UK Monetary Policy from Devaluation to Thatcher, 1967–82

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UK Monetary Policy from Devaluation to Thatcher, 1967–82

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To my parents

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Preface

This book charts the course of monetary policy in the UK from the 1960s to the early 1980s. It shows how events such as the 1967 sterling devaluation, the collapse of Bretton Woods, the stagflation of the 1970s, and the International Monetary Fund (IMF) loan of 1976 all shaped policy. It challenges the existing historiography by showing the Bank of England and the UK Treasury experimenting with money supply targets nearly a decade before the Thatcher government placed monetarism at the heart of economic policy. The catalyst was provided by the IMF after devaluation in 1967. The result, in 1971, was Competition and Credit Control – the most radical overhaul of UK monetary policy since the Second World War.

This early experiment in monetary targeting was not a success. Despite having unpublished monetary targets in place, 1972–73 saw unprecedented growth in the UK money supply. Two years later, inflation hit record levels, apparently vindicating Milton Friedman's claim that excess monetary growth leads inexorably to higher prices after a long and variable lag. The experience reminded senior Bank and Treasury officials that it is impracticable to exercise tight control over the UK money supply. Paradoxically, it also persuaded influential politicians, academics, and commentators, less aware of the technical difficulties and realities of monetary policy implementation, that only tighter control of the money supply would cure Britain of her inflationary ills. The result was the Medium-Term Financial Strategy (MTFS), launched by the Thatcher government in March 1980.

The MTFS was based on a fundamental misreading of 1970s monetary policy. It produced a recession of unnecessary depth and severity that required the monetary policy U-turn of the 1981 Budget, the most controversial in postwar British history. Fiscal policy was tightened – to the bewilderment of much of the economics profession; monetary policy was loosened – to the relief of British business. This rebalancing allowed personal consumption, through increased household debt, to become the engine of growth in the 1980s. This failure to heed the lessons of 1970s monetary policy, and the subsequent increase in personal debt, has had profound long-term consequences for the shape of the British economy.

Note on Chronology

In this book, '1972/73' means the fiscal year ending April 1973. '1972–73' means the two calendar years 1972 and 1973. This sometimes differs in quotations from primary sources.

Definitions of UK Monetary Aggregates

- M0 Monetary liabilities of the Bank of England, coin issued by the Royal Mint, and the fiduciary note issue of the Scottish and Northern Irish banks.
- M1 Currency in circulation with the public and UK residents' sterling sight deposits with UK banks.
- M3 Currency in circulation with the public (excluding cash in banks' vaults but including non-UK residents' currency holdings) and the (sterling and foreign currency) deposits (including time deposits and certificates of deposit) of UK (public and private) residents with UK banks.
- £M3 Currency in circulation with the public and the sterling deposits of UK residents with UK banks.

Acknowledgements

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Special thanks go to my PhD supervisor Martin Daunton for always asking the difficult questions.

List of Abbreviations

BEQB	Bank of England Quarterly Bulletin
BOE	Bank of England Archive
CBI	Confederation of British Industry
CCC	Competition and Credit Control
CPA	Conservative Party Archive
CPRS	Central Policy Review Staff
CRD	Conservative Research Department
DCE	Domestic Credit Expansion
EBM	Executive Board Minutes (IMF)
EEC	European Economic Community
ERG	Economic Reconstruction Group
ERI	Exchange Rate Index
ERM	Exchange Rate Mechanism
<i>FT</i>	Financial Times
GDP	Gross Domestic Product
HMG	Her Majesty's Government
HMT	Her Majesty's Treasury
IBEL	Interest-Bearing Eligible Liabilities
IMF	International Monetary Fund
LBS	London Business School
LSE	London School of Economics
MBC	monetary base control
MLR	Minimum Lending Rate
MPG	Monetary Policy Group comprising Bank and Treasury officials
MTFS	Medium-Term Financial Strategy
NAIRU	Non-Accelerating Inflation Rate of Unemployment
NEDC	National Economic Development Council
NEDO	National Economic Development Office
OPEC	Organization of the Petroleum Exporting Countries
PCC	Policy Co-ordinating Committee, HM Treasury
PSBR	Public Sector Borrowing Requirement
SDR	Special Drawing Rights
TNA	The National Archives
TUC	Trades Union Congress