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## *The Sterling Devaluation of 1967, the International Economy and Post-War Social Democracy\**

THE Labour government of Harold Wilson devalued sterling from £1 = \$2.80 to £1 = \$2.40 on 18 November 1967. It had come to power in 1964 committed to the modernisation of Britain to be achieved by an average annual growth in the economy up to 1970 of 3.8 per cent. The vehicle for this transformation was to be the National Plan, in which the government was to co-operate with industry and the unions to increase both private and public investment, with rises in income held to what could be justified by improvements in productivity. Wilson's government had, however, been immediately confronted by a large current account deficit following a period of sustained economic expansion by the preceding Conservative administration. That deficit was estimated at the time to be approaching £800m, but later revised down to nearer £300m. Labour's attempts to turn round this position at the existing sterling parity of £1 = \$2.80 failed to win the confidence of the financial markets, and the pound came under pressure. The defence of the parity, reinforced by borrowing from central banks and the International Monetary Fund (IMF), became the major preoccupation of the government's economic policy. The National Plan was eclipsed by an economic strategy based on a vain effort to satisfy creditors.

From the moment of the devaluation, there has been a consensus, only recently challenged, that the devaluation came too late. Indeed, Fred Hirsch had already argued in 1965 that devaluation in 1964 would have stimulated exports with favourable results following for the balance of payments current account. His viewpoint was shared by Michael Stewart,<sup>1</sup> who was an economic adviser to the Labour government. For Stewart, there was evidence that British exports had become steadily less competitive since the 1950s as a result of slow productivity growth. The obvious solution was devaluation so that the price of British goods in foreign markets would fall relative to those of the country's competitors, and the profit margins resulting from exports would increase.<sup>2</sup> Alec Cairncross and Barry Eichengreen argued that the political and

\*I would like to thank an anonymous referee for helpful comments on this article, which is based on a research project funded by the Economic and Social Research Council on the 1964–70 Labour governments and the international economy.

1. F. Hirsch, *The Pound Sterling: A Polemic* (London, 1965); J. Leruez, *Economic Planning and Politics in Britain* (London, 1975); M. Stewart, *The Jekyll and Hyde Years. Politics and Economic Policy in Britain since 1964* (London, 1977).

2. Stewart, *Jekyll and Hyde Years*, 30.

economic case for devaluation may not in fact have been convincing in 1964 but there was no doubt that it was time to act by the spring of 1967 with the share of both the domestic and the world markets taken by British goods slipping.<sup>3</sup> Clive Ponting supported this case, and maintained that the underlying economic situation facing the country was as bad in November 1967 as it had been in October 1964.<sup>4</sup> Keith Middlemas claimed that the Government continued to resist devaluation during the summer of 1967 when its inevitability was obvious to investors as well as to speculators, while Wilson himself fought it to the end, trying in November to ‘stampede the US authorities into a final \$1,000m rescue operation’.<sup>5</sup> Gianni Toniolo<sup>6</sup> argued that Labour devalued only because Wilson and James Callaghan, Chancellor of the Exchequer, were unable to drum up the external support which had saved sterling in each of the previous three years.

There are, however, signs of a shift towards more favourable views, possibly influenced by the release of previously confidential Government papers covering the 1960s. The work of T. Thirlwall was central to this process, but remained rather isolated until Roger Middleton and Jim Tomlinson showed that the case for devaluation in 1964 or 1966 was by no means conclusive.<sup>7</sup> Their arguments were supported by the work of T. Bale, who pointed to the political constraints on the government, and of Glenn O’Hara<sup>8</sup> who drew attention to the positive record of the Wilson governments measured by investment in science, education and industry. I have suggested that Labour’s reliance on external support for sterling was justifiable given that the currency’s difficulties could not be attributed simply to defects in economic policy or performance, but rather to increasing international financial instability.<sup>9</sup>

This article aims to take the revision a stage further. After setting out the conventional wisdom surrounding devaluation, it reassesses the evidence upon which this is based. It examines the extent to which

3. A. Cairncross and B. Eichengreen, *Sterling in Decline. The Devaluations of 1931, 1949 and 1967* (Oxford, 1983), 213–17.

4. C. Ponting, *Breach of Promise* (London, 1989), 295.

5. K. Middlemas, *Power, Competition and the State. II: Threats to the Post-War Settlement, 1961–74* (Basingstoke, 1990), 190–1.

6. G. Toniolo (with the assistance of Piet Clement), *Central Bank Co-operation at the Bank for International Settlements, 1930–73* (Cambridge, 2005), 398–9.

7. R. Middleton, *Charlatans or Saviours? Economists and the British Economy from Marshall to Meade* (Cheltenham, 1998), 262; T. Thirlwall, *Balance-of-Payments Theory and the United Kingdom Experience* (Basingstoke, 1986), 186–9; J. Tomlinson, *The Labour Governments, 1964–70*, III, *Economic Policy* (Manchester, 2004), 223–4.

8. T. Bale, ‘Dynamics of a Non-Decision: The “failure” to devalue the pound, 1964–7’, *Twentieth Century British History*, x (1999), 192–217; G. O’Hara, ‘“Dynamic, Exciting, Thrilling Change”: The Wilson Government’s Economic Policies, 1964–70’, *Contemporary British History*, xx (2006), 383–402.

9. S. Newton, ‘The Two Sterling Crises of 1964 and the Decision not to Devalue’, *Economic History Review*, lxii (2009), 73–98.

difficulties on the balance of payments current and capital accounts undermined the pound in 1967. Following a discussion of the government's response to the developing pressure on sterling in 1967, it considers whether devaluation should have come earlier than 18 November and whether the decision to devalue was forced or deliberate. Its conclusions reinforce my analysis of the 1964 sterling crisis in finding that the 1967 devaluation followed neither from policy mistakes by the government nor from the performance of the balance of payments current account. Rather, it was a response to changes within the international economy corrosive of the environment which had sustained the post-war social–democratic synthesis of liberalism and socialism.

Britain's weak external position in 1964–67 was not only a function of the current account deficit Labour had inherited. It was compounded by the existence of £4.5 billion in sterling balances banked in London and owned by overseas governments, corporations and individuals. These obligations had developed after the Conservative governments of 1951–64 had promoted the use of the pound sterling as a trading and reserve currency. During the 1950s, it was estimated that the international use of sterling contributed about 10 per cent of the national income.<sup>10</sup> The introduction of sterling convertibility for current transactions at the end of 1958 confirmed London's position as Europe's most liberal international financial centre, and by 1964 the volume of the sterling balances was equivalent to about one-eighth of Gross National Product.<sup>11</sup> Schenk has demonstrated that these balances showed no noticeable tendency to volatility in the 1950s.<sup>12</sup> But the position changed in the 1960s. The growth of the external deficit, combined with the ambitious plans of the new Labour government, led holders of sterling to start becoming anxious about whether the liabilities were adequately covered. They were not reassured by limited liquid assets and reserves of gold and foreign currency worth just £909m. This concern led to especially intense speculation against the pound in November 1964, July to August 1965, July to August 1966 and again in October to November 1967. If Labour's policies failed to lift the balance of payments permanently out of the red, for how long would it be possible for Britain to bridge the gap between its reserves and its liabilities at the current rate of exchange? This was the question which led sterling to be deserted in favour of alternatives, notably dollars or deutschmarks.

10. A. Milward, *The European Rescue of the Nation State* (London, 2000), 389.

11. S. Newton, 'Wilson and Sterling in 1964', *Lobster*, xlix (2005), 14.

12. C. Schenk, *Britain and the Sterling Area: From Devaluation to Convertibility in the 1950s* (London, 1994), 25ff, 130–1.

Wilson had made it very clear that he was determined to stick to the \$2.80 parity. He did not wish Labour, in power when sterling had been devalued in 1931 and 1949, to be considered 'the party of devaluation'. Commentators have alleged that Wilson wished to preserve Labour from political embarrassment. Whatever the truth of this, it is on the record that, first of all, both he and Callaghan knew devaluation could not succeed in the absence of measures to deflate demand in the economy; and secondly, they were concerned that devaluation would mean reduced real wages, and therefore weaken efforts to win the unions to the cause of wage restraint. The government therefore attempted to steer resources into exports without pressing down too hard on domestic activity.<sup>13</sup>

This struggle to close the current account deficit was monitored by Working Party 3 of the Organisation for Economic Co-operation and Development (OECD). The OECD, composed of the leading industrial states, exercised 'multilateral surveillance' over economies running either large external deficits or surpluses, and attempted to produce a consensus view on how they could be urged to return to a more balanced position. The senior Dutch financier, Emile Van Lennep (Treasurer-General and Dutch government delegate to OECD), was arguing as early as 1964 that the pound was overvalued.<sup>14</sup> The Labour government, however, borrowed heavily from the IMF, from the central banks of the Group of Ten (composed of the six nations making up the European Economic Community (EEC), together with the UK, USA, Canada and Sweden, with the Swiss becoming associate members in 1964) and from the Bank for International Settlements (BIS) in Basle in order to provide itself with financial reserves large enough to protect the exchange rate while it attempted to transform the economy. A large part of this borrowing came under the heading of 'swap agreements', by which central banks extended short-term (usually three months, renewable) credit facilities to each other. The Bank of England made especially heavy use of swap facilities in sterling's favour at the Federal Reserve Bank of New York, and these were steadily increased between 1964 and 1967. This external support was accompanied by two deflationary packages, in July 1965 and twelve months later.

The accepted narrative of the 1967 devaluation holds that with the July 1966 measures the government put modernisation of the economy below the restoration of confidence in sterling on the part of foreign creditors and the foreign exchange markets. The package aimed to cut domestic demand by 1.72 per cent of GDP by the end of 1967 so that

13. Bale, 'Dynamics of a Non-Decision', 199–203.

14. J. Callaghan, *Time and Chance* (London, 1987), 171.

production would shift more to the export sector. This reduction of demand was intended not only to reduce imports but also to turn the tide in favour of sterling by providing a demonstration of Labour's determination to take undesirable steps to defend the pound. It underpinned a modified economic strategy for the period to 1970 designed to balance annual surpluses of at least £100m with annual growth of 3 per cent and unemployment at slightly over 2 per cent. The measures certainly gave the *coup de grace* to the growth targets in the National Plan, but for a time they did appear to be achieving their objectives. From October 1966, the trade figures stayed in the black for six months in a row. Moreover, less deflation had been involved than would have followed from devaluation at the time, which the Treasury estimated would have required reduction of demand by 2 per cent, or slightly more, of GDP.<sup>15</sup>

This modification of economic strategy seemed to survive a perceptible slowdown in world trade during the first half of 1967. The balance of payments remained in surplus. A significant reduction of external debt was achieved, with all swap facilities drawn on to support the reserves in the summer of 1966 having been reconstituted by the end of April. In May, the government repaid to the IMF, ahead of schedule, £145m of the £357m it had borrowed at the end of 1964. The action was well received, and the Fund signalled its confidence by encouraging countries borrowing from it to draw sterling.<sup>16</sup> By May to June 1967, the government's attention was concentrated on action to prevent unemployment, which had almost doubled over the previous twelve months from 280,000 (1.2%) to 540,000 from rising further. The rate of 2.3 per cent was slightly above the target; given the improved external position it now seemed appropriate to consider selective reflation. The OECD Secretariat supported the modified strategy, and having over the past three years spent a good deal of time on the problems of sterling and the British economy, now became preoccupied instead with the impact of deceleration in West Germany on international trade.<sup>17</sup> A Bank Rate cut from 6 per cent to 5.5 per cent in May was generally welcomed: *The Times*, noting the favourable external position and the 'depressed' state of industrial activity, argued that 'a further mild shot in the arm is not out of place'.<sup>18</sup>

It is at this point that the recovery appeared to stall. After a promising start to the year, exports dropped back in the second and third quarters, and slumped dramatically in the last one. Imports, however, increased

15. T[he] N[at]ional A[rchives], P[ublic] R[ecord O]ffice, T312/1635, 'Accompanying Measures', draft by Godley and Atkinson, 22 Aug 1966.

16. 'IMF aid for sterling', *The Times*, 15 May 1967, 21, col. B.

17. TNA, PRO, T277/1943, meetings of WP 3, especially meetings on 1-3 Mar and 19-20 July.

18. 'Good Reasons for Bank Rate Cut', *The Times*, 5 May 1967, 23, col. A.

from £1463m in the first quarter to £1559m, a record, in the fourth. Their buoyancy was taken as an indicator that domestic producers were failing to address foreign competition. There was now no likelihood of a trade surplus in 1967 and prospects for a surplus in 1968 were rapidly diminishing. During the summer, the government attempted to boost demand via selective reflation, relying on hire purchase relaxations and on modest public spending increases. These led to rises of 3 per cent in retail sales in the second half of the year compared with the first half,<sup>19</sup> which fed the demand for imports and worsened the trade deficit.

The decision to pursue reflationary measures when the trade position was so precarious led foreign central bankers to draw the conclusion that the government now rated the reduction of unemployment as a higher priority than saving the exchange rate.<sup>20</sup> Such suspicions, in conjunction with the reappearance of pressure on the balance of payments, eroded confidence in sterling on the foreign exchange markets, a problem exacerbated by the implications of the decision (announced in May) to apply for membership of the EEC. There was a general expectation, encouraged by statements on the part of the French government, that devaluation would be a necessary accompaniment to British entry into the EEC; the subject of a change in the exchange rate became discussed in the press and in Parliament, a development which contributed to the mounting speculation against sterling. Selling of the currency increased in the autumn. The drain on the reserves accelerated to £500m in the third quarter, almost as much as at the end of 1964.<sup>21</sup> The Bank of England, acting through the Exchange Equalisation Account (EEA), countered the sale of sterling at a discount by guaranteeing holders that it would honour the parity three months later. Between September and the end of November, its obligations under this heading increased by £699m.<sup>22</sup>

By mid-October, the government was running out of options. Alec Cairncross, Head of the Government Economic Service, had several weeks earlier come to the conclusion that the gold and foreign exchange reserves would dribble away unless there was early action to improve the trade position and therefore the balance of payments. Either the government had to restrict imports through quotas, or it would have to devalue the pound so that the price mechanism could check import growth while encouraging a rise in exports.<sup>23</sup> Devaluation might take

19. Cairncross and Eichengreen, *Sterling in Decline*, 187ff.

20. C. Coombs, *The Arena of International Finance* (New York, 1976), 147.

21. Cairncross and Eichengreen, *Sterling in Decline*, 188.

22. TNA, PRO, T 295/904 'Lord Kahn's enquiry into the position of sterling, Jan 1966-Feb 1968', 31, 36.

23. A. Cairncross, *The Wilson Years: A Treasury Diary, 1964-69* (London, 1997), 229-30, entries for 18 and 22 Sept 1967.

longer to work through, but there was a good chance that an exchange rate which was regarded as more in line with the UK's relative costs and prices would be more acceptable to the markets than the current one. As a result, speculation would die down and pressure on the reserves would lift. There would even be hope of a reflux of currencies back into sterling. There were suspicions that the Governor of the Bank of England, Sir Leslie O'Brien, was thinking the same way.<sup>24</sup>

Wilson, however, continued to play for time. Import controls were considered and rejected in September,<sup>25</sup> while repeated commitments were made that the sterling-dollar parity would not be altered. Wilson and Callaghan argued that the current difficulties facing the pound were only transitory. They anticipated that 1968 would see lower defence expenditure and average wage settlements holding at just 2 per cent per annum. Internal activity was expected to pick up and Federal government-led expansion was thought likely in the USA, given that 1968 was a Presidential election year: it was anticipated that President Johnson would seek to boost his chances of re-election with an economic stimulus.<sup>26</sup> For the UK, falling unemployment and rising exports were thus in prospect for 1968. Callaghan argued that the trade figures for early 1968 would be much better than those of the third and fourth quarters of 1967: they would quieten the speculation, allowing Labour the freedom to undertake an orderly devaluation in the spring as part of a move into the EEC.<sup>27</sup>

The markets were not impressed. They sensed prevarication. They failed to react well to two Bank rate increases amounting to 1 percentage point on 19 October and 9 November, regarding these as modest deflationary steps unlikely to make much difference to the trade balance. Pressure on sterling intensified after the release of a dreadful set of trade figures for October. Discussions about another support package for the pound started with the IMF and with the central banks of the leading industrialised countries. There was little enthusiasm, although the Americans did make one last-minute rescue attempt. They failed. It all meant that there was now no alternative to devaluation: the descent to \$2.40 was forced, a matter of 'bowing to the inevitable'.<sup>28</sup>

The foregoing narrative, therefore, has four key elements. First, the devaluation on 18 November 1967 is seen as the outcome of an intensifying weakness in the British economy, namely an increasing

24. Coombs, *The Arena of International Finance*, 147; King, entry for 31 Aug 1967, 141.

25. TNA, PRO, PREM 13/1440, Sept (undated), 'The UK's international obligations on the introduction of import restrictions or an import deposit scheme'; Cairncross, *Wilson Years*, entry for 18 Sept 1967, 229–30.

26. Cairncross, *Wilson Years*, entry for 18 Sept 1967, 229–30.

27. Middlemas, *Power, Competition and the State. Volume 2*, 191.

28. Toniolo, *Central Bank Co-operation*, 398–9.



propensity to import exacerbated by the failure of exports to increase at a comparable rate. Secondly, balance of payments difficulties arising from the trade performance undermined foreign confidence in sterling, leading to pressure on the reserves throughout much of the summer and most of the autumn of 1967. Thirdly, the government's perceived mismanagement of the economy reinforced the loss of foreign confidence and the run on sterling. Fourthly, the government could have addressed the external position earlier, either through import controls or devaluation, but it prevaricated until its hand was forced by the markets. Each of those assumptions can be questioned.

The trade and current account performance in 1967 was subject to unexpected and unfortunate developments. The economy had been upset by a series of events outside the control of the government. To begin with, there was a slowdown in the growth of world trade. The BIS argued that deflation in the USA (provoked by concern at a mounting external deficit) and above all in West Germany (arising from anxiety about inflationary pressure) contributed heavily to this. German imports slid by \$600m (3.5 per cent) compared with 1966, while its export surplus more than doubled from \$2 to \$4.2 billion, a record.<sup>29</sup> The fall in demand, mainly for manufactures and consumer durables, affected growth throughout continental Western Europe, where it slipped from 3.7 per cent in 1966 to 2.9 per cent in 1967.<sup>30</sup> British exports were adversely affected, while France and Italy recorded deficits in 1967.<sup>31</sup> Then the June Arab–Israeli Six-Day War provoked an oil embargo and the closure of the Suez Canal. As a result, the UK was forced to replace Middle Eastern oil with more expensive supplies (largely because of freight costs) from elsewhere. At the same time, export shipments were delayed. The estimated cost to the balance of payments was £20m a month.<sup>32</sup> In September, before the economy had a chance to recover from these shocks, unofficial dock strikes started in Liverpool and London. Their effect was very damaging: the loss in exports which were held back amounted to £120m–£140m between October and January.<sup>33</sup> The very poor trade figures in the last quarter, and especially those for October, reflected this extraordinary combination of events.

Although informed commentators accept that there was an element of misfortune involved in the circumstances which led to the devaluation,

29. B[ank] for I[nternational] S[ettlements], *38th Annual Report* (Basle, 1968), 93.

30. *Ibid.*, 47.

31. *Ibid.*, 5–6, 91.

32. H. Wilson, *The Labour Government 1964–70. A Personal Record* (London, 1971), 400; Thirlwall, *Balance of Payments Theory*, 186.

33. Cairncross and Eichengreen, *Sterling in Decline*, 193.

they still maintain that there was an unmistakable underlying trend: both the visible and the current account balance were deteriorating. Yet on closer examination, this trend is not as evident as has been claimed. A different long-term perspective was already provided by the economist Sir Roy Harrod in 1966 when he pointed out that before 1939 financial income from overseas had provided for 'about 35 per cent' of British imports so that exports needed to pay for only the remaining 65 per cent. The loss or sale of overseas investments during the war had transformed this position, and had necessitated an expansion of exports. This had been so successful that exports were by 1964–6 covering 95 per cent of the import bill.<sup>34</sup> This analysis was supported by later work. Rowthorn and Wells showed that Britain's commercial balance with the rest of the world (the sum of all imports and exports of goods and non-government services) swung from an average annual deficit worth 1.9 per cent of GDP in 1952–5 to one of 0.1 per cent between 1961 and 1965 and to a surplus worth 0.2 per cent of GDP between 1966 and 1970, a set of figures figure consistent with the achievements of other leading industrial states.<sup>35</sup> Middleton's statistics reveal that export values grew more rapidly than import values between 1964 and 1967, the former rising from 100 to 119.2 while the latter went from 100 to 115.5.<sup>36</sup> There was, therefore, no noticeable trend: the visible trade account was not inexorably worsening. The unusually poor figure for 1964 was so far out of line with the preceding three years that it is hard to attribute it to adverse movements in relative costs within the British economy. It is more plausible to suggest that it was caused by the speed of the macroeconomic expansion engineered by Conservative Chancellor Reginald Maudling in 1963–4. Thanks to this boom, growth spurted from little over 2 per cent in 1961, and not much more than 1 per cent in 1962, to 4.7 in 1963 and to 5.4 per cent in 1964. Consumer expenditure rose, but there is no evidence to suggest that it exerted a disproportionate pull on imports. There are, however, indications that the sudden swing to high levels of demand did produce bottlenecks, which tended to be filled by imports.<sup>37</sup>

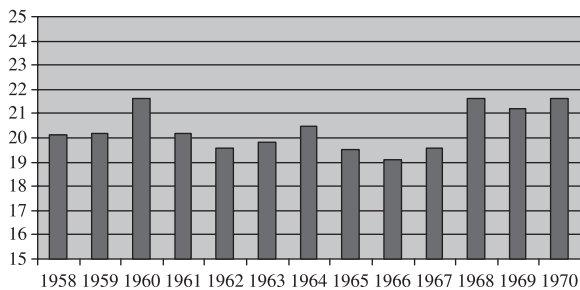
In 1967, the visible trade deficit grew once more, to £444m, but, as we have seen, even commentators critical of the government's performance accept that there were special circumstances at work affecting exports that year. Cairncross and Eichengreen, however, claimed that imports

34. 'No Help to Devalue', *The Times*, 31/8/66, 12, col. D.

35. R. Rowthorn and J. Wells, *Deindustrialisation and Foreign Trade* (Cambridge, 1987), Table 4.1, 79.

36. R. Middleton, *The British Economy since 1945* (Basingstoke, 2001), Table II.3, 150–1.

37. *Ibid.*, Table II.1, 146–7; Tomlinson, *The Labour Government 1964–70*, 223; Thirlwall, *Balance of Payments Theory*, 185–7.



**Fig. 1.** Imports as a percentage of GDP.

Source: Middleton, *British Economy since 1945*, Table II, 146–7.

were rising while exports were falling as a share of world markets. There was a noticeable acceleration of import volume, especially of finished manufactures, across the year as a whole, from a rate of growth of 2.5 per cent in 1966 to one of 7.5 per cent in 1967.<sup>38</sup> This expansion of imports had occurred not just when economic activity was buoyant, in the second half of the year, but when it was slack (and therefore conditions were supposedly less favourable to rising imports), in the first half of the year. The trend suggested a real loss of competitiveness on the part of British manufacturing at home as well as overseas, and was the main reason why the balance of payments swung into the red by an average of £68m per month between the first and last quarters of the year.<sup>39</sup>

Cairncross and Eichengreen are not, however, entirely convincing, for three reasons. First of all, the import statistics do not support such a conclusion: imports of goods actually dropped, from £1463m to £1447m, between the first and third quarters of 1967. The increase of £29m in the figure for goods and services (from £1895m to £1924m) over the same period reflected a rise in imports of services, not of finished manufactures.<sup>40</sup> It is true that visible imports reached an all-time high in the last quarter (see Table 1); but that figure reflects the impact of the 14.3 per cent devaluation on import prices for the last six weeks of the year. Once that is removed from the equation, the value of imports in the last quarter was little different from the level it reached in the preceding three. In other words, imports were flat rather than buoyant: after a jump in the first quarter, mainly due to the removal of a temporary import surcharge imposed in October 1964, they hovered around the same level.<sup>41</sup> Secondly, imports in 1967 took a lower share of the national product than at any time during 1958–64 (figure 1), apart from 1962,

38. *Ibid.*, 192.

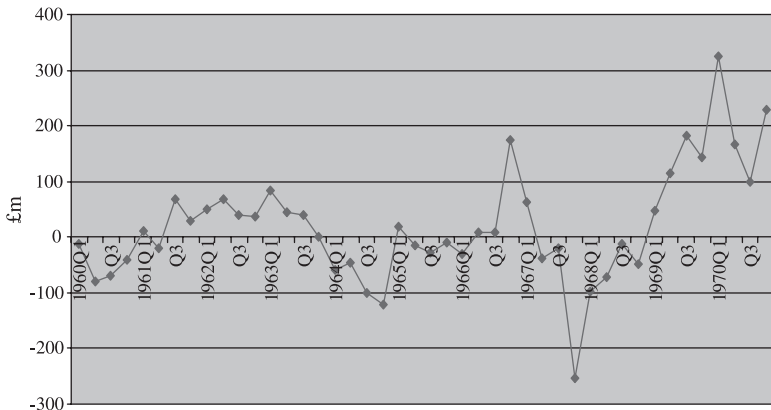
39. Cairncross and Eichengreen, *Sterling in Decline*, 193.

40. National Statistics Online: balance of payments quarterly first release (current prices, seasonally adjusted).

41. 'No Shocks in the Trade Figures', *The Times*, 14/4/67, 27, col. D.

when they reached the same level of 19.6 per cent. Their performance was very much in line with those for 1965 and 1966: there is no discernable trend of rising import penetration prior to devaluation (ironically, there is afterwards, though this was more than outweighed by the increase in exports). Thirdly, the size of the trade deficit is no guide to the economy's propensity to import in so unusual a year, especially in view of the dock strikes. Indeed the fourth quarter figures are entirely atypical: there is no quarter in the decade which comes near them for the size of the deficit (see figure 2), and the wild deviation which is evident can only be attributable to the strikes and the distortion caused by devaluation. Thirlwall estimated that £130m of the October to December increase in the current account deficit was caused by the dock strikes; Callaghan put the figure at £100m.<sup>42</sup>

It is, of course, true that there was growing pressure on the reserves during the summer and autumn of 1967. In the third quarter of the



**Fig. 2.** Balance of payments current account quarterly balance, 1967–70 (£m: seasonally adjusted). Source: National Statistics Online: HBOP (balance of payments current account quarterly balance).

Table 1: Exports and imports of goods and services, 1967 (£m).

	Q1	Q2	Q3	Q4
Exports	1891	1839	1863	1777
Imports	1895	1903	1924	2092
Balance	-4	-64	-59	-315

Source: National Statistics Online: balance of payments quarterly first release (current prices, seasonally adjusted).

42. Callaghan, *Time and Chance*, 216; Thirlwall, *Balance of Payment Theory*, 189.

year, the drain exceeded £500m, almost as much as at the end of 1964.<sup>43</sup> The figures for the official reserves released each month did not reflect the scale of the run on sterling (they dropped by just £70m, from £1055m to £985m between May and August).<sup>44</sup> They were deliberately managed to look respectable, so as not to give further shocks to international confidence: the Bank of England drew on its extensive network of foreign credits to cover the exodus of money.<sup>45</sup> In July and August, for example, assistance accounted for £411m of the £438m needed to finance sales of spot sterling.<sup>46</sup> £115m came from the Sterling Group Arrangement, a £1 billion facility negotiated by the BIS with the central banks of the Group of Ten in June 1966, to be drawn on when the sterling balances were being run down as a result of speculative pressure. \$1064 billion was drawn from the Federal Reserve under its swap agreement with the Bank of England worth \$1350m.<sup>47</sup> With losses of £286m forecast for September, there was a growing danger that in the absence of 'a significant turnaround in our affairs . . . and a marked revival of confidence in our prospects, the UK would soon have run through virtually the whole of our remaining (credit) facilities'.<sup>48</sup>

The damage to Britain's external position was not being done by a poor performance on the current account but by capital outflow. Some historians have suggested that net government invisible imports, growing from £55m in 1953 to £472m in 1966, played an important role and that the bulk of this was accounted for by public sector payments, some being related to overseas aid but most to overseas military spending.<sup>49</sup> There can be no doubt that the UK's global strategic commitments, notably east of Suez, did involve significant disbursements, but these were brought under tight control (see figure 3). Moreover Thirlwall held that overseas government spending was offset by receipts in other invisible items.<sup>50</sup> It is of course arguable that the invisible surplus would have been larger in the absence of the overseas military commitments, and that the level of the reserves would therefore have been higher. As a result, sterling's cushion against external shocks would have been fatter. Yet it is hard to see how the government could have reduced its overseas defence spending more rapidly, in view both of the prevailing political situation in the Far East (dominated by the Vietnam War and,

43. Cairncross and Eichengreen, *Sterling in Decline*, 188.

44. TNA, PRO, T 318/190, 'Sterling: Position and Prospects', memo by Goldman, 6 Sept. 1967.

45. TNA, PRO, T 318/190: 'Sterling', minute by Hubback following meeting with the Governor, 23 Aug. 1967.

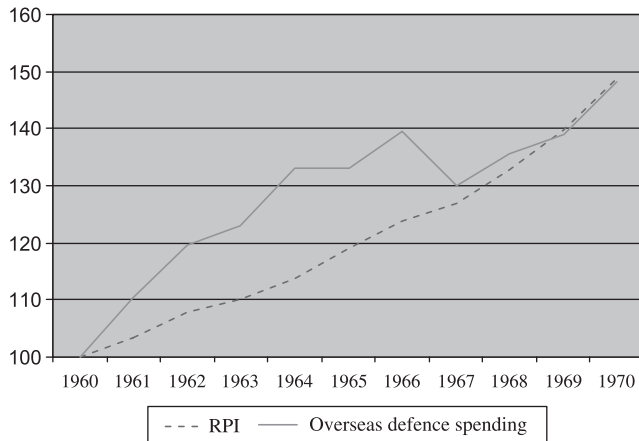
46. TNA, PRO, T 295/904, Kahn, 'Enquiry', 29.

47. TNA, PRO, T 318/190, minute by Copeman, 'Prospects for the reserves and central bank borrowing'.

48. TNA, PRO, T 318/190, Goldman, 'Sterling: Position and Prospects', 6 Sept. 1967.

49. J. Tomlinson, *Public Policy and the Economy since 1900* (Oxford, 1990), 241.

50. Thirlwall, *Balance of Payments Theory*, 179.



**Fig. 3.** RPI and overseas defence spending, 1960–70.

Source: derived from National Statistics Online: CZBH: RPI annual percentage change, and F.T. Blackaby, ed. *British Economic Policy 1960–74* (Cambridge, 1978), 23, Table 7.4.

until 1966, the Indonesian Confrontation) and of the determined opposition it faced from the military establishment.<sup>51</sup> Indeed, from 1964 to 1968 the level of overseas defence expenditure actually fell in real terms, after rising sharply between 1960 and 1964.

In fact, most of the capital outflow was short term. Over the third quarter, total reserve financing requirements amounted to £551m. Only £60m of this could be accounted for by the current account deficit. For the rest, £456m was attributable to short-term movements. A Treasury 'Enquiry into the Position of Sterling, January 1966 to February 1968' by Lord Kahn, found that £260m of this came from a reduction in sterling balances, and estimated that a further loss of £126m resulted from 'leads and lags' (foreign traders delaying payment for imports of British goods in the expectation that sterling would shortly be devalued, or British importers accelerating payment for imports to avoid having to pay the higher costs which would follow from devaluation). On top of these movements, there was a drain of £51m in non-sterling currencies from the reserves, as the EEA used these to buy sterling when it came under pressure in the foreign exchange markets.<sup>52</sup>

Clearly, there was failing confidence in sterling, provoked by the disappointing trade figures for the second quarter. But the fluctuating fortunes of the current account do not provide the full explanation for reluctance to hold sterling in the summer and autumn of 1967. Another

51. See S. Dockrill, *Britain's Retreat from East of Suez: The Choice between Europe and the World* (Basingstoke, 2002).

52. TNA, PRO, T 295/905, Kahn, 'Enquiry', 27–8ff.

factor was the international situation. The instability in the Middle East had sparked off selling of the currency. In May and June, there had been a net reduction of £134m in the overseas sterling area (OSA) sterling balances, mainly those held by Arab countries. These were either selling sterling for political reasons (disagreement with the pro-Israeli position of the British Government) or drawing down their holdings so that they could increase spending on military and related items. There was, for example, a drop of £81m in Kuwaiti sterling balances in June alone, and a somewhat less dramatic fall in Libyan balances.<sup>53</sup> The rundown accelerated in July and August as rumours of Arab sales of sterling multiplied, along with the speculation in the press and in Parliament about the possibility that membership of the EEC would require devaluation. As a result confidence weakened further, and the OSA sterling balances of sterling area members fell by another £86m in August, once again concentrated in Arab states.<sup>54</sup>

The decline in OSA sterling balances eased somewhat in September and October, but confidence was not restored. The damage had already been done, and a shift away from sterling continued, this time led by a £322m fall in the balances of non-sterling area members (NSA) between July and October.<sup>55</sup> The NSA included the central banks of other advanced industrial states, involved in foreign currency credit and swap arrangements with the Bank of England. Many, however, were private banks, corporations or individuals rather than official institutions. They were drawn to sterling by the prospect of short-term profits arising from advantageous interest rates and by the availability of forward cover (usually for three months), which, in return for a small premium, insured holders of dollars (or other currencies) exchanging these for sterling against losses resulting from devaluation.

Britain's vulnerability to these short-term movements arose partly from the international role played by sterling as a trading and reserve currency, and partly from changes in the international economy. Perhaps the most significant of these was the development of an increasingly liberal system of international payments, characterised by large financial flows across national boundaries. This development was especially marked in the Eurocurrency and Eurodollar markets. These had grown rapidly since the introduction of convertibility at the end of the 1950s, as a result of which bank branches and large firms had been able to switch surplus cash in and out of local European currencies in search of the best short-term return. As a result, 'a highly efficient international market in short-term money'<sup>56</sup> developed, with London the most important

53. *Ibid.*

54. *Ibid.*, 31–2.

55. *Ibid.*, 33–4.

56. TNA, PRO, PREM 13/866, Kahn, 'Enquiry', 5.

centre. Continental banks and companies contributed to this new market, but its growth was driven by developments within the US economy, which had stimulated the rise of the Eurodollar.

Eurodollars were balances of dollars banked in Europe. They were not a new feature, but until the late 1950s their role in the European financial markets had been small. From this point, however, they expanded rapidly. 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 by depositing funds in European banks. 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. 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 to another in search of a good rate of return, dependent on interest rate changes (and expectations of exchange rate alterations).<sup>57</sup>

London was the destination of choice for these Eurodollar funds, for four main reasons. First, given sterling's role as the world's second international reserve currency, it seemed a safe asset for overseas investors. Secondly, rates on deposits in London tended to be higher than elsewhere in the leading advanced economies. Thirdly, there were a large and growing number of US subsidiaries in the UK compared to the rest of Europe (over 25 per cent of all long-term private US investment was located in the UK by the late 1960s).<sup>58</sup> Finally, London's experience and specialisation in global insurance, shipping and acceptances made it a natural magnet for overseas banks with international connections, and in the 1950s and early 1960s most of these tended to be American in origin.<sup>59</sup> Even in 1953, there were 10 US banks with branches in London. The number then grew steadily, until it reached 21 by the end of 1965. These included some of the most famous concerns such as the Bank of America, the Chase Manhattan, First National City Bank and Morgan Guaranty.<sup>60</sup> This process was accompanied by the expansion of international business on the part of domestic banks in London, keen to attract balances from private creditors throughout the OECD.

By the end of 1965, out of total Eurodollar deposits of \$9102m, \$4257m (46.8 per cent) was banked in London.<sup>61</sup> The large short-term

57. S. Newton, *The Global Economy 1944-2000: The Limits of Ideology* (London, 2004), 88.

58. F. Tipton and R. Aldrich, *An Economic and Social History of Europe from 1939 to the Present* (Basingstoke, 1987), 145; P. Dicken and P. E. Lloyd, 'Geographical Perspectives on United States Investment in the United Kingdom', *Environment and Planning*, viii (1976), 686-7.

59. See C. Schenk, 'The Origins of the Eurodollar Market in London 1955-1963', *Explorations in Economic History*, xxxv (1998), 230-5.

60. *The Banker*, 116 (Nov. 1966), 782-5.

61. TNA, PRO, PREM 13/866, Kahn, 'Enquiry', 9.



money market there was highly attractive to US banks, and these in turn could deploy their dollars in a variety of ways. They could offer them 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 Bills.<sup>62</sup> This option also appealed to other NSA financial interests, especially in Western Europe. Yet these funds could move out of sterling as fast as they had entered it. Each of the sterling crises experienced by Labour in 1964, 1965 and 1966 had been characterised by substantial movements of short-term funds out of sterling and into dollars. Exactly the same started to occur in the summer of 1967, and continued into the autumn, when a trend towards the purchasing of deutschmarks as well as dollars became evident.

Once rates swung against sterling, the currency started to lose its attractiveness. In June, demand for Eurodollars pushed up rates on Eurodollar deposits by 0.5 per cent, eroding what had been an interest differential in favour of sterling. The three-month Eurodollar/local authority deposit comparison also turned against sterling. By the end of June, the comparison was showing a 0.25 per cent per annum advantage in favour of the Eurodollar, despite heavy EEA intervention in the forward market and a consequent fall in the three-month premium on forward sterling. In October, the government reluctantly reversed May's 0.5 per cent Bank Rate cut, but this was regarded as inadequate in the face of the currency outflow. Although Treasury Bill and local authority rates now rose by 0.75 per cent per annum, the Eurodollar rate increased by a similar amount in response to heavy demand. By the start of November, the returns on Eurodollars were once again exceeding those on loans to local authorities.<sup>63</sup>

By this time, the short-term outflow occurring as a result of interest arbitrage was encouraging and being reinforced by continuing speculation that the pound would soon be devalued. The pound's vulnerability was enhanced by rumours of a deutschmark revaluation, which prompted 'sweeping transfers' of sterling (and of the Canadian, Italian and Scandinavian currencies), into deutschmarks.<sup>64</sup> Further speculation against the pound was now being almost openly promoted by the French government in a series of leaks to the press timed to coincide with talks concerning Britain's application to join the EEC, a development confirmed late in November by former US Treasury Undersecretary Robert Roosa.<sup>65</sup> It had long been an object of French

62. TNA, PRO, PREM 13/866, Kahn, 'Enquiry', 7; Newton, 'The Two Sterling Crises', 90.

63. TNA, PRO, T 295/904, Kahn, 'Enquiry', 32, 36–7.

64. TNA, PRO, T 295/904, Kahn, 'Enquiry', 33; Wilson, *The Labour Government 1964–70*, 449; Peter Jay, 'Mark's "Revaluation" Give the Pound a Hard Time', *The Times*, 15 Nov. 1967, 21, col. E.

65. 'Paris Blamed for Devaluation', *The Times*, 23 Nov. 1967, 7, col. F.

President Charles de Gaulle's foreign economic policy to undermine the Bretton Woods international monetary system based on the convertibility of dollars into gold at \$35 to the ounce. The view from Paris was that dollar-gold convertibility was no more than a confidence trick which allowed American corporations and the US government to accumulate unlimited credit from European governments and banks, on the understanding that these funds were convertible into gold. This money in turn enabled the corporations to buy up continental firms and provided the US government with the resources to fight an unwinnable war in south-east Asia. European administrations and banks were meanwhile left with ballooning sums of dollars which in truth were too large to be redeemable, given America's weak external balance and declining gold reserves in Fort Knox. If sterling, junior partner to the dollar as international currency, were forced into devaluation, then speculative money would move against the dollar and threaten its parity against gold. This would in turn spoil the Bretton Woods confidence trick, and necessitate a reform of the international monetary system so that it became less favourable to American capital.<sup>66</sup>

The combination of high politics and commercial self-interest on the part of sterling holders had a powerful impact in the first half of November. The short-term capital outflow in this brief time exceeded £340m, composed of a £170m fall in NSA balances (mainly those of North American and West European holders), and of unidentified further losses of £171m (most likely attributable to leads and lags).<sup>67</sup> A further rise in the Bank rate made no impression on this flight from sterling, which ended with devaluation on 18 November.

In the end, it was short-term capital outflow, not the trade performance, which had provoked the 1967 sterling crisis. The exodus of money had led to a crisis of confidence, which then, in a negative feedback loop, had exacerbated the run on sterling. The dramatic nature of the outflow resulted from the interaction of sterling's position as an international reserve currency with the increasing interdependence of the capital markets in the advanced industrial states. During the period from late 1962 to the summer of 1964, this had enhanced the currency's attractiveness to the expanding volume of footloose funds within the international economy. But in 1967, as in the crises of 1964–6, the fragile external balance, exiguous reserves and volatile interest rates in different financial centres, all operated as effectively to promote an exodus of funds from London as they had to attract them. In 1964–6, the government had been able to defend sterling, albeit

66. Newton, *The Global Economy*, 94–5.

67. TNA, PRO, T 295/904, Kahn, 'Enquiry', 39.

with assistance. In 1967, this became increasingly difficult because new factors were at work which reinforced the temptation to abandon sterling. These were the Middle East crisis, the dock strikes, the slowdown in international trade and the persistent rumours about the currency's future.

The constant recourse to a shrinking pile of international credit began to provoke concern in the Treasury and the Bank as the summer drew towards a close. By the start of September, Britain was left with just £270m of its central bank borrowing facilities left, having taken £621m from this source during the summer, plus £116m remaining under the Sterling Group Arrangements.<sup>68</sup> The outlook for the balance of payments, so promising in the first half of the year, was now becoming bleak. A September Department of Economic Affairs paper attributed this to the closure of the Suez Canal, which had lasted longer and had a greater impact than anticipated.<sup>69</sup> By the middle of the month, Alec Cairncross was estimating that the deficit for the year might reach £300m.<sup>70</sup> The government had already raised the possibility of further help from the IMF, in conversations during July and August with Pierre-Paul Schweitzer, Managing Director of the Fund. The results had not been encouraging. Britain was due to pay the Fund £117m in December (the final instalment in the repayment of the £357m borrowing in December 1964) and had yet to start its repayment of a £500m loan negotiated in the spring of 1965. Schweitzer made it clear that any new credits would be accompanied by harsh conditions concerning macroeconomic policy, given that further assistance would add to what were already significant obligations.<sup>71</sup> Moreover, the government was warned that that credit arrangements with the US Federal government and Federal Reserve Bank might become exhausted.<sup>72</sup> By the end of the summer, it seemed as if confidence in sterling was disappearing along with the financial resources available to defend the currency. If Britain could not command foreign credit, it would have to fall back on its own reserves, and these were not large enough in the absence of policy measures to improve the current account. Yet Labour waited for over two months from the end of August before devaluing the pound, despite a growing chorus of voices urging it to do so. Why did it delay?

To begin with, governments generally resort to devaluation (or import controls) when there is evidence that exports are persistently

68. TNA, PRO, T 318/190, Goldman, 'Sterling: Position and Prospects', 6 Sept. 1967.

69. TNA, PRO, PREM 13/1440, 'Measures to Improve our Economic Performance', 8 Sept. 1967.

70. Cairncross, *The Wilson Years*, 229, entry for 18 Nov.

71. TNA, PRO, T 295/904, Kahn, 'Enquiry', 86.

72. TNA, PRO, T 318/190, minute by Copeman, 24 Aug. 1967; TNA, PRO, T 312/1827, meeting between Callaghan and Fowler and others, 27 Aug. 1967.

failing to earn the money to finance imports. But the UK's recent export performance had been encouraging, even if not sustained after April 1967. Moreover the third quarter trade figures exceeded expectations; the developing crisis could not at this stage be attributed to them. The seasonally adjusted figures saw the current account deficit fall back from £37m to £20m (see figure 2), with an export surplus of £48m in services (this had been £32m in the second quarter). As late as August, both the Treasury and the National Institute for Economic and Social Research (NIESR) had been forecasting a small current account surplus for the year, varying between £30m and £100m, even allowing for the impact of the crisis in the Middle East.<sup>73</sup>

Against this background, late in July, Wilson reaffirmed his commitment to the 3 per cent per annum growth strategy developed in the aftermath of the July 1966 measures, and argued for a selective programme of reflation concentrated mainly on infrastructural spending and on regional development, to reduce unemployment without stimulating an increase in imports.<sup>74</sup> This was put to Britain's partners in the OECD, both in July and August, and did not meet with any criticism. At Working Party 3 in both July and August, it was accepted that the failure to sustain the balance of payments progress made earlier was mainly a result of 'unexpected factors' beyond the government's control. Neither the US Treasury nor the Federal Reserve took the view that sterling was overvalued, though they were worried by the pressure on it.<sup>75</sup> Even Emile van Lennep, advocate as early as 1964 for the view that sterling was overvalued, accepted that 'external' factors were causing problems for Britain. He and his colleagues understood the government's reluctance to compensate by introducing additional deflation, and cautioned only that any reflationary steps would be seen in the light of the priority given to the external balance.<sup>76</sup> Given that Britain's economic difficulties were seen to be largely the result of temporary, exogenous developments, there seemed to be no reason to suppose that devaluation would improve the external position.

Secondly, there were grounds for hoping that there would be assistance available to carry the British balance of payments through to 1968, by which time exports of goods were expected to be improving, thanks to the likely end of the dock strikes by this time and to a return to expansion

73. TNA, PRO, PREM 13/1440, 'The Economic Situation', undated but based on data available by mid-Aug; Peter Jay, 'NIESR Sees 750,000 Jobless and Major Recession Risk', *The Times*, 15, col. E, 18 Aug. 1967.

74. TNA, PRO, PREM 13/1440, 'A Possible Economic Strategy', memorandum by the Prime Minister, 23 July 1967.

75. Callaghan, *Time and Chance*, 217.

76. TNA, PRO, T 277/1943, minutes of WP 3 meetings held on 19–20 July and 28–29 Aug. 1967.

in the USA and Germany. This was not an unreasonable prospect. The dock strikes were unofficial and therefore not expected to last into the New Year. Working Party 3 was told at the end of August that expansion of \$55 billion (6 per cent of GDP) was being forecast for the US economy in 1968. The German government had already confirmed to the OECD that it was taking action designed to accelerate domestic growth.<sup>77</sup> This still left an awkward last three months of the year, and at the end of August Callaghan warned US Treasury Secretary Henry ('Joe') Fowler that in the absence of support for the pound there could soon be a crisis of confidence in sterling.<sup>78</sup> The prospect worried Fowler and his colleagues, since they feared that a sterling devaluation might lead to a run on the dollar. They were therefore keen to help. Their preferred option was a long-term loan. This suited the Bank of England, whose Governor, Sir Leslie O'Brien, was not keen on more short-term borrowing in view of the repayments due at the end of the year.<sup>79</sup> Although the European members of the Group of Ten were uncomfortable with this idea,<sup>80</sup> O'Brien found the climate 'remarkably friendly' when he went to Basle in September to meet his colleagues for the monthly BIS meeting. He reported that 'there was agreement that we had done all the right things and understanding of the moderate relaxation we had allowed'.<sup>81</sup> There were spontaneous suggestions of help from the Swiss as well as from the BIS, and another international support operation seemed likely. This did not in the end emerge, but two packages did materialise. One was a \$37.5m loan from the Swiss banks, and the other was £90m from the BIS, designed to facilitate the final, December payment on the 1964 IMF loan to the UK. The BIS facility was not finally agreed until mid November, but the gap was bridged by assistance from the USA, in the form of an addition of \$100m to the UK's credit line with the Federal Reserve and, in the last week of October alone, of sterling purchases worth \$47.1m.<sup>82</sup>

Thirdly, there was no dramatic run on sterling during September and October. November opened, as Wilson said, with 'hardly a serious

77. TNA, PRO, T 277/1943, remarks of Schiff (USA) at the WP 3 meeting, 28–29 Aug. 1967; BIS, *38th Annual Report*, 22, 60–1.

78. TNA, PRO, T 312/1827, 'Note for the Record', of meeting between Chancellor and Rickett (UK) and Fowler, Martin, Deming, Daane, Bator and Willis (USA), 27 Aug. 1967.

79. TNA, PRO, T 318/190, minute by Hubback following a meeting with the Governor, 23 Aug. 1967.

80. TNA, PRO, T 312/1827, 'Note for the Record', of meeting between Callaghan and Rickett (UK) and Fowler, Martin, Deming, Daane, Bator and Willis (USA), 27 Aug. 1967.

81. Cairncross, *The Wilson Years*, 232–3, entry for 3 Oct. 1967.

82. *Ibid.*, 239, entry for 23 Oct. 1967; Coombs, *The Arena of International Finance*, 147.

commentator pressing for devaluation'.<sup>83</sup> Worrying as the external position was, July 1966 had been worse: forward sterling obligations had increased in October by £252m, but in July 1966 the equivalent figure had been £428m.<sup>84</sup> The crises of 1964–6 had each been accompanied by blunt criticisms of Labour's macroeconomic strategy by members of the OECD and the Group of Ten, including some senior Americans. Some of these comments had leaked into the open and had intensified the loss of confidence in sterling. Yet in 1967, the government was receiving a better press from central banks and foreign treasuries; the sense of crisis which had been so obvious in previous years was not present.

One reason for its absence was the continuing prospect of available external resources to support sterling. Calculations made by the Treasury in October suggested that the likely balance of payments deficit for the year (estimated at £200m) plus obligations to the forward market (worth £1100m)<sup>85</sup> now exceeded the reserves (£903m by the start of November).<sup>86</sup> Remaining short-term credit facilities amounted to £220m.<sup>87</sup> There were further assets in the UK Treasury's dollar portfolio, and by selling part of this the government was able to raise a further £175m by the start of November. On the surface this left a very thin margin to cover external commitments, especially if, as was feared, short-term credits were exhausted in November.<sup>88</sup> Yet the BIS loan was still to come and the use of this to complete repayment of the December 1964 IMF loan would re-establish substantial medium-term drawing rights on the Fund. The situation was therefore grave but not critical. Hamilton notes that, even allowing for the use of £194m to service debts at the end of November, the reserves would still be only £225m less than at the end of August 1965 and £190m higher than during the forthcoming March 1968 gold crisis. Sterling was not devalued in either 1965 or 1968, when the country's foreign exchange position was almost as bad (1965) or worse (1968) than in the autumn of 1967.<sup>89</sup> It can therefore be argued that the question historians need to address is not why the government delayed before devaluing sterling, but why should the position in October to November 1967 have led to a change in the rate anyway?

83. Wilson, *The Labour Government 1964-70*, 444.

84. T295/205, Kahn, 'Enquiry', statistical table A.

85. Cairncross, *The Wilson Years*, 242, entry for 4 Nov. 1967.

86. TNA, PRO, T 312/1827, 'Possible Short-Term Reflux Following a Devaluation', Table II, undated.

87. *F[oreign] R[elations] [of the] U[nited] S[tates], 1964-1968*, VIII, document 147, Fowler to President, 19 Oct. 1967. Fowler had been briefed by Callaghan at the recent IMF AGM in Rio. See TNA, PRO, T 318/190, Goldman to Maude, 12 Oct. 1967.

88. Cairncross, *The Wilson Years*, 242, entry for 4 Nov. 1967.

89. A. Hamilton, 'Beyond the Sterling Devaluation: The Gold Crisis of March 1968', *Contemporary European History*, xvii (2008), 79.

The decision to devalue was finally determined not by acceptance on the part of Wilson and Callaghan that the rescue of sterling was impossible, but by a political judgement that the cost of preserving its parity was unacceptable. It became apparent during the autumn that the avoidance of devaluation would necessitate protecting the reserves either by turning to protectionism or by accepting the loss of economic autonomy and substantial deflation. Neither course would have been easily compatible with the government's social-democratic outlook and strategy. The protectionist option involved quantitative restrictions or import deposits. A government survey of September advised against taking this road. It argued that quantitative restrictions would require IMF and General Agreement on Tariffs and Trade (GATT) approval, and it was agreed that there was no guarantee either body would support the case. One reason the Fund had approved the government's significant drawings so far had been to avert the danger that Britain would have to 'resort to serious restrictions on international trade and payments'. The GATT rules did permit the introduction of quantitative restrictions by a state whose trade was disrupted by a war in which it played no part: but the problem was that the trade balance was not the main source of Britain's problems. Moreover, there was no precedent for the imposition of such controls by an advanced industrial state since the arrival of convertibility; the government would not have been able to use the argument that the GATT had experienced such action before. This left import deposits, which were regarded unfavourably since they contravened GATT (if not IMF) rules.<sup>90</sup>

The objection to either form of import restriction was not merely legalistic. There was a political principle at stake. The government had from the start supported international trade liberalisation. It was committed to backing the Kennedy Round of talks in the GATT designed to reduce tariff and non-tariff barriers.<sup>91</sup> Wilson took the argument a step further with calls for international monetary reform,<sup>92</sup> and was keenly backed by Callaghan. Both were anxious about the increasing vulnerability of national currencies to speculative activity and feared devaluation might spark a return to the economic nationalism of the 1930s, with nation states taking refuge in competitive devaluations and trade controls to protect themselves from attacks on their reserves.<sup>93</sup> Wilson made no

90. TNA, PRO, PREM 13/1440, 'The UK's international obligations on the introduction of import restrictions or an import deposit scheme', Sept. 1967.

91. Helen Parr, *Britain's Policy towards the European Community: Harold Wilson and Britain's World Role, 1964-1967* (London, 2006), 130.

92. TNA, PRO, T 267/35, Treasury Historical Memorandum, 25, 1975, 'International Liquidity: An Account of the Negotiations Leading to the Creation of Special Drawing Right in the International Monetary Fund, 2-3, 41. See also Harold Wilson, *Purpose in Politics* (London, 1964), 209.

93. Callaghan, *Time and Chance*, 157-60, and Wilson, *The Labour Government 1964-70*, 6.

secret of his reluctance to take the protectionist route: in September he provided an informal briefing on government economic policy to newspaper City editors, in the process giving 'the most convincing arguments ever' against quantitative restrictions.<sup>94</sup>

Labour was not just in favour of freer trade and payments. It was concerned to ensure that an open world economy was compatible with full employment and expansion at home: as Callaghan himself pointed out on more than one occasion, this was the 1945 social–democratic synthesis which Keynes had worked for in the last years of his life.<sup>95</sup> When in the face of foreign exchange shortages, the 1945–51 Attlee governments had negotiated a \$3.75 billion US credit, under the Anglo-American Financial Agreement of 1946 (Keynes leading the British negotiating team), and then participated in the Marshall Aid programme, they were making a commitment to what was called at the time a 'liberal socialist' political economy. This was founded upon the mixed economy, progressive taxation, high levels of public investment and the reduction of barriers to trade. It meant the rejection of 'Gosplan' socialism, namely central planning, protectionism and an inconvertible currency, with a very limited role for free markets.<sup>96</sup> The party had remained true to this fundamental politico-economic choice under the leaderships of Hugh Gaitskell and Harold Wilson.<sup>97</sup>

If the introduction of protectionist measures to safeguard the reserves was unacceptable because it threatened to reverse progress towards the Keynesian goal, what measures were left? There were three choices remaining—the same three that the government had faced since its arrival in office back in October 1964. The first was to devalue. The second was to take deflationary measures, so that imports fell as a result of lower internal demand. The third was to take external assistance. The first option had always been rejected. The second would have been seen as betrayal of Labour's modernisation project and a return to the pre-war era of mass unemployment. Moreover the temporary surge in joblessness following the July 1966 measures was blamed for electoral unpopularity and the loss of two formerly safe Labour seats.<sup>98</sup> On the other hand, the government had hitherto been able to take the third option, largely because the assistance which it had received from central banks, the BIS and the IMF had left its economic autonomy unaffected. It is of course true that in July 1966 its ambitions for annual growth had

94. Cairncross, *The Wilson Years*, 242, entry for 18 Sept.

95. Newton, *The Global Economy*, 7–16; TNA, PRO, T 267/35, 'International Liquidity', 2, 106.

96. S. Newton, 'Britain, the Sterling Area and European Integration 1945–50', *Journal of Imperial and Commonwealth History*, xiii (1985), 164–5.

97. See for example, *The National Plan* (London, 1965), chapter 1, paragraphs 10–12, 2–3.

98. Wilson, *The Labour Government 1964–70*, 447.



been adjusted to a lower level than set out in the 1965 National Plan. Yet although the target of 3 per cent may have been modest by comparison with what had been achieved by the West European economies, it was still above the average for post-war Britain. Meanwhile Labour remained committed to full employment, as it demonstrated in the summer of 1967.

External support appeared to be available in the autumn of 1967: the problem was, however, its compatibility with the government's continuing freedom of action. Quite apart from Schweitzer's warning about the possible consequences of more IMF assistance, Callaghan did not believe it was 'sensible' to continue defending the parity if the only support available was 'short-term credits from other countries needing to be renewed every three months'.<sup>99</sup> It followed that the first of the three options might now be unavoidable. Wilson agreed. In July, he had told Barbara Castle (who had supported a sterling float since November 1964) that devaluation 'must be a political issue when it comes: we devalue to preserve our independence'.<sup>100</sup> He now concluded that unless significant, unconditional, backing for sterling could be arranged, it would be necessary to consider devaluation (or floating, which was his own preference).<sup>101</sup>

It was this calculation which now, at the start of November, led the Prime Minister and the Chancellor to initiate 'Operation Patriarch' (the code name for the devaluation of sterling). Senior civil servants and officials in the Bank of England had been preparing contingency plans for this eventuality since early 1965 (called F.U., which was short for 'forever unmentionable', after Wilson had ruled that the subject of devaluation was not to be openly discussed). There was a 'War Book', in which all the necessary steps on the road to devaluation, including informing other governments and the IMF, were set out in the form of a timetable. There were detailed plans ready on 'accompanying measures'.<sup>102</sup> There had for some time been a clear expectation that if sterling were to be devalued the new rate would be between £1 = \$2.40–\$2.45, on the assumption that a devaluation of only 14–15 per cent was small enough to avert retaliation from other advanced industrial states concerned about the loss of competitiveness.<sup>103</sup> Yet even now Wilson and Callaghan held back from taking the final decision, and continued to see if there was an alternative. Kahn says their refusal to accept that

99. Callaghan, *Time and Chance*, 219.

100. Barbara Castle, *The Castle Diaries 1964–76* (London, 1990), 142, entry for 22 July 1967.

101. TNA, PRO, PREM 13/1447, Prime Minister personal minute to Chancellor, 6 Nov. 1967.

102. See for example, Bank of England, OV 44/137, 'Accompanying Measures', F.U. paper by Godley and Atkinson, Sept. 1967.

103. TNA, PRO, CAB 147/11, Stewart to Balogh, 22 July 1965; and TNA, PRO, T 312/1635, 'F. U. and All That' memo by Walker to Armstrong, 5 May 1966.

the game was up left them 'clutching at straws', notably an American-led rescue.<sup>104</sup> Hamilton meanwhile states that they 'prevaricated'.<sup>105</sup>

These are unfair accusations. For a start, notwithstanding the deliberately modest nature of the change being contemplated to sterling's value, the Treasury did not know whether a British devaluation would be followed by other countries, who would of course nullify the exercise if they did so. These were not groundless fears. There were repeated rumours that the French would devalue the franc in the event of an adjustment to sterling. On 8 November, Van Lennep reported that he had heard Rene Larre, the French Finance Minister, say that 'he wouldn't let the UK get away with a devaluation', and on 13 November Cairncross wrote in his diary that he had seen a telegram stating that the French 'might follow us'.<sup>106</sup> As Wilson argued, this would leave the country's relative position unchanged. Moreover the sterling balances would be at risk, since the holders would have lost confidence in a banker whose repeated denials of intent to devalue had turned out to be worthless. No pledge against further depreciation would be believed.<sup>107</sup> This was why Wilson favoured floating and why both he and Callaghan took the view that it was worth continuing to look for support on appropriate terms.

The government therefore took a twin-track approach. On the one hand, it was planning for devaluation. Wilson and Callaghan agreed on 8 November that the appropriate date should be 18 November, a Saturday and therefore a day when the markets would not be open. They decided that it was time to consider the implementation of accompanying measures set out in the War Book. These aimed to shift demand and resources to the value of £500m out of the home and into the export market by 1969.<sup>108</sup> They featured tax increases, a £150m cut in government spending, a 2 per cent rise in the Bank rate and reductions in the investment programmes of the nationalised industries. Callaghan sent Sir Denis Rickett, Second Secretary of the Treasury in charge of international monetary matters,<sup>109</sup> to consult tactfully with the governments of the EEC Six about their reaction to a devaluation of the pound (though without giving away that such a move was at that very time under active consideration). On the other hand, it explored the possibility of a rescue operation, though it was clear that this would have to amount to a long-term loan of \$3 billion.

Rickett returned to London late on 9 November. Among his consultations, there had been a long meeting with Otmar Emminger, a

104. TNA, PRO, T 295/904, Kahn, 'Enquiry', 85.

105. Hamilton, 'Beyond the Sterling Devaluation', 77.

106. Cairncross, *The Wilson Years*, 243–4, entries for 9 and 13 Nov.

107. TNA, PRO, PREM 13/1447, handwritten note by Wilson, 6 Nov. 1967.

108. TNA, PRO, CAB 128/42, CC (67) 66th conclusions, 16 Nov. 1967.

109. Callaghan, *Time and Chance*, 219–20.

director of the German Bundesbank and acting President of the EEC Monetary Committee. As a result of this talk in particular, Rickett was able to report that he had found no confirmation of fears the Six might follow a sterling devaluation.<sup>110</sup> By now both Wilson and Callaghan 'considered devaluation virtually inevitable'.<sup>111</sup> The Permanent Secretary to the Treasury, Sir William Armstrong, chairing an F.U. meeting that day, warned colleagues that 'there must be a serious possibility of a devaluation on either the 18th or the 25th'.<sup>112</sup>

The government recognised, however, that there was an obstacle in the way, in the form of the US government. George Brown, the Foreign Secretary, felt that the potential fallout from a sterling devaluation was so serious for the dollar that it was necessary to approach President Johnson and his advisers to see if they would be able to launch an emergency rescue package for the pound. Officials in Washington were worried that a sterling devaluation would lead to a strong bear attack on the dollar. There might be a flight out of the dollar into the stronger European currencies (such as the deutschmark) or into gold. Pressure on the ability of the USA to hold the gold-dollar price would grow. In consequence, there would be increasing danger that Washington might be forced either to devalue the dollar against gold, or abandon gold-dollar convertibility, or introduce trade and exchange controls to prevent an outflow of dollars. The future of the Bretton Woods system was threatened. If the system were to collapse the consequences for international economic co-operation would be serious; there was a good chance that a move to protectionism throughout the advanced capitalist world might start.<sup>113</sup>

The British government was aware that President Johnson and Treasury Secretary Fowler viewed the prospect of sterling devaluation with dismay. Indeed, Fowler had called it 'a step into the abyss'.<sup>114</sup> In these circumstances, it was in the US national interest to try as hard as possible to put together another rescue package. This point was appreciated in London, where it was also understood that if the sterling rate was changed and the dollar came under pressure as a result, it would not be possible to count on support for the new sterling rate from the Federal Reserve.<sup>115</sup> Whether Britain devalued or not, therefore, it had to consult Washington first and allow the latter some room to see if an acceptable rescue deal was feasible.

110. TNA, PRO, PREM 13/1447, note for the record of meeting held in No. 11, Downing Street at midnight on 9–10 Nov. 1967.

111. Wilson, *The Labour Government 1964–70*, 451.

112. Bank of England, OV44/139, note for the record by McMahon.

113. Francis J. Gavin, *Gold, Dollars and Power. The Politics of International Monetary Relations, 1958–71* (Chapel Hill, 2004), 167–71.

114. TNA, PRO, T 295/904, Kahn, 'Enquiry', 85.

115. Bank of England OV44/140, Armstrong to Maude: 'Fund Drawing and Standby', 15 Nov. 1967.

These considerations, rather than any last-ditch enthusiasm for the old parity, were what persuaded Wilson to send Rickett (who had only just flown back from Paris) out to Washington on 10 November, along with Jeremy Morse (Bank of England), to discuss a rescue. The government was clear that it was looking for 'a \$3 billion package of long-term help', preferably in the form of a multi-government operation led by the USA, Germany and Italy.<sup>116</sup> A telegram from Wilson to Johnson on 9 November explained that any arrangement had to include measures to underwrite the sterling balances, with British dollar investments as collateral.<sup>117</sup> This would immunise Britain from the effects of changes in the level of the balances, and bring to an end 'the period of existence from hand to mouth'. The government added (in an effort 'to make their flesh creep'<sup>118</sup>) that in the absence of a solution on such lines, it would have to reduce Britain's defence commitments in the Far East and in Germany.<sup>119</sup>

The British approach made an impression. Johnson was very keen to prevent devaluation but clear that Congress would not give him the authority to deliver the grand package outlined in the telegram of 9 November.<sup>120</sup> As a result, the Americans turned to the IMF and the central banks of the Group of Ten, whose Governors were then meeting in Basle. The upshot of all these discussions was a proposal for a \$3 billion IMF stand-by arrangement for Britain, which emerged on Sunday 12 November. This was a very ambitious initiative. It would take the UK to more than 250 per cent of its quota in the Fund, and therefore would necessitate the waiver of the usual 200 per cent limit. The Managing Director of the Fund, meeting Morse and Evan Maude (British Economic Minister in Washington), pointed out that a standby on such a scale 'would be unique in the Fund's history', and would therefore be conditional on a series of assurances about the direction of British economic policy. These would involve, first, restraints on the money supply, including ceilings on bank credit; secondly, a budgetary policy appropriate to an annual growth rate compatible with a balance of payments surplus; thirdly, an incomes policy; and lastly assurances that there would be no imposition of quantitative restrictions or of exchange controls on current transactions unless the Fund agreed. Schweitzer also insisted that if, after all, the parity was changed, it should be to a fixed and not to a floating rate.<sup>121</sup>

116. *FRUS*, 1964–68, VIII, document 150, Fowler to Johnson, 12 Nov. 1967.

117. Wilson, *The Labour Government 1964–70*, 451.

118. Cairncross, *The Wilson Years*, 244, entry for 13 Nov. 1967.

119. Bank of England, OV44/143, Flash Telegram from Prime Minister to Washington, 9 Nov. 1967.

120. Wilson, *The Labour Government 1964–70*, 452.

121. TNA, PRO, PREM 13/1854, Dean (Washington) telegram to Foreign Office, 12 Nov. 1967.

The next stage has become the subject of some confusion. Callaghan and Wilson have recorded that they found the conditions unacceptable and rejected the IMF's terms. Roy, followed by Hamilton, argued that this is untrue.<sup>122</sup> They say that the offer was withdrawn, because Schweitzer felt that the \$3 billion standby was so far above the 200 per cent quota that it would represent a major policy departure for the IMF and alter the institution's character.<sup>123</sup> It was this act which led Wilson and Callaghan to admit that 'twelve o' clock had struck' and that devaluation had become inescapable.<sup>124</sup> This picture, of a forced devaluation, or at least of one in which the government 'decided to jump before they were pushed',<sup>125</sup> is however itself inaccurate. Although it is true that Schweitzer did perform a volte-face, Wilson and Callaghan had already decided to turn down the IMF proposal before they heard about the Managing Director's change of mind.<sup>126</sup> Callaghan was not prepared to recommend the conditions to the Cabinet.<sup>127</sup> Wilson regarded them as 'intolerable', involving 'the most searching intrusions not only into our privacy, but even into our economic independence'.<sup>128</sup>

A sterling rescue was not compatible with the requirements of the economic strategy developed after July 1966. The government feared that the restrictions on output for which the Fund was looking as a condition of saving sterling would have involved severe deflation and continued growth in unemployment. Forecasts were predicting (accurately, as it turned out) growth rising to 4 per cent in 1968, but this was a level deemed by the Fund to be too high for the return of balance of payments equilibrium; to satisfy the organisation, therefore, there was a requirement for cuts in public and private spending even more extensive than those involved in a package supporting devaluation. Wilson told the Queen that the 'economic and financial conditions' attached to the package 'would have been totally unacceptable to Your Majesty's Government and to the British people'.<sup>129</sup>

The failure to launch the \$3 billion standby was the end of the matter for Wilson and Callaghan. Governor of the Bank of England O'Brien, meeting the central bankers in Basle, telephoned to report a new US

122. R. Roy, 'The Battle for the Pound', Univ. of London Ph.D. thesis (2001), 302; Hamilton, 'Beyond the Sterling Devaluation', 78.

123. TNA, PRO, PREM 13/1854, Dean to Foreign Office, 12 Nov. 1967.

124. Hamilton, 'Beyond the Sterling Devaluation', 78, quoting a minute from Trend to Wilson of 16 Nov.

125. Hamilton, *ibid.*, 79.

126. TNA, PRO, T 295/904, Kahn, 'Enquiry', 86; Cairncross, *The Wilson Years*, entry for 13 Nov., 244; Wilson, *The Labour Government 1964-70*, 453.

127. Callaghan, *Time and Chance*, 220.

128. Wilson, *The Labour Government 1964-70*, 453.

129. TNA, PRO, PREM 13/1447/1, Prime Minister to HM the Queen, 16 Nov. 1967.

initiative, offering a \$2 billion loan composed of a \$1.40 standby from the IMF and \$600M from themselves. Callaghan was unimpressed; the sums involved were too small, and the deal would provide relief only 'for a year or two',<sup>130</sup> whereas the government was clear that any rescue had to be long term. By late on 13 November, neither Wilson nor Callaghan were in any doubt about the decision to devalue, and concluded that their attention should now focus on details such as the level of the new rate. \$2.40 was agreed, and the Prime Minister accepted that sterling should be fixed at this level and not allowed to float. He accepted warnings from the Bank and the Treasury that a float, being downward, might spark 'a stampede out of sterling by official holders', would not be supported by the IMF (being in breach of the UK's obligations to the Fund) or the EEC, and would antagonise the Americans. In the absence of external backing, the rate would simply keep falling unless the government was prepared to accompany the float with a severe deflationary shock to the economy.<sup>131</sup>

At this point, a general acceptance began to spread around the European governments, the IMF and leading US officials that it was time 'to prepare for a change in the rate'<sup>132</sup>—but there was to be another, final, twist in the story, which developed as a result of an intervention by President Johnson himself. He now insisted that the European governments be pressed 'very hard' to produce a rescue package.<sup>133</sup> Washington's opposition to a sterling devaluation, which had seemed to have collapsed, suddenly revived. During the rest of the week from 13 to 18 November, Fowler laboured hard to put together financial support for sterling. On 15 November, Maurice Parsons (Bank of England) and Sam Goldman (Treasury) were informed by Dewey Daane, a US delegate to the Group of Ten, that Johnson and Fowler were opposed to devaluation, and that they could not guarantee Federal Reserve backing for sterling if the rate were to change, because of the likely threat to the dollar which would result.<sup>134</sup> By 16 November, the Group of Ten were offering the UK \$1375m in short-term bilateral credits, 'on assumption of no devaluation' (sic). With this, and a \$1400m IMF standby as well as \$500m in the dollar portfolio, there was now \$3275m available to defend the sterling-dollar parity.<sup>135</sup>

130. Callaghan, *Time and Chance*, 220.

131. Bank of England, OV 44/139, memorandum by McMahon, 9 Nov. 1967; TNA, PRO, T312/2764, FU paper (67) 5, 2nd revise, for the 'Winter Dossier 1967/8' on devaluation: 'Fixed or Floating Rates'.

132. TNA, PRO, PREM 13/1854, Dean to Foreign Office, 23:57, 13 Nov. 1967.

133. TNA, PRO, T 294/904, Kahn, 'Enquiry', 86–7.

134. TNA, PRO, PREM 13/1447, 'points raised at Sir William Armstrong's meeting at 3.00 p.m. this afternoon'.

135. *FRUS* 1964–68, vol. xii, document 281, record of 17 Nov. conversation between Deming and Griffin (USA) and Armstrong and Rickett (UK).

The problem for the USA was that the British government had decided to devalue by the time Fowler had assembled this deal. The British could not, however, afford to make this public until all the steps in the War Book had been completed. This was not just a question of procedural niceties. The accompanying measures had to be agreed, government departments briefed, a Cabinet meeting convened, Britain's remaining colonies and the OSA informed and the IMF notified. The War Book also made provision for communication with the USA and Germany, and then other OECD members, in that chronological order. The last-minute intervention by the USA, however, disrupted the timetable. It meant that the government had to be seen to be continuing with negotiations. Yet these were a charade designed to prevent a collapse of sterling in the market. The government was clear that it would accept no more short-term support; this would merely involve it in further applications for assistance three months down the line. Nor was it interested in a new IMF standby for the old rate: this would take too long to arrange and, said Callaghan, would be likely to involve 'a nice letter from the Chancellor' to Schweitzer, as well as 'a more searching consideration of our economic policy than on previous occasions' when Britain had received IMF support.<sup>136</sup> On the other hand, Schweitzer had already informed Callaghan that he saw no problems with the rapid organisation of a \$1.4 billion standby, if there was a devaluation. This would be unconditional, 'provided that, as he wd (sic) expect, we came to him with a programme of accompanying measures which was comprehensive and adequate to the situation'.<sup>137</sup> Meanwhile Emminger had told Rickett on 9 November that EEC central banks, with the possible exception of the French, would consider 'substantial support for sterling' in the event of devaluation.<sup>138</sup> Despite the doubts about the US attitude, there was, therefore, the prospect of significant financial backing for the new rate, which would protect it from speculative attack without impeding the government's economic autonomy. This led to general agreement, expressed by Armstrong at a meeting with Callaghan and O'Brien on the morning of Thursday 16 November, that the necessary shift of resources towards exports would involve 'even more severe deflation without devaluation than with it'.<sup>139</sup> When it was set against this alternative, the Fowler package simply lacked the qualities the government had sought in any rescue: it was unlikely to be raised,

136. Bank of England, OV 44/140, note by Baldwin of a meeting on the morning of 16 Nov. 1967.

137. TNA, PRO, PREM 13/1854, Dean to Foreign Office, 23:57, 13 Nov. 1967.

138. TNA, PRO, PREM 13/1447, note for the record of meeting held at midnight 9–10 Nov. 1967.

139. Bank of England OV 44/140, note for the record by Baldwin, 16 Nov. 1967.

in its totality, very fast; the IMF component would be likely to involve unacceptable interference in economic policy; and it was neither large enough nor long-term enough.

Callaghan told the Cabinet, meeting later that morning, that both he and the Prime Minister were recommending devaluation 'not out of sheer insufficiency of liquid resources', but because the interaction of low international confidence in the pound with an unsatisfactory balance of payments prospect had set off a wave of speculation which was unlikely to die down. Continued defence of the parity would lead to the exhaustion of the reserves, and there would be nothing left with which to defend a new rate. The Chancellor did acknowledge that there was a possibility of backing from the international monetary community, on a short-term basis, for a few months. But he did not believe this to be 'acceptable'. 'When the credits were exhausted we would be in the same boat as we are now', he told his colleagues. Moreover 'we would require considerable standby support from the IMF, which we could only hope to secure if we were prepared to accept conditions involving an unacceptably stringent international surveillance of our economic policies'. The Cabinet, which needed little persuasion, agreed that the pound should be devalued to £1 = \$2.40<sup>140</sup> and the decision was made public in a broadcast on the evening of 18 November, President Johnson having been told after lunch on the 17th (Washington time).

Despite all the planning and deliberation behind Operation Patriarch, its implementation was surrounded by confusion. Rumours that a rescue deal was being negotiated appeared in the press, and in BBC reports, on Thursday 16 November. They prompted a Parliamentary question from Labour backbencher Robert Sheldon about what conditions were likely to be attached. Callaghan, knowing that the Cabinet had just endorsed devaluation, neither could confirm that there would be a rescue nor could he deny that there would be one, in case this let loose a wave of speculation against sterling.<sup>141</sup> His refusal to make a comment one way or the other was, however, taken by the markets as an indication that the government was contemplating devaluation. A massive sale of sterling commenced. Substantial Bank support of the currency became necessary, as the rate, which had risen to \$2.7848 when the rumours of a rescue were published, slid down to its floor level of \$2.7825 (below which it was not supposed to drop unless it was being formally devalued) before closing on \$2.7831.<sup>142</sup> Kahn found that although the Chancellor's reply did not reach the news agency tapes until 4.00 pm on Thursday afternoon 'some \$50 million of support was

140. TNA, PRO, CAB 128/42, CC (67) 66th conclusions, 16 Nov. 1967.

141. Wilson, *The Labour Government 1964-70*, 456-7.

142. Keith Payne, 'Chaos in the Markets', *Times*, 17 Nov. 1967, col. A.



given in the forward market and \$76 million spot before the close of business in New York (at 10.00 pm GMT)'. The turbulence became more intense on Friday, with the EEA spending \$1,450m, of which \$1,316m was spot, defending a currency whose devaluation was just hours away. It all meant that Saturday's announcement came as no surprise; as Kahn writes, 'the deliberate and orderly programme of the contingency plan' had been 'disrupted'.<sup>143</sup> The devaluation, following on the sudden and chaotic loss of almost \$1,600m from the reserves in less than two days, appeared to have been forced on a government which had lost control of events. It left a very misleading impression behind, which long influenced the way historians wrote about the devaluation.<sup>144</sup>

The 1967 devaluation of sterling was the outcome of a choice. It did not represent surrender to market forces, but a recognition that the construction of a social-democratic Britain could not proceed at the old parity. Soldiering on at £1 = \$2.80 meant either protectionism or deflation. Following the July 1966 measures, the government had attempted to steer a middle course between deflation on the one hand and over-ambitious expansionism on the other. The decision to devalue was an attempt to maintain this middle way, but in the end the path took Labour further than it had expected to go in the direction of deflation. The year 1968 was turbulent; it took time for confidence in sterling to return. In the first months after devaluation, the import bill rose sharply. As a result markets shared the view expressed by the IMF in November 1967 that external balance would require tighter restrictions on public as well as private spending than was congenial to the British government. A sharply deflationary budget in March 1968, reinforced in November by rises in indirect taxation, restrictions on bank lending and, finally, by import deposits, did however succeed in shifting resources into exports. By early 1970, the problems of 1964–8 were a bad memory; the current account surpluses for 1969 and 1970 amounted, respectively, to £554m and £911m.<sup>145</sup> Exports in 1970 accounted for 22.5 per cent of GDP, their highest level since 1952. This achievement was accompanied by a squeeze on domestic consumption, and growth actually fell closer to 2 than to 3 per cent in 1969 and 1970, before picking up strongly in 1971. Although unemployment never rose above 2.5 per cent, the electorate punished Labour in June 1970 by narrowly electing (with an overall majority of 30) a Conservative government. Yet

143. TNA, PRO, T 295/904, Kahn, 'Enquiry', 94.

144. See for example, K. O. Morgan, *The People's Peace* (Oxford, 1992), 275–6, which also mistakenly says that the Bank rate was raised to 16 per cent in Nov. 1967, whereas it went up to 8 per cent after the devaluation.

145. Middleton, *British Economy since 1945*, Table II.3, 150–1.

the new administration inherited an external position which appeared to provide a good foundation for sustained expansion of the economy.

Wilson presented the devaluation as an opportunity for Britain to escape from external constraints on growth. He was widely criticised for appearing to make a virtue out of an event which he had for three years been trying to prevent. Yet both the Prime Minister's opposition to devaluation and his willingness to embrace it were rational. On the one hand, the new rate arguably provided current and future administrations with the opportunity to achieve export-led growth, an objective of governments of both main parties from the early 1960s up to the end of the 1970s. On the other hand, devaluation did necessitate more deflation. Moreover the crisis which had led to it, like those which had preceded it every year since 1964, was a clear indication that the international environment which had since the late 1940s supported the Keynesian synthesis of full employment and an open international trading system was itself running into crisis. The financial architecture of this system had been constructed according to rules agreed at the Bretton Woods conference of 1944 which had led to the establishment of the IMF and the World Bank. The rules in question had committed IMF members to fixed exchange rates, in return for which they qualified for financial support in the event of balance of payments problems which threatened their reserves. Devaluations were acceptable only when the economic evidence, based on relative costs and export and import levels over several years, pointed to a nation's currency being in 'fundamental disequilibrium'. But a rate change was very much a weapon of last resort, since there was anxiety that it could provoke retaliation and trigger a return to 1930s-style economic nationalism. Accordingly, the advanced industrial states had developed a set of powerful, if ad hoc, mechanisms to support national currencies through periods when they had come under pressure as a result of persistent balance of payments difficulties. In 1961, the Group of Ten had established the swap agreements and the General Arrangements to Borrow, by which they agreed to make \$6 billion available to the IMF, so that it could offer more backing to national currencies.

The increasing availability of this central bank and IMF credit was, therefore, designed to allow national governments to sustain expansionary domestic policies even when their economies were in external deficit. Britain had made considerable use of these facilities since 1961. As a result, even when there had been a significant current account deficit, as in 1964–5, the defence of the pound had not involved any sacrifice of the post-war nation state's commitment to the preservation of full employment.

The problem was that the growing size of private financial balances, notably the Eurodollars, was eroding the ability of public power, expressed through the central banks, national treasuries and ministries

of finance and the IMF, to stabilise currencies even when the rescue packages were large (as in the sterling rescue of November 1964). The public authorities had established a set of criteria by which they assessed national adjustments to external disequilibria; their ideas of 'confidence', involving in Britain's case stable wage costs, control of government spending and progress towards a current account surplus at £1=\$2.80, had governed the behaviour of the markets towards sterling in 1964–6. Yet there had been clear signs that a new dimension was also influencing sterling's international standing, namely the tendency of the footloose Eurodollars to move from one financial centre to another. This constantly weakened the ability of the national and international agencies to give governments a convincing vote of confidence even when, as with the UK in 1967, there was a consensus that the Labour administration's economic strategy was the appropriate one. Private funds tended to react more sharply to crises affecting sterling even if these were beyond the government's power to control, such as the crisis in the Middle East, higher interest rates elsewhere, the international economic slowdown and the unofficial dock strikes. Without the £322m rundown in NSA balances between July and October 1967, sterling's position that autumn would not have become so difficult.

The 1967 devaluation of sterling was therefore a response on the part of the British government to this changing balance of power in the international economy. It involved an acceptance that a convincing process of adjustment meant accommodation with the markets. In November 1967, this accommodation was acceptable because it seemed compatible with the government's economic strategy. In 1968, however, further bouts of speculation against sterling, in the teeth of international conviction that the government was taking the correct steps to correct the external deficit, precipitated two major economic crises whose implications were so serious that the government was forced to consider opting out of the global economy. For a brief time, the price of economic independence seemed to involve reverting to a wartime siege economy.<sup>146</sup> The liberal socialist synthesis survived in the end, thanks to concerted international action. But the events of 1967–8 provided a glimpse of what would happen to Labour when the international environment which had supported British social democracy passed away during the 1970s and 1980s: a choice between autarky and compromise with resurgent neo-liberalism. It was a dilemma which was to greet socialist and social-democratic governments throughout the advanced industrial world.

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146. See Hamilton, 'Beyond the Sterling Devaluation', 86–8.