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Sterling, Bretton Woods, and Social Democracy, 1968–1970

SCOTT NEWTON

Following the November 1967 sterling devaluation, the British Labour government of Harold Wilson struggled to defend the new exchange rate of £1 = \$2.40. Sterling's travails continued throughout 1968 and well into 1969 despite growing evidence that the external balance was moving into the black. Its problems arose from external difficulties, notably from the growth of footloose balances of foreign currencies—especially Eurodollars—within the international economy and from instability caused by the decline of the Bretton Woods system. Labour was determined to protect the new exchange rate, since a new devaluation or even a float would have led to a run on the pound, the collapse of its economic strategy, and the failure of its attempt to build a social-democratic order in Britain. It was successful in the end thanks to growing confidence in its policies and to belated international co-operation designed to salvage the Bretton Wood regime.

For many years, analyses of sterling and macroeconomic policy in Britain during the 1960s focussed on the struggle of the Labour governments of Harold Wilson to defend sterling between 1964 and 1967. Little was published on the tribulations of sterling after devaluation from £1 = \$2.80 to £1 = \$2.40 on 18 November, 1967, although its fragility throughout 1968 was acknowledged by Tomlinson, and Cairncross and Eichengreen pointed to the significant level of international support required to preserve the new parity.¹ Their work showed that Britain needed £1,300m in backing from overseas monetary authorities in 1968. This covered a current and short-term capital account deficit of over £1,400m without running down gold and foreign exchange reserves to the point at which further devaluation became inescapable.

The accepted explanation for this apparent generosity has been that after devaluation the international financial community—the Bank for International Settlements (BIS) in Basle, the central bankers of the leading

industrial states, and the International Monetary Fund (IMF)—were all determined to support sterling to avert further devaluation. They feared that the collapse of the junior reserve currency could lead to the development of pressure on the main one, the dollar, itself also in deficit with the rest of the world. This would menace the American ability to maintain gold–dollar convertibility at the fixed price of \$35 an ounce, and in so doing threaten to destabilise the Bretton Woods international monetary system based on the universal acceptability of the dollar and on fixed—but adjustable—exchange rates. The fear was not groundless: there had been a rush to sell dollars and buy gold at the time of the sterling devaluation. The widely accepted imperative of sustaining Bretton Woods meant that sterling’s survival throughout 1968 at the \$2.40 parity was less troubled than it had been between October 1964 and November 1967, despite the existence of a deficit considerably larger than at any point in the previous four years.²

Recent work, however, has led to a shift of perspective following the demonstration of sterling’s vulnerability and exposure to recurrent crises after its November 1967 devaluation.³ In response to the weakness of sterling in the markets, whilst developing contingency plans for floating the currency and blocking the sterling balances, the Treasury discussed with the United States ways in which the international monetary system could be reformed. Although accurate as far as it goes, the argument ignores the events of summer–autumn 1969 and underplays the government’s commitment to the Bretton Woods order of fixed exchange rates and its hostility to floating. Wilson and his chancellor of the Exchequer, Roy Jenkins, believed the maintenance of the Bretton Woods order to be essential to the success of the post-devaluation economic strategy. Given that floating rates were incompatible with Bretton Woods, they could only be defended as a strategy of last resort, to be implemented in the event of its breakdown. In the absence of such an eventuality, they were seen as likely to bring disaster on both the British and the international economy. It is true that prior to the devaluation, senior Labour economic advisers and even Wilson were prepared to consider the possibility of a floating rate.⁴ But the appeal of this option withered thanks to the increasing instability of the post-devaluation international environment. Changing circumstances led Wilson and Jenkins to fear that if they were forced to float the pound, they would be faced with the defeat of their economic strategy and the collapse of British social democracy.

There were three sterling crises in 1968–1969: in March and November 1968 and in August 1969. Moreover, for much of the period between December 1967 and September 1969, sterling faced pressure in the foreign exchange markets even when its parity was not being threatened. Sterling’s weakness stemmed from two underlying causes. The first was fragile confidence in the Labour government’s post devaluation economic strategy. It was intended to deliver a balance of payments surplus running at an annual rate of £500m to be achieved by the end of 1969. It was a tall order,

but the surplus had to be large enough to permit repayment of the large external debts acquired by Wilson's government in its efforts to defend the old exchange rate and provide a platform for a sustained expansion of the British economy—the Holy Grail of economic policy for the best part of a decade.

Much of this debt was short-term, owed to the United States Federal Reserve Bank and to central banks in the leading industrialised states under three-month currency swap arrangements organised by the BIS. In addition, the Bank of England had provided very considerable support to the forward market in sterling—mostly three-month—during autumn 1967; these obligations had amounted to \$4,782m on devaluation.⁵ These either had to be rolled over or, more likely, redeemed at the old rate. By the end of February 1968 the reserves totalled \$2,771m and available short-term borrowing facilities were \$1,686m. Indebtedness to foreign central banks and the BIS was running at \$3,384m and forward market commitments now stood at \$2,851m. There was no doubt that liabilities exceeded assets. Excluding from calculations the forward position on the one side and the undrawn credits on the other, the Britain had a negative reserve position of \$613m.⁶

Thanks to the existence of foreign-owned sterling balances banked in London, the position of sterling was, however, even more precarious than suggested by these figures. Of these, almost £4 billion—\$9.6 billion—had arisen as a result of sterling's historic role as an international reserve and trading currency. The balances represented significant liabilities and demonstrated considerable volatility. In the six weeks after devaluation, Overseas Sterling Area (OSA) balances, belonging for the most part to interests in Commonwealth countries or nations with longstanding economic ties to Britain, were run down by £200m, a very high figure in relation to fluctuations normally recorded in this category of holdings over the recent past.⁷ Their withdrawal from London in favour of diversification into other currencies added to the strain on Britain's external financial position; acting through the Exchange Equalisation Account (EEA), the Bank of England was required to provide gold, dollars, deutschmarks, or any other currency in demand from British foreign currency reserves in exchange for unwanted sterling. A danger existed that the losses to the reserves provoked by switching out of sterling on such a scale would lead balance holders to fear further sterling depreciation. In consequence they would decide to continue with diversification, which in turn would cause more pressure on the reserves and therefore add to anxiety about the future of the exchange rate. A vicious circle loomed, threatening to cause financial crisis in the City, the abrupt termination of sterling's international role, and disruption to the international monetary system.

Labour had been searching since summer 1965 for international agreement on measures to underpin sterling for the long-term,⁸ thereby forestalling such a denouement. The best that could be achieved was the Sterling

Group Arrangement (SGA), established by the BIS in June 1966. It provided the Bank of England with up to \$1 billion in credits. They could, however, only be drawn to finance 50 per cent of the losses to British reserves caused by diversification. Initially the SGA was limited to nine months but it was renewed annually until liquidated by instalments between September 1969 and January 1971.⁹

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

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

There were, however, two other factors contributing to sterling's weakness. The first stemmed from the growing instability of the Bretton Woods international monetary order based on fixed exchange rates and the convertibility of the world's leading reserve currency, the dollar, into gold. Unfortunately the dollar as well as sterling had accumulated considerable liabilities by the mid-1960s. These, the dollar balances above all, had provided the liquidity that had underpinned the expansion of world trade since the late 1940s. There had been a steady outflow of dollars from the United States, caused initially by foreign assistance programmes such as Marshall aid but then sustained by military spending overseas—now including the commitment to the Vietnam war—imports, and foreign investment mainly by multinational corporations. The latter had from the late 1950s been building factories or buying firms, especially in Western Europe. This process had led to an accumulation of dollars in the world economy, some of which were held by the central banks of surplus countries such as West Germany or France. Others were deposited in private banks, many of them in London,

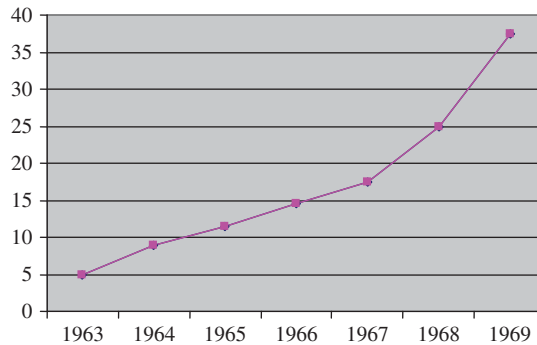


FIGURE 1 Estimated Size of the Eurodollar market (\$bn) (color figure available online).

Source: BIS Annual Reports, 1965–70.

and became known as “Eurodollars” (see Figure 1, above). They remained acceptable to the holders because of the dollar’s convertibility into gold at \$35 an ounce; but by the early 1960s, there were increasing anxieties on the part of the Americans themselves and their creditors that American liabilities far exceeded the reserves available to honour such obligations.

The IMF appreciated that the growth of dollar holdings was a weakness in the world monetary system: what would happen if and when American policy began to focus on correcting the external position? If supplies of dollars and gold in the world economy became inadequate, some countries would seek to build up their reserves, essential for the financing of external deficits, through protectionist or deflationary steps. The effect would be to reduce the reserves of other countries, which would then have to respond in kind. The upshot would be a downward spiral of world trade, production, and employment. One of the most debated schemes to address this issue was the Triffin Plan, named after the economist Robert Triffin, which proposed a substantial increase in world liquidity.¹⁰ But Triffin was not alone and, by 1963, within Britain, both the Conservative chancellor, Reginald Maudling, and the then Labour Opposition leader, Wilson, proposed that the IMF “create international credit *parri passu* with the development of world trade.”¹¹

Britain’s campaign for extra liquidity was driven by two considerations. First, both the Conservative government of Harold Macmillan and Wilson’s subsequent Labour administration were committed to expansionary economic strategies. But Maudling’s stimulus measures after 1962 had led to a growing current account deficit. Access to more generous and automatic external support than provided for by the IMF at the time would allow British governments and others with external financial difficulties to adjust to the deficits without recourse to deflationary measures. Secondly, both Maudling and his successor, James Callaghan, believed that it might be possible for sterling holders to exchange their balances for a new reserve asset to be

held by the Fund, hence reducing the reserves' vulnerability to runs on the pound caused by "confidence" rather than trade factors.¹² Callaghan was especially committed to reform of the international monetary system based on the creation of more liquidity. He pointed out that the commitment of the American and British governments to "a quantum of foreign currency," governed by the actual needs of international commerce and "capable of deliberate expansion and contraction to offset deflationary and inflationary tendencies," went back to 1942 when Lord Keynes had launched his plan for an International Clearing Union.¹³

An international monetary system that ensured the compatibility of full employment and national economic expansion with membership of an open world economy provided the foundation of the synthesis between liberalism and socialism for which Keynes had worked in his last years,¹⁴ and to which the Labour Party had been committed since 1945. A mechanism for providing external liquidity to debtor nations was central to the project. Keynes's Clearing Union was designed to perform this function but it had failed to gain American backing. It followed that when the Clement Attlee's Labour government came to power in summer 1945—committed to an ambitious programme of national and social reconstruction—it had faced what Keynes called a "financial Dunkirk": a grave shortage of foreign exchange. Without external assistance it would either have had to cut the import bill via drastic deflation, thereby creating large-scale unemployment, or impose a system of rigorous protectionism that might have sustained a higher level of employment but at a more intense level of rationing and suppression of personal consumption than in wartime. It would have been a choice between abandoning its mission and attempting to salvage it via recourse, for an indefinite period, to a political economy close to the Soviet *Gosplan* model: central planning both of the domestic economy and of the foreign trade sector, with trade and exchange rate arrangements characterised by protectionism and an inconvertible currency. The role of free markets and the price mechanism would have been very limited. External financial support, in the form of American aid under the Anglo-American Financial Agreement of 1946 and then the Marshall Aid scheme of 1948–51, had however allowed Labour to reject both of these options and embark on the construction of a liberal socialist or social-democratic political economy. This involved the mixed economy, progressive taxation, high levels of government spending on housing, health, and social services, and commitment to non-discrimination in foreign trade and exchange rate policies.¹⁵

The party had remained true to this tradition under the leadership of Hugh Gaitskell and Wilson. Wilson's governments backed international trade liberalisation and supported the Kennedy Round of talks in GATT designed to reduce tariff and non-tariff barriers.¹⁶ Labour's National Plan for the modernisation of the economy, launched in 1965, explicitly stated the government's commitment to the market economy¹⁷; and it took an

“indicative” approach based on co-operation between the government, private industry, and the trade unions. The objective was an annual average growth rate of 3.8 percent. This attempt to construct a “New Britain” depended on engagement with a global economic environment that would support growth-oriented policies: international monetary reform designed to improve liquidity was therefore a national interest, especially after Labour’s election in October 1964.

Discussions about international monetary reform had started within the IMF during the early 1960s. But Britain’s enthusiasm for more liquidity was not powerful enough to prevent the talks from lasting for the best part of six years, concluding with the Fund’s adoption of the Special Drawing Right at its AGM in September 1968. The inability of the world’s ten wealthiest states—the Group of Ten—and the IMF to reach a consensus on international monetary reform meant that the growth of global trade and finance continued to depend on two reserve currencies whose value was not universally trusted. Why did the talks take so long? One problem derived from Washington’s anxiety that the creation of a new reserve asset might lead to a decline in the dollar as an international reserve currency: until well into the Lyndon Johnson Administration, the consensus in Washington was that a series of *ad hoc* measures to preserve exchange rate stability, the “ad hoceries,” together with steps to restrict the flow of capital out of the United States and a successful conclusion of the Kennedy Round of multilateral tariff reductions, would bring the deficit back under control and lead to its elimination.¹⁸ Washington’s “ad hoceries” were focussed on the gold pool, set up in 1961; the General Arrangements to Borrow (GAB), 1961; and the swap network, which started in February 1962. The first of these allowed for intervention by the leading industrial Powers to keep the price of gold stable against the dollar, by co-operation in buying gold when the price slipped, and in selling it when the price of gold rose. The second led to an expansion of \$6 billion in IMF resources to be managed by the Group of Ten. The third involved the extension of short-term, usually three-month, mutual credit facilities between the central banks of the Group of Ten—including Switzerland—and administered by the BIS. These could be drawn on to counter-act speculative flows of money out of one currency and into another that might otherwise have led governments under attack in this manner to invoke trade and exchange controls, devaluations, or currency floats.¹⁹

It was not until after Johnson won the November 1964 presidential election that he felt confident enough to consider moving beyond such piecemeal tinkering. There was, however, another major obstacle in the way of rapid international agreement. This was the French attitude.²⁰ The French President, Charles de Gaulle, argued that the Americans had used the dollar’s status as the world’s leading international reserve currency to accumulate excessive amounts of credit from the world’s leading industrial Powers. By 1965 the French were committed to their own reform scheme,

based upon increasing the price of gold and creating a new reserve asset—the Collective Reserve Unit, partially convertible into gold—to supplement and ultimately replace the dollar.²¹ Finally, the pace of the talks was retarded by the determination of the six countries comprising the European Economic Community (EEC) to negotiate with a single voice and boost its international bargaining power. The problem was that there were significant differences within the Six. French determination to undermine the position of the dollar was not shared by the other Five, whose main concern was not about replacing the current system but keeping it and introducing more liquidity, whilst ensuring that debtors would not be indulged.

It followed that there could be no rapid external solution to the British problem. London was left negotiating with the Group of Ten, the Fund, the Americans, and the BIS to establish its own network of “*ad hoc*” arrangements based on IMF support, short term central banks loans, and swap agreements designed to protect sterling and the reserves. This failure to resolve the international liquidity problem enhanced the vulnerability of the reserve currencies to speculative movements based on anxiety that they would be devalued. And the growth of such speculative movements of money across national borders, notably in the form of Eurodollars, was the second factor contributing to sterling’s ongoing instability.

Eurodollar balances had expanded with the trend to trade and payments liberalisation common to most advanced industrial states from the later 1950s. To begin with, they were driven by the efforts of American banks and multinational corporations to escape from domestic exchange controls and banking regulations. This outflow of dollars from the United States then accelerated as American corporations increased direct investment in Western Europe, attracted by relatively lower wage costs and rapidly expanding markets. Although the growth of this new market was driven by developments in the American economy, continental banks and companies were contributing by the second half of the 1960s. All these firms tended not to repatriate their overseas earnings but either placed them in banks where they could be drawn for investment or moved them from one financial centre and one national currency to another in search of a good rate of return, dependent on interest rate changes and expectations of exchange rate alterations.²²

The most favoured destination for these funds was London, and by the end of 1965, out of total Eurodollar deposits of \$9,102m, \$4,257m (46.8 per cent) was banked there.²³ London was home to a large highly attractive short-term money market, especially to American banks. They were able to offer their dollars on the European inter-bank market or convert them into sterling loans—usually of three months—to British local authorities and hire-purchase companies, where rates were generally between 0.5 and 1 per cent higher than those offered by Treasury Bills.²⁴ This option also appealed to non-dollar Non-Sterling Area (NSA) interests, many of which were private organisations rather than official institutions.

The increasing interdependence of capital markets in leading industrial states during the 1960s, arguably a key stage in the development of economic globalisation, generated an international financial community dominated initially by the IMF and the BIS with its own priorities. The most significant of these was “confidence,” which when applied to Britain meant assurance that the government was genuinely committed to an economic strategy capable of delivering a sustained balance of payments surplus at the prevailing exchange rate within the short to medium term. The sterling crises of 1964–1967 demonstrated the fragility of sterling’s position: on each occasion, the catalyst was a lack of confidence in the currency’s future as an international reserve currency.

The question of “confidence” was, however, increasingly complicated by the freedom of the rapidly growing mobile private funds to move in and out of national currencies regardless of the opinion of international organisations like the IMF or the BIS and the central banks of the Group of Ten. Their motives were often speculative: the sterling crisis of November 1964 was exacerbated by short selling; dealers borrowed sterling and then sold it for dollars, anticipating that they would be able to repay their debts at a profit on the New York market following the devaluation of the currency.²⁵ Held by foreign central banks, governments, corporations, banks and private individuals, NSA sterling balances fell by almost £500m from July through to mid-November 1967.²⁶ As long as this somewhat febrile external environment lasted, it turned the search for a macroeconomic strategy that would win the confidence of the markets into Labour’s *ignis fatuus*. 1968–1969 was to see runs on the pound that occurred even after the government’s post-devaluation economic strategy had been endorsed by the IMF and the Group of Ten.

A sustained and considerable current account surplus may not have been a sufficient condition of restoring confidence to sterling, but it was necessary. Detailed contingency planning for devaluation had been ongoing within the Treasury and the Bank of England since the first half of 1965. The civil servants and advisers involved understood that devaluation would have to be accompanied by action to ensure that the home market did not pre-empt the resources required for an export drive.²⁷ When the pound was devalued, therefore, the government quickly introduced supporting measures. The IMF supported the new rate with a standby credit of \$1.4 billion, short-term central bank credits on a three-month, renewable, basis worth \$1.425 billion, and steps designed to curb the expansion of the home market. These included a rise of two percentage points in the Bank Rate as well as hire-purchase restrictions, tax rises, and spending cuts designed to reduce demand by between £400m and £450m. The package was intended to be the first stage of a programme for the transformation of the British external position, called the “Switch of Resources Strategy,” and designed to rebalance the economy in favour of export-led growth.²⁸ It was accepted that, thanks to

the expected operation of the J-curve following devaluation, export values would only start to overtake import values in the last quarter of 1968, but the measures were expected to deliver a balance of payments surplus worth £500m by the end of 1969. The second stage, involving further measures to limit home demand, would be introduced in the spring Budget.

This two-stage approach failed to inspire confidence. It was greeted with dismay by O'Brien, who argued that more needed to be done now; otherwise it would be unclear to the markets about government seriousness concerning reducing demand in the home market and transferring resources to export production. He said that whilst the steps announced so far might be intended to reduce demand at home by £400m, their impact would be more modest, and given the focus on tax and monetary changes, they would fall most heavily on business and industry²⁹. This would not assist the export drive.

O'Brien's misgivings were re-enforced a few weeks later as a result of meeting other central bankers at the BIS in Basle. He reported that his colleagues possessed little confidence in the government's approach, an assessment confirmed by the development of pressure on sterling in the markets. It was down at \$2.38. Arguing that unless the government acted very soon, it would struggle to hold the new parity, O'Brien said that only a programme of public spending cuts brought forward at the earliest opportunity would guarantee the new rate. Moreover, since devaluation to a new fixed rate would be unthinkable—there not being enough resources in terms of reserves and foreign credit—it would be necessary to consider whether a sterling float was now inevitable; its direction would be downwards.³⁰ A further slide in sterling would mean “a total and explicit failure of policy.”³¹

O'Brien's anxieties found support within the OECD and the IMF. The OECD finance ministers Working Party 3 met every month to monitor members' balance of payments positions and the steps taken by surplus and deficit countries to return closer to equilibrium. At the December meeting, Christopher Dow of the OECD Secretariat complained that there were times when Britain “gave the awful impression of a man standing in a lake of water, whose only ambition was that the water would not rise much above his chin.”³² Notwithstanding the standby arrangement, the IMF had doubted from devaluation onwards whether London was doing enough to hold down public expenditure. Winter 1967–1968 saw an outside world unconvinced that Wilson's government aimed for an economy capable not just of paying off existing debt but of maintaining a surplus thereafter.

The Treasury responded initially that little need existed for precipitate deflationary action on the domestic front. There was already—so the argument went—slack in the economy: unusually high unemployment by the standards of the 1960s (over 2.3 percent) could be turned to production for the export market. The Budget was the time for any further action; by that stage it would be possible to forecast the likely growth of domestic

output for the period to 1970 and, if necessary, adjust with taxation rises and expenditure cuts. This was however the line that had earlier damaged confidence, and in December both Wilson and Jenkins worried about the possibility of another crisis. The urgency of the situation was underlined when it became clear that the economy was actually expanding quickly, possibly by as much as 4.5 percent annually thanks to steps to ease credit and increase public spending taken in summer 1967 when it seemed as if the main issue was rising joblessness and slow growth. Fearing the development of a consumer boom,³³ Wilson and Jenkins set to work on a programme of public spending reductions with the intention of complementing them with a tough March Budget. A White Paper announcing details of some dramatic cuts appeared in the second half of January. They included the historic commitment to withdraw Britain's military presence east of Suez by 1971, as well as decisions to re-introduce National Health Service prescription charges and postpone raising the school leaving age from fifteen to sixteen.³⁴ The reductions amounted to £700m in civil expenditure programmes in 1968–1970—equivalent to 0.9 per cent of GDP in each year. These were re-enforced by substantial cuts in defence spending. The decision to cancel the order for the US-made F-111 fighter bomber could expect to save £400m by 1976, and the Cabinet agreed on annual economies amounting to two per cent of the 1967–1968 defence budget until 1972.³⁵

Wilson and Jenkins had seized the initiative so that the post-devaluation macroeconomic strategy could proceed free from crisis. The OECD saw the White Paper as being of “major political significance.” But even here the point was made that the cuts were not likely to have an early impact. The economy would still grow at a rate of more than four per cent in the current year, something likely to stimulate the home market, attract imports, and therefore exaggerate the impact of the J-curve on the balance of payments. Both the Dutch and German representatives in Working Party 3 thought a three per cent growth rate more compatible with the government's objectives. If government strategy was to retain credibility, the coming Budget would have to restrain demand by at least £400m—1 per cent of GDP—in 1968–1969.³⁶

Within the Bank of England and the City, even more pronounced scepticism existed about the long-term prospects facing the economy, plus some sympathy for the view of former Bank of England Governor Lord Cromer that a second devaluation was likely before long.³⁷ Motivated by a political distaste for the Labour government, some opinions expressed were characterised by a barely rational pessimism;³⁸ but with monthly trade figures throughout the first half of the year showing an unexpected surge in imports, they were not wholly unjustified.³⁹ Despite slackening pressure on sterling during February, the government still remained some way from gaining the confidence of either the international financial institutions or the markets.

Both Wilson and Jenkins understood that the Budget remained fundamentally important to a successful government strategy in terms of both its measures and the impact on confidence. Sterling remained vulnerable on the exchanges during February and early March. Imports were running on average £80m a month higher than before the change in the sterling rate.⁴⁰ Whilst exports performed well, those doubting the effectiveness and urgency with which Labour pursued its strategy lacked reassurance. Gilt-edged stocks lost ground when March trade figures were announced, and sterling fell on both the spot and forward markets.⁴¹

Between January and mid-March, the Treasury therefore focussed on the Budget. Jenkins accepted that the government had to aim for a three percent annual growth rate rather than maintain the current four percent annual rate of expansion. To this end, he determined to take a minimum £500m out of the economy largely through a rise in indirect taxation—bearing directly on consumption—but the final version went a good deal further, raising £923m (2.3 per cent of GDP). This even exceeded the kind of figures suggested by the OECD's Working Party 3, which early in March called for an increase in taxation ranging from £450m-£800m.⁴²

The combination of tax increases and spending cuts amounted to a very powerful dose of deflation, possibly the most severe since the war. Writing in *The Times* immediately after the Budget, Peter Jay reckoned that the chancellor had “risen fully and *magnificently* to the occasion. Yesterday's Budget was really everything that was economically needed. It should give devaluation a virtually certain guarantee of success.” He added that Britain had now “done everything required to correct the fundamental weakness of the economy and the balance of payments which has bedevilled economic policy as well as international adjustment most of this decade.”⁴³ But even before government strategy had been announced in the 19 March Budget, another foreign exchange crisis almost wrecked it. Notwithstanding the weak confidence in the British economy within international organisations and the financial markets—at least, in March 1968—the roots of this crisis, and of those occurring in November 1968 and August 1969, can be traced to the growing weakness of the Bretton Woods order.

There were three fundamental conditions for the success of Labour's post-devaluation strategy. The first involved maintaining the Bretton Woods order of fixed exchange rates.⁴⁴ The sustained existence of this system guaranteed an external environment in which pressures on sterling would be minimised through international collaboration between the advanced industrial states and through an expansionary economic climate conducive to the promotion of exports.⁴⁵ The alternative would be “monetary breakdown,” in which nations running deficits embraced economic nationalism and the “beggar thy neighbour” practices of the 1930s. These revolved competitive devaluations—floating rates—and protectionist measures in trade.⁴⁶ The second condition constituted a surge in exports and restraint in imports. The

third centred on curbing demand at home via both deflationary monetary and fiscal measures and an incomes policy.⁴⁷

The March 1968 crisis threatened all three conditions.⁴⁸ This was provoked by developments in Vietnam. During the February 1968 Tet offensive, Viet Cong forces for a time succeeded in reaching Saigon and even in penetrating the American Embassy compound. Although the battle produced Viet Cong defeat, it left the impression that an early end to the Vietnam War seemed unlikely. Hence, the commitment of American forces and material to support the South Vietnamese regime would continue for several years. Such assumptions stimulated vigorous speculation against the dollar on the grounds that the strategic fallout from Tet would undermine Lyndon Johnson's latest efforts to reverse the American deficit announced over New Year 1968.⁴⁹ Mounting demand for gold became evident in the London gold pool. It turned into a rush following a call by a senior American senator, Jacob Javits, that dollar-gold convertibility be abandoned, which in turn fed speculative expectations of a rise in the price of gold against the dollar.⁵⁰

Sterling came under heavy pressure as holders sold it for dollars that they then converted to gold. As selling mounted, so did market expectations that the new parity might have to be sacrificed. On 14 March, the sterling three-month forward rate, often a key indicator of medium-term expectations concerning a currency's future, showed a discount of 5.75 cents on official parity in New York.⁵¹ The Bank of England intervened heavily on the spot market, only to see a rapid rundown of the exiguous foreign exchange reserves. During the first half of the month, they fell from \$2,771m to \$1,340m.⁵² Substantial drawings were then made on central bank credit facilities arranged to support sterling after its devaluation. Necessary to keep the reserves' net loss to \$912m (£380m) for the first three weeks of March,⁵³ these drawings added to the country's liabilities. The Treasury calculated that by 14 March the negative reserve position had deteriorated to -£881m.⁵⁴ Frightened by reserve losses and the scale of the action needed to contain them, the Bank let the spot rate fall to \$2.3740 in New York on 15 March.⁵⁵ This action undershot the \$2.38 floor below which, under Bretton Woods rules, sterling was not to drop unless it was to be formally devalued. Failure to intervene was greeted with great dismay in the Treasury, but defended by the Bank on grounds that distrust for the currency was too widespread.⁵⁶ It feared repetition of what had happened on the day before the announcement of the November devaluation: £500m—\$1.4 billion at the old rate—had flowed out of the reserves. Sterling balance losses re-enforced these anxieties; as the crisis intensified in the first two weeks of March, the balances ran down by £180m. Most of this switching (£155m) occurred through NSA sterling holders concerned about the possibility of a second devaluation.⁵⁷ O'Brien warned Jenkins that sterling's position was becoming unsustainable; he would have to let it float.⁵⁸

The gold rush reached a peak in the week starting Monday, 11 March. By Thursday, the United States Treasury worried that demand for gold was forcing its price to a point that would either compel dollar devaluation against gold or render gold-dollar convertibility unsustainable. It therefore asked the British to close the London gold market on Friday. Wilson and Jenkins agreed, and a Bank holiday was declared. In part, the willingness to accede to Washington's request emerged out of concern that the entire Bretton Woods edifice was in danger of failing. But the real possibility that another £300m or £400m might be lost to the reserves very quickly if the gold-buying spree was not arrested proved an even more immediate concern. As O'Brien had said, this would certainly have made it impossible to hold the rate, precipitating either another sterling devaluation or a downward float of the currency.⁵⁹

The closure of the gold market gave both sterling and the dollar relief whilst a conference in Washington, involving finance ministers and officials from the countries making up the gold pool, was hastily arranged for the weekend. Its outcome was likely to determine both the future of the Bretton Woods system and of the British economic strategy. The British made it clear that they needed a new credit package, worth \$5 billion, to support sterling, and that they favoured agreement on the rise in the price of gold against the dollar. They believed the latter would involve a relatively painless American adjustment and would draw a line under the speculation. But first indications from Washington were not encouraging. There seemed little enthusiasm for more assistance to Britain,⁶⁰ whilst Johnson was adamant that there would be no devaluation of the dollar against gold. Instead Washington suggested separating gold's official and the market prices. This would involve limiting central bank gold market activities. The central banks would abstain from the free market and deal only with each other at the official price. The United States would meanwhile no longer provide gold to private parties at \$35 an ounce. The gold pool would cease operations. The British were unconvinced that it would be possible to keep this distinction between the free and the official markets. They did however accept the two-tier plan in the hope that their own requirement for more assistance would in return gain American backing, whilst at the same time working on contingency plans in case the conference ended in failure. These plans were code-named "Brutus"—after the Ides of March—and based on discussions about floating and its consequences already held in the Bank and the Treasury.

There were three versions of Brutus, each more rigorous than the last. Common to each version was the suspension of sterling convertibility for all balances held in the NSA and the OSA: no sterling area resident would be able automatically to buy gold or foreign exchange from Britain in exchange for existing sterling holdings. Under Brutus 1, sterling balances holders would be able to run-down their holdings only to finance imports from the UK. Brutus 2 would block all sterling balances, with releases only

allowed for specified purposes. Most far-reaching, Brutus 3 would not only freeze access to all OSA and NSA balances but also involve the imposition of exchange controls on transactions between British residents and the sterling area; it would mean the “effective abolition of the sterling area,”⁶¹ with the pound’s acceptability confined to Britain and Ireland.

Brutus’ original intent involved stopping a run on the reserves to maintain the parity. It quickly became apparent to the Treasury that blocking and floating were not practical alternatives. If Britain floated, it would have to block to prevent a mass exodus from sterling. On the other hand, given that blocking could only occur once it was obvious that there were not enough reserves to sustain sterling parity, its introduction would have to be accompanied by a float.⁶² The question facing Wilson and Jenkins therefore became whether to go for a free float or one that would be controlled and limited thanks to the application of one of the varieties of Brutus. It was clear that Brutus 1 would be the easiest to introduce quickly—but in the event of continuing international uncertainty, it might be necessary to go all the way to the much more comprehensive exchange control regime of Brutus 3.⁶³

The government was prepared to opt for Brutus 1, moving over a two to three week period to Brutus 3.⁶⁴ The impact on British living standards would have been dramatic. Not only would foreign travel become restricted as a result of the need to prevent losses of convertible foreign currency from the reserves, but the shortage of foreign exchange would mean a reduction of imports of essential goods.⁶⁵ Trade with countries unwilling to hold sterling would revert to the kind of barter arrangements common during and just after the Second World War.⁶⁶

The Bank of England regarded this prospect with apprehension. O’Brien doubted whether effective blocking was feasible in short-run and, in any case, the suspension of convertibility would be far more serious for the City than floating.⁶⁷ It would amount to the declaration of a default with the effect being similar to a bank suspending cash payments. But given sterling’s status as a reserve currency, the bank in question was the second largest in the world, and its actions would have brought about the destruction of almost £4 billion worth of global liquidity. Meanwhile British assets would be at risk of retaliatory action on the part of overseas—possibly including Commonwealth—governments. Britain’s international creditworthiness would collapse and sterling’s career as an international trading and reserve currency would be over.⁶⁸

The government held no illusions about the implications of Brutus, regarded as preferable to the domestic and international economic consequences of moving to a freely floating rate. A sterling collapse to £1 = \$1.50, 37.5 per cent below the \$2.40 level and 46 per cent below the pre-devaluation rate of \$2.80, was feared. This would prompt a disorderly withdrawal of as much of £2 billion from the sterling balances,⁶⁹ leading to bank failures in London and a drastic contraction of credit in Britain.⁷⁰ It

would also intensify strains on the current account, provoke price increases, and jeopardise trade union consent to pay restraint. On the external front, the breach of the Bretton Woods rules governing the international monetary system would cause "great confusion," with "some, perhaps many other countries" expected to let their currencies float as well. There would be further speculative rushes into gold and the "collapse" of the dollar.⁷¹ Jenkins warned the Cabinet that such a scenario could lead to a return to the trade wars of the 1930s, as nation-states embraced protectionism, competitive devaluations, and floats.⁷² Clearly, adoption of a freely floating rate was incompatible with the conditions required for the success of Labour's post-devaluation strategy.

In the end it was not necessary to introduce any of Brutus's different varieties, although the Treasury continued to work on this contingency for months. Wilson had referred to the scheme as "some means of blackmail."⁷³ Both he and Jenkins saw Brutus as a way of persuading the participants at Washington to provide the crucial \$5 billion package of external support for sterling, and, thus, the new economic strategy, by showing them the consequences of failure to do so.⁷⁴ The tactic worked. The Americans were especially concerned about what would happen to the dollar-gold relationship if the floating and blocking of sterling was introduced.⁷⁵ Further backing for sterling was therefore agreed. Britain's credit facilities were increased to \$4,050m. This figure included the \$1.4m standby available with the IMF, plus \$1,175m in new support. \$700m of this came from the United States, the rest via Belgium, Italy, the Netherlands, Switzerland, and West Germany. The overall figure was rather less than the government had wanted but, as Jenkins told the Cabinet, "the small group of Ministers" who had handled the crisis were convinced that accepting the support was preferable to Brutus.⁷⁶ When the markets opened on Monday, 18 November, both sterling and the dollar made gains, the former returning to just over \$2.40.⁷⁷ The crisis passed, and Jenkins presented his Budget without disruption. The conference, with its introduction of the two-tier market and international support for sterling, had settled the international environment and given Britain's strategy breathing space in which it could operate free from fear of destabilisation at the hands of the markets. Strengthened by the good reception accorded the Budget, sterling stayed at or very near parity for the whole of April.

Further international support for sterling was announced in July, with agreement in the talks between the Bank of England and the BIS about a loan to insulate British reserves from diversification out of sterling by balance holders. Alarm on the part of European central bankers about the impact on sterling of the gold crisis had been the catalyst. Concern was expressed that if no international action to support the pound occurred, larger balance holders like Kuwait might diversify into gold and undermine the recent Washington agreement to stabilise the dollar-gold relationship.

Blocking balances—Brutus—would then be the only action available to Britain to avert what the Governor called “a disorderly disaster.”⁷⁸

This anxiety gave urgency to the talks that had started in February. Early in July, the BIS stood prepared to offer a \$2 billion credit facility to Britain, on which it would be possible to draw for three years, with repayment taking as long as ten. The Bank of England would then be able to propose to OSA members a dollar guarantee of 90 percent of their holdings, in return for a slow and orderly diversification. The next eight weeks saw intense and difficult negotiations with sterling area members⁷⁹; but in September the Bank issued a public statement confirming that thirty countries, whose holdings accounted for 77 percent of all the balances, had signed on to what were known as the “sterling agreements.”⁸⁰

This constituted a considerable achievement and brought a longstanding objective of the government’s external economic policy to a conclusion. But it did not lead to the construction of the stable international environment that sterling and the government’s strategy required. After a good run through the summer, the pound came under more intense pressure in the autumn. The August–September trade figures had been healthy. Announced on 13 November, October’s were disappointing. Imports showed a £13m increase over their level in September. Aware of the resilience of imports, The Treasury was preparing further measures to slow down domestic activity but, as in March, a crisis that started abroad almost undermined the macroeconomic strategy. This time the problem centred on expectations within the markets that the West German deutschmark was undervalued against other currencies whilst the French franc was over-valued.⁸¹

The German economy had for most of the past decade been generating visible trade surpluses, leading to a long period of export-led growth. By autumn 1968, growing enthusiasm existed on the part of the markets for deutschmarks. Sentiment in favour of the currency surged in September, when Bundesbank reserves rose by \$1.4 billion in ten days and, again in November, when they grew by \$2.4 billion over the first three weeks.⁸² Two developments provoked the timing. First, an increasingly obvious contrast existed between price stability in West Germany and inflationary pressures elsewhere.⁸³ Second, rumours—proved accurate⁸⁴—began circulating in the Group of Ten financial markets that the Bundesbank supported a revaluation of the deutschmark to counter the inflationary impact of capital inflows on the financial system.⁸⁵ Reducing interest rates within West Germany might have deterred this inflow; but threatening to add to inflationary pressures, such action was not compatible with the priority of low inflation, an imperative of Bonn’s post-war economic policy.⁸⁶

The rush for deutschmarks paralleled speculation against the franc. This came after the May *événements*, when France had for a short time been brought to a halt by a wave of student unrest and industrial disputes. The franc’s vulnerability was intensified by an agreement between government

and unions providing for a ten percent rise in wages and shorter working hours.⁸⁷ The concessions undermined international confidence in the French economy, notwithstanding only a small trade deficit for the year. The franc slipped to its floor level against the dollar and the deutschmark on the markets, and there occurred a steady outflow of capital with short-term losses amounting to \$2 billion.⁸⁸ This delicate situation became highly sensitive in September, with the lifting of exchange controls and the first wave of speculation favouring a deutschmark revaluation. There was renewed heavy selling of the franc in favour of deutschmarks, which intensified in November as expectations of a deutschmark revaluation peaked. At a central bankers' meeting in Basle on 16–17 November, Jacques Brunet, Governor of the Banque de France, told his colleagues that the French could not sustain the massive capital losses to Germany for more than another week. He would not borrow to protect the franc against the sell-off. It would therefore be necessary to announce devaluation, by as much as 15 percent, unless the deutschmark revalued.⁸⁹

The November crisis posed another serious threat to the Bretton Woods order and to sterling. OECD finance ministers met at Bonn on 20 and 21 November to discuss exchange rate realignment based on franc devaluation and deutschmark revaluation. *The Times* commented that parity of the deutschmark against other currencies was now unjustifiably low “and is before long bound to be changed upwards.”⁹⁰ The British and the Americans were looking for a German revaluation of between five to ten per cent to offset an expected ten to 15 per cent devaluation of the franc. The German government was, however, known to be reluctant to revalue the deutschmark, notwithstanding the views of the Bundesbank. The Christian Democratic Union, which shared power with the Social Democrats in a Grand Coalition, did not wish to lose the support of farmers and industrial exporters enjoying the benefits of a competitive exchange rate.⁹¹ As a result, the possibility that the French might act alone by a margin as great as 15 per cent became very real. For London, this was extremely disturbing. Exports might be adversely affected by the new level of the franc, with a 15 per cent devaluation likely to cost the British balance of payments between £75m and £80m per annum⁹². In addition, the fundamental cause of the currency instability, the undervalued deutschmark, would still exist. With the franc having fallen, speculators would turn on sterling.

During the first half of November, sterling came under pressure following the disappointing October trade figures. On 15 November sterling finished at \$2.3840, and only intervention worth \$250m by the Bank of England on that day alone prevented it from falling further.⁹³ Given short and medium term debt of £3,132m with repayment due in the next three to five years⁹⁴ there was no question of further borrowing to support the pound; and within the Treasury and the Bank, fear existed that the reserves

would not be able to sustain either the \$2.40 rate or a new, lower parity. Contingency planning—now called “Priam”—for a float in the event of French devaluation began. It was recognised that such action would require a deflationary support package to reassure the markets that another fall in the rate would not lead to a *dégringolade* of the currency as a result of inflationary price rises and wage settlements. The squeeze would involve import restrictions—“Operation Orestes”⁹⁵—and austerity measures to cut domestic demand, via public spending cuts, tax rises, credit tightening, and a period of severe pay restraint—all coming on top of the action taken in the Budget.⁹⁶

In theory, with the Basle Agreement in place, no need existed to block the sterling balances, but it was accepted that the move to a floating rate would still be regarded as “such a major failure as to lead to a breakdown in confidence in our economic management.”⁹⁷ The resulting rush from sterling might be too great even for the resources available under Basle, forcing a return to the contingency plans first revealed in Brutus.⁹⁸ The crisis would be intensified by on-going external instability, with the dollar the next domino to fall as speculators continued to seek deutschmarks. As in March, Bretton Woods’ would be in jeopardy. To avert so threatening a development, the British government argued for agreement on a new structure of fixed exchange rates, featuring the relationships between sterling, the dollar, the deutschmark, and other EEC members’ currencies so that they genuinely reflected the surplus and deficit positions of nation-states within the international trading system.⁹⁹ Seeing this as the first stage of the wider realignment, Jenkins and the American Treasury secretary, Henry Fowler, attended an OECD finance ministers meeting in Bonn hoping for a five percent revaluation of the deutschmark. But the Germans kept parity unchanged. Instead they announced a reduction in export subsidies, an adjustment of their border tax to raise the price level of imports, and restrictions on the inflow of foreign capital.¹⁰⁰

A unilateral French devaluation was now expected. Information from within the French government led British ministers to expect a fall of just over 11 per cent. Treasury projections suggested that if the franc was reduced by less than 12 per cent, a good chance existed that sterling would survive, but only if more was done to reduce import demand. To this end Jenkins introduced a package of import deposits, increases in indirect taxes designed to take £350m, or just under 1 per cent of the GDP, out of the economy, and credit restrictions aimed at shaving £100m from private sector lending by March. At this point De Gaulle announced to near universal astonishment that there would be no franc devaluation. The franc would remain at its current rate with the assistance of a French austerity programme.

In the short term this unexpected turn of events did not upset the markets and both the of the French and German determination not to budge and the British mini-Budget led to calmer conditions—for most of the time—during the next few months. With British trade figures for the last part of

1968 showing real improvement, it seemed as if the switch of resources strategy was working. At the OECD Working Party 3 meeting in December 1968, Otmar Emminger, a member of the Bundesbank board, accepted that “there was now a good chance of the United Kingdom reaching its goal.”¹⁰¹

The more peaceful climate allowed the government to reaffirm its strategy at a meeting of its Steering Committee on Economic Strategy held on 4 December. The latest forecasts indicated that 1969 would see a balance of payments surplus in the region of £450m. Wilson and Jenkins made clear their determination that policy should aim to facilitate the achievement of the £500m annual current account surplus by the end of 1969, to be sustained for several years thereafter. Only by continuing to remain in the black on this scale could British governments repay debt and preside over steady, crisis-free expansion of the economy at the targeted three percent annual rate of growth.¹⁰² Some Cabinet colleagues called for adoption of an alternative strategy based on the adoption of protectionist measures to prevent domestic expansion from being derailed by balance of payments difficulties.¹⁰³ These were, however, rejected. Wilson, Jenkins, and Callaghan all argued that such an approach would, in adding to domestic demand, divert resources from production for exports.¹⁰⁴

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

During the first nine months of 1969, the monthly balance of payments figures had largely been good and, by mid July Jenkins was able to announce a net improvement to the foreign exchange reserves of \$1 billion since January.¹⁰⁵ The lurch into instability that followed resulted from the realisation of the scenario considered in the Priam plan. The French unilaterally devalued the franc on 8 August—resistance to the move having collapsed after the resignation of De Gaulle at the end of April. Predictably, this led to another wave of speculation favouring a deutschmark revaluation and, equally predictably, sterling found itself under pressure. On 14 August, spot market sterling fell to \$2.3812, with the Bank letting the rate rather than the reserves take the strain.¹⁰⁶ The 90-day forward rate fell to \$2.35. It remained low, slipping even further, to \$2.3431 on 10 September, the day after a short outbreak of fighting in the Middle East (see Figure 2).

The Bank’s behaviour indicated a growing interest in floating, or at least more flexible rates, both within its own walls and within the Treasury. In part this stemmed from concern about the sustainability of the current fixed rate

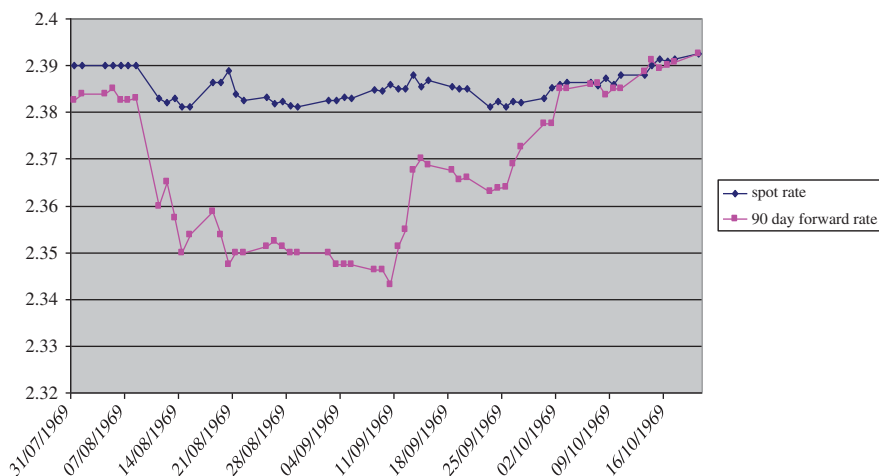


FIGURE 2 Sterling spot and forward rates 1 August–20 October 1969 (color figure available online).

(source: The Times foreign exchange reports).

regime, given the large currency imbalances now within the system. This thinking found reflection in the pages of influential weekly journals such as *The Economist*. Here, the virtues of floating had been proclaimed for some time; they supposedly permitted automatic adjustment to disequilibria, and hence made unnecessary both dramatic IMF and central bank support deals and recourse to credit squeezes and import and exchange controls by states facing speculative attacks on their currency.¹⁰⁷ In addition, there was within the Treasury an outburst of gloom about whether devaluing sterling had worked, prompting concern that \$2.40 was now too high.¹⁰⁸

Confident that devaluation had worked, Jenkins regarded all these views as “defeatism.” To agree to a further reduction in the sterling rate would “be to throw away victory just when we were achieving it,”¹⁰⁹ a view confirmed by excellent July and August trade figures. Far from accepting the new thinking, Jenkins told the IMF Annual General Meeting in late September that he favoured fixed rates. A case existed, he argued, for a wider margin on either side of parity rather than the one percent currently allowed—he favoured two per cent. But floating rates were neither “desirable” nor “durable,” said the Chancellor. He maintained that most economies now had foreign trade sectors so large that national governments would not wish to surrender control of exchange rates to market forces. Concurrently, the growth of trade had generated economic interdependence between nations, and this would be undermined by floating rates.¹¹⁰

All the objective evidence about what was happening to the economy backed Jenkins. Since November 1967 the government had striven with success to switch resources into the export sector, an achievement now

recognised within the IMF, the Bundesbank, and the American Treasury.¹¹¹ Yet the price of 90 day forward sterling remained almost four cents below par. The problem was that the currency's fate was not within its complete control but dependent on external events. This became obvious when sterling began a strong recovery after 29 September, the day a new West German government, now a Centre-Left coalition of the Social Democrats and the Free Democrats, allowed the deutschmark to float. As expected the deutschmark moved up, and its new level was confirmed on 24 October when a 9.29 per cent revaluation was announced. The effect of the new deutschmark rate put a temporary end to the speculative waves that had been afflicting the international economy for the best part of the decade. Sterling's three-month forward rate jumped, reaching the same level in the spot market. By mid October it exceeded \$2.39, where it remained—occasionally reaching parity—for the rest of Labour's time in power.

Sterling's freedom from turbulence was a function in part of the government's achievement but also of greater international economic stability. Economic historians and other commentators have argued that the upheavals of 1967–1969 marked the beginning of the end for the Bretton Woods system of fixed exchange rates, which finally collapsed between 1971 and 1973.¹¹² Yet it did not seem at the time as if an era was drawing to a close. Indeed, 1969 appeared to have been the year when important and constructive improvements had been made to the Bretton Woods order. September saw the launching of Special Drawing Rights (SDR) to be managed by the IMF. The SDR devolved from discussions about international liquidity started in the early 1960s. Its creation involved an addition of \$49 billion to global reserves; it supplemented international liquidity that did not add to the global surplus of dollars and thus to the growing volume of mobile short-term capital. The SDR was, therefore, intended to promote an international economic system harmonising exchange rate stability, open trade and convertible currencies, and national expansion. Pointing to this reform, the British surplus, and the franc and deutschmark exchange rate realignments, the BIS argued that the international monetary system had finished an “eventful” year in a sounder condition than at the start.¹¹³

This more stable external environment allowed Labour to complete its post-devaluation strategy successfully. Labour had fallen short of the growth target in the 1965 National Plan, but much of the agenda contained within that document was being pursued. Expenditure on roads, housing, education, and health had all increased broadly if not exactly in line with Plan projections, whilst defence had been held down.¹¹⁴ By March 1970 the combination of large external surpluses—£554 million in 1969, with an even more sizeable one expected for the current year¹¹⁵—and expectations of sustained growth running at three per cent had led the OECD to declare that Britain was “no longer a problem country.”¹¹⁶ By spring 1970, all outstanding short

and medium term obligations had been met; this included \$1,400m borrowed from the IMF in May 1965, the last instalment repaid two months ahead of schedule at the end of March.¹¹⁷ The achievement came at a high political cost: the restraints on private consumption that had been necessary to ensure Labour met its objectives are generally held to have cost it the 1970 general election.¹¹⁸ The Conservative Party inherited the opportunity for sustained expansion Labour had struggled to create.

The events of 1968–1969 represented a major challenge to the Labour government because they threatened the collapse of the external environment that supported British social democracy. The recurrent shocks to sterling in 1968–1969 stemmed from the failure of the November 1967 devaluation to stabilise the foreign exchange markets, partly because these were unconvinced that Labour's initial response would deliver the scale of external surplus required to lift sterling out of further danger. But during the course of 1968, the leading cause of sterling's woes became interaction amongst the dollar, the franc, the deutschmark, and the Eurodollar market. The existence of currency rates that did not reflect the current account positions of the economies in question gave the growing volume of Eurodollar balances the chance to move from one financial centre to another in search of speculative reward. In the absence of international co-operation Britain could only have insulated itself from the shocks involved in these movements by measures such as Brutus or Priam, which involved abandoning liberal socialism, or by the adoption of floating rates mitigated by severe deflation. In either case, a repudiation of the post-1945 social democratic synthesis would have been necessary.

In combination with the Basle arrangements and the French and German currency moves, Labour's macroeconomic strategy had averted the need for such drastic action. But the stability that returned to the international financial system late in 1969 was transient. The problem of the American deficit remained, although in 1968–1969 the position was masked by capital inflows, attracted by higher interest rates in the United States than in Western Europe. In 1970 and 1971, however, these were reversed as American authorities responded to sluggish growth by cutting taxes and interest rates. Capital flooded back to Europe. Worried that the incoming funds were either going to force unwanted exchange rate revaluations—damaging for exports—or unwelcome credit booms, European governments vainly called for the Americans to adjust to their deficit by raising taxes and interest rates. By 1971 the United States ran a current account deficit of \$3.8 billion, whilst the capital account was \$26.9 billion in the red.¹¹⁹ There was a renewal of international anxiety about the ability of the United States to honour dollar-gold convertibility, and spring–summer 1971 saw vigorous speculation favouring most other currencies in the Group of Ten. The Germans, Dutch, and Belgians floated against the dollar, whilst the Swiss and Austrians revalued. Finally, with the price of gold in the private market

by August 1971 reaching \$44 an ounce, Washington abandoned dollar-gold convertibility and introduced a ten per cent import tax rather than embark on a tough deflationary programme. Sterling itself became a fully floating currency in June 1972.

All this marked the collapse of the Bretton Woods order. The continued compatibility of fixed rates, an open trading system, and domestic expansion after 1945 had become unsustainable. In the circumstances, governments now found it easiest to adjust to payments imbalances by allowing exchange rates to take the strain. There was no economy large enough to replace the role of creditor played by the United States in the generation after 1945. Promising though the SDR was, it was incapable of supporting the Bretton Woods system: its first issue came in January 1970, under the IMF management. The total of \$49 billion proved more modest than it seemed, since the release was to be spread over a three year period. In any case, by 1970, the chief threat to Bretton Woods lay in the excess of liquidity being generated by the American deficit, a problem that could only be solved within the Bretton Woods parameters by deflation in the United States, or by some combination of multilateral exchange rate realignment and more rapid expansion on the part of the Europeans and the Japanese. Not one of these options was acceptable to all parties. As a result, the Group of Ten opted to sacrifice fixed rates rather than full employment and participation in a global trading system that had delivered abundant rewards to working populations in terms of what Alan Milward called "increasing ease of life."¹²⁰

At first, as an international boom developed in 1970–1973, it seemed as if the anxieties expressed about the implications of floating in the late 1960s had been seriously over-cooked. Floating rates appeared capable of providing an environment with all the advantages of Bretton Woods without the disadvantages. But the coming of the oil price shock in 1973–1974 led to the appearance of currency disequilibria so large that it became increasingly hard to reconcile floating rates with open trade and international expansion. The British Labour Party, back in government after 1974, faced the reappearance of the dilemma that had threatened it in 1967–1969: preserving domestic expansion and high levels of employment behind protectionist barriers or continuing engagement with the open international trading system at the price of domestic deflation and the erosion of national economic sovereignty by market forces.

The Wilson and Callaghan governments of 1974–1979 succeeded in avoiding having to make this choice. Callaghan's famous 1976 Labour Party Conference speech, despite appearing to reject Keynesianism, did not involve a philosophical breach with the post-1945 politico-economic tradition¹²¹. But the cost of sustaining the Keynesian synthesis, involving restraints on personal income and public expenditure, as well as unemployment at just over five percent of the work force—at the time a post-1945 high¹²²—led to the collapse of support for it within the Labour

Party. In 1981 Labour split. A significant fraction of those who considered themselves Keynesians and liberal socialists—Jenkins amongst them—left to join the new Social Democratic Party. The majority left behind adopted, not always enthusiastically, the Alternative Economic Strategy (AES), which involved extensions of public ownership, economic planning, and controls on imports and on the movement of capital.¹²³ The main condition of the AES involved “the substantial severing of the ties which bind the British economy to the world economy,” to establish a “full economic sovereignty” designed to protect policy from being “undermined by foreign pressures.”¹²⁴ The origins of this schism can be traced to the slow disintegration of the Bretton Woods order, which as it unravelled had slowly destabilised the external environment congenial to British social democracy.

It is not clear that the contradiction between increasingly free global trade and capital markets and the pursuit of economic growth and full employment by national governments can be resolved in the absence of both international support for debtor countries and agreed arrangements to facilitate smooth adjustments to exchange rate disequilibria—something highlighted by the current crisis in the Euro group. Since the end of the 1970s, the question for the British Left and beyond has become how, and on what terms, co-existence between national social democracy and an open world economy can be managed.¹²⁵ The electoral failure of the AES in 1983 led to a gradual accommodation between the British Labour Party and an international economy moving rapidly towards globalisation. The result was the liberal political economy of New Labour, a synthesis now facing its own crisis as a result of the breakdown, albeit possibly temporary, of the external environment that sustained it.¹²⁶

NOTES

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