



# Managing the UK economy

## Fiscal and monetary policy since 1945

Week 6 – 1968-79: Inflation and the crisis  
of the post-war settlement

AY 2024-25

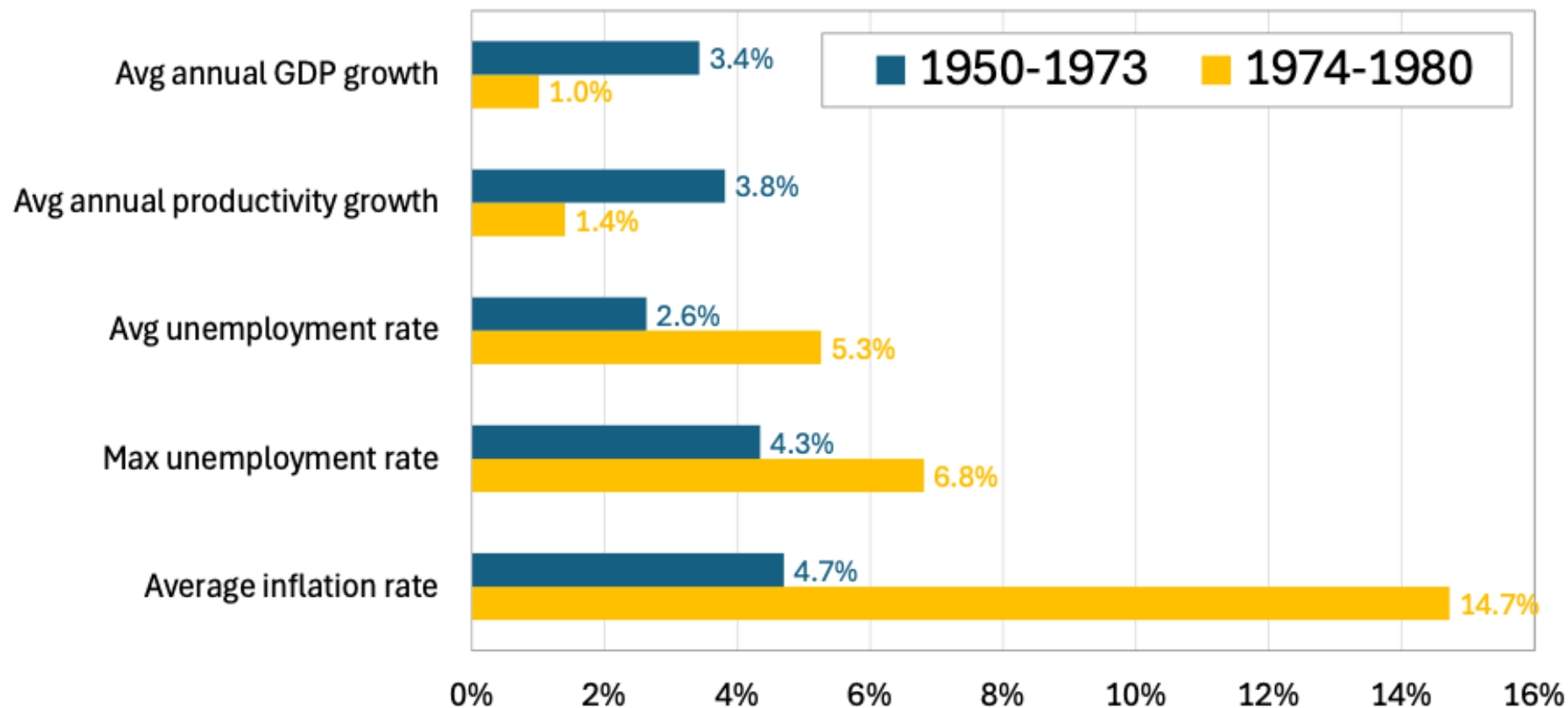
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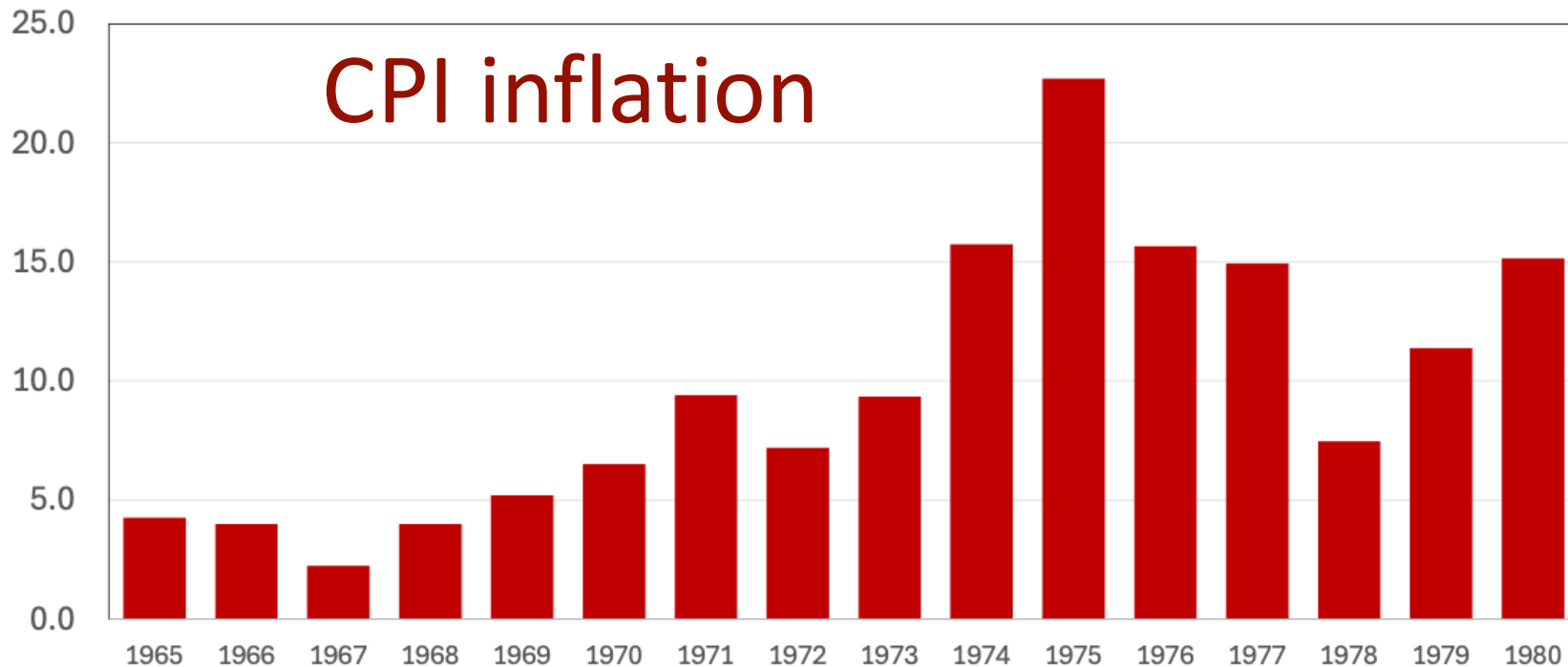
# 1968-1979: Overview

- 1973/74 oil shock marks the end of the post-war expansion



# 1968-1979: Overview

- Inflation imposes itself as the No.1 priority of policy

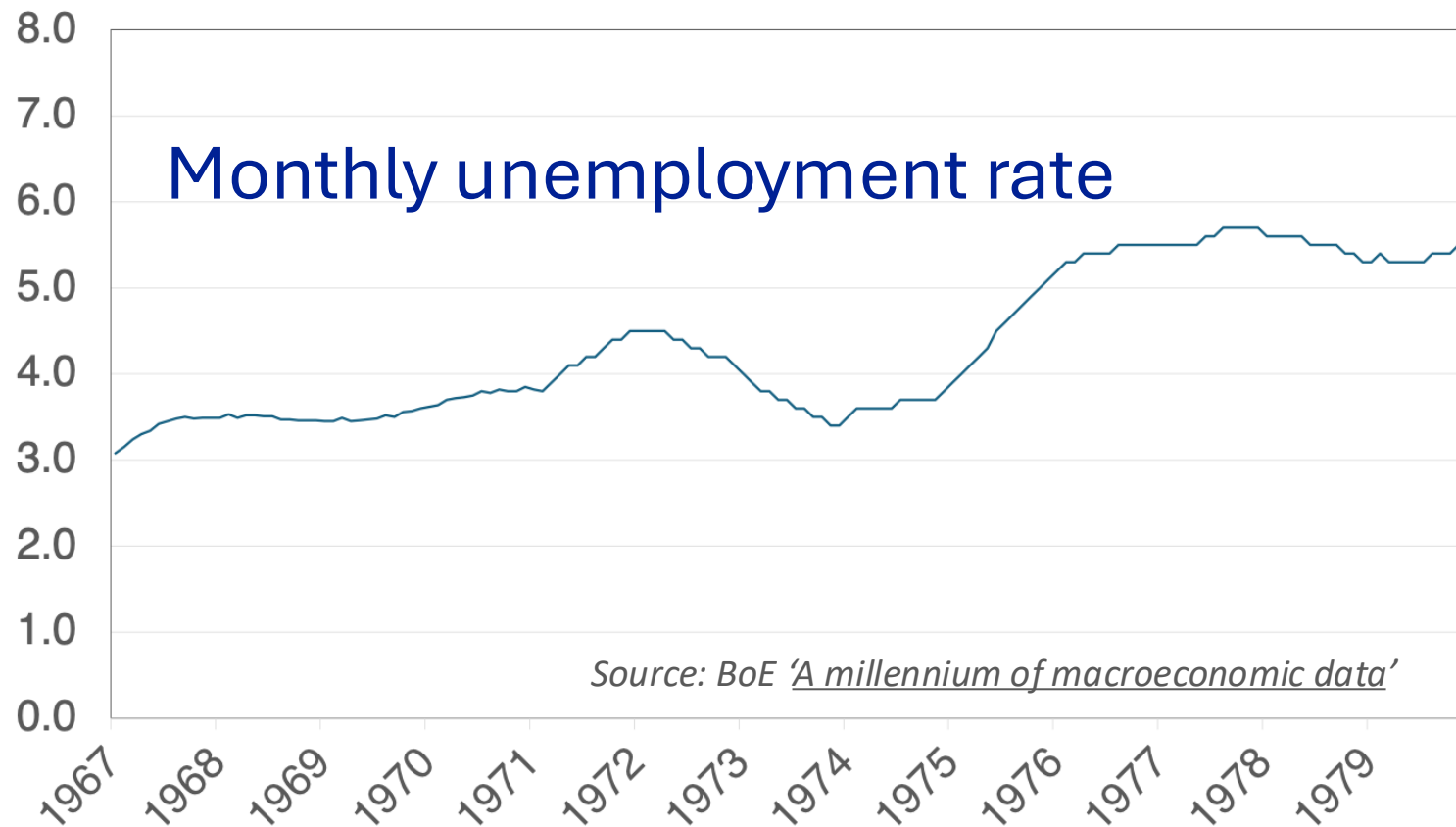


Source: BoE *'A millennium of macroeconomic data'*

- Rising trend in 1968-1972
- Explodes after the 1973/74 oil shock

# 1968-1979: Overview

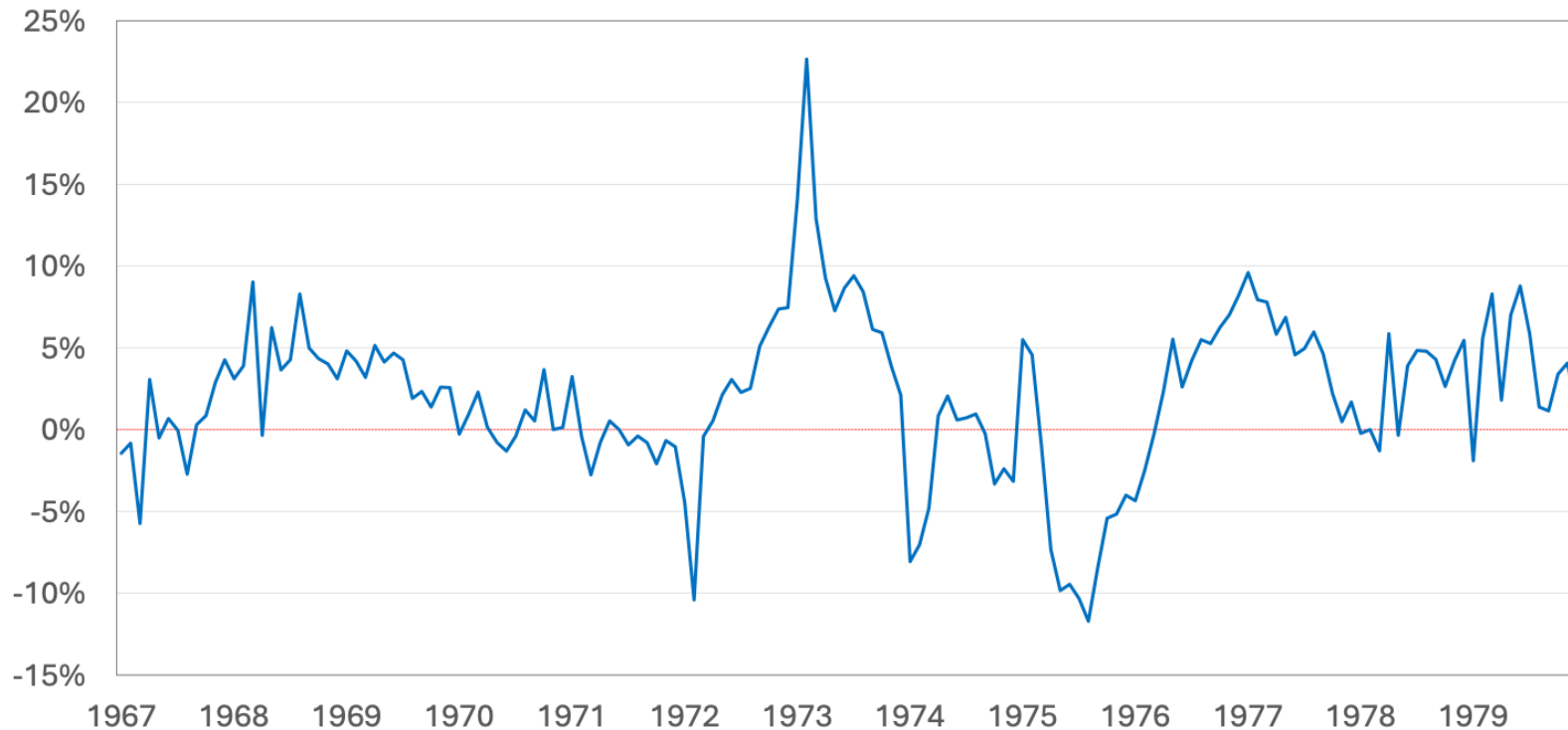
- *Stagflation*: unemployment increases at the same time as inflation



- Rising trend.
- Temporary decrease after 1972 'Barber boom'
- New rise in mid-1970s.
- Still not very high by historical standards.

# 1968-1979: Overview

## Monthly industrial production (year-on-year growth)

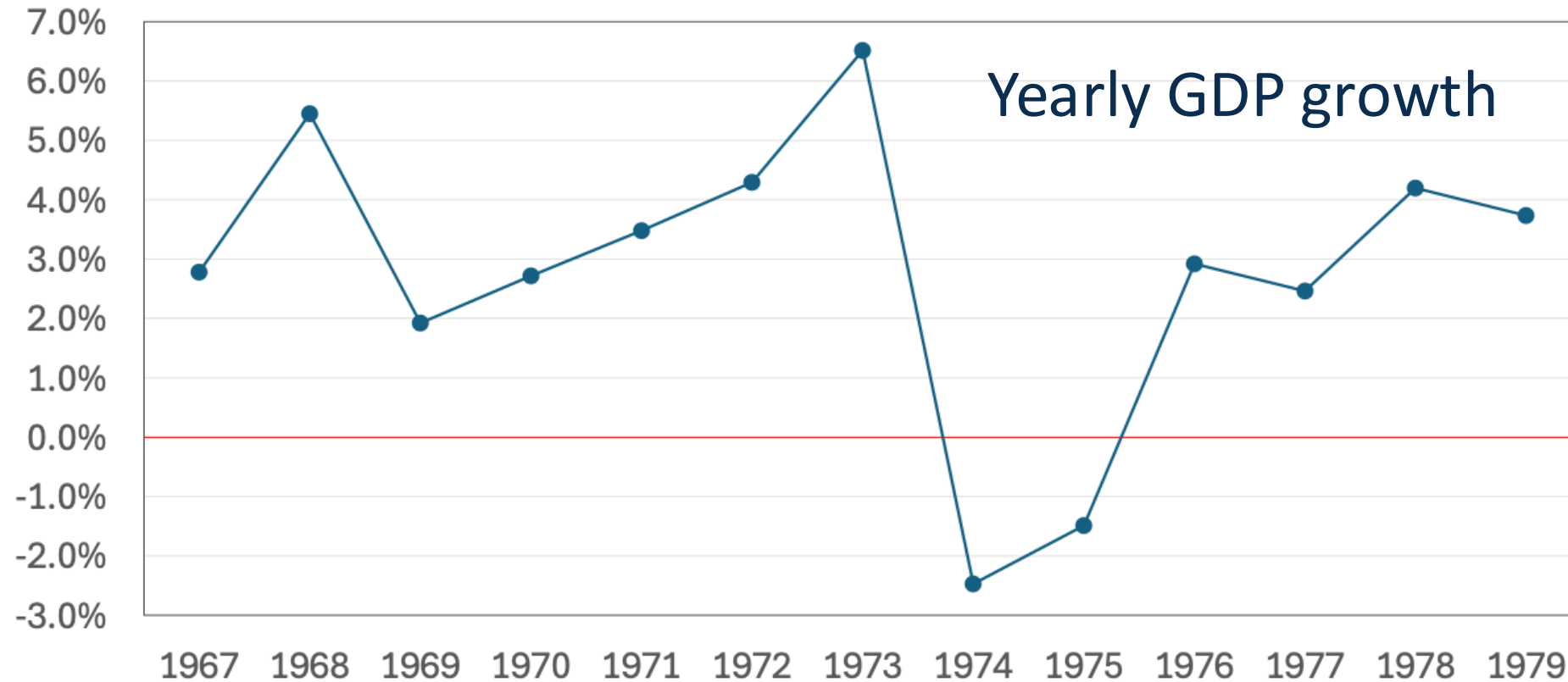


Source: BoE *'A millennium of macroeconomic data'*

- Post-devaluation recovery.
- Slowdown in 1970-71.
- Heath-Barber boom steep but short-lived
- Deep downturn after 1973/74 oil shock.
- Recovery after IMF loan agreement.

# 1968-1979: Overview

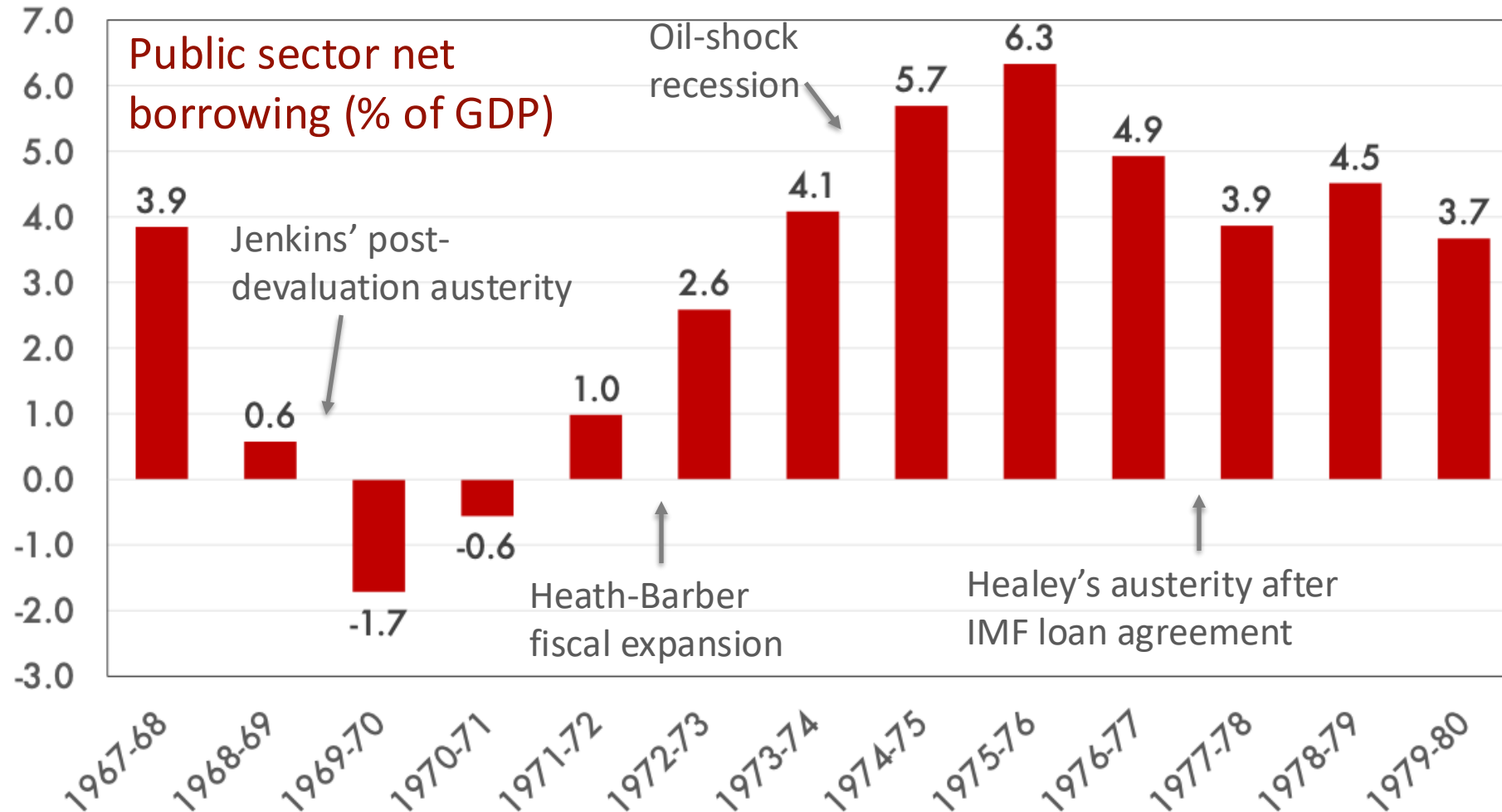
- 1974-75 is the first recession since 1948



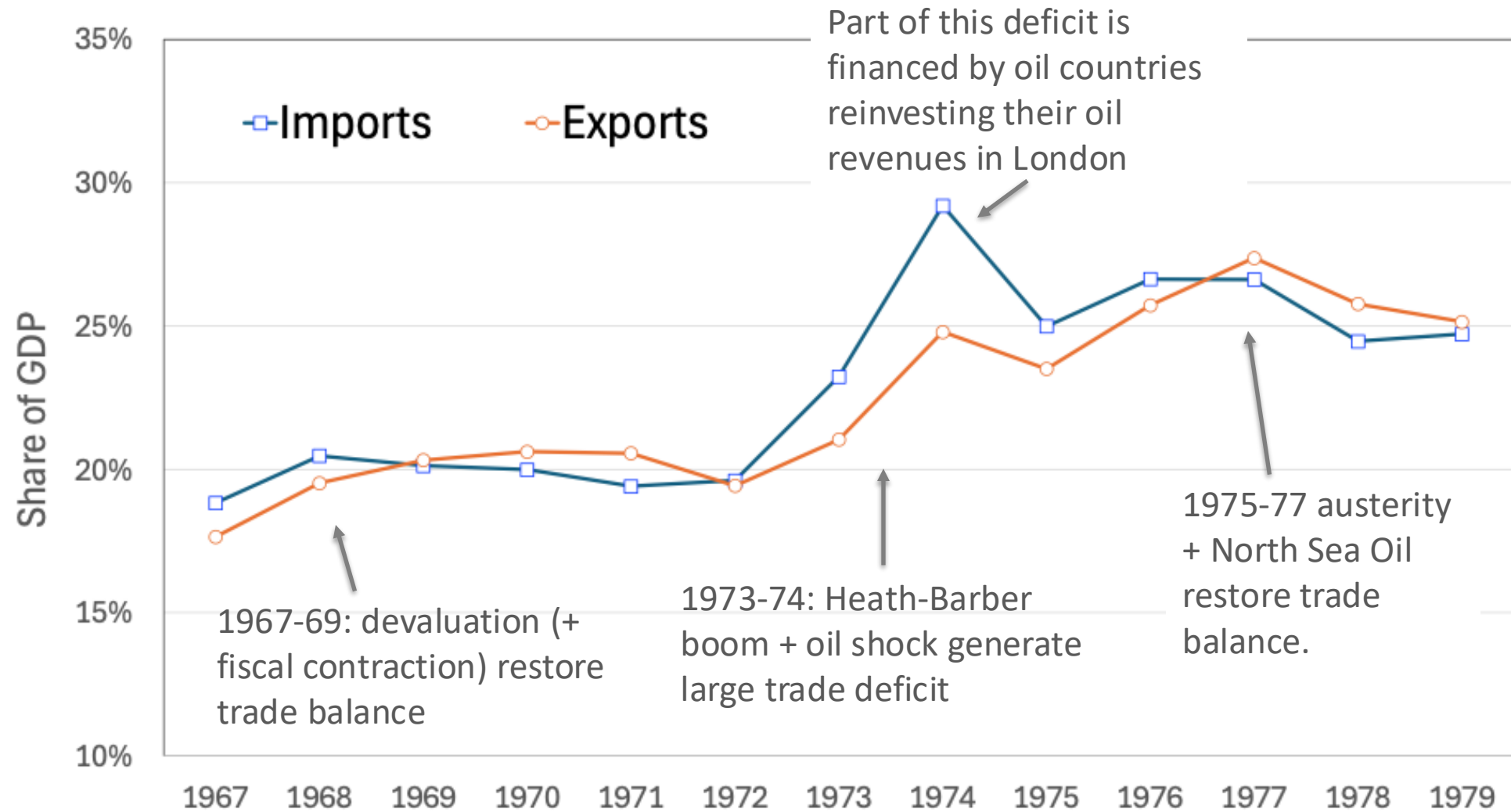
Source: BoE *'A millennium of macroeconomic data'*

# 1968-1979: Overview

- 1968-70 budget surpluses give way to large deficits in the 1970s



# 1968-1979: Overview





# 1968-1979: Overview

## The crisis of the post-war settlement

- With inflation the new priority, commitment to full employment is gradually abandoned (1975 budget a turning point).
- Growing skepticism of Keynesian demand-management policies.
- Government starts attacking trade union power (unsuccessfully until mid-1980s).

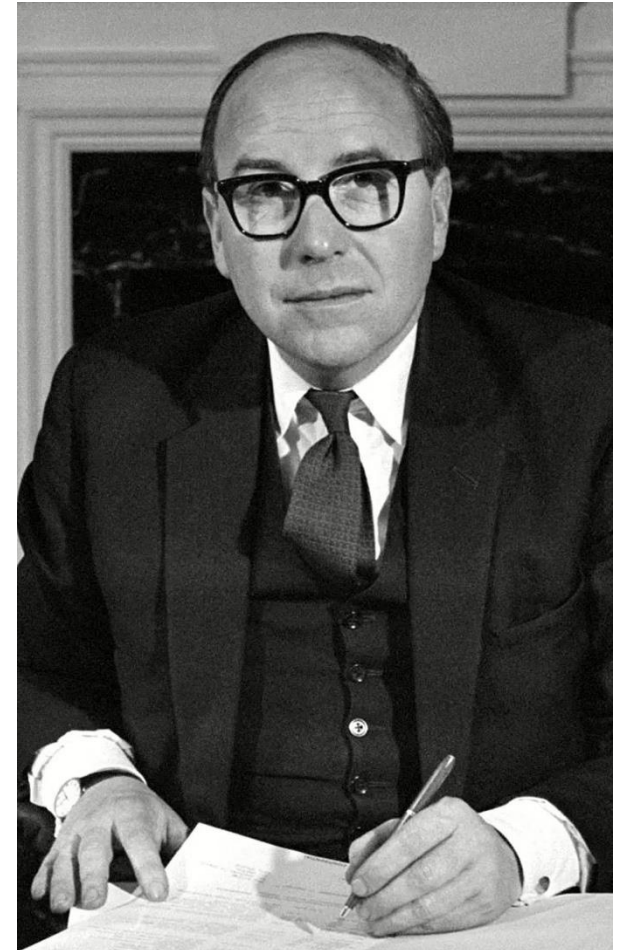
### Internationally:

- End of Bretton Woods system.
- Oil shocks end the 1945-1973 'Golden Age' of regulated capitalism



# 1968-1970: The years of hard slog

- Nov 1967: Deflationary measures “to make devaluation work”
  - 8% bank rate, credit restrictions, wage freeze
  - £500m fiscal package (~1% of GDP)
- New Chancellor Roy Jenkins: more drastic austerity
  - Jan 1968: £525m of spending cuts (~1% of GDP)
  - 1968 & 1969 budgets: £1,263m of tax increases (~2.5% of GDP)
- 1968 still a year of currency crisis
  - £ repeatedly on the verge of further devaluation or floating.
- 1969: Success at last – The BoP crisis is over
  - devaluation + fiscal tightening eventually do the job
  - BoP turns to substantial & durable surplus (until 1972-3)
- In 1970 austerity can be relaxed
  - Apr 1970 budget: a (very) cautious tax cut (£179m , ~0.3% of GDP)



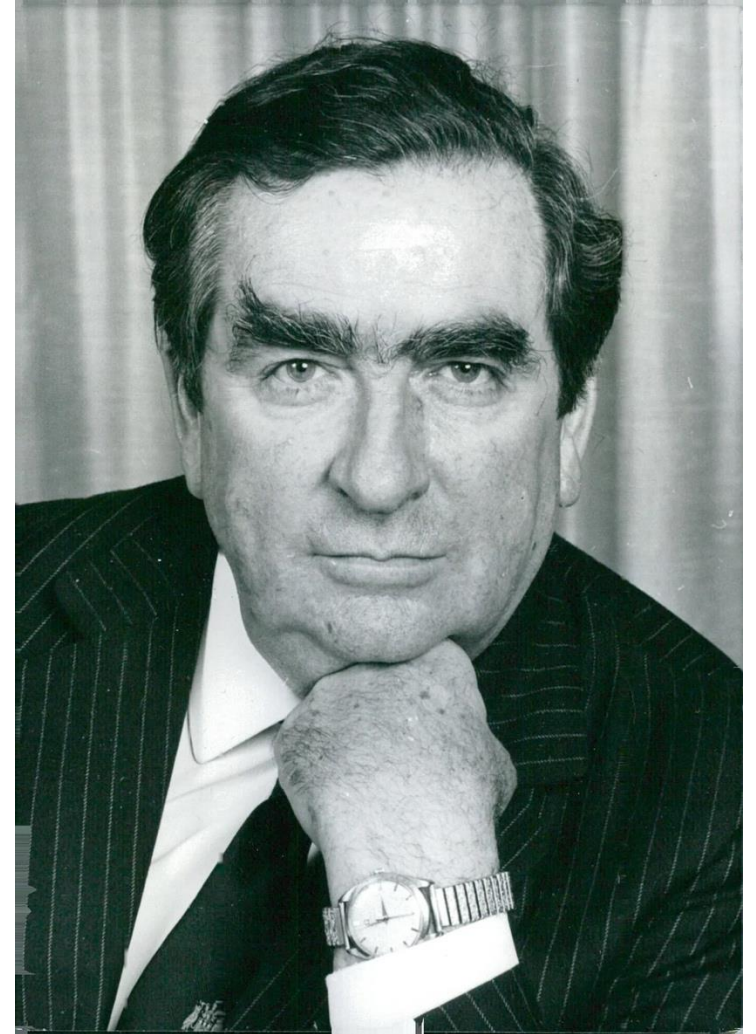
# 1970-1974: Heath Government

- June 1970 election: surprise Conservative victory.
- Electoral platform: reducing state intervention in the economy, clamping down on unions, reducing inflation.
- 1970-71: Attempted 'free-market' revolution
  - Refusal to rescue troubled firms
  - Discontinuation of incomes policy & industrial policies
  - Industrial Relations Bill regulating unions & restricting strikes
  - Opposition to the coal miners pay demands
- By 1972, failure and U-turn across the board
- Fiscal policy: An ill-timed dash for growth
  - 1970 budget neutral
  - 1971 and (mostly) 1972: huge fiscal expansion through tax cuts
  - 'Barber boom' was short lived and highly inflationary
  - 1974 budget starts to (timidly) reverses course



# 1974-1975: Healy & the economic crisis

- 1974: oil shock leaves UK in deep crisis
  - Recession & unemployment, external deficit & inflation.
- Feb & Oct elections give Labour a thin majority
  - Wilson PM until 1976, then Callaghan
  - Denis Healy Chancellor throughout
- Initial attempt to avoid deflationary policies
  - Social Contract with unions to moderate wages
  - 1974 budget(s) broadly neutral
  - But deficit explodes and inflation accelerate
- 1975: Healey turns to deflationary policies
  - 1975 budget raises taxes
  - Program of public expenditure cuts effective since 1976
  - Stricter incomes policy negotiated with TUC
  - 1976 budget: tax cuts for pay moderation



# 1976: Currency crisis & IMF loan

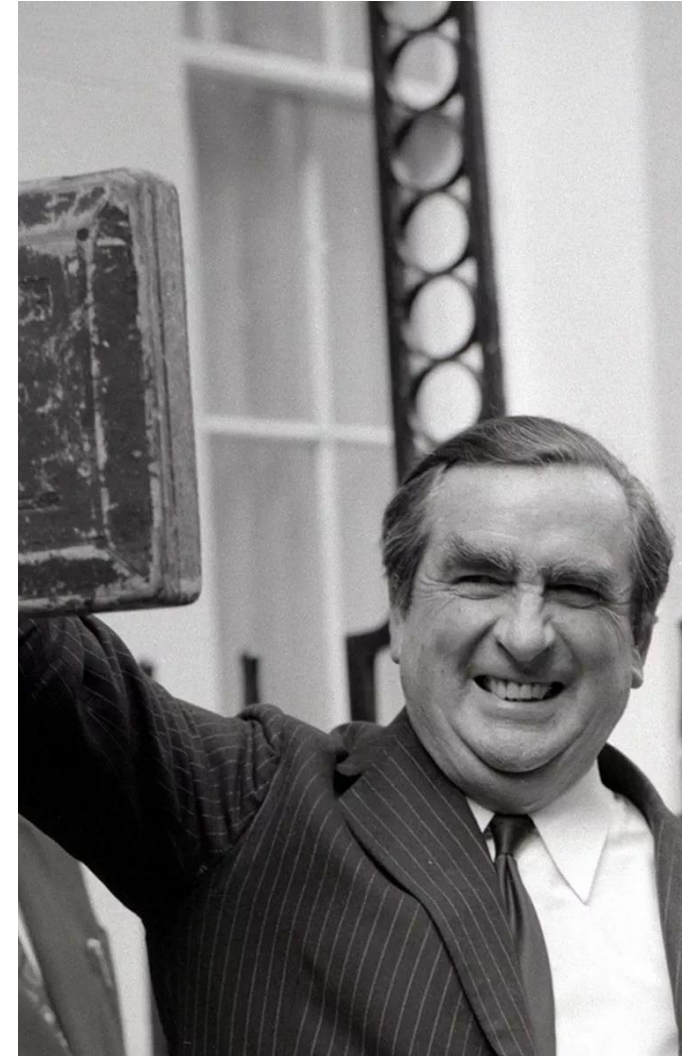
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- March/April : run on sterling begins
  - UK had higher inflation and trade deficit than its peers
  - Notwithstanding austerity turn & decrease in inflation, investors had low confidence in the Labour government
  - Expectation of large depreciation
- Government fears a freefall and supports the pound
  - \$5.3 billion short-term loan from foreign CBs, to be repaid December 9
  - \$1 billion spending cuts, Bank Rate at 13%
- Sep/Nov: IMF loan negotiation (\$3.9 billion)
  - UK commits to reduce deficit by £2.5 billion in two years
  - 2 billion spending cuts + 0.5 billion sales of assets (BP shares)

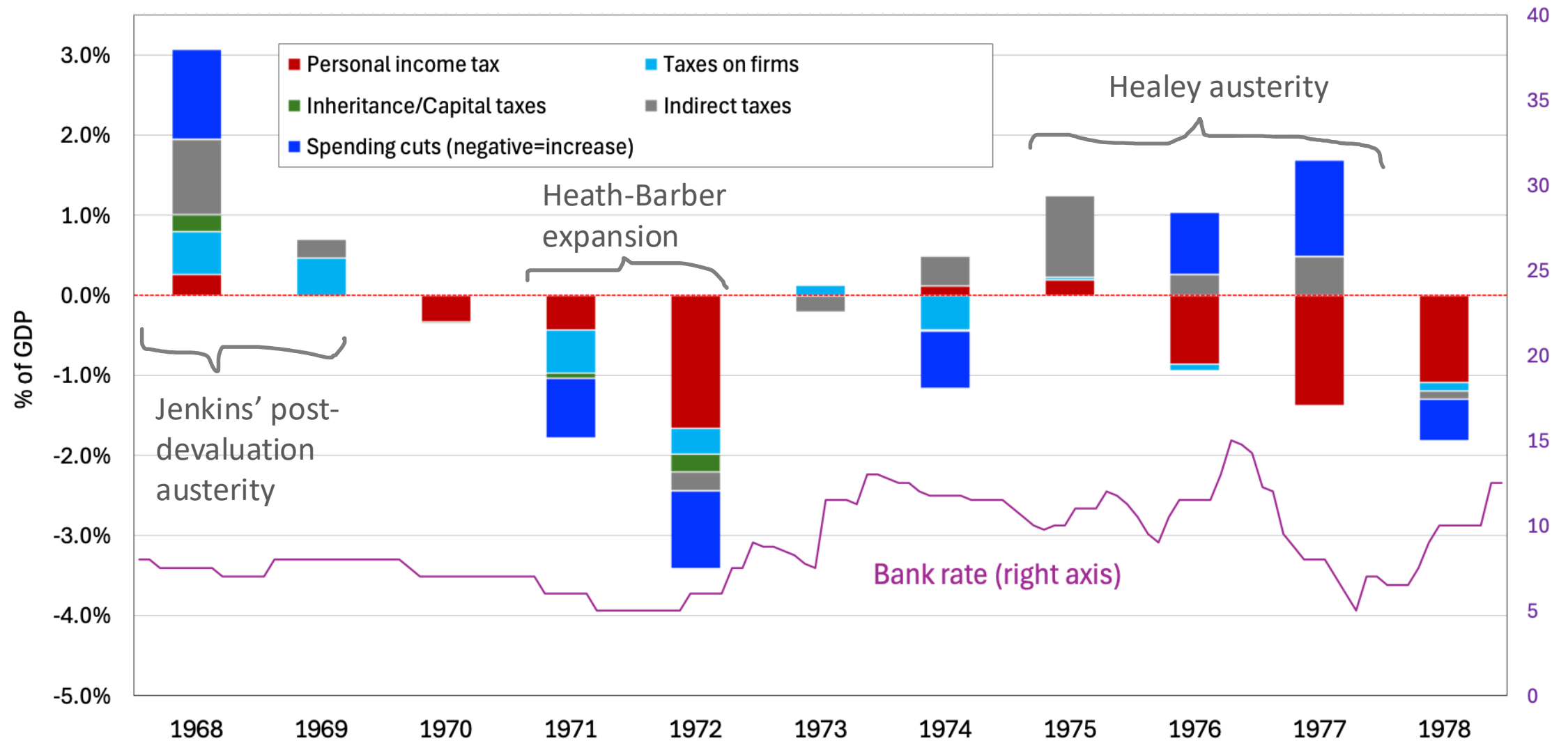


# 1977-1978: Recovery

- IMF loan agreement halts & reverses the currency crisis
  - Pound recovers and starts appreciating
- Lower than expected 1967-77 deficit makes it easier to meet the IMF conditions.
  - PSBR £8.5 billion instead of the expected £10.5
  - Basically no change needed to meet agreement
- 1977-78 recovery
  - BoE lowers bank rate and accumulates reserves
  - Helped by North Sea oil, current account returns to balance
  - IMF loan not drawn in full and repaid by 1977
  - Expansionary 1978-79 budget
  - Both unemployment and inflation stabilize
- But prolonged wage restraint causes a 1978-79 ‘winter of discontent’



# Fiscal & monetary policy, 1968-78



Sources: Tait (1968, 1969, 1970, 1971, 1973, 1974); Bristow (1978) and BoE, 'A millennium of macroeconomic data'.

# The transition to a flexible exchange rate

**Aug 1971:** Dollar inconvertibility – end of Bretton Woods.

**Aug-Dec 1971:** World currencies float.

**Dec 1971 Smithsonian Conference:** new dollar parities, wider ( $\pm 2.25\%$ ) bands.

**May 1972:** UK joins the European ‘snake in the tunnel’: fixed parities with narrower bands among European currencies.

**June 1972:** After 1972 budget, UK forced out of the snake and “temporarily” floats the pound.

**Feb 1973:** Smithsonian agreement collapses, all major currencies float.

**Mar 1979:** European ERM, but UK stays out (until 1990).





# The UK and Europe

## 1957: Treaty of Rome creates EEC (Fra, Ita, Ger, BeNeLux)

- Common market
- In retrospect, probably a mistake for UK to stay out

## 1963 & 1967: France vetoes UK application

## 1973: UK joins the EEC

- Labour gov't slightly renegotiates terms & launches referendum
- 1975 referendum confirms UK membership

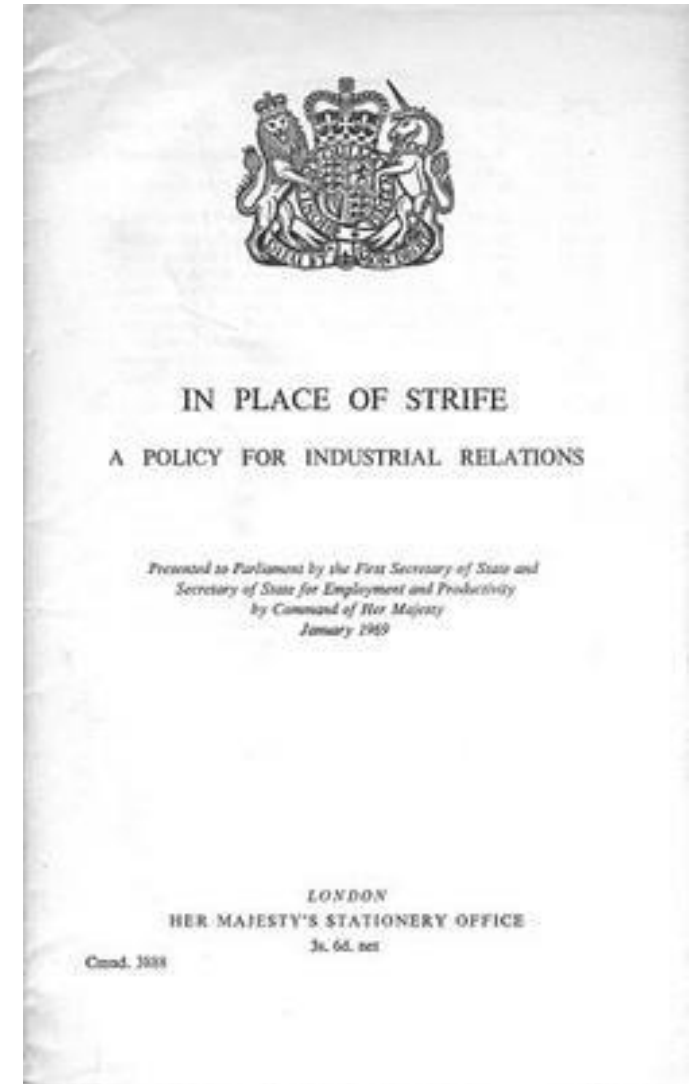
## 1978: UK stays out of Exchange Rate Mechanism

- Looks good in retrospect (1990 accession will prove a disaster).
- Treasury provided excellent macroeconomic analysis which helped the government decide not to join (Dell, [1994](#) and [1996](#)).
- Would probably have brought more disruptive currency crises.



# Incomes policy: 1968-69

- Incomes policy helped contain inflation during the 1964-67 currency crisis
- But largely broke down in 1968-69.
  - Proliferation of ‘productivity exceptions’.
  - Unions seem to be losing authority over their members (labor militancy, wildcat strikes, ...).
- 1969: Labor government issues ‘In Place of Strife’
  - A white paper with proposals for regulating industrial relations
  - Commission on Industrial Relations forcing wage settlements.
  - Stricter regulation of strikes.
  - After negotiations, the proposal is retracted in exchange for a commitment by the TUC to clamp down on wildcat strikes.



# Incomes policy: 1970-72

- 1970-71: Heath gov't rejects incomes policy
- 1971 Industrial Relations Act tries to weaken unions
  - Restricted right to strike by reducing unions' legal immunities.
  - Unions required to strictly regulate their strike procedures (cooling-off periods, ballots, limits on who & when can strike).
  - National Industrial Relation Court, where all unions register, would scrutinize their rule book.
- Fails to restrain industrial action & wage claims.
- 1972 U-turn: government seeks cooperation of unions & employers for an incomes policy



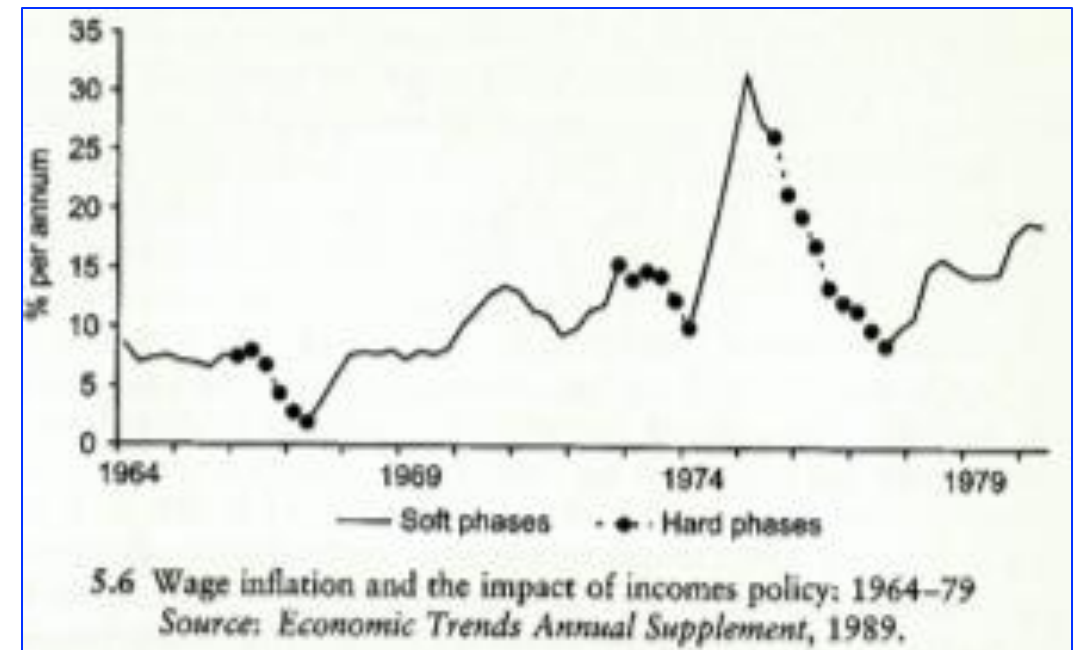
# Incomes policy: 1972-74

- 3 stages of Heath government incomes policy:
  1. Nov 1972-Apr 1973  
6-months statutory freeze on wages and prices (after failure of talks with TUC & CBI).
  2. Apr-Nov 1973  
Wage increases limited to £1/week + 4%.
  3. Nov 1973-Jul 1974  
Largest of 7% or £2.24/week  
But if inflation > 7%, an extra £0.40 for each 1% increase in inflation.
- Oct 1973-Feb 1974: miners' strike leads to state of emergency and brings down the government.



# Incomes policy: 1974-79

- Labour leverages its good relations with unions.
- 1974 Social Contract: ‘responsible bargaining’ for union-friendly policies.
- 1975-77: Amid inflation surge, stricter incomes policy successfully negotiated.
  - Strict limits on wage increases in 1975-77
  - Effective in limiting wage inflation
  - Again, union-friendly policies in exchange
- After 1977 negotiations break down
  - Government unilaterally imposes statutory wage growth limits
  - Wage claims & strikes increase again in 1978-79
- 1978-79 ‘Winter of discontent’ against wage limits





**Thank you for your attention**