GERRARD & NATIONAL

Monthly Economic Review

No. 87, September 1996

Contents | Page No.

GERRARD

Gerrard & National Holdings PLC

Gerrard & National Limited
Cannon Bridge,
25 Dowgate Hill,
London, EC4R 2GN
Tel: 0171 337 2800
Fax: 0171 337 2801

Lombard Street Research Ltd.
Cannon Bridge,
25 Dowgate Hill,
London, EC4R 2GN
Tel: 0171 337 2975
Fax: 0171 337 2999
e-mail: lsr@lombard.demon.co.uk
www.cbot.com/lrwelcom.htm

GNI Limited
Cannon Bridge,
25 Dowgate Hill,
London EC4R 2GN
Tel: 0171-337 3500
Tlx: 884862
Fax: 0171-337 3501

Gerrard Vivian Gray Limited
Burne House,
88 High Holborn,
London WC1V 6LS
Tel: 0171-831 8883
Tlx: 887080
Fax: 0171-831 9938
Stx: 74377

We're having a little party on our own

Upturn in UK domestic demand not matched in our neighbours

More signs of rising UK domestic demand

Signs are multiplying of an upturn in UK domestic demand. Confident reports of rising sales have come from the retailers. (See, for example, the CBI Distributive Trades survey and the survey from the British Retailers Confederation.) Meanwhile the housing market is improving, with house prices on an upward trend and quite marked increases in the level of mortgage approvals. (The value of new mortgage loans approved in the second quarter (Q2) was £16.8b., almost 29% up on the year-earlier figure.)

but not matched in our neighbours,

But the UK is having this little party very much on its own. Late 1995 and early 1996 was a difficult period for the German, French and Italian economies, as they struggled to meet the Maastricht convergence criteria. The deterioration may now have ended, but there is scant evidence of improvement. (A leading indicator index of Europe's four largest economies prepared by Lombard Street Research has moved sideways in the last six months, but that is with the help of a good increase in the UK leading index. The leading indices for Germany, France and Italy have actually been *falling*.) Unfortunately, the party-poopers in continental Europe will dampen the celebratory spirit in the UK. In particular, the weakness of demand in our neighbours has constrained export growth. The value of the UK's exports to other members of the European Union was lower in Q2 than in Q1, whereas exports to the rest of the world were up by over 6%.

whose exports may be suffering from a deep-seated lack of competitiveness at current exchange rates

The UK upturn will be held back if other EU countries cannot achieve trend or above-trend growth in recent quarters. However, the damage should not be exaggerated. Strictly speaking, the crucial influence on UK demand from other countries is not exports by themselves but "net exports" (i.e., exports minus imports). The surprising feature here is that in the last few quarters the volume of exports to the EU has been rising more quickly than the volume of imports from the EU, so that net exports to the EU have in fact been a *positive* influence on the UK economy. (It would of course have been even more positive with stronger European growth.) There has been a striking contrast between rapid growth in the volume of imports from outside the EU (up by 17.8% in the year to Q2, partly because of huge recent imports of planes from the USA) and very modest growth in imports from the EU (up by only 2.8% in the year to Q2). This marked divergence in import patterns suggests that something is wrong with the competitiveness of Europe's products. The USA has indeed been gaining share in world export markets, largely at the expense of European countries, since the dollar's devaluation in 1986 and 1987. Worries about the over-valuation of Europe's currencies, particularly the franc, seem inevitable in the rest of 1996 and will probably also be a theme of financial markets in 1997.

Professor Tim Congdon

2nd September, 1996

Summary of paper on

Fiscal policy in the UK since the Second World War

Purpose of the paper

Fiscal policy is often thought to have moved away from old- fashioned budget-balancing notions to modern "Keynesian" concepts (of anti-cyclical fiscal adjustments to the budget balance) after the Kingsley Wood Budget of 1941. The main purpose of the research paper is to ask whether this was really the case. There is no doubt that concerns about medium- and long-run fiscal solvency returned in the mid-1970s.

Main points

* **UK fiscal policy is generally regarded as having been "Keynesian" in the 1940s, 1950s and 1960s. The contrast with the previous budget-balancing orthodoxies is usually described as "the Keynesian revolution". (See pp. 3 - 6.)**

* **Although policy-makers may have had Keynesian intentions at times, the trend *level* of the budget balance was determined in the 25 or so years to the mid-1960s by the old Treasury principle, dating back to Gladstone's day, that the Budget should be balanced above-the-line. (See pp. 7 - 8.)**

* **In the 1950s and 1960s *changes* in the budget balance were often due to the international balance-of-payments position and the state of the pound, not the requirements of full employment policy. (See pp. 8 - 9.)**

* **After the election of the Wilson Labour Government in 1964, many Keynesian economists became official advisers in Whitehall. But anxiety about the balance of payments and the pound continued to dominate policy. The external constraint was abandoned only in the early 1970s, leading to the catastrophic "Barber boom" of 1973. (See pp. 10 - 11.)**

* **So it seems very doubtful that there ever was "a Keynesian revolution", in the usually understood sense.**

This paper, written by Professor Tim Congdon, is the first of a two-part research study on "Fiscal policy in the UK since the Second World War". It is to appear in a book on the history of UK fiscal policy since the 18th century, edited by Dr. John Maloney of Exeter University, to be published by Edward Elgar in 1997.

Fiscal policy in the UK since the Second World War

Part I: Was there a Keynesian revolution?

Common view that UK's fiscal policy has been "Keynesian" since early 1940s

The common understanding of the phrase, "the Keynesian revolution", is a re-appraisal of the theory of fiscal policy after the publication of Keynes' *The General Theory of Employment, Interest and Money* in 1936, followed by the practical adoption of the new ideas by the major industrial countries in the 1940s and 1950s. Specifically, whereas before the Keynesian revolution governments' priority in fiscal policy was to maintain a balanced budget, afterwards the budgetary balance was varied contra-cyclically in order to reduce fluctuations in economic activity. Britain is often regarded as the home of the Keynesian revolution. For example, the opening sentence of chapter VII of Christopher Dow's *The Management of the British Economy 1945 - 60* asserts, "There is probably no country in the world that has made a fuller use than the UK of budgetary policy as a means of stabilizing the economy."(1) The characterisation of British macroeconomic policy as "Keynesian" in the immediate post-war decades has become routine and unchallenged in standard textbooks.

but - unlike the USA - no detailed narrative account has been provided

A detailed narrative account the evolution of fiscal policy in the Keynesian direction has been provided in the USA by Herbert Stein's *The Fiscal Revolution in America*. Stein describes the immense initial enthusiasm of young American economists, such as Samuelson and Boulding, for *The General Theory* in the late 1930s. As a result, "By 1940 Keynes had largely swept the field of the younger economists, those who were soon to be 'back-room boys' in Washington and who, when they reached the age of forty-five or so, would be ready to come into the front room when John F. Kennedy became President in 1961."(2) No similarly organized story has been told about the UK, perhaps because the policy revolution is deemed to be so self-evident that an analysis of personalities and events is unnecessary. (Incidentally, the relationship between Keynes' thought and Keynesianism is an important subject in its own right. In various ways Keynes himself had rather different attitudes and emphases from the Keynesians.(3))

Purpose of this paper is to cast doubt on the common view

The purpose of this paper is to suggest that, between the 1940s and 1970s, both the thinking behind British macroeconomic policy-making and the actual conduct of policy were far from the Keynesian model. As there is little question that after the mid-1970s fiscal policy ceased to be Keynesian, the paper raises doubts about whether Britain ever had a Keynesian revolution. To throw more light on the issue, statistical tests are conducted of the relationship between the budget position and the level of economic activity. The results of these tests are reported in an appendix, to be published in the next *Monthly Economic Review*. They show that the level of economic activity was not a significant influence on the level or the change in the cyclically-adjusted budget position in the supposedly Keynesian period between 1948 and 1974. (Less surprisingly, it was also not a significant influence between 1975 and 1994.) The answer to the question "did Britain have a Keynesian revolution?" is "no".

Policy-makers may nevertheless have had Keynesian intentions

Of course, the demonstration that statistically there never was a Keynesian revolution does not rule out the possibility that, from time to time, key decision-takers and their advisers did alter fiscal policy in a Keynesian manner. It may even be consistent with their desire to conduct fiscal policy on Keynesian lines all the time. Plans to vary the budget balance contra-cyclically may have been frustrated by sterling crises, of which there were many between 1945 and the mid-1970s, and other external shocks, such as the Korean War in 1950 and 1951. The absence of a Keynesian revolution in fact does not exclude the possibility that there was a Keynesian revolution in intention. The paper's first task has to be a review of the structure of macroeconomic policy-making, and the ideas held by policy-makers, from the 1930s onwards.

I. The case for a Keynesian revolution, at the level of ideas

Budget cuts of early 1930s provoke *General Theory*

Keynes was appointed to the Economic Advisory Council, a high-level body to advise the Government on economic matters, at its formation in 1930. It was the successor to a similar committee, created in 1925, to advise the Cabinet. The importance of this appointment should not be exaggerated, because - in the words of Lord Bridges - both the 1925 committee and the Economic Advisory Council were throughout the 1930s "rather remote from the active centre of things".(4) In particular, Keynes failed in 1931 and 1932 to halt the public expenditure cuts advocated by the May Committee, despite his ferocious and well-known attack on them in the *New Statesman*.(5) These cuts were a classic example of government expenditure being determined by budget-balancing principles, instead of by the requirements of the business cycle. They were also an important part of the provocation for the new theories expressed in *The General Theory*.

Economists active in government during Second World War,

Despite Keynes' apparent ineffectiveness in the policy debate of the early 1930s, the Economic Advisory Council set the precedent for professional economists supplementing civil service advice on key issues in economic policy. Because of the imperative to reach the best possible decisions in war-time, the Economic Advisory Council was followed in 1939 by a Central Economic Information Service in the Cabinet Office. It had a whole-time staff of economists and statisticians, and they were given the job of assembling in one place information about production which had previously been available only from a wide variety of sources. This had obvious significance for the organization of military output, but it also made possible the first estimates of national income and expenditure. Early in 1941 the Central Economic Information Service was split into two, with the economists becoming the Economic Section of the Cabinet Office and the statisticians the Central Statistical Office. The service's work made possible the publication of the first National Income White Paper, which informed the tax decisions taken in the Budget on 7th April 1941 by Sir Kingsley Wood, the Chancellor of the Exchequer.

According to Sabine, "1941 ... was the watershed year when the Budget could

with strong influence on 1941 Budget, with its Keynesian elements

at last be seen to be performing its correct dual function of raising the taxation required and restricting purchasing power."(6) The connection between tax decisions and consumer spending power - and so, by extension, between the Government's financial position and aggregate demand - had been emphasized by Keynes in articles in *The Times* on 'How to Pay for the War', where he developed the idea of an "inflationary gap". The gap, the excess of the nation's *ex ante* propensity to spend over its *ex ante* ability to supply, made sense conceptually only in the context of his theory of national income determination. "It is impossible to divorce the practice of the Kingsley Wood regime from the theories of Keynes", particularly "in the recasting of Budget mathematics to highlight the gap".(7) Dow agrees that 1941 was the turning-point. "Since 1941 almost all adjustments to the total level of taxation have been made with the object of reducing excess demand or of repairing a deficiency."(8)

1944 White Paper appears to be charter for contra-cyclical demand management

Keynes is also attributed with a role in the authorship of the 1944 White Paper on *Employment Policy*. The *Employment Policy* White Paper is widely regarded as the charter for demand management policies in the post-war period, largely because of its reference to "a high and stable level of employment" as an objective of official policy. However, the actual wording of the White Paper is far from enthusiastic in its endorsement of a Keynesian purpose for fiscal policy. One passage reads, "To the extent that the policies proposed in this Paper affect the balancing of the Budget in a particular year, they certainly do not contemplate any departure from the principle that the Budget must be balanced over a longer period." Further, "An undue growth in national indebtedness will have a quick result on confidence. But no less serious would be a budgetary deficit arising from a fall in revenues due to depressed industrial and commercial conditions."(9) It is plainly implied that depressed conditions might not justify discretionary action to expand the budget deficit.

Endorsement of key role for fiscal policy by Cripps in 1950

At any rate, by the late 1940s ministers and many civil servants recognised that the annual Budget ought to be framed with a view to influencing the level of economic activity. In 1948 Sir Stafford Cripps combined the functions of Chancellor of the Exchequer with that of Minister for Co-ordination of Economic Affairs. In his Budget speech of 1950 he said, "Excessive demand produces inflation and inadequate demand results in deflation. The fiscal policy of the Government is the most important single instrument for maintaining that balance."(10) This is clear and straightforward, and undoubtedly represents an official stamp of approval for Keynesianism.

Monetary policy subordinate, even in the 1950s

There is also no question that - when it was given - the statement was uncontroversial and commanded support from all parts of the political spectrum. The Conservative Party came to power in 1951 and made more deliberate use of monetary policy than its predecessor. Most notably, it allowed Bank rate to rise from 2 per cent (where it had been stuck, apart from a brief period at the start of the Second World War, since 1932) to 2 1/2 per cent in November 1951 and 4 per cent in March 1952. (See chart on p.6.) Thereafter Bank rate was varied mostly in response to the vicissitudes of the exchange rate. But monetary policy was not thought to have a major part to play in influencing demand. Because it was assigned to the task of stabilizing foreign exchange sentiment towards the pound, fiscal policy could instead be used for the vital aim of managing the domestic economy and trying to secure, on average, a high level of employment. The 1941 and other war-time Budgets left a strong impression on the operation of fiscal policy in practice. Fiscal policy was taken as being more or less equivalent to discretionary changes in taxes, as public expenditure was judged too inflexible for short-run demand management.(11) In Ian Little's words, commenting on fiscal policy in the 1950s, "in almost all respects, taxation (and, more generally, fiscal policy) is superior to monetary policy."(12)

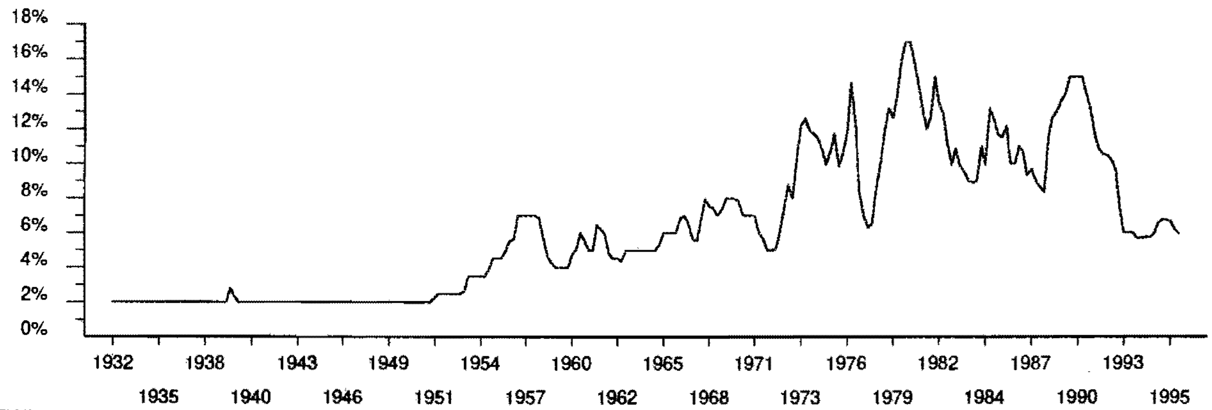
Little's praise for embryonic economic forecasting, and link with budget-making, in the early 1960s

By the start of the 1960s economists began to feel more confident about quantifying the effect of tax changes on demand. As they could estimate the link between tax changes and consumption, and since consumption was the largest component of aggregate demand, they believed they had leverage over the economy as a whole. "[T]he procedure of official forecasting is designed to fit in with the procedure of budget-making."(13) To quote Little again, writing in 1961, "Mr. Heathcoat-Amory was the first Chancellor to predict demand in percentages in his 1960 Budget speech. More recently, Mr. Selwyn Lloyd has said, 'I believe it will be within our power to expand at the rate of 3 per cent per annum over the next five years, but to do this our exports will have to rise at approximately double this rate'." Little welcomed the shift to forecasts of demand constituents in percentage terms, concluding his references to Heathcoat-Amory and Selwyn Lloyd with the remark "Let us hope these are straws in the wind of change".(14)

Superficially, informed views on fiscal theory and the actual conduct of fiscal policy had made a comprehensive shift from primitive pre-Keynesian budget-balancing in the early 1930s to sophisticated Keynesian demand management in the early 1960s. This shift seems to have comparable to that in the USA, as described by Stein in his *The Fiscal Revolution in America.* The

The liberation of monetary policy in late 1951 and early 1952

Chart shows short-term interest rates. (Bank rate to 13th October 1972, Minimum Lending Rate from 14th October 1972 to 20th August 1981 and clearing bank base rate thereafter.) Note constant Bank rate from 1932 to late 1951, apart from spike at the start of the Second World War.



standard textbook characterisation of the period as "the age of Keynes" appears to be justified.

II. The case against a Keynesian revolution, also at the level of ideas

However, even at the level of ideas, the Keynesian triumph was far from complete. Influential writers in the Keynesian camp themselves concede that official thinking was more muddled and ambivalent in this period than commonly thought. In particular, the conventions for measuring the various categories of public expenditure, taxation and the differences between them harked back to the budget-balancing orthodoxies of the pre-Keynesian era. For example, in his book on *The Management of the British Economy* Dow protested against the survival of accounting practices which originated in the Exchequer and Audit Departments Act of 1866 or even earlier. To those well-versed in the precepts of modern macroeconomics, "The traditional Exchequer accounts have constantly to be explained away as misleading." Indeed, in a footnote Dow admitted that the references to fiscal policy in the 1944 White Paper on *Employment Policy* were "highly confused", because of tensions between economists working in Whitehall and "the guardians of the older Treasury tradition".(15)

Role of "guardians of older Treasury tradition"

such as Sir Herbert Brittain

Moreover, these guardians of the older tradition did write, quite extensively, about how they thought the public finances should be organized. In 1959 Sir Herbert Brittain, a recently-retired senior Treasury official, published a book on *The British Budgetary System*, to serve as "a new and comprehensive account of our budgetary system and of the parliamentary and administrative arrangements that are part of it". He saw his book as following in the wake of *The System of National Finance* by Lord Kennet and Mr. Norman Young, which had previously "filled that role". The book contained not a single reference to Keynes. Indeed, it is not going too far to say that, in certain respects, Brittain's description of budgetary arrangements appeared to be deliberately anti-Keynesian. Chapter III, on 'The general design of the Budget', placed a section on 'Prudent finance' before sections on 'Social and political questions' and 'Broad economic and financial policy'.

Brittain critical of rises in national debt because of increase in debt interest; he favoured balanced budgets

The comments on budget deficits under the 'Broad economic and financial policy' heading were highly traditional. Not only must the deficit be as low as possible in the interests of control, but also "regard must be had to the fact that any deficit inevitably means an increase in the national debt". Brittain noted the doctrine that "an indefinite increase in the national debt does not matter so long as the rate of increase is less than the rate of increase in national income", but rejected it on the grounds that the tax burden depended on the size of all transfer payments and not on the debt interest charge alone. "[I]t may be dangerous to mortgage in advance any given part of the increase in revenue for the debt charge, irrespective of other possible claims."(16) The section's verdict was that "dangerous results" might proceed from a lack of confidence in the public finances. Finally, a footnote was attached, claiming that most of the 1944 *Employment Policy* White Paper, and in particular the passage in paragraphs 74 to 79 "dealing with Central Finance", had stood up "to the test of post-war expenditure".(17) Paragraphs 74 to 79 were exactly those which had reiterated the virtues of balancing the budget over the business cycle.

Budgets to be balanced "above-the-line", with revenue covering recurrent capital expenditure

How should this balancing of the budget be defined? The central principle of the Treasury's fiscal conservatism was that the budget should be balanced "above-the-line". The distinction between items above and below the line was related, but not identical, to the distinction between income and capital. The crucial difference was that recurrent items of capital expenditure were regarded as above-the-line, "as there is no case for spreading it over a period, and to borrow every year would only increase the cost over the years by unnecessary payments of interest".(18) So borrowing was legitimate to cover the cost of exceptional, non-recurrent capital expenditure, but that was all. The intended aim of this type of fiscal conservatism was to prevent the national debt rising faster than the stock of capital assets owned by the Government. The cyclical state of the economy was a secondary consideration.

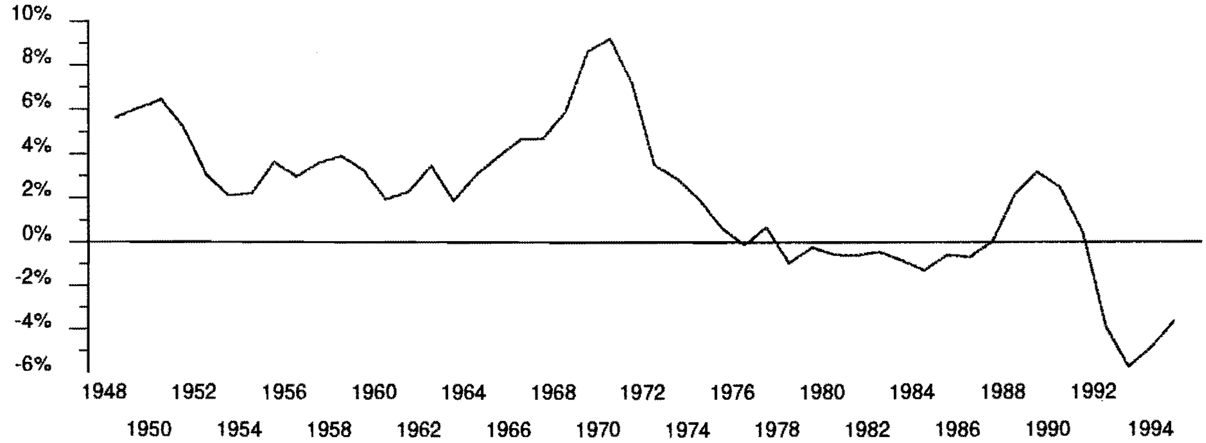
Keynesianism vs. the "older Treasury tradition"

Treasury tradition seemed to win in terms of the trend *level* of the budget balance

Which set of ideas - the Keynesian contra-cyclical activism described by Dow and Little or the fiscal conservatism defended by the Treasury knights - was in fact the predominant influence in the late 1940s, the 1950s and early 1960s? On some interpretations the data give a clear-cut answer. As noted by Robin Matthews writing in 1968, "throughout the post-war period the Government, so far from injecting demand into the system, has persistently had a large current account surplus...[G]overnment saving has averaged about 3 per cent of the national income".(19) A surplus of this kind would be the likely outcome of applying the above-the- line/below-the-line methodology favoured by Brittain and traditional Treasury knights, since it would correspond to the recurrent capital costs covered by revenue. The ratio of the UK's national debt to its gross domestic product fell sharply from 1945 to the mid-1970s, despite the charter for permissive deficit financing which Keynes was supposed to have given policy-makers in his *General Theory*.

The UK Government's financial position since 1948

Chart shows ratio of general government current account deficit or surplus to GDP at factor cost, %. Note that deficits began only in the mid-1970s and large deficits only in recent years. The surpluses of the late 1940s and 1950s reflected the rule that the Budget should be balanced "above-the-line".



But is it the *level* or the *change* in the budget balance that defines "policy"?

Matthews continued, provocatively, to assert that fiscal policy appears "to have been deflationary in the post-war period". However, there is an important theoretical objection to this conclusion. The characterisation of fiscal policy is beset with ambiguities. Quite apart from all the uncertainties about specifying the appropriate concept of the budget balance, fiscal policy can be measured and described in terms of either the *level* or the *change* in the budget balance. Matthews' conclusion depends on the premises that fiscal policy is best described in terms of the level of the budget balance. A counter-argument could be made that the change in the balance, appropriately defined, is the Government's discretionary response to the economic situation and is therefore a better way of thinking about "policy".

But studies of relationship between *changes* in the budget balance and the economy also argue against the reality of a Keynesian revolution

Fortunately, a number of studies have been made of the relationship between the economy and changes in the budget balance in the first 25 years after 1945. Hansen, conducting a statistical review of *Fiscal Policy in Seven Countries 1955 - 65* for the OECD, judged that fiscal policy in the UK, measured in terms of changes in the cyclically- adjusted deficit, had been destabilizing over the period.(20) (In other words, action had been taken to increase the deficit when the economy was operating at an above-normal level and to reduce it when economy was beneath-normal.) In his narrative account *The Treasury under the Tories 1951 - 64*, Samuel Brittan was also highly critical. In 1971 he published *Steering the Economy*, a revised and up-dated version of *The Treasury under the Tories*. In it he suggested that, "Chancellors behaved like simple Pavlovian dogs responding to two main stimuli: one was 'a run on the reserves' and the other was '500,000 unemployed' - a figure which was later increased to above 600,000."(21) Even Dow - who made such strong claims for the historical reality of the Keynesian revolution in the early chapters of *The Management of the British Economy 1945 - 60* - acknowledged in later chapters that practice and outturn had been very different from theory and plan. In the event many "adjustments of policy were occasioned by the balance of payments", not the level of unemployment relative to a desired figure. The external interference had the result that, "[a]s far as internal conditions are concerned..., budgetary and monetary policy failed to be stabilizing and must on the contrary be regarded as having been positively destabilizing. Had tax changes been more gradual, and credit regulations less variable, demand and output would probably have grown much more steadily".(22)

Older Treasury tradition dominant until mid-1960s

The conclusion must be that, over at least the first two-thirds of the period from 1945 to the mid-1970s, fiscal policy was not Keynesian in the normally understood sense. The trend level of the budget deficit was determined by "the older Treasury tradition", with its emphasis on the sustainability of government debt relative both to national income and the size of the public sector's stock of capital assets. Policy- determined variations in the deficit around this trend level were largely motivated by the balance of payments and the state of the pound, not by the counter-cyclical requirements of the domestic economy and unemployment. Moreover, many economists active at the time must have been fully aware that there was a sharp divergence between the actual conduct of fiscal policy and their Keynesian views of what fiscal policy ought to have been.

Was there a change with the Labour Government of 1964 to 1970?

The election of the Labour Government in October 1964 was accompanied by a large influx of professional economists into Whitehall. Many of them thought fiscal policy could and should be used to manage the economy. But economic policy in the years from 1964 to 1970 was again dominated by the balance of payments. The Government sought financial help from the International Monetary Fund after the pound's devaluation in November 1967. The Budget of 1968 contained the largest tax increases since 1945, with fiscal policy specifically designed to curb the current account deficit. Unhappily, the current account's initial response to devaluation was slow. In June 1969 the Government and the IMF reached agreement on further measures, with the Letter of Intent referring to a target for domestic credit expansion of £400m. in the 1969/70 year. Domestic credit expansion was a new policy indicator, essentially equal to all new bank credit extended to the public and private sectors. DCE to the public sector was equal to the public sector borrowing requirement (PSBR) minus net sales of public sector debt to non-banks. A target for DCE implied some sort of limit on the budget deficit and so precluded contra-cyclical action to lower unemployment.

Policy still geared to the balance of payments

But at least the definitions and categories began to change

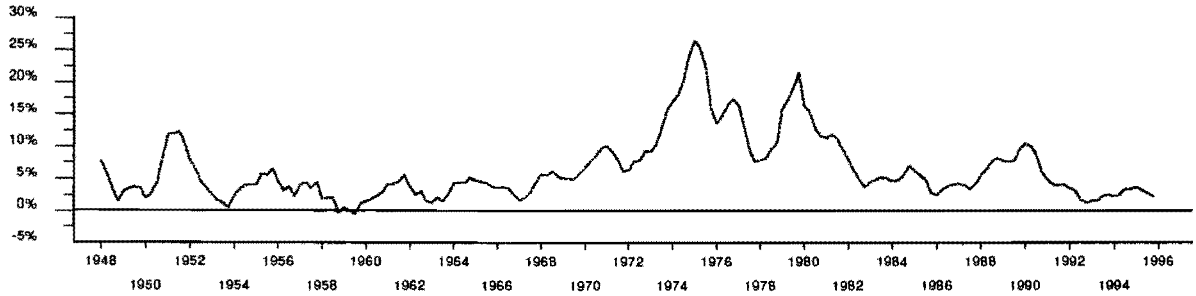
One result of the IMF's involvement in British macroeconomic policy was to end the old-fashioned above-the-line/below-the-line convention and to replace it with concepts closer to the requirements of modern economic analysis. But the conduct of policy itself was certainly not Keynesian. Keynesians in the

The instability of the mid-1970s

The mid-1970s saw the highest inflation and some of widest deficits on the current account of the balance of payments in the post-war period

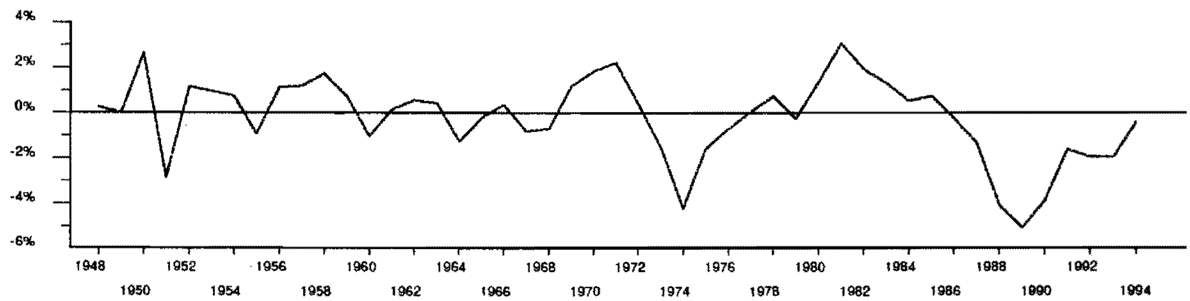
1. The inflation record

Chart shows annual increase in the retail price index. Quarterly data.



2. The balance-of-payments record

Chart shows current account surplus/deficit as % of GDP at factor cost. Annual data.



Cambridge tradition of the 1940s and 1950s were mostly scornful of the IMF medicine, on the grounds that it was merely a refurbishment of old sound finance doctrines. But the current account of the balance of payments was converted, after adoption of the IMF's prescription, from deficit in 1968 to large surplus in 1970. Indeed, a common refrain in 1970 and 1971 was that the fiscal contraction of 1968 had not turned the balance of payments round, whereas the monetary squeeze of 1969 had worked. The effectiveness of fiscal policy was compared unfavourably with that of monetary policy.

Another theme in policy-making circles in the early 1970s was that the UK's poor long-term record on economic growth could be largely blamed on undue anxiety about the balance of payments and the exchange rate. For example, Brittan argued that a balance-of-payments deficit was a non- problem, since the drain on the UK's foreign exchange reserves could be halted simply by allowing the exchange rate to float.(23) The editor of an important collection of essays on *The Labour Government's Economic Record 1964 - 70* judged in 1972 that, because of the reluctance to devalue the pound earlier, "the Government never achieved any room for manoeuvre...It is little wonder that they were eventually blown off course".(24)

Aggressive expansion of early 1970s,

The intellectual groundwork had been laid for the aggressive expansionism of macroeconomic policy in the two years to mid-1973. Policy-makers were determined that the exchange rate would not be allowed to hold back economic growth. Credit restrictions were relaxed in late 1971 and a highly stimulative Budget was introduced by the Chancellor of the Exchequer, Mr. Anthony (later Lord) Barber, in March 1972. In response to the inevitable resulting weakness of the pound, the exchange rate was floated in June 1972. In 1973 gross domestic product rose by over 7 per cent. But the trend growth rate of the UK economy remained much as before and the "Barber boom" led to severe over-heating. Inflation (as measured by the 12-month increase in the retail price index) rose to double-digit rates in 1974 and peaked at 26.9 per cent in August 1975, while the current account of the balance of payments incurred the heaviest-ever deficits (relative to GDP) until then in the post-war period.

which is often described as "Keynesian",

In the policy debates which followed this disaster, the policy thinking behind the expansionism of the early 1970s was often labelled "Keynesianism". This may be rather unfair, since Keynesianism encompasses a wide variety of positions about the relative importance of the different branches of policy and is merely "an apparatus of thought" (in Keynes' own words), not a well-defined set of rules about policy. Two years in the early 1970s (from mid-1971 to mid-1973) may nevertheless be the only phase in the entire post-war period when policy was properly Keynesian, uncluttered by the constraints of the fixed exchange rate (as before 1971) or by an entirely different framework of thought (as after the mid-1970s). At the time the Barber boom was regarded as Keynesian in intention by those who decided policy and as Keynesian in form by the majority of commentators. It was also an unmitigated disaster. The euphoria of 1973 was followed over the next two years by the worst recession, the highest inflation and the widest payments gap in the post-war period.

was an unmitigated disaster

Notes

(1) J. C. R. Dow *The Management of the British Economy 1945 - 60* (Cambridge: Cambridge University Press, 1964), p. 178.

(2) H. Stein *The Fiscal Revolution in America* (Chicago and London: Chicago University Press, 1969), p. 165.

(3) See, for example, 'Are we really all Keynesians now?', pp. 197-209, of T. G. Congdon *Reflections on Monetarism* (Aldershot: Edward Elgar for the Institute of Economic Affairs, 1992), originally published in the April 1975 issue of *Encounter*.

(4) E. E. B. (Lord) Bridges *The Treasury* (London: George Allen & Unwin, and New York: Oxford University Press, 1964), p. 90.

(5) 'The Economy Report', pp. 141-5, and 'The Economy Bill', pp. 145-9, in D. E. Moggridge and Mrs. E. Johnson (eds.) *The Collected Writings of John Maynard Keynes: vol. IX Essays in Persuasion* (London and Basingstoke: Macmillan, 1972), originally based on articles published in *New Statesman and Nation* on 15th August and 19th September 1931.

(6) B. E. V. Sabine *British Budgets in Peace and War* (London: Allen & Unwin, 1970), p. 300.

(7) Sabine *British Budgets*, p. 300.

(8) Dow *Management of British Economy*, p. 198.

(9) White Paper on *Employment Policy* (London: H. M. S. O., 1944), paragraphs 77 - 79.

(10) Bridges *The Treasury*, pp. 93 - 4. The quotation is from p. 93.

(11) Dow *Management of British Economy*, p. 180.

(12) I. M. D. Little 'Fiscal policy', ch. 8 of G. D. N. Worswick and P. H. Ady (eds.) *The British Economy in the Nineteen-Fifties* (Oxford: Oxford University Press, 1962), pp. 231 - 91. The quotation is from p. 251.

(13) Dow *Management of British Economy*, p. 161.

(14) Little in Worswick and Ady (eds.), *British Economy in Nineteen- Fifties*, p. 275.

(15) Dow *Management of the British Economy*, pp. 183 - 88. The quotations are from p. 183 and p. 187 respectively.

(16) Sir Herbert Brittain *The British Budgetary System* (London: George Allen & Unwin, 1959), p. 53 - 4.

(17) Brittain *British Budgetary System*, p. 56.

(18) Brittain *British Budgetary System*, p. 43.

(19) R. C. O. Matthews 'Why has Britain had full employment since the War?', *Economic Journal*, September 1968, vol. LXXVIII, pp. 555 - 69. The quotation is from p. 556.

(20) B. Hansen *Fiscal Policy in Seven Countries 1955 - 65* (Paris: Organisation of Economic Cooperation and Development, 1969).

(21) S. Brittan *Steering the Economy* (Harmondsworth: Penguin, 1971), p. 455.

(22) Dow *Management of the British Economy*, p. 384.

(23) S. Brittan *The Price of Economic Freedom* (London: Macmillan, 1970).

(24) W. Beckerman (ed.) *The Labour Government's Economic Record 1964 - 70* (London: Duckworth, 1972), p. 25.