1976 and all that: the IMF event

Robin Ramsay

I still buy a daily paper, *The Times*. One of its regular columnists is Daniel Finkelstein. Lord Finkelstein, as he is now, has been around the upper reaches of the centre (and latterly the centre–right) of British politics for 40 years and is thus one of the architects of the disastrous mess the UK is in. In his column of 17 April, 'Truss's excuse sounds like Labour in 1976',[1] he considered Liz Truss's claims that her economic policies were undermined by unelected officials, notably in the Office for Budget Responsibility. He commented:

> 'Anyone seeking a history of this sort of thinking should begin by reading Tony Benn's diaries and the memoirs of Denis Healey [. . . .] for years afterwards Denis Healey complained that the whole crisis [the IMF crisis of 1976] had been unnecessary. The Treasury had overestimated future government borrowing [. . . .] But as Professor Sir Vernon Bogdanor argued . . . . Labour lost the confidence of markets through its earlier borrowing and because lenders worried it did not have the political will or majority to cut spending, whatever it might say.'

Alas, Prof Bogdanor (and Lord Finklelstein) haven't done their homework. What happened in 1976 was more interesting, and more complex, than that. I wrote about this in *Lobster* 34 in 'Back to the future: the 1970s reconsidered'. But that is behind *Lobster's* modest paywall. What follows is based on a section of that.

Faking the figures

In 1976 the minority Labour administration[2] was wrestling with the biggest economic problems since WW2. In 1974 Harold Wilson's government had inherited inflation running at over 20% a year, a growing balance of payments

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[1] <https://www.thetimes.co.uk/article/trusss-excuse-sounds-like-labour-in-1976-dw9pxprjp>

[2] That Government had been elected with a majority of three seats in 1974. However, 1976 saw Harold Wilson's resignation but the advancement to PM of James Callaghan – who immediately lost Labour's tiny majority in the Commons. See 'BBC on this day: 5th April, 1976' at <http://news.bbc.co.uk/onthisday/hi/dates/stories/april/5/newsid_4074000/4074428.stm>.

deficit and a pound that was in danger of falling too far against the dollar.[3] The conventional view, the view of H.M. Treasury, was that the way to reduce inflation was to reduce consumption by cutting wages and it wanted a statutory incomes policy. For a Labour government, largely funded by the trade unions, this was politically impossible – even if they had thought it a good idea. This was rejected by Labour in 1975.

The political struggle with the Treasury then shifted to the level of government borrowing. The Treasury wanted the government to borrow less and so spend less. The conflict centred round the projected Public Sector Borrowing Requirement (PSBR) – the amount the government would need to borrow to pay its bills. The government didn't want to make the kind of substantial cuts being suggested by the Treasury and the idea of getting what was essentially a kind of bridging loan from the International Monetary Fund (IMF) was being considered. But, in return for the loan, the IMF would also require cuts in government expenditure – the standard IMF formula.

In February 1976 the Treasury issued grossly inflated figures on public spending. Quoting the memoirs of Sir Leo Pliatzky, a Treasury official at the time, William Keegan referred to this false figure as

> one of the *least fortunate mistakes* of the year; double counting certain items of local authority and nationalised industry spending, and failing to compare like with like, so that what later turned out to be 46 per cent of gross domestic product was printed for all to see as 60 per cent early in that crucial year.'[4] (Emphasis added.)

I don't know why Keegan felt obliged to describe this as a mistake. This was psychological warfare. The Treasury faked the figures to make life difficult for the government: by this stage an approach to the IMF was being discussed. A similar move was made during the early stages of the negotiations with the IMF. Another grossly exaggerated Treasury estimate of the PSBR for 1977-8 was leaked to the *Financial Times.*[5] With memories of the previous year's Treasury and Bank of England-led attempt to coerce the Labour government into a statutory incomes policy, Bernard Donoughue, of the Downing Street

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[3] Conservative PM Edward Heath had created a credit boom in his 'dash for growth' and this greatly aggravated the inflation which all industrialised economies suffered when the price of oil went up in 1973. See <https://shorturl.at/6CUrm> or <https://www.theguardian.com/uk-news/2022/sep/25/why-the-barber-boom-that-kwasi-kwartengs-mini-budget-recalls-was-destined-for-disaster>.

[4] William Keegan, 'The farce that was '76', The *Observer* 21 March 1982.

[5] Kathleen Burk, and Alec Cairncross, *Goodbye Great Britain: the 1976 IMF Crisis* (Yale University Press, 1992) p. 70.

Policy Unit, recorded

> suspicions in [the government's] minds that the [PSBR] had been inflated to create an atmosphere of crisis enabling the Treasury to 'bounce' large cuts through Ministers.[6]

These doubts of Donoughue's were shared by Prime Minister Callaghan, Chancellor Denis Healey and Cabinet member Peter Shore that we know of; and also by the IMF official in charge of the IMF team in London – a former Bank of England official, Alan Whittome.[7]

At the time of the IMF negotiations, members of the Callaghan government knew their opponents were working against them. Callaghan 'received well authenticated reports that a prominent front-bench Conservative spokesman, who has since served in Mrs. Thatcher's Cabinet, was in Washington trying . . . to influence the Administration against the Labour government.'[8] In the *Guardian* 28 October 1976 Peter Jenkins reported information from a 'wholly authoritative' American source:

> 'One of the problems is the axis between your Treasury and our Treasury. They seem to be agreed that the Labour Manifesto is a manual for suicide . . . . they are constantly in touch with our people saying, "Don't bale these bastards out."'[9]

In November 1976 Liberal MP John Pardoe stated that 'he had received reliable reports that a number of people from Britain representing both Treasury and City interests had at that time told the U.S. Treasury that it would be better if Britain were to get no more loans from the IMF.' [10]

Just over a decade later, we learned from Bernard Donoughue that elements within the US state wanted to use the crisis to get rid of the Labour

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[6] Bernard Donoughue, *Prime Minister: The Conduct of Policy under Harold Wilson & James Callaghan* (London: Jonathan Cape, 1987) p. 94.

[7] For Whittome see Denis Healey, *The Time of My Life*, (London: Michael Joseph, 1989) p. 431.

On 23 November 1976 Tony Benn noted in his diary, 'Peter [Shore] suspected the figures produced by the Treasury.' As did Prime Minister Callaghan: 'The only doubt in my mind, borne of previous experience, was how far to trust the figures.' James Callaghan, *Time and Chance* (London*:* Collins, 1987) p. 422. Healey wrote: 'I cannot help suspecting that Treasury officials deliberately overstated public spending in order to put pressure on governments which were reluctant to cut it.' *The Time of my Life* p. 402.

[8] Callaghan (see note 7) p. 431.

[9] Cited by Chris Harman in 'Why Labour fails' at <https://www.marxists.org/archive/harman/1979/06/labour.html>.

[10] Ken Coates (ed.), *What Went Wrong,* (Nottingham: Spokesman, 1979) pp. 181/2.

government. In a 1989 seminar on the IMF events, Donoughue revealed the following.

> . . .in the middle of this crisis I was privately summoned to the United States Embassy for a secret meeting with a very senior official there who said, 'You should be aware of something, which is that parts of the Treasury are in very deep cahoots with parts of the U.S. Treasury and with certain others in Germany who are of very right-wing inclination and they are absolutely committed to getting the IMF here and if it brings about the break-up of this government, they will be very, very happy.' He actually showed me a copy of a secret communication between London and Washington which seemed to confirm this view.

Looking back from the late 1980s, Donoughue commented:

> We were not being paranoid in 1976 in our suspicion that the IMF was capable of launching economic 'remedies' which would destroy governments (especially governments of the left). A year later in November 1977 the IMF mission to Portugal (including a senior member of the 1976 mission to the UK) refused to grant a credit tranche to the socialist minority government led by Mr. Soares because he would not make immediate savage economies which would certainly have brought down his administration and allowed back into power the old anti-democratic parties of the far right. Internal IMF briefing, which we saw among diplomatic papers in Downing Street, at that time stated quite brutally that the *IMF policy was to create a foreign exchange crisis* over the next two months. The IMF staff explicitly asked the Western Governments of the United States, Germany, Japan and Britain to withhold financial and economic aid in order to create a foreign exchange crisis which would bring the Soares Government to its knees and so force it to accept the harsh IMF prescriptions.[11] (Emphasis added.)

At the end of all the wrangles, the months of cabinet debate, the international horse-trading and arm-twisting, and the disinformation from within the financial nexus in Britain, the result was a compromise. Accepting the need for a deal with the IMF – if only for the IMF 'seal of approval' to display to the international money markets – Prime Minister Callaghan used the NATO alliance dimension and the sympathy of other democratic heads of state to

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[11] Donoughue (see note 6) pp. 99 and 100. There is another version of this in Burk and Cairncross (see note 5) p. 107.

greatly reduce the conditions on the loan.[12]

And, as it turned out, the cuts in public expenditure agreed with the IMF were smaller than those already working their way through the system as a result of changes – the introduction of so-called cash limits – inside the Treasury made before the IMF crisis blew up. Callaghan commented in his memoir:

> Partly as a result of cash limits, public spending fell sensationally short of expectations in 1976-77, so that the forecasts which so alarmed the IMF and the financial markets painted a much more gloomy picture than was really necessary.[13]

The accounts I have read of this episode are unclear about who knew what about the probable effects of the 'cash limits' which had been introduced before the arrival of the IMF. In their version, Burk and Cairncross state that 'Unknown to all during the whole of 1976, but more obviously in 1977, cash limits brought about a scaling down of public spending'.[14] Certainly none of the politicians centrally involved seemed to have had any idea. How far the knowledge had spread – if it had spread at all – among the Treasury staff involved simply isn't known.

The last big 'bounce'

Defeated again, the Treasury faction which wanted the IMF to teach the government a harsh lesson, was privy to a final attempt at deception. In the Prime Minister's Policy Unit, Bernard Donoughue was monitoring the conclusion of the IMF negotiations. The focus of his interest was the Letter of Intent, the contract between the government and the IMF.

> It seemed to me very important to scrutinise the small print on this document in case some nasty provisions and unnecessarily harsh conditions had been slipped in at the last moment.

The Treasury stone-walled him about the Letter of Intent. Eventually he found it in the Prime Minister's box of papers. Donoughue's suspicions were justified.

> The terms were extremely tough, much tougher than had been agreed with the Prime Minister as far as detailed monetary targets were concerned. The imposition of tight ceilings on both the PSBR and on

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[12] Callaghan's politicking is described in Kathleen Burk, 'The Americans, the Germans and the British; The 1976 IMF Crisis', in *Twentieth Century British History*, vol. 5, issue 3, 1994, pp. 351–369.

[13] William Keegan (see note 4)

[14] Burk and Cairncross (see note 5) p. 15.

> Domestic Credit Expansion (the increase in domestic money supply before making allowance for balance of payments effects) seemed to rule out any possibility of reflation before the next election and even made it likely that we would be forced to trigger off a fresh round of deflationary cuts in order to meet these targets.

Donoughue claims that with his input Callaghan got significant changes made to the Letter of Intent.[15]

'We faced the collapse of the currency, the collapse of the Government and the collapse of the Labour Party' – so said an unnamed Treasury official in 1976.[16] The true economic significance of the 'crisis' in 1976, however, can be judged by the fact that the cuts finally required by the IMF were not very big; they were all quietly restored by the government the following year; only half the IMF loan was used, and the rest was repaid without incident. Six months after the IMF team flew back to Washington, the problem with the pound wasn't that it was falling too far – the proximate cause of the approach to the IMF in the first place – but rising too fast.

Conspiracy or cock-up

The events described above are clear evidence of a conspiracy between the IMF, elements within the UK and US Treasuries and various politicians. In a 1989 symposium on these events,[17] there is a section headed 'Conspiracy theory and 1976'. In that, Bernard Donoughue begins his statement with this: 'We all know, and history shows, that most conspiracies were not conspiracies but were cock-ups. That's the basis I start from. But . . . .' Another member of the Labour government who was involved, Harold Lever, comments: 'Now I'm not a conspiracy theorist, but . . . .' And both, of course, then lay out elements of the conspiracy they witnessed.

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[15] Donoghue (see note 6) pp. 99 and 100.

[16] Quoted in Stephen Fay and Hugo Young, *The Day the £ Nearly Died*, (*Sunday Times* [pamphlet], 1978), p. 5.

[17] *Contemporary Record,* vol. 3 no. 2, November 1989 pp. 39-45.