111, 22 November 1976, 1-3), and was followed by his assertion at Cabinet that although 'the situation was very difficult […] it would be worse if the negotiations broke down' (TNA CAB 128/60, CM (76) 33rd Conclusions, 23 November 1976, 1). The argument however, did not resonate with the whole Cabinet, Anthony Crosland arguing that the 'proposed reduction in the PSBR in 1977-78 could not be defended on any reasonable grounds' (ibid, 3), which led the Prime Minister to conclude that 'many of the Cabinet at present felt that the scale of the public expenditure cuts at present proposed was too great to accept' (ibid, 4).

On this basis Callaghan informed the Fund team of the political difficulties being faced. However, because, 'to the IMF a PSBR of £9.5 billion for 1977/78 was not convincing because they were sure it would not appear convincing to millions of bankers all over the world' (TNA T 364/50, Note of a Meeting, 23 November 1976, 3), it was agreed, without Cabinet approval, that the Treasury and Fund teams begin considering the implications of a reduction in the PSBR to £8.5, £9 and £9.5 billion (ibid, 5). The three packages were presented to Cabinet for discussion on 1 December, when a full examination of alternative possibilities would also be considered, under the clear understanding that it would be difficult to reach agreement with the Fund on anything less than the largest package (see TNA PREM 16/803, Healey to Callaghan, 25 November 1976, 9). In recognition of this view, Healey submitted a paper arguing that his judgement, 'reached independently of the Fund – is that there is a powerful case for a fiscal adjustment' which should 'reduce the PSBR to something like £8.5 billion in 1977/78 and perhaps to a similar figure the following year' (TNA CAB 129/193, CP (76) 123, 30 November 1976, 3). He concluded that although the proposals 'are not agreeable and will be difficult to sell to the Party and the TUC […] if there were a better or more viable set of policies [he] should propose them' (ibid, 6).

At this meeting, the left of the Cabinet made their opinions vocal, demonstrating they did not believe the Treasury or the Chancellor's argument that there was no alternative to the IMF loan by making their own proposals, the most radical of which was once again Tony Benn's advocacy of the Alternative Economic Strategy (AES). He argued that Britain should introduce overall import quotas for manufactures, enforce exchange controls, introduce a Capital Investments Committee to channel investment to priority areas, and take reserve powers to introduce planning agreements through the National Enterprise Board. He furthermore argued that this would be compatible with an agreement with the IMF because of the degree of international interdependence in the world economy (TNA CAB 129/193, CP (76) 117, 29 November 1976, 4-6). Anthony Crosland took a similar line, noting that by threatening to impose protectionist measures, 'we shall find that the IMF cannot afford *not* to give us the loan' (TNA CAB 129/193, CP (76) 118, 29 November 1976, 2). Peter Shore furthermore noted that the case against import controls had been overstated, that there was no evidence that they would create excess demand and therefore force rationing, and that there was no case for retaliation by other nations under international law (TNA CAB 129/193, CP (76) 124, 30 November 1976, 3).

Despite these arguments however, no new work was commissioned on the feasibility of import controls implied by an alternative strategy, and papers on the issue prepared by the CPRS in October were simply circulated to Cabinet under new cover. The case against noted that whilst an alternative approach may work in theory, in practice it 'ignores the practical implications of the immediate situation [and] disguises or assumes away, a number of fundamental difficulties, which will in practice prevent it from achieving the results claimed' (TNA CAB 129/193, CP (76) 116, 30 November 1976, case against, 1). Firstly, it argued that it would not be possible to 'get all the fences up fast enough to prevent a collapse of sterling.' Secondly, that the scheme would be 'contrary to [European] Community Law', that Britain 'would certainly be exposed to retaliation by other countries' and that it would undermine 'the whole philosophy behind our international policies – both political and economic' (ibid, 2-3). Finally, it was suggested that it assumed that industry would reorganise itself competitively and that there was 'no reason to think that protection – even in the absence of retaliation – would produce anything of the kind' (ibid, 6).

Fay and Young (28 May 1978, 33) note that at Cabinet on 1 December, Healey 'used Benn's argument as an object for derision', and in general discussion it was noted that if Britain were unable to finance the deficit after imposing import controls it might be necessary to resort to drastic measures such as rationing, and that this risk was unacceptable on the grounds that if the IMF refused to make the loan available on these terms, 'the country would be facing a bankrupt situation' (TNA CAB 128/60, CM (76) 35th Conclusions, annex, 2). This cleared the way for Healey to argue once again that 'without the IMF loan the external deficit could not be financed, there would be no safety net for the sterling balances, no acquiescence by other countries in a scheme of import deposits, and no bilateral lending' (ibid, annex, 6). This led to Cabinet agreement to continue attempts to settle with the Fund (ibid, annex, 7), and on the following day Callaghan noted that 'the majority took the view that in order to get the loan there should be an adjustment of £1.5 billion in 1977-78 which the Chancellor should lead to one of £2 billion in 1978-79' (TNA CAB 128/60, CM (76) 36th Conclusions, 2 December 1976, annex, 7).

Whilst the argument that there was no alternative to the Fund's conditions was successful in securing Cabinet agreement to reduce the PSBR to £8.7 billion in 1977/78, the second year of the package was still unresolved, and when discussed on 3 December looked to be leading the parties towards an impasse. The Fund's Managing Director, Johannes Witteveen, informed Healey he wanted an adjustment of £3 billion, to which Healey said he could 'take a running jump' (TNA PREM 16/805, Note of a meeting, 3 December 1976, 1). However, this agreement was resolved simply by introducing 'a contingent undertaking to do more than the Chancellor had proposed to Cabinet in 1978/79, which would be linked to achieving a lower level of unemployment than was now forecast' (ibid, 4), and carrying Cabinet was the final obstacle to achieving the cuts desired by the Treasury. The case for taking this action was decisively made in a note by Wass on contingencies for the event Fund negotiations broke down. He argued that if negotiations failed, sterling would be subject to an attack which would require a substantial package of public expenditure cuts of up to £1000 million, increases in duties on tobacco, alcohol and oil of £430 million, plus the sale of £500 million of BP shares in addition to a scheme of import deposits that would contract the economy sharply, which was a more severe approach than that required by the Fund (TNA PREM 16/805, Wass to Callaghan, 5 December 1976, annex, 3-6).

On this basis, Cabinet was informed on 6 December that it was a matter of urgency to give shape to the package, which involved immediate agreement of £1 billion cuts for 1977/78 and £1.5 billion cuts for 1978/79, which may later be revised dependent on the performance of the British economy relative to a target growth rate of 3.5 per cent (TNA CAB 128/60, CM (76) 37th Conclusions, 6 December 1976, annex, 1-2). The remainder of the meeting, and subsequent discussions on 7 December[iv] were devoted to discussing public expenditure programmes, whilst attention in the Treasury and the Fund teams turned to finalising the wording of the letter of intent, and setting targets for Domestic Credit Expansion compatible with the agreed PSBR targets. This work was completed in the early hours of 13 December, with targets set at £7.7 billion for 1977/78 and £6 billion for 1978/78 (TNA PREM 16/808, Monck to Stowe, 13 December 1976, 1).

Conclusions

The agreement of the letter of intent concluded the IMF negotiations substantively, and in accordance with a theme that consistently emerges throughout 1976. This begins with the statement of Treasury preferences for fiscal reductions, often supported by the Chancellor, and opposition from the left of the Labour Party on the grounds that deflation would have profound social and political consequences. The subsequent appearance of acute economic crisis in the foreign exchange markets and the implications for external financing then allowed the Treasury to argue, despite its preference for depreciation, that the measures it had advocated were absolutely necessary in order to ensure that Britain could continue to finance its external deficit because this was the only way in which confidence could be restored. In June and July 1976, the argument that failure to act would fundamentally undermine British economic strategy was clearly used as a way of creating a political argument that the level of the PSBR was, for all intents and purposes, beyond the control of the government because of its dependence on confidence.

As it became clear that these cuts had not achieved the scale of reduction deemed appropriate by the Treasury and conservative elements of the Labour leadership, it was decided to delay fiscal action until after the IMF negotiations on political grounds. At this stage the IMF came to play an important role in justifying further expenditure cuts in two ways. Firstly, delaying the negotiations by limiting the Treasury's negotiating mandate and inviting the Fund to take the initiative helped to foster the impression that the Treasury was resisting calls for deflation that originated from the IMF, even though British officials were in broad agreement. In this respect, conditionality was notional, but represented a credible rule onto which the consequences of deflationary policies could be shifted. Secondly, by identifying agreement with the Fund as the keystone to the credibility of British economic strategy, a convincing case was made that any alternative course would produce a worse outcome than that implied by agreement with the IMF. It is therefore the case that during 1976, and specifically during the IMF crisis, competing interests within the British state were resolved in favour of addressing decline by reducing the public sector's claim on resources, firstly through what can aptly be described as a process of *preference shaping* depoliticisation in July, and ultimately, through *rules based* depoliticisation during the IMF crisis itself.

By demonstrating the way in which policy-makers used economic crises and the appearance of economic crisis to create political opportunities to implement deflationary policies throughout 1976, the findings offer the opportunity for reflection on the limits of social-democratic policies. It is especially interesting to question why, despite being elected on a progressive left-wing platform, once in office, the Labour government accepted preferences for deflation and the prioritisation of its balance of payments and competitiveness objectives ahead of social priorities. As Hay (1998, 529, original emphasis) succinctly phrases it, we need to question whether '*space for alternative welfare trajectories does indeed exist, but it is no longer to perceived to exist',* or whether it is 'a distinct absence of political imagination and/or a severe dose of political fatalism' that subordinates social policy to accumulation.

In the case of the IMF crisis, the fact that AES and its variants competed for political acceptance with orthodox deflationary approaches, whether or not they could have worked in practice and despite the failure of those involved in broader debates about economic policy to win over those at the heart of the policy-making process, suggests that there was no lack of imagination or political fatalism; there were clearly individuals making alternative proposals and willing to argue for them. A superficially attractive alternative explanation is that the Treasury suffers from an institutional inertia that frustrates change, that its expertise has placed it in a powerful position relative to ministers, and that this has allowed it to 'bounce' ministers into policies with which they do not agree. Arguments of this kind however, are objectionable the grounds that they reflect a way of 'talking about the Treasury as though the Department was somehow separate from its ministers and could operate without them', when in fact, the Treasury is only able to circulate documents to Cabinet under cover of the Chancellor or the Chief Secretary if they are also a Cabinet member (Pliatzky, 1984, 130).

A more theoretically robust suggestion is that 'the limits of social democracy are not simply the limits of leadership or political programmes but are the limits of the capitalist state form itself' (Burnham, 2008, 62). It is widely accepted that order in society is both dependent on the sustainability of systems of production and exchange and the legitimacy of its political authorities, and whilst these constraints cannot determine specific policies, both must be understood as playing a role in determining governments' general objectives. However, the subordinate role of the majority of individuals in the system of production and the political authorities' dependence on their support to preserve legitimacy, demonstrates that there are clear contradictions in social and economic relations in capitalist societies. These general constraints and the contradictions therein mean that governments are not able to completely subject the interests of capital to labour or *vice versa* without undermining social relations more generally, and there nevertheless remains considerable room for manoeuvre within these boundaries so long as social and economic relations can be managed. Recognising this can help foster an understanding of the sustainable limits of social-democratic endeavours in a way that cannot be reduced to simplistic structural functionalism or overt 'politicism', and is therefore worthy of further empirical examination so that these boundaries may be more clearly defined, alternative strategies for managing social relations within them more clearly articulated, and the 'logic of no alternative' prevented from becoming accepted by policy-makers as truth, with all the consequences for accumulation and legitimation that the contradictions therein imply.

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[i] The 'Treasury View' presented in this paper does not intend to suggest there was unanimity of opinion within the institution, but reflects what the documents reveal about the preferences of those in key roles, with the most access to the political level.

[ii] For instance, on the return to the Gold Standard, see Kettell (2004), on the abandonment of the Gold Standard, see Kunz (1987), and on the debate over operation Robot in 1952, see Burnham (2003).

[iii] Similar arguments had been made in January and March 1976. See TNA CAB 134/4048, MES (76) 12, 29th January 1976, and TNA CAB 134/4048, MES (76) 32, 12 March 1976.

[iv] The discussions are recorded in TNA CAB 128/60, CM (76) 38th Conclusions and CM (76) 39th Conclusions, 7 December 1976.

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