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Politics and public deficits: England in 1976

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This blog explains the Labour Party's recourse to the IMF in Great Britain in 1976

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The relationship between the political leanings of governments—right or left—and the dynamics of public deficit or debt shows a surprising consistency, which is discussed in another blog. The purpose of this contribution is to discuss a specific case: Great Britain in 1976. The Labour Party came to power in Great Britain in 1974; it initially increased the public deficit and pursued a policy of income support. It was then forced to acknowledge an economic impasse and requested assistance from the IMF in September 1976 in the form of a conditional loan. This request was perceived as a national humiliation and contributed to the election of Margaret Thatcher in 1979.

What happened in Great Britain? Can lessons be learned for the current situation? We begin by summarizing economic history to clarify the scale of events, before turning to English political history.

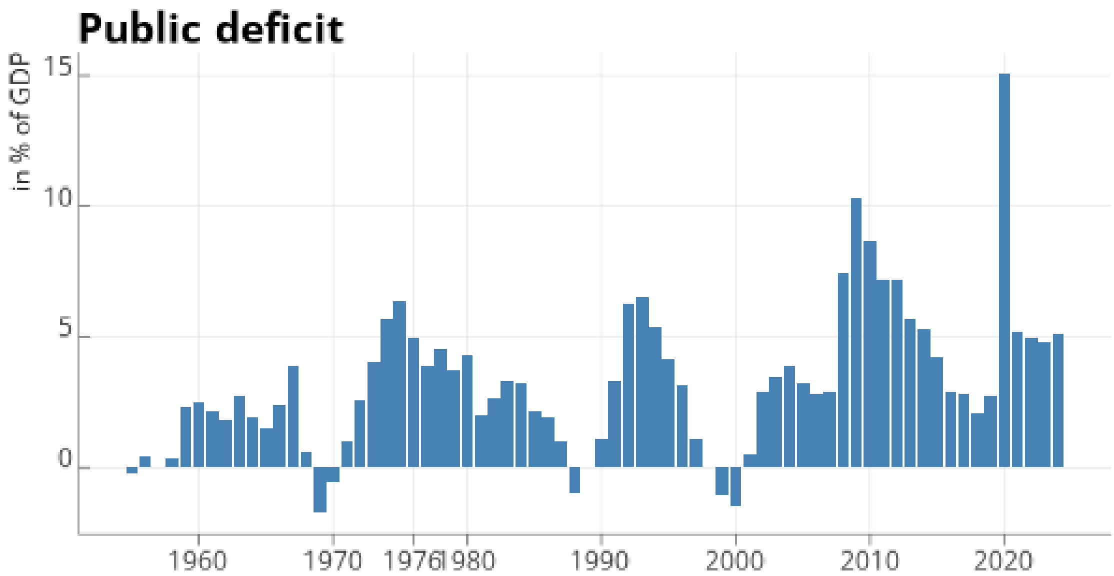
Great Britain 1976: a macroeconomic history

The following three graphs summarize the main elements of British public finances: the public deficit, public debt, and the current account balance. Other elements are discussed below.

Figure 1: Key macroeconomic indicators

Public deficit

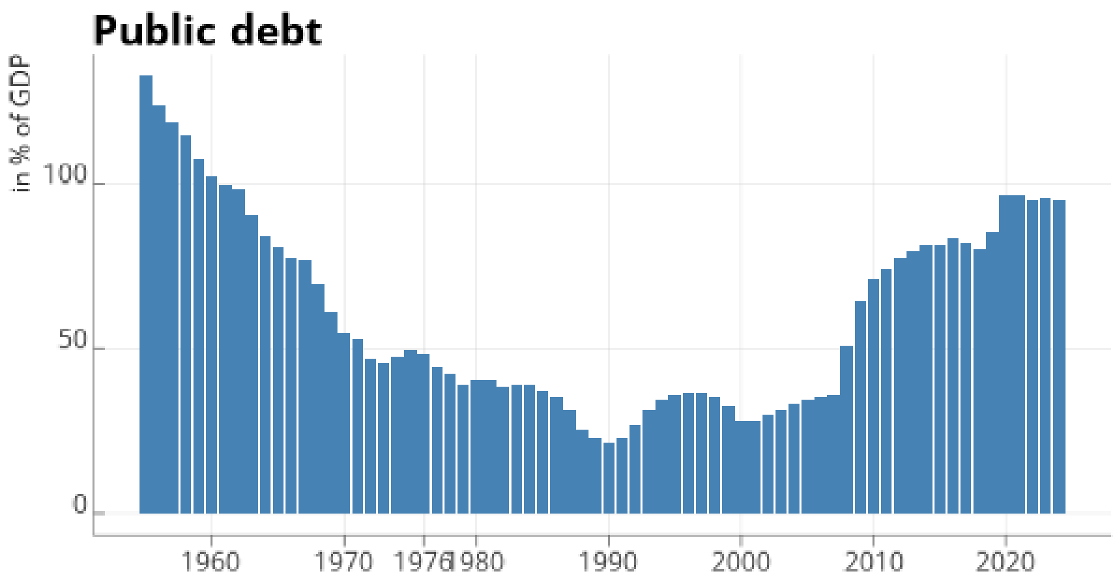
(a)



Sources. OBR, ONS and World Bank, OFCE's computations.

Public Debt

(b)



Sources. OBR, ONS and World Bank, OFCE's computations.

Balance of payments

(c)

- Figure 1a shows the uneven nature of the public deficit. The year 1976 saw a deficit of 6.3% of GDP, which is certainly significant compared to previous deficits, but does not appear particularly high compared to other post-war peaks.
- On the other hand, debt shows a clear downward trend, from its post-World War II peak to a low of 25% in 1990, before rising again in 2024 to 106% of GDP, as shown in Figure 1b.
- Fiscal stimulus financed by public deficit and an income policy favorable to wage increases generate a price-wage spiral. The inflation rate is 16 % in 1974 and rises to 24 % in 1975, before falling back to 16% in 1976. By comparison, the inflation rate was around 6% in the United States in 1976 and 1977.
- Ten-year interest rates rose in England: 11 % in 1973, then 15 % in 1974 and 1975, before falling back to 14 % in 1976. The rise in interest rates was offset by higher inflation in the public accounts: the interest burden relative to GDP remained stable at around 4% throughout the 1970s.
- The energy crisis caused a recession in 1974. Growth fell from 6.5 % in 1973 to −2.5 % in 1974 and −1.5 % in 1975, before rising again to 2.9 % in 1976.
- How did such a volatile and high public deficit profile lead to a smooth downward trajectory in public debt? The nominal growth rate is much higher than the interest rate on public debt, which explains why, even with a high public deficit, public debt continued on a downward trajectory over the period.
- With regard to foreign trade, the 1974 recession caused a significant drop in the current account balance, which fell to −3.6 % of GDP in 1974. However, the trade balance recovered quickly to −1.4 % in 1975 and −0.6 % in 1976, as shown in Figure 1c. Thus, the request for an IMF loan was made with the current account almost in balance.

Finally, the exchange rate fell in 1976. The pound lost value over the period, falling from $2.4 in 1973 to $2.2 in 1975 and $1.8 in 1976, before rising to around $2.10 in 1979.

Faced with such a chronicle, the macroeconomics of Great Britain seem simple: after the oil crisis, Great Britain (like most developed countries) pursued the wrong policy. It tried to revive the economy by supporting demand and increasing incomes, while production slowed down due to the oil shock. These demand-side policies led to a sharp rise in inflation with no effect on growth: stagflation. The solution was a policy adapted to weaker growth and a shock to the productive fabric. This shift took place after 1976, as can be seen in the public deficit. Inflation fell to around 16 % in 1977. There was no public finance crisis (debt was falling, interest charges on GDP were stable, and interest rates were rising less than inflation), nor was there a balance of payments crisis (the current account was almost in balance in 1976, and the exchange rate was moving in line with the inflation differential).

Nothing very surprising, then. So what does the IMF have to do with this story?

The IMF as a solution to a triple crisis

The United Kingdom resorted to IMF loans several times between 1974 and 1976. However, it was the request for intervention in 1976 that marked a turning point, as it appeared to be the solution to a triple internal crisis: an intellectual, political, and institutional crisis. It was the combination of these crises that led to mistrust of the pound sterling.

- The **intellectual crisis** stemmed from the need to renew the framework for analyzing economic policies after the oil crisis. The Labour Party, like the Conservative Party before it, responded to the first oil shock with policies to support demand and household incomes. These policies were inappropriate and highly inflationary because growth was constrained by supply, not by a lack of demand. This error in analysis was initially shared by the IMF, which supported demand-side policies in 1973 before changing its doctrine, as Kevin Hickson notes in his thesis on the 1976 crisis.[1] The latter moved from a doctrine of fiscal expansion in 1974 to a doctrine of disinflation in 1976. Thus, it can be said that in 1976 the IMF was ahead of its time in its understanding of the crisis.[2]
- The second crisis was **political**. In 1974, Labour won the elections, amid heated internal debates. The Labour Party was composed of two main factions. One faction supported demand and income policies by leveraging fiscal and monetary policy. This faction could be described as "Keynesian," even if the term is somewhat inaccurate. The second faction was socialist, represented by Tony Benn, and advocated a program of nationalizing businesses. This program, called the Alternative Economic Strategy (AES), was developed starting in 1970 in collaboration with radical trade unions (see the description by Hickson). Its references are more Marxist than Keynesian. Furthermore, the macroeconomic series should not obscure the social conflict in Great Britain: in 1974, strikes were frequent. The miners' strike, which began before the 1974 elections, ended after the elections with a 29% wage increase, granted on March 6, 1974. From then on, it became clear how difficult it was in Britain to defend a paradigm shift in economic policy, moving from defending wage increases to a policy of fighting inflation. James Callaghan, who became Prime Minister in April 1976, used the IMF as an authority to change positions within his government. It was only after his finance minister, Denis Healy, requested support from the IMF that Callaghan buried demand-support policies in a public speech: "We used to believe that we could pull ourselves out of a recession and create jobs by cutting taxes and increasing government spending. I must tell you, quite frankly, that this option no longer exists and that, if it ever did, it was only by injecting ever-higher levels of inflation into the economy." (quoted by Esposito (2021) in his analysis of the year 1976).
- Finally, the third crisis is **institutional**, between the Treasury and the Bank of England, concerning exchange rate policy. The Treasury is more in favor of allowing the pound to fluctuate, while the Bank of England advocates a policy of pound stability within the European Monetary Snake, established in 1972. The Bank of England exhausted its foreign exchange reserves to maintain the pound's exchange rate in a country where inflation was high compared to other countries.

[1]See Hickson, Kevin (2002) The 1976 IMF Crisis and British Politics. University of Southampton, Doctoral Thesis, page 55, for example.

[2]See also chapter 5 in Goodbye, Great Britain: The 1976 IMF Crisis, by Kathleen Burk and Alex Cairncross, 1992, Yale University Press on the intellectual role of recourse to the IMF. Kevin Hickson emphasizes a change in practice rather than the emergence of a coherent alternative way of thinking.

Thus, more than through its direct intervention, the IMF's role was to contribute to a shift in the economic paradigm in Great Britain. The country needed this external reference point to resolve internal crises. The press and public opinion criticized the failure of the elites, fueling a sense of national humiliation that Margaret Thatcher seized upon in her campaign before her election in 1979.

What lessons can be learned for the current situation?

This description shows that the economic lessons for the French debate are very indirect. While the common factor is high public deficit (lower in France today), the situation is very different: in 1976, the UK was struggling with high inflation at a time of low and declining public debt. Secondly, and more importantly, the inconsistency of British policy can be seen in the evolution of the exchange rate, which does not exist for a country that is a member of a monetary union. The interest rate on public debt is a more relevant indicator in a monetary union, but it only partially reflects the contradictions in economic policy.

In a sense, the French situation is simpler: there is only a political crisis. Left-wing, right-wing, or centrist policies are possible to reduce the deficit and stabilize debt, as discussed by the CAE or the OFCE[3]. The difficulty lies in choosing between them within the institutions of the Fifth Republic.

Références

Esposito, M.-C. (2021). Crise de la livre sterling de 1976 et crédibilité. *Revue Française D'histoire économique*, *16*(2), 58–72. https://doi.org/10.3917/rfhe.016.0058

[3]for the CAE, see Note 82 (July 2024), by A. Auclert, T. Philippon, and X. Ragot. For the OFCE, see the Policy Brief "What trajectories for France's public finances? (July 2025)", E. Heyer, M. Plane, X. Ragot, R. Sampognaro, X. Timbeau