Why were capital controls abandoned? The case of Britain's abolition of exchange controls, 1977-9

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Abstract: This article examines the politics of capital control liberalisation through an archival analysis of Britain's exchange controls abolition. While the political economy consensus states that capital controls were abandoned because of a desire to boost the competitiveness of national financial centres and the ascendance of laissez-faire ideas, this article will challenge this interpretation. The James Callaghan and Margaret Thatcher governments were concerned by the worsening performance of British *industrial* exporters, and exchange control abolition constituted a strategy to depreciate sterling and thus boost export competitiveness. Yet this beggar-thy-neighbour strategy risked spooking global markets and provoking a run on sterling. Thus, the Thatcher administration publically masked its intentions by emphasising that this deregulation was motivated by laissez-faire ideology. This article thus reconceptualises the role of competition and ideas in spurring capital control liberalisation by demonstrating the importance of industrial competitiveness and the role of ideas as rhetoric.

Keywords

British politics, capital controls, financial deregulation, financialisation, international political economy, Thatcherism

While countries in the Global South and the European periphery have continually contested the policy dogma of 'no capital controls', few cracks have appeared in the most advanced capitalist economies' commitment to capital mobility. Yet this is potentially changing with the ongoing populist surge. Both left and right-wing political challengers have expressed willingness to reimpose capital controls, either to rein in financial speculation – as suggested by UK Shadow Chancellor John McDonnell – or defend the national economy against unpatriotic capital flight – as in the case of the Front National's Marine Le Pen (Parker et al., 2015; Melander et al., 2017). By characterising the imposition of capital controls as a matter of political will – something that their establishment opponents ostensibly lack – these movements implicitly contain an explanation of why capital controls were abandoned in the first instance, namely mainstream politicians' preferential treatment of financial capital or the prevalence of pro-globalisation ideology.

International Political Economy (IPE) accounts of capital control liberalisation have also relied chiefly on two factors to explain this trend: 1) the competitive dynamics unleashed by increasing global capital flows, expressed as the threat of capital flight or the incentive of promoting domestic financial centres (Andrews, 1994; Bhagwati, 1998); and 2) the rise of neoliberal economic ideas, at the national scale and within international organisations (Best, 2004; Chwieroth, 2010). Britain's 1979 abolition of exchange controls is said to best exemplify the interaction of these competitive and ideational pressures. Margaret Thatcher's government was motivated, it is argued, by a desire to boost the City of London's prospects (referred to here as the City) – at the expense of industry – and a commitment to neoliberal policy norms (Helleiner, 1994; Germain, 1997).

This article will question this conventional wisdom regarding the role of competition and ideas in capital control liberalisation by examining Britain's abolition of exchange controls through an analysis of primary archival sources. While archival evidence cannot be used to provide an entirely definitive explanation of this liberalisation, it can challenge the existing consensus and suggest an alternative narrative. Exchange controls were scrapped in four stages, by Conservative and Labour governments, from 1977-9. This article will argue that the British state was not chiefly motivated by a desire to promote the City's interests nor by laissez-faire ideological commitments. Although there is evidence that certain civil servants believed this liberalisation would benefit the City's global operations, the key driver of this deregulation appeared to lay in the intensifying stagflation crisis. In the context of sterling appreciation, following the 1976 IMF bailout and rising revenues from North Sea oil, the British state was confronted with a governing dilemma: the strong pound acted to combat inflation, yet it simultaneously depressed the competitiveness of the struggling industrial export sector. Both the governments of James Callaghan and Thatcher prioritised the export competitiveness goal, and thus sought to depreciate sterling by relaxing exchange controls and encouraging an investment outflow. Yet two obstacles stood in the way of this strategy. Firstly, the trade union movement was opposed to exchange control liberalisation, and the Labour government was wary of further alienating union leadership as they attempted to gain union acquiescence to an unpopular incomes policy. Secondly, in a context of floating exchange rates, any attempt to manufacture a currency depreciation could spook currency markets and provoke a sterling crisis. While these hurdles ultimately impeded the Callaghan administration from pursuing full liberalisation, the Thatcher government faced a weakened union movement, and constructed a rhetorical strategy to placate currency markets by emphasising that exchange control abolition was an internationally-credible policy driven by laissez-faire ideology. This combination of factors provided the Thatcher administration with the confidence to completely abolish controls in October 1979.

This article will thus suggest that IPE scholars rethink the role of competition and ideas in capital control liberalisation. While conventional IPE accounts insist that deregulation was a strategy to boost national financial sectors' competitiveness in a world of cross-border capital flows, the evidence presented here suggests that the British governments' key aim was to boost ailing *industrial* exporters' competitiveness. Crucially, this policy was not a blueprint to secure the City's dominance, but was rather intended to be a palliative measure, to postpone the effects of the crisis of British industry. This argument lends support to critical work that characterises neoliberal financial liberalisation as a series of ad hoc, pragmatic responses to immediate governing dilemmas associated with the decline of post-war affluence (Krippner, 2011; Streeck, 2014). Furthermore, in contrast to the IPE orthodoxy's emphasis on the role of neoliberal ideology in stigmatising capital controls, this article suggests that the role of ideas in the British case was primarily as *rhetoric*. By crafting a rhetorical strategy that publically exaggerated the administration's commitment to laissez-faire, the Thatcher government believed they could pursue this palliative measure in a covert manner and avoid provoking a sterling crisis. This argument contributes to literature that focusses on the role of ideas as rhetoric in the construction of national economic credibility (Hay and Rosamond, 2002; Clift and Tomlinson, 2006).

IPE perspectives on capital control liberalisation

Within IPE, the widespread abandonment of capital controls since the 1970s has chiefly been explained by reference to two factors: the competitive dynamics unleashed by the increase in deterritorialised capital flows, and the growing hegemony of neoliberal economic ideas (Helleiner, 1994; Andrews, 1994; McNamara, 1998; Gallagher, 2015). The manner in which these factors are employed to explain capital control liberalisation is quite diverse. While competition explanations have pointed to both the sanctioning power of mobile capital flows and the incentive they provide to aspirational financial centres, constructivist approaches have focussed on the stigmatisation of capital controls at the national level and within international organisations.

For accounts that emphasise the role of competitive deregulation, of critical importance was the increase in capital mobility during the post-war period, and the pressures this exerted on states' policy toolkits. These approaches point to the rise of the Euromarkets and the shift to floating exchange rates, among other events, in provoking intensified capital flows (Watson, 2007; Green, 2016). Heightened capital mobility pressed states to liberalise their capital controls through the threat of sanction and the lure of incentive. Regarding the potential sanction, Goodman and Pauly (1993: 79) showed that the growth of offshore financial markets and evasion strategies 'eroded national financial barriers', forcing governments to either continuously tighten controls and face declining competitiveness or abandon controls. The heightened 'capacity of capital asset-holders to evade the jurisdiction of unfriendly regulators', Andrews (1994: 199) argued, meant that states were 'effectively competing for the right to regulate capital'. Certain scholars have insisted that the sanctioning power of capital flows has been exaggerated (Garrett, 1995; Mosley, 2003); yet McNamara (1998: 52) points out that 'a government seeking to ensure politically acceptable levels of economic growth may eschew capital controls in the fear that they will dampen economic activity', demonstrating the pre-emptive sanctioning power of capital mobility.

The existing literature also claims that rising capital mobility presented a powerful incentive for certain states to scrap capital controls. Countries with strong financial sectors sought to boost their competitive advantage in financial services and attract footloose capital through competitive deregulation (Cerny, 1994). The US financial industry played a particularly important role in global capital control liberalisation by using its political connections to press the US state to pursue deregulation at home and abroad through bilateral and multilateral avenues. As Bhagwati (1998) argued, the 'Wall Street-Treasury complex' exerted a powerful force in international politics towards the full abandonment of controls, in part by pressuring the IMF to rewrite its Articles of Agreement to promote capital control liberalisation. Overall, the competitive explanation conceptualises mobile capital flows as both a cause and consequence of competitive liberalisation.

Constructivist accounts have placed greater emphasis on the importance of ideational transformations in stigmatising capital controls. Best (2004) argued that the gradual 'hollowing out' of Keynesian norms in the post-war period transformed how US policy-makers came to view speculative capital flows. Instead of conceiving of such flows as 'psychologically-driven and structurally dangerous', they were seen as 'expression[s] of a healthy market economy', thus delegitimising the use of capital controls (ibid: 401, 400). In a similar vein, Chwieroth (2007) drew on the concept of epistemic communities to analyse how the formation of coherent policy-making teams constituted by neoliberal economists in emerging markets has encouraged capital account liberalisation in the Global South.

In addition to the national level, several scholars have explored such ideational transformations amongst international organisations. Leiteritz (2005) argued that the IMF's promotion of capital account openness resulted largely from important 'norm entrepreneurs' within the Fund establishing a liberal policy consensus through communicative action. Chwieroth (2010) advanced a 'strategic constructivist' approach to explain capital controls' informal fall from grace within the IMF since the 1980s, arguing that the IMF's attitude towards capital controls resulted not only from pressure by powerful member states, but from the changing beliefs and strategic manoeuvrings of its staff. Similarly, Moschella (2010) analysed the 'co-evolution' of ideas about capital controls within the IMF and the economic context in which such ideas are embedded. In sum, the constructivist literature emphasises the gradual stigmatisation of capital controls in policy circles.

Britain's abolition of exchange controls occupies a special position within the IPE literature. Exchange controls – a subset of capital controls that had been in place since 1939 – constituted a system of limits on the use of UK funds for overseas investment and rules for the repatriation of profits earned overseas (Shepherd et al., 1985: 156). Alongside the US' 1974 scrapping of capital controls, this event is seen as one of the 'crucial turning points' in the history of capital control liberalisation (Best, 2005: 126). Furthermore, this liberalisation perhaps best demonstrates the manner in which the IPE literature has weaved together the competitive deregulation and ideas narratives to explain capital control abolition. Indeed, the notion that Thatcher's pro-City stance and ideological commitment to laissez-faire lay behind this policy has reached the level of near truism.

Helleiner (1994: 150-1) argued that the 'key explanation' for exchange control abolition 'was the neoliberal orientation of the new Thatcher government, which perceived exchange controls as preserving outdated Keynesian strategies', combined with the fact that 'the Bank of England saw the abolition of exchange controls as a way of attracting more financial business to London'. Overbeek (1990: 196) too claimed this policy was the first act of the Thatcher administration that demonstrated its 'dedication to the "free market"'. Recently, Green (2016: 447) has argued that this deregulation resulted chiefly from the Bank's desire to respond to Wall Street's 'competitive challenge'. This promotion of the City's competitive position is often seen as directly to the detriment of British industry. As Coakley and Harris (1992: 37) argued, this liberalisation demonstrated that 'whatever happened to manufacturing, the City was intended to flourish'. Capturing the broad IPE consensus, Germain (1997: 147) summarised the causes of this deregulation as 'the ideological predispositions of the newly elected Thatcher government and the clear desire to maintain London's position at the center of the Eurocurrency market and European finance'.

If IPE explanations of capital control liberalisation have been dominated by two key factors – competition and ideas – then Britain's abolition of controls has been understood as the archetypal case of these two factors in action. The British state was motivated, it has been argued, by a desire to boost the City's global position, and, interrelatedly, an ideological opposition to capital controls. The following sections will interrogate the validity of this hypothesis.

Rethinking competition and ideas in the British case

While Britain's exchange controls liberalisation has generally been accompanied by words like 'overnight', 'unexpected', and 'radical' (IMF, 1992: 7; Johnson, 1991: 37; Jenkins, 2006: 58), exchange controls were actually removed in four stages by the Callaghan and Thatcher governments: October 1977, January 1978, July 1979, and October 1979. The motivations behind this four-part liberalisation can only be understood by examining the specific dynamics of the stagflation crisis in the late 1970s.

In 1977, the UK consumer price index increased by 15% (Britton, 1994: 251), while British industrial and commercial companies' profit rate (excluding North Sea oil) fell to 4%, down from 8.6% in 1971.[1] Unusually, this intensification of stagflation coincided with a net current account surplus. The reasons for this were twofold. Firstly, the boost in global confidence in Britain's policy programme following the IMF's 1976 'seal of approval' led to a sharp appreciation of sterling, allowing the Bank to 'cream off' foreign currency and replenish the reserves, which reached £20.2 billion in November 1977 (Dow, 2013: 281). Secondly, North Sea oil began to flow in 1975, leading to a dramatic increase in UK exports, resulting in further sterling appreciation (Booth, 1995: 78). Nevertheless, this positive external position masked a dangerously high inflation rate and the deterioration of non-oil exports.

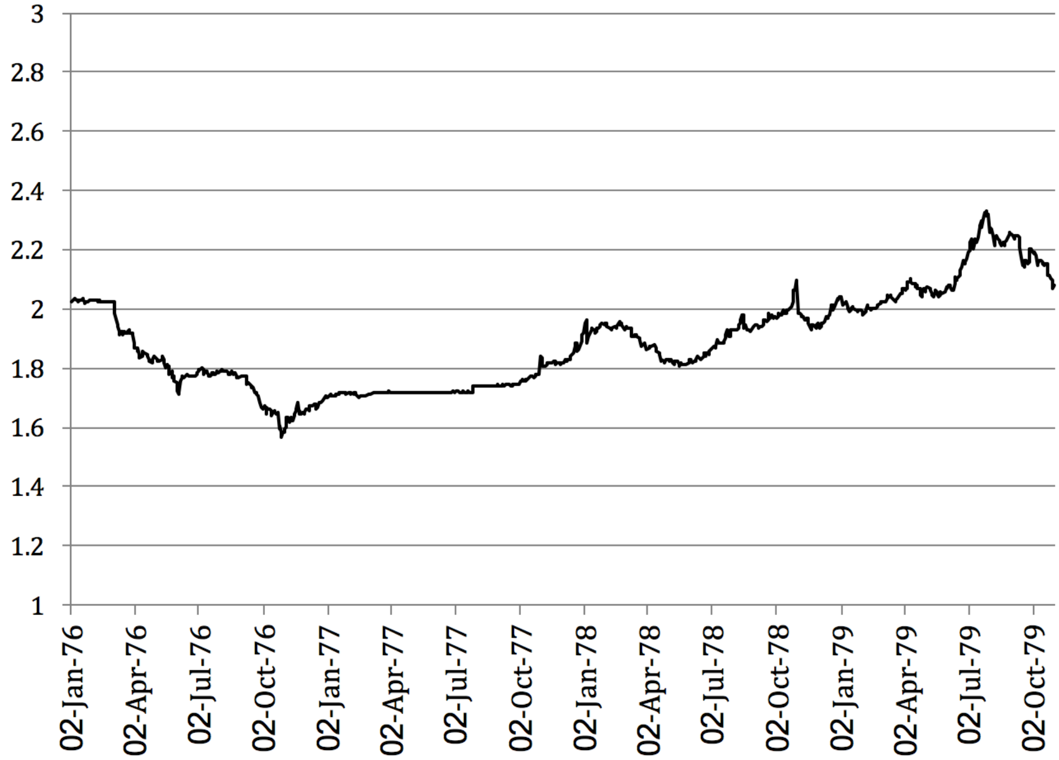

Figure 1. The sterling exchange rate (spot exchange rate, US dollars into sterling), 1976-1979 (Bank of England, Interactive Database).

In this context, the rise of sterling presented the Callaghan and Thatcher governments with a dilemma. The strong pound aided the state's attempts to temper unions' wage demands and bring down inflation; yet it further eroded the competitiveness of Britain's struggling exporters. This article will suggest that the Callaghan and Thatcher governments prioritised rescuing Britain's non-oil industrial exporters over tackling inflation, and that both governments viewed the relaxation of exchange controls as a strategy to depreciate sterling for this purpose.

However, it was not clear how exchange control relaxation could be sold to an opposed trade union movement, nor how an orderly depreciation of sterling could be effected in the context of volatile floating exchange rates. The first problem arose from the fact that Britain's Trade Union Congress (TUC) favoured a strong pound because of its downward pressure on the cost of living and supported the *extension* of exchange controls as part of a proactive industrial strategy. As the unions were bearing the brunt of Callaghan's anti-inflation incomes policy, Labour policy-makers were wary of further incensing them. The second problem was a direct result of the move to floating exchange rates in 1973. The onset of this currency regime entailed an increase in speculative activity and exchange rate volatility. As a result, governments struggled to reconcile their political and economic objectives with the 'imperatives of exchange rate stabilization' (Eichengreen, 2008: 142). Thus any attempt to manipulate the value of sterling required extremely careful public presentation.

Therefore, in order to boost UK export competitivity through exchange control relaxation, politicians required a strategy that would both disarm the unions' opposition and avoid spooking financial markets. This article will argue that the Callaghan and Thatcher governments' different degrees of success in developing such a strategy is what best explains the dynamics of exchange control liberalisation. The Labour administration was ultimately constrained by its tense relations with the unions and unfamiliarity with floating rates, resulting in their moderate easing of controls. The Conservatives, however, faced a much weakened labour movement, and crafted a rhetorical strategy that they believed would convince financial markets that exchange control abolition was in fact motivated by laissez-faire principles, allowing them to bring about a *managed* sterling depreciation.

This article thus argues that the role of competition and ideas was crucial in motivating Britain's capital control liberalisation, but not in the way that these explanations have traditionally been deployed. While conventional IPE wisdom indicates that Britain scrapped exchange controls in order to boost the City's competitiveness (Helleiner, 1994; Germain, 1997), this article disagrees. Although there is evidence that certain officials considered exchange control liberalisation to be beneficial to the City's global prospects, the bulk of evidence suggests this policy was chiefly implemented as a short-term strategy to boost the competitivity of Britain's emaciated industrial exporters. In addition, the interests of finance and industry did not appear inherently opposed, with the government favouring one over the other, as certain existing accounts insist. Rather, British governments during this period were generally concerned with the overall national trade performance in a context of global crisis, and ultimately pursued this liberalisation to support the export position and to avoid political backlash that could follow the industrial base's collapse. These findings chime with Krippner's work, which stresses that the US deregulatory agenda should be understood as an ad hoc strategy to alleviate the stagflation crisis (2011). Similarly, Streeck (2014) uses the concept of states 'buying time' through delaying measures in order to postpone the crisis that had undermined the post-war growth model. Furthermore, such deregulations should not be understood as resulting from fractions of capital – financial or industrial – ruling through the state, but rather as attempts by the state to reproduce general capital accumulation (Copley and Giraudo, 2018: 6).

Ideas also played an important role in this liberalisation, yet not through the ideological stigmatisation of capital controls in British policy-making circles (Chwieroth, 2010; Moschella, 2010). While certain Conservative politicians were driven by laissez-faire convictions, the Thatcher government also publically exaggerated their commitment to neoliberal principles as a rhetorical strategy to grant them the policy space to pursue currency depreciation without spooking financial markets, which points to the importance of ideas as rhetoric in the politics of economic credibility. As Grabel (2000: 4) writes, 'neoliberal reform programmes themselves are not intrinsically credible' – governments must convince global markets that such policies are sustainable rather than designed to meet short-term political objectives. Similarly, Baker (2006: 32) argues that in order to avoid 'excessive movements in major currencies', governments employ 'declaratory policy'. Such an approach was exemplified by New Labour, Hay and Rosamond (2002: 153, 152) insist, whose 'invocation of globalization as [a] non-negotiable external economic constraint' was a purposeful discursive strategy to ‘legitimate specific courses of action’. These accounts suggest IPE should focus on politicians’ strategic inflation of their neoliberal credentials in order to garner credibility with financial markets and ultimately create greater ‘room for manoeuvre’ (Clift and Tomlinson, 2006: 59).

The following sections make the case for the above interpretation through a close examination of the archival record. The evidence is presented chronologically, for clarity purposes.

Abolishing exchange controls, 1977-9

The Callaghan administration

On 26 October 1977, Labour Chancellor Denis Healey announced the relaxation of exchange controls affecting inward direct investment, travel, cash gifts, and emigration. Then, on 1 January 1978, the government relaxed controls on outward direct and portfolio investment in the EEC, by abolishing the rule whereby British investors had to surrender 25% of proceeds from foreign currency sales to the Bank for conversion into sterling.

The competitive pressure that motivated a Labour government to enact the most significant dismantling of exchange controls in nearly 40 years was not immediately apparent. It appeared in 1977 that Healey ‘was one of the few post-war Chancellors to preside over a growing economy, falling inflation, falling unemployment, and a balance of payments surplus’ (Needham, 2014: 109). Yet there remained deep-seated problems veiled by the IMF’s endorsement and North Sea oil. Capital inflows were causing sterling to appreciate steeply, which aided the government's attack on inflation but exacerbated non-oil exporters' lack of competitiveness. In this context, exchange control liberalisation became a key discussion topic within the Callaghan administration.

On 19 October, Healey circulated a proposal outlining various possible exchange control relaxations. His motivations for proposing the consideration of these changes were threefold: the difficulty in justifying exchange controls during a period of sustained current account surplus; the need to give some indication to the EEC that the government took their stance on capital mobility seriously; and the need to offset destabilising capital inflows.[2] The responses Healey received from various government departments generally focused on his third concern. Roy Hattersley, Secretary of State for Price and Consumer Protection, urged Healey *against* relaxing controls. Hattersley argued that, '[f]or exporting industries, a policy of depreciation would represent the abandonment by Government of an important sanction in our fight against inflation'.[3]

However, Hattersley was in the minority. The Department of Trade (DoT), Department of Industry (DoI), and the Bank all favoured some depreciation of sterling in order to increase export competitiveness. DoT official Hans Liesner wrote to his Secretary of State, Edmund Dell, that the 'the UK's long-run trade and hence industrial performance will be threatened by a worsening of competitiveness, and that exchange rate policy should be conducted accordingly … [This] is where the exchange control relaxations should help'.[4] In turn, Dell explained to Callaghan, Healey, and Bank Governor Gordon Richardson that further sterling appreciation 'would be deleterious to investment, to employment, and to the industrial strategy', and thus he recommended a close examination of exchange control liberalisation, which would allow 'money to flow out of the country as freely as it could now flow in'.[5]

Similarly, the DoI informed Callaghan that it 'very much welcome[d]' Healey's proposed deregulation on the grounds that 'there is scope for certain selective relaxations of controls on outward investment that could benefit UK industry'.[6] The Secretary of State for Industry, Eric Varley, further emphasised the gravity of the situation:

> Some of our industry was barely competitive at the present exchange rate. The textile and clothing sectors, for example, employing 850,000 people, would be severely hit, with serious political consequences … The prospect for export-led growth, on which the industrial strategy rested, could be greatly reduced by too rapid an appreciation of the exchange rate.[7]

The Bank too positioned itself against the existing controls. While they had been traditionally hostile towards exchange controls, this sentiment intensified following the abandonment of fixed exchange rates (Dow, 2013:143). By the middle of 1977, Bank advisor Charles Goodhart was advocating the greatest relaxation possible, while Executive Director Kit McMahon and Chief of Exchange Controls Douglas Dawkins also favoured relaxation but were more concerned about timing (Capie, 2010: 766-67).

With regards to lobbying, there is more evidence of pressure from domestic industry than the financial sector, in contrast to the IPE literature. The Confederation of British Industry (CBI) launched a campaign in 1976 to convince the government of the benign effects of overseas investment, so as to hasten the removal of exchange controls, which included commissioning a consultancy firm to produce a favorable report on overseas investment, as well as lobbying the government through the National Economic Development Council and directly through meetings with the Treasury.[8] The City's lobbying efforts were much more limited. In July 1977, Treasury Permanent Secretary Leo Pliatzky went for dinner with London Stock Exchange Chairman Nicholas Goodison, who argued that a relaxation of exchange controls could help the City become the center of securities in Europe, yet he claimed that he would be satisfied to see some action on exchange controls within a timeframe of three years.[9]

Nevertheless, certain officials did support exchange control relaxations due to the advantages for the City and Britain's invisible earnings. The Treasury's Deputy Secretary, F. Russell Barratt, argued in May 1977 that it was 'very much in the national interest that the general capacity of the City to engage profitably in international financial business should be sustained and enhanced', which was dependent on the ability to operate freely in foreign currencies.[10]

This article suggests that the creation of a consensus within the Callaghan government and the Bank in favour of some degree of exchange control liberalisation was primarily the result of concerns over export competitiveness. While there is some evidence as to the role of complying with EEC guidelines on capital controls, the presentational discrepancy of maintaining controls despite the positive balance of payments, and a desire to boost the City's global prospects, the overwhelming motivation for pursuing liberalisation appears to be the need to rescue exporters by depreciating sterling. This evidence directly challenges the accounts of Helleiner (1994) and Germain (1997) which emphasise the centrality of the British state's pro-City agenda. The next section will examine why, despite this competitive pressure, the Callaghan administration did not go further in liberalising these controls.

Market uncertainty and union militancy

There is no single reason why the Callaghan government did not completely abolish exchange controls. One important factor was that the deregulation of controls on investment was counterintuitive to a Labour government that had come to power promising an interventionist industrial strategy.[11] Yet of greater importance was the difficulties of managing currency depreciation, and the political constraints upon the Chancellor and Treasury ministers exerted by their fractious relations with the unions.

In May 1977, when talks about exchange control relaxation began in earnest, the Bank and Treasury was split on the issue of the best way to devalue sterling in a floating rate system.[12] By October, on the eve of Healey's first exchange control liberalisation, Treasury Permanent Secretary Douglas Wass admitted that there was still 'no effective means for bringing the rate down in the current situation. A step devaluation, always difficult in a floating rate regime, would in the current circumstances lead to a chaotic market'.[13] Yet a gradual 'engineered slide would require a change in market sentiment' with regards to sterling that was equally difficult to manufacture without causing panic.[14] After meeting Treasury officials in October to discuss exchange control relaxations, CBI Deputy Overseas Director explained: 'I can characterise the attitude of the Treasury officials as exceedingly cautious … They were clearly not confident that the large inflow of currency into our reserves of late is here to stay'.[15]

The government was also impeded by its tense relations with the unions. Labour had come to power in 1974 promising a Social Contract, in which the unions would voluntarily moderate their wage demands in return for greater welfare provisions and a favourable industrial policy, creating a 'self-reinforcing spiral of disinflation' (Britton, 1994: 19). While Phases I and II of the government's incomes policy were quite successful in balancing wage restraint with social expenditure, this compromise came under increasing strain due to the public spending cuts necessitated by the IMF bailout. This event marked the unofficial end of the Social Contract, engendering a 'strong undertow of tension and resentment' within the union movement (Thorpe, 1999: 144). Phase III began in August 1977 without formal TUC backing, as union leaders struggled to impose the government's requests on their increasingly dissatisfied membership – a membership that voted overwhelmingly for an immediate return to free collective bargaining at the 1977 TUC conference (ibid: 144-5). As Jack Jones (head of the

Transport and General Workers' Union) argued in May 1977, for the unions to gain grassroots backing for the government's incomes policy, the government needed to present 'an alternative economic policy', which would include 'import deposits or controls' (Coates, 1980: 73).

Thus, an extensive relaxation of exchange controls, during a period in which the government was attempting to impose Phase III of its incomes policy on a disillusioned union movement, appeared politically very risky. Not only were important union officials like Jones calling for greater import controls, but the TUC was in fact lobbying the government in 1977 for the creation of a new agency that would 'examine all applications for outward investment' on a case-by-case basis.[16] To entirely disregard the TUC's concerns by abolishing controls ran the risk of undermining union acquiescence to the government's embattled incomes policy. As Barratt argued in a meeting with Treasury and Bank representatives in May 1977, 'the need to move gently in such a politically sensitive area … had deterred the Treasury from putting forward definite proposals for relaxation'.[17] Indeed, Joel Barnett, Chief Secretary to the Treasury, explained to Callaghan's Principal Private Secretary, Kenneth Stowe, in September 1977, that 'we cannot ignore political considerations, and in my judgement the inevitable (if ill-informed) outcry there would be is not worth provoking for a comparatively modest relaxation'.[18] Thus when Healey finally announced his exchange control proposal in October, he acknowledged that the more radical measures 'might cause some political difficulty, especially with the TUC'.[19] Callaghan echoed this concern, insisting on delaying any extensive relaxations 'until there has been the discussion in the TUC/Labour Party Liaison Committee'.[20]

There undoubtedly existed a consensus within the Callaghan government in favour of a significant degree of exchange control relaxation, primarily to check sterling's appreciation and therefore boost export competitiveness. Yet there was also considerable apprehension as to the external economic and domestic political consequences. Labour lacked a rhetorical strategy that would convince markets that exchange control abolition was *not* a cynical strategy to boost exports, and were wary of further alienating the unions as they attempted to enact an unpopular incomes policy. This confluence of pressures resulted in the moderate liberalisations of October 1977 and January 1978.

The Thatcher administration

On 12 July 1979, Conservative Chancellor Geoffrey Howe announced extensive relaxations of exchange controls on outward direct investment and minor relaxations on outward portfolio investment. The remaining controls were completely abolished on 23 October. In contrast to the IPE consensus, this article suggests that this bold move did not result primarily from a desire to propel the City's competitiveness nor did it chiefly constitute one part of a coherent neoliberal agenda. In fact, scrapping exchange controls clashed with Thatcher's later monetarist experiment – the Medium Term Financial Strategy – by making money supply aggregates harder to anticipate and control and by directly undermining the government's 'corset' controls (Needham, 2014: 143-5). While key Conservative politicians were certainly motivated by a radical laissez-faire vision, the Thatcher government's exchange control liberalisation was driven chiefly by the need to rescue industrial competitiveness by depreciating sterling.

After the Conservative victory, Financial Secretary Nigel Lawson set up a team to investigate the possibility of further exchange control liberalisation, led by Treasury Under Secretary David Hancock and Dawkins, which set about consulting the relevant departments (Capie, 2010: 769). Similar to the Callaghan years, there was some division as to whether inflation or exports should be prioritised. As Hancock succinctly explained (in patronising language), officials would prefer to increase competitiveness by reducing inflation, yet in current circumstances this was wishful thinking:

> Like the Irishman, we would prefer not to start from where we find ourselves. The controversial question is what we should do given our present situation. In particular, given that we significantly lost competitiveness over the past winter, is it better: (i) to pursue policies which help to get our rate of inflation down and thus keep the rate high; or (ii) to encourage the nominal exchange rate to fall (if we can) in the hope that this will increase output in the short term and thus possibly mitigate the damage that is being done to our industrial base.[21]

Wass believed that Conservative ministers would favour the high exchange rate, 'partly because of the beneficial price effects it will have and partly because, by reducing corporate profit margins, it will put increasing pressure on private employers to bargain toughly in the next pay round'.[22] This line of reasoning was adopted by P.V. Dixon of the Treasury's Industrial Economic Division. Industry, he explained, was 'caught between the upper millstone of monetary policies/exchange rate and the lower millstone of wage costs … firms will go bust if there is not a very substantial deceleration of wage costs'.[23] For this reason, Dixon urged Lawson *not* 'to move too quickly to industry's rescue' through exchange control abolition.[24]

However, the majority of voices within the government viewed this recessionary strategy as unacceptably risky. British industry's profits had fallen by 13.5% in the first three months of 1979 (Riddell, 1979c). When Howe arrived in office in May, Richardson advised him that the government should respond to sterling's overvaluation with 'significant relaxation of exchange control'.[25] The nature of the dilemma was captured best by Treasury official George Malcolm Gill, who explained to Hancock in late June that 'we may well be moving into an area now where the benefits to inflation from a higher rate may be obtained at too great a cost in terms of output and the current account of the balance of payment'.[26] There was a great difference, Gill argued, between an 'organically' high rate based on a strong economic performance, and a high rate 'imposed on industries which were inherently weak'.[27] '[T]oo fast a rise in the rate', he argued, 'will cause immediate damage to the viability of these industries before the counter-inflation benefits have had time to come through'.[28] For this reason he encouraged Lawson to continue with exchange control liberalisation.

The DoT and DoI also positioned themselves firmly against exchange controls for this reason. The DoT Under Secretary explained in early May that '[d]espite the inflationary disadvantages I think from the Department's point of view there is a strong case for supporting *some* relaxation'.[29] Hancock was also contacted by a top DoI official in early May, who urged the Treasury to address the 'serious and general lack of competitiveness … in British industry'.[30] Advising against monetarist penance, he wrote: 'I do not believe that the adjustment that is necessary in our economy will come about through an overvalued pound, Germany and Japan did *not* attain their virtuous circles in that fashion'.[31] Finally, at a May meeting with officials from a variety of government departments and the Bank, the Foreign Office representative, M.D. Butler, explained with great clarity that there was a 'case for relaxing exchange controls completely over the next three years, in order to stimulate large outflows … and thus to keep the exchange rate competitive'.[32] Summarising the various discussions taking place on this topic, Hancock wrote to Lawson that while depreciating sterling through exchange control abolition could damage the fight against inflation, it was likely a less inflationary strategy for effecting a competitive depreciation than direct intervention in the exchange rate.[33]

Contrary to the claims of Helleiner (1994) and Germain (1997), it appears that the Thatcher government's advocacy of exchange control liberalisation was not chiefly driven by a desire to consolidate the City's global position, nor by a single-minded commitment to neoliberal principles. Instead, this article follows Bellringer and Michie (2014: 122) in suggesting that 'no evidence can be uncovered that the decision was designed to improve the competitive position of the London Stock Exchange', nor other sectors of the City. Furthermore, while key figures in the government were certainly ideologically opposed to controls, the most immediate concern was the lack of export competitiveness. The Thatcher government intended to temporarily alleviate the stress on British exporters by placing downward pressure on sterling through exchange control liberalisation. The final section will explore the Conservatives' strategy for overcoming the barriers that had restricted their predecessors' deregulatory agenda.

The Winter of Discontent and spooking the market

If the Callaghan and Thatcher governments both shared the same motivation in pursuing exchange control liberalisation, then what of the impediments to full deregulation that the former administration had faced? This section will argue that while the domestic political constraint had significantly eased, the problem of volatile currency markets remained. Yet unlike their predecessors, the Thatcher government crafted a rhetorical strategy that they believed would allow them to circumvent the latter obstacle. By publically emphasising their commitment to laissez-faire, the Thatcher government intended to create the policy space to pursue currency depreciation without spooking the markets.

Domestically, Thatcher was less constrained by the unions than her predecessors. To some extent, this was due to the public relations defeat suffered by the unions following the Winter of Discontent. As Gamble (1994: 94-95) observed, the 'myth of the Winter of Discontent, with its images of closed hospitals, rubbish piling up in the streets, and dead bodies rotting unburied in graveyards', reinforced the notion of the bankruptcy of benign state collaboration with the unions. A directly oppositional policy towards the union movement was now not only possible but electorally savvy: the 'old Tory disadvantage of a cold and distant relationship with the union movement … turned into an asset' (Dorfman, 1983: 20). This calamitous event, combined with 'rising unemployment and de-industrialisation', meant that 'Mrs Thatcher inherited a strong strategic position in relation to the trade unions' (Marsh, 1992: 64). Indeed, the government 'used their obvious political leverage over trade unionism' to enact a radical overhaul of macroeconomic strategy 'without so much as consulting nor considering trade union views' (Dorfman, 1983: 20). Whereas the Callaghan government had moved tentatively on the issue of exchange control relaxation because of tense government-union relations, the Thatcher administration in fact believed that the abolition of exchange controls would 'help the Government's position vis-a-vis the trade unions, by showing that the Government were determined that investors should be allowed to put their money where they can earn the best return'.[34]

The external constraint, however, remained. There was a sense of unease within the government about managing a floating rate. The Official Committee on External Economic Affairs insisted that exchange control liberalisation measures should be gradual 'in order to avoid the risk of a foreign exchange crisis'.[35] The Overseas Trade Board concurred, arguing that government intervention to lower the rate 'could easily get out of hand because of speculative action'.[36] Despite the recent accumulation of foreign reserves, the authorities still feared that the floating rate system ruled out 'an orderly devaluation of sterling because any *overt* action by the government would have the potential to provoke a diversification out of the pound' (my emphasis; Rogers, 2012: 203).

The Thatcher administration concocted a rhetorical strategy to neutralise these dangers. By justifying exchange control abolition under the banner of 'good housekeeping', they intended to manufacture a currency depreciation in a seemingly unintentional manner. In June, Hancock wrote to Lawson: 'it is risky for Government spokesmen to *say* that it [exchange control relaxation] was intended to secure a depreciation in the exchange rate. Once that feeling got abroad, the short term consequences for the exchange rate could be very destabilizing'.[37] For this reason, the government should avoid 'the argument that exchange control relaxation is intended as a means of increasing competitiveness'.[38] Lawson agreed that

> reasoning based on the premise that the exchange control relaxations would help prevent this country catching the "Dutch disease" should be avoided; *while the Financial Secretary sees some merit in the argument, it is not one that he would want to use publicly* and prefers instead to contend that the revenue from north sea oil should be used to build up overseas investments whose future earnings can provide a stream of foreign-generated income ... *In this way the exchange control relaxations can be presented as good housekeeping*.[39]

In August, Lawson explained to Howe that while he favoured a strong pound for anti-inflation purposes, he proposed 'a bonfire of most (if not all) of the remaining exchange controls this autumn'.[40] This deregulation '*might'* slow sterling's rise without overtly signaling that 'we are unhappy at the strength of the £', which 'would quickly lead to a very serious loss of confidence in our resolve to stick to [anti-inflationary] policy'.[41]

Nott demonstrated this strategy in an interview after the first round of relaxations in July. In response to a question about whether this relaxation was an attempt to depreciate sterling, Nott said:

> it's very difficult to say whether overseas opinion will take this … liberalisation with exchange control, in such a way that it thinks that the pound is all the more worth-while buying, because it is an act of self confidence, or whether they will say "well, this means there's going to be a little bit more money going out of the country into overseas investment and therefore, we must sell the pound" … What the strong pound has enabled us to do is pursue what I regard as the correct policies in themselves.[42]

This strategy was also visible following the final abolition of controls in October. Speaking to the House of Commons, Howe insisted that the aim was not to weaken sterling, but rather to build up overseas income streams and provide greater ‘freedom of choice’ to ‘companies and individuals’.[43] At a later press conference, Lawson was questioned on the relationship between exchange control abolition and sterling’s value, but he ‘refused to speculate about the possible outflows or impact on sterling from the changes’ (Riddell, 1979b).

The government’s pursuit of this rhetorical strategy must be understood in the context of the rise of new classical economics, with its emphasis on the importance of ‘policy credibility’ (Grabel, 2000). Propelled by several pivotal articles in the late 1970s, this approach argued that rational agents ‘assess the credibility of an announced policy’ before acting (ibid: 3). Particularly influential for the Thatcher government was Patrick Minford’s ‘rational expectations’ model, which too stressed the centrality of perceived credibility for policy-making (Cooper, 2012: 39-40). Indeed, this rhetorical strategy *was* convincing, due to the perceived sincerity of the Thatcher administration’s commitment to free market principles. At a November 1978 Commons debate, Howe had decried the controls as ‘a bureaucratic hallmark of a society that has no confidence in itself’ (1994: 140-1). Lawson had also condemned them in his ‘maiden speech’ as Opposition Treasury Spokesman in November 1977 and then in a *Financial Weekly* article in 1979 (Lawson, 1992: 38). Such pronouncements also convinced the financial press, with the *Financial Times*’ Peter Riddell reporting in July that ‘the latest moves are not designed as a response to the recent sharp rise in the [exchange] rate’ (1979a), and arguing in October that the ‘Government has decided to go all the rest of the way now because Minsters believe it is right on its own merits to give additional freedom to investment’ (1979b).

Ideas, this article has suggested, played a crucial role in British exchange control liberalisation, but not in the manner that conventional IPE accounts have stressed. Laissez-faire ideas were deployed as rhetoric by the Thatcher administration in order to facilitate what was chiefly a palliative strategy to promote British exports. This article does not to discount the causal power of ideas: the belief that this rhetorical strategy would be successful was itself dependent on government figures' acceptance of new classical economics. Rather, the point is that the Thatcher government's public pronouncements of their neoliberal credentials must be understood as instrumental rhetoric, deployed in pursuit of pragmatic governing goals, instead of taken at face value.

Conclusion

IPE accounts have generally emphasised two factors in explaining capital control abolition in advanced capitalist economies: dynamics of competitive deregulation, experienced either as the sanctioning power of capital flows or the incentive to promote national financial centres; and the stigmatisation of capital controls amongst national policy-makers and international organisations. This article sought to challenge this literature through an in-depth archival analysis of Britain's exchange control liberalisation. While the archives cannot conclusively disprove accounts that stress the role of the City's competitiveness or laissez-faire ideology, the evidence does suggest that this liberalisation can be better explained by focussing on Britain's faltering *export* competitiveness and the role of ideas *as rhetoric* in constructing economic credibility.

In the context of inflationary pay settlements and poor export competitiveness, sterling's appreciation from late 1976 presented the British state with a contradiction. The rising exchange rate aided in tackling inflation, while placing further pressure on critically uncompetitive exporters. The archives demonstrate that the Callaghan and Thatcher governments prioritised the latter goal, and thus endeavoured to depreciate sterling by relaxing exchange controls and allowing an investment outflow. Yet two obstacles stood in the way of this deregulation: tense relations with the unions, and currency volatility in a floating rate system. The Callaghan administration was unable to forge a strategy to overcome these barriers, resulting in their weak relaxation of controls in 1977-8. The Thatcher administration, however, faced a weakened union movement, while devising a rhetorical strategy that veiled their intended competitive devaluation with appeals to laissez-faire ideology.

In sum, this article suggests that IPE reconsider the role of competition and ideas in motivating capital control liberalisation. The purpose was not to advance a new theoretical orthodoxy through which to understand specific national deregulations, but rather to encourage further historical analyses of discrete liberalisations. The evidence presented here suggests that British liberalisation was not driven chiefly by a desire to boost the City's competitiveness, but was rather an attempt to raise the short-term competitiveness of exporting industry by effecting a managed sterling depreciation. This evidence contributes to literature that conceives of financial deregulation as part of a palliative response to crisis. Furthermore, contrary to IPE's focus on the role of changing policy norms in transforming capital controls' legitimacy, this article argued that the Thatcher government publically promoted their own neoliberal ideology as a rhetorical strategy to avoid provoking a damaging run on sterling. This finding lends support to literature that examines policy-makers' deployment of ideas as rhetoric or declarative strategy, in order to boost a government's policy credibility in the eyes of financial markets.

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Notes

1. Modern Records Centre (MRC) MSS.200/c/3/dg2/23, *Trade and Industry* magazine, 22 September 1978.

2. The National Archives (TNA) FV 89/2, Healey to Callaghan, 19 October 1977.

3. TNA FV 89/2, Hattersley to Healey, 19 October 1977.

4. TNA FV 89/2, Leisner to Secretary of State, 20 October 1977.

5. TNA PREM 16/2108, Note of a Meeting, 28 October 1977.

6. TNA FV 89/2, EGV to Callaghan, 24 October 1977.

7. TNA PREM 16/2108, Note of a Meeting, 28 October 1977.

8. MRC MSS.200/c/3/eco/11/24, Memorandum, 1 February 1978; MRC MSS.200/c/3/eco/11/25, Minutes of a Meeting, 6 July 1977; MRC MSS.200/c/3/eco/11/26, Memorandum, 11 October 1977.

9. TNA PJ1/91, Pliatzky to Wass, 6 July 1977.

10. TNA T 388/154, Barratt to Payton, 27 May 1977.

11. TNA FV 89/2, Healey to Callaghan, 19 October 1977.

12. TNA T 388/154, Note of a Meeting, 31 May 1977; TNA T 388/154, Note of a Meeting, 31 May 1977.

13. TNA FV 89/2, Note of a Meeting, 21 October 1977.

14. Ibid.

15. MRC MSS.200/c/3/eco/11/26, Memorandum, 11 October 1977.

16. MRC MSS.292D/462/3, TUC Comment on NEDC Paper, 1 July 1977; MRC MSS.292D/40.2LPMR/2, Report of TUC-Labour Party Liaison Committee Meeting, 25 April 1978.

17. TNA T 388/154, Note of a Meeting, 31 May 1977.

18. TNA T 364/211, Smith to Stowe, 30 September 1977.

19. TNA FV 89/2, Healey to Callaghan, 19 October 1977.

20. TNA PJ 1/92, Stowe to Battishill, 26 October 1977.

21. TNA T 388/203, Hancock to Butler, 23 May 1979.

22. TNA T 388/154, Wass to Couzens, 19 July 1979.

23. TNA T 381/145, Dixon to Airey, 31 May 1979.

24. TNA T 381/143, Dixon to Lawson, 29 July 1979.

25. Bank of England G 3, accessed: http://www.margaretthatcher.org/document/113156.

26. TNA T 388/204, Gill to Hancock, 25 June 1979.

27. Ibid.

28. Ibid.

29. Emphasis in original; TNA PJ1/93, Lanchin to Gray, 8 May 1979.

30. TNA PJ1/93, Lippett to Hancock, 3 May 1979.

31. Emphasis in original; ibid.

32. TNA PJ1/93, Note of a Meeting, 17 May 1979.

33. TNA T388/203, Hancock to Lawson, 4 June 1979.

34. TNA T 388/207, Note of a Meeting, 17 October 1979.

35. TNA PJ 1/92, Note of a Meeting, 2 March 1979.

36. TNA PJ 1/92, Wilks to Pliatzky, 5 April 1979.

37. Emphasis in original; TNA T388/203, Hancock to Lawson, 4 June 1979.

38. TNA T388/203, Hancock to Lawson, 4 June 1979.

39. Emphasis added; TNA T 388/203, Diggle to Hancock, 11 June 1979.

40. TNA T 388/59, Lawson to Howe, 28 August 1979.

41. Emphasis in original; Ibid.

42. TNA PJ 1/94, BBC Radio 4 interview, 19 July 1979.

43. Hansard, House of Commons, vol. 968, cc235-264, 12 June 1979.

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