

Sterling, Bretton Woods and social democracy, 1968-70¹

I

For many years analyses of sterling and macroeconomic policy in Britain during the 1960s focussed on the struggle of the Wilson governments to defend sterling between 1964 and 1967. Until recently little had been published on the tribulations of sterling after devaluation from £1 = \$2.80 to £1 = \$2.40 on 18 November, 1967, although it has been acknowledged that the post-November 1967 sterling rate required considerable international support. For example, Cairncross and Eichengreen show that the UK needed £1300m in backing from overseas monetary authorities in 1968². This allowed it to cover a current and short-term capital account deficit of over £1400m without running down the gold and foreign exchange reserves to the point at which another devaluation became inescapable.

The accepted explanation for this apparent generosity has been that after devaluation the international financial community, in the shape of the Bank for International Settlements (BIS), the central bankers of the leading industrial states, and the International Monetary Fund (IMF), were all determined to support sterling in order to avert another devaluation. They feared that the collapse of the junior reserve currency could lead to the development of pressure on the main one, the dollar, itself also in deficit with the rest of the world. This would threaten the ability of the USA to maintain gold-dollar convertibility at the price of the fixed price of \$35 to one ounce, and in so doing threaten to destabilise the Bretton Woods international monetary system based on the universal acceptability of the dollar and on fixed (but adjustable) exchange rates.

The fear was not groundless: there had been a rush to sell dollars and buy gold at the time of the sterling devaluation. The widely accepted imperative of sustaining Bretton Woods meant that sterling's survival throughout 1968 at the \$2.40 parity was less troubled than it had been between October 1964 and November 1967, despite the existence of a deficit considerably larger than at any point in the previous four years³.

Recent articles by Michael Oliver and Arran Hamilton have however led to a shift of perspective following their demonstration of sterling's vulnerability and exposure to recurrent crises after its November 1967 devaluation⁴. Their important work shows that in response to the weakness of sterling in the markets the Treasury developed contingency plans for floating the currency and blocking the sterling balances, and discussed with the United States ways in which the international monetary system could be reformed. While this is accurate as far as it goes, the argument ignores the events of the summer and autumn of 1969 and also underplays the government's commitment to the Bretton Woods order of fixed exchange rates and its hostility to floating. This article maintains that the Prime Minister (Harold Wilson) and the Chancellor (Roy Jenkins) believed the maintenance of this order to be essential to the success of the post-devaluation economic strategy. Given that floating rates were incompatible with Bretton Woods they could only be defended as a strategy of last resort, to be implemented in the event of its breakdown. In the absence of such an eventuality, they were seen as likely to bring disaster on both the British and the international economy: Wilson and Jenkins feared that if they were forced to float the

pound they would be faced with the defeat of their post-devaluation economic strategy and the collapse of British social democracy.

II

There were three sterling crises in 1968-69. These came in March and November 1968 and in August 1969. Moreover, for much of the period between December 1967 and September 1969 sterling was under pressure in the foreign exchange markets even when its parity was not being threatened. Sterling's weakness in this period stemmed from two underlying causes. The first was fragile confidence in the Labour government's post devaluation economic strategy. This was intended to deliver a balance of payments surplus running at an annual rate of £500m, to be achieved by the end of 1969. It was a tall order, but the surplus had to be large enough to permit repayment of the large external debts acquired by the Labour government in the course of its efforts to defend the old exchange rate, and to provide the platform for a sustained expansion of the British economy – the Holy Grail of economic policy for the best part of a decade.

Much of this debt was short-term. It was owed to the US Federal Reserve Bank and to central banks in the leading industrialised states under three month currency swap arrangements organised by the BIS. In addition, the Bank of England had provided very considerable support to the forward market in sterling (mostly three month) during the autumn of 1967; these obligations had amounted to \$4782m on devaluation⁵. These

either had to be rolled over or (more likely) redeemed at the old rate. By the end of February 1968 the reserves totalled \$2771m and available short-term borrowing facilities were \$1686m. Indebtedness to foreign central banks and the BIS was running at \$3384m and forward market commitments now stood at \$2851m. There was no doubt that liabilities exceeded assets. Excluding from calculations the forward position on the one side and the undrawn credits on the other, the UK had a negative reserve position of \$-613m⁶.

The position of sterling was however even more precarious than suggested by these figures, thanks to the existence of foreign owned sterling balances which were banked in London. These, which were worth almost £4 billion (\$9.6 billion), had arisen as a result of sterling's historic role as an international reserve and trading currency. The balances represented significant liabilities, and were demonstrating considerable volatility. In the six weeks after devaluation, Overseas Sterling Area (OSA) balances, belonging for the most part to interests in Commonwealth countries or nations with longstanding economic ties to the UK, were run down by £200m, a very high figure in relation to fluctuations normally recorded in this category of holdings over the recent past⁷. Their withdrawal from London in favour of diversification into other currencies added to the strain on Britain's external financial position, since the Bank of England, acting through the Exchange Equalisation Account (EEA), was required to provide gold and dollars (or deutschmarks or any other currency in demand) from the UK foreign currency reserves in exchange for unwanted sterling. There was a danger that the losses to the reserves provoked by switching out of sterling on such a scale would lead

balance holders to fear further sterling depreciation. In consequence they would decide to continue with diversification, which in turn would cause more pressure on the reserves and therefore add to anxiety about the future of the exchange rate. A vicious circle loomed, threatening to cause financial crisis in the City, the abrupt termination of sterling's international role and disruption to the international monetary system.

Labour had been searching since the summer of 1965 for international agreement on measures to underpin sterling for the long-term⁸, thereby forestalling such a denouement. The best that could be achieved was the Sterling Group Arrangement (SGA), established by the BIS in June 1966. It provided the Bank of England with up to \$1 billion in credits. These could, however, only be drawn on to finance 50 per cent of the losses to the UK reserves caused by diversification on the part of OSA and NSA members. Initially the SGA was limited to 9 months but it was renewed annually until liquidated by instalments between September 1969 and January 1971⁹.

Early in 1968 the question of opening talks designed to reach agreement on a larger and less restrictive arrangement was raised again, in Basle, by Sir Leslie O'Brien, Governor of the Bank of England. Discussions between Bank officials and BIS staff began in March. But it was clear that any agreement to insure sterling would take time to organise, and in the meantime the government needed to show its commitment to a macroeconomic strategy which would, in facilitating an external surplus, remove the doubts about the ability of the UK to service its debt and about whether sterling's new value would prove to be any more trustworthy than the old one.

Unfortunately, it took over a year before the government was able to convince Britain's creditors and the foreign exchange markets that its economic strategy would work. In other circumstances, central bankers, foreign governments, and even the markets might have been less nervous about a currency's future. But they were perhaps over-sensitive about sterling since they had already witnessed what they now saw as a set of false dawns, between September 1965 and May 1966 and between September 1966 and the summer of 1967, when it had briefly seemed as if Britain's external position was on the road to recovery from the red. As a result, each piece of discouraging news, whether it related to the monthly trade figures or to events beyond the control of the government (such as trouble in the Middle East, the fortunes of US forces in Vietnam or political instability in France) was liable to shake the pound on the exchanges.

III

There was, however, two other factors contributing to sterling's weakness. The first of these stemmed from the growing instability of the Bretton Woods international monetary order based on fixed exchange rates and the convertibility of the world's leading reserve currency, the dollar, into gold. Unfortunately the dollar as well as sterling had accumulated considerable liabilities by the mid 1960s. These, the dollar balances above all, had provided the liquidity which had underpinned the expansion of world trade since the late 1940s. There had been a steady outflow of dollars from the USA, caused initially by foreign assistance programmes such as Marshall aid but then

sustained by military spending overseas (now including the commitment to the Vietnam war), imports, and foreign investment, mainly by multinational corporations. The latter had from the late 1950s been building factories or buying up firms, especially in Western Europe. This process had led to an accumulation of dollars in the world economy, some of which were held by the central banks of surplus countries such as West Germany or France. Others were deposited in private banks, many of them in London, and became known as 'Eurodollars' (Figure 1). They remained acceptable to the holders because of the dollar's convertibility into gold at \$35 to 1 ounce, but by the early 1960s there were increasing anxieties on the part of the Americans themselves and their creditors that US liabilities far exceeded the reserves available to honour such obligations.

It was appreciated by the IMF that the growth of dollar holdings was a weakness in the world monetary system: what would happen if and when US policy began to focus on correcting the external position? If supplies of dollars and of gold in the world economy became inadequate, some countries would seek to build up their own reserves, essential for the financing of external deficits, through protectionist or deflationary steps. The effect would be to reduce the reserves of other countries, which would then have to respond in kind. The upshot would be a downward spiral of world trade, production and employment. One of the most debated schemes to address this issue was the Triffin Plan (named after the economist Robert Triffin), which proposed a substantial increase in world liquidity¹⁰. But Triffin was not alone, and by 1963, within the UK, both the Conservative Chancellor (Reginald Maudling) and the Labour Opposition leader

Harold Wilson were proposing that the IMF 'create international credit *parri passu* with the development of world trade'¹¹.

The UK's campaign for extra liquidity was driven by two considerations. First, both the Conservative government of Harold Macmillan and Wilson's subsequent Labour administration were committed to expansionary economic strategies. But Chancellor Maudling's stimulus measures after 1962 had led to a growing current account deficit. Access to more generous and automatic external support than provided for by the IMF at the time would allow British governments (and others with external financial difficulties) to adjust to the deficits without recourse to deflationary measures.

Secondly, both Maudling and his successor, James Callaghan, believed that it might be possible for sterling holders to exchange their balances for a new reserve asset to be held by the Fund, hence reducing the vulnerability of the reserves to runs on the pound caused by 'confidence' rather than trade factors¹². Callaghan was especially committed to reform of the international monetary system based on the creation of more liquidity. He pointed out that the commitment of US and UK governments to 'a quantum of foreign currency', governed by the actual needs of international commerce and 'capable of deliberate expansion and contraction to offset deflationary and inflationary tendencies', went back to the 1940s, when Lord Keynes had launched his plan for an International Clearing Union¹³.

An international monetary system which ensured the compatibility of full employment and national economic expansion with membership of an open world economy

provided the foundation of the social-democratic synthesis for which Keynes had worked in his last years¹⁴, and to which the Labour Party itself had been committed since 1945¹⁵. The party had remained true to this tradition under the leadership of Hugh Gaitskell and Harold Wilson. Its National Plan for the modernization of the economy, launched in 1965, explicitly stated the government's commitment to the market economy¹⁶ and took an 'indicative' approach based on co-operation between the government, private industry and the trade unions. The objective was an annual average growth rate of 3.8 per cent (reduced in 1966 to 3 per cent as a result of ongoing balance of payments problems). This attempt to construct a 'New Britain' depended on engagement with a global economic environment which would support growth-oriented policies: international monetary reform designed to improve liquidity was therefore a national interest, especially after Labour's election in October 1964.

Discussions about international monetary reform had started within the IMF during the early 1960s. But Britain's enthusiasm for more liquidity was not powerful enough to prevent the talks from lasting for the best part of six years, concluding with the Fund's adoption of the Special Drawing Right at its AGM in September 1968. The inability of the world's ten wealthiest states (known as the Group of Ten) and the IMF to reach a consensus on international monetary reform meant that the growth of global trade and finance continued to depend on two reserve currencies whose value was not universally trusted. Why did the talks take so long? One problem derived from US anxiety that the creation of a new reserve asset might lead to a decline in the use of the dollar as an international reserve currency: until well into the Johnson Presidency the consensus in

Washington was that a series of ad hoc measures to preserve exchange rate stability (known as the 'ad hocceries') together with steps to restrict the flow of capital out of the USA and a successful conclusion of the Kennedy Round of multilateral tariff reductions, would bring the deficit back under control and lead to its elimination¹⁷.

Washington's 'ad hocceries' were focussed on the gold pool, set up in 1961; the General Arrangements to Borrow (GAB), 1961; and the swap network, which started in February 1962. The first of these allowed for intervention by the leading industrial powers to prevent the price of gold rising against the dollar, by co-operation in buying gold when the price slipped and in selling it when the price of gold rose. The second led to an expansion of \$6 billion in IMF resources, to be managed by the Group of Ten. The third involved the extension of short-term (usually three month) mutual credit facilities between the central banks of the Group of Ten (including Switzerland) and administered by the Bank for International Settlements in Basle (BIS). These could be drawn on to counteract speculative flows of money out of one currency and into another which might otherwise have led governments under attack in this manner to invoke trade and exchange controls, devaluations, or currency floats¹⁸.

It was not until after he won the November 1964 Presidential election that Johnson felt confident enough to consider moving beyond such piecemeal tinkering. There was, however, another major obstacle in the way of rapid international agreement. This was the attitude of the French¹⁹. The French President, General de Gaulle, argued that the US had used the dollar's status as the world's leading international reserve currency to accumulate excessive amounts of credit from the world's leading industrial powers. By

1965 the French were committed to a reform scheme of their own, based upon an increase in the price of gold and the creation of a new reserve asset, partially convertible into gold, to supplement (and ultimately replace) the dollar: the Collective Reserve Unit²⁰. Finally, the pace of the talks was held back by the determination of the six countries comprising the European Economic Community (EEC) to negotiate with a single voice, to boost its international bargaining power. The problem was that there were significant differences within the six. The French determination to undermine the position of the dollar was not shared by the other Five, whose main concern was not about replacing the current system but keeping it and introducing more liquidity, while ensuring that debtors would not be indulged.

It followed that there could be no rapid external solution to the British problem, and London was left negotiating with the Group of Ten, the Fund, the USA and the BIS, to establish its own network of 'ac hocceries', based on IMF support and on short term central banks loans and swap agreements designed to protect sterling and the reserves. This failure to resolve the international liquidity problem enhanced the vulnerability of the reserve currencies to speculative movements based on anxiety that they would be devalued. And the growth of such speculative movements of money across national borders, notably in the form of Eurodollars, was a second reason for questioning the prospects for future international economic stability.

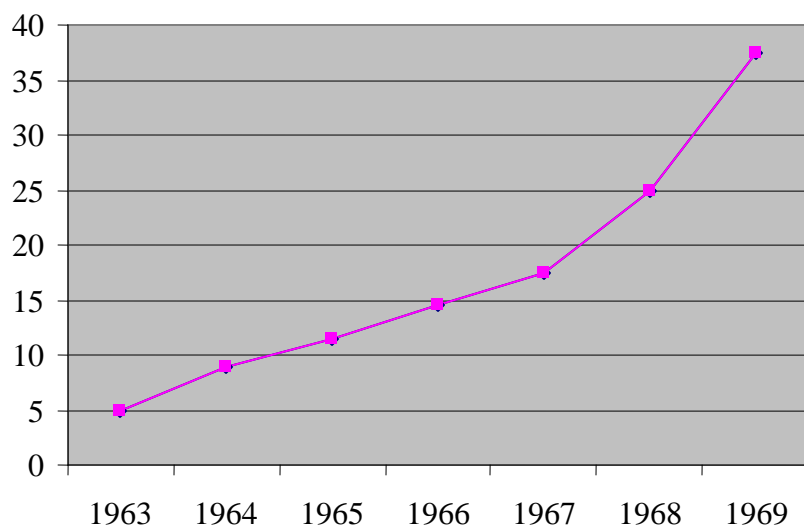
Eurodollar balances had expanded with the trend to trade and payments liberalization common to most advanced industrial states from the later 1950s. To begin with, they

were driven by the efforts of US banks and multinational corporations to escape from exchange controls and banking regulations at home. This outflow of dollars from the USA then accelerated as American corporations began to increase direct investment in Western Europe, attracted by relatively lower wage costs and rapidly expanding markets. Although the growth of this new market was driven by developments in the US economy, continental banks and companies were contributing by the second half of the 1960s. All these firms tended not to repatriate their overseas earnings but either placed them in banks where they could be drawn on for investment or moved them from one financial centre and one national currency to another in search of a good rate of return, dependent on interest rate changes (and expectations of exchange rate alterations)²¹.

The most favoured destination for these funds was London, and by the end of 1965, out of total Eurodollar deposits of \$9102m, \$4257m (46.8 per cent) was banked there²². London was home to a large short-term money market which was highly attractive, especially to US banks. They were able to offer their dollars on the European inter-bank market or convert them into sterling loans (usually of three months) to UK local authorities and hire purchase companies, where rates were generally between 0.5 and 1 per cent higher than those offered by Treasury Bills²³. This option also appealed to non-dollar Non Sterling Area (NSA) interests, many of whom were private organizations rather than official institutions.

Figure 1: Estimated Size of the Eurodollar market (\$bn).

Source: BIS Annual Reports, 1965-70



The increasing interdependence of capital markets in leading industrial states during the 1960s, arguably a key stage in the development of economic globalization, generated an international financial community, dominated initially by the IMF and the BIS, with its own priorities. The most significant of these was 'confidence', which when applied to Britain meant assurance that the government was genuinely committed to an economic strategy capable of delivering a balance of payments surplus at the prevailing exchange rate within the short to medium term. The fragility of sterling's position was demonstrated in the sterling crises of 1964-67: on each occasion the catalyst was indeed a lack of confidence in the currency's future as an international reserve currency.

The question of 'confidence' was, however, increasingly complicated by the freedom of the rapidly growing mobile private funds to move in and out of national currencies regardless of the opinion of international organizations such as the IMF or of the BIS and the central banks of the Group of Ten. Their motives were often speculative: the sterling crisis of November 1964 was exacerbated by short selling (dealers borrowed sterling and then sold it for dollars, anticipating that they would be able to repay their debts at a profit following the devaluation of the currency) on the New York market²⁴. NSA sterling balances, held by foreign central banks, governments, corporations, banks and private individuals, fell by almost £500m from July through to the middle of November 1967²⁵. As long as this somewhat febrile external environment lasted it turned the search for a macroeconomic strategy which would win the confidence of the markets into Labour's *ignis fatuus*. 1968-9 was to see runs on the pound which occurred even after the government's post-devaluation economic strategy had been endorsed by the IMF and the Group of Ten.

IV

A sustained and considerable current account surplus may not have been a sufficient condition of restoring confidence to sterling, but it was a necessary one. Detailed contingency planning for devaluation had been ongoing within the Treasury and the Bank of England since the first half of 1965. The civil servants and advisers involved understood that devaluation would have to be accompanied by action to ensure that the home market did not pre-empt the resources required for an export drive²⁶. When the

pound was devalued, therefore, supporting measures were quickly introduced by the government. The new rate was supported by an IMF standby credit of \$1.4 billion, short-term central bank credits (on a three month, renewable, basis) worth \$1.425 billion, and steps designed to curb the expansion of the home market. These included a rise of 2 percentage points in the Bank Rate as well as hire purchase restrictions, tax rises and spending cuts designed to reduce demand by between £400m and £450m. The package was intended to be the first stage of a programme for the transformation of the British external position, called the 'Switch of Resources Strategy' and designed to rebalance the economy in favour of export-led growth²⁷. It was accepted that, thanks to the expected operation of the J-curve following devaluation, export values would only start to overtake import values in the last quarter of 1968, but the measures were expected to deliver a balance of payments surplus worth £500m by the end of 1969. The second stage, involving further measures to limit home demand, would be introduced in the spring Budget.

This two-stage approach failed to inspire confidence. It was greeted with dismay by Sir Leslie O'Brien, Governor of the Bank of England, who argued that more needed to be done now; otherwise it would not be clear to the markets that the government was serious about reducing demand in the home market and transferring resources to production for exports. He said that the steps announced so far might be intended to reduce demand at home by £400m, but their impact would be more modest than this, and given the focus on tax and monetary changes they would fall most heavily on business and industry²⁸. This would not assist the export drive.

O'Brien's misgivings were reinforced a few weeks later, as a result of meeting other central bankers at the BIS in Basle. He reported that his colleagues possessed little confidence in the government's approach, an assessment confirmed by the development of pressure on sterling in the markets. It was down at \$2.38. O'Brien argued that unless the government acted very soon it would struggle to hold the new parity. He said that only a programme of public spending cuts, to be brought forward at the earliest opportunity, would guarantee the new rate. Moreover, since a devaluation to a new fixed rate would be unthinkable (there not being enough resources, in terms of reserves and foreign credit) to support it, it would be necessary to consider whether or not a sterling float was now inevitable (and the direction would be downwards)²⁹. A further slide in sterling would mean 'a total and explicit failure of policy'³⁰.

O'Brien's anxieties found support within the OECD and the IMF. Finance Ministers of Working Party 3 of the OECD met every month to monitor members' balance of payments positions and the steps taken by surplus and deficit countries to return closer to equilibrium. At the December meeting Christopher Dow (OECD Secretariat) complained that there were times when the UK 'gave the awful impression of a man standing in a lake of water, whose only ambition was that the water would not rise much above his chin'³¹. Notwithstanding the standby arrangement, the IMF had doubted from devaluation onwards whether the government was doing enough to hold down public expenditure. The winter of 1967-68 saw an outside world unconvinced

that the government was aiming for an economy capable not just of paying off existing debt but of maintaining a surplus thereafter.

The Treasury's initial response was that there was no need for precipitate deflationary action on the domestic front. There was already (so the argument went) slack in the economy (unemployment was over 2.3 per cent, unusually high by the standards of the 1960s) which could be turned over to production for the export market. The Budget was the time for any further action; by that stage it would be possible to forecast the likely growth of domestic output for the period up to 1970, and adjust it if necessary with taxation rises and expenditure cuts. This was however the line that had damaged confidence, and both Callaghan's replacement as Chancellor, Roy Jenkins, and Wilson became worried about the possibility of another crisis. The urgency of the situation was underlined when it became clear that the economy was now actually expanding fast, possibly by as much as an annual rate of 4.5 per cent, thanks to steps to ease credit and increase public spending taken back in the summer of 1967, when it had seemed as if the main issue was rising joblessness and slow growth. Wilson warned the TUC that the country was experiencing a consumer boom³². In December both Prime Minister and Chancellor therefore set to work on a programme of public spending reductions, with the clear intention that this would be complemented by a tough March Budget. A White Paper announcing details of some dramatic cuts was released in the second half of January. They included the historic commitment to withdraw from a military presence east of Suez by 1971 as well as decisions to reintroduce NHS prescription charges and to postpone the raising of the school leaving age from fifteen to sixteen³³. The

economies amounted to reductions of almost £700m in civil expenditure programmes up to 1970 plus savings of £350m from defence up to 1976.

Wilson and Jenkins had seized the initiative so that the post devaluation macroeconomic strategy could proceed free from crisis. The White Paper was well received in the OECD, as being of 'major political significance'. But even here the point was made that the cuts were not likely to have an early impact. The economy was still likely to grow at a rate of more than 4 per cent in the current year; this was likely to stimulate the home market, attract imports and therefore exaggerate the impact of the J-curve on the balance of payments. Both the Dutch and the German representatives in Working Party 3 suggested that a growth rate of 3 per cent was more compatible with the government's objectives. If the government's strategy was to retain credibility the coming Budget would have to restrain demand by at least £400m in 1968-69³⁴.

Within the Bank of England and the City there was even more pronounced scepticism about the long-term prospects facing the economy, and some sympathy for the view of former Bank of England Governor Lord Cromer that a second devaluation was likely before long³⁵. Some of the opinions expressed were characterised by a pessimism which was barely rational, and were motivated by a political distaste for the Labour government³⁶, but with the monthly trade figures throughout the first half of the year showing an unexpected surge in imports³⁷ they were not wholly unjustified³⁸. Despite a slackening in the pressure on sterling during February, the government was still some

way from gaining the confidence of either the international financial institutions or the markets.

Both Wilson and Jenkins were aware that the Budget was of fundamental importance to the success of the government's strategy, in terms both of the measures within it and of its impact on confidence. The importance of action to restore this was clear, with sterling remaining vulnerable on the exchanges during February and early March. The trade figures for the four months since devaluation showed a big leap in imports, which were running on average £80m a month higher than prior to the change in the sterling rate³⁹. Exports were performing well, but the returns did little to reassure those who doubted the effectiveness and urgency with which Labour was pursuing its strategy. Gilt-edged stocks lost ground when the March figures were announced, and sterling fell both on the spot and forward market⁴⁰.

Throughout January, February and the first half of March the Treasury therefore focussed on the Budget. Jenkins worked on the assumption that the external surplus Labour required made it necessary to aim for a 3 per cent annual growth level rather than maintain the current 4 per cent annual rate of expansion. To this end, he determined to take a minimum of £500m out of the economy, largely through a rise in indirect taxation (which would bear directly on consumption), but the final version went a good deal further than this, raising £923m.. This even exceeded the kind of figures suggested by the OECD's Working Party 3, which early in March called for an increase in taxation ranging from £450m-£800m⁴¹.

The combination of tax increases and spending cuts amounted to a very powerful dose of deflation, possibly the most severe since the war. Writing in the Times immediately after the Budget, Peter Jay wrote that the Chancellor had 'risen fully and magnificently to the occasion. Yesterday's Budget was really everything that was economically needed. It should give devaluation a virtually certain guarantee of success'. He went on to say that the UK had now 'done everything required to correct the fundamental weakness of the economy and the balance of payments which has bedevilled economic policy as well as international adjustment most of this decade'⁴². But even before the government's strategy had been announced in the 19 March Budget it had almost been wrecked by another foreign exchange crisis. Notwithstanding the weak state of foreign confidence in the British economy within international organisations and the financial markets (at least, in March 1968), the roots of this crisis, and of those occurring in November 1968 and August 1969, can be traced to the growing weakness of the Bretton Woods order.

V

There were three fundamental conditions for the success of Labour's post-devaluation strategy. The first of these was the maintenance of the Bretton Woods order of fixed exchange rates⁴³. The continued existence of this system guaranteed an external environment in which pressures on sterling would be minimised through international collaboration between the advanced industrial states and through an expansionary

economic climate conducive to the promotion of exports⁴⁴. The alternative was seen as 'monetary breakdown', in which nations running deficits embraced economic nationalism and what were called the 'beggar thy neighbour' practices of the 1930s. These revolved competitive devaluations (or floating rates) and protectionist measures in trade⁴⁵. The second condition was a surge in exports and restraint in imports. The third was the curbing of demand at home via both deflationary monetary and fiscal measures and an incomes policy⁴⁶.

All three of these conditions were threatened by the March 1968 crisis⁴⁷. This was provoked by developments in Vietnam. During the Tet offensive of February 1968 Viet Cong forces had for a time succeeded in reaching Saigon and even in penetrating the US Embassy compound. Although the battle had ended in defeat for the Viet Cong, the impression it left behind was that no early end to the Vietnam War was likely. It followed that the commitment of US forces and material to the support of the South Vietnamese regime would be ongoing for several years. The result was to stimulate vigorous speculation against the dollar, on the grounds that the strategic fallout from Tet would undermine President Johnson's latest efforts to turn around the US deficit, announced over New Year 1968⁴⁸. A mounting demand for gold became evident in the London gold pool. This turned into a rush following a call on the part of senior US Senator Jacob Javits that dollar-gold convertibility be abandoned, which in turn fed speculative expectations of a rise in the price of gold against the dollar⁴⁹.

Sterling then came under heavy pressure as holders sold it for dollars which they were able to turn into gold. As the selling mounted, so did market expectations that the new parity might have to be sacrificed. The sterling three month forward rate, often a key indicator of medium-term expectations concerning a currency's future, showed a discount of 5.75 cents on the official parity in New York on 14 March⁵⁰. There was heavy intervention by the Bank of England on the spot market, but this led to a rapid rundown of the exiguous foreign exchange reserves. During the first half of the month they fell by \$1441m, from \$2771m to \$1340m⁵¹. Substantial drawings were then made on the central bank credit facilities arranged to support sterling after its devaluation. These drawings became necessary in order to keep the net loss to the reserves down to \$912m (£380m) for the first three weeks of March⁵², but they added to the country's liabilities. The Treasury calculated that by 14 March the negative reserve position had deteriorated to -£881m⁵³. Frightened by the reserve losses and the scale of the action needed to contain them, the Bank let the spot rate fall to \$2.3740 in New York on 15 March⁵⁴. This undershot the \$2.38 floor level below which, under the Bretton Woods rules, sterling was not supposed to drop unless it was going to be formally devalued. The failure to intervene was greeted with great dismay in the Treasury⁵⁵ but defended by the Bank on the grounds that distrust for the currency was too widespread. It feared a repeat of what had happened on day before the announcement of the November devaluation, when £500m (\$1.4 billion at the old rate) had flowed out of the reserves⁵⁶. Sterling balance losses reinforced these anxieties: as the crisis intensified in the first two weeks of March, the balances were run down by £180m. Most of this (£155m) switching was undertaken by NSA sterling holders who were concerned about the

possibility of a second devaluation⁵⁷. O'Brien warned Jenkins that the position of sterling was becoming unsustainable; he would have to let it float⁵⁸.

The gold rush reached a peak in the week starting Monday 11 March. By Thursday 14 March the US Treasury was worried that demand for gold was forcing its price to a point which would either force a dollar devaluation against gold or render gold-dollar convertibility unsustainable. It therefore asked the British to close the London gold market on the Friday. Wilson and Jenkins agreed, and a Bank holiday was declared. In part, the willingness to accede to the US request was born out of concern that the entire Bretton Woods edifice was in danger of failing. But the real possibility that another £300m or £400m might be lost to the reserves very quickly if the gold-buying spree was not arrested was an even more immediate concern. As O'Brien had said, this would certainly have made it impossible to hold the rate, precipitating either another sterling devaluation or a downward float of the currency⁵⁹.

The closure of the gold market gave both sterling and the dollar a breathing space while a conference in Washington, involving Finance Ministers and officials from the countries making up the gold pool, was hastily arranged for the weekend. Its outcome was likely to determine both the future of the Bretton Woods system and of the British economic strategy. The British made it clear that they needed a new credit package, worth \$5 billion, to support sterling, and that they favoured agreement on the rise in the price of gold against the dollar. They believed the latter would involve a relatively painless adjustment for the USA and would draw a line under the speculation. But first

indications from Washington were not encouraging. There seemed little enthusiasm for more assistance to the UK⁶⁰, while the US President himself was adamant that there would be no devaluation of the dollar against gold. Instead the US suggested separating the official and the market price of gold. This would involve limiting central bank gold market activities. The central banks would abstain from the free market and deal only with each other, at the official price. The USA would meanwhile no longer provide gold to private parties at \$35 an ounce. The gold pool would cease operations. The British were not convinced that it would be possible to keep this distinction between the free and the official markets. They did however accept the two-tier plan in the hope that their own requirement for more assistance would in return gain US backing, while at the same time working on contingency plans in case the conference ended in failure. These plans were codenamed 'Brutus' (after the Ides of March) and based on discussions about floating and its consequences already held in the Bank and the Treasury.

There were three versions of Brutus, each one more rigorous than the last. Common to each version was the suspension of sterling convertibility for all balances held in the NSA and the OSA: no sterling area resident would be able automatically to buy gold or foreign exchange from the UK in exchange for existing sterling holdings. Under Brutus 1, sterling balances holders would be able to run down their holdings only to finance imports from the UK. Brutus 2 would result in the blocking of all sterling balances, with releases only being allowed for specified purposes. Brutus 3 was the most far-reaching, since it would not only freeze access to all OSA and NSA balances but also

involve the imposition of exchange controls on transactions between UK residents and the sterling area; it would mean the 'effective abolition of the sterling area'⁶¹, with the pound's acceptability confined to the UK and Ireland.

The original intention of Brutus was to stop a run on the reserves and therefore maintain the parity. It quickly became apparent to the Treasury, however, that, blocking and floating were not practical alternatives at all. If Britain floated it would have to block (to prevent a mass exodus from sterling). On the other hand, given that blocking could only occur once it was obvious that there were not enough reserves to sustain the sterling parity, its introduction would have to be accompanied by a float⁶². The question facing Wilson and Jenkins therefore became whether to go for a free float or for one which would be controlled and limited thanks to the application of one of the varieties of Brutus. It was clear that Brutus 1 would be the easiest to introduce quickly – but that in the event of continuing international uncertainty it might be necessary to go all the way to the much more comprehensive exchange control regime of Brutus 3⁶³.

The government was prepared to opt for Brutus 1, moving over a two-three week period to Brutus 3⁶⁴. The impact on UK living standards would have been dramatic. Not only would foreign travel become restricted (as a result of the need to prevent losses of convertible foreign currency from the reserves) but the shortage of foreign exchange would mean a reduction of imports to essential goods⁶⁵. Trade with countries unwilling to hold sterling would revert to the kind of barter arrangements common during and just after World War Two⁶⁶.

Within the Bank of England this prospect was regarded with apprehension. O'Brien said that he doubted whether effective blocking was feasible in short-run, and that in any case the suspension of convertibility would be far more serious for the City than floating⁶⁷. It would amount to the declaration of a default, with the effect being similar to suspension of cash payments by a bank. But given sterling's status as a reserve currency, the bank in question was the second largest in the world, and its actions would have brought about the destruction of almost £4 billions' worth of global liquidity. Meanwhile British assets would be at risk of retaliatory action on the part of overseas (possibly including Commonwealth) governments. Britain's international creditworthiness would collapse and sterling's career as an international trading and reserve currency would be over⁶⁸.

The government was under no illusions about the implications of Brutus but these were regarded as preferable to the domestic and international economic consequences of moving to a freely floating rate. A sterling collapse to £1 = £1.50, 37.5 per cent below the \$2.40 level and 46 per cent below the pre-devaluation rate of \$2.80, was feared. This would prompt a disorderly withdrawal of as much of £2 billion from the sterling balances⁶⁹, leading to bank failures in London and a drastic contraction of credit in the UK⁷⁰. It would also intensify strains on the current account, provoke price increases and jeopardise trade union consent to pay restraint. On the external front the breach of the Bretton Woods rules governing the international monetary system would cause 'great confusion', with 'some, perhaps many other countries' expected to let their currencies

float as well. There would be further speculative rushes into gold and the 'collapse' of the dollar⁷¹. Jenkins warned his Cabinet colleagues that such a scenario could lead to a return to the trade wars of the 1930s, as nation-states embraced protectionism, competitive devaluations and floats⁷². Clearly, adoption of a freely floating rate was incompatible with the conditions required for the success of Labour's post-devaluation strategy.

In the end it was not necessary to introduce any of Brutus's different varieties, although the Treasury continued to work on this contingency plan for months. Wilson had called the scheme 'blackmail'. Both he and Jenkins saw Brutus as a way of persuading the participants at Washington to provide the crucial \$5 billion package of external support for sterling, and therefore the new economic strategy, by showing them what would be the consequences of their failing to do⁷³. The tactic worked. The US was especially concerned about what would happen to the dollar-gold relationship if the floating and blocking of sterling was introduced⁷⁴. Further backing for sterling was therefore agreed. Britain's credit facilities were increased to \$4050m. This figure included the \$1.4 standby available with the IMF, plus \$1175m in new support. \$700m of this was provided by the USA, the rest by Belgium, Italy, the Netherlands, Switzerland and West Germany. The overall figure was rather less than the government had wanted, but, as Jenkins told the Cabinet, 'the small group of Ministers' who had handled the crisis were convinced that accepting the support was preferable to Brutus⁷⁵. When the markets opened on Monday 18 November both sterling and the dollar made gains, the former returning to just over \$2.40⁷⁶. The crisis passed and Jenkins was able to present

his Budget without disruption. The conference, with its introduction of the two-tier market and international support for sterling, had settled the international environment and given the British strategy a breathing space in which it could operate free from fear of destabilisation at the hands of the markets. Strengthened by the good reception accorded to the Budget, sterling stayed at or very near parity for the whole of April.

VI

Further international support for sterling was announced in July, with agreement in the talks between the Bank of England and the BIS about a loan to insulate the British reserves from diversification out of sterling by balance holders. Alarm on the part of European central bankers about the impact on sterling of the gold crisis had been the catalyst for this. Concern was expressed that if no international action to support the pound was taken, larger balance holders such as Kuwait might diversify into gold and undermine the recent Washington agreement to stabilise the dollar-gold relationship. Blocking of balances – Brutus - would then be the only action available to the UK to avert what the Governor called 'a disorderly disaster'⁷⁷.

This anxiety gave urgency to the talks which had started in February. Early in July the BIS stated that it was prepared to offer a \$2 billion credit facility to Britain, on which it would be possible to draw for three years, with repayment taking as long as ten. The Bank of England would then be able to propose to OSA members a dollar guarantee of 90 per cent of their holdings, in return for a slow and orderly diversification. The next

eight weeks saw intense and difficult negotiations with sterling area members⁷⁸, but in September the Bank was able to issue a public statement confirming that thirty countries, whose holdings accounted for 77 per cent of all the balances, had signed up to what were known as the 'sterling agreements'⁷⁹.

This was a considerable achievement and brought a longstanding objective of the government's external economic policy to a successful conclusion. But it did not lead to the construction of the stable international environment which sterling and the government's strategy required. After a good run through the summer, the pound came under more intense pressure in the autumn. The August and September trade figures had been healthy. October's, announced on 13 November, had however been disappointing, with imports showing a £13m increase over their level in September. The Treasury, aware of the resilience of imports, was preparing another set of measures to slow down domestic activity, but as in March a crisis which started abroad almost undermined the macroeconomic strategy. This time the problem was centred on expectation within the markets that the West German currency, the deutschmark, was undervalued against other currencies while the French franc was overvalued⁸⁰.

The German economy had for most of the past decade been generating visible trade surpluses, leading to a long period of export-led growth. By the autumn of 1968 there was growing enthusiasm on the part of the markets for deutschmarks. Sentiment in favour of the currency surged in September, when the Bundesbank's reserves rose by \$1.4 billion in ten days, and again in November, when they grew by \$2.4 billion over

the first three weeks⁸¹. The timing was provoked by two developments. First, there was an increasingly obvious contrast between price stability in West Germany and inflationary pressures elsewhere⁸². Secondly rumours (which were accurate⁸³) began to circulate in the financial markets of the Group of Ten that the Bundesbank supported a revaluation of the deutschmark in order to counter the inflationary impact of capital inflows on the financial system⁸⁴. Reduction in interest rates within West Germany might have deterred this inflow; but such action, in threatening to add to inflationary pressures, was not compatible with the priority of low inflation, an imperative of post-war economic policy in Germany⁸⁵.

The rush for deutschmarks was paralleled by speculation against the franc. This was an after effect of the May 'evenements', when France had for a short time been brought to a halt by a wave of student unrest and industrial disputes. The franc's vulnerability was intensified by a pay agreement with the unions which provided for a 10 per cent rise in wages and shorter working hours⁸⁶. The concessions were bad for international confidence in the French economy, notwithstanding only a small trade deficit for the year. The franc slipped to its floor level against the dollar and the deutschmark on the markets, and there was a steady outflow of capital, with short-term losses amounting to \$2 billion⁸⁷. This delicate situation became a highly sensitive one in September, which saw the lifting of exchange controls and the first wave of speculation in favour of a deutschmark revaluation. There was renewed heavy selling of the franc in favour of deutschmarks, which intensified in November as speculation that a deutschmark revaluation was imminent reached a peak. At a central bankers' meeting in Basle on 16-

17 November, Brunet, Governor of the Banque de France, told his colleagues that the French could not sustain the massive capital losses to Germany for more than another week. He would not borrow to protect the franc against the selling. It would therefore be necessary to announce devaluation, by as much as 15 per cent, unless there was a deutschmark revaluation⁸⁸.

The November crisis posed another serious threat to the maintenance of the Bretton Woods order and to sterling. The finance ministers of the OECD met at Bonn on 20 and 21 November to discuss the question of exchange rate realignment based on franc devaluation and deutschmark revaluation. The Times commented that parity of the deutschmark against other currencies was now unjustifiably low, 'and is before long bound to be changed upwards'⁸⁹. The British and the Americans were looking for a German revaluation of between 5 to 10 per cent to offset an expected 10 to 15 per cent devaluation of the franc. The German government was, however, known to be reluctant to revalue the deutschmark, notwithstanding the views of the Bundesbank. The Christian Democratic Union, which shared power with the Social Democrats in a Grand Coalition, did not wish to lose the support of farmers and industrial exporters enjoying the benefits of a competitive exchange rate⁹⁰. As a result the possibility that the French might act alone by a margin as great as 15 per cent became very real. For the British, this was extremely disturbing. One problem was that exports might be adversely affected by the new level of the franc, with a 15 per cent devaluation likely to cost the UK balance of payments between £75m and £80m per annum⁹¹. In addition, the

fundamental cause of the currency instability, the undervalued deutschmark, would still exist. With the franc having fallen, speculators would turn on sterling.

During the first half of November sterling did indeed come under pressure, following the disappointing October trade figures. On 15 November sterling finished at \$2.3840⁹² and only intervention worth \$250m by the Bank of England on that day alone had prevented it from falling further⁹³. Given short and medium term debt of £3,132m (with repayment due in the next 3-5 years)⁹⁴ there was no question of further borrowing to support the pound, and there fear within the Treasury and the Bank that the reserves would not be able to sustain either the \$2.40 rate or a new, lower parity. Contingency planning (now called 'Priam') for a float in the event of a French devaluation was therefore undertaken. It was recognised that such action would require a deflationary support package in order to reassure the markets that another fall in the rate would not lead to a *degringolade* of the currency as a result of inflationary price rises and wage settlements. The squeeze would involve import restrictions (known as 'Operation Orestes'⁹⁵), and austerity measures to cut domestic demand, via public spending cuts, tax rises, credit tightening, and a period of severe pay restraint – all coming on top of the action taken in the Budget⁹⁶.

In theory, with the Basle Agreement in place, there would be no need to block the sterling balances, but it was accepted that the move to a floating rate would still be regarded as 'such a major failure as to lead to a breakdown in confidence in our economic management'⁹⁷. The resulting rush from sterling might be too great even for

the resources available under Basle, forcing a return to the contingency plans first revealed in Brutus⁹⁸. The crisis would be intensified by ongoing external instability, since the dollar would be the next domino to fall as speculators continued to seek deutschmarks. As in March, the world of Bretton Woods would face eclipse. In order to curtail the development of so hostile an environment, the government argued for agreement on a new structure of fixed exchange rates, featuring the relationships between sterling, the dollar the deutschmark, and the currencies of other EEC members⁹⁹ so that they genuinely reflected the surplus and deficit positions of nation-states within the international trading system¹⁰⁰. Jenkins and the US Treasury Secretary Fowler went to the Bonn meeting of OECD finance Ministers hoping for a 5 per cent revaluation of the deutschmark, seeing this as the first stage of the wider realignment. But the German government kept the parity unchanged. Instead they announced a reduction in export subsidies, an adjustment of their border tax to raise the price level of imports, and restrictions on the inflow of foreign capital¹⁰¹.

A unilateral French devaluation was now expected. Information from within the French government led Ministers to expect a fall of just over 11 per cent. Treasury projections suggested that if the franc was reduced by less than 12 per cent, there was a good chance that sterling would survive, but only if more was done to reduce demand for imports. To this end the government introduced a package of import deposits, increases in indirect taxes (designed to take £350m, or just under 1 per cent of the GDP, out of the economy) and credit restrictions aimed at shaving £100m from private sector lending by March. At this point President De Gaulle announced, to near universal

astonishment, that there would be no franc devaluation. The franc was to be held at its current rate with the assistance of a French austerity programme.

In the short term this unexpected turn of events did not upset the markets and both the determination of the French and German governments not to budge and the British mini-Budget led to calmer conditions (for most of the time) during the next few months. The British trade figures for the last part of 1968 showed real improvement; it seemed as if the switch of resources strategy was working. At the OECD Working Party 3 meeting in December 1968 Otmar Emminger (a member of the Bundesbank board) accepted that 'there was now a good chance of the United Kingdom reaching its goal'¹⁰².

The more peaceful climate allowed to government to reaffirm its strategy at a meeting of its Steering Committee on Economic Strategy held on 4 December. The latest forecasts indicated that 1969 would see a balance of payments surplus in the region of £450m. Wilson and Jenkins made clear their determination that policy should aim to facilitate by the end of 1969 the achievement of the £500m annual current account surplus, to be sustained for several years thereafter. Only by continuing to remain in the black on this scale would governments be able to repay debt and preside over steady, crisis-free expansion of the economy at the 3 per cent annual rate of growth which remained the target¹⁰³. This was rather unambitious for some Cabinet colleagues, who called for adoption of an alternative strategy based on the adoption of protectionist measures to prevent domestic expansion from being derailed by balance of payments

difficulties¹⁰⁴. These were, however, rejected. Wilson, Jenkins and Callaghan all argued that such an approach would, in adding to domestic demand, divert resources from production for exports¹⁰⁵.

VII

The stability which followed the events of November came to an abrupt end in the summer of 1969, and the last sterling crisis faced by Wilson's Labour government lasted erupted in August 1969. This had less to do with the British trade performance and the long-term prospects facing the economy than any of the perturbations faced by sterling since the autumn of 1964. It followed instead from the failure of the Bonn meeting to agree a co-ordinated exchange-rate realignment centring on a deutschmark revaluation and franc devaluation, and led to a short-lived burst of enthusiasm for floating within the Treasury, much to Jenkins's alarm.

During the first nine months of 1969 the monthly balance of payments figures had for the most part been good and by mid July Jenkins was able to announce a net improvement to the foreign exchange reserves of \$1 billion since January¹⁰⁶. The lurch into instability which followed resulted from the realization of the scenario considered in the Priam contingency plan. The French unilaterally devalued the franc on 8 August (resistance to the move having collapsed after the resignation of President De Gaulle at the end of April). Predictably, this led to another wave of speculation in favour of a deutschmark revaluation, and, equally predictably, sterling found itself under pressure.

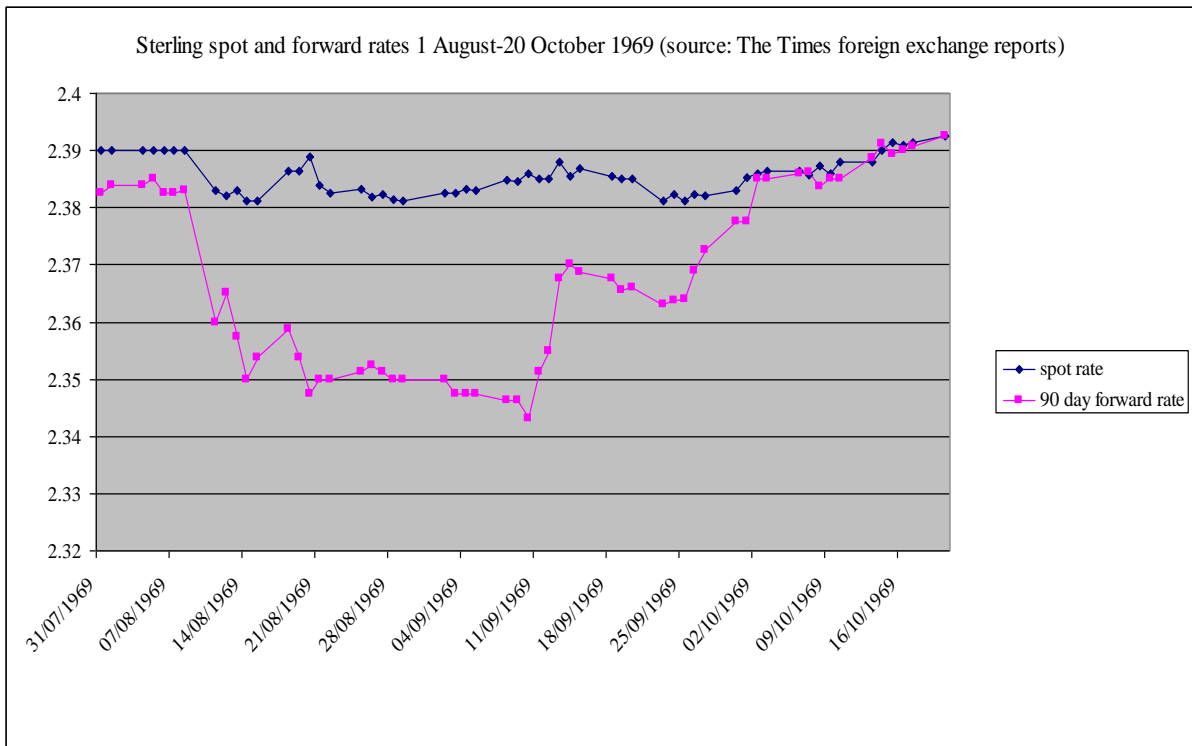
On 14 August spot market sterling fell to \$2.3812, with the Bank letting the rate rather than the reserves take the strain¹⁰⁷. The 90-day forward rate fell to \$2.35. It remained low, slipping even further, to \$2.3431 on 10 September, the day after a short outbreak of fighting in the Middle East (Figure 2).

The Bank's behaviour was indicative of a growing interest in floating, or at least more flexible rates, both within its own walls and within the Treasury. In part this stemmed from concern about the sustainability of the current fixed rate regime, given the large currency imbalances now within the system. This thinking was reflected in the pages of influential weekly journals such as The Economist. Here, the virtues of floating had been proclaimed for some time, on the grounds that they permitted automatic adjustment to disequilibria, and therefore made unnecessary both dramatic IMF and central bank support deals and recourse to credit squeezes and import and exchange controls by states facing speculative attacks on their currency¹⁰⁸. In addition, however, there was within the Treasury an outburst of gloom about whether the devaluation of sterling had worked, prompting concern that \$2.40 was now too high¹⁰⁹.

Jenkins regarded all these views as 'defeatism'. He was confident that that the devaluation had worked. To agree to a reduction in the sterling rate now would 'be to throw away victory just when we were achieving it'¹¹⁰, a view confirmed by excellent July and August trade figures. Far from accepting the new thinking, Jenkins told the IMF Annual General Meeting in late September that he favoured fixed rates. There was, he argued, a case for a wider margin either side of parity rather than the 1 per cent

which was currently allowed (he favoured 2 per cent). But floating rates were neither 'desirable' nor 'durable', said the Chancellor. He maintained that most economies now had foreign trade sectors which were so large that national governments would not wish to surrender control of exchange rates to market forces. At the same time the growth of trade had generated economic interdependence between nations, and this would be undermined by floating rates¹¹¹.

All the objective evidence about what was happening to the economy backed Jenkins. Since November 1967 the government had striven with success to switch resources into the export sector. Its achievement was now recognised within the IMF¹¹², the Bundesbank and the US Treasury¹¹³. Yet the price of 90 day forward sterling remained almost four cents below par. The problem was that the fate of the currency was not within its complete control but dependent on external events. This became obvious when sterling began a strong recovery after 29 September, the day a new West German government, now a Centre-Left coalition of the Social Democrats and the Free Democrats, allowed the deutschmark to float. As expected the deutschmark moved up, and its new level was confirmed on 24 October when a 9.29 per cent revaluation was announced. The effect of the new deutschmark rate was to put a temporary end to the speculative waves which had been afflicting the international economy for the best part of the decade. Sterling's three month forward rate jumped, reaching the same level as in the spot market. By mid October it exceeded \$2.39, where it remained (occasionally reaching parity) for the rest of Labour's time in power.



Sterling's freedom from turbulence was a function in part of the government's achievement but also of greater international economic stability. Economic historians and other commentators have argued that the upheavals of 1967-69 marked the beginning of the end for the Bretton Woods system of fixed exchange rates, which finally collapsed between 1971 and 1973¹¹⁴. Yet it did not seem at the time as if an era was drawing to a close. Indeed, 1969 appeared to have been the year when important and constructive improvements had been made to the Bretton Woods order. September saw the launching of Special Drawing Rights (SDR), to be managed by the IMF. The SDR was the outcome of the discussions about international liquidity which had started in the early 1960s. Its creation involved an addition of \$49 billion to global reserves; it

was a supplement to international liquidity which did not add to the global surplus of dollars and thus to the growing volume of mobile short-term capital. The SDR was, therefore, intended to promote an international economic system which harmonised exchange rate stability, open trade and convertible currencies, and national expansion. The BIS, pointing to this reform, to the British surplus and to the franc and deutschmark exchange rate realignments, argued that the international monetary system had finished an 'eventful' year in a sounder condition than at the start¹¹⁵.

This more stable external environment allowed Labour to complete its post devaluation strategy successfully. Labour had fallen short of the growth target in the National Plan of 1965, but much of the agenda contained within that document was being pursued. Expenditure on roads, housing, education and health had all increased broadly if not exactly in line with the projections in the Plan, while defence had been held down¹¹⁶. By March 1970 the combination of large external surpluses (£554 million in 1969, with an even more sizeable one expected for the current year¹¹⁷) and expectations of sustained growth running at 3 per cent had led the OECD to declare that Britain was 'no longer a problem country'¹¹⁸. By the spring of 1970, all outstanding short and medium term obligations had been met; this included \$1400m borrowed from the IMF in May 1965, the last instalment of which was repaid two months ahead of schedule at the end of March¹¹⁹. The achievement came at a high political cost: the restraints on private consumption which had been necessary to ensure Labour met its objectives are generally held to have cost it the 1970 general election¹²⁰. It was the Conservative Party which inherited the opportunity for sustained expansion Labour had struggled to create.

VIII

The events of 1968-69 had represented a major challenge to the Labour government because they threatened to result in the collapse of the external environment which supported British social democracy. The recurrent shocks to sterling in 1968-69 stemmed from the failure of the November 1967 devaluation to stabilise the foreign exchange markets, partly because these were unconvinced that Labour's initial response would deliver the scale of external surplus required to lift sterling out of further danger. But during the course of 1968 the leading cause of sterling's woes became the interaction between the dollar, the franc and the deutschmark and the Eurodollar market. The existence of currency rates which did not reflect the current account positions of the economies in question gave the growing volume of Eurodollar balances the chance to move from one financial centre to another in search of speculative reward. In the absence of international co-operation Britain could only have insulated itself from the shocks involved in these movements by measures such as Brutus or Priam, which involved the abandonment of liberal socialism, or by the adoption of floating rates mitigated by severe deflation. In either case, a repudiation of the post-1945 social democratic synthesis would have been necessary.

Labour's own macroeconomic strategy, in combination with the Basle arrangements and the French and German currency moves, had averted the need for such drastic action. But the stability which returned to the international financial system late in 1969

was transient. The problem of the US deficit remained, although in 1968-69 the position was masked by capital inflows, attracted by higher interest rates in the USA than in Western Europe. In 1970 and 1971, however, these were reversed as the US authorities responded to sluggish growth by cutting taxes and interest rates. Capital flooded back to Europe as a result. European governments, worried that the incoming funds were either going to force unwanted exchange rate revaluations (which would be damaging for exports) or unwelcome credit booms, vainly called for the USA to adjust to its deficit by raising taxes and interest rates. By 1971 the USA was running a current account deficit of \$3.8 billion, while the capital account was \$26.9 billion in the red¹²¹. There was a renewal of international anxiety about the ability of the USA to honour dollar-gold convertibility, and the spring and summer of 1971 saw vigorous speculation in favour of most other currencies in the Group of Ten. The Germans, Dutch and Belgians floated against the dollar, while the Swiss and Austrians revalued. Finally, with the price of gold in the private market by August 1971 reaching \$44 to the ounce, the USA abandoned dollar-gold convertibility and introduced a 10 per cent import tax rather than embark on a tough deflationary programme. Sterling itself became a fully floating currency in June 1972.

All this marked the collapse of the Bretton Woods order. The continued compatibility of fixed rates, an open trading system and domestic expansion after 1945 had become unsustainable. In the circumstances, governments now found it easiest to adjust to payments imbalances by allowing exchange rates to take the strain. There was no economy large enough to replace the role of creditor played by the United States in the

generation after 1945. Promising though the SDR was, it was not capable of supporting the Bretton Woods system: its first issue came in January 1970, under the management of the IMF. The total of \$49 billion was more modest than it seemed, since the release was to be spread over a three year period. In any case, by 1970 the chief threat to Bretton Woods lay in the excess of liquidity being generated by the US deficit, a problem which could only be solved within the Bretton Woods parameters by deflation in the USA, or by some combination of multilateral exchange rate realignment and more rapid expansion on the part of the Europeans and the Japanese. Not one of these options was acceptable to all parties. As a result, the members of the Group of Ten opted to sacrifice fixed rates rather than full employment and a participation in the global trading system which had delivered abundant rewards, in terms of what Alan Milward has called 'increasing ease of life', to working populations¹²².

At first, as an international boom developed in 1970-73, it seemed as if the anxieties expressed about the implications of floating in the late 1960s had been seriously overcooked. Floating rates appeared capable of providing an environment which had all the advantages of Bretton Woods without the disadvantages. But the coming of the oil price shock in 1973-74 led to the appearance of currency disequilibria so large that it became increasingly hard to reconcile floating rates with open trade and international expansion. Labour, back in power from 1974, was to face the reappearance of the dilemma which had threatened it in 1967-69: the preservation of domestic expansion and high levels of employment behind protectionist barriers, or continued engagement

with the open international trading system, at the price of domestic deflation and the erosion of national economic sovereignty by market forces.

The Wilson and Callaghan governments of 1974-79 succeeded in avoiding having to make this choice. Callaghan's famous 1976 Labour Party Conference speech, despite appearing to reject Keynesianism, did not involve a philosophical breach with the post-1945 politico-economic tradition¹²³. But the cost of sustaining the Keynesian synthesis, involving restraints on personal income and public expenditure, as well as unemployment at just over 5 per cent of the work force (at the time a post-1945 high)¹²⁴, led to the collapse of support for it within the Labour Party. In 1981 the party split. A significant fraction of those who considered themselves Keynesians and liberal socialists (Roy Jenkins amongst them) left to join the new Social Democratic Party. The majority which was left behind adopted, not always enthusiastically,¹²⁵ the Alternative Economic Strategy (AES) which involved extensions of public ownership, economic planning, and controls on imports and on the movement of capital. The main condition of the AES was 'the substantial severing of the ties which bind the British economy to the world economy', in order to establish a 'full economic sovereignty' designed to protect policy from being 'undermined by foreign pressures'¹²⁶. The origins of this schism can be traced to the slow disintegration of the Bretton Woods order, which as it unravelled had slowly destabilised the external environment congenial to British social democracy.

It is not clear that the contradiction between increasingly free global trade and capital markets and the pursuit of economic growth and full employment by national governments can be resolved in the absence both of international support for debtor countries and of agreed arrangements to facilitate smooth adjustments to exchange rate disequilibria (a problem highlighted by the current crisis in the Euro group). Since the end of the 1970s the question for the Left in Britain and beyond has become how, and on what terms, co-existence between national social democracy and an open world economy can be managed¹²⁷. The electoral failure of the AES in 1983 led to a gradual accommodation between the British Labour Party and an international economy moving rapidly towards globalization. The result was the liberal political economy of New Labour, a synthesis now facing its own crisis as a result of the breakdown, albeit possibly temporary, of the external environment which sustained it¹²⁸.

¹ This article is part of an ESRC-funded research project on ‘The Labour Governments, 1964-70, and the international economy’.

² Alec Cairncross and Barry Eichengreen, Sterling in Decline: the devaluations of 1931, 1949 and 1967 (Oxford, 1983), pp. 210-212.

³ Gianni Toniolo, Central Bank Co-operation at the Bank for International Settlements, 1930-1973 (Cambridge, 2005), p. 399.

⁴ Michael Oliver and Arran Hamilton, 'Downhill from Devaluation: The battle for sterling 1968-72', Economic History Review, vol. 60, no. 3 (2007), pp 486-512.

⁵ TNA T318/201, minute by Wiles, 'EEA's forward liabilities at devaluation', 20 October 1968.

⁶ TNA T318/191, 'UK Reserves and Borrowing, late February 1968.

⁷ TNA T318/191: Bank of England paper by Morse on 'Extending the Basle Arrangements', 14 February 1968.

⁸ TNA CAB128/39, CC (65)41, 27 July 1965.

⁹ Charles A. Coombs (New York, 1976), p. 133.

¹⁰ Scott Newton, The Global Economy 1944-2000. The Limits of Ideology (London, 2004), p. 80.

¹¹ Harold Wilson, Purpose in Politics (London, 1964), p. 209.

¹² TNA 267/35, Treasury Historical Memorandum 25, 'International liquidity: an account of the negotiations leading up to the creation of special drawing rights in the International Monetary Fund 1962-1968', pp. 59-60.

-
- ¹³ TNA T267/35, 'International Liquidity', pp. 2-3 and p. 133.
- ¹⁴ Newton, The Global Economy, pp.7-16; TNA T267/35, 'International Liquidity', pp.2, 106.
- ¹⁵ Scott Newton, 'Britain, the sterling area and European integration 1945-50', Journal of Imperial and Commonwealth History, XIII (1985), pp. 164-5.
- ¹⁶ The National Plan (Cmnd. 2764, London 1965), p. 2, paragraphs 10-12.
- ¹⁷ FRUS 1964-68, VIII, document 19, 'Visit of Prime Minister Harold Wilson: international economic situation', 4 December 1964.
- ¹⁸ Toniolo, Central Bank Co-operation, p. 388.
- ¹⁹ Catherine Schenk, 'Sterling, International Monetary Reform and Britain's Application to Join the European Economic Community in the 1960s', Contemporary European History, II, 3 (2002), 350-2.
- ²⁰ Newton, The Global Economy, p. 94.
- ²¹ *Ibid*, p. 88.
- ²² TNA PREM 13/866, Kahn Enquiry, 9.

²³ TNA PREM13/866, Kahn Enquiry, p. 7; Scott Newton, 'The two sterling crises of 1964 and the decision not to devalue', Economic History Review, vol. 62, no. 1 (2009), pp. 90-91.

²⁴ Newton 2009, p. 93.

²⁵ TNA T295/905, 'Lord Kahn's enquiry into the position of sterling, January 1966-February 1968, vol. II, p. 33; TNA T295/904, 'Lord Kahn's enquiry into the position of sterling, January 1966-February 1968', vol. I, p. 39.

²⁶ TNA T312/2542, Report by a Group of Advisers, 'Problems of economic strategy following devaluation', undated but November 1967.

²⁷ See for example TNA PREM 13/2138, 'Economic strategy post devaluation: switch of resources into exports', memorandum by the Prime Minister, 30 April 1968.

²⁸ TNA PREM 13/1447, letter from O'Brien to Callaghan (Chancellor of the Exchequer), 17 November 1967.

²⁹ Bank of England OV 44/140, letter from O'Brien to Roy Jenkins (now Chancellor), 12 December 1967.

³⁰ TNA T312/2549, paper by McMahon (Bank of England) on 'The question of planning for floating'.

³¹ TNA T277/1943, summary of discussions held in the Treasury with Van Lennep and Dow on 21 December 1967.

³² Alec Cairncross, The Wilson Years: a Treasury Diary 1964-69 (London, 1997), p. 260, entry for 19 December 1967.

³³ Roy Jenkins, Life at the Centre (London, 1991), pp. 220-8; Harold Wilson, The Labour Governments, 1964-70 (London, 1971), pp. 479-486.

³⁴ TNA T277/2052, meeting of OECD Working Party no. 3, 31 January 1968.

³⁵ Scott Newton, 'Harold Wilson, the Bank of England, and the Cecil King 'coup' of May 1968', Lobster, 56 (2008), p. 4.

³⁶ See Cecil King, The Cecil King Diaries 1965-70 (London, 1972), pp. 171-2 (entry for 25 January 1968) and p. 175, (entry for 13 February 1968).

³⁷ Frances Cairncross, 'Imports put the brake on Britain's progress', The Times, 26 July 1968, p. 25 col. C.

³⁸ Oliver and Hamilton, 'Downhill from Devaluation', p. 489.

³⁹ 'Britain's trade deficit doubles: imports leap', 'Fixed Interest', The Times, 14 March 1968, p. 27, col. A.

⁴⁰ 'Very big demand for gold', The Times, 14 March 1968, p. 27, col. G.

⁴¹ Peter Jay, 'OECD urges Jenkins to make sharp increases in tax rates', The Times, 8 March 1968, p. 17, col. B.

⁴² Peter Jay, 'Jenkins to the rescue', The Times 20 March 1968, p. 25, col. C. The emphasis is in the original.

⁴³ TNA T267/36, Treasury Historical Memorandum, 'The collapse of the Bretton Woods system, 1968-1973, p. 3.

⁴⁴ TNA T267/36, 'The collapse of the Bretton Woods system', p. 3.

⁴⁵ TNA PREM 13/2050, master copy of telegram from Wilson to President Johnson, 15 March 1968; TNA T267/36, 'The collapse of the Bretton Woods system', pp. 3-4.

⁴⁶ See for example TNA CAB 147/13, 'The Economic Outlook', Anstee to Hall, 9 July 1968.

⁴⁷ The detailed story of this affair has been told by Arran Hamilton in 'Beyond the Sterling Devaluation: the Gold Crisis of March 1968', Contemporary European History (2008), 17:73-95.

⁴⁸ See Francis J. Gavin, Gold, dollars and power. The politics of international monetary relations 1958-71 (Chapel Hill and London, 2004), pp. 178-80.

⁴⁹ Robert Solomon, The International Monetary System, 1945-1976 (New York and London, 1976), p. 117.

⁵⁰ 'The pound hits new low', The Times, 15 March 1968, p. 26, col. E.

⁵¹ TNA T318/191, C. J. Wiles, 'Credit Facilities: position at 15 March', 15 March 1968.

⁵² TNA T318/178, C. J. Wiles, 'Report for 18-22 March', 25 March 1968.

⁵³ Oliver and Hamilton, 'Downhill from devaluation', p. 490.

⁵⁴ TNA T318/191, Goldman, 'Sterling below \$2.38 in New York', 19 March 1968.

⁵⁵ TNA PREM 13/2051, Balogh to Prime Minister, 'Note for the record', 16 March 1968.

⁵⁶ Cairncross, The Wilson Years, entry for 15 March, p. 178.

⁵⁷ TNA T318/178, Copeman to Goldman, 20 March 1968.

⁵⁸ TNA PREM 13/ 2051, Balogh, 'Note for the Record', 16 March 1968...

⁵⁹ TNA CAB 128/46, note of a meeting at no. 10 Downing Street, 1.15 a. m., 15 March 1968.

⁶⁰ Jenkins, Life at the Centre (London, 1991), p. 241.

⁶¹ TNA PREM 13/2051, note by Treasury, 'Contingency Planning', 16 March 1968

⁶² Jenkins, Life at the Centre, p. 241.

⁶³ TNA PREM 13/2051, note by Treasury, 'Contingency Planning', 16 March 1968.

⁶⁴ CAB 128/46, CC (68) 21st conclusions (Confidential Annex), 15 March, 1968.

⁶⁵ TNA PREM 13/2052, note by Allen, 'Contingency Planning: Operation Brutus', 20 March, 1968; 'Brutus: Travel; Cash Gifts; Emigrants', minute of 20 June 1968.

⁶⁶ TNA PREM 13/2051, 'Operation Brutus', 16 March 1968.

⁶⁷ TNA PREM 13/ 2051, Balogh, 'Note for the Record', 16 March 1968.

⁶⁸ TNA T312/2549, paper by McMahon on 'The question of planning for floating', 20 December 1967.

⁶⁹ TNA PREM 13/2051, 'Blocking', 17 March 1968. The £2 billion figure was a Bank of England estimate.

⁷⁰ TNA T312/2549, paper by McMahon on 'The question of planning for floating', 20 December 1967.

⁷¹ TNA PREM 13/2051, 'The Consequences of Floating', 16 March 1968.

⁷² TNA T267/21, 'The Gold Crisis March 1968', p. 19.

⁷³ Wilson, The Labour Government, p. 512; Solomon, The International Monetary System, p. 121.

⁷⁴ TNA T267/21, Treasury Historical Memorandum on the International Gold Crisis, p. 19.

⁷⁵ *Ibid*, p. 21.

⁷⁶ 'Gains for Pound and Dollar', The Times, 18 March 1968, p. 1. col. D.

⁷⁷ TNA T267/33, Treasury Historical Memorandum, 'The 1968 Sterling Agreements', pp. 8-9.

⁷⁸ Ibid, pp. 15-25

⁷⁹ Toniolo, Central Bank Co-operation, p. 425

⁸⁰ 'A Year at \$2.40', The Economist, 16 November 1968

⁸¹ BIS, Thirty-Ninth Annual Report (1969), p. 10

⁸² BIS, Thirty-Ninth Annual Report, p. 3.

⁸³ Hubert Zimmerman, 'West German monetary policy and the transition to flexible exchange rates, 1969-73', in David M. Andrews (editor), Orderly change: international monetary relations since Bretton Woods (Ithaca and London, 2008), p. 163.

⁸⁴ Bank for International Settlements (BIS), Thirty-Ninth Annual Report (Basle, 1969), p. 11.

⁸⁵ Zimmerman, 'West German monetary policy', p. 156.

⁸⁶ BIS, Thirty-Ninth Annual Report, p. 15.

⁸⁷ BIS, Thirty-Ninth Annual Report, p. 17.

⁸⁸ Cairncross, The Wilson Years, p. 343, entry for 18 November.

⁸⁹ 'Bonn's Crisis Meeting', The Times, Thursday, Nov 21, 1968; pg. 11; Issue 57414; col. A.

⁹⁰ Zimmerman, 'West German monetary policy', p. 162.

⁹¹ TNA T132/2542, 'Contingency planning: Priam', undated but late October or early November 1968.

⁹² 'Scramble for D-Marks hits franc, pound and dollar', Anthony Thomas, The Times, 16 November, p. 13, col. A.

⁹³ Jenkins, Life at the Centre, p. 262.

⁹⁴ TNA PREM 13/2054, Jenkins to Prime Minister, 13 November 1968.

⁹⁵ Oliver and Hamilton, 'Downhill from devaluation', p. 496.

⁹⁶ TNA T312/2548, 'Note for the record: Priam', 19 November 1968; 'Priam: impact on sterling and action by HMG', undated.

⁹⁷ TNA T312/2548, 'Priam – accompanying measures', note by McMahon, 22 October 1968.

⁹⁸ TNA T267/36, 'The collapse of the Bretton Woods system' p. 11.

⁹⁹ TNA T312/2542, 'Priam: Talks with the Americans', 11 November 1968; anon., 'Priam: Impact on Sterling and Action by HMG', undated, January 1969'

¹⁰⁰ TNA T312/2542, 'Contingency planning: Priam', undated but October 1968.

¹⁰¹ Jenkins, Life at the Centre, p. 263; Wilson, The Labour government 1964-70, p. 583.

¹⁰² TNA T277/2052, minutes of OECD Working Party 3 meeting held in Paris on 19 December 1968.

¹⁰³ TNA CAB134/3201, SEP (68), 29th meeting, 4 December 1968.

¹⁰⁴ Barbara Castle, The Castle Diaries 1964-1976 (London, 1990), entry for 4 December, pp. 282-3.

¹⁰⁵ TNA CAB 134/ 3201, SEP (68) 29th meeting, 4 December 1968.

¹⁰⁶ Ibid.

¹⁰⁷ TNA T267/36, p. 20; Jenkins, Life at the Centre, p. 281.

¹⁰⁸ For example, 'A Float for Freedom', The Economist, 4 October 1969, pp. 14-15.

¹⁰⁹ TNA T312/2549, J. H. Williamson, 'Is \$2.40 right?', 4 July 1969.

¹¹⁰ Jenkins, Life at the Centre, p. 282.

¹¹¹ TNA 267/36, 'The Collapse of the Bretton Wood System, 1967-1973, p. 29.

¹¹² Anthony Thomas, 'Britain is to draw on its IMF credit next month', The Times, 16 August 1969, p. 13, col. B.

¹¹³ Jenkins, Life at the Centre, p. 283

¹¹⁴ See for example Scott Newton, The Global Economy, p. 97.

¹¹⁵ BIS, Fortieth Annual Report (Basle, 1970), pp. 3-7.

¹¹⁶ The National Plan, pp. 177-9 and table 18.1, p. 178, provides the projections. Tomlinson, The Labour governments, table 9.1, p. 202 shows the out-turn.

¹¹⁷ Roger Middleton, The British Economy since 1945 (Basingstoke, 2000), Table II.3, p. 150-1.

¹¹⁸ Peter Jay, 'UK "no longer a problem country"', The Times, 6 March 1970.

¹¹⁹ Anthony Thomas, '\$338m repaid to IMF 2 months early', The Times, 2 April 1970, p. 17, col. E

¹²⁰ Scott Newton and Dilwyn Porter, Modernization Frustrated: the politics of industrial decline in Britain since 1900 (London, 1988), p. 159

¹²¹ Herman Van der Wee, Prosperity and Upheaval: The World Economy 1945-1980 (London, 1987, p. 451, table 37

¹²² Newton, The Global Economy, p. 63; Alan S. Milward, The European Rescue of the Nation-State (London, 2000), p. 129-30, p. 367ff.

¹²³ William Keegan, Mrs Thatcher's Economic Experiment (London, 1984), pp. 89-91; Ben Clift and Jim Tomlinson, 'Negotiating Credibility: Britain and the International Monetary Fund, 1956-1976', Contemporary European History, vol. 17, no. 4, (2008), p. 346.

¹²⁴ Unemployment between 1974-79 reached its highest level in 1978, when it amounted to 5.6 per cent of the workforce. When Labour left office the following year it was 5.3 per cent. Thereafter it rapidly climbed into double figures, peaking at 11.9 per cent in 1984. It did not

fall back to the levels seen in the 1970s until 2000 (Office of National Statistics, Time Series Data, 'Unemployment Rate: UK: all: aged 16 and over (%)').

¹²⁵ David Kogan and Maurice Kogan, The Battle for the Labour Party (London, 1982), and Austin Mitchell, Four Years in the Death of the Labour Party (London, 1983), provide two powerful expressions of this disillusionment with the politics and economics of the AES on the part of social democrats who remained in the Labour Party after 1981.

¹²⁶ Michael Newman, Socialism and European Unity. The dilemma of the Left in Britain and France (London, 1983), p. 265.

¹²⁷ Jim Tomlinson, 'Tale of a Death Exaggerated: How Keynesian Policies Survived the 1970s', Contemporary British History, 21, 4 (2007), 429-48.

¹²⁸ Scott Newton, 'UK manufacturing decline is the real story of the Budget', History and Policy, May 2009, http://www.historyandpolicy.org/opinion/opinion_07.html