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# Inter-Organisational Distrust and the Political Economy of Central Bank Independence in the UK

**Recto running head :** NEW POLITICAL ECONOMY

**Verso running head :** J. BULLER AND B. WHISKER

Jim Buller, Ben Whisker**[Q1]** 4

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**ABSTRACT**

This article revisits a puzzle: why did the Conservative Governments of Margaret Thatcher and John Major not grant independence to the Bank of England? A substantial literature offers several explanations for why New Labour carried out this reform to UK monetary policy, many of which ought to have been relevant to the Conservatives' stewardship of the economy in the 1980s and 1990s. So why did the Conservatives fail to see the advantages of a policy that the Blair Government seized on as one of its first acts of office? Combining new archival research with elite interviews of some key participants during this period, this article re-examines this neglected question. It argues that one overlooked reason why the Conservatives decided against granting independence to the Bank of England relates to the role and importance of inter-organisational distrust. Conservative leaders (and Treasury officials) had negative expectations about the Bank's ability to implement monetary policy and did not want to increase their dependence on that institution to fulfil a function deemed crucial to their political fortunes.

**KEYWORDS**

- Central bank independence
- trust
- Bank of England
- monetary policy
- Conservative party

## Introduction

There is now a significant literature on the economic policies of the Thatcher and Major administrations (e.g. Keegan 1984, 1989, Smith 1987, 1992, Johnson 1991, Thompson 2014). However, to our knowledge, no detailed study exists that exclusively examines ~~this question~~why they failed to grant independence to the Bank of England (BoE). Instead, academic consideration of Conservative attitudes towards central bank independence (CBI) tends to be absorbed into broader tracts on British political economy. Likewise, while there is extensive scholarship describing why New Labour granted independence to the BoE, discussion of why the Conservatives failed to implement such reform is usually subsumed within a broader investigation of the Blair Government. This literature provides a range of explanations for why elected politicians devolve responsibility for monetary policy on to non-elected central bankers. Some point to the power of economic ideas and their sponsors; some highlight electoral considerations; others emphasise broader constitutional factors. But what is striking is that many of these factors ought in theory to have applied to the Thatcher and Major Governments in the 1980s and the 1990s. So what stopped the Conservatives from granting operational independence to the BoE?

This article makes both an empirical and a theoretical contribution to scholarship on this subject. Combining new archival research with interviews from key participants, it uncovers the reasons behind what we claim to be the ambiguous behaviour of the Thatcher and Major Governments towards the issue of BoE independence. Theoretically, the article highlights the importance of inter-organisational distrust as an important part of the explanation for the decision not to introduce CBI. In particular, both Thatcher and Major (often with tacit support from Treasury officials) rejected the idea of CBI because they had negative expectations about the Bank's ability to implement monetary policy in a way commensurate with their broader objectives. The next section of the article reviews the existing literature on this topic and establishes the intellectual puzzle. We then examine the concept of inter-organisational trust/distrust and set out the theoretical approach underpinning our research. The second half of the article presents our empirical findings.

## The Conservatives and Bank of England Independence: Existing Literature

Many accounts of why governments grant independence to central banks begin with what might be termed an 'economist-centred' approach (Hall 1989). Politicians have come to accept the idea of CBI because of the gradual influence it has attained within the economics profession. Many economists have argued that central banks should have more autonomy over monetary policy because they view it as a more effective strategy for promoting low and stable inflation. Politicians are believed to be poor at delivering this outcome because of the so-called 'time-inconsistency' problem. While they constantly seek to reassure the markets and the public that they are committed to the control of prices, when an election approaches they will frequently be tempted to renege on this commitment, stimulate the economy and deliberately stoke an inflationary boom just before the polls. A more optimal solution to the problem of how to control inflation it to place responsibility for monetary policy in the hands of central bankers who will be insulated from such political pressure (e.g. Giavazzi and Pagano 1988, Gilardi 2007). While most academics accept that there is something to this explanation, there is a consensus in the literature that the spread of CBI reflects something more than the promotion of the idea by economists (Goodman 1991, McNamara 2002). CBI has become popular for parties in government because it allows them to realise other interests.

Arguably, the most extensive discussion of why the Conservatives found the idea of CBI unattractive makes precisely this argument. Michael King (2005) claims that the Thatcher and Major Governments failed to grant independence to the BoE because the idea conflicted with their objective of winning elections. This was despite the fact that CBI had powerful political sponsors in the form of two Chancellors of the Exchequer: Nigel Lawson and Norman Lamont. Moreover, CBI was discussed during periods of genuine uncertainty for economic management. Lawson proposed such a reform in 1988 at a time when both the notion of monetary targeting been abandoned and inflation was rising at a worrying rate (Oliver 1997, pp. 108–33). In 1992, Lamont revived the idea in the wake of sterling's ejection from the European Exchange Rate Mechanism (ERM) – the Major Government's preferred instrument for controlling inflation at the time. Ultimately the key reason why CBI was not pursued was opposition from Number Ten. Neither Thatcher nor Major was attracted to the scheme because ~~they wanted to maintain control over monetary policy~~it clashed with their political objectives. In particular, they were both worried about the ~~economic and political~~ impact of high interest rates on property-owning Conservative voters (King 2005, pp. 101–5).

While King's emphasis on the role of electoral considerations appears persuasive, a closer appreciation of the Conservatives wider economic strategy shows that electoral considerations can provide only part of the explanation for its behaviour. In particular, King does not account for the fact that, in the early 1990s, the Conservatives *did* implement a policy which, in effect, resulted in the government losing control over interest rates with disastrous political consequences. In agreeing to join the European Exchange Rate Mechanism (ERM), Whitehall accepted that interest rates would primarily be used to align sterling as close as possible to the parity of DM 2:95: a level that officials believed was consistent with low and stable inflation in the UK. As has been widely documented, this strategy did not produce the intended effects. To stop sterling falling out of the ERM, the government was forced to raise interest rates to fifteen per cent in the middle of a recession, leading to bankruptcies and negative equity for many households (Thompson 1996). In short, King's argument provides an answer to our puzzle but also raises a question: why did the Conservatives accede to ERM membership as a method for controlling inflation but not BoE independence? Constraints of space preclude a full empirical investigation of Conservative attitudes towards ERM membership, but below, we show how the importance of trust (or the lack of it) can also shed light on this conundrum.

Another influential explanation of CBI is the depoliticisation interpretation (Burnham 2001). Burnham (2001, pp. 128–9) defines depoliticisation as the practice whereby public officials place the political character of decision-making at one remove. New Labour's decision to grant operational independence to the BoE in the area of monetary policy is often viewed as a 'classic' example of depoliticisation because Labour politicians devolved responsibility for interest rate decisions to a neutral, non-partisan body at arms-length from government. For Burnham, depoliticisation does not denote the genuine devolution of power. Elites retain control over outcomes 'at a distance': for example, by having the power to define the mandate of the central bank, or changing the interest rate target. Burnham claims that politicians are motivated by the belief that ~~the~~ improved market expectations concerning the credibility of economic policy that result from this ploy will have electoral benefits. However, if a central bank turns out to be little better at controlling inflation, then this depoliticisation strategy will allow elected representatives to shift blame away from themselves (thus avoiding the resultant political opprobrium). Although some scholars (Dellepiane-Avellaneda 2013) have questioned the usefulness of depoliticisation (especially the idea of blame-shifting) when it comes to accounting for New Labour's decision to grant independence to the Bank of England, evidence does exist which supports the broad thrust of the thesis (e.g. Keegan 2004, p. 157, 164). The more pressing puzzle is why the Conservatives did not ~~identify~~appreciate the ~~appeal~~advantages of this move before 1997, or if they did, why they did not act on them~~it~~ (see also Burnham 2017)?

Dellepiane-Avellaneda (2013) also highlights the political ~~advantages~~benefits that accompany the idea of CBI but employs William Riker's concept of heresthetics to develop his argument. Heresthetics refers to the art of political manipulation: 'It is about "structuring the world so that you can win"' (Riker quoted in Dellepiane-Avellaneda 2013, p. 271). Political actors create, reform and then reproduce institutions so as to ensure the rules of the game are configured in their favour. For Dellepiane-Avellaneda, the Blair Government's decision to confer independence should be viewed in such a way. Chancellor Brown placed the implementation of monetary policy at one remove as a method of binding other groups into New Labour's economic strategy. His intention was to enable the leadership to deflect any calls from backbenchers, business and trade unions for lower interest rates and higher public spending – actions which could endanger the Blair Government's anti-inflation credentials. Again, while Dellepiane-Avellaneda's account of BoE independence is convincing, the question remains: why were the Conservatives not motivated to act in the same way? The concept of heresthetics has been used by Iain McLean (2001, p. 206) to make sense of Conservative policies in the 1980s. While he argues that Thatcher was a 'hesitant heresthetician', whose attempts at political manipulation were not always successful, in the field of economic policy, Thatcher's ability to redefine the political agenda and, more particularly, to limit the number of issues that the public believed government should be held responsible for (through her advocacy of free markets) was a key reason why Conservatives dominated the political scene in the 1980s.

Another strand of the literature that might help resolve this puzzle draws attention to the broader constitutional make-up of a country. Specifically, it is argued that independent central banks are more likely to exist in countries with a federal form of government. CBI is favoured in federal political systems because of the perceived need to insulate economic policy from veto players advancing claims for special treatment, often in the form of greater public expenditure. The broader political culture of federal systems is also opposed to the concentration of public power, especially in the hands of elected representatives because it is feared that they will use such a position to further their own interests rather than the welfare of the country as a whole (Banaian *et al.* 1986, Hallerberg 2003). Given its political tradition of centralised government and lack of institutional pluralism (certainly before 1997) Britain was unlikely to be amenable to the idea of CBI. If anything, the Conservatives presided over a further centralisation of power within Whitehall in the 1980s and 1990s (Holliday 2000, Moran 2003).

The centralised nature of the British political system provides a plausible answer to the question of why the Conservatives failed to perceive the attractions of CBI (Thatcher 1993, p. 706). However, it is dangerous to simply 'read-off' decisions from macro-level institutions. What may matter just as much are the beliefs that political actors have about these institutions, as well as other groups operating within them. Despite the hierarchical structure of British government, Conservative leaders throughout this period were consistently concerned about the threat of veto players to their economic strategy, most notably the trade unions. It was at this time that Thatcher and her supporters internalised a more general New Right critique of interest groups as self-interested lobbies capable of subverting the pursuit of low and stable inflation.[1] However, if ministers thought about their political position in this way, why did they not grant independence to the BoE as a method for insulating themselves from this domestic pressure? The rest of this article argues that a full answer to this puzzle lies beyond constitutional factors, electoral calculations or economic ideas. The role of trust, especially between organisations, also needs to be considered.

## Trust, Distrust and the Policy-Making Process

This article adopts an analytical narrative to explore this intellectual puzzle (Bates *et al.* 1998). Analytical narratives combine theoretical and methodological considerations found in the social sciences with the narrative form often utilised in historical studies. Analytical narratives are 'organising perspectives' or theoretical lenses that provide different ways of looking at the world. These narratives accept that theory should be grounded in factual detail, but also recognise that the 'facts don't speak for themselves'. All empirical analysis requires choices concerning what to include and what to leave out. These choices will, in turn, reflect more fundamental ontological assumptions about the world, some of which may not be subject to empirical refutation. Analytical narratives cannot in themselves be falsified, but produce more specific arguments and expectations that can be. One of their key contributions is to shine a light on neglected questions and provide new insights that may then help to stimulate new lines of research (Dowding 2016, pp. 72–9).

There is now a significant body of literature demonstrating the importance of trust for understanding individual and collective behaviour. That said, trust is not a straightforward concept to use in empirical research. It is employed in several academic disciplines, and is subject to a range of definitions, all of which have their own particular analytical focus (Hosmer 1995, Bottery 2003). For example, psychologists often conceptualise trust as a personal trait that individuals possess in varying degrees (for example, Hochreich and Rotter 1970). For economists, trust can involve a relationship and is something that reduces transaction costs between individuals or firms in the exchange of goods and services (Hill 1990). Sociologists often conceive of trust as a social reality: a property that permeates social systems (Davis Lewis and Weigert 1985). These different meanings are not mutually exclusive. As we shall see from the discussion below, trust is not something associated solely with agency or structure. However, the contested nature of the term makes the employment of trust (and distrust) more complicated.

Despite its contested nature, there is some common ground between these contrasting conceptions of trust. Oomsels and Bouckaert (2014) have provided a comprehensive survey of different definitions in the literature to show that a number of key attributes can be found in many usages of the term. These findings lead them to define trust as: ' … the intentional and behavioural suspension of vulnerability by a trustor on the basis of positive expectations of a trustee' (p. 582). Understood in this way, trust is a voluntary act associated with agency. It stems from the understandings that individuals, groups or organisations have about each other, although as we shall see, these beliefs will be shaped by the broader institutional environment within which the trust relationship exists (Grey and Garsten 2001, p. 233). The phrase 'positive expectations' relates to various qualities in the literature, but for the purposes of this article, the most relevant referent is the perceived skills or competencies of the trustee to make decisions in a way that is commensurate with the interests and beliefs of the trustor (Rommel and Christiaens 2009, p. 84). Based on these positive expectations, the 'suspension of vulnerability' denotes a willingness by the trustor to discount any uncertainty or ambiguity in the relationship and increase their dependence on the trustee to deliver certain outcomes (Van de Walle and Six 2014, p. 161).

Oomsels and Bouckaert (2014) move from this discussion to conceptualise inter-organisational trust as: 'the extent of trust placed in the partner organisation by members of the focal organisation … ' (p. 590) where trust is understood as the suspension of vulnerability on the basis of positive expectations. When operationalising inter-organisational trust, it is important not to commit the fallacy of reification. As noted already, trust relations flow through agency and inter-organisational trust can be said to exist when individuals mandated to act on an organisation's behalf cooperate with similarly mandated individuals in other organisations. Any such relationships of trust will not be based solely on personal attributes: those mandated to act for organisations will also engage with others on the basis of an outlook that will be shaped by the rules, routines and culture of their respective workplaces (Sztompka 1998). Inter-organisational trust is widely viewed as a positive thing. It ~~should~~is thought to result in greater collaboration, a sharing of information and opinion, which ultimately leads to an increase in the effectiveness of decision-making (Choudhury 2008).

Conversely, distrust is defined by Oomsels and Bouckaert (2014, p. 588) as ' … the intentional and behavioural rejection of vulnerability by a trustor on the basis of negative expectations of the trustee'. If trust is associated with cooperation and engagement, distrust signifies atomised behaviour. Organisations that do not trust each other will resist attempts to exert influence over their own activities. Efforts will be made to conceal or distort data and opinion, especially if such information is perceived to heighten the organisation's vulnerability. Ultimately an organisation may seek to withdraw contact from those it does not trust or, if that is not practical, will devise strategies to minimise the adverse impact of any dependency relationships. If trust is widely believed to have a beneficial impact on decision-making, it is often suggested that distrust diminishes the efficacy of joint problem-solving.

While inter-organisational trust/distrust comprises the study of relationships, it is important to note that these connections may be differentiated and complex. Even if we were concerned with analysing a simple association between two people (A and B) it is unlikely that A will trust B across all of the activities that they engage in together. What is true for individuals is more likely to be the case for inter-organisational relations. Organisation A will trust organisation B on some issues, but not others. To complicate matters, organisations are often divided: at any one moment, some individuals within an organisation will have a disposition to trust, whilst others (based on negative expectations) will caution against increasing their vulnerability and dependence. Trust and distrust perceptions may exist simultaneously between organisations, leading to a diverse range of connections over a number of matters (Lewicki *et al.* 1998, p. 441). As we shall see, these assertions have relevance to our empirical discussion. Both the Conservative leadership and the Treasury were divided over the merits of trusting the BoE with greater operational independence over monetary policy.

Moreover, trust (or the lack of it) will be affected by the way organisational relations play out over time. It is often argued that repeated encounters will enhance the knowledge the trustor (government) has of the trustee (BoE), which will, in turn, reduce uncertainty between the two and increase their propensity to trust each other (Choudhury 2008). More contact will bolster trust in a positive way; less contact will have the opposite effect. However, just as relevant may be the starting point of any relationship, as demonstrated in the work of Zand (1972). If two organisations (A and B) start off by distrusting each other, further contact may only strengthen suspicion and wariness. Organisation A, acting on the basis of negative expectations towards organisation B will refuse to share relevant and important information, while simultaneously trying to control its behaviour. Such actions will reinforce organisation B's own scepticism about organisation A, leading to an ' … equilibrium level of low trust' (ibid., p. 33). Zand developed what he termed the Spiral Reinforcement Model to account for such behaviour.

Finally, if we are to investigate the role of inter-organisational distrust as a factor underpinning the Conservative's reluctance to embrace CBI, it is important we place our discussion of these organisational relations within a broader institutional context (Luhmann 1979, Barber 1983). Like individuals, organisations do not exist independently of the system to which they belong. It may be possible to appreciate whether this institutional environment facilitates or constrains the potentialities for trust between the organisations under study. Some institutional settings may encourage the development of positive expectations, allowing organisations to suspend vulnerability and trust each other. Other structures may complicate or undermine the chances that organisations will co-operate and increase their dependency on each other. Moreover, institutional contexts are not static: they may change over time in ways that either help~~s~~ or hinder~~s~~ the prospects for inter-organisational trust (see also Bachmann and Inkpen 2011).

It is beyond the scope of this article to provide a detailed account of the institutional context underpinning relations between successive Conservative Governments and the BoE in the 1980s and 1990s. However, two features of this structure are relevant to the argument below. First, in the post-war period, relations between Whitehall and the BoE were often characterised by separation, sometimes fuelling mutual suspicion. Monetary policy was the main preserve of the BoE, while fiscal policy was the sole responsibility of the government. The nationalisation of the BoE (1946) had little impact on the practice of monetary policy and did little to bring the Treasury and the Bank together. When drafting the legislation, the Attlee Government failed to challenge Threadneedle Street's culture of secrecy, nor did ministers attempt to increase its accountability (Fay 1987, p. 30, Kynaston 2002, pp. 9–13). Occasional efforts by the Treasury in the 1950s and 1960s to lobby for ceilings on bank credit as a method of checking inflation were met by a hostile reaction from the BoE, which viewed such efforts as an unwanted intrusion into its own domain (Cairncross 1989, p. 21, 37–8, 41, 43, Kynaston 2002, pp. 25–7, 43–5, 67–76, 248–51).

A second feature of this institutional context was the gradual politicisation of monetary policy, as inflation replaced unemployment as the number one priority preoccupying governments in the 1970s (Burnham 2007). Ministers attempted to influence and direct interest rate policy, a development most graphically illustrated by Edward Heath's refusal to raise the Bank rate after economic growth took off in 1972 (Capie 2010, pp. 508–23). A similar tendency can be witnessed in the area of exchange rate policy, where it has been argued that the 1976 Sterling Crisis was precipitated by the Treasury's attempt to covertly devalue the pound (Fay 1987, p. 73, Healey 1989, p. 427). **[Q2]**[2] Finally, successive governments increasingly interfered in the BoE's management of the gilt market because of the interest that ministers had begun to take in the monetary target Domestic Credit Expansion and its relationship to inflation. In particular, Dennis Healey and Jim Callaghan were both critical of the Bank's failure to smooth out the sale of government securities: a shortcoming that was thought to contribute to the short-term growth of the money supply (Capie 2010, p. 667, 691–2). This criticism was shared by monetarists like Brian Griffiths, who had become Thatcher's economic adviser in opposition (Griffiths 1976). It short, it might be suggested that these two institutional features (separation; politicisation) did not provide a backdrop that was conducive to positive discussions o~~n~~f CBI.

Although other academics have tried to understand why the Conservatives failed to grant independence to the Bank of England, to our knowledge, this is the first investigation which focuses on providing an answer to this question based on an extensive search of the archives. For the pre-1990 period, we were able to consult relevant archival documents in the Bank of England Archive; the Treasury papers at the National Archives; and the Howe papers at the Bodleian Library. These archives were particularly useful for the discussion of CBI in the second half of the 1970s. For the 1980s and the 1990s, we supplemented gaps in our knowledge with a range of other sources, in particular elite interviews with five key participants from both the Thatcher and Major Governments and the BoE. We draw upon four of these interviews in this article, and additional written answers obtained from another key participant at the BoE in the 1990s. Furthermore, this interview material was cross checked against information from memoirs, government papers, parliamentary papers, speeches, party publications and other secondary sources. We focused on those books and articles that were either published by figures who had been close to events at the time (e.g. journalists), or scholars who have also based their accounts on extensive primary research.

To summarise, the Conservative's failure to grant independence to the BoE presents us with an intellectual puzzle. Many of the explanations put forward in the literature for why CBI occurs ought to have applied to the Thatcher and Major governments, so why did the party in office in the 1980s and 1990s fail to see the advantages of such an idea? While we accept that electoral considerations go some the way to ~~understanding~~answering this question ~~its behaviour~~, it will be argued below that inter-organisational distrust between Conservative leaders (supported by Treasury officials) and the BoE meant the idea of CBI did not gain traction in the 1980s and the 1990s. Following on from the discussion in Oomsels and Bouckaert, this distrust manifested itself in three ways: (i) the perception that CBI represented a loss of ministerial control over monetary policy; (ii) policy differences between Thatcherite Conservatives and the Bank over monetarist ideas, and; (iii) negative expectations about the BoE's competence to implement monetary policy in a way that was consistent with the Party's political objectives.

## The First Rejection: The Conservatives and Bank Independence (1977–79)

When Conservative attitudes towards CBI are examined in the existing literature, accounts usually begin in 1988 when Nigel Lawson (then Chancellor of the Exchequer) unsuccessfully attempted to persuade Margaret Thatcher about the merits of the idea. However, the Conservatives had arguably a more extensive discussion about BoE independence in opposition in the 1970s. The leadership was serious enough to mention such a proposal in its policy document *The Right Approach to the Economy* (Howe *et al.*

1977), which asserted~~argued~~ that Britain could learn useful lessons from other countries. David Howell, one of its principal authors, confirms these aspirations. He argues that the proposals for CBI were a conscious attempt to learn from the example of the Bundesbank, a stance that reflected a broader sympathy for German political economy within the Conservative party leadership at this time (Joseph 1976). To quote Howell (1986, p. 149) directly:

> There was a strong sympathy for the idea that monetary policy … was too important and complex to be left in the centre of the political arena, and that we could do worse than follow the German example of placing monetary judgments in more independent hands. In other words, if the Bank of England could be given the independence from the politicians … the management of monetary policy could be taken out of the front line, over-selling of monetarism avoided, and government policy generally presented in a less abstract and desiccated form.

In December 1977, the Bow Group (a prominent Conservative think tank) released a report with three more specific suggestions for CBI: (i) changing the 'main duty of the' Bank of England so it would be 'similar to that of the Bundesbank in Germany – with a duty of "safeguarding the currency"'; (ii) repealing the Treasury's authority to direct the Bank and; (iii) parliamentary approval for money supply targets 'agreed by the Treasury and ~~T~~the Bank of England', with any variation requiring parliamentary consent (Bow Group 1977). However, by 1979, the idea had been dropped and did not make it into the manifesto of that year.

This rejection, in part, reflected the presence of inter-organisational distrust: a refusal by the Conservatives to increase their vulnerability in the area of monetary policy because of negative expectations of the BoE's competence to fulfil this function.

~~F~~irst, *CBI was perceived to involve a loss of ministerial and bureaucratic control* – at a time where, as noted, Whitehall had begun to increasingly interfere in the conduct of monetary policy. We have already highlighted Howell's hope that BoE independence might help to reduce the influence of politicians on policy. At an October 1977 meeting between leading Conservatives and Bank officials, the Bank asked what would happen under independence if its views diverged with those of the Treasury. The minutes record that 'Sir Geoffrey Howe and Sir Keith Joseph indicated that we see the Bank as the conscience of monetary policy', adding that 'we welcome the idea of a degree of restraint on the Government's current power and degree of freedom' (Conservative Research Department 1977). However, in a letter written to Nigel Lawson (a spokesman in the Shadow Treasury Team) two months later, Howe himself expressed doubts about the wisdom of CBI. While supporting two of the Bow Group's proposals (noted above), Howe was 'much less certain' about a total repeal of the Treasury's authority to instruct the Bank as it 'would be more explosive than might be justified' (Howe 1977).

If the Conservatives shied away from CBI because they were concerned about losing control over monetary policy, there was no pressure from the Bank itself for a move in this direction. Without doubt, the BoE under Leslie O'Brien (Governor of the Bank of England, 1966 **[Q3]**–73) and Gordon Richardson (1973–83) was keen to have more influence over economic management. Fay (198~~6~~7 **[Q4]**, pp. 114–15) argues that independence would have been ' … a remarkably enticing prospect … ' for the Bank, adding that it ' … was freedom the Bank had always envied in the German and American central banks'. After the 1979 election victory, a Treasury memo felt the need to warn the incoming Conservative team that given the inclusion of the idea in *The Right Approach to the Economy*, the BoE, 'may well take the first possible opportunity to raise with the Chancellor the question of the independence of the Bank of England'. Indeed, the memo went as far as to set out counter-arguments for the Conservatives to use, expressing doubts about the feasibility of the Bank managing a self-contained monetary targeting regime separate from fiscal policy and ministerial decisions about wider economic trade-offs (Bridgeman 1979). In a belated reply, Douglas Wass, Permanent Secretary of the Treasury, noted that 'I have not had to draw upon' the counter-arguments because 'The danger which we feared has not in fact materialised' (Wass 1979). Terry Burns, who joined the Treasury as Chief Economic Adviser in 1980, commented that during this period he could 'recall no discussion about Bank of England independence at all' (Burns personal interview 2016). Although this correspondence does not explain the Bank's lack of support for CBI, a clue might be found in the experience of David Howell. After the publication of *The Right Approach to the Economy*, he went to see friends at Threadneedle Street to ask them what they thought of the idea of independence. He was told that it 'would never happen' for the simple reasons that politicians do not like to give away control over monetary policy (Fay 1986, p. 115, Hacche and Taylor 2013, p. 184).

Second, concerns about a loss of control were compounded by genuine *differences between Thatcherite Conservatives and the BoE over the doctrine of monetarism*. During the 1970s the Bank gradually endorsed the basic monetarist proposition that growth in the money supply was linked to inflation, however, Richardson was careful to hedge this argument with various qualifications. Rising prices were not the result of one factor, but instead reflected a multitude of determinants (including rising incomes). Where money was important, the causal line to inflation could plausibly run the other way: rising prices could actually lead to an increase in the money supply not vice versa (Lawson 1978, Richardson 1978, Ridley 1978). When monetarism~~it~~ was introduced after 1979, the BoE became increasingly unhappy ~~about the i~~ts practice.~~ of monetarism.~~ It criticised the introduction of the Medium Term Financial Strategy (MTFS), viewing it as a 'politicisation' of monetary policy (Howe 1994, p. 163, Kynaston 1995, Goodhart, 2014). In this context, it is worth remembering that Conservative politicians (especially Lawson) were the principal authors of the MTFS (the Bank wasn't consulted), including the M3 growth targets that were believed to be consistent with low and stable inflation. It is also important to stress the prominent role that fiscal policy played in the framework: there were targets for reducing the Public Sector Borrowing Requirement (PSBR) which was thought to be connected to M3 because government spending was a key component of this measurement of the money supply. Of course, this interpretation of monetarism granted further power to ministers who remained responsible for fiscal measures. The fact that the MTFS contained no exchange rate target was also a source of tension between the Thatcher Government and the Bank. The latter became increasingly concerned about the impact of sterling's appreciation on the fortunes of British industry (Browning 1986, pp. 149–50, Middlemas 1991, pp. 244–6, Hacche and Taylor 2013, pp. 193, 144, 154–6, 160, 176–8).

Finally, Conservative leaders had *negative expectations about the BoE's competence to implement monetary policy at this time*. We have already noted the reservations of monetarists like Griffiths over the Bank's management of the gilt market. Moreover, Williamson (2015, pp. 214–5) has suggested that the failure of the Competition and Credit Control Act (1971) during the Heath government may have contributed to the Party's scepticism towards Threadneedle Street. The Act (which reflected the ideas of John Fforde in the BoE) saw the BoE abolish a range of physical controls on the availability of credit to be replaced by a system whereby access to credit would be determined solely by price (i.e. level of interest). The outcome was that the BoE failed to control both the volume and the direction of lending, which in turn, contributed to a surge in inflation and a secondary banking crisis that required several financial institutions to be rescued from insolvency. The BoE's style of supervision was widely blamed; indeed some commentators accused it of no longer understanding the money markets. Its preference for monitoring the banking system via informal and personal contacts through the Discount Office was viewed as inadequate and out of date. While Heath's refusal to sanction interest rate ~~raises~~rises until it was too late also undermined the whole operation of CCC, the episode undoubtedly damaged the Bank's reputation for competence, something that Richardson was aware of (Kynaston 2002, p. 451).

## The Second Rejection: Lawson's 1988 Proposal

By 1988 the MTFS had been discarded and Lawson had placed BoE independence back on the agenda. According to his memoirs, the Bank was to be given sole responsibility for the operation of monetary policy, with a statutory duty to maintain the value of sterling. In light of this new obligation, the Bank would set short-term interest rates and monetary targets. While the Government would determine the exchange rate framework, the Bank would be given the power to implement currency policy within these parameters. It would be granted a portion of reserves for the purpose of intervening in the markets, but the Treasury would set the limits on total intervention. Lawson accepted the Bank would 'probably' have to be made politically accountable, although not, ' … in a way which … [subjected] … the Bank to unwanted Parliamentary pressure' (Lawson 1992, p. 1061). Thatcher's rejection of this proposal reflected the continued importance of inter-organisational distrust. She still saw CBI as involving a loss of control over monetary policy to an institution whose competence in this area she doubted. In these views she was again backed by Treasury officials, despite Lawson's support for BoE independence. Indeed, the Treasury viewed the government's record in this area (particularly the reduction of inflation) in positive terms, despite the problems it faced defining and controlling the money supply. This perception appears to have reinforced its sceptical stance towards the idea of CBI.

As in the 1970s, Thatcher continued to oppose CBI because she feared that elected politicians would *lose control* over interest rates and ultimately inflation (see also Lawson 1992, pp. 830, 871). For Thatcher, maintaining low and stable inflation was ultimately a political problem that could not be hived-off (Thatcher 1993, p. 707). Ministers had a crucial role to play in keeping prices down through their agency, strategic calculation and shrewd decision-making. To give away control over policy would be 'defeatist' or an admission of failure: something that could undermine the doctrine of ministerial responsibility, parliamentary accountability and, ultimately, the foundation of democratic legitimacy in Britain. Michael Scholar (personal interview 2016), Mrs Thatcher's private secretary (1981–83) and later a Deputy Secretary in the Treasury, confirmed that the Prime Minister saw interest rates as a 'lever of control' over the economy and believed 'it would be probably politically unwise to put that in the hands of […] people who'd not been elected.'

Treasury officials were also apprehensive. Discussing the prospect of Bank independence against the backdrop of ministers' success in getting inflation down to approximately three per cent by the mid-1980s, a Treasury paper argued:

> … the lower inflation (especially in recent years) by a hands on approach to monetary policy, is widely perceived as one of the government's key achievements. It may not be easy to explain why Ministers are content at this moment to hand over primary responsibility for controlling inflation to the Bank of England, whose stock (in the monetary field at least) has not been particularly high in recent years. Why should the government call into question its own future wisdom, or longevity (HM Treasury 1988, p. 25)?

The paper went on to claim that CBI would involve, ' … giving up the flexibility and adaptability of the current arrangements, and transferring elsewhere a considerable element of the Prime Minister's *and the Chancellor's power base* (authors' emphasis)' (Ibid., p. 28).

In trying to explain why Thatcher rejected CBI, it is worth clarifying what she (and the Treasury) meant when they feared Bank independence would lead to a loss of government control. The Treasury paper makes clear that it sees the advent of CBI as involving a 'considerable degree of co-operation and liaison' with a newly independent Bank – or to put it differently, a sharing of power (Ibid., p. 4). In particular, the paper discusses the need for more co-ordination between monetary and fiscal policy, especially as the Bank would now have sole responsibility for the former (Ibid., pp. 17–18). A similar picture is sketched out for exchange rate policy. Indeed, it is in this area where real limits to independence are identified. As we have seen,~~:~~ Lawson's proposals for CBI granted the Bank greater autonomy to intervene in foreign exchange markets. However, evidence from this period suggests a significant gap between these aspirations and policy practice. According to a note from David Perez (in charge of monetary policy at the Treasury) to Lawson in January 1988, the BoE failed to participate in coordinated currency intervention operations with other European central banks at this time because of Treasury delays in granting permission:

> The Bank of England were told about the operation in advance [but] … did not join in … [because] they judged that by the time they had got clearance from us [the Treasury] the moment would have passed. So they did not bother to ask. (Perez 1998)

Such evidence leads us to question whether the Conservative Government would have easily given up control over exchange rate policy at this time.

Moreover, some Treasury officials feared that a loss of control could put ministers in a position of having to accept responsibility without power in the area of monetary policy. The Treasury's 1988 paper (like Lawson's proposals) accepts that an independent Bank would have to be made accountable to parliament and briefly discusses how such an arrangement could be implemented. However, there is an awareness in the Treasury paper (but not Lawson's proposals) that Britain's constitutional tradition may well prevent ministers from escaping responsibility (and blame), especially if an independent Bank presided over controversial decisions:

> If the opposition put down a motion of no confidence in the BOMC … [Board of Monetary Control] … it is hard to imagine the Chancellor – who would have cooperated extensively with the BOMC on exchange rate policy and in devising monetary and fiscal targets – avoiding being drawn into debate and into using the government's majority in the House of Commons in support of the BOMC. So BOMC accountability to Parliament inevitably involves some degree of government approval of the BOMC (Ibid., p. 12).

These comments suggest that while Lawson may have hoped that Bank independence would depoliticise monetary policy (in Burnham's sense of the term) Britain's centralised polity made it a challenge to place the political character of decision-making at one remove (Diamond 2015).

Second, Thatcher and the Treasury continued to display reservations that the Bank in its current form *was not competent enough to implement monetary policy* if it was made independent. In her memoirs, Thatcher (1993, p. 706) recalls that she, ~~��~~'doubted whether we had people of the right calibre to run' an independent BoE. When asked why Lawson's 1988 proposal was rejected, Terry Burns argues that 'there was no evidence that the Bank of England would do the job any better' and that handing monetary policy 'over to the Bank of England was not thought by the politicians to be a very strong statement', adding that 'Mrs Thatcher was very much of this view' (Burns personal interview 2016). The 1988 Treasury paper was critical of the Court of the Bank, asserting that most members lacked any expertise in monetary policy(HM Treasury 1988, p. 9). It concluded that: 'Everything will depend on the people involved … No doubt new powers and status would in time attract people of the necessary calibre, but a difficult transition period could lie ahead' (Ibid., p. 27). Such ruminations hardly represented a ringing endorsement of the Bank's ~~current~~ personnel.

The Treasury also believed that if CBI was to operate effectively, the Bank would need to undergo institutional reform so that ' … the status of [its] decision-making would … be enhanced' (Ibid., p. 7). To do so, the paper proposed extending the Governor and governing board's period of office, while also giving parliament a say in appointments to these positions. In giving more weight to the Bank's decision-making, the paper suggested creating a Board of Monetary Control (BOMC), along the lines of both the Federal Open Market Committee and the Bundesbank Council. The BOMC would be staffed with officials who had an expert knowledge of monetary policy and who would hold this position on a full time basis (Ibid., pp. 8–9). Without these institutional reforms, the paper feared that the government would continue to try to influence (and would be seen to influence) the Bank, therefore undermining the whole rationale for the change: 'Since cooperation and liaison between the Bank and the Treasury would continue to be essential, there would be considerable scope for nudges and winks, and perhaps the occasional arm-twisting … ' (Ibid., p. 7) if the authority of the Bank was not boosted.

In short, the failure of the Conservatives to grant BoE independence in the late 1980s highlights the significance of inter-organisational distrust. In the Treasury, real concerns existed as to whether CBI could be made to work in an open economy which had traditionally been so reliant on the exchange rate as an instrument for influencing outcomes. The 1988 Treasury paper is littered with commentary questioning whether models of CBI elsewhere were applicable to Britain. It surmised that Bank independence was likely to involve a more open and transparent discussion of the ends and means of monetary policy, a prospect the Treasury deemed 'dangerous' in the short term, especially if the government and the Bank disagreed. The paper goes on:

> The experience of those countries which already enjoy a more open debate suggests that policy-making <u>is</u> possible under these conditions, though there can be very bumpy periods. Given the central importance of the exchange rate in the UK – and the extreme sensitivity of the exchange markets to rumour and careless talk – a more open approach to monetary policy could prove a more uncomfortable experience here than in Germany or the US, which has scarcely had, or needed to have, an exchange rate policy for most of its history (original emphasis) (Ibid., pp. 26–27).

Such reflections help to explain why the Thatcher Government ultimately favoured ERM membership over CBI as a tool for controlling inflation~~, although clearly this argument needs further development~~. The exchange rate would have been viewed as a policy instrument that kept elected representatives at the centre of monetary affairs, something that proved to be the case but not in the way those politicians intended.

## Bank of England Independence and the Major Government

So far, this article has argued that inter-organisational distrust helps explain the Thatcher Government's rejection of CBI. Number Ten (supported by analysis from the Treasury) had negative expectations about the Bank's ~~ability~~competence to implement monetary policy and saw no obvious reason for increasing its dependence on this institution~~autonomy in this area~~. Interestingly, the idea of using the ERM to control inflation may have become more attractive because (despite its Euro-scepticism) a broader coalition within the parliamentary party believed membership ~~of this institution~~ would be more effective at fulfilling this function. Indeed, it may have been thought ERM participation would actually extend the authority of politicians because this exchange rate system was inter-governmental and involved an element of diplomacy. In this final section, we argue that inter-organisational distrust between the Major Government and the BoE continued to thwart any prospects for CBI.

While Lawson put forward the idea of BoE independence and did not pursue it further, Norman Lamont advocated CBI ~~based on the New Zealand model~~ in September 1991 and then again following sterling's exit from the ERM, with papers submitted to Major in November 1992 and January 1993 (Lamont 1999, pp. 322–6). Although he does not reproduce a copy of his scheme in his autobiography, we can glean a reasonable sense of the details from contemporary Treasury papers. One Treasury~~'s~~ publication suggested the Bank be given operational independence to implement monetary policy, with reference to a broader framework of guidelines and targets (HM Treasury 1993). It also advised that decisions be taken by a Monetary Policy Committee, as opposed to the single Governor model, and considered whether this committee should be staffed at least partly by external figures from the City, industry and academia. As with Lawson's proposals, there was an acceptance that the Bank would need to be accountable to Parliament. The paper offers no firm conclusions concerning how exchange rate policy might operate if CBI was granted, but hints that the government would want to retain existing responsibility for formulating any strategy towards sterling (Patel 2008, p. 33).

Our research confirms that inter-organisational distrust prevalent during the Thatcher era continued to shape the Major government's consideration of BoE independence. As in 1979 and 1988, Treasury officials were hostile to the policy, with Lamont submitting the September 1991 proposal to Major without informing Terry Burns as Permanent Secretary 'because I knew he firmly opposed my views' (Lamont 199~~2~~9 **[Q5]**, p. 324). More significantly, like Thatcher, Major perceived CBI as a *loss of actual control* over monetary policy, not the appearance of it. As Lamont, who grew increasingly frustrated about interference by Number Ten in his remit, notes in his memoirs:

> Deep down the PM also believed it was the responsibility of politicians to run the economy. He quite enjoyed the power involved in making interest rate decisions and thought it perfectly natural that matters such as by-elections should be taken into account in the decision. (Lamont 1999, p. 325)

Major himself states that, because of Britain's constitutional convention of ministerial responsibility, it would be difficult to make an independent Bank accountable to parliament – a view which, as noted above, was shared in the Treasury (House of Commons 1994, p. v, Major 1999, p. 153, 675). The broader question of Europe was also perceived to be an issue, with Major worried that CBI would be seen by Euro-sceptics as a sign that sterling's membership of the Single Currency was on the agenda.

*Policy differences* between senior Conservatives and the BoE over Black Wednesday fuelled tensions that may have fed into the broader debate about Bank independence. Ken Clarke (2016, p. 304) (then Home Secretary) has asserted in his memoirs that he felt bounced by Terry Burns (Treasury) and Robin Leigh Pemberton (Governor of the Bank of England, 1983–93) into agreeing sterling's exit from the ERM – a move he initially resisted in alliance with Douglas Hurd (Foreign Secretary) and Michael Heseltine (President of the Board of Trade). Unsurprisingly, Lamont takes a different view of events, accusing his Cabinet colleagues of delaying the inevitable while currency reserves were haemorrhaging at an alarming rate (Lamont 1999, p. 251, Clarke 2016, p. 306). Quite what Major's view of the Bank's performance was during this crisis is unclear, but Sarah Hogg, his adviser, was scathing in her assessment. She blames the run on sterling on Threadneedle Street's lack of preparation (Clarke 2016, p. 304).

Referring to the prospect of BoE independence, she wrote to Major to complain:

> The idea that the government (which has taken the flak, including that which should have landed on the Bank) should now implicitly state that the Bank is better at monetary policy than a minister does stick in the gullet a bit. (quoted in Mance 2018, Seldon 1997, p. 317)

Furthermore, *negative expectations about the competence of the BoE to implement monetary policy* in the event of independence seem to have been behind Clarke's reluctance to promote such change after he became Chancellor, despite saying he was in favour of the idea in principle. In practice, Clarke seems to have been ambivalent towards CBI. In his evidence to the Treasury Select Committee investigation into the role of the Bank in economic policy, Clarke stated that he had no 'hard or fast opinion' on the subject of independence (House of Commons 1993, p. vi). One reason for this equivocation may have been his scepticism towards the Bank as an institution, and its capacity for implementing monetary policy. We have already noted Clarke's unhappiness at being bounced (as he saw it) into approving sterling's suspension from the ERM on Black Wednesday by the Bank and the Treasury. Budd asserts that Clarke had a 'life-long horror of experts', adding that 'Ken Clarke believed he was better than the Bank. It wasn't just a political instinct; it was also economic' (Budd personal interview 2016). When Gordon Brown unveiled New Labour's proposals to make the Bank independent in 1997, not only did Clarke oppose the move, but he added for good measure that Threadneedle Street was 'an institution with a track record showing that it has been wrong' (House of Commons 1997).

Furthermore, our research suggests that contrary to the arguments of some academics (Burnham 1999, pp. 47–8, Cobham *et al*. 2008, Blancheton 2016) Clarke (and the Treasury more generally) did not perceive the reforms he made to the conduct of monetary policy as a forerunner to independence. Burns stated that, 'Kenneth Clarke didn't really run with this idea' (Bank independence) and that Clarke 'enjoyed the "Ken and Eddie Show"' (Burns, personal interview 2016). Similarly, Alan Budd, who as the Chief Economic Adviser spoke first on behalf of the Treasury at these monthly meetings, further commented that he did not know if Clarke 'ever changed his mind as a result … ' of the discussions that took place (Budd, personal interview 2016). At this time, the BoE was certainly in favour of more independence, ' … and being able to put itself on the same footing as the Federal Reserve and the Bundesbank' (Anon 2, personal interview 2016). But Bank officials interviewed for this research remained unconvinced that Clarke's reforms represented a precursor to more radical action. Anon 1 (personal interview, 2016), a~~n~~ ~~anonymous~~ high-ranking official at Threadneedle Street in the mid-1990s, recalled lobbying the Treasury on the issue: 'Whenever we wanted to raise the independence issue~~s~~, these guys in the Treasury would say, "Come on, you've got your opportunity now. You've got your forum. You don't need independence now"'. This implies that Treasury officials saw the new framework as a substitute for independence. The same official doubted whether Clarke's reforms actually enhanced the authority of the Bank. For example, the published minutes were thought to be 'pretty anodyne actually' and that they 'did not properly reflect some of the discussions we had' as the minute-takers had 'learnt to write fairly meaningless minutes' (Anon 1, personal interview 2016). Some Bank officials even saw disadvantages with the existing institutional position under Clarke. In 1996, a BoE paper was published arguing that the increased transparency of central banking correlated with reduced autonomy (Briault *et al*. 1996).

## Conclusion

This article has argued that inter-organisational distrust helps us explain why the Conservatives were not attracted to the idea of CBI in the 1980s and 1990s. Ministers (supported by Treasury officials) possessed negative expectations concerning the BoE's ability to implement monetary policy and were unwilling to increase their dependence on that institution. As suggested in the literature on trust, these inter-organisational relations were differentiated and complex. At times there were divisions between the Prime Minister and the Chancellor (Thatcher – Lawson; Major – Lamont). Moreover, differences existed in the Treasury. Under Lawson in particular, some officials were un-enthusiastic about the prospect of giving the Bank more autonomy, and this scepticism may have helped to bolster Thatcher's arguments. Finally, our research also supports Zand's idea of 'spiral reinforcement'. It is possible to uncover evidence of Conservative (and Treasury) distrust towards the BoE as far back as the 1970s (if not before). The experience of implementing monetary policy in the 1980s and 1990s entrenched the belief that ministers were as competent as the Bank (if not more so) to keep inflation under control, and such perceptions undermined the case for CBI.

Do these conclusions have any relevance for contemporary debates about central banking, especially at a time when central banks themselves have become increasingly powerful, yet controversial (Jones and Matthijs 2019)? In one sense, our case helps to demonstrate how attitudes to CBI have changed since the 1990s, certainly within government. While the Thatcher and Major Administrations may have had doubts about the competence of the BoE to implement monetary policy, these have long since disappeared. Indeed, one peculiar tendency since 2010 is the way the BoE (and other central banks) have gained greater discretion and power, despite widespread criticism of their performance during the global financial crisis. While the Bank's narrow focus on inflation targeting before 2007 has now been discredited, politicians have shown no inclination to reassert ministerial responsibility over monetary policy. Instead, the BoE has been encouraged to adopt 'unconventional' monetary measures, such as Quantitative Easing (QE), especially when an economic recovery failed to materialise after the credit crunch. It is also now accepted that when implementing monetary policy, the BoE needs to take into account not just price developments but the emergence of credit and asset bubbles. Indeed, Threadneedle Street has reacquired sole responsibility for financial regulation just so that it can discharge this dual mandate. These developments may lead us (along with Paul Tucker, former member of the Monetary Policy Committee) to conjecture whether the British government has become 'too casual' (or trusting) about delegating policy to arms-length bodies (Tucker 2018, pp. 320–1)?

Second, as central bankers have become more powerful, there is a feeling they are becoming more 'political'. In one sense, central banks have never been independent, an argument made by Hartwell (2019). They have always had to operate within the confines of a political system and will inevitably be affected by the biases and pressures of that environment. However, the wider mandate and greater discretion they have enjoyed since the global financial crisis has highlighted the fact that central banks are making decisions that have re-distributional consequences. One example is the impact of Quantitative Easing (QE). Each time the BoE injects liquidity into the financial system by purchasing certain types of assets, such actions can benefit some groups while penalising others. In particular, it has been argued that the BoE's preference for buying government gilts has inflated the price of assets held by the wealthiest in society, whilst the low interest rates that have accompanied QE have punished small savers (Green and Lavery, 2015). Historically, the case for placing the conduct of monetary policy at one remove from politicians was because monetary policy was thought to be a technocratic exercise involving considerations of efficiency and not distribution. Commentators have now started to challenge this assumption (see also Balls *et al*. 2016, King 2016, pp. 207–9).

Finally, these developments have prompted the question: can these increasingly powerful central banks be legitimised (Fernandez-Albertos 2015)? While we have not emphasised such concerns in this article, our evidence shows the issue of legitimacy played some role in the arguments deployed by Thatcher and Major to rebut the case for BoE independence. The idea of CBI was resisted because it was thought to be incommensurate with the constitutional importance of accountability (encapsulated in the doctrine of ministerial responsibility). One response to this dilemma has been to suggest that central banks can be legitimised, so long as they are designed and governed in accordance with the values and principles underpinning governance in liberal democracies in the twenty-first century (Tucker 2018). Others are more sceptical of such a project. Even if it could be made to work, what evidence is there to show that the values and principles of liberal democracy can confer legitimacy on non-majoritarian institutions like central banks (Koop and Reh 2019)? We live in a world where the idea of representative democracy is in crisis, in part perhaps because our elected representatives themselves disavow responsibility for policy outcomes. Yet the 'technocratic' arms-length bodies that replace our politicians only further stoke this feeling of anti-politics, therefore undermining the conditions for their own existence. Resolving this conundrum is a particularly important challenge facing British governments in a post-Brexit world.

## Notes

1. For a statement of this position, see Nigel Lawson's speech 'The New Conservatism' delivered to the Bow Group in 1980s and reprinted in his memoirs (1992, pp. 1039–54).
2. Some Treasury officials (Wass 2008, p. 179) 2 contest this interpretation and argue that the crisis was the result of an accident. However, it is not denied that, at the time, the Treasury desired devaluation and lobbied the BoE (which was sceptical) to adopt such a policy.

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