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## *The two sterling crises of 1964: a reply to Oliver<sup>1</sup>*

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Oliver's Comment on my recent article challenges my argument that there were two sterling crises in the autumn of 1964. He argues that there was one only and that the Labour government mishandled it. Oliver has, however, reached these conclusions on the basis of a partial reading of the evidence and a failure to grasp how the changing international context imposed constraints on national economic sovereignty.

Oliver's Comment on my recent article arguing that there were two sterling crises in the autumn of 1964 (one in October, the other in November)<sup>2</sup> claims that both were really the same one.<sup>3</sup> Oliver maintains that the November collapse of confidence in sterling occurred because the new Labour government (elected on 18 October) had failed to show that it had policies that would speedily address an inherited balance of payments deficit then estimated to be heading for an annual figure of £800 million. The weak external financial position led to adverse sentiment about the prospects of sterling in the foreign exchange markets; devaluation was expected. The magnitude of the sterling problem was best identified by Lord Cromer, Governor of the Bank of England. It was the Bank's responsibility for maintaining sterling's day to day stability and long-term attractiveness that gave Cromer an insight into the sentiments of the foreign exchange markets and of central bankers in the leading industrialized countries. To Cromer it was clear by early November that both the markets and the bankers had lost what little confidence they had had in Labour's strategy for returning Britain to the black. The Governor believed that a decisive shift in monetary policy, namely a rise in the Bank Rate, was needed if the pressure on sterling was to abate. It was Labour's failure to take this action quickly that exacerbated the crisis; and its consistent refusal thereafter to support sterling via appropriate fiscal and monetary measures meant that extensive foreign credits were in the end unable to stave off devaluation, even though they delayed it for three years.

This is not a new argument, but Oliver has made it cogently and has supported the case with important evidence. There are certainly some problems with his critique, but before addressing those it is perhaps best to acknowledge that there are areas where we are in agreement. To begin with, it is fair to state that the triumvirate at the top of the administration—the Prime Minister, Harold Wilson, the Chancellor of the Exchequer, James Callaghan, and the Secretary of State for Economic Affairs, George Brown (in charge of the new Department responsible

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<sup>2</sup> Newton, 'Two sterling crises'.

<sup>3</sup> Oliver, 'Two sterling crises'.

for delivering the modernization strategy set out in the government's National Plan)—were warned several months prior to the general election that a Labour government would inherit a large external deficit. It is also true that when Labour did take power Wilson, Brown, and Callaghan discovered that the external financial position was worse than they had been expecting.<sup>4</sup> Secondly, the prospect of major changes to the taxation system, trailed by Callaghan in his Emergency Budget early in November, did cause anxiety in the City.<sup>5</sup> Thirdly, the markets expected a rise in the Bank Rate following some tough talk on supporting the sterling rate by Wilson in his speech to the Lord Mayor's Banquet on 17 November—and their surprise and disappointment when one was not forthcoming did lead to an increase in reserve losses.<sup>6</sup> Finally, there is no doubt that central bankers in the Group of Ten leading industrialized countries encouraged Cromer to press Wilson and Callaghan to agree to a rise in the Bank Rate.<sup>7</sup>

There are, however, good reasons why the Comment cannot be allowed to stand without this Reply. It attributes to me an argument I never actually made, it makes claims which cannot be supported for some of the material employed, both documentary and statistical, and its perspective on the events of autumn 1964 is seriously limited.

First of all, Oliver states that I 'claim' that 'the government could have avoided the crisis'.<sup>8</sup> Where is this 'claim' in the text? My argument revisited the policy response of the Wilson government to external financial pressure on sterling in the autumn of 1964. This had surfaced in the foreign exchange markets during the general election campaign. Traditional City fears about the consequences of a Labour victory at the polls along with the current account deficit provoked by Maudling's 'dash for growth' had led to uneasiness about the ability of British governments to sustain the sterling-dollar parity of £1 = \$2.80; the tight result ensured this would not go away. At the end of Labour's first day in office the spot rate had fallen to £1 = \$2.7825, its lowest point since 1957 and a level normally considered a trigger for Bank of England support.<sup>9</sup> This was the first crisis. The new government's attempt to address it with an early package, including an import surcharge, designed to cut back the balance of payments deficit and so reduce pressure on the currency, briefly settled market sentiment.

The calm was, however, short-lived: the second crisis, provoked by renewed fears of devaluation, exploded a few weeks later. The two need to be differentiated since although they were related the causes were not identical. There was a new dimension to sterling's problems in November, rooted in the internationalization of production and finance. This trend had become noticeable during the late 1950s and had accelerated after the reintroduction of convertibility for current transactions at the end of the decade. Its most obvious manifestation could be seen in the growth of the Eurodollar market, and from the early 1960s international financial transactions were characterized by increasing flows of mobile international capital beyond the control of national governments.<sup>10</sup> Sterling was especially vulnerable to

<sup>4</sup> *Ibid.*, pp. 316–17.

<sup>5</sup> *Ibid.*, p. 318.

<sup>6</sup> A view endorsed in the recent study by Capie, *Bank of England*, pp. 198–206.

<sup>7</sup> Oliver, 'Two sterling crises', pp. 318–19.

<sup>8</sup> *Ibid.*, p. 316.

<sup>9</sup> 'Sterling under pressure: some support given', *The Times*, 19 Oct. 1964, p. 22, col. C.

<sup>10</sup> Newton, 'Two sterling crises', pp. 89–93.

disruption by these flows, given both its position as an international reserve currency with significant external liabilities and the sizeable current account deficit. The point was made by the intensity and magnitude of the run on sterling in November: the volatile new environment facilitated the development of a 'second generation currency crisis' as market perceptions of sterling's stability deteriorated even though the fundamentals of Britain's domestic and international economic position had not changed in the short time since the government had come to power.<sup>11</sup>

Labour resisted Cromer's call for a deflationary package designed to return international confidence to the currency but was forced to increase the Bank Rate. Other measures liable to restrict economic growth were averted thanks to a \$3 billion credit from foreign central banks, and pressure on the Rate died down. The crisis however underlined the existence of an external constraint on the new government. It was impelled to place the objective, set out in the National Plan, of securing an annual average growth rate of 3.8 per cent up to 1970 second to policies which would lead to a large and long-term balance of payments surplus; in the absence of such an achievement, sterling's vulnerability to ongoing speculative shocks was likely to be acute.

As far as the documentary evidence is concerned there are four areas where Oliver's account needs amendment. First, he states that the White Paper announcing emergency measures designed to reduce the balance of payments deficit, released on 26 October, was not well received in the press. He quotes in support the work of William Davis, city editor of the London *Evening Standard* at the time, and a *Times* leader of 27 October.<sup>12</sup> Davis's comments, however, were published four years later, after the November 1967 sterling devaluation had appeared to cast doubt on the efficacy or even the validity of the government's attempt to defend the exchange rate. Meanwhile *The Times* was rather more positive than Oliver suggests. It offered a qualified welcome for the package, commended Labour for 'avoiding deflation and the old round of stop-go' and stated that 'there is much to be said for the (import) surcharge given the need for immediate action'—while accepting that the transformation of the external position would in the end be dependent on the success of the government's long-term plans for the improvement of the country's industrial performance.<sup>13</sup>

Second, Oliver challenges the accepted view that Labour's antipathy to a Bank Rate increase was shared 'at the highest level in the US', quoting in support the comments of Robert Roosa (US Treasury Under-Secretary for Monetary Affairs) and Al Hayes (Chairman of the Federal Reserve Bank of New York).<sup>14</sup> Yet whatever the viewpoint of these senior public servants it is clear that the outlook from the White House was somewhat different. On 19 November Wilson informed President Johnson that there was a 'serious situation on sterling' which threatened to exhaust existing credit facilities 'within a matter of weeks'. He was being advised that a rise in the Bank Rate 'this week' would 'probably halt the drain'. Wilson explained that the government was reluctant to do this given that it ran 'counter to the long-term policies we are developing for dealing with our basic economic

<sup>11</sup> See Obstfeld, 'Logic'; Sbracia and Zhagini, 'Expectations and information'.

<sup>12</sup> Oliver, 'Two sterling crises', p. 317.

<sup>13</sup> 'First steps only', *The Times*, 27 Oct. 1964, p. 11, col. B.

<sup>14</sup> Oliver, 'Two sterling crises', p. 318.

problems'. He asked the President if it was correct to assume that 'an increase in our Bank Rate would be as unwelcome to you as it would be to us'.<sup>15</sup> Johnson's answer was, 'We agree with your concept that more fundamental attacks on the basic problem of your trade deficit are preferable to early and indiscriminate use of the Bank Rate'.<sup>16</sup> This reply may not have excluded US acquiescence in British action on the Rate but it indicated the President's preference and therefore did not amount to an endorsement of the views expressed by Roosa and Hayes, let alone by Cromer.

Third, Oliver argues that the government was mistaken to hold back on raising the Rate because of uncertainty within the Treasury about the pressure of demand in the economy, adding that this was the first of 'many occasions' between 1964 and 1967 when it underrated the strength of sentiment against sterling.<sup>17</sup> Whether or not the observation is accurate for 1965–7, the position in 1964 was more complex. Oliver argues that the Treasury figures for losses to the reserves should be treated with caution, with the true picture to be found in the Bank's files. In fact the only differences between the graph he produces for 'Daily changes in total reserves', based on Bank material,<sup>18</sup> and my own graph covering 'Loss of reserves, 5–27 November 1964', from Treasury files,<sup>19</sup> are the chronological period covered and the fact that one presents the evidence in dollars while the other (my own) does so in pounds sterling. The figures were compiled from the daily updates of reserve losses (usually stated in both sterling and dollars) and the latest spot and forward sterling–dollar rates provided for the Chancellor by the Bank.<sup>20</sup> When the sterling is converted into dollars (or vice versa) at the then exchange rate, the amounts involved appear very similar indeed!<sup>21</sup> The Treasury was therefore aware of the pressure on sterling,<sup>22</sup> but according to the statistical information available to policy-makers at the time the explanation for this could not be attributed to overheating. A key indicator here was the seasonally adjusted all industries index for industrial production (published as an integer two months in arrears in *Economic Trends* and the *Monthly Digest of Statistics*), and for the first three-quarters of 1964 this had been flat. Subsequent revisions revealed that in reality the figure had been rising at an annual rate of between 5 and 6 per cent, leading one commentator, who had worked in the Treasury at the time, to admit that restraining action might have been recommended to Conservative Chancellor Reginald Maudling as early as July if the real picture had been visible.<sup>23</sup>

<sup>15</sup> Foreign Relations of the United States (hereafter FRUS), 1964–1968, vol. XII, document 233, Prime Minister Wilson to President Johnson, 19 Nov. 1964 (<http://history.state.gov/historicaldocuments/frus1964-68v12/d233>).

<sup>16</sup> FRUS, 1964–1968, vol. XII, document 234, President Johnson to Prime Minister Wilson, 19 Nov. 1964 (<http://history.state.gov/historicaldocuments/frus1964-68v12/d234>).

<sup>17</sup> Oliver, 'Two sterling crises', p. 318.

<sup>18</sup> *Ibid.*, fig. 2, p. 316.

<sup>19</sup> Newton, 'Two sterling crises', fig. 2, p. 82.

<sup>20</sup> Callaghan, *Time and chance*, p. 167. See also TNA, T171/769, 16 (iii), 'The reserves position, 1–24 November'; TNA, T171/769, 16 (iv), (vi), (ix), 'Sterling reports, 25–27 November'.

<sup>21</sup> There is only one noticeable difference in the figures: Oliver has the reserves taking in funds on 23 Nov. whereas mine show a loss on that day, albeit on a small scale. The discrepancy arose from an error on my part, reading a rather faint plus in photocopied documents as a minus.

<sup>22</sup> See, for example, TNA, T171/769/17 (ii), paper by Goldman, 'Monetary policy', 16 Nov. 1964; TNA, T171/769/17 (vii), submission by Sir D. Rickett considering the questions which might be raised in talks in Washington, undated but probably 16 Nov. 1964.

<sup>23</sup> Middleton, ed., *Inside the Department of Economic Affairs*, app. IV, pp. 205–6.

Given that such hindsight was unavailable to the Treasury, it should not be surprising to the historian that its preference was for central bank assistance, with physical controls on the availability of credit, such measures appearing appropriate responses to a crisis located more in speculative movements against the pound than in excess domestic demand. It was not irrational for the government to prefer this approach to Cromer's, which seemed, on the basis of inconclusive evidence, to advocate a swift return to the stop-go policies both major political parties had now rejected: a case supporting Eichengreen's recent suggestion that in conditions of uncertainty decision-makers can be guided by 'goal reference', namely on this occasion the goal of sustained annual economic growth comparable with what seemed routine in western Europe.<sup>24</sup> Moreover, as documents in the National Archives as well as Wilson's memoirs show, the Governor was arguing that the necessary monetary measures should be accompanied by the announcement of a target for public spending reductions, steps which directly contradicted the government's mandate from the electorate.<sup>25</sup> This was hardly likely to enhance the attractiveness of Cromer's advice about the Bank Rate. His campaign was not restricted to monetary policy: Oliver fails to place the Rate recommendations in their true political context.

Fourth, Oliver makes a good deal of sterling's lack of credibility in 1964–5, if this is tested by following the three-month forward rate for the period or by the construction of 95 per cent confidence intervals to test how far the expected rate of realignment deviates from zero. This technique is by no means foolproof. Neither the three-month forward rate nor the construction of 95 per cent confidence intervals, when applied to 1968–9, suggest that the post-devaluation sterling rate was credible (as he himself has acknowledged elsewhere),<sup>26</sup> as late as the summer of 1969 (see Figure 1).

Yet there was no second devaluation, and by the winter of 1969/70 sterling was hitting its \$2.40 parity against the dollar on a regular basis. The implication is clear: the statistical exercises indicate market sentiment but this is not a reliable guide to the appropriacy of policy. Throughout most of the period from March 1968 through to September 1969 sterling was almost continuously under pressure from violent speculative movements within the international monetary system, despite the fact that the government was following a strategy which was widely applauded in the financial press, in the Organisation for Economic Co-operation and Development, the International Monetary Fund, the US Treasury, and the Bank for International Settlements, and one which led to an emphatic balance of payments surplus.<sup>27</sup> Sterling's volatility over this time owed an increasing amount to the weakness of the dollar and the strength of the Deutschmark; it stabilized only with the revaluation of the Deutschmark in the autumn of 1969.<sup>28</sup>

Finally, Oliver is mistaken to state that the pound was devalued in November 1967 because 'foreign credits ran out'. The real story here is that Wilson and Callaghan did have the option of taking another rescue package, but turned this

<sup>24</sup> Eichengreen, 'Economic history and policy', p. 297.

<sup>25</sup> TNA, T171/269, note of a meeting held in the Treasury Chambers, 24 Nov. 1964; TNA, PREM 13/261, note of a meeting in no. 10, 24 Nov. 1964; Wilson, *Labour government*, pp. 34–5.

<sup>26</sup> Bordo, MacDonald, and Oliver, 'Sterling in crisis', pp. 5, 18, 20–1.

<sup>27</sup> See Jenkins, *Life at the centre*, pp. 285–6; S. Newton, 'The defence of sterling, 1968–70', unpublished paper (2009), pp. 41–2.

<sup>28</sup> Jenkins, *Life at the centre*, p. 285.

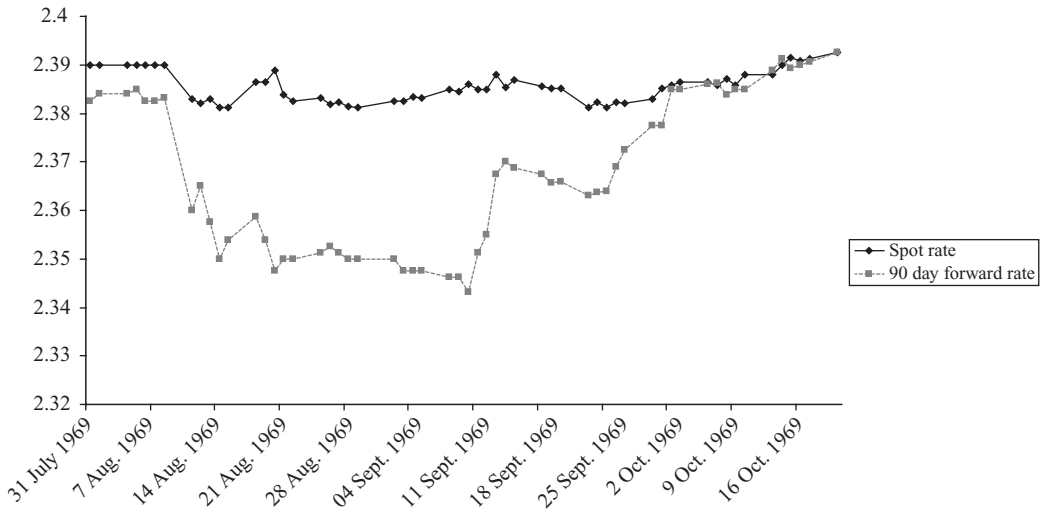


Figure 1. *Sterling spot and forward rates, 31 July–20 Oct. 1969*

Source: *The Times* (31 July–20 Oct. 1969).

down because they found the conditions unacceptable. The devaluation of sterling was an attempt by the government to retain a measure of economic sovereignty compatible with social democracy's historic postwar commitment to growth, full employment, and membership of a liberal world economy.<sup>29</sup>

In conclusion, Oliver's critique fails to acknowledge the existence of paradigm-changing developments in the global economy. His analysis cannot therefore engage with the emergence of new external economic pressures on the British (and indeed, other) governments, notwithstanding that by 1971 a series of exchange rate realignments had been forced on unwilling administrations in Paris, The Hague, Bonn, and Washington, as well as London. In these circumstances it is a pity, but perhaps not surprising, that Oliver pays no attention to the work of Hirsch<sup>30</sup> or, of direct relevance to these articles, to Lord Kahn's report on sterling's travails in 1964–5: these are among the few pieces of contemporary material which pointed to the changing international economic context and the problems this posed for national governments.<sup>31</sup>

The Wilson governments did not have the option, available to the 1945–51 Labour governments, of falling back on sterling inconvertibility and quantitative restrictions on imports, to help the economy adjust to external crisis without deflation. They faced an external environment in which, as Kahn noted, 'the growing sophistication and capacity of the financial markets' meant 'the external financial problems which have to be faced and resolved [by modern states] are far more complex and seemingly intractable than any encountered before'.<sup>32</sup> The

<sup>29</sup> Newton, 'Sterling devaluation'.

<sup>30</sup> Hirsch, *Money international*.

<sup>31</sup> TNA, PREM13/866, Lord Kahn's enquiry into the position of sterling, 1964–5, pp. 3–6; Newton, *Global economy*, pp. 85–100.

<sup>32</sup> TNA, T295/905, Lord Kahn's enquiry into the position of sterling, January 1966–February 1968, vol. 2, p. 188.

1964–70 Labour governments were the first in a line of postwar social-democratic administrations throughout the developed capitalist world to be confronted by a conflict between economic rationality and the psychology of the markets. It is not clear that the contradiction can be resolved: the question became how, and on what terms, co-existence could be managed.<sup>33</sup>

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<sup>33</sup> Tomlinson, ‘Tale’.

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