UK economic policy in the 1960s and 1970s and the challenge to learning

Michael J. Oliver[1]

Hugh Pemberton[2]

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INTRODUCTION

In a recent review of White Heat, Dominic Sandbrook's survey of Britain in the 1960s, Vernon Bogdanor criticised Sandbrook's failure to construct an analysis that placed the economy at its centre. He noted that

> Wilson and his closest allies such as his economic adviser, Thomas Balogh, believed that Britain's problems were deep seated. They required not tinkering with the exchanges but supply-side remedies – better management, higher-quality education, trade union reform, improvements in productivity and an end to restrictive practices. They were Thatcherites ahead of their time.[3]

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[1] Michael Oliver can be contacted via email at mjo@btinternet.com

[2] Email and other contact details for Hugh Pemberton can be found at www.hughpemberton.org.uk

[3] Bogdanor, 'Not swinging but sinking', Financial Times Magazine, 29-30 July 2006.

It is unlikely than many would agree with Bogdanor about the application of the 'Thatcherite' label to the 1964-70 Labour government, nor its application to the preceding Conservative administration – from which, it might be argued, sprang many of Labour's policies for the modernisation of Britain. Nonetheless, it is certainly true that governments of both left and right sought to bring about the 'modernisation of Britain' and remove supply-side impediments to growth throughout much of the 1960s and 1970s.[4] In fact it tends to be forgotten that the years between the early-1960s and the mid-1970s were ones in which British governments made extensive changes to the framework of British economic policy, both internal and external, to just these ends. Why then, as Bogdanor went on to ask, did their thinking have so little effect? Or perhaps the better question is why do all the policy changes, many of them quite fundamental, that were made in these years no longer resonate?

Instead, the late-1970s is generally seen as the period in which everything changed in economic policy.[5] Peter Hall, for example, invokes the Kuhnian notion of a paradigm shift, arguing that the changes made after 1979 went beyond the resetting of economic policy instruments (what he terms 1st order change) and the devising of new instruments (2nd order change). Instead Hall sees evidence of a 3rd order of change, one involving alterations to the very goals of policy and thus a fundamental change in the ideational framework within which policy was made – an economic policy paradigm shift.[6]

It is our contention, however, that between 1961 and 1976 the major changes that took place in British economic policy had the potential to be as fundamental and as long-lasting, and thus as significant, as those that took place in the years that

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[4] For example, every prime minister in these decades (with the possible exception of Alec Douglas-Home) would, we suspect, have agreed with Walter Rostow's observation in 1965 that 'what is needed is a basic change in British way of doing business: getting to work earlier, having fewer upper class dullards on boards of directors, etc'., 21 May 1965, National Archives, College Park, Maryland, USA (hereafter NA, US), RG59/Box 303.)
[5] See, for example: Cairncross, The British economy, p. 226; Gamble, Britain in decline, p. 194; Gardner, Decade of discontent; Hay, 'The "crisis" of Keynesianism'; Smith, Rise and fall, p. 70.
[6] Hall, 'Policy paradigms'.

followed.[7] These changes encompassed both the domestic and external dimensions of the United Kingdom's economic policy and, unusually, were often characterised by alterations not just to policy instruments and policy settings but by changes to the very goals of policy. For example, the early- to mid-1960s saw a concerted attempt, first by the Conservative government and then by its Labour successor, to shift Britain towards a system of tripartite economic planning in the domestic policy arena. In the process, governments amended and recalibrated domestic policy goals, with the introduction of targets for economic growth, and with higher growth itself, made the primary goal of economic policy. Alternatively, in the realm of international financial policy, one might point to floating of the pound in 1972 or, more fundamental, the withdrawal of foreign official sterling balances in 1977 and thus the downgrading, perhaps even effective ending, of sterling's reserve currency role. Both in the domestic and in the external policy arenas therefore changes took place that involved both substantial changes both to the instruments of policy and to policy goals and which thus might be thought to qualify for 'paradigm shift' or '3rd order change' status if Hall's model of social learning in economic policy is correct.

This paper will examine the policy changes that occurred in the 1960s and early-1970s in both domestic and external economic policy and will consider why those changes, despite their potential for fundamental change, proved to be less significant than their architects hoped. We will ask whether any part in the failure of those policy changes to fulfil their potential was played by discrepancies between the respective internal and external policy agendas. In doing so we will first discuss relevant theoretical work in political science before going on to use this framework in an analysis of developments in the domestic and international financial policy arenas.

AGENDA SETTING

It is generally assumed that 'ideas matter' if we seek to explain economic policy change; that policy might best be seen as the product of 'the gradual encroachment

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[7] Over the last five years, the archives of the Treasury and Bank have yielded significant new material on monetary and fiscal policy between 1964 and 1976, much of which has yet to be fully analysed by economic historians. We draw on some of these sources in this paper.

of ideas', as Keynes put it.[8] This is surely too simplistic, however, not least because it puts too much emphasis on the inevitability of good ideas succeeding.[9] Yet devising theories or analytical frameworks that explain the relationship between ideas and policy change is far from easy. One might identify three principal means of conceptualising the influence of ideas on public policy.[10] Peter Hall, for instance, has argued that for ideas to be used as the basis of policy they must be economically viable, consistent with prevailing political interests, and administratively expedient.[11] Colander and Coates, and others, have suggested viewing the process in terms of viral infection, or the development of a marketplace for ideas, or in terms of information theory.[12] Others have identified 'policy networks' or 'advocacy coalitions' as the means by which ideas enter the political process and are taken up and turned into policy.[13] In fact the mechanisms by which government's 'learn' remain the subject of intense disagreement.[14] A particular problem for theories that seek to explain policy change is that they find it difficult to explain why it is that some ideas are successful and some are not. They also struggle to explain why it is that governments sometimes seem to fail to learn lessons from past experience, or learn only slowly.[15] Indeed, some political scientists have questioned whether governments can actually learn at all.[16]

However, it seems to us that John Kingdon's seminal work on the interaction of ideas and political agendas in public policy remains pertinent in the context of UK economic policy making in the 1960s and 1970s.[17] Kingdon deconstructed the process of policy making; identifying three major process streams in government. The first was the stream of policy problems faced by both government officials and

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[8] Keynes, <u>The general theory</u>, p. 383.
[9] Critics arguing that Keynes' assumption about the almost irresistible power of new ideas is too naïve include Parsons, 'Keynes'; Gamble <u>Ideas</u>; Colander and Coates, <u>Spread of economic ideas</u>.
[10] Parsons, <u>Public policy</u>.
[11] Hall, <u>The political power</u>.
[12] Colander and Coates, <u>Spread of economic ideas</u>; Richardson, 'Government'.
[13] Sabatier, 'An advocacy coalition' and 'Towards better theories'; Haas, <u>When knowledge is power</u>; Barberis and May, <u>Government, industry and political economy</u>; Daugbjerg and Pedersen, 'New policy ideas'; Morone and Taylor, 'Knowledge diffusion dynamics'; Howlett, 'Do networks matter?'; Pemberton, 'Policy networks'.
[14] John, 'Ideas and interests', p. 40; Brown, Kenney and Zarkin, <u>Organizational Learning</u>.
[15] Etheredge, 'Government learning'; Sabatier, 'Knowledge, policy-oriented learning'.
[16] Etheredge, <u>Can governments learn?</u>
[17] Kingdon, <u>Agendas</u>.

politicians (a condition being seen by Kingdon as a problem when people 'become convinced that something must be done to change it').[18] Three mechanisms are seen by Kingdon as bringing problems to the fore: indicators; events; and feedback arising from past decisions demonstrating either a failure to achieve desired ends or revealing unintended consequences.

The second stream was what Kingdon termed a 'policy stream' in which specialists in the field (possible candidates for inclusion in the context of British economic policy might be civil servants in the Treasury, officials at the Bank of England, policy analysts in think-tanks, and academic economists) seek to devise solutions to those problems. In an arresting image, Kingdon likened the process of policy emergence in this stream to the way in which life first came into being from the 'primeval soup' before life came into being.[19] In the process new ideas emerge, and old ideas mutate and recombine. Of course, ideas are better able to survive if they are technically feasible, acceptable to the policy community's pre-existing values, and anticipate, to some extent, possible future constraints. But the emergence of new ideas is also a function of 'policy entrepreneurs' pressing proposals and 'softening up' the policy community. Gradually a consensus emerges, the idea 'catches-on'. 'After some degree of diffusion, there seems to be a take-off point'.[20] People start to refer to a 'widespread feeling'. As Kingdon notes, this all looks a bit like Shelling's 'tipping model' but the phenomenon differs from its equivalent in the political arena.[21]

It is the political arena that provides Kingdon's third stream; one which he saw as having a powerful impact on agendas. The stream is made of elements such as the 'national mood' (which may precede political realignments such as elections, but which one might presume could also precede them); organized political forces such as political parties or pressure group campaigns; and shifts in government thinking in terms of ideological shifts within political parties, changes of government arising from election results, or shifts in the ideological predispositions of political actors. As in the

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[18] Kingdon, Agendas, p. 114.
[19] Kingdon, Agendas, pp. 116-7.
[20] Kingdon, Agendas, p. 140.
[21] Schelling, Micromotives and macrobehavior, pp. 99-102.

policy stream, in the political stream a process of consensus building around a particular idea takes place, but in the political stream the process of 'tipping' is a process of coalition building.[22]

One attraction of Kingdon's model is its portrayal of policy-making as 'fragmented, contingent and highly fluid'.[23] In our view, however, Kingdon's most important insight was that change is only precipitated when these streams converge or 'couple'; at which point a 'policy window' opens up, perhaps quite briefly. A window opens because of either a change in the political stream or because a new problem captures the attention of officials. 'A problem is recognised, a solution is developed and available in the policy community, a political change makes the right time for policy change, and potential constraints are not severe'.[24] Problem windows and political windows are, of course, related. For example, if a window opens because of a pressing problem, how the proposed solutions fare will depend on political acceptability. But coupling is important because 'Problems of politics by themselves can structure the *governmental* agenda. But the probability of an item rising on the *decision* agenda is dramatically increased if all three streams - problems, policies, and politics, are joined'.[25] Policy entrepreneurs are an important factor in the process: waiting for windows to open, and pressing policy solutions.[26]

We question, however, the implicit assumption in Kingdon's work that all windows are the same. We note, for example, Exworthy and Powell's distinction between 'big windows' and 'little windows'.[27] They were thinking in terms of 'big' windows opening at national level and 'little' windows at local level. In economic policy, we prefer to conceptualise this distinction somewhat differently – seeing a difference between windows that open *within* the domestic or international policy dimensions and windows that open *across* them (i.e. where windows open simultaneously in both

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[22] Kingdon, Agendas, pp. 145-64.
[23] Tiernan and Burke, 'A load of old garbage'; Mucciaroni, 'The garbage can'.
[24] Kingdon, Agendas, p. 165.
[25] Kingdon, Agendas, p. 178 (original emphases).
[26] Kingdon, Agendas, pp. 179-82.
[27] Exworthy and Powell, 'Big windows'.

dimensions). And in allowing such 'big' windows to open we see an important role for the 'catalytic' impact of crises.[28]

In the remainder of this paper, we will go on to consider developments in UK economic policy in the 1960s and 1970s in the context of Kingdon's policy stream model, but paying attention to the ways in which the opening of windows occurred in either the domestic dimension of economic policy or the international dimension, but rarely in both – as shown in Figure 1 (at the rear of the paper). The exception, we argue is 1976 – and here we see the IMF crisis as precipitating the opening of a 'big' window encompassing both policy dimensions. However, whereas Kingdon sees window openings as fleeting events we see the window opened in 1976 as having stayed open for some time.[29]

THE POSTWAR ECONOMIC PARADIGM

We begin with the observation that in the postwar period UK economic policy was pursued within different frameworks, or paradigms, in the domestic and international arenas. In terms of macro-economic policy, we note that in British universities and in Whitehall 'Keynesianism' dominated economic thinking. We will not here engage with the extensive debate about 'what Keynes really meant' in the *General Theory* and whether post-war British economic policy was truly Keynesian.[30] Instead, we accept that the domestic economic policy framework can be described as 'Keynesian' in the sense that the government, encouraged by economists in the Treasury's Economic Section, actively sought to manage aggregate demand, and hence output and employment, the aim being to maintain employment by 'fine-tuning' the economy on the basis of national income forecasts via changes in taxation and public spending.[31] Fiscal policy dominated the thinking of officials with monetary policy relegated to the back-burner.

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[28] Stern, 'Crisis and learning'.
[29] Kingdon, Agendas, p. 166.
[30] Blaug, 'Recent biographies of Keynes', pp. 1204-1215, 210-12; Tomlinson, British macro-economic policy and 'An unfortunate alliance'; Rollings 'Poor Mr. Butskell'.
[31] Feinstein, The managed; Peden, The Treasury; Booth, 'Britain in the 1950s'.

In international financial policy, since 1944 sterling had been managed within the context of the Bretton Woods system, the implicit goals of which were exchange rate stability and trade liberalisation.[32] The former was to be achieved by countries operating a fixed but adjustable exchange rate and the latter through the acceptance of current account convertibility. This meant that within the Bretton Woods system Britain had to undertake to hold a fixed rate of exchange in relation to other currencies.[33] The Bank of England accomplished this through the use of the Exchange Equalisation Account (EEA), in which it held foreign exchange that could be used to purchase sterling, in order to stabilise its rate of exchange. However, the continued use of this mechanism required a ready supply of foreign currencies. This in turn necessitated:[34]

- Balance of payments surpluses, so that the accrued foreign exchange could be passed to the EEA.
- The maintenance of confidence in sterling, in order to attract, and to retain, flows of foreign capital to the city of London, which in turn could be used to bolster the EEA.
- If these could not be achieved, then Britain could turn to the international financial community in order to borrow foreign exchange.
- Under circumstances where all of the above failed to supply enough foreign exchange to hold the rate, the rate itself would be adjusted.

Furthermore, it is important to recognise that within the Bretton Woods system, sterling acted as the second reserve currency.[35] Countries of the sterling area (which almost mirrored the Commonwealth) held their foreign reserves in sterling and were entitled to buy and sell sterling in order to maintain the stability of their own currencies. In short, when they acted to stabilise their own currencies, this had a destabilising effect on sterling.

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[32] Horsefield, International Monetary Fund, pp. 185-218 and Ruggie, 'Embedded Liberalism Revisited', p. 203.
[33] 'Treasury Historical Memorandum No. 30: The Collapse of the Bretton Woods System, 1968-1973', The National Archives, Kew (hereafter TNA) T 267/36.
[34] Adapted from Hirsch, Pound Sterling, pp. 47-49.
[35] 'Treasury Historical Memorandum No. 16: Sterling Balances Since the War', TNA T 267/29.

POLICY PROBLEMS AT THE END OF THE 1950s

In domestic terms, it was clear by the end of the 1950s that the Keynesian framework was not infallible. Critics pointed to a number of failings but particularly to the 'stop-go' (or more correctly 'go-stop') pattern of economic performance during the decade. Keynesian demand management had not abolished the business cycle; nor did it seem to have attenuated either its amplitude or its frequency. In fact, by the beginning of the 1960s there seemed good reason to believe that demand management was tending to exaggerate rather than smooth the economic cycle, with interventions tending to be both too late and too great as a consequence of problems with timely data collection and accurate forecasting.[36] As a result, it was believed the government's 'stabilisation policy' was actually destabilising the economy and, by creating unrecoupable costs in excessive downswings, crippling both long and short-term expansion. By the early-1960s it was being identified as a significant constraint on economic growth and thus as a major failure of post-war Keynesian demand management.[37] Britain also continued to experience recurrent sterling crises. There were fears that this flowed directly from balance of payments problems that were seen to stem directly from competitive inadequacies on the supply-side of the domestic economy. Perhaps more important for the long-term stability of the Keynesian policy framework, the 1950s saw a continuous rise in both prices and wages and after 1952 wages began to rise faster than the increase in productivity.[38] Finally, contemporaries drew profoundly negative conclusions about the prevailing policy framework from the evidence emerging from the new institutions of the postwar world that demonstrated Britain's relative decline was not just continuing but, apparently, actually accelerating.[39]

In the international policy arena, one of the central problems for the UK after the Second World War was illiquidity. The excess of short-term liabilities over short-term assets was not addressed by either Conservative or Labour governments and

[36] Dow, The management.
[37] Worswick and Ady, The British economy.
[38] Worswick and Ady, The British economy, pp. 51-3.
[39] Tomlinson, The politics of decline.

because foreign exchange reserves were not allowed to increase to a level which would have made it possible to sustain sizable fluctuations in the balance of payments and movements in short-term capital, economic policy was geared towards policies which distorted and inhibited development and growth. Reserves were spent as fast as they accrued and any earnings from current account surpluses were applied to increasing long-term assets rather than improving the short-term balance. Due to the low level of reserves, whenever imports increased in periods of economic expansion, there were invariably financial problems until an increase in exports could redress the balance. In short, internal growth and external equilibrium appeared to be incompatible. Another major cause for concern throughout the period was the increasing doubts about the viability of the international monetary system under the gold-exchange standard, with both the UK and US persistently in deficit.

1961 – THE 'MODERNISATION OF THE BRITISH ECONOMY'

In July 1961 the then Chancellor, Selwyn Lloyd told the House of Commons during a debate on measures required to deal with yet another sterling crisis, that the Conservatives were no longer afraid of the word 'planning' and set in train a major overhaul of the government's domestic economic policy objectives, and the policy instruments used to achieve those objectives. Within a year, the government had placed faster economic growth at the top of its policy priorities, endorsing the ambitious target of 4 per cent annual growth recommended by the new National Economic Development Council (NEDC).[40] The NEDC was itself part of an ambitious attempt, outlined by Selwyn Lloyd in his speech to the House, to shift the British economy towards a continental style model of economic planning involving tripartite bargaining between government, employers and trade unions. Set up by the government in 1962 it sought 'indicatively' to plan the economy to attain the required level of faster growth by setting targets for key indices such as the rate of growth of gross domestic product and of investment in specific industrial sectors. Its definition remained somewhat vague but most commentators hoped it would improve growth via improved expectations, better knowledge, coordinated output decisions, and the

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[40] Middlemas, Keith, Industry, unions and government; Ringe and Rollings, 'Responding to relative decline'; Mitchell, 'The function of the NEDC'.

removal of supply-side obstacles to growth.[41] It operated both at the national level in the NEDC and through a series of subordinate development councils at industry level.

At the same time as it embraced planning, however, the government also undertook an overhaul of policy instruments that were also aimed at achieving the new growth target.[42] It sought to promote other changes to promote efficiency on the supply-side of the economy, such as the institution of a training levy and the setting up of new institutions at the national and industrial level to encourage more and better industrial training.[43] It overhauled fiscal policy: setting up a new Public Expenditure Survey Committee (PESC), 'a centralized attempt to allocate resources rationally' and more efficiently, and a means of ensuring public spending decisions were taken with the attainment of faster growth in mind; and it began to look for ways in which the tax system could be altered, particularly to improve the efficient use of labour and to enhance incentives to invest.[44] It also began a parallel, though not in truth very successful, attempt to craft a permanent voluntary incomes policy through agreement with the employers and trade unions – the intention being to avoid the benefits of much faster growth being frittered away in inflationary pay awards that would degrade international competitiveness and weaken the balance of payments.[45]

This 'great reappraisal', as Samuel Brittan termed it, was a major change to both policy goals and policy instruments and, as Brittan also pointed out, the policy changes set in train by the Conservatives in July 1961 were essentially continued by the incoming Labour government in 1964.[46] Labour endorsed the 4 per cent per annum economic growth target; it continued the attempt to modernise and streamline the supply side via a new Department of Economic Affairs as well as through institutions such as the NEDC and Industrial Training Council that came out of the

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[41] Sandford, National economic planning. The NEDC's analysis of the possibilities of faster growth and the means of achieving it were set out in a series of publications: Conditions favourable to faster growth; Growth of the United Kingdom; and The growth of the economy.
[42] Pemberton, Policy learning and British governance
[43] Page, The Industrial Training Act; Perry, The evolution of British manpower policy
[44] Lowe, 'The core executive', Pemberton, 'A taxing task'.
[45] Blackaby, 'Incomes policy'; Dorfman, Wage politics; Fishbein, Wage restraint
[46] Brittan, The Treasury, ch. 7.

Conservatives realignment of policy; it too planned public spending through PESC; it redoubled efforts to overhaul the tax system to promote growth (undertaking an overhaul of company taxation, introducing a new capital gains tax designed to promote long-term investment, and instituting a 'selective employment tax' designed to discourage labour hoarding and promote a shift of workers into manufacturing industry); and, building on its historic relationship with organised labour, it managed to institute a voluntary incomes policy in 1965. In short, the 1960-61 'great reappraisal' and the policies that flowed from it under both major political parties was evidence of high-order policy learning leading to radical policy change.

What forces had been at work in leading British policy makers to alter domestic economic policy so radically in 1961? Firstly, in Kingdon's 'policy stream' by the late-1950s the postwar Keynesian policy framework was beginning to look somewhat ragged. The 1950s had seen a series of sterling crises which were seen, not entirely accurately, as a function of problems with the balance of payments, which was in turn seen as a function of the uncompetitiveness of British industry. There were fears that inflation was creeping up. The pattern of economic growth, whilst historically good, had also been quite erratic, being characterised by the 'go-stop' cycle in which relatively fast growth would be cut off by deflationary measures that would themselves be succeeded by action to stimulate the economy. The Treasury was widely blamed for this. By the late-1950s, evidence of continuing relative economic decline was also inescapable, particularly notable being Britain's relatively poor performance vis-à-vis the continental economies.[47]

At the same time, there were important developments in both the policy and politics streams in the lead-up to 1961. In the policy stream, the Board of Trade was becoming concerned that investment in British industry was inadequate and that the performance of industrial management could be improved. Treasury officials were becoming aware of shortcomings in their economic forecasting. They were also increasingly conscious that their ability to 'fine-tune' the economy on Keynesian lines was constrained by the lack of tax instruments that could be reset without the need

[47] Tomlinson, The politics of decline; Bean and Crafts, 'British economic growth', pp. 142-147.

for a formal budget. By 1960, under the leadership of Sir Frank Lee, formerly permanent secretary at the Board of Trade, the Treasury was actively seeking new and improved means of managing the economy. It was also seeking ways in which it might better promote growth. This interest in growth was, at least in part, a function of the climate of ideas with the economics profession. Although Abramovitz had remarked that 'the problem of economic growth lack[ed] any organized and generally known body of doctrine' in the early-1950s, as the decade proceeded this lacuna was being to be filled.[48] True, much of the work concentrated on underdeveloped countries, with Rostow's stage theory of growth being particular influential, though it is arguable how much effect this had in terms of theory that might be of use to economic policymakers in developed economies such as the UK.[49] Nonetheless the growing interest in growth amongst academic economists coupled with the emerging evidence of Britain's relative decline had important effects in both the policy and politics streams, thereby helping to change the intellectual climate within which economic policy was made by ministers and officials.

The change in the intellectual climate can be seen in both policy and politics streams. Firstly, ideas about the need radically to change policy in order to achieve faster growth were injected into the thinking of Harold Macmillan, the then prime minister, by his personal economics advisor Sir Roy Harrod.[50] Secondly, the idea that faster growth was possible was taken up by pressure groups such as Political and Economic Planning, think tanks such as the National Institute for Economic Research and, particularly, by journalists. As Parsons noted:

> That such ideas were being voiced in the leading organs of the financial press could only have served to enhance its political acceptability … what was most significant about the contribution of economic journalists was

[48] Abramovitz, 'Economics of Growth'.
[49] Rostow, The stages of economic growth; Middleton, 'Economists and Economic Growth'.
[50] 'Correspondence between prime minister and Sir Roy Harrod on economic policy and growth', 1957-60, passim, TNA PREM 11/2973; 'Correspondence with Sir Roy Harrod on economic problems and policy', 1960-61, passim, TNA PREM 11/3287.

> they had a capacity to aggregate and disseminate ideas by applying them to events: they caught the mood.[51]

They did more than this, however, for by disseminating both the idea that radical policy change was required, by increasingly pressing upon the government a common policy solution, and by creating support for that solution amongst voters financial journalists helped to create a political environment that favoured such change.

In short, during 1960-61 developments in all three of Kingdon's steams in the domestic policy context – policy problems, policy ideas, and politics – were conducive to change. As a result a window opened that allowed 3rd order learning about the need for changes to both policy objectives and policy instruments to be translated into attempts to achieve that change.

THE MISSING EXTERNAL DIMENSION IN 1961

It is noticeable, however, that the 'great reappraisal' of 1961 largely ignored the external policy dimension. Certainly advocates of radical new policies on growth saw the need for fresh thinking in the external as well as internal policy – Harrod, for instance, advised Macmillan that running the economy under a high pressure of demand would require a preparedness to 'drive through' any fluctuations in the balance of payments and consider both the possibility of import controls and the possible need to devalue.52 Nonetheless, in pressing the Chancellor for new policies on growth Macmillan did not advocate a radical review of external policy. As for Treasury officials, in a long memorandum on the need for new thinking on growth that was submitted by the Treasury to the cabinet shortly before Selwyn Lloyd announced his policy revolution, the Treasury noted that:

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[51] Parsons, Power of the financial press, p. 109

[52] See, for example articles by Harrod: 'Still time for expansion', Financial Times, 24 February 1960; 'The question of imports', Financial Times, 20 November 1960; 'The need for a proper policy of economic growth', Financial Times, 2 January 1961; 'Import restrictions needed', Financial Times, 15 March 1961

> Of particular significance is the effect of economic growth on other major aspects of policy, notably the level of public expenditure and the imperative need to restore the external financial position. … A slow rate of growth of 'national efficiency' may weaken Britain's international competitive position and thus produce constant strain in the balance of payments and a threat to the maintenance of the sterling system.[53]

In other words, far from seeing a review of attitudes towards sterling as part and parcel of new policy objectives in the internal arena, the Treasury saw the dynamising of the economy as the means by which the balance of payments might be strengthened and the parity of sterling defended. To increase the reserve base would have taken time and would have possibly held back growth to such an extent that it would have been politically unacceptable. The alternative – to pursue a policy of growth, accept the deficit and finance it by foreign borrowing if necessary – was riskier but gave more immediate return. Hence the irony that a policy that, in the absence of new thinking in the external dimension of economic policy, would inevitably cause problems for sterling was implemented in the emergency budget required by the need to defend sterling in 1961 as, yet again, it came under pressure.

1964 – A MISSED OPPORTUNITY

By 1964, British policy makers had signed up to a domestic economic strategy that implied internal demand and domestic investment would not be sacrificed in order to improve the external position. However, it was apparent that the dash for domestic growth was creating substantial tensions. The deficit in 1964 – and the prospect for 1965 – was much larger than had been expected in official circles or amongst outsiders who had supported the decision to inflate. With the election of a Labour government in 1964 there was a potential window of opportunity in external policy. If Labour was to avoid deflation, as the programme of modernisation for growth on which it had been elected demanded, then in the external dimension it must

[53] 'Economic growth and national efficiency', paras 1 & 20, July 1961, TNA CAB 129/105, C(61) 94.

necessarily rethink its approach in the external policy dimension. This did not happen.

In the external policy stream, the Treasury immediately urged the new government to eschew devaluation arguing that it would be ‘an act of desperation that would have far-reaching consequences extending well beyond the immediate economy’ in terms of inflationary pressures at home and disruption of the sterling area and the international system.[54] It advised ministers that experience had demonstrated that the 4 per cent growth target was unrealistic in its current form.[55] The Governor of the Bank of England had already rejected ‘expedients such as import controls or surcharges, export subsidies and extended exchange controls as measures which offer no long term solution but would meanwhile damage the status of sterling’.[56]

Amongst Labour politicians too, there was extreme reluctance to devalue – partly because the party had been elected on a programme for faster growth not deflation, partly because of the possibility of competitive devaluations, but partly also because of the new government’s desire, given Labour’s 1949 devaluation, to maintain its international economic credibility – let alone to envisage recasting the entire international system.[57]

Thus, despite considerable pressure in Kingdon’s ‘problems’ stream conditions in the policy and politics streams were not conducive to change. No window opened in external financial policy. The incoming government determined not to devalue and to press on with its plans for faster growth. Unfortunately for the Labour government things went badly wrong between 1964 and 1967, with repercussions first for domestic policy and then in international financial policy.

[54] ‘Devaluation’ and ‘Floating exchange rates’, 15 Oct. 1964, TNA T 171/758.
[55] ‘Problems arising from the growth target’ (note by the National Economy Division), GB (64) 48, 16 Oct. 1964, TNA T 171/758.
[56] Note by Derek Mitchell, 23 Sep. 1964, TNA PREM 11/4771.
[57] Tomlinson, The Labour governments.

1966 – THE DEFENESTRATION OF 'PLANNING'

Almost without exception, commentators at the time and subsequently have declared the 'planning' revolution to have been an abject disappointment. Many reasons for the failure to achieve the faster growth that was desired have been cited, but a key aspect of that failure was the exclusive focus of the policy revolution on the internal arena. The Treasury assumed that the new policy on growth would begin with a tighter fiscal stance that would last for some years and that a tighter economy coupled with the range of new policy instruments would help to increase 'national efficiency', and thus in the end achieve faster growth. It would be 'jam tomorrow' rather than 'jam today'. The problem with this, however, was that much of the logic of the new tripartite approach to economic policy depended on gaining the confidence of both industrialists and trade unionists. This was never going to be achieved in a climate of deflation. Thus the government inevitably found that it was expected to put its money where its mouth was and demonstrate its commitment to faster growth. In a political climate that was increasingly intolerant of Conservative failures in economic policy, Macmillan appointed a new chancellor, Reginald Maudling, who immediately embarked on a 'dash for growth'.

In an economy operating at the limits of capacity, however, such an injection of demand inevitably sucked in imports. As the balance of payments deteriorated sterling began to come under pressure. The Conservatives then lost the general election of October 1964. This opened a window for change in the external dimension, as discussed above, but the opportunity was not taken. Labour determined to extend the Conservative's policy revolution whilst continuing to defend the existing sterling parity.

To some extent this decision actually helped Labour carry through its economic policy agenda in the months after the election. For instance, George Brown, the minister appointed to head the government's new Department of Economic affairs, skilfully used the external pressure on sterling to appeal trade unions to sign up to a voluntary incomes policy in 'the national interest'.

Ultimately, however, the failure to carry through an overhaul of policy objectives in both the internal and external dimensions of policy led to the collapse of the government's new National Plan and to the effective end of the attempt to build a voluntary incomes policy. In July 1966, in yet another sterling crisis, the government acted to defend the pound – deflating the economy and instituting statutory wage controls. Brown himself privately described it as the 'complete abandonment of the whole of [Labour's] economic philosophy'.[58]

Overwhelmingly this decision to abandon much of the 'planning' project was the product of developments in Kingdon's policy problems stream that were themselves the product of the fact that in 1961 a window had opened in internal but not external policy. It was, of course, also the product of the reactions of officials and ministers in the policy stream to those problems. And, though to a lesser extent, it was the product of an important facet of developments in the political stream that were in turn a function of the fateful decision in the external policy dimension taken by Labour when it entered office – the conclusion reached by Wilson, Callaghan and Brown that Labour could on no account be seen as weak on sterling and that it must therefore defend the sterling parity. A decision which eventually entailed the abandonment of the government's domestic policy programme.

THE 1967 DEVALUATION

Policy problems

By 1964, the Europeans, chiefly the French, were annoyed that reserve currency countries such as Britain were financing deficits (and increasing inflationary pressures in Europe) by adding to their short-term liabilities. The UK seemed to be doing this as an act of policy in 1964. While the US was always seen to come to the aid of sterling, the Americans increasingly had difficulties of its own to contend with. Consequently, if the UK were required to garnish support from European central bankers, it would be less than wholehearted. Between 1964 and 1967, there were

[58] Undated minute by George Brown, TNA EW 28/22.

several occasions when patience for the British predicament among European central bankers wore very thin.[59]

The government's decision to publicise the size of the balance of payments deficit for 1964, at around £800 m, after taking office for just ten days, a neutral budget on November 11 and then a delay in raising Bank Rate to 7% until 23 November, all appeared to show signs of mismanagement to overseas holders of sterling. A currency crisis on 25 November resulted in credits of $3 bn, whipped up by the Governor from foreign central bank which prevented a devaluation of sterling. Between January 1965 and November 1967, when the pound was devalued, there were a further three major crises.[60]

Discussions on reforming the international monetary system had been instigated following the Fund Staff's report on liquidity in 1958. Initially, reform equated to finding a new source of international liquidity and, as discussed below, the British initiated the discussions which led in 1962 to the General Agreement to Borrow (GAB). From 1964, for the Treasury and then the Prime Minister, an additional factor was ending sterling's reserve role and providing sterling holders with an alterative asset in which to keep their reserves. As the threat of devaluation increased between 1964 and 1967, the Bank feared it would be faced with demands for compensation for overseas sterling holders and sucked in to offering guarantees against future exchange risks. Concomitantly, another new problem became what to do about the sterling balances – but this nettle was not to be grasped for nearly a decade.

The policy stream

In terms of developments in the policy stream, it is important to note that in 1964, the Bank and Treasury supported the Labour government's strategy of maintaining the $2.80 parity but in the wake of the 1967 devaluation, there was a significant change in the strategy towards the management of sterling as new developments occurred in the policy and political streams.

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[59] For example, see Toniolo, Central bank cooperation, pp. 392-399.
[60] Oliver, 'Revisiting'.

Between March 1965 and November 1967, Treasury and Bank officials prepared a contingency plan for devaluation. Although senior members of the Bank were at first reluctant to become involved in these discussions, the Governor had been impressed with the 'meeting of minds' between the Treasury and the Bank during the Balance of Payments Group work in 1964 and was happy to co-operate.[61] Over the next two years, the discussions centred *inter alia*, on the accompanying measures to devaluation, choosing the rate whether or not there should be guarantees for overseas holders of sterling.[62] There was some detailed discussion on whether to float the pound if sterling was forced off its $2.80 peg. However, aside from a very small minority of advisers, the Treasury or the Bank did not seriously pursue this course of action.

Some of the wider macro questions about the sustainability of Bretton Woods, which grew in importance, only appear to have been floated as an academic exercise in some of the committee's papers. This is not to downplay the wide-ranging discussions on international liquidity in this period which Callaghan contributed to and which have so far been neglected by the academic literature. However, many of the ideas contained in papers were not taken outside the committee despite Wilson and Callaghan agreeing that the papers would be brought to the attention of the Steering Committee on Economic Policy in August 1966, after the July crisis.[63]

Potential external policy windows

Clearly, there appear to have been numerous occasions on which policy windows might have opened after 1964 and yet they remained shut. Why was this the case? The fact that there was no opening of the external policy window in 1964, or in subsequent years between 1964 and 1967, was conditioned by three factors. First, and perhaps most importantly, the government had committed itself to maintaining

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[61] Handwritten note on Allen to Governors, 28 Aug. 1964, BE OV44/132.

[62] See for example 'Accompanying Measures', FU (66) 8, TNA T 312/1636; 'Accompanying Measures', FU (67) 3, TNA T 230/878; FU (67) 6th Meeting, 21 Sep. 1967, TNA T 230/881. 'Prices and Incomes Policy in the Context of Accompanying Measures', FU (67) 18 and 'Accompanying Measures: Public Expenditure', FU (67) 19, TNA T 230/879; 'Guarantees, Forward Cover and Compensation', FU (67) 2 (Revise), 31 July 1967, TNA T 230/878.

the $2.80 parity and had promised the Americans, Britain's most important creditors, that the pound would not be devalued. This international commitment was coupled to a belief by the government that they would be able to turn around the balance of payments by supply-side measures. Secondly, the Treasury and the Bank remained implacably opposed to devaluation for various reasons, ranging from disbelief that the Wilson government would be able to stomach the accompanying deflationary measures which were required, through to a belief that a change in parity would betray overseas holders of sterling. Finally, although the arguments were being made for floating exchange rates, by and large these were confined to academic circles and had little serious input into the decision making process at either supra-international level (IMF) or domestic political level.

In the typology of Hall's model, the 1967 devaluation was merely a first-order change.[64] Perhaps this is why, from a theoretical perspective, it was not significant enough to automatically open an external policy window. The potential for such a window was there in 1967 (as it was in every other sterling crisis after 1964), but although this was considered by government ministers, chiefly Wilson, there was no groundswell of support for such a move among the Treasury or the Bank – i.e. in the policy stream. Moreover, such a decision would have had major repercussions on Britain's wider overseas role. Most prominently, her commitment to the sterling area would be called into question and at that stage, the issue of exchange control and guarantees for the sterling area required more considered work. From a purely practical point of view, the IMF made it clear that if Britain did float the pound, it would not receive the stand-by assistance that was required. It took another four years for officials and politicians to realize that changing the setting of the instrument was inadequate and that a move to a new instrument (a second order change) was necessary.

[63] 'Note for the record', 24 August 1966, TNA T 312/1635.
[64] Hamilton and Oliver, 'The evolution of an external paradigm'.

1970 – HEATH'S 'PROTO-THATCHERITE POLICY REVOLUTION'

As described above 1967 saw a potential opening of a policy window in international financial policy. There was, however, no possibility of such an opening in the domestic field – because the key changes had already been made in 1966. Thereafter, the next potential opening of the domestic policy window came in 1970 with the unexpected election of a Conservative government. In this case, the government half opened that window, but stepped back from actually stepping through it.

In the aftermath of their defeats in both the 1964 and 1966 general elections the Conservatives had embarked on a comprehensive review of policy. In the domestic policy sphere, by the end of the 1960s the failure of indicative planning to achieve its objectives and signs that both unemployment and inflation were rising served to call into question the extant policy framework. Under the leadership of Edward Heath, and in the light of the failure of the interventionary policies followed by both Conservative and Labour governments since 1961, it devised a very different economic programme.[65] 'There was to be no national economic planning, no pursuit of faster economic growth under government direction, no statutory incomes policy or intervention in wage settlements in the private sector [and] agencies instruments associated with such activities were to be eliminated'.[66] The power of the trade unions would be reduced, there would be extensive reforms and reductions to taxation, and the government would seek to unleash the full power of competitive forces within the economy, not least via a concerted attempt to realign the economy with Europe by entering the EEC. As the new prime minister told the Conservative Party conference in October 1970, the party had been 'returned to office to change the course of the history of this nation – nothing less'.[67]

In a sense, therefore, we see in the domestic programme on which the party was elected in 1970 a clear harbinger of the Thatcherite policies of the early-1980s, albeit

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[65] Gamble, The Conservative nation, pp. 92-93, 134-135; Holmes, Political pressure; Ramsden, The winds of change.
[66] Cairncross, 'The Heath government', p. 110.
[67] Blackaby, British economic policy.

Heath did not propose major cuts in public spending or wholesale denationalisation and, fundamentally, his government remained committed to full employment over inflation. What we do not see, however, was any equivalent in external policy to this radical rethinking in the domestic sphere.

A key reason for the Heath government's lack of attention to the external policy dimension was that Labour's devaluation of the pound in 1967 and its subsequent tight fiscal stance had by 1970 delivered a balance of payments surplus and a recovery of sterling in the foreign exchanges. Since these external problems appeared to have receded there was no need to open up and review external policy, and thus, for the moment at least, no such re-examination took place.

On the domestic front, however, although it achieved great success in negotiating entry into the EEC, much of the Heath government's new economic policy approach did not last. Most notably, its attempt to 'disengage' from intervention on the supply-side of the economy was derailed by the government's panic at rising unemployment, its famous industrial policy 'u-turn' in 1972, and its failure to achieve its desired reform of industrial relations.[68] As we have previously noted:
Despite the rhetoric of the 1970 manifesto, therefore, there was no paradigm shift under Heath. There was a gradual accumulation of anomalies to the existing Keynesian-plus paradigm and a brief experimentation with changed instrument settings and new instruments.[69]

Although the extent of Heath's 'betrayal' of economic principles dear to the new Right may have been somewhat overplayed, there seems little doubt that by the end of 1972 much of the government's new thinking on the economy had been put to one side as it stepped back from its consequences, not least from the widespread 'shake-out' in British industry that must necessarily follow from a more laissez faire policy and the encouraging of greater competition between firms.[70] Instead, the

[68] Kirby, 'Supply-side management', pp. 251-2; Holmes, Political pressure; Wrigley 'Trade unions'; Taylor, The trade union question, Ch. 6.
[69] Oliver and Pemberton, 'Learning and change', p. 429.
[70] Note that some commentators see Heath's determination to make UK companies more efficient an innovative as unchanged by 1972, locating the causes of the shift to a more active industrial policy in

Heath government after 1972 reverted to a Keynesian-plus framework (what Alan Budd termed 'the apotheosis of crude Keynesianism') that viewed faster growth as best means of controlling inflation in that, it was argued, it would provide the necessary resources to assuage the desire for higher wages.[71]

1968-72 – THE DEMISE OF BRETTON WOODS

Problem stream

In the external dimension, the backwash from the 1967 devaluation began to put pressure on the very fabric of the Bretton Woods system. As various players responded to the devaluation by converting dollars into gold, the US gold stocks dwindled (persistent US balance-of-payments deficits were also instrumental in this regard). By March 1968, the situation had become intolerable. The US gold reserves were reaching the crucial 'bedrock' $10 billion mark, below which action would have to be taken.[72] The problem stream for the UK from the gold crisis arose out of the drain on the UK's foreign exchange reserves and the possibility of another devaluation. Urgent discussions between the Bank and Treasury resulted in either the option to float the pound or to block the sterling balances. The Bank's preferred floating, but the Treasury disagreed, arguing that the pound would collapse, followed by the dollar and in turn, the international monetary system would break-up. The Treasury feared that it would then get the blame for wrecking Bretton Woods.[73] Conversely, the Bank could not agree to the Treasury's suggestion because it would be defaulting on its customers and it would stop flows of funds into the City.[74] Neither course of action was pursued because the US and the G-10 extended a facility of $4,050 million to the UK.

1968 was a turbulent year for the UK authorities as they had to draw up contingency plans fearing a franc devaluation accompanied by a large speculative movement into

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the government's frustration at the reluctance of British industry to react to the competitive forces arising from entry to the EEC. See, for example, Taylor, 'The Heath government', pp. 139-160.

[71] Quoted in Britton, Macroeconomic policy, p. 86.

[72] Strange, 'Bolstering the dollar', pp. 290-92.

[73] 'The consequences of floating' (Annex III), 15 March 1968, TNA T 295/489.

[74] Oliver and Hamilton, 'Downhill', p. 5.

marks and downward pressure on sterling. The failure of talks at the G10 Bonn summit in November led to a widespread feeling that the summit process was now unsuitable for general currency realignment.[75] In essence, however, the Bretton Woods system was now running up against several problems: the liquidity constraint as a result of the reliance on a fixed price for gold, the conflict of political ambition, which superseded multilateral economic solidarity, adjustment imprecision, and the ever-present confidence issue.[76]

The system soldiered on until the announcement by President Richard Nixon on 15 August 1971 that the Americans would suspend the convertibility of the dollar into gold in order to conserve what remained of the US reserves in Fort Knox. In the wake of Nixon's announcement, Bank and Treasury officials did agree to keep the official parity of sterling unchanged at $2.40 but would allow the market rate to rise above its existing ceiling of $2.42, allowing for the rate to reach $2.46 before the Bank started intervening, with hopes that the rate would not rise above $2.50 – an unofficial 'snake in the tunnel'.[77] This temporary measure last only four months, when the pound was revalued by 8.6 per cent against the dollar as part of the Smithsonian Agreement and a wider band (4.5 per cent) was introduced. Following further pressures on the exchanges, in June 1972 the pound was floated.

Policy and Political Streams

The March 1968 gold crisis prompted a great deal of work in the policy stream. Initially, the Treasury continued to study proposals to block the sterling balances and the Bank began work which culminated in the 1968 Basle Agreement. Under this agreement, the central banks of Austria, Belgium, Canada, Denmark, Italy, Japan, the Netherlands, Norway, Sweden, Switzerland, the Federal Republic of Germany, and the US, along with the Bank of International Settlements (BIS), collaborated in providing the UK with swap facilities to offset most of any reduction in their reserves caused by fluctuations in sterling held both publicly and privately overseas. The irony

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[75] Jenkins, A Life, pp. 253-7; James, International monetary cooperation, pp. 177-8, 193-5.
[76] Aldcroft and Oliver, Exchange rate regimes, p. 102.
[77] 'Note of meeting', 24 Aug. 1971, TNA PREM 15/309.

was that in the event of another sterling crisis, even with the Basle Agreement in place, the only viable option would have been to float the pound.[78]

The gold crisis did bring a sea change in the government's policy towards sterling, when the Prime Minister created a new Cabinet committee, MISC 205, which was to act as a sterling steering group.[79] Developments in the policy and political stream reinforced one another and because all of the policy papers for the committee came from the Treasury and the Bank, these two organisations were still able to shape the context within which ministerial decisions were taken. Indeed, because of the strain to the foreign exchange reserves, which had resulted from sterling area conversion during the March 1968 gold crisis, there was at last some radical re-thinking by the Bank and Treasury to their commitment to fixed exchange rates.

The first evidence of this change was the recognition that devaluation had forced policymakers out of a self-imposed monetary straightjacket. In 1968, this was followed by a greater willingness to talk about currency problems in the open which by the end of 1969 had led the Treasury to admit that they were no longer 'nervous' about public discussions on the larger issue of reform of the international monetary system being conducted by the IMF.[80] This metamorphosis was aided by a number of publications advocating flexibility, some of which had preceded the devaluation of sterling but were only later assimilated into Treasury and Bank thinking, coupled to a realisation that the existing international monetary framework was no longer working effectively.[81] In this regard, it is important to note that newly elected President Nixon showed considerable interest in greater exchange rate flexibility and appointed three proponents of floating exchange rates to his Council of Economic Advisers. Despite such changes, however, by 1970 there were few academics and politicians who publicly embraced floating and fewer still who supported Milton Friedman's position

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[78] Oliver and Hamilton, 'Downhill', pp. 7-9.
[79] Cairncross, Wilson, p. 288; Wilson, Labour, p. 513 and 'MISC 205 (68): First Meeting', 17 March 1968, TNA CAB 130/497.
[80] Figgures to Mitchell, 31 Dec. 1969, TNA T 312/2676.
[81] Halm, The band; Williamson, The crawling; Meade, 'Exchange-rate'; Brittan, The price.

of a free float without any intervention by the central bank.[82] While a 'theoretical consensus' for greater flexibility in the exchange rate system might have existed among economists, the German Council of Economic Experts were regarded as 'politically irresponsible' for endorsing the Friedman line.[83] As Harold James noted, between 1971 and 1974 the entire international community was pushed towards floating 'not so much because this was an agreed solution, but because it emerged out of a failure to produce an agreed solution'.[84] This was never truer than in the case of the UK.[85]

Further changes in the political stream occurred after Roy Jenkins was appointed Chancellor in 1967. Jenkins had long believed that sterling's international status was something of a problem but he stopped short of advocating a solution.[86] During the negotiations for the sterling area guarantee system, Jenkins was to fundamentally reappraise the desirability of sterling's international currency role. He had come to view the currency role as a structural disabler rather than as an enabler and he hoped that 'under cover of [the Basle Agreement] we could set in train the overdue dissolution of the sterling area'.[87] The aim was to use the discussions with the sterling area countries, over the guarantee scheme, effectively to kill two birds with one stone. It was hoped that it would also be possible to negotiate the extension of exchange control to the sterling area. However, although there was clearly a change in attitude towards the international currency role, under Jenkins, there was to be no change in policy.

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[82] For academic support see, for example, Johnson, 'The case' and 'The safety valve in a floating exchange rate', The Times, 9 Dec. 1968, p. 23, col. C; 'Exchange cooperation', The Times, 17 Sept. 1970, p. 24, col. F. For political support see 'A floating exchange rate', The Times, 10 June 1969, p. 11, col. C; 'Powell on Maudling and floating exchange rates', The Times, 30 Oct. 1969, p. 25, col. D; For an alternative view, see Sir Maurice Parsons' contribution 'A floating exchange rate not the answer', The Times, 15 Sept. 1970, p. 22, col. E and Sir Eric Roll, 'Floating above the ground', The Times, 3 Sept. 1970, p. 21, col. D.

[83] James, International, p. 213.

[84] James, International, p. 234.

[85] See Oliver, 'From fixed to floating'.

[86] Jenkins, The Labour Case, ch. 5.

[87] Jenkins, A Life, pp. 255-6. See also 'Memorandum by the Chancellor of the Exchequer', 12 July 1968, TNA T 295/514.

External policy windows

Was there the possibility of the external window being opened in 1968, when the gold crisis threatened to topple the international monetary system? It was only in the wake of the gold crisis that the UK core executive began to seriously question the viability of the status quo ante, but did not have the wherewithal to pull the plug on their commitment to Bretton Woods. In any case, the government had managed to weather several crises between 1964 and 1967 without resorting to panic measures, and in this instance it would take a longer period of time before a tactical withdrawal from the fixed exchange rate was economically and politically feasible. Moreover, Ministers and officials still hankered after a fixed exchange rate in the wake of the November devaluation.

To be sure, the 1968 crisis was the first move towards the opening of the next window in the external policy dimension but even by 1970, Prime Minister Edward Heath was unimpressed with Milton Friedman's appeal that the UK should float.[88] A year later, with Nixon's decision in August 1971 to suspend the convertibility of dollars into gold, there was a short-lived experiment with the 'half-float' but like the decision to float the pound in June 1972, it was a tactical decision, seen as a temporary measure in the context of external pressures. As Hamilton and Oliver argue, the adoption of floating exchange rates might appear as 'third order change', but it was not a paradigm shift although it did involve a significant adjustment of the prevailing Bretton Woods paradigm.[89] We note that it was accompanied by no such opening of the policy window in the domestic arena. Instead the Heath government stepped back towards the Keynesian-plus policy framework it had set out radically to amend when it was elected in 1970.

1976 – A CRISIS FOR INTERNAL AND EXTERNAL POLICYMAKING

When a Labour government was elected in the general election of 1974 it returned to power on a manifesto itself largely based on what Tony Benn dubbed 'the most

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[88] 'Note for the record', 18 Sept. 1970, TNA PREM 15/722 and conversation with Brian Reading on 12 April 2005 [Oliver].
[89] Hamilton and Oliver, 'The evolution of an external paradigm'.

radical programme that the party ha[d] prepared since 1945'.[90] Labour's 'Alternative Economic Strategy', with its objective of full employment via reflation, widespread intervention in industry via nationalisation and the introduction of planning agreements, industrial democracy, extensive price controls – and, from 1976, the nationalisation of the four largest banks and the institution of import controls – need not detain us here since the party's tenuous grip on power, the fact that the leadership remained lukewarm towards the programme, combined with the exigencies of managing Britain's worst economic crisis since the 1930s, meant that most of the programme was never implemented and those elements that were implemented were substantially diluted.[91]

The fact that the Left could have such success in getting the party to adopt such a radical policy framework is evidence, however, of the way in which mounting economic problems in the early-1970s were beginning to open up the policy process to new ideas. In fact in the wake of OPEC I and, particularly, in the lead up to and aftermath of the IMF crisis that occurred in the summer of 1976 we find, for the first time since the second world war, Kingdon's three streams combining in both the external and internal arenas.

Internal policy

Problem stream

In terms of internal economic policy, we note in Kingdon's 'problems' stream an accumulation of severe difficulties with the 'Keynesian-plus' framework that taxed policy-makers in the mid-1970s. For example, in response to mounting unemployment, the Heath government responded not just with a u-turn in its industrial policy but also with a budget in 1972 that envisaged higher public expenditure plans and tax cuts. However, instead of the results which might have been expected from this quintessentially Keynesian response, policy-makers found that they faced both the rising inflation that had hitherto been associated with fast

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[90] Labour Party, Labour's Programme; The Times, 1 October 1973, quoted in Wickham-Jones, Economic strategy, p. 53.

economic growth and rising unemployment arising from stagnating growth (the conjunction of the two phenomena being dubbed 'stagflation').[92] Although the government had imposed controls on bank lending via the supplementary special deposit scheme (the 'corset') in December 1973, the rise in world commodity prices in the same year and the quadrupling of oil prices in 1973-74 added to the upward trend in both inflation and unemployment in the UK. When Labour entered office after its election in 1974 it too faced the conjunction of rising inflation and unemployment, along with a host of other problems not least the consequences of the 'Barber boom' for the balance of payments and for sterling. Clearly, therefore, there was no shortage of policy challenges facing both Conservative and Labour governments in the 'problems' streams during the 1970s, both internal and external.

Policy stream

In the domestic policy stream after 1970 the Treasury struggled valiantly to address those problems in the face of a failure of the Keynesian framework to provide solutions – in 'a world without rules that had broken loose from Bretton Woods' as Dell put it.[93] In retrospect, we can see that Labour's attempts to tackle stagflation after 1974 were not without successes. Inflation was reduced after peaking at nearly 25 per cent in 1975. Growth was resumed in 1976. It had less success at reducing unemployment, but even this began to reduce in 1979. Nonetheless, the government's achievements were less apparent at the time than they seem with the benefit of hindsight. One might also legitimately question the degree to which they were durable. What Labour attempted to do was pragmatically to integrate into their policy framework those elements of the new economic thinking that seemed likely to be of use to it.

Nevertheless, as we have noted elsewhere, although inflation was reduced after 1975, reaching 8.3 per cent in 1978, this was still relatively high and it began to

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[91] Coates, 'Labour in power', Ch. 6; Cronin, New Labour's Pasts, Ch. 6; Wickham-Jones, Economic strategy, Ch. 6.

[92] Schulze and Woodward, 'The emergence', pp. 112-3. The wider implications of this policy response are discussed in Beenstock, 'The rise and fall of OPEC'.

[93] Dell, A hard pounding, p. 4.

creep up subsequently. Coupled with the continuing high level of unemployment, the growth of the public sector borrowing requirement, the fall of sterling on the foreign exchanges in 1976 and the high rate of inflation began to call into the prevailing Keynesian policy framework into question. The problem here was that the framework appeared unable adequately to predict, explain or solve the array of 'anomalous' policy problems that the country faced.[94] As the Keynesian paradigm began to be called into question experts outside government began to promote the development of an alternative framework.[95]

Politics stream

The process by which new thinking penetrated government and led to the replacement of the Keynesian policy framework by a new neo-liberal paradigm was complex and we do not propose to describe it here. Instead, we focus on the means by which the 'window' through which the neo-liberal framework entered into British policy making was opened. This process was both ideational and political, and it spanned both the internal and external dimensions of policy.

In terms of policy ideas, Peter Hall has noted that the failure of the HM Treasury to devise solutions to the severe economic crises of the 1970s and particularly to the problem of 'stagflation' served to discredit it and, in doing so, to break open the policy process and encourage the development of a 'marketplace for ideas' developed.[96] Britton notes how important the breakdown of the apparent trade off between unemployment and inflation was to the beginnings of the 'monetarist challenge', though he is careful to deconstruct this, noting that it really comprised both a neo-classical challenge to Keynesian economists who had played down markets and emphasised the importance of government and the arguments of the monetarists that inflation could only be defeated through government control of the money supply.[97] Ultimately, however, a replacement of the prevailing Keynesian

[94] Hall, 'Policy paradigms', p. 285.
[95] Oliver and Pemberton, 'Learning and change', p. 429; Oliver, Whatever Happened, pp. 52-55.
[96] Hall, 'Policy paradigms', pp. 285-7.
[97] Britton, Macroeconomic policy, pp. 86 and 93-95.

policy framework could only take place 'through the conversion of influential people' to new ideas.[98]

Particularly important in this context is the fact that such people were open to such ideas. The predominant discourse amongst 'informed opinion' in the mid- to late-1970s was profoundly negative about Britain's economic prospects. That this was so was due, in large part, to a growing perception that Keynesian policies were failing adequately to produce solution to deep-seated economic problems and to the problem of Britain's relative economic decline. There was a tendency here to ignore the fact that other advanced industrial economies were also struggling, but the data did suggest that Britain was doing less well than most and that its relative economic decline might well be accelerating. Perhaps the most important factor creating this declinist zeitgeist, however, was the 1976 IMF crisis. Not for nothing did Burk and Cairncross entitle their book on this *Goodbye Great Britain*.

External policy

Confidence in sterling began to evaporate in early March 1976, as it appeared that the authorities did not wish to see sterling appreciate. It was thought that the authorities wished to see a lower rate for sterling and this prompted selling of sterling. By June 1976, Chancellor Denis Healey claimed that there was no economic justification for the fall in sterling that had taken place but he focused on the behaviour of broad money and not on Domestic Credit Expansion (DCE).[99] The warning of trouble to come came in June 1976 when published data showed that DCE during the three months to mid-May was running at 23%, expressed as a percentage of the stock of broad money (sterling M3) and as an annual rate.[100] The cause of the growth of DCE was the government's refusal to cut the budget deficit. The growth of DCE was then an important cause of the outflow of sterling across the foreign exchanges. A severe sterling crisis followed in October 1976, with the UK

[98] Britton, Macroeconomic policy, p. 103.
[99] DCE corresponded to the change in the money stock on its M3 definition plus the balance of payments deficit on current account less net private sector borrowing overseas.
[100] 'Monetary Bulletin, No. 54', W. Greenwell and Co., June 1976, http://www.mjoliver.co.uk/greenwells/098.pdf

being forced to borrow from the IMF and accept its conditions, one of which was a constraint on DCE.

Monetary targets were published for the first time in the UK in 1976, just before the negotiations with the IMF after the sterling crisis. However, the introduction of the target was only a second order change and was part of an extensive amount of second order learning between 1972 and 1977 because of the domestic and external policy changes. The float in 1972 prompted an extension of exchange controls for the first time to the overseas sterling area, which if it had not been done, UK residents would likely have moved their funds to overseas sterling area countries whose currencies would probably have appreciated in relation to a floating pound. The overseas sterling area allowed for this, expecting guarantees following the period of exchange control, and the action flew under the banner of 'action taken in response to the temporary floating of sterling'.[101] Sterling's role as a reserve currency had been undermined ever since the devaluation of the pound in 1967 but there was still the practicable problem of what to do about the sterling balances.

It was not until the 1976 sterling crises that Prime Minister Callaghan wrestled with this particular Gordian knot. Without notifying the Treasury, Callaghan told the BBC television programme *Panorama* on 25 October:

> 'I would love to get rid of the reserve currency', he said. 'I am not sure that everybody in the Treasury would, or maybe in the Bank. But from Britain's point of view I can see no particular advantage of being a reserve currency at all'. … Get rid of the balances, he said, 'and then we would be able to get back and look more readily at our long--term strategy'.[102]

As Burk and Cairncross document, the discussions to end the balances were protracted and frequently acrimonious, but on February 1977, the agreement came

[101] 'Treasury Historical Memorandum No. 23: Exchange Control 1959-1972; UK attitudes and actions', p. 54, TNA T 267/34.
[102] Burk and Cairncross, <u>'Goodbye, Great Britain'</u>, p. 67.

into force.[103] In short, the sterling balances held abroad by official entities would not exceed $6.75 billion net of public sector foreign currency borrowing and over the next three years, the official reserves of sterling held by governments and central banks abroad would be reduced to working balances.[104]

Conclusions on 1976

As Burk and Cairncross pointed out, there is ostensibly little reason to see 1976 as decisive. None of the problems that came to a head that year was new. Indeed, 'Apart from the continuing fall in sterling, the outlook in 1976 was in many ways more reassuring than in either of the two preceding years'.[105] Despite this, however, there was a crisis of confidence in sterling; and this served to provoke a crisis of confidence in domestic informed opinion. For The Times, for instance, the need for an IMF loan was evidence, if evidence were needed, that 'The government's short-term tactics … are falling apart' and that 'the basic problems are domestic and … the solutions can only be domestic'.[106] The monetarist solutions being urged by the financial markets chimed with those being urged by influential financial journalists, not least Peter Jay in *The Times*. It is in this sense that the travails of sterling played a key role in pushing government policy towards monetarist nostrums.

What we find in 1976, therefore is that in the political stream the 'national mood' became even more negative towards prevailing policies and open to the idea of radical alternatives – be they the product of left or right. In electoral terms, this inevitably benefited the Conservatives more than it benefited Labour. For the government, what was required was a major overhaul of its policy framework that must be accomplished 'in-flight' as it were. This was not impossible, we note the adoption of elements of monetarism by Chancellor Healey for example, but it was far from easy. It is one thing to repudiate the policies of the past in opposition; for a party in power it is hard to find the time to rethink and the risk is that to do so courts electoral disaster. For the Conservatives, things were easier. As an opposition party

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[103] Burk and Cairncross, 'Goodbye, Great Britain', pp. 64-65, 111-126.
[104] de Vries, Cooperation on Trial, pp. 475-476.
[105] Burk and Cairncross, 'Goodbye, Great Britain', p. 215.
[106] 'Sterling's grave crisis', 8 Oct. 1976, The Times, p. 15, col. A.

there were in a much better position to reinvent themselves, not because they had a new leader in place after 1975, and in the process draw on monetarist thinking and on the more general resurgence of neo-liberal ideas.

In 1976, therefore a coupling of problem, policy and politics streams took place in both the internal and external dimensions. It is this, we feel, that explains why subsequent change was so radical and so far-reaching. But the window that opened in 1976, partly because it was so big (being wide-open across the two policy dimensions), did not close for some time. The process of framework change which it initiated took several years to work itself out. This was a function of the complexity of the change involved, but it was also because there was more than one possible solution to the problems that Britain faced in the mid- to late-1970s. The battle of ideas that ensued was a battle about fundamentals. It was therefore, inevitably, a highly political process. Not until the Conservatives won the general election of 1979 was this battle won; and even then, as we have argued elsewhere, it took some time for the new framework to settle down into the generalised 'neo-liberal' policy paradigm that continues to govern policy today.[107]

CONCLUSIONS

This survey of nearly twenty years of UK economic policy making between 1961 and 1979 has emphasised the extent of policy change that took place during the period. What is notable is the frequency and extent of change. Important modifications were made to the settings of policy instruments (not least in the exchange rate). There were many instances of new instruments being implemented. On some occasions, revisions were made to the very goals of policy. In this conclusion, we return to the question at the start of the paper. Why was the potential for many of these policy alterations to have enduring effects on the framework within which British policy making too place not realised? Why do the policy changes implemented between 1961 and the general election of 1979 no longer resonate?

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[107] Oliver and Pemberton, 'Learning and change', pp. 432-434.

During these years, significant economic problems arose and were addressed. Sometimes new ideas entered the thinking of policy makers and shaped solutions to those problems. Changes in the political stream could be significant. Sometimes the problem, policy and political streams converged and opened 'windows' of opportunity that entailed more than just day-to-day 'fire-fighting'. Where this happened, change could be radical. The 'great reappraisal' of domestic economic policy ushered in by the Conservatives in 1961 is one example. But such change proved relatively transient – in this case the attempt radically to alter the framework of domestic economic policy being abandoned in 1966.

More often, problem, policy and political streams converged and created potential 'windows' of opportunity that remained unopened: Labour's decision in October 1964 not to reappraise external financial policy as a means of defending its internal policy programme; the decision not to press beyond devaluation in 1967 to a radical overhaul of the overarching policy framework; the reluctance to consider floating the pound in 1968 for fear of bringing down the Bretton Woods system; the 1972 decision to move sterling to a 'half-float' rather to a 'full-float'. And sometimes these windows were half-opened and then quite rapidly shut without lasting policy change: the Heath government's short-lived domestic policy revolution between 1970 and 1972 being a case in point here.

There was thus no shortage of policy problems, nor a shortage of new ideas for solving them. Political changes were often conducive to change and, indeed, there was no shortage of attempts at changing the framework of policy. We find it striking, however, that until 1976 such windows of opportunity were 'small' rather than 'big' windows. Problem, policy and political streams converged to create windows, or potential windows, but they did so either in the domestic arena or in international financial policy; but not in both simultaneously. In our view, the fact that developments in the internal and external dimensions of economic policy were asynchronous was a significant problem. It meant that policy changes in one dimension could be derailed by developments in the other dimension flowing from a failure to revise policy in that dimension. The failure of 'planning' is perhaps the most important example of this.

In 1976, however, we see problems, policy and politics coupling in both the internal and external dimensions of economic policy. The effect of this was to open a ‘big’ window that spanned the whole of British economic policy. This, we suggest, is why the policy changes that flowed from that coupling were so wide-ranging, so fundamental, and ultimately so long-lasting. Yet it is the breadth, depth and extent of change that explains why this window, once it had been opened, stayed open for so long. Policy change on this scale was inevitably highly contested. It is this that explains why it was not until the 1979 election that alternatives began to be closed off, though even then it took some time for the new policy framework to take the definitive ‘neo-liberal’ form that continues to govern policy today.

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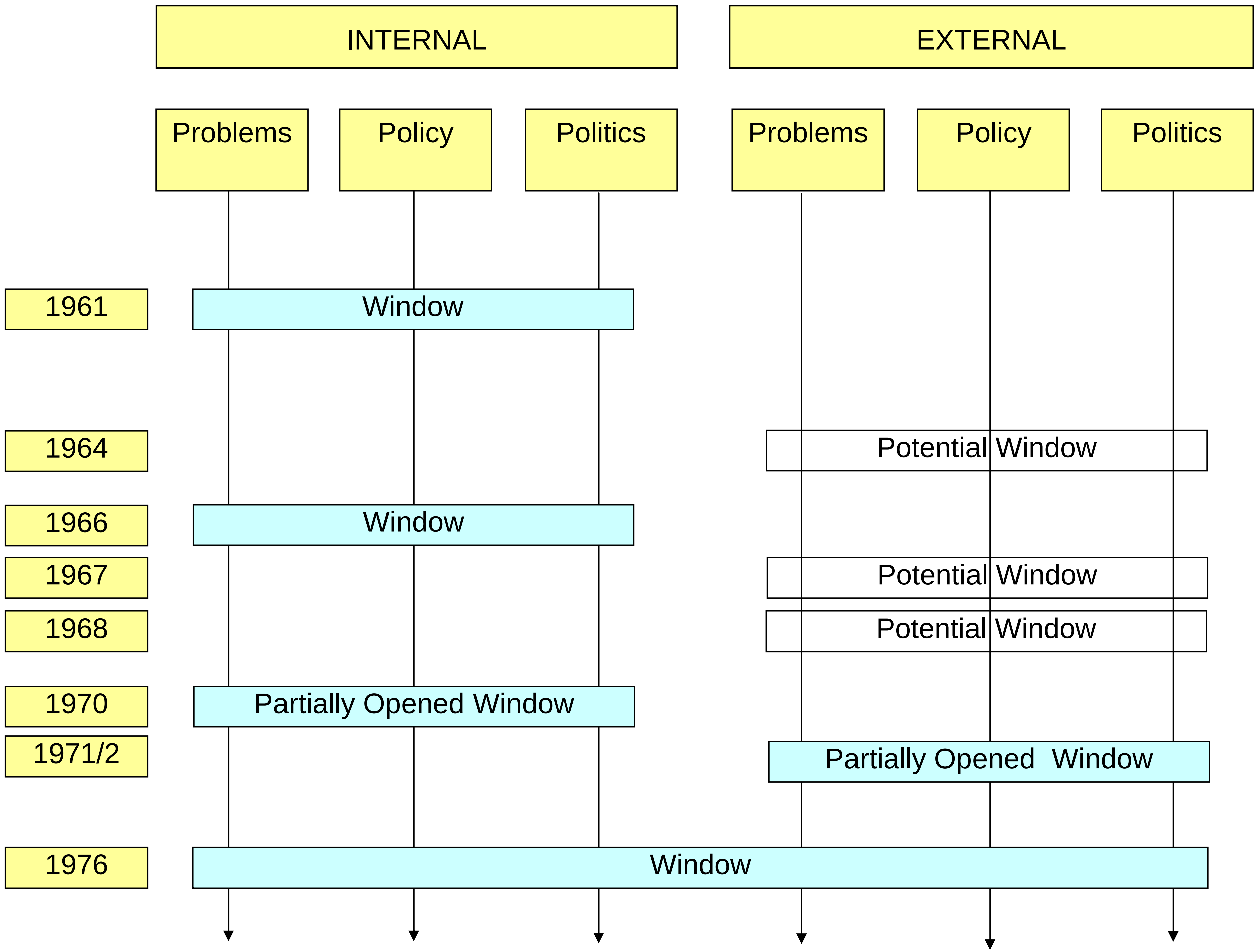
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