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Downhill from Devaluation: the Politics of Currency Management in 1960s Britain.

by

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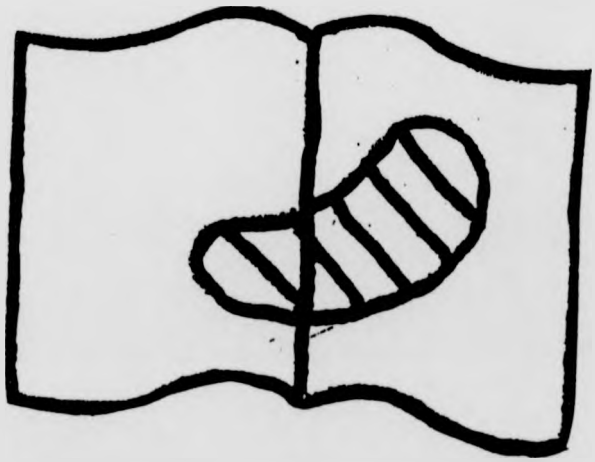

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Declaration

This thesis is entirely my own work and it has not been submitted for a degree at another university.

List of Abbreviations

Bank	Bank of England
BIS	Bank of International Settlements
BOP	Balance of Payments
CAB	Cabinet
DEA	Department of Economic Affairs
EC	Exchange Control
EEA	Exchange Equalisation Account
EEC	European Economy Community
EFTA	European Free Trade Area
EID	Economic Intelligence Department
FO	Foreign Office
FP	Finance Planning
FU	'Follow Up' Planning Group
G10	Group of Ten
GAB	General Agreement to Borrow
GATT	General Agreement on Tariffs and Trade
IMF	International Monetary Fund
IMS	International Monetary System
MISC 205	Miscellaneous Cabinet Committee 205
MIT	Massachusetts Institute of Technology
MP	Member of Parliament
MSP	Minimum Sterling Portion
NATO	North Atlantic Treaty Organisation
NSA	Non Sterling Area
OSA	Overseas Sterling Area
PRO	UK National Archives: Public Record Office
RAF	Royal Air Force
WP3	Working Party Three
SDP	Social Democratic Party
SDR	Special Drawing Rights
SEP	Steering Economic Policy Committee
TUC	Trade Union Congress
UN	United Nations
UK	United Kingdom
US	United States
USSR	Union of Soviet Socialist Republics
WWII	World War Two

Summary

The 1967 devaluation of sterling has been the subject of considerable academic interest. However, its aftermath represents one of the great silences in the literature. This thesis aims to rectify this deficiency. The principal argument is that the devaluation may have been avoidable in the short-term but in implementation; the shift in parity was not a significant event in itself. It must be viewed as a setting change rather than an instrument shift. Therefore, its real importance rest in its legacy because its implementation was to greatly alter the context within which sterling's managers operated. In the aftermath, the problem of sterling was actually far greater than it had ever been before and the solutions proposed were far more radical.

During 1968, the Treasury and the Bank of England devised three main solutions to the problem of sterling. The first, Operation Brutus, was designed to block the sterling balances to ensure that the pound would maintain parity with the dollar. The operation would have necessitated the re-introduction of rationing, a ban on foreign travel and strict controls over imports. During the gold crisis of March 1968 the core executive came close to implementing the plan. Second, in September 1968, the Bank and Treasury implemented the Basle agreement. Under the terms of the agreement, sterling area countries undertook not to diversify their reserves any further, on the understanding that the British government would write up their balances if the pound was again devalued. This agreement marked the implementation of a fresh instrument with which to stabilise sterling's parity within the fixed rate Bretton Woods system. Consequently, it was of far greater importance than the devaluation. Third, by the end of 1968 members of the core executive began to question the sanctity of Bretton Woods and devised Operation Hecuba, which was a plan to float the pound. Although it was not implemented during the Wilson government's term of office, it formed the basis of the 1972 operation to float sterling.

Chapter 1 Introduction

In the analysis of British external economic policy during the 1960s, academics have become obsessed with the 1967 devaluation to the exclusion of all else. This is understandable because while sterling's journey during that decade is an interesting story, particularly dramatic is the Labour government's ability to hold the parity of the pound for three long years, until it finally devalued November 1967. The academic debate has centred on why the decision to devalue was not taken sooner, the measures that could have been utilised to avoid it and why a move to floating rates was not considered.[1] However, the literature on the devaluation is grounded in the traditional orthodoxy that Labour came to power in 1964 and both refused to consider the possibility of devaluation or to plan for it.[2] Of course, this is only a half-truth. Between 1964 and 1967, the Treasury in consultation with the Bank of England (the Bank) embarked on full scale contingency planning so that they would be prepared for the 'great unmentionable'[3], should the traditional deflationary packages fail to improve the position of the currency.

The drama with sterling does not end with the devaluation however, and scholars who have ignored the late 1960s and have instead turned their attention to the implications for sterling following the break up of Bretton Woods in the early 1970s have missed some exciting and important developments during 1968. The conventional view amongst scholars is that 'the

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[1] See for example Bale, T. 'Dynamics of a Non-Decision: the 'Failure' to Devalue the Pound, 1964-67', Twentieth Century British History, 10 (1999). p.192-217; Bruce-Gardyne, J. and Lawson, N. The Power Game: An Examination of Decision-making in Government, (London: Macmillan, 1976);
Burk, K. '1967 Devaluation Symposium', Contemporary Record, 1 (1987). p.44-53; Davis, W. Three Years Hard Labour: the Road to Devaluation, (Boston, MA: Houghton Mifflin, 1968);
Hirsch, F. The Pound Sterling: A Polemic. (London: Victor Gollancz, 1965);
Shipman, A. 'Falling with the Pound: The Labour Party's Exchange Rate Problems 1947-76', Contemporary Record, 5 (1991), p.105-114 and
Stewart,M. Politics and Economic Policy in the UK Since 1964: the Jekyll and Hyde Years (London: J.M. Dent,1977).

[2] Ponting, C. Breach of Promise: Labour in Power 1964-70. (London: Hamish Hamilton, 1989), p.189-190&292.

[3] This was the phrase used by Harold Wilson, to refer to the possibility of a sterling devaluation. See Cairncross, A. Managing the British Economy in the 1960s: A Treasury Perspective. (London: Macmillan, 1996), p.105.

new $2.40 parity seems not to have come up for reconsideration before President Nixon's speech on 15 August 1971'[4], when Bretton Woods collapsed. However, this is simply not true. As the official papers show, the repercussions of the devaluation were highly significant.

In this thesis, I propose to rectify the deficiencies in the existing literature. This account will make use of both archival documents and oral histories and the devaluation will provide a starting point for an analysis that focuses on the immediate aftermath. Particular emphasis will be placed upon the relations between ministers, the Treasury, and the Bank and their attempt to manage sterling during 1968.The principal argument is that although sterling was devalued in November 1967, the devaluation was not forced and could have been avoided in the short-term. Furthermore, as the table below suggests and as chapter two will elaborate on, the fact that sterling was devalued is of little significance in itself. It only amounted to a first order setting change to the second order *fixed but adjustable peg* instrument.[5] It did not constitute the abandonment of that instrument nor did it represent a withering of the underlying goal of stable exchange rates. In short, in the terminology of Peter Hall, there was neither a third order paradigm shift nor even an instrument shift.

Table 1.1 Orders of Change

Third Order Goal	Second Order Instruments	First Order Instrument Settings
Exchange Rate Stability	*International*: IMF, GAB, SDRs.	Drawing Rights
	Domestic-External: Fixed but adjustable exchange rates, Exchange Control, Import Controls.	Devaluation/revaluation; level of current and capital account convertibility etc
	Domestic-Internal: Prices and Incomes Policy, Credit Controls, Domestic Taxation, Public Spending, Interest Rates	Tax and interest rate settings Etc

[4] Tew, B. International Monetary Cooperation. (London: Hutchinson & Co, 1970), p.315.
[5] Adapted from Hall, P. 'Policy Paradigms, Social Learning and the State: the Case of Economic Policy--making in Britain', Comparative Politics 25 (1992), p. 275-296.

Consequently, it is difficult to understand why the build up to devaluation has attracted so much attention. One supposes that in contrast to interest rate management, policymakers regarded sterling's parity 'as a matter of national pride-almost as a national virility symbol-and devaluation or revaluation as a national disaster if not a national disgrace'.[6] In short, it was a setting change that had emotional and moral connotations and this explains somewhat the reluctance to use it. However, the real significance of the devaluation rests not in the event itself but in its aftermath and in the way that it altered the context within which economic policymaking was conducted. Once the setting change was made, it was to have grave repercussions on the management of the pound. Firstly, the resultant J-curve effect was to exacerbate the balance of payments difficulties.[7] Secondly, because the confidence of the Overseas Sterling Area was greatly reduced, the sterling balance holders sought to diversify into dollars and gold.[8] This meant that the meagre foreign exchange reserves faced pressure from two sources simultaneously. The problem of managing sterling was actually greater in the period after devaluation than it had ever been before. The solutions proposed were far more radical and amounted to an instrument shift rather than a mere setting change.[9]

The Structure and Argument of the Thesis

In order to show the originality of this work, it is first necessary to provide an overview of the existing literature on the aftermath of the devaluation and to explain how this account differs and builds upon it. Furthermore, to understand the environment in which economic policymaking was conducted in the late 1960s it is also necessary to highlight the nature of the economic crisis that sterling's managers faced. These tasks will be completed in the remainder of this chapter, which concludes with an examination of the principal actors

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[6] National Archives: Kew, [henceforth PRO] T267/36 'THM: The Break up of Bretton Woods', p.27.
[7] PRO T230/1052 Paper by Economic Section 'The Domestic Prospect after Devaluation', January 1968.
[8] Bank of England Archive [Henceforth Bank] OV44/159 C. W. McMahon 'The Future of the Sterling Balances', February 1968;
[9] Bank G3/287 Parsons to Armstrong 7/3/68

involved in external economic policymaking. Chapter two outlines the theoretical framework that is used in this investigation. It is divided into two parts. The first deals with the deductive assumptions upon which this inquiry is based. These are that whilst the world exists independently of our perceptions of it we only come to understand it though those perceptions. This means that academic inquiry must be interpretative and that the scholar must attempt to reconstruct the constructions of those that are being observed so that they can be described in detail. Consequently, the project is qualitative in its research design and the role of theory is to provide a vocabulary with which to make sense of the data and to place it in an intelligible framework. The second part of the chapter concerns itself with the inductive premises, which were teased out only after data collection ceased. These are (1) that the relations between economic policymakers are best conceptualised using the core executive prism combined with a variant of policy network theory. (2) That agents act in response to the possible or actual onset of crisis conditions and (3) their choice of action is guided by self interest which manifests itself in the form of a shared institutional interest or a departmental view.

The third chapter analyses the contingency planning conducted by the Treasury and Bank in the mid-1960s. It them moves on to assess the build up to and implementation of the 1967 devaluation. The aim is to provide a base point from which an analysis of post-devaluation policy can proceed. The central arguments are that whilst the devaluation was clearly planned for in advance, its implementation could have been avoided in the short-term. However, once the decision to devalue was taken, it was to have severe consequences and to greatly alter the context within which economic policy was conducted. This was because after devaluation, imports became more expensive thereby worsening the balance of payments. Furthermore, the sterling balance holders, stung by the reduction in purchasing power of the currency, began to diversify. Therefore, the problem of managing sterling was greater than it had ever been before.

Chapter four begins by outlining the shape of post-devaluation economic policy. It then moves on to assess the origins and consequences of the gold crisis that erupted in March 1968 and which had the potential to have more long lasting repercussions for sterling than the devaluation. The gold crisis was to lead to such a drain that the reserves were actually far lower than on the eve of devaluation and it seemed unlikely that the new $2.40 rate would be maintained. In response, the Treasury advocated blocking the sterling balances by force under the code name Operation Brutus, as a means of stopping the outflow and maintaining parity with the dollar. The Bank, which recognised the severe implications of blocking to its client groups, objected and instead suggested that sterling should be moved to a floating rate. However, the Treasury was fearful that floating would dent its reputation. This was because it would put undue pressure on the dollar, probably culminating in the destruction of Bretton Woods. Thankfully the Labour government was saved from either course of action by timely financial assistance from the United States and the G10. However, without that assistance it is likely that Brutus would have been implemented. This was because the Treasury had overruled the Bank's objections and was therefore able to shape the context within which ministers made their decisions.

Even though the meltdown of the currency had been averted, the Treasury recognised that unless confidence amongst the sterling balance holders was to increase and the balance of payments improve, it would only be a matter of time before another crisis materialised. Because of this, it continued to hone the Brutus scheme, with the reluctant acquiescence of the Bank, between March and July 1968. Chapter five assesses this. The argument is that although the Treasury initially favoured blocking, the horrors of it became apparent after it began to plan for it in-depth. The Treasury quickly realised that for the block to be totally effective, it would require the abolition of the sterling area, import controls, the imposition of food rationing at home, and a total ban on foreign travel. In short, the British government would have been forced to raise the drawbridge, to implement a siege economy, and descend into a financial little England. It was because of this that the Treasury's initial enthusiasm was

quickly mitigated. However, Treasury officials also recognised that during an emergency there still might be no alternative to blocking, because if the currency was allowed to float the sterling balance holders would quickly rid themselves of sterling, pushing the exchange rate to a very low level.

The Bank with its intense dislike of Brutus had begun work on a more palatable alternative of its own, which culminated in the 1968 Basle agreement. This is discussed in chapter six. Under the agreement, concluded in September 1968, the sterling area official balance holders agreed to hold a minimum percentage of their reserves in sterling, in exchange for the UK guaranteeing their balances against devaluation. In short, they had agreed to voluntarily block their balances in return for compensation, should the rate again fall. It is argued that although the Bank began with the aim of dismantling the reserve currency role, the agreement actually reinvigorated it for a short time. Consequently, it is more significant than the devaluation. This is because it involved the crafting of a new instrument, in order to protect sterling, rather than the tweaking of an old one.

The Basle agreement also altered the context within which contingency planning was conducted. In implementation, it met the central objective of Brutus, as it made a large portion of the sterling balances inconvertible. In the aftermath of Basle, the Treasury recognised that the move to a floating rate would not necessarily result in the sterling balance holders divesting, because the agreement would protect them against a fall in the rate. Consequently, it was possible that if sterling faced an insurmountable crisis it would be possible to let the rate float rather than block, as the rate would not fall too far. Therefore, the Bank and Treasury began to plan for such a possibility under the code name Operation Hecuba, from September 1968. This is discussed in chapter seven. The principal argument is that although policymakers were not prepared to consider floating as a policy in its own right, they were finally prepared to consider it as the least worst alternative, instead of blocking, under conditions where the reserves were clearly inadequate. Thus, September 1968 is an

important watershed in official thinking and one that paved the way for the eventual float in 1972. Chapter seven also examines the French devaluation crisis of November 1968 and its ramifications for sterling. The impact of this crisis seemed less severe, because officials had learned from the past and were not caught off guard, but it is a juncture at which sterling narrowly missed moving to a floating rate. The conclusion is divided into two parts. The first summarises the main arguments within the context of the theoretical framework and the second provides an overview of sterling between 1969 and 1972. There is also an appendix, which outlines how the thesis was researched and written.

The Existing Literature

The construction of a literature review is never an entirely straightforward process. This is because it involves the marshalling of a large amount of data. Furthermore, for the sake of clarity, it is necessary to catalogue the various approaches and interpretations to whatever academic conundrum one is investigating, and place them into boxes that they do not quite fit within. However, there are generally two things which ensure that no matter how much literature there is to review and no matter how many competing interpretations exist, the process is not as cumbersome as all that. First, in any given sub-field, there is usually widespread agreement between practitioners on what the facts are. Second, the disagreements that do arise are over how those facts are to be interpreted. In short, they are disagreements over the significance of the event, the motivations of participants, and the theoretical underpinnings that should be used to make sense of them.

However, in the analysis of sterling in the aftermath of devaluation scholars are not quite so lucky. For it is a topic area where there is no established tradition of research. In fact, as Bulpitt attests, practitioners of British political science have made little attempt to develop an

historical research paradigm.[10] Thus it is arguable many political scientists lack interest in the governing regimes that operated before the 1980s, except when they are viewed in macro terms as the prologue to the break up of the supposed post-war consensus.[11] Consequently, very few political science accounts of the Wilson governments' have been produced and of these, most focus on the issue of industrial relations.[12] Clearly, the state's relationship with trade unions is connected to the management of sterling, because wage increases that are not matched by improvements in productivity will undoubtedly harm the balance of payments and hence destabilise the currency. However, whilst sterling and industrial relations are symbiotically linked, the existing political science accounts tend to place sterling on the peripheries of their trade union centred analysis. The only real exception to this is the work of Rob Stones, which uses policy network theory as a conceptual prism with which to explain the fact that sterling was not devalued between 1964-67.[13] The theoretical framework that Stones employs is useful as a means of theorising about the various international players that came to the aid of sterling and the way that these alliances unravelled in 1967, prompting devaluation. There are, however, two principal problems with Stones' accounts. Firstly, they rely entirely on secondary sources. Secondly, analysis is not extended into the period beyond devaluation.

The few accounts of the post-devaluation period that do exist have generally been produced not by political scientists, but by historians, economic historians and by the politicians and

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[10] Bulpitt, J. 'Historical Politics: Macro, In-Time, Governing Regime Analysis', paper given at the PSA Annual Conference, University of York, Easter 1995, in the Political Science Specialist Group Panel on 'Politics, Contemporary History and History'. See also Johnson, N. The Limits of Political Science. (Oxford, 1989), p.35-56.

[11] See for example Kavanagh, D. and Morris, P. Consensus Politics from Attlee to Thatcher. (Oxford: Blackwell, 1989).

[12] See Coates, D. The Labour Party and the Struggle for Socialism, (Cambridge: Cambridge University Press, 1975), p.97-129; Coates, D. The Crisis of Labour: Industrial Relations and the State in Contemporary Britain. (Oxford: Philip Allan, 1988), p.37-57; Hall, P. Governing the Economy: the Politics of State Intervention in Britain and France. (Oxford: Oxford University Press, 1986), p.85-88; Panitch, L. Working Class Politics in Crisis: Essays on Labour and the State. (London: Verso, 1986), p.79-104;

[13] Stones, R. 'Labour and Industrial Finance, 1964-1967' in Marsh, D. and Rhodes, R. Policy Networks in British Politics. (Oxford: Clarendon Press, 1992), p.200-225 and Stones, R. The Myth of Betrayal:

officials that participated in the events. However, almost without exception, they are devoid of any explicit theoretical backbone or for that matter any real argument. They prove to be little more than potted histories that veer firmly away from attempts to explain or theorise. Furthermore, because the files at the PRO have not yet been systematically pillaged, these published accounts are also often factually inaccurate. There is no widespread agreement on what the facts are; or rather, scholars working without reference to the archives simply do not realise that they have it wrong.

It is impossible to distinguish between the existing accounts of the period based on their differing interpretations of events. The only real way to differentiate between them is in terms of their data type. Broadly, there are three types of literature on this period. Firstly, published diaries and memoirs written by those who took part in the events. Secondly, accounts written by academics, which are based on these published diaries and memoirs. Finally, more recent reports that are grounded either on interviews or a limited number of PRO files. The table below shows the accounts that fall under each heading. The rather scant collection of names listed shows how little research has been done.

Table 1.2 The existing literature

Memoirs and Diaries (MD)	Secondary work based on MD	PRO and interview based accounts
Barbara Castle[14]	Alec Cairncross[15]	Anthony Dunne[16]
Alec Cairncross[17]	Clive Ponting[18]	Peter Hennessy[19]
~	~	Jon Davis[20]

Structure-Agency in the Labour Government's Policy of Non-Devaluation, 1964-67. (Unpublished PhD Thesis, University of Essex, 1988).

[14] Castle, B. The Castle Diaries: 1964-70. (London: Weidenfeld and Nicolson, 1984).

[15] Cairncross, A. Managing the British Economy in the 1960s: A Treasury Perspective. (London: Macmillan, 1996).

[16] Dunne, A. "The Pound in your Pocket" A Study of the Economic Policy of the Wilson Government and the Devaluation of Sterling 1964-1970. (Unpublished M.Litt. thesis, University College Dublin, 2000).

[17] Cairncross, A. The Wilson Years: A Treasury Diary 1964-69, (London: Historians Press, 1997).

[18] Ponting, C. Breach of Promise: Labour in Power 1964-1970. (London: Hamish Hamilton, 1989).

[19] Hennessy, P. The Prime Minister and its Office Holders since 1945. (London: Penguin, 2000).

[20] Davis, J. "Staring over the Precipice and Into the Abyss" An Anatomy and an Analysis of 'Operation Brutus' November 1967- July 1968. (Unpublished MA thesis, University of London, 1999).

The earliest published account that contains references to the management of sterling post-devaluation is that of Barbara Castle. Although less than 1% of the work is devoted to discussion of Brutus, Hecuba, and the Basle agreement, the following positions can still be clearly gleaned. Firstly, that according to Castle, Brutus and Hecuba were intended purely as contingencies that would be implemented from a position of weakness and that the administration hoped that it would never be forced to execute the plans.[21] Secondly, during the French devaluation crisis, in the winter of 1968, blocking no longer seemed to be considered as a serious contender for implementation should total meltdown of the reserves have been reached. Instead, the Chancellor and the Prime Minister were more inclined to float the pound.[22] Thirdly, that during the French devaluation crisis members of Misc 205, the secret Cabinet committee that dealt with economic issues, asked the Chancellor to prepare for them a paper on floating.[23] However, he was reluctant to do so and it was not until the 4 February 1969 that operation Hecuba was presented to the Cabinet.[24]

Factually the Castle account is very interesting, if a little on the short side, but theoretically it is decidedly lacking. However, because the work is in fact the published diary of an ex-cabinet minister who was a key participant in the events themselves, it could almost be characterised as a primary source in its own right. Thus to criticise Castle for presenting little more than a potted history is somewhat misguided. Of course, because Castle was a serving politician, her obsession with macro issues looms large and no matter how factually accurate her account is it fails to provide the essential details. Words like 'blocking', 'floating' and 'guarantees' are used continually, yet no attempt is made to explain how the various schemes would have been implemented.[25] Furthermore, because Castle was not made a member of Misc 205 until June 1968, her diary is unable to provide any information on the build up to

[21] Castle, p.463
[22] ibid, p.552
[23] ibid, p.557
[24] ibid, p.600
[25] See for example Castle's diary entry for the 13 June 1968, p462.

devaluation or the March 1968 gold crisis, and thus the context under which planning commenced and evolved.

Perhaps then, the work of Sir Alec Cairncross can fill in the gaps that exist within the Castle account? After all, during his time as head of the Treasury's economic section Cairncross kept a detailed diary and this was later published. As well as this, twenty-eight years later, he was to produce his lengthy work on the British economy in the 1960s. Within this short literature review, it is best to treat both works as a single entity. As Cairncross himself admits, his scholarly interpretation of economic policy in the 1960s is more memoir*ish* than he would have liked.[26] Whilst his analysis of the years 1960-67 was based on a detailed examination of PRO documents, his account of policy making during 1968 and 1969 is based almost entirely on his own personal recollections as recorded in his published diaries. This was because the archive material required to produce a more sophisticated account was still restricted under the thirty year rule. In fact, the documents would not be released until after Cairncross's death.

It is unfortunate that, like Castle, Cairncross does not provide an explicit theoretical framework. His book and diary do however provide a useful overview of the events leading up to the March 1968 gold crisis and the conditions under which Brutus was developed. However, depth is sacrificed for breadth and his descriptive treatment is limited. For example, he explains that during the March crisis the Treasury developed three blocking schemes, Brutus I, II, and III, and that they were planning to implement Brutus I if the situation did not improve.[27] However Cairncross does not explain what the schemes were designed to block, why blocking was necessary, how they would have been implemented or for that matter what the key differences between the schemes were.

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[26] Cairncross, A. Managing the British Economy. p.x (preface)
[27] ibid, pp.207-210.

Furthermore, after the March 1968 crisis Cairncross was to work almost exclusively on the development of plans to reduce the level of imports to Britain. He was no longer privy to information on the problem of sterling and was no longer involved in discussions about the development of the contingency plans or the proposed Basle agreement.[28] Without the availability of PRO documents to fill in the gaps, his diary and book present a skewed picture of the management of the currency.[29] Therefore, whilst Cairncross's work does build upon Castle's in so much as it provides more detail and an insight into the mindset of economic policymakers, it would be wrong to categorise it as the definitive work on the management of sterling in the aftermath of devaluation.

The other account of the period, based on secondary sources, is that of Clive Ponting. However, his work is little more than a flawed regurgitation of what Castle wrote in her own published diary.[30] For example, he states that in early February 1969, Treasury economists devised Hecuba, which he describes as 'the usual deflationary package'.[31] It was to comprise a wage freeze, a considerable increase in taxation and severe public expenditure cuts.[32] However, Ponting has misinterpreted the events. Firstly, Hecuba was not devised in February 1969 but during the autumn of 1968. It was simply that the Chancellor would not allow Misc 205 to examine the plan earlier, possibly because he was fearful of a leak. Secondly, Ponting has also misunderstood the nature of the Hecuba proposal. It was not a set of deflationary measures but was in fact the plan for the floatation of sterling. Ponting's account more than any other illustrates that an analysis of the period by an individual that was not a party in the events, which does not use archival data, is likely to be factually inaccurate.

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[28] For example in Managing he states ' Throughout my time in the Treasury I could never count on seeing the papers or knowing what papers had been circulated, much less being consulted or even informed...There could be long periods when I never set eyes on the Chancellor', p221-222.
[29] Interview with Sir William Ryrie.
[30] His examination of Brutus can be found on pp.373-374 of his book Breach of Promise.
[31] ibid, p374-375.

Anthony Dunne's thesis, on the other hand, is primarily concerned with answering the following question: Why did the Wilson government devalue the pound in November 1967? In that respect, much of what he has to say is only of passing relevance to this project. His work contains no mention of Hecuba, pays scant attention to both the Basle agreement and the French franc crisis of November 1968, just as one would expect from a thesis on devaluation. It does however contain an entire chapter on Operation Brutus. His account of it does two things that the previous works have failed to do. Firstly, it uses material from the Bank of England archive that suggests that the Bank had considered Brutus type plans as early as September 1967 and had dismissed them.[33] Secondly, he attempts to explain in detail how Operation Brutus would have been enacted.[34] However, because the Treasury files were not available at the PRO when Dunne was researching, he had to rely entirely on Prime Ministerial (PREM) files. Consequently, his discussion of Brutus is deficient.

Firstly, he does not recognise that Brutus I did not constitute either full blocking or the wind up of the sterling area but was in fact a proposal to make the sterling balances inconvertible. Secondly, he fails to see that the definition and function of No. 1, 2, 3 and 4 accounts, which formed an integral part of the schemes, changed in each version of the plan. Thirdly, he does not explain how and why the Brutus proposal evolved from version I to version III but more importantly, like Cairncross, he does not recognise that there was any development of the plan post-Brutus III. This is odd considering that the PREM files that he examined contained clear references to Brutus IV and V. There are further factual errors within his work. For example, he states that the Cabinet Secretary, Burke Trend, advised the Prime Minister that Brutus should be renamed so that more officials could be included in the planning exercise.[35] However, Dunne concludes that the change of name never occurred. Whilst he is correct in saying that Trend called for the re-branding, he is incorrect when he states that it never

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[32] ibid
[33] Dunne, A. *Op. Cit.* p.212-213
[34] ibid, p221-235.

occurred. In June 1968 the operation was renamed Cranmer. He also misinterprets Trend's motives for advocating the change. It is not clear how simply renaming the scheme would aid further inclusion. Nor is it clear that an expansion in personnel would have been desirable, because if more individuals participated, there would be a greater chance of leakage. If the proposal had become public knowledge, it would have undermined confidence in the currency, thereby necessitating its implementation. It is more likely that the operation was renamed in order to maintain secrecy. After all Brutus, with its *Ides of March* connotations, conjures up images of backstabbing. It would not be too difficult for the uninitiated to decipher from the name alone, the nature of the plan. What was needed was a more neutral code word. Cranmer would well fit that brief.

Dunne's account also significantly fails to examine *why* political actors called for Brutus to be devised in the first place. He is content to assume that desperate times call for desperate measures, that liberal democracies are likely to procrastinate longer over tough economic decisions that could loose the incumbents votes and as a result of indecisiveness, tougher action has to be considered later.[36] His assessment of actors' motives and his theoretical framework is no more complicated than this. Finally, the entire work is marred by severe structural deficiencies. The story is not told chronologically but instead thematically. The chapter on Brutus does not explain why the March 1968 crisis lead to the consideration of the measures, how the plans developed over the coming months and why Brutus was not considered seriously during the November crisis.

The remaining accounts are those of Peter Hennessy and Jon Davis. Of the two, Hennessy's contribution is barely worth noting. It amounts to little more than two descriptive paragraphs in his book on post-war British Prime Ministers.[37] His real contribution was to highlight the

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[35] 'Indeed at one time the Cabinet secretary suggested that the operation be renamed because of the necessity to extend details to a greater number of people', Dunne, A. p.238.
[36] ibid, p.211.
[37] See Hennessy, P. p.316-319.

fact that one of his students wrote an unpublished MA dissertation on operation Brutus. That student was Jon Davis. The Davis account is a narrative history on the March 1968 gold crisis, although it is a good one. It is factually correct, fairly detailed, and makes use of both archival documents and oral histories. Its main arguments are (i) that during the gold crisis, the British government intended to use Brutus as leverage in order to cajole the US into providing much needed foreign exchange.[38] (ii) If the US failed to co-operate and Britain had to block, it was expected that this would put pressure on the US to develop a solution to the problem of the sterling balances.[39] (iii) If no solution were found it was believed that the dollar would be forced to float and (iv) that in response, the pound would peg itself against the dollar. It was also hoped that the economic instability created in Europe would lubricate Britain's entry to the EEC.[40]

However, the account is deficient in a number of respects. Firstly, it is broadly narrative and contains no theoretical framework. Secondly, although much consideration is given to the behaviour of ministers in the Labour government, little emphasis is placed on the Treasury or the Bank and the way in which they shaped ministerial action. Thirdly, it does not properly analyse the content of the Brutus plan or consider the likely domestic effects of implementation. Finally, it also fails to consider the wider context. Little attention is paid to either the role of devaluation before the crisis or the changing shape of economic policy in the aftermath.

It is clear that the existing research into the management of sterling in the aftermath of the devaluation is virtually non-existent. The few accounts that do exist are wanting. Without exception, they are lacking in terms of the provision of theory. The vast majority also lack in terms of argument and there are significant factual errors. From the existing literature alone, a synthesis could not be drawn. What is required is a fresh account that is able to provide a

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[38] Davis, J. p.26
[39] ibid.

detailed overview of the whole period and one that is both factually accurate and theoretically underpinned.

The Problem of Sterling

In order to understand the environment in which economic policymaking was conducted in the late 1960s it is necessary to highlight the nature of the economic crisis that sterling's managers faced. That is the task of this section. Between 1945 and 1971, the UK was bound by the Bretton Woods system. Under it, British policymakers undertook to do two things in relation to the sterling exchange rate. First, they agreed to fix the foreign exchange value of sterling in terms of gold at $35 per ounce and declare a par value, or parity, expressed in terms of the US dollar. Secondly, they agreed to intervene in UK exchange market to prevent the value of sterling moving more than 1 per cent above or below its declared parity.[41] The aim of Bretton Woods was to promote stability within the international monetary system (IMS) by introducing a system of 'fixed, but adjustable parities'.[42] Ostensibly, parities were fixed as a means of promoting regularity in international transactions. However, the founding fathers recognised that over time, it was likely that currencies would become under or over valued and their parities would have to be adjusted.

In reality, only the fixed part of the agreement was adhered to because countries were reluctant to adjust their exchange rates. Both devaluation and revaluation were treated as dirty words, and in Britain, the pound's parity was regarded as national virility symbol.[43] Equally abhorrent was the idea of returning to flexible exchange rates, because it was believed that this would represent the restoration to *laissez faire* system of the 1930s.

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[40] Ibid. p.26-27
[41] PRO T267/36 'Treasury historical memorandum on the Break up of Bretton Woods', undated.
[42] ibid
[43] ibid

However, during the 1960s economic policymakers within the UK were finding it harder to manage sterling and to maintain its parity. The consensus is that sterling's weakness was the result of four inter-related variables:

- Firstly, that in terms of foreign trade Britain seemed, since the end of World War II, to be in constant balance of payments deficit.[44]

- Secondly, in its role as banker to the Sterling Area the UK held on deposit in London sterling liabilities that far outstripped the reserves available to back those claims. The ratio of assets to liabilities was thought to be somewhere in the region of 1:4 and should the sterling holders have decided en-mass to cash in their holdings, the sterling ship would have been sunk.[45]

- Thirdly, that these two weaknesses undermined confidence in the currency to such a degree that speculation against it from the non-sterling area (NSA) was rife. It is thought that speculative attacks led to the haemorrhaging of nearly $12 billion dollars from the exchange equalisation account between 1945 and 1965.[46] Of course, the Bank of England usually recouped much of the dollar outflow when confidence returned.

- Finally, that the foreign exchange reserves held by the United Kingdom to maintain its parity were woefully inadequate and they could not cope with the pressure placed upon them from these three sources.[47]

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[44] Financial Statistics. (CSO: No.93, Jan. 1970), p.95.
[45] PRO T267/29 'THM: the Sterling Balances Since the War', undated.
[46] Hirsch, F. The Pound Sterling. (London: Victor Gollancz, 1965), p47-49.
[47] PRO T318/188 'Breakdown of Gold and Convertible Currency Reserves', January 1968.

Each of these weaknesses will be assessed in more detail in the remainder of this section. It will be argued that the balance of payments, reserve position and speculation proved to be real constraints on the management of sterling throughout the whole of the 1960s. Whereas the sterling area balances only became a cause of concern after the 1967 devaluation, making the management of the currency in 1968 more difficult than it had ever been before.

Balance of Payments

Figure 1.3 outlines the UK balance of payments for 1960-1969 as estimated at the time. The table demonstrates that in terms of physical goods, the UK imported far more than it exported and was in continual visible deficit during the 1960s. Yet, this was no way a new phenomenon. The available data suggests that Britain only ever achieved a visible surplus on seven occasions, namely, 1797, 1902, 1816, 1821, 1822, 1956 and 1958.[48] However, the current account balance, as a whole, generally recorded a surplus because the visible deficits were offset by surpluses in the invisibles. During the 1960s, the UK balance of payments did not buck this trend. In fact, the invisible surplus was so large that it was also able to compensate for fluctuations in the capital account. Only during 1964 was a deficit recorded on the balance of current and capital transactions and in many of the remaining years there were sizeable surpluses. Nevertheless, the balance of payments as a whole (as recorded at the time) was in deficit during the 1960s; except in 1961, 1962, and 1969. The cause of this deficit was government overseas spending, which averaged at £692m per annum. The nation having made a surplus on its private dealings in goods, investments and services proceeded to overspend this income on overseas military and economic aid.[49] It was Britain's role as world policeman and not the inefficiency of her industry that was the cause of her deficits throughout this period. None of this however detracts from the fact that based on the

[48] See Imlah, A. Economic Elements in the Pax Britannica. (Harvard: Harvard University Press, 1958).
[49] Manser, W. Britain in Balance. (London: Longman, 1971), p.29.

estimates produced at the time, the balance of payments was to siphon £1933m from the reserves during the 1960s.

However it is important to recognise that, unlike unemployment or price change figures, the balance of payments statistics are subject to constant revision.[50] There is also a tendency for more recent figures to be more positive, or less negative, than those previously published. This is because when the statistics were originally compiled the officials at Customs and Excise rarely had complete data.[51] There was a tendency for imports to be recorded immediately but exports only with a time lag. More recent surveys by the Office of National Statistics suggest that whilst the balance of payments still tended towards deficit, this was over recorded by at least £749m throughout the 1960s as a whole.[52] Therefore, the total deficit was a third lower, somewhere in the region of £1184m. Although, this is still a sizeable figure and one that would undermine the solidity of the currency.

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[50] Mosley, P. The Making of Economic Policy: Theory and Evidence from Britain and the United States. (Sussex: Harvester Press, 1984), p.243.
[51] Interview with Sir Kit McMahon
[52] 'Summary of Balances 1944-2003' ONS data set www.statistics.gov.uk/STATBASE/tsdataset.asp?vlnk=209 accessed 10/8/04.

Figure 1.3 UK Balance of Payments as Estimated at the Time 1960-1969 and a Revised Total £ million

	1960	1961	1962	1963	1964	1965	1966	1967	1968	1969
Visibles										
Imports	-4 138	-4 043	-4 095	-4 362	-5 003	-5 042	-5211	-5576	-6807	-7153
Exports	+3 732	+3 891	+3 993	+4 282	+4 486	+4817	+5168	+5122	+6273	+7056
Balance	-406	-152	-102	-80	-517	- 225	-43	-454	-534	-97
Invisibles										
Payments	-1 546	-1 541	- 1 576	- 1 697	- 1 880	- 2016	- 2051	- 2160	- 2530	- 2657
Receipts	+2 117	+2 185	+2 297	+2 405	+2 566	+2783	+2832	+3028	+3561	+3967
Balance	+571	+644	+721	+708	+686	+767	+781	+868	+1031	+1310
Current Balance	+165	+492	+619	+628	+169	+542	+738	+414	+497	+1210
Long-term Capital Exports (Net)	-89	+113	+6	-44	-247	-117	-32	-82	-110	+116
Current and Long-term Capital Balance	+76	+605	+625	+584	-78	+425	+706	+332	+387	+1326
Government										
Current	-430	-496	-507	-514	-550	-592	-674	-736	-806	-847
Long-term Capital	-103	-45	-104	-105	-116	-85	-80	-57	+21	-95
Total	-533	-541	-611	-619	-666	-677	-754	-793	-785	-942
Government and Private Balance	**-457**	**+64**	**+14**	**-35**	**-744**	**-252**	**-48**	**-461**	**-398**	**+384**
Revised Total	**-397**	**+154**	**+100**	**+21**	**-684**	**-208**	**+70**	**-396**	**-310**	**+458**

Source: Original estimates from CSO publications (1965/1971) and revised total from 'Summary of Balances 1944-2003' NSO data set www.statistics.gov.uk/STATBASE/tsdataset.asp?vlnk=209 accessed 10/8/04

The Sterling Area Balances

The perception of the sterling area balance 'problem', as recorded in the Treasury historical memorandum that explains their development, was that they

> '..were a source of embarrassment to the Treasury. Throughout there was a danger that they would be run down at a rate which would be damaging to sterling'.[53]

In short, it was believed that these balances, which existed because of sterling's role as a reserve currency, constituted an excessive burden on the British economy and the strength of the pound during the post-war period. This was because there was thought to be a poor ratio of assets to liabilities.[54] It was obvious that if the sterling area, *en masse*, attempted to convert its holdings, that the UK would be bankrupted.

One can only suppose that the fear of a run on the sterling manifested for two reasons. The first is that the balances were thought to be a mass of liquid assets that could be withdrawn from London, almost at the click of a finger. Second, because it was assumed that after 1945, the balances were more precarious than before. This was because it was believed that they had not been built up by the free will of their holders but were instead amassed as the result of UK war debts to a number of commonwealth countries.[55] Consequently, it was felt that these reluctant sterling holders would be likely to convert to dollars at the earliest possible opportunity. Both assumptions are misplaced. In fact throughout *all* of the 1950s and *much* of the 1960s the sterling balances were stable and represented little threat to the stability and strength of the pound.

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[53] PRO T267/29 "Treasury Historical Memorandum No.16: Sterling Balances Since the War", January 1972.

[54] Stones, R. The Myth of Betrayal: Structure-Agency in the Labour Government's Policy of Non-Devaluation, 1964-67. (Unpublished PhD Thesis, University of Essex, 1988), p.58.

Indeed by 1950 the major war time creditors, India and Egypt, drastically reduced their sterling assets and these balances had been replaced by the holdings of other Overseas Sterling Area (OSA) countries, that had freely chosen to use the pound as their reserve currency.[56] It is also clear that at anyone time, less than 40% of the balances were held in a liquid form (see table 1.4). As Schenk has pointed out, the colonial balances were earmarked for a variety of specific purposes that greatly reduced their liquidity.[57] For example, one third of these balances existed because of the requirement that local money supplies had to be backed by 100% sterling reserves and in reality most kept 110% reserves. Colonial governments also controlled a number of special funds, which were set aside for specific purposes and they had limited liquidity. These included post office savings funds, pension schemes and development funds.

Table 1.4 Length of maturity of sterling area balances, 1954-6 £m

	Liquid	0-5yrs	6-10yrs	11-15yrs	>15yrs	Total
1954	1201 (43)	618 (22)	319 (12)	319 (12)	304 (11)	2761 (100)
1955	1054 (39)	700 (26)	361 (14)	332 (12)	226 (9)	2673 (100)
1956	938 (36)	807 (31)	247 (10)	373 (14)	239 (9)	2604 (100)

Source: Adapted from C. Schenk (1994), table 2.7, p 43
Note: Percentages are in brackets

Furthermore, during the 1950s the OSA was usually in balance of payments surplus with the Non Sterling Area (NSA) and was a net dollar earner. When this is combined with the fact that members of the OSA were required to pool their foreign exchange earnings in London, it becomes evident that during the 1950s it was actually a contributor to the foreign reserves rather than a burden on them. In fact throughout the 1950s, the net contribution of the OSA to the UK central reserves averaged £29.6m a year.[58]

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[55] Interview with Dudley Allen
[56] ibid
[57] Schenk, C. Britain and the Sterling Area: From devaluation to convertibility in the 1950s. (London: Routledge, 1994), p.22.
[58] ibid

However, if it is to be convincingly argued that the sterling balances were stable during much of the 1960s, it is necessary to outline the potential causes of a drain and demonstrate that the threat was in no way real. The balance 'overhang' could have been damaging to sterling in two possible ways.[59] The first was if the OSA had a run of disastrous trading years and continually got into balance of payments deficit with the NSA. This could have intensified pressure on the British reserves as the OSA might have attempted to convert its sterling balances in order to cover the deficit. The second possibility would have been straight diversification on the part of the OSA. In other words, if either official and or private holders decided that they wanted a more balanced portfolio comprising some NSA currencies and securities, this too would have led to a drain via conversion. It will be argued that during the 1960s the first was never a possibility and that the second only became so after the devaluation.

Figure 1.5 shows the overall balance of payments for the OSA's trade with the NSA for the period 1960-68. What it demonstrates is that unlike Britain, the OSA as a whole had a leaning towards continual and hefty deficits on its current account. In spite of this, it managed to stay in overall surplus with the NSA in almost every year, with 1964 and 1965 being the exceptions. This was primarily due to the net inflow of capital to the OSA, an inflow that far outstripped the deficit on current account.

[59] Adapted from Cohen, B. The Future of Sterling as an International Currency. (London: Macmillan, 1971), p.147.

Table 1.5
Overseas Sterling Area Balance of Payments with NSA 1960-1968 £m

Year	Current Balance	Capital Balance	Overall Balance
1960	-401	+406	+5
1961	-194	+355	+161
1962	-200	+440	+240
1963	-289	+530	+241
1964	-633	+604	-29
1965	-1005	+883	-122
1966	-469	+623	+154
1967	-734	+1056	+322
1968	-686	+1237	+551

Source: Central Statistics Office, *Economic Trends*

This almost continual surplus ensured that it was not necessary for the OSA to draw on its sterling balances to meet deficits. Although during 1964 and 1965 when there were deficits the Bank of England noted that 'many countries tended to use their IMF drawing rights to pay off deficits and this tended to limit the extent to which they drew on their reserves'.[60] One can only conclude that OSA balance of payments considerations did not in anyway jeopardise the position of sterling as an international currency during the 1960s.

What then of diversification? It is clear that during the 1960s, the OSA did begin the process of diversification. In 1964, the sterling balances made up 83% of the reserves of the sterling area. By 1966, this figure had fallen to 75% and by 1967, the sterling percentage of their reserves had been reduced a further 5%.[61] However the process of diversification was *indirect* and did not actually lead to any drain on the reserves held in the EEA. This was because the OSA did not actually offload sterling and replace it with NSA currencies and gold. Instead, when it ran a balance of payments surplus, it failed to deposit the newly acquired foreign exchange in London in return for sterling. Instead, it began to build up substantial holdings of

[60]Bank of England Archive [henceforth Bank] OV44/152 "The Problem of the Sterling Balances", 1/12/65.
[61] Bank OV44/159 C. W. McMahon 'The Future of the Sterling Balances', February 1968.

alternative reserves. In fact 'at the end of 1965, the net balances of the sterling area were at about the same level as the end of 1951'.[62]

However table 1.6 does show that there was a degree of *direct* diversification taking place between 1962 and 1967, which resulted in the loss of £320million from the official balances. Nevertheless, it is worth bearing two things in mind: Firstly this loss occurred over five years and would not have put the reserves under the same strain as if it had been presented all at once. Secondly and more importantly, this fall in the official balances was matched by a significant rise in the private balances which offset it completely in every year bar 1967. In fact, up until the 1967 devaluation, the total balances of the Sterling Area were on an upward rather than a downward trend.

Table 1.6
UK Gross Liabilities to the Sterling Area 1960-1969 **£m**

Year	Official	Private	Total
1960	2,029	656	2,685
1961	2,097	715	2,812
1962	2,056	810	2,866
1963	1,898	1,044	2,942
1964	1,947	1,101	3,048
1965	1,911	1,150	3,061
1966	1,855	1,129	3,084
1967	1,736	1,246	2,982
1968	1,650	1,231	2,881
1969	2,039	1,134	3,173

Source: PRO T267/29 "Treasury Historical Memorandum No.16: Sterling Balances Since the War", January 1972.

The fact that the sterling balances remained stable throughout much of the 1960s is attributable to a number of factors. The first is that significant proportions of balances were still held in forms that were not immediately realisable. During the 1960s, the Bank's Economic Intelligence calculated that 'certain sterling funds are not intended to be moved, for various reasons...leaving a residue that is more volatile'.[63] That residue was thought to be in

[62] Bank OV44/152 'The Problem of the Sterling Balances', 1/12/65.
[63] Bank EID10/14 'Liquidity of Sterling Funds of RSA Countries', 23/8/61.

the region of £300-£600 million.[64] The second reason for durability was that interest rates in London were significantly higher than in the NSA. It was therefore not in the interest of balance holder to move their funds.[65] This coupled with the fact that membership of the OSA gave official holders freer access to the British capital market and that the OSA still did a considerable amount of trade with the UK, made the continued holding of sterling necessary if not desirable.[66] Furthermore, the OSA private balances could be counted upon to remain stable because local exchange control restrictions often prevented the possibility of conversion. Although in practice, these balances increased in size because of the attractive interest rates.

With the conclusion in 1966 of the Basle agreement to provide a standby facility of over $1 billion to protect the British reserves from short-term fluctuations in the balances, confidence amongst the holders could only be increased.[67] The only way in which the sterling area balances could have been a danger to the stability of sterling was in terms of reducing confidence in the currency amongst NSA holders. It was only after the devaluation that the balances proved to be a threat and then merely the official ones. The reduction in parity, it appears, finally reduced the resolve of the sterling area to hold the currency. As the government command paper on the 1968 Basle agreement testifies

> 'The financial links between the United Kingdom and the rest of the sterling area were felt to have been loosened still further [as a result of devaluation]. Diversification of reserves by sterling area countries increased and, in contrast to earlier periods there was a significant fall in the total of officially held sterling balances as considerable sums were switched into other forms of reserves. This movement was

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[64] Ibid. See also Livingstone, J. Britain and the World Economy. (London: Penguin, 1966), p.42.
[65] Bank OV44/159 C. W. McMahon 'The Future of the Sterling Balances', February 1968.
[66] ibid.
[67] ibid R. Raw and C.W. McMahon 'The Extension of the Basle Arrangements', 16/1/68.

> particularly marked in the second quarter of 1968, when holdings of sterling by central monetary institutions of the sterling area were depleted by £230 million.'[68]

However, with the enactment of the 1968 agreement to guarantee the sterling area's official holdings against further devaluation, in an exchange for a pledge by the holders not to diversify any further, the movements out of sterling stopped and actually reversed. In truth then it was only the period between November 1967, when the devaluation occurred, and September 1968, when the agreement was put into force, that sterling was actually made vulnerable by the actions of the OSA. Although it is likely that if the agreement had not been put into effect, that diversification would have continued. It is fitting then, that it is the analysis of this period to which the majority of subsequent chapters are devoted.

NSA Speculation

The OSA was not the only significant holder of sterling. The non-sterling area also held a large portion of the currency and its balances were divided into official and private holdings. Of these, the official holdings can be largely ignored because they were not prone to speculative movements. They were held by international organisations such as the IMF and the central banks of Western Europe and the US, which possessed sterling because of their swap arrangements with the Bank of England.[69] Therefore, these balances were unlikely to be run down during times when there was low confidence in the pound. In fact, the swaps were designed to help shield the reserves from the pressures of speculative attacks and because these holders were able to obtain forward cover, they were to all intents and purposes guaranteed against the possibility of devaluation.[70]

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[68] Cmnd3787, The Basle Facility and the Sterling Area. (London: HMSO, 1968), p.2-3.
[69] Cohen, B. The Future of Sterling as an International Currency. (London: Macmillan, 1971), p.150.
[70] Bank OV44/159 C. W. McMahon 'The Future of the Sterling Balances', February 1968 and PRO T312/1636 Paper by the Bank of England 'Guarantees', 2/9/66.

This then leaves only the private balances of the NSA. These balances, by contrast, proved to be anything but stable. Unlike the private balances of the OSA, they were not subject to exchange control restrictions and it was remarkably easy for holders to convert them. Table 1.7 shows the composition of the balances from 1960-69. It is clear that holders had no particular loyalty to sterling and that movements in the balances were erratic. Indeed, during 1960, they stood at £1078m, the following year they had fallen by almost £400m, only to rise and fall again throughout the rest of the decade. In short, they constituted hot money and were sensitive to changes in interest rates, the balance of payments, and the relative merits of alternative currencies. As the Bank of England report on 'The Problem of the Sterling Balances' attests

> 'Withdrawals [of NSA private balances] tend to occur because of lack of confidence due to the balance of payments position or because of a belief in the revaluation of other currencies or gold.'[71]

When confidence in sterling returned, many private holders would switch back into sterling; this explains the fluctuations in the balances. However, because the flight from these balances usually coincided with a payments deficit, and was in fact often triggered by it, the pressure on the reserves was intensified.

[71] Bank OV44/152 'The Problem of the Sterling Balances', 1/12/65.

Table 1.7
UK Gross liabilities to the NSA 1960-1969 **£m**

Year	Official	Private	Total
1960	499	1078	1557
1961	440	680	1120
1962	375	689	1064
1963	437	853	1290
1964	379 [114]	847	1226
1965	303 [366]	845	1148
1966	332 [606]	724	1056
1967	365 [1246]	656	921
1968	161 [2010]	537	698
1969	107 [1410]	546	653

Source: PRO T267/29 "Treasury Historical Memorandum No.16: Sterling Balances Since the War", January 1972.
Note: Figures in brackets denote central bank assistance.

The Reserves

Conan has argued that the reserves available in the exchange equalisation account were adequate to back the currency.[72] This was because very few of the sterling balances were readily convertible and many of those funds that were liquid, if used at all, would be utilised to fund payments to the UK for exports. In his view, 'liabilities that were stable did not need to be back by £ for £ liquid resources'.[73] I accept that the reserves were large enough to cover the sterling area balances, shifts in hot money or the balance of payments. Nevertheless, they were not large enough to deal with pressure from all three sources simultaneously. In every year, apart from 1961, it is clear that if pressure had borne down on the currency from all three directions, the reserves would have quickly become exhausted. On average, the ratio of assets to *volatile* liabilities was 1:1.5 throughout the 1960s. Although this was far better than the 1:4 ratio of assets to *all* liabilities, it is clear that there was on average a gap of £500m between what was available and what would have been needed to cover movements in the more volatile balances.

[72] Conan, A. The Rationale of the Sterling Area. (London: Macmillan, 1961), p.13.
[73] ibid

However, Conan also argues that the total reserve position was actually far better than the published figures made out. This was because they excluded Britain's second line of reserves, namely, the dollar securities that were acquired during WWII by the British government.[74] These were held in the form of 9.5 million shares, which were invested in 198 US companies.[75] By 1965, the dollar portfolio was valued at £500m and it would seem that it plugged a considerable gap in the reserves.[76] However by August 1966, £325m had already been converted from equities into dollars and had been drawn upon.[77] Therefore, it is clear that the dollar portfolio did not close the breach in the ratio between assets and volatile liabilities. It actually comprised a part of that ratio.

There was of course a third line of reserves. In times of absolute emergency, there was the possibility of mobilising UK citizen's private portfolio holdings. The 1965 Bank of England review put the value of the private portfolio at £3,600m-£4,000m.[78] In theory, the British authorities could have compulsorily purchased these equities and converted them into foreign exchange to feed the reserves. In fact, the Treasury planned for such an eventuality from 1965 onwards, under the code names Bootstrap and Androcles.[79] Nevertheless, it would have proved extremely difficult to mobilise the third line reserves. Firstly, it would have taken many months for the Treasury to acquire ownership of portfolio. Secondly, it would have made the Wilson government very unpopular with the equity owning middle and upper classes, which would have been forced to sell their holdings to the government. Finally, the process of conversion into foreign exchange would have to have been engaged in slowly. For if all the shares were cashed in simultaneously the returns would be have been low.

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[74] ibid, p.14.
[75] Schenk, C. Britain and the Sterling Area. p.41.
[76] PRO T312/1827 'The Possible Short-term Reflux Following a Devaluation, Table II', undated.
[77] ibid
[78] PRO T295/256 Rawlinson to Radice 'Bootstrap', 24/11/65.
[79] ibid

Figure 1.8 Total possible drain to the reserves and facilities to meet it 1960-68 **£ million**

Year	Volatile OSA Balances*	Volatile NSA Balances	Balance of Payment	Total possible drain to reserves	Available Reserves	Ratio of assets to liabilities
1960	300-600	1078	-397	2075	1154	1:1.8
1961	300-600	680	+154	1126	1185	1:0.9
1962	300-600	689	+100	1189	1002	1:1.2
1963	300-600	853	+21	1432	949	1:1.5
1964	300-600	847	-684	2131	827	1:2.6
1965	300-600	845	-208	1653	1073	1:1.5
1966	300-600	724	+70	1254	1152	1:1.08
1967	300-600	656	-396	1652	1088	1:1.5
1968	300-600	537	-310	1447	1145	1:1.3

Sources: NSA volatile balances PRO T267/29 "Treasury Historical Memorandum No.16: Sterling Balances Since the War", January 1972; OSA volatile balances Bank EID10/14 "Liquidity of Sterling Funds of RSA Countries", 23/8/61.; Reserve figures PRO T318/188 'Breakdown of gold and convertible currency reserves', undated; Balance of payments, NSO data set. * It has only been possible to compile this data for 1961 and it is assumed that the liquefiable portion of the balances stayed relatively stable throughout the whole of the 1960s.

It is clear that the context in which sterling's managers controlled the currency was a difficult one. They faced almost constant balance of payments deficits and the continual risk of flights in hot money. The reserves available to protect the currency from these two sources of pressure were at best slim. After the devaluation, diversification from the official sterling area balances was to provide a third source of pressure and because of this, the risks to the currency were greater than at any other time. For whilst the ratio of assets to liabilities during 1968 looks better than during 1967, it is important to note that throughout 1968, the reserves were composed almost entirely of IMF and central bank borrowings.[80] In short, by this stage the till was actually empty.

Principal Actors[81]

Allen, Douglas/Lord Croham (b.1917)

Left the LSE with a first in economics in 1938 and joined the Board of Trade. By 1966, he had risen to become permanent under-secretary at the DEA and in April 1968 became

[80] PRO T312/189 'Reserve Position', 14/3/68 and PRO T312/2132 Paper by the Bank of England "Potential Drain on the Reserves and facilities to meet it", 11/10/68.
[81] Biographical data obtained from various editions of Who's Who

permanent secretary to the Treasury. He chaired the 'Allen group', which focused on sterling contingency planning, and he formed a small internal think tank headed by Posner and Rawlinson. Rawlinson's first impression of him was that 'he could not understand how a man with such a clear desk had got such a grasp of the issues'.[82] Allen remained at his post in the Treasury until 1974, when he became head of the home civil service. He was made a life peer in 1978.

Goldman, Sir Samuel (b.1912)

Studied economics at the LSE, where he was taught by Hayek.[83] After a spell in the Bank of England, he entered the Treasury in 1947. By 1968, he had risen to the rank of second permanent secretary, with special responsibility for overseas finance. During 1968, he played an important role in sterling contingency planning and he also co-ordinated the negotiations with the sterling area countries, which culminated in the Basle agreement. He retired from the Treasury in 1972 and took up a number of directorships.

Jenkins, Roy/Lord Jenkins of Hillhead (1921-2003)

After gaining a first in PPE from Oxford, he was commissioned into the army and during WWII was drafted for code breaking duties at Bletchley Park, which he admitted he did not always understand. In 1948, he was elected as a Labour MP and at 27, was the youngest member of the House. When Labour won the 1964 general election, he was appointed Minister of Aviation and then Home Secretary. After the 1967 devaluation, James Callaghan resigned as Chancellor and Jenkins replaced him. He presided over economic policy in 1968 and with Treasury assistance managed to avoid both a further devaluation and the floatation of sterling. Later he was to become the President of the European Commission, in 1977. When he returned to British politics in the 1980s, it was as a member of the SDP.

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[82] Interview with Anthony Glover
[83] Interview with Sir Samuel Goldman

McMahon, Sir Christopher 'Kit' (b. 1927)

Entered Oxford as a Rhodes scholar and graduated with a first in PPE in 1953. Became an economics assistant in the Treasury the same year and a fellow and tutor in economics at Oxford in 1960. He entered the Bank of England as an advisor in 1964 and was advisor to the governors between 1966 and 1970. During 1968 he strongly opposed the Brutus plan and argued vehemently for a floating pound. He was also heavily involved in the development of the guarantee scheme that formed the foundation of the 1968 Basle agreement. In 1970, he was made an executive director at the Bank and by 1980, he had become its deputy governor.

O'Brien, Leslie/Lord O'Brien of Lothbury (1908-1995)

Entered the Bank of England straight from school in 1927 and by 1964 he had risen to the rank of deputy governor. He was made full governor in 1966 and was the first to be promoted from the ranks. His appointment came as a surprise to him but he was widely respected within the Bank because he encouraged freethinking.[84] Although he did not take a close interest in sterling contingency planning, he was heavily involved in the development of the 1968 Basle agreement. Initially he rejected the idea of using the agreement to implement a sterling guarantee but he soon came to see the benefits of it. He left the Bank in 1973 and held a number of directorships.

Posner, Michael (b. 1931)

Cambridge economics don, seconded to the Treasury as economic advisor from 1967-69. He worked on the development of operation Brutus during the summer of 1968. Although, after the successful conclusion of the 1968 Basle agreement, he recognised that a floating rate for sterling was no longer out of the question and he turned his attention to Hecuba. He was later to become the chairman of the SSRC, 1977-83, and the secretary-general of the European science foundation, 1986-93. He is now retired and lives in Oxford.

Rawlinson, Sir Anthony (1926-1986)

Son of the Bishop of Derby, graduated from Oxford with a first in classics in 1949. He entered the Treasury in 1953; was assistant secretary from 1963 to 1968, when he was appointed under secretary in the finance group. He developed considerable expertise in the field of exchange control and was initially an enthusiastic supporter of operation Brutus. He also advocated the abolition of the sterling area. After a distinguished career in the Treasury, he became the joint permanent secretary at the DTI. A keen mountaineer and a member of the Alpine Club, he died in 1986 after falling from mount Snowdon.

Wilson, James (Harold)/Lord Wilson of Rievaulx (1916-1995)

After graduating from Oxford with a first in PPE, he became a lecturer in economics at New College in 1937. In 1945, he was elected Labour MP for Ormskirk and between 1947 and 1951 he was President of the Board of Trade. In 1963, he became the leader of the Labour party and after the 1964 general election victory, Prime Minister. Between 1964-67, he took little interest in the Treasury's contingency planning operations, but this changed after the devaluation. Whilst it is unclear what Wilson's preferred course of action for sterling would have been in the wake of a crisis, it is clear that he used the Treasury's planning dossiers as leverage to cajole the international financial community into backing sterling. After Labour lost the 1970 general election, he became leader of the opposition. However, success at the polls led to a second term of office from 1974, although he resigned in 1976.

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[84] Interview with Sir Jeremy Morse

Chapter 2 Theoretical Framework

In this chapter, I will outline the theoretical framework that will be utilised to make sense of our object of investigation. This inquiry begins with the premise that the political and economic spheres are socially constructed entities.[1] In other words, although at an ontological level it is presumed that the world is made up of brute data, at the epistemological level, this account recognises that agents interpret and make sense of that world through their thought process, perception, language and beliefs. This means that, from such a perspective, the political realm operates within a web of constructions and that political science is the study of those constructions.[2] What then, are the implications of this particular set of assumptions for the conduct of this research project?

Firstly, because it is assumed that agents within the political realm operate within a web of their own constructions, what we call out data are really only constructions. This means that analysis must be interpretative. The aim of the inquiry must be to understand the meanings that the agents themselves ascribe to their surroundings and their behaviour.[3] The development of theory on the basis of some sort of principle of scientific causation is something to be avoided. This is because: (a) many of the important relationships between social phenomena within political institutions cannot be directly observed since they have no direct physical embodiment and (b) scientific theories only serve to simplify a complex social reality for the purpose of developing predicative hypotheses.[4] Parsimony can only be achieved at the cost of sacrificing the realism of ones theoretical assumptions.[5]

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[1] Searle, J. The Construction of Social Reality. (London: Penguin, 1995), p.165; Brown, C. Understanding International Relations. (Basingstoke: Palgrave, 2001), p.52 and Taylor, C. Philosophy and the Human Sciences. (Cambridge: Cambridge University Press, 1993), p.19-21.
[2] I do of course recognise that these theoretical assumptions are not empirically testable. They do however, provide a useful perspective from which the observer can make sense of the events that they observe. See Hay, C. Political Analysis: A Critical Introduction. (Basingstoke: Palgrave, 2002), p.64
[3] Geertz, C. The Interpretation of Cultures. (New York: Basic Books, 1973), p.20.
[4] Hay, C. Political Analysis, p.29.

Therefore, academic inquiry of this sort must be interpretative.[6] The scholar must attempt to make sense of the constructions that emerge from the interactions of the agents that are being investigated. The observer reconstructs the constructions of those that are being observed, so that they can be rendered and described in great detail.[7] The aim is to record the discourse that emerges from agent interaction and to turn it from a passing event that exists only in its own time frame and into an account that is preserved, albeit imprecisely, for study.[8] However, that fact that this sort of exercise is a reconstruction is something that cannot be emphasised enough. What it means is that the observer is forced to engage in the double hermeneutic.[9] Our analysis is made up of 'our construction of other people's constructions of what they and their compatriots are up to'.[10] This means that the inquiry itself is a second order interpretation of other people's first order interpretations.

It also means that methodologically, the research gathered and utilised in this project is by its very nature qualitative: unstructured elite interviews and archival analysis were the principal methods of data collection employed. However, the interpretative method also has implications for the process of theory generation. As the aim of the inquiry is to reconstruct a particular set of events, it means that the role of theory must be to provide a vocabulary in which the observer can make sense of their observations and place them within an intelligible framework.[11] If such theory is to be a useful vehicle through which to reconstruct, it needs to stay as close to the ground as possible, to avoid being overly abstract. It cannot be *either* inductive *or* deductive but must be *both* inductive *and* deductive. By this, I mean that if the researcher begins entirely upon a deductive basis, then their *a priori* categories and

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[5] King, G., Kohane, R., and Verba, S. Designing Social Inquiry: Scientific Inference in Qualitative Research. (Princeton: Princeton University Press, 1994), p.20. Whilst King et al draw this conclusion they do believe that there is some place for parsimony in the political sciences.
[6] Winch, P. The Idea of the Social Science and its Relation to Philosophy. (London: Routledge, 1958), p.93-94.
[7] Geertz, C. The Interpretation of Cultures. p.15.
[8] ibid, p.19
[9] Marsh, D. and Furlong, P, 'A Skin Not a Sweater', in Marsh, D. and Stoker, G. (eds.), Theory and Methods in Political Science. (2nd ed.), (Basingstoke: Palgrave, 2002), p.19.
[10] Geertz, C. The Interpretation of Cultures. p.2.
[11] ibid, p.24.

conceptions will cloud their ability to immerse themselves in the constructions of the actors they investigate.[12] Instead, there is the danger that the observer will merely project their worldview onto those being observed, rather than attempt to make sense of reality from the perspective of those they observe.

The alternative is to operate inductively, to begin with no preconceptions, to finely comb the available data and to then search for a theory that best renders it. However, I accept that such an approach is equally dubious. Without some prior theoretical assumptions, no matter how basic, it would be impossible for the scholar to have any conception of politics, to decide which events are worthy of empirical investigation and upon what basis that investigation should proceed.[13] It is because of this that the solution is to burn the candle from both ends and to operate both inductively and deductively. The inquiry must be deductive to the extent that some sort of basic theory is required to get the enterprise off the ground in the first place. In fact, in the preceding discussion I have broadly outlined the deductive assumptions that framed this inquiry. The only deductive assumptions that have not yet been explicitly stated are:

- That this project proceeds on the basis that the study of British economic policy in the 1960s is a fruitful endeavour and that the topic area should be studied for its own sake.

- In terms of structure-agency, this account must place more emphasis on agency. For the institutional structures that agents work within and which are seen as constraining or shaping their actions are actually created by them through their interaction and have little physical embodiment outside agents' own mental conceptions. This does not mean that institutional structure is irrelevant or that it does not constrain. It simply means that structures that restrict agents in their choice of institutional action are in reality those that

[12] Popper, K. Conjectures and Refutations. (London: Routlege, 1969), p.53.
[13] Weber, M. The Methodology of the Social Sciences. (New York: Free Press, 1969), p.29.

they have mentally created themselves and that those institutional constraints are wholly perceived. When agents bring about institutional alteration or transformation, the strategy they employ in that process will be greatly influenced by the imagined institutional constraints that they collectively adhere to. Yet, in bringing about such change they are in effect doing little more than altering their collective mentality. However, this new institutional mentality will in turn alter the framework within which future institutional change is brought about.[14] The most striking aspect of this process is that agents treat these perceived constraints as real brute entities, which clearly they are not.[15]

In theoretical terms, the rest of this work proceeds inductively. The grounded theory that has been used as an aid in the formation of my second order interpretation of the first order interpretation of those I observe[16], was developed only after data collection ceased. As much of the pre-existing theoretical literature as possible was mined in order to determine which theory or theories best illuminated the object of study. However these theoretical formulations hover so low over the interpretations they are used to make sense of that they may not make much sense or hold much interest outside that framework.[17]

After data collection had ceased the process of developing an empirically grounded theoretical framework was embarked on. In the search for the most appropriate framework, and given my ontological and epistemological assumptions, three questions were posited:

1. How are we to conceptualise the relations between the various actors that take part in the policy process we are investigating?

2. What makes it necessary for our actors to act?

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[14] See Pierson, P. 'The Path to European Integration: A Historical Institutionalist Analysis', Comparative Political Studies. Vol.23, 1996, p.122-63.
[15] Searle, J. The Construction of Social Reality. p.42.
[16] Geertz, C. The Interpretation of Cultures. p.15.

3. What is it that motivates them to choose one kind of response over another?

Within political science, these issues would normally be conceptualised within the bounds of a theory of the state. This is because theories of the state generally contain within them an account of how the state is organised (1), assumptions relating to the interests that state actors pursue (3) and an explanation of why crises occur and consequently why it is necessary for the state to exist (2).[18] However, it is not self evident that the state is the most appropriate unit of analysis for this inquiry. Firstly, although the state is a concept that is inter-subjectively recognised within most facets of British society, there is little agreement upon what exactly is within, or for that matter outside, its bounds.[19] In other words, there is a problem of definition.

Secondly, theories of the state tend to be couched in very abstract terms and this means that it is difficult to plug them into empirical reality in a way that makes them useful vehicles for the analysis of relations between political actors. One possible solution would be to accept that there is no commonly agreed account of the state, with respect to our three questions, but to maintain the concept as our principal unit of analysis. If this tactic were pursued much of the proceeding discussion would centre on how the state is defined and how a theory of it is operationalised, so that it might usefully inform our empirical data. If this study were primarily focused on the relations between 'state' actors and 'non-state' actors then this approach would have certain attractions. This is because theories of the state are, overall, a very useful device for conceptualising the relations *between* actors in the public and private

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[17] ibid, p.25.
[18] Dunleavy, P. and O'Leary, B. Theories of the State: The Politics of Liberal Democracy. (Basingstoke: Macmillan, 1987) break their analysis of state theories down into the following categories: State organisation, crises and methods and values, p.vii.
[19] For example Althuser, L. 'Ideology and Ideological State Apparatuses' in his Lenin and Philosophy. (London: New Left Books, 1971) argues that in capitalist societies the family is part of the state. Whilst Anderson, P. 'The Anatomies of Antonio Gramsci' New Left Review. 161, p.20-77, denies that this is the case, except under fascism. For an examination of rival definitions of the state see Hay, C. Restating Social and Political Change. (Buckingham: OUP, 1996), ch.1 and Mann, M. States, War and Capitalism, (Oxford: Blackwell, 1988), p.4.

spheres, irrespective of their other weaknesses.[20] However, the current inquiry almost exclusively centres on relations between actors *within* the public sphere. Therefore, it is not essential to postulate a well worked out account of the relations between 'state' and 'non-state' actors. By abandoning the state, as the main unit of analysis, it is possible to seek out or devise a formalised account of the relationship between the economic policymakers that is less macro, and more meso, and which more closely approximates empirical reality. As well as this, it is possible to make such a conceptualisation more neutrally grounded in terms of its assumptions about actors' rationale for action. In the remainder of this chapter, the focus will shift to the development of an account that can help us to answer the three questions that have previously been posited.

1. **How are we to conceptualise the relations between the various actors that take part in the policy process we are investigating?**

If the state is not to be used as the primary unit of analysis, and the development of a theory of it is to be abandoned, it becomes necessary to propose a more useful alternative. One possibility would be to narrow the focus from state to government, in the manner that pluralists tend to.[21] However, within the popular psyche government is thought to refer to the hundred or so ministers that sit atop the Whitehall machine. Yet, it is clear that these ministers are not the only individuals that are involved in economic policymaking. Furthermore, the vast majority of those one hundred ministers are actually excluded.[22] Therefore, if focus were narrowly placed on government, a large number of actors, that potentially had great impact of economic policy, would be excluded from our deliberations. The solution might be for us to

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[20] This is usefully characterised in terms of 'input politics'. See Dunleavy, P. and O'Leary, B. Theories of the State. p.11.
[21] Dyson, K. The State Tradition in Western Europe. (Oxford: Martin Robertson, 1980), p.4.
[22] In the field of external economic policy in 1960s Britain less than ten ministers, and often fewer than five, played any part in decision making. See Castle, B. Diaries. (London: Weidenfeld and Nicolson, 1984), p.462.

widen our definition of government, so that it also included other actors that were involved in economic policymaking. However the price for such a conceptual slight of hand would be that our notion of government would differ greatly from that employed by both scholars and policymakers; the concept would no longer be grounded in empirical reality and instead would become as vacuous as 'the state'.

A more inclusive alternative framework that has been usefully employed in the past is the *Westminster model*.[23] At heart, it is an organising perspective that works on the assumption that parliament and not government should be treated as the principal actor.[24] This is because government is drawn from parliament, its actions are scrutinised by it, and its legislation requires parliamentary approval. It is possible that by widening our focus to parliament, from the rather more narrow conception of government, that many of the important economic policymakers will be brought back into the analytic fold. The model also has the advantage of mirroring the popular perception of the policy process as reported in the media. However, the approach is lacking in terms of its fit with empirical reality. Whilst it is clear that the Wilson government relied on its majority and the support of its MPs in the House, in order to operate as a governing entity, there is little evidence that the legislature played any significant role in economic policymaking. None of the recently released archival documents in any way suggests that parliament was an important actor in this field. In fact, very few of the contingency plans produced would have required an act of parliament in order to be implemented.[25] This was because, in most cases, the prerequisite legislation was already on the statue books. This does not mean that a parliament centred approach would be useless for analysing other issues or policy areas; it simply means that there is no fit between such a perspective and the present data set.

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[23] Rhodes, R. Understanding Governance. (Buckingham: Open University Press, 1997), p.5.
[24] See Mackintosh, J. The Politics and Governance of Britain. (London: Hutchinson, 1977).
[25] Interview with Anthony Glover.

The available data, which has been collated from interviews and archival analysis, strongly suggests that the principal actors involved in the development of economic planning in the mid to late 1960s were: the Treasury; the Bank of England; a small number government ministers, most notably the Prime Minister and the Chancellor, and very occasionally the entire Cabinet.[26] This means that our organising perspective must attempt to unravel the relations and power dynamics between these institutions. Of the pre-packaged theories that are still available, the *core executive* would appear to offer the most analytic mileage.[27] This is because

- It is compatible with the assumption that political institutions are socially constructed entities. In other words, it does not become necessary to abandon the notion that bodies like the Treasury and the Bank of England are imagined entities which exist primarily within the minds of their members;[28] or that they evolve through the development of shared meanings amongst their membership and that this results in the emergence of an institutional identity. This means that it is possible to view many of the structural enablers and disablers that affect policy outcomes as the product of the mental conceptions that actors develop regarding what is acceptable policy and what is not.

- Furthermore, the core executive prism postulates that the policymaking process is best viewed in terms of the interaction between central political institutions such as the Prime Minister, Cabinet, Cabinet Committees and key co-ordinating departments such as the Treasury and the Foreign

[26] See the following PRO series: CAB 130 'Cabinet: Miscellaneous Committees (GEN, MISC and REF Series), 1945-1970'; PREM 13 'Prime Minister's Office: Correspondence and Papers, 1964-1979' and T295 'Treasury: Finance Overseas and Co-ordination Division: (2F Series), 1954-1972'.
[27] For a discussion of the core executive concept see Dunleavy, P. and Rhodes, R. 'Core Executive Studies in Britain', Public Administration, 68. 1990, p.3-28.

Office.[29] However, it is arguable that in its choice of departments to focus on, the theory is somewhat lacking. This is because in our policy area, the Foreign Office acts only at the periphery, whilst the Bank of England, along with the other actors on the core executive list, assumes great importance.

- Yet, the apparent weakness is in no way real. This is because the core executive perspective recognises that the policymaking process is dynamic and that the specific institutions and actors that are prevalent can alter both temporally and across sub-fields.[30] In short, the approach does not attempt to overly simplify our understanding of the policy process but instead it seeks to capture its true complexity.

Core executive theory, and this study, proceeds on the basis of a number of assumptions about the interaction of institutional actors. The first is that it is impossible to locate an absolute and authoritative source of power within the British political system. No one single actor or institution within the polity has accrued so many structural advantages that they are able to bend the will of other actors to make it match their own. Instead, it is argued that the core executive has been constructed in such a manner as to ensure that power is dispersed through its branches.[31] This is because actors within it are mutually dependent on one another, as no single institution or actor possesses all of the necessary resources for them to achieve the outcome that they desire. This means that the political process progresses in an environment in which actors must exchange resources with one another in order to bring about policy outcomes. It is through the process of exchange that actors can influence the policy process. However, not all actors and institutions control an equal amount of resources and those that

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[28] This builds upon Anderson's conception of the nation as an imagined entity. See Anderson, B. Imagined Communities: Reflections on the Origins and Spread of Nationalism, (London: Verso, 1983).
[29] Smith, M. The Core Executive in Britain. (London: Macmillan, 1999), p.2.
[30] ibid

they do control are liable to alter over time, depending on the context of exchange and the tactics that they utilise in the deployment of their resources.

Second, it is argued that because the core executive is both large and fragmented, it is impossible for it to manage British economic policy as a collective body. Instead, it breaks itself down into smaller overlapping units that develop expertise in particular sub-fields, including economic management.[32] For example, during the 1960s, it is possible to distinguish between sub-divisions that focused on the management of the domestic economy and those that centred on the external side. Even the sub-field of external economic management was further divided into smaller segments that dealt with exchange control, the sterling balances, Western European policy and contingency planning.[33] Interested parties drawn from the Treasury, Bank, and ministerial circles staffed these sub-divisions.

In recent years, the concept of *policy networks* has been used by scholars to make sense of and capture this process and it is a concept that I choose to employ.[34] However I do not treat it as an independent variable that explains policy change and accord it the status of a theory, but instead view it as a useful metaphor/organising perspective that aids in the development of my second order interpretation.[35] I do however recognise that many of the scholars that make use of the policy network approach tend to use it as a means of conceptualising the relations between the core executive and civil society.[36] Yet, as I have already stated, this analysis focuses almost exclusively on the relations between actors within the core executive and it is possible that the idea of a policy network is not particularly appropriate in our case. If the concept is to be retained for usage within this study then there are two possible rejoinders to

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[31] ibid, p.11.
[32] Dunleavy, P. and O'Leary, B. Theories of the State. p.172-3. See also Mosely, The Making of Economic Policy: Theory and Evidence from Britain and the US since 1945. (Brighton: Harvester, 1984).
[33] See for example PRO T199/1239 'H.M. Treasury Organisational Chart, July 1968'.
[34] Smith, M. The Core Executive in Britain. p.18.
[35] Hay, C. 'The Tangled Webs We Weave: The Discourse, Strategy and Practise of Networking' in Marsh, D. (ed.) Comparing Policy Networks. (Buckingham: Open University Press, 1998), p.34.
[36] Marsh, D. 'Development of the Policy Network Approach' in his Comparing Policy Networks. p.8.

this. The first would be to argue that not all of the actors involved in our brand of economic policymaking are drawn from the core executive and that some civil society members were included. It could be argued that the Bank of England should be treated as part of civil society and that it is a peak organisation which represents the interests of the City of London, the domestic banking system and the overseas sterling area.[37] Furthermore, it would be argued that it has attained the status of a peak insider group because of its role in controlling the EEA and because of the fact that it has expertise in financial management that the core executive can draw upon.

However, there are clear difficulties in defining the Bank as a civil society player. First, it is evident that when the Bank was nationalised in 1946 it became a public body and it is therefore more proper to view it as an executive agency.[38] Second, even if it were possible, through some slight of hand, to retain the notion of the Bank as a peak association, this account would now contain both core executive and civil society players. Whilst this would aid the quest to utilise the concept of policy networks, it would present further difficulties. Part of the reason that it was possible to dispense so swiftly with the idea of developing a theory of the state was that such theories are generally used as an aid in mapping the relations between the core executive and civil society. If the Bank is to be treated as a civil society player, then there is the danger that a theory of the state would have to be brought back into the fold.

The second rejoinder, and perhaps the more plausible, is to argue that policy networks are fluid and dynamic. That at times they can be composed of both core executive and civil society players but at other times, and in our particular case, these networks can be made up solely of core executive actors. Therefore a network must be conceived of as an alliance between two or more institutions, either from within our outside the core executive, that come together for the purpose of devising a solution to an issue that has been defined by them or by

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[37] Grant, W. Economic Policy in Britain. (Basingstoke: Palgrave, 2002), p.201-203.
[38] Fforde, J. The Bank of England and Public Policy: 1941-58. (Cambridge: CUP, 1992), p. 7&30.

others as problematic.[39] This definition therefore presupposes two things. Firstly, that networking is not a phenomenon that is engaged in solely by policymakers, it can also take place within the private sphere. Of course in our case, we are interested in networking within the core executive. However, it is also recognised that at times these networks can be trans-national and that they can incorporate players from different nations, where those players also define an issue as problematic. Secondly, for a network to form there must be some sort of shared goal or outcome that the interested networking parties wish to work towards.[40]

Furthermore, networks will generally operate only were collective action is more likely to bring about the declared goal that singular institutional action. After all, if one of the parties in the policy network were able to bring about their policy objectives without networking, then there would be no need to network.[41] However, because power within the core executive is so widely dispersed its member institutions must network. In short, for a network to form, it is clear that there must be: (a) the belief amongst the potential network partners that there is a problem that needs tackling, or there would be nothing to network about; (b) shared overarching goals between the partners in terms of the resolution of that problem, or they would refuse to network; (c) a sense of mutual dependency in terms of resources, expertise and authority, or there would be no need to network and (d) shared social constructions about the nature of the political realm, or they would be unable to network.

However, networks will not develop spontaneously. For them to be established requires the existence of a dominant partner that searches for other interested parties that can help it achieve its goals. Nonetheless, because of the complex nature of network relations, the party that dominates may change over time, depending on its resources, and different parties may dominate different sub-nodes of the same overarching network.[42] For example within the

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[39] Hay, C. 'The Tangled Webs We Weave', p.38.
[40] ibid
[41] ibid, p.39.
[42] Smith, M. The Core Executive in Britain. p.17.

broad umbrella of the external economic policy network, it is clear that the Treasury acted as hegemon in the sub-sphere of contingency planning and that the Bank was dominant in the forging of a network to develop a workable sterling guarantee scheme.[43]

It is also clear that network membership also alters over time. Players will come and go depending on the resources they have to contribute and the degree to which their goals coincide with those of the wider network. For example, in the Treasury dominated contingency planning network representatives from Customs and the Board of Trade were admitted briefly because they had expertise that was of use to the network core.[44] They acquiesced in this arrangement because it gave them the opportunity to influence the shape of economic policy. However, when their expertise was no longer useful they were removed from the network, which reformed around Bank-Treasury-Ministerial lines. Furthermore, if a network is able to devise a successful solution to the problem it was designed to tackle, then that network will cease to exist.

As these networks are dynamic, fluid and overlapping it is impossible to capture them and map them once and for all, even within a single policy area over a relatively short period of time. However, core executive networks in the field of external economic management do usually contain some sort of ministerial presence.[45] This is because it is elected politicians that hold the legal authority to make executive decisions. Yet, it is wrong to think of these policy networks as committees comprising both ministers and civil servants. Instead it is more useful to view them as the composite of two concentric circles; one made up of bureaucrats and the other of elected politicians. The vast majority of individuals working within one circle will have little or no contact with the membership of the other. Information exchange between the

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[43] See PRO T295/489 'Contingency Planning', 15/3/68 and Bank OV44/159 McMahon 'The Future of the Sterling Balances', February 1968.
[44] Interview with Lord Croham
[45] For evidence of this see PRO CAB 130/499 'Minutes of MISC 205 (68) 1st Meeting', 17/3/68.

two will generally occur via an individual or small group of individuals that act as an interface, for example the Cabinet Secretary, or through the written word.[46]

The central resource of the ministerial circle is its authority and its key function is to decide upon the course of action to be taken to deal with the perceived problem.[47] The bureaucratic element should not however be viewed as neutral implementers of policy. Its key resources are (1) the ability to define certain issues as problems and to ignore others and (2) its monopoly on knowledge and expertise. Through this monopoly, it is possible for it to define issues in certain ways and to highlight some policy options and to purposefully ignore others.[48] In this manner, it is feasible for the bureaucratic circle to shape the environment in which the ministerial circle makes its choices. It is because of this, that it is best to view power as dispersed throughout the network. The fact that neither the political or bureaucratic circles are unified entities further adds to the complexity of the power dynamic. For example, within the bureaucratic external economic policy circle in the 1960s, the Bank and Treasury had developed very different institutional imperatives and agendas. The Treasury contingent tended to couch its position in terms of its desire to maintain the stability of the international financial system, whilst the Bank was more concerned with protecting the City of London and its customers, the sterling balance holders.[49] Where there was a single policy that would achieve the institutional aims of both bodies, then the bureaucratic element would be unified in its approach to the ministerial circle, but where there was not, they could not.[50] Furthermore, it is also difficult to conceive of the ministerial circle in any given policy network as a unified entity. This is because ministers are likely to be members of many different policy networks

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[46] Interview with Anthony Glover.
[47] Smith, M. The Core Executive in Britain, p.117-119.
[48] Brittan, S. The Treasury Under the Tories: 1951-1964, (Middlesex: Penguin, 1964), p.303-306.
[49] Interview with Sir Kit McMahon.
[50] See for example Bank OV44/167 Morse to O'Brien, 9/7/68 and PRO T295/514 Figgures to Goldman 'Brandon and Androcles' 20/6/68 which suggest that whilst the Treasury were lobbying ministers to dismantle the sterling area the Bank of England were opposed to the idea.

and are unlikely to have the time available to consult with their colleagues on a regular basis in order to develop an agreed line prior to the meeting of the network in question.[51]

It is clear then, that these networks provide the structural context in which strategic decisions are taken by actors that are mutually dependent on one another for the success of any given strategy. It is with the context of networks that problems are defined, solutions considered and through collective action, those solutions are employed. The actions of agents within a network in bringing about institutional change will however alter the contextual structure within which future decisions are taken.[52] Furthermore, because the policymaking process does not operate within a vacuum, the actions taken will not only alter the structural terrain of the network within which it was taken. It is likely that they will also affect the choices and strategies of actors working within other networks both within and outside the policy field in question. In other words, there is a high degree of path dependency.[53] Networks will also act as a site for policy learning. It is through the process of networking that actors can evaluate the success or failure of previous strategies and hypothesise about the implications of future ones.[54]

2. What makes it necessary for our actors to act?

In the preceding section, the concepts of the core executive and policy networks were elucidated as vehicles through which to make sense of the context that our chosen actors operate within. However, it was also made clear that in order for networks to form in any given policy area, there must be some issue which is defined by agents as problematic and as

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[51] Simon highlights this problem when he refers to bounded rationality. See Simon, H. Administrative Behaviour. (New York: Free Press, 1957), p.3.
[52] See Sabatier, P and Jenkins-Smith, H. 'The Advocacy Coalition Framework' in Sabatier, P. Theories of the Policy Process. (Boulder: Westview Press, 1999), p.122.
[53] Lowndes, V. 'Institutionalism', in Marsh, D. and Stoker, G. Theory and Methods in Political Science. (2nd ed.), p.101.
[54] Hay, C. 'The Tangled Webs We Weave', p.43.

requiring a concerted attempt by them at collective resolution. In short, there must be something that makes it necessary for our actors to act.

This account assumes that the behaviour of our actors must be viewed in terms of crisis management and crisis avoidance. In other words, our agents act in response to the possible or actual onset of crisis conditions.[55] However, a crisis cannot be understood from outside the perspective of those that define and experience it.[56] It is through agent interaction that structures like the international economic system develop and through interaction that agents define the rules that constitute the normal operation of those economic structures. Therefore a crisis is the moment at which some group of actors come to the realisation that the structures that they uphold and work within are: (a) no longer operating in what they regard to be normal tolerance; (b) that they have exhausted the available techniques of amelioration and (c) that if the structural framework broke down, this would be regarded by the actors, for whatever reason, as catastrophic.[57] The mere fact that a structure has broken down is not enough to guarantee the event the status of a crisis, for it to be a crisis proviso C must also hold.

It is assumed that the Bank-Treasury-Ministerial core executive network was united in its belief that the destabilisation of sterling and/or the international monetary system would be catastrophic (c). At this level, the network can be viewed as a unitary actor. Yet, the individual motives for agents holding position (c) might be different, and in fact might alter over time. Furthermore, the strategies for crisis resolution advocated by each of the respective actors may also differ in light of their conflicting motivations for holding (c) to be true. Therefore at this level, it is possible that the network is not a unitary actor.

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[55] This section also proceeds inductively and the decision to use a crisis framework was made after I had analysed the official documents.

[56] Habermas, J. Legitimation Crisis. (London: Heinemann, 1976), p.1; Hay, C. Restating Social and Political Change, p.86-87 and Jackson, R. 'Crisis Management and Policymaking: an Explanation of Theory and Research' in Rose, R. (ed.) The Dynamics of Public Policy: a Comparative Analysis, (London: Sage, 1976), p.209.

However, the fact that these agents all agree on the definition of what constitutes a crisis is not enough for them to begin networking. There must also be the shared belief that the economic structures are no longer working within their normal tolerance levels (a), and that if some intervention is not embarked upon it will only be a matter of time before it is too late and available mechanisms for crisis resolution are exhausted (b). Therefore, it is also postulated that proposition (a) also holds true and that the external economic system was not working within normal tolerance levels. This was because:

- Firstly, there were insufficient foreign exchange reserves with which to maintain the stability of sterling.[58]

- Secondly, that Britain was in almost continual balance of payments deficit and this placed the meagre reserves under intolerable and constant strain.[59]

- Thirdly, that because of its role as banker to the sterling area, the UK held on deposit, in London, liabilities that far outstripped the reserves available to back those claims.[60]

- Finally, these three weaknesses undermined confidence in the pound to such a degree that speculation against it was rife.[61]

As our group of institutional actors within the core executive believed that the collapse of the fixed exchange rate system was to be regarded as catastrophic (c) and because it was also clear that the economic system was not working within acceptable tolerances (a), they attempted to ensure that proposition (b) would be avoided and they entered into network relations in order

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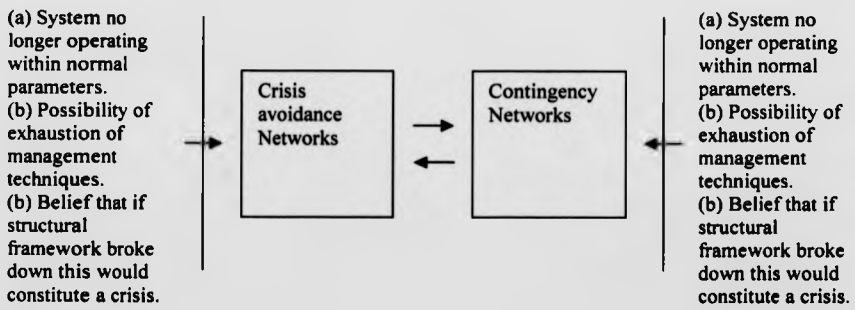
[57] Offe, C. Contradictions of the Welfare State. (London: Hutchinson, 1984), p.36-39.
[58] PRO T318/188 'Breakdown of Gold and Convertible Currency Reserves', January 1968.
[59] Financial Statistics. (CSO: No.93, Jan. 1970), p.95.
[60] PRO T267/29 'THM: the Sterling Balances Since the War', undated.

to avert the onset of a full scale crisis. Consequently, institutional actors formed themselves into two types of overlapping networks in order to manage the currency. The first type of network predominantly searched for techniques to *reduce* the likelihood of crisis. The second type engaged in contingency planning. In other words, it considered the possibility of alternate futures in which crises did occur because the techniques employed by agents in the first type of network failed to stabilise the international economic structures.[62] The main function of this type of network was to dampen the effects of any external economic crisis that could not be avoided. However, both of these network types operated within a context of mutual path dependency. In other words, the success or failures of the strategies employed by the first type of network influenced the future choices of the second type and vice versa.

Figure 2.1 Networks and Crises



3. What is it that motivates them to choose one kind of response over another?

Thus far, I have explained how institutional actors within the core executive form themselves into policy networks in order to resolve issues that they or others have defined as problematic. However, I have not attempted to explain how the decision making process works within networks or what it is that motivates our institutional actors to agree on one possible means of

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[61] Hircsh, F. The Pound Sterling: a Polemic. (London: Victor Gollancz, 1965), p.24.
[62] Rosenthal, U. and Kouzmin, A. 'Globalizing an Agenda for Contingencies and Crisis Management: an editorial statement' Journal of Contingencies and Crisis Management. Vol.1 (1), 1993, p.1.

problem resolution rather than another. In this section I will attempt to resolve this deficiency, because it is clear that there are many strategies that economic policymakers could have employed in order to ameliorate the problem of sterling. In fact, it is evident that there were broadly four different approaches that could have been utilised. These were:[63]

- **First Order Change**, which constitutes tinkering with the settings of the *pre-existing* instruments for economic control. This includes raising interest rates to attract foreign capital and increase the size of the reserves. Using credit controls and public expenditure caps to deflate the economy in order to ensure that British goods will be redirected to the export market, to improve the balance of payments. Borrowing money from foreign governments and central banks and lowering the exchange rate in order to reduce the propensity of speculative attacks and to make British exports more internationally competitive.

- **Second Order Change** refers to the development and deployment of *new* instruments in order to uphold the fixed rate system. This would include the implementation of a system of import controls, in order to physically reduce the amount of goods entering the UK, in an attempt to improve the balance of payments.[64] The development of a sterling area guarantee scheme which would protect the sterling balances from a reduction in the exchange rate, thereby reducing the propensity of holders to convert their holdings into foreign exchange.[65] The extension of exchange control to physically prevent the conversion of the sterling balances[66] and the mobilisation of UK citizen's private portfolio holdings to bolster the official reserves.[67]

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[63] This Framework has been adapted from Hall, P. 'Policy Paradigms, Social Learning and the State: the Case of Economic Policymaking in Britain', Comparative Politics. 1993, p.275-296.
[64] See PRO T312/2914 'Sterling Contingency Planning: UK Import Controls- Operation Orestes (Quantitative import controls) January 1969-December 1971,
[65] See PRO T267/33 'THM on the 1968 Basle Agreement', undated.
[66] See PRO T295/514 'Operation Brandon (Exchange Control within the Sterling Area), 1968'.

- **Third Order Change**, which amounts to institutional actors within our two types of policy networks abandoning the central policy that had hitherto been used as a mechanism for upholding the external economic structures and instead replacing it with something else. In other words, agents abandon the goal of maintaining a fixed rate of exchange as a means of upholding global capitalism and instead implement a system of floating rates or a crawling peg.[68] This type of change can occur for a number of reasons, including (1) the failure of first or second order changes to stabilise the existing economic sub-system. (2) The belief that the first or second order change required to bring about stability involves more costs to the overarching economic system than implementing third order change. Alternatively, (3) because of a wider change in the belief systems of actors, which may be wholly unrelated to the possibility of crisis within the economic sub-system.

- **Fourth Order Change**, which in essence refers not only to a change of goals within the pre-existing economic system but the wholesale abandonment of that system.[69] In other words, a fourth order change would refer not to a shift from fixed rates to floating rates but from capitalism to post-capitalism. However, I will not elaborate any further on this possible type of change because it is not relevant to an understanding of the events that this framework has been designed to render.

What then, is it that predisposes our institutional actors to advance one type of change over another? Firstly, it is postulated that institutional actors are satisfiers rather than maximisers. As they do not have the time or cognitive capacity to search out all possible remedies they will satisfice and choose a course that is good enough to meet their desires.[70] In other words, they

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[67] See PRO T295/256 'Redeployment of Overseas Assets (Operation Bootstrap) 1965-1967'.
[68] See PRO T312/2544 'Sterling Contingency Planning: Operation Hecuba 1968-1969'.
[69] Hay, C. Restating Social and Political Change. p.95.
[70] Mosely, P. The Making of Economic Policy. p.106.

will make incremental change. Within our context agents' [fourth order] goal is broadly to uphold a system of international capitalism. Prior exchanges have determined that this goal was to be achieved within a [third order] framework of a fixed exchange rate. When that framework appears to be operating sub-optimally and there is the risk that it might unravel, agents will search for strategies that might enable them to stabilise it. As they are satisficers, they will engage in a limited search. Not all alternatives will be examined. Instead those alternatives which are most familiar to decision makers, which deviate least from the existing practices will be examined first, in order to cut down the information and transition costs associated with more radical change.[71] In short, they will begin by implementing first order change and alter the settings of the existing instruments, in the hope that it will re-stabilise the third order framework and hence ensure the continued operation of the fourth order system.

Once first order change has been embarked upon, agents within the external economic policy networks will examine the impact that their intervention has had on the third order framework in order to determine whether any further intervention is required. Where further intervention is required agents must determine whether or not supplementary adjustment to the settings of existing instruments will be successful in bringing about stability and whether or not the costs associated with further setting changes outweigh the rewards. In other words, it will become clear to policymakers that there are only so many changes that can be made to the settings of the existing instruments before those changes begin to have dire consequences for other aspects of economic management. For example, it would not be possible for policymakers to increase interest rates ad infinitum in order to attract foreign capital to the city of London. There would quickly come a point when further rate changes became detrimental to the operation of the domestic economy, in terms of its effect upon the housing market and in terms of consumption.

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[71] Cyert, R. and March, J. A Behavioural Theory of the Firm. (New Jersey: Prentice-Hall, 1963), p.118.

When institutional actors become aware of the fact that either: (a) changes to the settings of the existing instruments are having no stabilising effect; or (b) that setting changes are having an effect but that there is no further scope to bring them about or that the effect is not being felt quickly enough, they will then more fully consider the possibility of implementing second order change.[72] As has already been outlined, this form of change involves the crafting of new policy instruments that can be used to stabilise the third order framework. New instruments will however only be crafted when agents believe that there is sufficient time to develop them and when the costs involved in deploying them are considered to be less than the costs of altering the pre-existing third order framework. Where time is available and the costs are considered to be low, second order change will occur and the crafting of new policy instruments will allow a greater degree of first order change because there will be more instrument settings to alter. However, where there is insufficient time or when the costs are deemed too great or where deployment occurs but fails to meet the desired objective of stability, institutional actors will instead consider the possibility of third order change. In short, they will prepare themselves for the prospect of replacing the entire framework that they use to achieve their fourth order goal. In the context of external economic policy, this means considering whether or not to move away from a system of fixed exchange rates towards something more flexible.

Nonetheless, whilst this framework enables us to render the context within which institutional actors incrementally adjust the strategies they use in order to achieve their goals, it fails to do three things. Firstly, it fails to tell us why our agents hold their particular fourth order goal in the first place. Secondly, it does not tell us why institutional actors often disagree on the first, second and third order mechanisms that should be used in order to achieve that fourth order goal. Thirdly, it also fails to tell us how agents arbitrate between their differing proposed first, second and third order strategies. These omissions point to a serious deficiency within the

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72 Hall, P. 'Policy Paradigms, Social Learning and the State', p.281.

theoretical framework but one that is difficult counter once and for all. However, in the remainder of this chapter I will outline a number of plausible hypotheses and provide a preliminary indication as to which is/are most beneficial to our interpretation.

Hypothesis 1- a passive core executive

This interpretation would view the core executive as a passive mechanism that is controlled entirely from the outside by agents within wider society.[73] In other words, our institutional actors would have no goals or motives of their own but would instead pursue the goals of other interested parties. This would mean that the external economic policy network adopted its particular fourth order objective because this is in the interest of the external actors that control the core executive. Where actors within our policy network advocate different first, second or third order responses, this is because each potential mechanism of control has either a favourable or adverse impact on a certain societal interest that attempts to exert control. Various core executive institutions would be viewed as colonised by different interests and institutional actors would be seen as pawns in a game of pushpin, where the most dominant interest would see its preferred first, second or third order response implemented.[74]

Yet, in order to advance such a hypothesis it is necessary for us to be explicit about what sort of groups are supposedly exerting this kind of control. Three possible sub-hypotheses could be developed. Namely, (1) that it is the electorate, parties and interest groups that lobby the core executive;[75] (2) that it is a socially[76] and/or economically dominant elite[77] or (3) some combination of the two. Nonetheless, the clear problem with this hypothesis is that none of the data gathered from either archives or interviews suggests that any such lobbying took place. The external economic policy network was completely closed. It contained no members from

[73] MacPherson, C. Democratic Theory: Essays in Retrieval. (Oxford: OUP, 1973), p.188.
[74] Dahl, R. Modern Political Analysis, (New Jersey: Prentice-Hall, 1963), p.50.
[75] Birch, A. Representative and Responsible Government, (London: Allen Unwin, 1964), p.236.
[76] Edelman, M. The Symbolic Uses of Politics. (Urbana: University of Illinois Press, 1964), p.19.

outside the core executive, its deliberations were considered top secret, were covered by the Official Secrets Act, members were positively vetted by the security service, and it is extremely unlikely that they discussed these issues with any outside group.[78] Therefore this possible interpretation must be considered the most unlikely, although it cannot be completely dismissed. This is because it is possible that outside consultations did take place and that these were not recorded within the official documents.

Hypothesis 2- a partisan core executive

Under this interpretation agents within the external economic policy networks would be viewed as motivated by their own self interest and personal welfare and as working on their own behalf.[79] The fact that they shared the same fourth order goal would not be explained in terms of it being posited upon them by outside actors but instead would be seen as emanating from the collective realisation that it was in their shared interest. In this case, their common goal was to maintain the stability of the currency.[80] It would be argued that they pursued this because if they did not the domestic economy would become destabilised with disastrous consequences for institutional actors in terms of their own financial well being.

Where institutional actors could not agree on the first, second or third order mechanisms that were to be utilised, this again would be explained in terms of self-interest. In other words, different institutional actors would opt for different delivery mechanisms based on what they thought would be in their own interest. The deadlock between actors would be resolved through bargaining and coalition building.[81] The agents that were able to muster the most institutional resources would be able to successfully lobby for their chosen delivery

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[77] See Kautsky, K. The Class Struggle. (New York: Norton, 1971).
[78] Interview with Sir William Ryrie.
[79] Dunleavy, P. and O'Leary, B. Theories of the State. p.331-334.
[80] Brittan states that the families of Treasury officials 'would tend to have small private incomes invested in government stock or other fixed private securities, and would thus be ultra sensitive to any threat of inflation or currency debasement'. See Brittan, S. The Treasury Under the Tories. p.22.

mechanism. However, the clear problem with this interpretation is that it is impossible to falsify. Where agents couched their motives in terms of defending the public interest, a supporter of this interpretation would simply dismiss this as a charade perpetuated by self interested officials who wished to hide the degree to which they manipulated the core executive towards their own vested interests.[82] Where outcomes actually benefited the public interest, this would be deemed coincidence.

Hypothesis 3- attenuated self-interest

This interpretation is a more sophisticated version of the previous one. Under it, it is assumed that core executive agents act in their own self interest and that they primarily desire to ensure that their institutional positions become as entrenched as possible. However, they recognise that entrenchment can only take place when they are seen to be acting in the interests of key societal groups from which they derive support and therefore it is in their interest to do so or to be seen to be doing so.[83]

Institutional actors hold the [fourth order] goal of maintaining the existing economic structures because this is in the interests of the core executive as a whole. More specifically, it would be possible that both the tax revenues and the perceived legitimacy of the core executive would be diminished to such a degree that its continued existence would be brought into question, if the economic system were operating sub-optimally. Therefore institutional actors recognise that because they operate within a capitalist framework, they are dependent on the success of capitalism if they are going to be able to pursue their own interests in terms of sustaining themselves in office. This means that whilst they work in their own interests, they recognise

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[81] Sabatier, P and Jenkins-Smith, H. 'The Advocacy Coalition Framework', p.122.
[82] This is a problem of unfalsifability. See Popper, K. Conjectures and Refutations. (London: Routledge, 1969), p.53.
[83] Block, F. 'The Ruling Class does not Rule: notes on the Marxist Theory of the State' in his Revising State Theory: Essays in Politics and Post-Industrialisation. (Temple University Press, 1987), p.62-65.

that these are best achieved by pursuing the interests of capital, although not necessarily its optimal interests.[84]

Disagreements within the core executive relating the first, second and third order delivery mechanisms would be explained in terms of the fact that different institutional actors derive their support from different societal interests and that they must be seen to be taking their interests into account. For example, elected officials draw their support from their electoral and party base. Therefore, they recognise that it is in their interest, because they wish to remain in power, to consider what the likely implementation implications of the different delivery mechanisms are on their core base of support and to opt for the mechanism that does the least harm to this group. Of course, because no public consultation takes place, elected officials must rely on their own perceptions of what would be in the best or least worst interests of their support groups and therefore in their own best interests.

Where non-elected officials posit different delivery mechanisms to their elected counterparts, this would be explained in terms of the fact that they derive institutional support from a different source, more specifically from organised interests that they are dependant on for information and advice. As it is in their interest to court these groups, non-elected officials will consider the impact of various delivery mechanisms upon them and/or on their own institution's prestige. Where different non-elected officials propose different delivery mechanisms this would be explained in terms of the fact that different bureaucratic institutions derive support from different sources. Yet, because the various core executive institutions have to operate within networks, they need to secure collective agreement before they can proceed. This means that different institutions will, through self-interest, end up defending different aspects of the public good related to its client groups and/or its institutional interests.

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[84] ibid

As in hypothesis two, the deadlock between the different factions of the policy network would be resolved through bargaining and coalition building.

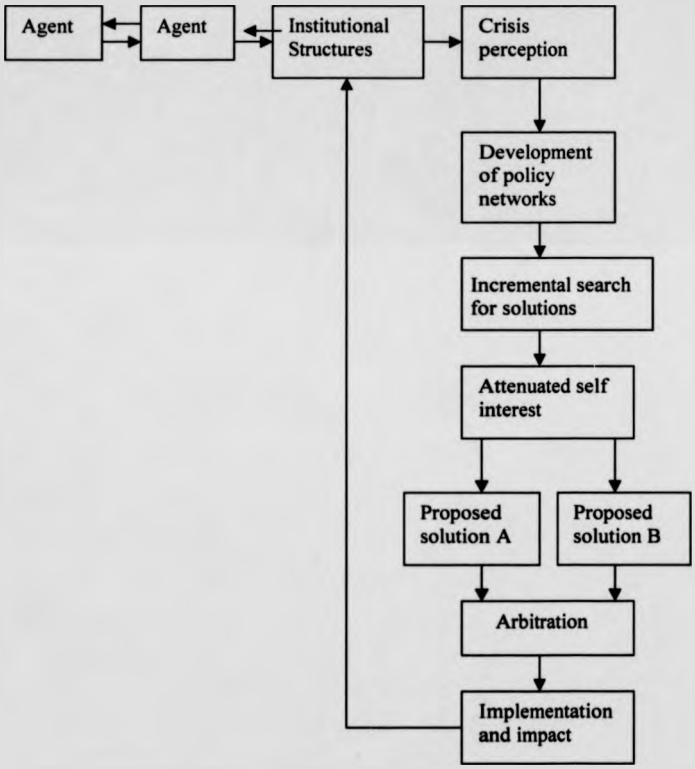
Although this interpretation of interests suffers from many of the defects of the previous one, it is more sophisticated and strikes a balance between hypothesis one and two. This is because it recognises that whilst outside actors within society do not have a direct influence on the closed external economic policy network, they do have an attenuated one. For self interested policymakers must be mindful of the impact of their chosen policy on key societal groups if they are to maintain their power base. Consequently, it is the interpretation that will be advanced throughout this study.

Summary

This chapter has outlined the theoretical framework that is used to make sense of our object of investigation. It began with the premise that the political and economic spheres are socially constructed entities and that empirical investigation should proceed on the basis of attempting the reconstruct the constructions of those that it observes. From such a perspective, the role of theory is to provide a vocabulary that allows the observer to make sense of the object of study. Within the bounds of the present investigation, it was recognised that there were three central issues that the theoretical framework needed to respond to. Firstly, how are we to conceptualise the relations between the various actors that take part in the policy process we are investigating? Secondly, what makes it necessary for our actors to act? Finally, what is it that motivates them to choose one kind of response over another? In response to these questions, it has been argued that the most useful way of conceptualising the relationship between actors in the policymaking process is to utilise of combination of core executive and policy network theory. Furthermore, the propensity towards action by members of networks must be understood in terms of a shared perception about the actual or potential onset of crisis

conditions. The policy response chosen by actors, in order to deal with a crisis, will be conditioned by their attenuated self interest.

Figure 2.2 Overview of Theoretical Framework[85]



[85] Adapted from Sabatier, P. and Jenkins-Smith, H. 'The Advocacy Coalition Framework', p.122.

Chapter 3 Sterling Contingency Planning: Pre-Devaluation

As I made clear in the introduction, this thesis is primarily concerned with external economic policymaking in the aftermath of the 1967 devaluation. One of the principal arguments is that the existing scholarly accounts are too devaluation centred; they are overly focused on the build-up to the event but pay scant attention to the aftermath. Furthermore, I regard this to be a great deficiency, because the devaluation itself represented only first order change. This is because it amounted to nothing more than an alteration to the settings of existing economic instruments. There was no move to create either new second order policy mechanisms or to alter the third order fixed rates paradigm towards something more flexible. Yet, in the aftermath this was no longer the case. The Treasury-Bank-Ministerial networks crafted new second order instruments during 1968 and also gave serious thought to the mechanisms, tactics and consequences of abandoning a fixed rate of exchange for sterling. This does not mean to say that the devaluation was an irrelevance. Merely that its significance has been overplayed. The shift in parity and the build-up to it is however of some importance, because it provided the context in which economic policymakers operated during its aftermath. For this reason, any analysis of external economic policy post-1967 must pay some attention to it. In the discussion that follows, I intend to outline the state of thinking within the minds of ministers and officials in the build up to devaluation. In so doing, a useful base point is established, from which to assess the change in attitudes and *modus operandi* post-devaluation.

The Road to 1968

When Harold Wilson took over the office of Prime Minister on 15 October 1964, he made a conscious decision that the devaluation of the pound was out of the question. This decision was ratified two days later by his Chancellor of the Exchequer, James Callaghan and by

George Brown, who was First Secretary and head of the DEA.[1] At the time, the decision was not out of line with thinking in official circles in Whitehall. Indeed, Sir William Armstrong (Joint Permanent Secretary to the Treasury), Sir Burke Trend (Cabinet Secretary) and Sir Eric Roll (the Permanent Under-Secretary at the DEA) had all come to similar conclusions. Only Sir Donald MacDougall, the Director General at the DEA, argued in favour of a change in parity.[2]

The decision to rule out devaluation was taken not because the assorted ministers and officials believed that the position of sterling was relatively strong, but because they believed it was weak and that the economic and political situation would be made worse by a change in parity. For even though the balance of payments deficit inherited from the Conservative government was thought to be in the region of £800 million, Wilson was not prepared to devalue the moment he took office and blame his predecessors.[3] This was because he felt that

> 'The financial world at home and abroad was aware that the postwar decision to devalue in 1949 had been taken by a Labour Government. There would have been many who would conclude that a Labour Government facing difficulties always took the easy way out by devaluing the pound. Speculation would be aroused every time that Britain ran into minor economic difficulties....'[4]

Callaghan's support of Wilson's decision is attributable to the fact that before taking office, Nuffield College had arranged for his introduction to the US financial community. In May 1963 he met a number of American financial leaders including the Chairman of the Federal Reserve and the Secretary of the Treasury and had pledged that Labour would not voluntarily

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[1] Bale, T. "Dynamics of a Non-Decision: the 'Failure' to Devalue the Pound, 1964-67", Twentieth Century British History. Vol.10, No.2, 1999, p.198.
[2] Burke, K. "1967 Devaluation Symposium", Contemporary Record. Vol.1, No.4, 1987. p.46.
[3] Wilson, H. The Labour Government 1964-1970: a personal record. (London: Weidenfield, 1971),p.6.
[4] ibid.

devalue if it were the next party in government.[5] Brown too acquiesced, for although his knowledge of economics was at best limited, he believed that devaluation would hurt the working class.[6]

Whilst the majority of officials in the Treasury and Bank of England were loath to see a reduction in the parity the perception was that it was still possible that it could occur. Especially if the government did not have the stomach for the deflationary measures necessary to improve both confidence and the balance of payments.[7] Sir William Armstrong, in particular, did not believe that it was desirable to 'get caught with..[his]..trousers down'.[8] At the beginning of December 1964, he authorised the initiation of small-scale contingency planning into the possibility of a forced devaluation. Initially only Robert Neild (Economic Advisor to the Treasury), Alec Cairncross (Head of the Economic Section) and Donald MacDougall were involved in the operation.[9] The three advisors, in complete secrecy, undertook to examine as a matter of urgency, a number of issues relating to the possible forced devaluation of sterling.[10] In particular this embryonic planning group considered the amount by which the rate should be adjusted, whether the move should be to a fixed or floating rate and the question of offering either compensation or guarantees to sterling holders in the aftermath, in order to reduce diversification. The advisors also considered whether the

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[5] Bruce-Gardyne, J. and Lawson, N. The Power Game: An Examination of Decision-making in Government. (London: Macmillan, 1976), p.126.
[6] Burke, K. '1967 Devaluation Symposium', Contemporary Record. Vol.1, No.4, 1987. P.45.
[7] The reluctance of officials to advocate devaluation as a deliberate act of policy can be attributed to a number of factors. Firstly, as sterling was a reserve currency the devaluation of it might trigger a chain reaction amongst other currencies including the dollar, perhaps even precipitating the destruction of the fixed rate system. Secondly, it would reduce confidence amongst OSA official holders, potentially leading to a problem of direct diversification. See PRO T312/1399 'International Monetary Implications', 13/7/65 and T312/1636 'Paper by Bank of England "Guarantees"', 21/9/66. One also suspects that the pound held symbolic value to some of the officials and that a reduction in its parity would to them represent a national defeat.
[8] Robert Neild speaking at the devaluation symposium, Burke, K. '1967 Devaluation Symposium', Contemporary Record. Vol.1, No.4, 1987. p.52.
[9] PRO T312/1635 Walker to Armstrong 'Contingency Planning', 5/5/66.
[10] Cairncross, A., Managing the British economy in the 1960s: a Treasury perspective, (London: Macmillan, 1996), p.24.

UK might use the act of devaluation to promote wider changes to the international monetary system.[11]

In the end, three papers were prepared and between them they covered these issues in a very preliminary way. At this stage, however, only the advisors themselves discussed the papers and although Sir William Armstrong saw copies, he did not comment upon them. Indeed the documents, and all discussions pertaining to them, were effectively put into cold storage between January and March 1965, because confidence in the currency had increased. Nonetheless, by the end of March, speculation against sterling intensified and sizeable losses were incurred. Armstrong came to the conclusion that it was necessary to take contingency planning out of the deep freeze and placed David Hubback, Under-Secretary at the Treasury, with John Portsmore, from the Bank, at the apex of the planning group.[12]

Armstrong also set up a contingency planning committee, which initially comprised Sir Denis Rickett, Second Secretary at the Treasury, Alec Cairncross, his deputy Fred Atkinson, and Robert Neild, amongst others.[13] The exercise itself was labelled F.U.[14] and main thrust of planning took place between March and November 1965, amidst great secrecy. The papers produced were abridged and placed into a devaluation war book, which was updated by officials in the light of changing circumstances.[15] The Chancellor was aware that the planning was being conducted expressly against the wishes of the Prime Minister, yet 'reluctantly accepted that this was necessary but...expressed neither interest in nor enthusiasm for it'.[16] This meant that during the pre-devaluation contingency planning, ministerial involvement was made conspicuous by its absence. This was in direct contrast with the planning that

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[11] PRO T312/1635 Walker to Armstrong 'Contingency Planning', 5/5/66.
[12] ibid.
[13] PRO T312/1401 'F.U. (65) 7th Meeting', 16/6/65.
[14] '"FU" on the basis that it might be thought of as entailing [F]ollow-[U]p action after the budget', PRO T312/1635 Walker to Armstrong 'Contingency Planning', 5/5/66. Although, according to Sir Kit McMahon, it came to have a more colourful meaning.
[15] PRO T312/1398 David Walker 'Procedure', 21/9/65.
[16] ibid.

occurred after the devaluation, where ministers welcomed the initiatives and took a more hands on approach.

In broad-brush terms, the F.U. group considered the following issues:[17]

(1) *Were there any policies, apart from the usual deflationary ones, that could be deployed at short notice to avert the need for devaluation?* The possible alternatives included

- Offering guarantees to balance holders to reduce the chances of conversion.
- Blocking the sterling balances.

(2) *If devaluation proved to be unavoidable what were the main decisions that had to be taken?* These included

- Deciding the threshold at which officials would advise ministers that there was no alternative to devaluation.
- The choice between moving to a fixed or a floating rate.
- If a fixed rate was decided upon then it was necessary to determine what that rate should be.

In the discussion that follows, I intend to examine each of the issues listed above in the order that they are laid out, so that we might have some degree of comparison between Treasury and Bank thinking pre and post-devaluation.

It was recognised by the FU contingency planning group that one way of potentially avoiding the possibility of devaluation, over and above attempting to improve the balance of payments,

was to offer guarantees to sterling holders.[18] Under such a system, the sterling balances would have been guaranteed against a reduction in value should the pound be devalued. The purpose would have been either to deter the liquidation of holdings that might trigger devaluation, or to check diversification that might occur after devaluation, so that the maintenance of the new rate would be more sustainable.[19] If guarantees were presented in a form that was attractive to sterling holders, their effectiveness would have been dependant on whether or not they were perceived as credible. If they were interpreted as a sign of weakness, it was thought that they would actually speed up, rather than reduce the conversion process.

If the proposal were ever to be implemented, it was recognised by both the Treasury and the Bank, that it would be wisest to offer a dollar value.[20] Under such a system, should the pound have been devalued by say 10% against the dollar, the sterling balances would have been written up by a corresponding amount, to maintain their dollar purchasing power. However, the majority of officials in both the Bank and the Treasury were loath to advocate such a system of guarantees.[21] The balance holders had, after all, received generous rates of interest on their holdings and had they chosen to hold dollars they would have received lower rates and nothing if they have moved into gold. It was arguable that the high interest rates could be regarded as compensation for the risk of devaluation.[22] Furthermore, the reserves of the sterling area were held in part to cover their borrowing in sterling and it was felt that there was no reason why a bonus through guarantees should be payable on this element of their sterling reserves. Equally, if the UK authorities were to implement a system of full guarantees they may have been forced to honour them because of action that was outside their control.

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[17] Drawn from PRO T312/1399 'Summary of Papers (F.U. Series)', 27/7/1965.
[18] PRO T312/1636 'Guarantees', 2/9/66.
[19] PRO T312/1398 'Guarantees and Compensation', 12/7/65.
[20] A guarantee in terms of gold would have been risky, as there was constant speculation that the price of gold would be substantially increased. If the price of gold were say doubled it would have obliged the UK authorities to double the value of the guarantee and the purchasing power of the sterling balances would also have doubled.
[21] PRO T312/2734 'Guarantees and Compensation', 11/9/67.
[22] PRO T312/1398 'Guarantees and Compensation', 12/7/65.

For example, in the unlikely event that the dollar was re-valued, the UK would have to have written up the sterling balances by a corresponding amount.[23]

It was also believed that if guarantees were extended with the aim of averting devaluation, they would in all probability have been offered when the UK was in a position of absolute fragility. The risk was that this would have been interpreted as an act of weakness and that speculative outflows would actually have increased. It would also have been impossible to extend guarantees to all holders without reducing the credibility of the system. Those holders that were not guaranteed would have had less incentive to hold the currency and it was possible that they would convert their balances. Furthermore, if the system was put into practise, it was felt likely that pressure would also come to bear on the US to offer something similar. It was believed that the Americans would be extremely unlikely to entertain the idea and in all probability would have been very unhappy with the UK for putting them in such an awkward position.[24] Thus, all of the Treasury and Bank officials concluded that it would be unwise and probably harmful to guarantee sterling holdings.[25]

Whilst everyone was agreed that guarantees before devaluation should not be actively considered, not everyone was quite so convinced about the case against compensation in the aftermath. Robert Neild, in particular, believed that if a devaluation occurred, the sterling area holders would not remain loyal but would instead embark on a process of direct diversification. Consequently, he argued that it would have been far better, under such circumstances, to offer compensation at the start 'than to be driven to it by the beginning of a wave of conversion, or threats thereof'.[26] However, his was the minority view. The majority, including Rickett, argued that after a devaluation where compensation was offered, the

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[23] ibid
[24] PRO T312/1636 'Guarantees', 2/9/66.
[25] PRO T312/1637 'F.U. (66) 1st Meeting', 11/11/66.
[26] PRO T312/1398 Robert Nield 'Annex A: Compensation', 20/7/65.

holders would be more likely to liquidate their windfall and run than to stay loyal.[27] Although compensation might have reduced the grievances of sterling holders, for it to actually diminish their propensity to convert they would have to have believed that it would be offered again if there were another devaluation. In other words, by offering compensation it was felt likely that demands for formal guarantees would come soon afterwards and with them all the problems relating to confidence in the currency that had led officials to reject them pre-devaluation.[28]

With hindsight, it is clear that Neild was correct. The shock of devaluation was to greatly undermine the loyalty of the OSA official holders and bring with it a bout of direct diversification. If a system of guarantees or compensation had been administered as part of the devaluation package, it is arguable that much of the instability that occurred during 1968 could have been avoided. The irony is that by May 1968, the Bank's prior scepticism had been greatly reduced. Furthermore, by September 1968, the Bank in collaboration with the Treasury had successfully negotiated a sterling guarantee for OSA holders. Contrary to the view that guarantees would undermine confidence, rather than improve it, the system that was put in place greatly increased the stability of sterling. The assumption that the US would not welcome the scheme also proved to be faulty. In fact, it became the largest financial contributors to the operation. If the guarantee proposal had been negotiated the in 1965 rather than 1968, it is arguable that the pressure on sterling would have been greatly reduced. Therefore, the decision to avoid this form of second order change was perhaps the biggest mistake of both the contingency planning and crisis avoidance networks pre-devaluation.

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[27] PRO T312/1401 'F.U. (65) 6th Meeting', 19/5/65.
[28] PRO T312/1398 'Guarantees and Compensation', 12/7/65. However PRO T312/1637 'F.U. (66) 1st Meeting', 11/11/66 does suggest that there was some softening amongst officials on the issue of compensation. Of course, when devaluation did finally occur, none was given.

A second possible means of avoiding a forced devaluation was also considered, albeit briefly, by the FU group. That possibility was the blocking of the sterling balances. It was recognised that a

> 'a sufficiently draconian system of controls and restrictions regardless of the consequences, accompanied by a total repudiation of international obligations, could theoretically prevent.. [devaluation].'[29]

Blocking the sterling balances during a time of absolute crisis would have protected the reserves in the EEA from the demands of conversion because free convertibility would have been suspended. Of course under such a regime, sterling holders would have been able to use their currency for the purchase of British imports and to avoid this it would have been necessary, in addition to the suspension of convertibility, to completely freeze the sterling balances.[30] However, the possibility of blocking was considered only momentarily by the FU group. The consequences of embarking on this course were regarded as potentially worse than the devaluation it would be intended to avoid. This was because blocking would have been the equivalent of the Bank suspending cash payments to its customers. A large part of the reserves of the OSA would immediately have been made illiquid and London would be shut down as a source of borrowing for the finance of short-term trade. Officials believed that the international liquidity problem and the financial banking problem that would be created would completely undermine the existing international monetary arrangements and that British assets held overseas would undoubtedly have been frozen in retaliation. Whilst it was recognised that intense exchange control had been accepted by sterling holders during the war, it was felt that they would not be so obliging during peacetime. If exchange control restrictions had to be implemented in the post-war era, officials regarded it as tantamount to

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[29] PRO T312/1398 'Blocking', 12/4/65.
[30] PRO T295/489 William Hughes 'Trade Effects of Brutus', 19/3/68.

declaring bankruptcy. Consequently, 'the position of sterling as a trading, investment and reserve currency would have been destroyed overnight'.[31]

Both Bank and Treasury were unanimous in their conclusion that blocking could never be preferable to devaluation. However in the post-devaluation era, this unanimity was to be eroded. In fact, the Treasury, much to the displeasure of the Bank, instead concluded that blocking would actually be preferable to another devaluation. Furthermore, it is arguable that it was the Treasury's preference for blocking that led the Bank to reconsider its objections to sterling guarantees. To the Bank, guaranteeing sterling was a lesser evil than defaulting on its customers.

Having rejected all but the usual first order deflationary strategies as a means of avoiding devaluation, the FU group had to consider the threshold at which they would advise ministers that the defence of the present parity was futile. However, agreement between the Bank and the Treasury on the minimum level of reserves required to maintain the parity was hard to come by. For Robert Neild the figure was £800-£1000m.[32] Although he doubted that ministers would be prepared to devalue at this level, he felt that 'it would be foolish to let the reserves run so low that we had inadequate means with which to intervene in the exchange market after devaluation'.[33] Of course, throughout much of the 1960s, the reserves were never far from the £1000m benchmark. Even so, it is arguable that it is impossible to set a figure below which devaluation is automatically advocated. Whether the level of reserves are dangerously low or not cannot be deduced simply by toting them up; instead it is important to understand the situation at the time, the level of confidence and the degree to which conversion represents a real risk of their exhaustion. The Bank took such a line arguing

[31] PRO T312/1398 'Blocking', 12/4/65.
[32] PRO T312/1399 Neild to Armstrong 'The Trigger', 15/7/65.
[33] ibid

> 'We cannot say that even £500 million of reserves is the minimum where, if HMG were willing and able to enforce unquestionably effective measures, we could hold a new position. We can say that if HMG are not so willing and able, five times that figure would not be enough.'[34]

It is arguable, therefore, that the attempt to come to a core figure, beyond which devaluation was unavoidable, was a futile endeavour. It would only be during the midst of a crisis, that those concerned could come to a decision. The fact that neither the Treasury nor the Bank papers were actually discussed at the FU meetings suggests that this was a view shared by its chair, Sir William Armstrong. Far more important was whether, once devaluation came, it should be to a fixed or floating rate.

The argument was not about whether a general system of flexible rates was to be preferred to the pre-existing Bretton Woods system. Instead, the emphasis was on whether it would be better to allow the rate to be determined by the market than to re-peg it at a lower parity, in conditions where the UK could no longer maintain the present parity. Kaldor, the Chancellor's special advisor, and Neild, were attracted to the idea of letting the pound float. Kaldor advocated it as a temporary expedient that would allow the UK authorities to devalue by the correct amount before re-pegging.[35] Whilst Neild hoped that a decision to float would result in the (third order) reform of the international monetary system and push it towards multilateral flexible rates.[36]

The general argument in favour of a move to floating rates was, according to Neild, that a fixed rate easily gets out of line with the competitive position of the economy.[37] He felt that it

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[34] PRO T312/1399 Paper by the Bank of England 'Trigger', 26/7/65.

[35] PRO T312/1399 Kaldor 'Fixed or Flexible Rates', 23/7/65.

[36] PRO T312/1399 Neild 'Fixed or Flexible Rates', 23/7/65.

[37] PRO T312/1398 Neild 'Fixed or Flexible Rates', 26/4/65.

ought to be possible to avoid this, by adjusting the rate to keep it in line with competitive positions. However under the existing system of fixed rates, politicians had become reluctant to alter the rate and the maintenance of the parity had become a matter of national prestige. Furthermore, if a fixed rate devaluation were initiated, any move would have to have been large in order to convince the world that it would be stable. The process of adjustment required to take advantage of this kind of change would be painful. It would involve a huge package of deflation, as home demand would have to be cut back severely in order to encourage export volume to increase.[38] It was thought possible that these changes could be made more efficiently, if the adjustment could be made more incrementally through recourse to flexible rates. It was also possible that by adopting a floating rate the potential to over-devalue would be avoided, and that ministers and officials would not have the worry of deciding what the new rate should be.

However, the vast majority of Bank and Treasury officials were not swayed by the Neild-Kaldor creed. Cairncross, in particular, felt that a move to floating rates would be disastrous.[39] It was clear to him that the shock to the international system, if a key currency such as sterling was to flout IMF rules by moving to a floating rate, would be great. It was probable that the UK would have been disbarred from her IMF drawing rights if she had floated. Without such credits, any chance of managing the floating rate would have been reduced to nil. There was also a severe danger that the reactions of other countries, to a move by Britain, could have been very damaging. Foreign powers might have decided to devalue or float themselves, in order to deny the UK her competitive advantage, or at the very least, they could have been expected to introduce tariffs, import quotas, and export subsidies.[40]

There was also the danger that floating presented to the reserve currency function of sterling. If sterling moved to a new fixed parity, it was possible that balance holders would feel that

[38] PRO T312/1636 Ryrie 'Fixed or Flexible Rates', 22/9/66.
[39] PRO T312/1398 Cairncross 'Floating Rates', 2/4/65.

nothing was to be gained from diversifying. However, the majority of the FU group recognised that a move to flexible rates would probably 'precipitate an enormous withdrawal of sterling balances'.[41] It was likely that the amount of sterling that would be disposed of in the market would be so great that 'the rate could be depressed so far as to bear no relation whatever to the competitive strength of the economy'.[42] The group could only conclude that the risk that the rate might fall too far, coupled with the difficulties associated with Britain's IMF obligations and sterling's role as a reserve currency, precluded the possibility of adopting flexible rates.[43]

Of course, this was to become another area were Bank and Treasury disagreed after devaluation. Whilst the vast majority of Treasury officials were to reject the possibility of floating in the early part of 1968 the Bank could see the attractions of it, especially when the Treasury's alternative to it was blocking. However with the conclusion of the sterling area guarantee system in September of 1968 the argument against floating, because it would trigger a bout of OSA diversification, lost much of its force. Consequently, the Treasury was to become a late convert to the floating camp. Of course, they would never advocate it as a deliberate act of policy, but they were prepared to recommend it under crisis conditions.

However in the pre-devaluation era, floating was never to be seriously considered. Indeed, the officials involved in FU were horrified when at the end of July 1965 Armstrong reported to them that 'the Prime Minister was understood to have a firm preference for floating if the need for devaluation arose'.[44] To make matters worse, it also appeared that the Chancellor shared similar sentiments, although he at least was not completely committed to them. The Bank was especially worried by Wilson's enthusiasm. Maurice Parsons, the deputy governor,

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[40] PRO T312/1827 'Fixed or Floating Rates', undated.
[41] PRO T312/1636 Ryrie 'Fixed or Flexible Rates', 22/9/66. Of course, it was rather naïve to think that holders would stay put after a fixed rate devaluation because in the end they did not.
[42] ibid
[43] PRO T312/1401 'F.U. (65) 4th Meeting', 13/4/65.
[44] PRO T312/1401 'F.U. (65) 10th Meeting', 29/7/65

thought that it was essential that officials should have adequate time to discourage ministers, in the wake of a crisis, before a decision to float was taken.[45] In the meantime, all that could be done was to ensure that the papers that formed the war book ridiculed floating to the maximum. One of Neild's earlier papers suited that task well. For

> 'though it finally rejected them the paper started from a position fundamentally in favour of flexible rates; given the views of Ministers, as they are understood, this would clearly be a most useful document in the situation envisaged. But it was felt necessary to add to the dossier an "official" and "impersonal" document which would provide a more direct argument coming to the same conclusion.'[46]

Therefore, it was hoped that via a combination of papers and oral advice it would be possible to shape the context within which ministers made their decisions and prevent them from doing the unthinkable. However, even if the Bank and Treasury were successful in their aim, an important question remained. Namely, if a fixed rate devaluation was forced upon sterling, at what level should they peg the new rate?

Calculations by the Economic Section estimated that a 10% devaluation, with appropriate accompanying measures should be sufficient to improve the balance of payments, during 1967, by between £600-£800m. This would have meant lowering the exchange rate from $2.80 to the pound to $2.52.[47] Of course, the J-curve effect would ensure that it would only be after a significant period of time that the improvement was noticed and in the short-term, the balance of payments would actually worsen.[48] This is because, in the interim, even though

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[45] ibid
[46] PRO T312/1401 'F.U. (65) 6th Meeting', 19/5/65. This was confirmed by Lord Croham.
[47] PRO T312/2764 'The Choice of a New Rate', undated.
[48] For an examination of the J-curve phenomenon see Dornbusch, R and Krugman, P. 'Flexible Exchange Rates in the Short Run', Brookings Papers on Economic Activity. Vol. 7, No.3, 1976, pp.558-566.

demand for imports would lessen in the aftermath of devaluation, the cost would remain static or possibly rise, because those goods that entered would cost more. It was felt likely that it would take, at the very minimum, several months before British exporters managed to take advantage of their increased competitiveness by carving out a share of new markets, thereby improving the visible account. Therefore, Treasury planners believed that a margin of safety was required, because 'in a position in which our resources to support the new rate were very limited, it would be important to choose a rate which was virtually certain to do the trick…'.[49] Equally, it would also be important to establish confidence in the UK's ability to hold the new rate but not to go so far down as to provoke retaliation by other countries.[50] The former requirement meant that devaluation would have to be by at least 10%, whilst the latter ruled out a move beyond 15%.[51] However, it was clear that a judgement about the precise degree of devaluation required could not be made in advance. It was only possible to come to some provisional conclusions but above all else, it was essential that there should be no retaliation.[52] Yet by the end of 1967, the events that the FU had planned for, but hoped would not occur, seemed more likely than ever.

The Devaluation

During the first half of 1967, confidence in sterling seemed to have increased. This was mainly due to the fact that in the last quarter of 1966, there had been a visible trade surplus and 'calculations made by the Treasury during the summer of 1967 showed that [the] overseas payments had actually been in surplus for the first half of the year and forecast a small surplus for the year as a whole'.[53] By the end of March 1967, nearly all central bank assistance had been repaid.[54] However, this tranquil state of affairs was not destined to last for

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[49] PRO T312/2764 'The Choice of a New Rate', undated.
[50] PRO T312/1399 'The Choice of Rate and International Acceptability', 26/7/65.
[51] PRO T312/1398 Note by the Economic Section 'Choice of a New Fixed Rate', 2/4/65.
[52] PRO T312/2764 'The Choice of a New Rate', undated.
[53] Callaghan, J. Time and Chance. (London: Collins,1987), p214.
[54] Burke, K. '1967 Devaluation Symposium', p.53.

long. Three factors were set to undermine confidence in the currency, and it is fair to say that two of them were outside the control of the administration. The first was the government's decision, at the beginning of May, to announce that the UK would formally apply to join the Common Market. It was widely known that the cost of entry to the balance of payments would be substantial, and in view of this, sterling balance holders suspected that entry into the EEC might be accompanied by devaluation.[55] The position was not helped by the French, who were highlighting the difficulties that sterling was likely to encounter.[56] Therefore, the announcement triggered a bout of speculation. Secondly, at the beginning of June, came the six-day Arab-Israeli War, an oil embargo, and the closure of the Suez Canal.[57] This development was most harmful to Britain. It meant that exports destined for the Commonwealth had to traverse the Cape, and consequently took longer to arrive. This greatly increased the costs of shipping, as did the rise in the price of oil.[58] Thirdly, by mid-September a series of dock strikes, within the UK, ensured that goods destined to make the long journey around the Cape instead lay idly on the docks. Although the goods had left the factories and were destined for overseas, they could not be recorded as exports until they had actually been loaded onto ships.[59] From the balance of payments perspective, this was a rather unfortunate anomaly. Consequently, the small surplus was to turn into a substantial deficit and the effects on confidence were disastrous.

It was from these events that the seeds of devaluation were sown. The orthodox view is that the balance of payments deficit and the speculation that it provoked so drained the reserves that devaluation became unavoidable.[60] The truth of the matter is that just sixteen days before devaluation took place Callaghan was not easily persuaded that it was either necessary or

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[55] Cairncross, A. Managing. p.180.
[56] Burke, K. '1967 Devaluation Symposium', p.52.
[57] Wilson, H. The Labour Government. p.440.
[58] ibid. Wilson states that this penalty increased costs by £200m.
[59] Callaghan, J. Time and Chance. (London: Collins,1987), p.215.
[60] Rhodes-James, R. Ambitions and Realities: British Politics 1964-70. (London: Weidenfeld, 1972), p.39. Stones, R. 'Labour and International Finance', p.222-3; Bale, T. 'Dynamics' p.217; Bruce-Gardyne, J. and Lawson, N. The Power Game: An Examination of Decision-making in Government. (London: Macmillan, 1976), p.118; Ponting, C. Breach. p.290; Roy, R. 'Battle', p.302.

inevitable.[61] Instead, he wanted to wait until the spring, as did Wilson. It was only when Cairncross, a recent convert to the devaluation camp, told Callaghan that *he* thought it was both necessary and inevitable that the Chancellor reconsidered.[62] Cairncross had come to that conclusion as far back as September.[63] If the Crossman diaries are to be believed, it would seem that Wilson too could not make up his mind. For on 3 November, the day after Cairncross's discussion with the Chancellor, Wilson reported to Crossman that he was now in favour of devaluation, adding that 'I'm for the floating pound but the fixed pound is what the other side want'.[64] Yet by 8 November it seemed that the Prime Minister had recanted and had swung back in favour of attempting to maintain the existing parity.[65] It also appeared that Callaghan had again reassessed the situation, and he reported to the S.E.P. that he was now against devaluation and that 'we must solider on'.[66]

It is difficult then, to properly assess ministerial thinking in the build up to the event. Although during a press conference after the event, Callaghan was to state that the decision was taken two weeks before its implementation, this is not strictly true.[67] It would seem that neither the Prime Minister nor the Chancellor could make up their minds, and both appeared to prevaricate. Of course, the vast majority of the Cabinet was in favour of a shift in parity. This was because they mistakenly believed it was a magic wand that would reduce the need for deflationary policies.[68] However most of them were not members of the SEP and consequently did not know that any discussions relating to the parity of the pound were taking place until, they ratified the decision two days before it was implemented.[69]

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[61] Burke, K. '1967 Devaluation Syposium', p.53.
[62] Callaghan, J. Time and Chance. (London: Collins,1987), p.218.
[63] Cairncross, A. Managing. p.181.
[64] Crossman, D. The Crossman Diaries 1964-1970. p.353. This account is confirmed by PREM 13/1447 P.M. to Chancellor 5/11/67.
[65] Crossman, p.358.
[66] ibid, p.357.
[67] PRO T312/1828 Baldwin 'Note for the Record', 4/12/67.
[68] PRO PREM 13/1447 Brown to Wilson, 15/11/67.
[69] Castle, B. Castle Diaries. (London: Weidenfeld, 1984), p.324-326.

The key discussion on devaluation by the SEP took place on 8 November 1967. No minutes of the meeting were taken; consequently, it is necessary to rely on ministerial memoirs in order to get a flavour of it. According to Crossman, Wilson, Callaghan, Crossman, Crosland, Stewart, and Gunter were present.[70] The Chancellor made it clear that he was both against devaluation and the floating of the pound and that he was not prepared to reconsider the issue for several months. Wilson however started the meeting provisionally in the pro camp and was prepared to keep his options open. He stated 'I am politically open on the subject. I am prepared to think that there could be some merit in a free decision...'.[71] However, by the end of the meeting it appeared that he too had lost his nerve. Instead, he advocated looking into the possibility of rallying support from foreign creditors.[72] This was something that particularly riled Crossman, because he feared that neither Wilson nor Callaghan had any intention of devaluing and that instead they would accept foreign credit no matter what sort of strings were attached.[73]

Although contingency planning was brought to a state of readiness in the Treasury, both Wilson and Callaghan attempted to employ the international support package gambit to avoid a shift in parity. There does however seem to have been a tacit understanding between them that if devaluation was to be avoided the funding would have to be large, in the region of $3billion, and for a long duration, not less than a year.[74] It is likely that both men felt a sense of defeat after working so hard to bring about a balance of payments surplus, only to have the rug pulled from under them.[75]It would seem therefore that they concluded that credit would have to be sought to, 'give some real security to sterling for a long period ahead'[76] and if it could not, only then would they opt for devaluation.

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[70] Crossman, D. The Crossman Diaries 1964-1970. p.357.
[71] ibid.
[72] ibid.
[73] ibid, p.358.
[74] PRO PREM 13/1854 Draft telegram to Washington 'Top Secret and Personal', undated and [74] PRO PREM 13/1447 'Note for the Record', 9/11/67.
[75] PRO PREM 13/1447 'Message to the President from the Prime Minister', 17/11/67.
[76] PRO PREM 13/1854 Draft telegram to Washington 'Top Secret and Personal', undated.

Two different strategies were adopted in the quest of gain additional funding, one by Wilson himself and the other by officials in the Treasury and Bank of England. Both projects were initiated the day after the SEP meeting on 9 November 1967. Wilson believed that the best possible method for securing the credits was for him to make a direct and personal plea to the American President.[77] For maximum effect, he felt that it would be better to see the President in person rather than to communicate via telegram. Of course, because the pressure on the pound appeared to be mounting, time could not be wasted and therefore he attempted to organise an impromptu visit to the White House.[78] Clearly, it would have been impossible for the Prime Minister to make the trip without attracting publicity, and Wilson was worried that speculators would guess that the pound was on the brink. Thus it was necessary to concoct an excuse that was wholly unrelated to 'economic and financial sphere' to which the meeting would have really related.[79] It appeared to Wilson that a possible rouse would be to declare that he was visiting the President to discuss policy relating to the war in Vietnam. Of course, the war was going badly for the Americans and it was not a cover story that the President was happy for Wilson to use.[80] In any case, it emerged that Johnson was fully occupied and it would have been difficult for him to make time to see the Prime Minister. However Wilson was by this stage desperate and was prepared to 'come for two hours...to any place you name'.[81] Furthermore, when he recognised that the Vietnam pretext was proving difficult for the President, he even considered using the excuse of a visit to his son Robin, who was studying for a degree at MIT, as a means of avoiding press interest.[82] However as Wilson himself states 'after preliminary soundings, we dropped the idea'.[83]

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[77] Pimlott, B. Harold Wilson. (London: Harper Collins, 1992), p.477.
[78] PRO PREM 13/1447 'Draft Message to the President', 9/11/67.
[79] Ibid. Wilson in his Labour Government. p.451 states that the proposed visit was intended as a method of telling the President that the decision to devalue had already been taken. Of course, this is not true.
[80] PRO PREM 13/1447 unknown to Wilson, 9/11/67.
[81] PRO PREM 13/1447 'Draft Message to the President', 9/11/67.
[82] Pimlott, B. Harold Wilson. (London: Harper Collins, 1992), p.478.
[83] Wilson, H. The Labour Government. p.451.

In the event, only the second strategy was fully enacted. On 10 November 1967, Dennis Rickett, from the Treasury, and Jeremy Morse from the Bank, made their way to the United States to begin the rigours of negotiation. The discussions began at the US Treasury on the morning of 11 November. The Americans, who recognised the serious consequences of a sterling devaluation for the dollar, believed that the figure of $3billion was not out of the question. However, as their balance of payments was in dire straights it would require a joint operation between themselves, the Europeans, and the IMF. Fowler, the Secretary to the US Treasury, proposed the following package:

United States	$500m
Germany	$250m
Italy	$250m
Others	$300m
IMF	$1400m
Banks	$300m[84]

The US recognised that it might take some time to negotiate these arrangements but suggested that in the meantime the UK could use its Federal Reserve swap drawing rights. It was also clear that the negotiations for a long-term package would not be problematic from a congressional perspective, and that only presidential approval would be required.[85] If this were granted, US Treasury officials agreed that they would discuss the arrangements with the Europeans.

The same afternoon, Rickett and Morse visited Schweitzer, the Managing Director of the IMF, in order to determine whether there was any chance of the Fund lending the $1400m that Fowler had suggested. Although Schweitzer was happy to put the matter before his

[84] PRO PREM 13/1854 'Tel. No. 3535', 11/11/67.
[85] ibid

board, he stated that he would need the support of all his major shareholders and in particular he did not know what the view of the French government would be.[86] It was clear that all members would have to agree if the Fund was to act. Although Schweitzer was only luke warm, the Americans seemed supportive, mainly because they feared the consequences for the dollar of a sterling devaluation. Much however would rest on how the Europeans reacted to the scheme.

Leslie O'Brien, governor of the Bank of England, negotiated that aspect of the exercise, at the BIS governor's monthly meeting in Basle on 12 November. However, the Europeans were not even luke warm. They refused to advance any credit and instead suggested that the IMF should finance the whole operation.[87] Schweitzer took this news calmly and discussed at length the problems involved. For if the proposal was accepted, the standby offered to the UK would be greater than any extended in the whole of the Fund's history. Consequently it could only be provided with strings attached and these would have included further deflation, a reduction in public expenditure, the introduction of incomes policy and assurances that exchange control would not be extended without the agreement of the Fund.[88] Callaghan, in his memoirs, states that it was the conditions attached 'which were not such as I could recommend to Cabinet' that led him to reject the offer.[89] However, this was simply not true.[90] The government did not reject the IMF loan; instead Schweitzer reconsidered and concluded that it was not a feasible proposition.[91] His reasons were that a stand-by going so far above 200% of the UK's quota, would be too great a departure from the policy and practise of the Fund. Furthermore, he felt that it would be wrong for the IMF to take on such an operation

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[86] ibid
[87] PRO PREM 13/1854 'Tel. No. 3540', 12/11/67.
[88] ibid
[89] Callaghan, J. Time and Chance. (London: Collins,1987), p.220.
[90] See Roy, R. The Battle of the Pound. (University of London: unpublished PhD thesis, 2001), p.302. In fact he argues that the economic package that the IMF would have requested if it had decided to offer the loan would have been little different from the one that the government embarked upon, of its own free will, in 1968.
[91] PRO PREM 13/1854 'Tel. No. 3541', 12/11/67.

alone. If the Europeans had been prepared to involve themselves, it would have been a wholly different matter.[92]

With this news, the Americans now recognised that a change in the rate was unavoidable. Yet, they half-heartedly proposed that the UK should 'have another go in Paris...on the lines of the Fowler package'.[93] However, Schweitzer confirmed that this would be futile because the Europeans had a 'complete lack of interest in direct central bank support'.[94] Without the possibility of additional funding, the British politicians had almost made up their mind that they would devalue. At the Treasury, planning for the devaluation was stepped up a gear, but the politicians did not *quite* accept that 'twelve o'clock has struck'.[95] Negotiations were to continue just in case they bore fruit.[96] However, the only possible source of funding by this stage, seemed to be an IMF loan of $1.4 billion, which Fowler urged the British to apply for.[97] Although it was recognised in London that such a loan would not provide enough resources to protect sterling in the long-term. Besides this, the IMF seemed to have moved into a position of actually favouring a reduction in the parity of the pound. One is led to this conclusion because it raised all sorts of objections to the possibility of providing the $1.4 billion to help prevent devaluation, but seemed more than happy to provide it in the aftermath to preserve the new rate.[98]

With this news, Wilson met with his Chancellor at 11.15pm on 13 November. Also present were Armstrong and Trend. The meeting must been seen as a key turning point in the deliberations over devaluation. This is because with the knowledge that an international support operation of adequate size was out of the question, the Prime Minster and Chancellor had to finally concede that midnight had struck. The 'decision subject to ratification by our

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[92] Ibid.
[93] PRO PREM 13/1854 'Tel. No. 3548', 13/11/67.
[94] Ibid.
[95] PRO PREM 13/1854 'Tel. No. 3548', 14/11/67
[96] Ibid.
[97] PRO PREM 13/1854 'Tel. No. 3593', 16/11/67

Cabinet colleagues, was to devalue'.[99] It appears, however that the technicalities of the issue were left untouched at that gathering. It was not until Wilson called together a group of ministers the next day that these issues were decided upon. The meeting, according to Wilson, came to be known as the 'Tuesday Club', because it met at 4.30pm on Tuesday 14 November.[100] It comprised the Prime Minister, Chancellor, Foreign Secretary, Commonwealth Secretary, President of the Board of Trade, Defence Secretary, and the First Secretary. Although Wilson's memoirs do not record what was discussed and no official record seems to exist, from the briefing memo prepared by Trend for Wilson's chairmanship of the session, it is possible to get some idea of the agenda.[101] In particular, it seems that the ministers discussed whether the new rate would be fixed or floating; the degree of devaluation; whether guarantees or compensation would be offered and the domestic accompanying measures.[102] The fact that the devaluation, when it took place, followed the recommendations of the FU group to the letter, would suggest that Bank and Treasury officials were successful in quashing any ministerial hankering for a floating rate. Furthermore, it is likely that it was at that very meeting that both floating and compensation were rejected.

The formal ratification of the decision to devalue did not take place until 16 November, just two days before the event itself.[103] Cabinet minutes are often unreliable as an accurate and verbatim record of events.[104] However, the documentation for this particular discussion is worse than most. This was because Burke Trend recognised that the Cabinet Minutes, which would be circulated around Whitehall, could contain no reference to the impending devaluation, as a leak to the press would undermine the whole operation. Instead, he suggested that all that should be recorded was that 'the Cabinet then discussed the political

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[98] PRO PREM 13/1854 'Tel. No. 3573', 15/11/67 and 'Tel. No. 3592', 16/11/67.
[99] Wilson, H. The Labour Government. p.454. This account is confirmed by Callaghan, J. Time and Chance, p.221.
[100] ibid
[101] PRO PREM 13/1447 Trend to Wilson 'Operation Patriarch', 14/11/68.
[102] ibid.
[103] PRO PREM 13/1444 Trend to Wilson 'Cabinet: Operation Patriarch', 16/11/67.
[104] Interview with Sir Donald MacDougall.

situation'.[105] Therefore, it is again necessary to rely on the accounts of the diarists within the Cabinet. It appears that at the very least, Barbara Castle did not suspect that the Cabinet meeting was to be used to ratify the decisions of the Tuesday club. Although, it is likely that all of those who were not a part of the meeting three days prior were in the same boat. However Castle records that soon into the meeting Callaghan announced 'I have decided that the pound must be devalued...This is the unhappiest day of my life'.[106] He then explained to his colleagues that the pressure on the currency in the previous weeks had been great and that the thought facing a battle similar to that of 1966 was sickening. Consequently, both he and Wilson had decided to recommend a devaluation of 14.3%, reducing the parity with the dollar from $2.80 to $2.40.[107] Apparently some of the Cabinet questioned whether 14.3% was enough and Castle herself advocated a floating rate. However, the decisions had already been taken at the Tuesday club, and all that was intended was for the Cabinet to rubber stamp them. Keeping information away from the full Cabinet for so long before their consent was required was a useful tactic, both for reducing the chance of leaks and for ensuring that colleagues in favour of a more radical course would not have the time to put a proper case together. The whole exercise was presented to the Cabinet almost as a *fait accompli.*

However, whilst the meeting was taking place it became clear that Robert Sheldon, a Labour backbencher, had tabled a ministerial question to ask whether it was true that a $1billion loan was being negotiated with foreign bankers.[108] The Cabinet discussed whether they should try to get him to withdraw it. Consequently, the Chief Whip went to Parliament in an attempt to persuade Horace King, the Speaker of the House, that the question should not be allowed because it was against the national interest. However, the Speaker would have none of it. Callaghan, whose job it was to reply, was put in a very difficult situation. From his

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[105] PRO PREM 13/1444 Trend to Wilson 'Cabinet: Operation Patriarch', 16/11/67.
[106] Castle, B. Castle Diaries, p.325. Of course, Callaghan had good reason to be upset; for him devaluation was a resignation matter. In fact he soon swapped jobs with Roy Jenkins and became Home Secretary.
[107] ibid.
[108] PRO PREM 13/1447 Minute to Wilson, 16/11/67.

perspective there were only three alternatives open to him, first, to make no statement. Second to say that the rumour was correct, or third to state that the government was to devalue on Saturday. Each of these strategies was, to his mind, equally flawed. To have failed to make a statement would have been just as damaging to confidence as if he actually admitted that devaluation was to take place.[109] Equally, he could not very well have commented on the negotiations in Europe because no further credits were likely to emerge. Consequently, Callaghan replied 'I did not start the rumours and I do not propose to comment on them'.[110] Callaghan's dodging of the issue was, overall, damaging. It did not put the markets at rest; in fact, it did quite the opposite. It signalled that sterling was on the brink and on Friday 17 November, £415m was lost from the EEA.[111] The loss was greater than during the whole of the crisis filled month of July 1966.

On Saturday 18 November, the devaluation took place. The existing accounts tend to assume that the move was forced upon the Wilson administration because it was impossible to hold out any longer.[112] Yet, this is not strictly true. Although confidence in the currency had been greatly eroded by the events of the summer and autumn, the reserves at the beginning of November stood in the region of £1915m.[113] Of course, when Britain's short and medium-term liabilities to the IMF and central banks are factored in, this figure falls to £903m.[114] Yet, even by 16 November, in spite of the speculative pressure, the till was still far from empty. The remaining resources comprised an IMF standby of £420m, central bank facilities totalling £280m, market swaps of £36m and a BIS credit of £90m. [115] Furthermore, the Bank had managed to raise an additional £175m by liquidating a portion of the government's dollar

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[109] PRO T318/1828 Baldwin 'Note for the Record', 4/12/67
[110] House of Commons Debates. Vol. 754, (London: HMSO,1967), cols. 632-5.
[111] PRO T318/183 'The Length of our Tether as at 17th November 1967'.
[112] Rhodes-James, R. Ambitions and Realities: British Politics 1964-70, (London: Weidenfeld, 1972), p.39. Stones, R. 'Labour and International Finance', p.222-3; Bale, T. 'Dynamics' p.217; Bruce-Gardyne, J. and Lawson, N. The Power Game: An Examination of Decision-making in Government. (London: Macmillan, 1976), p.118; Ponting, C. Breach. p.290; Roy, R. 'Battle', p.302. Burke, K. 'Symposium', p.52.
[113] PRO T312/1827 'Possible Short-Term Reflux Following a Devaluation, Table II', undated.
[114] ibid.
[115] PRO T318/183 'The Length of our Tether as at 16th November 1967'.

portfolio. In short, total assets amounted to £1,001m. Given that £194m would be required to service debts at the end of November, £805m remained. This meant that the reserves were only £226m lower than at the end of August 1965 and that they were actually £190m higher than during the March 1968 gold crisis.[116] Thus, it is possible that sterling could have weathered the storm. This does not mean, however, that devaluation *per se* was avoidable. It simply means that in November 1967 Wilson and his Chancellor had a choice and that they decided to jump before they were pushed. If the Wilson government had decided to hold out, it would have been necessary to implement a massive deflationary package in order to improve both the balance of payments and confidence in the currency. Although such package was implemented in the aftermath of the rate change, it may have been politically difficult for the Chancellor to gain support for it within the Cabinet, amongst ministers who understood little of economic affairs, without the backdrop of the devaluation crisis to send the message home.[117]

However, up until 16 November, Wilson and Callaghan could have recanted and instead opted for either inaction or the deflationary route. Although, the former would have been extremely unwise and the latter risky, without adequate financial underpinning.[118] In any case, Callaghan's performance in the House of Commons, in response to Robert Sheldon's question, finally closed off both these options and made a November devaluation unavoidable. Indeed, 'heavy pressure against sterling developed...following the Chancellor's statement'.[119] In the wake of this, the reserves totalled a meagre £390m.[120] If plans had not already been put in motion to devalue the currency the next day, the government would have been forced to develop them rapidly. Given this, it is tempting to argue that devaluation was unavoidable in November 1967 and that the Labour government would have been forced off

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[116] PRO T312/1827 'The Financial Position: Quick Assets and Liabilities', October 1967 and PRO T318/189 'Reserve Position at close of Business on 14th March'.
[117] Modern Records Centre: University of Warwick [MRC], Crossman Papers MSS.154/8/120, 21/3/68.
[118] Bank 2A93/1 O'Brien 'Cablegram 22145', 18/11/67.
[119] PRO T318/178 'Report on the Reserves and Exchange Rates: week ended Friday, 17 November', 1967', undated.

parity even if it had been decided to hold the rate. However, it is clear that Callaghan's response to Sheldon's question was conditioned by the fact that the decision to devalue had already been taken. If it had been decided to soldier on, then it is likely that Callaghan would have taken a different tone.

What is more interesting, is that when the decision was taken, Wilson and Callaghan opted for a fixed rate move. Had they opted to float, the events of 18 November 1967 would have represented a more significant policy departure: because the second order fixed but adjustable mechanism would have been abandoned and with it, the third order goal of fixed exchange rates. The devaluation, by contrast, was only significant in so much as it altered the structural context within which policymakers operated. Its importance lay in its legacy. However, it seems odd that Callaghan and his Prime Minister decided upon a first order fixed rate move, when both had previously declared a preference for floating rates.[121] It is unlikely that the decision to avoid floating stemmed from Cabinet opposition, because influential ministers like Barbara Castle and Richard Crossman were also known to favour them.[122] Instead, it is far more likely that officials from both the Bank and Treasury had done their utmost to dissuade the P.M. and his Chancellor from taking any action that would undermine either Bretton Woods or sterling's reserve currency role.[123] Although devaluation was seen as less damaging to the IMS than floating, Wilson himself recognised that it 'would not be the end of the affair but the beginning of a long and dangerous process which could lead us not upwards but still further downwards'.[124] The danger was that the prognosis for sterling would be no better in 1968 and that it might actually be made worse because of the devaluation. This was because the balance of payments would worsen, as imports became more expensive.[125] It was

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[120] PRO T318/183 'The Length of our Tether as at 17th November 1967'.
[121] PRO T312/1401 "F.U. (65) 10th Meeting", 29/7/65
[122] Castle, Diaries, p.325.
[123] PRO T312/1401 "F.U. (65) 6th Meeting", 19/5/65 and interview with Lord Croham
[124] PRO PREM 13/1447 Crossman to Wilson, 13/11/67.
[125] PRO T230/1052 Posner to Armstrong 'Export Prices and Devaluation', 2/1/68.

also likely that the sterling balance holders would search for a more stable reserve asset and that this would exacerbate the drain on the reserves.

Summary

This chapter has examined the role, remit and outcome of the planning undertaken by the sterling contingency planning network. The aim has been to provide a base point for comparison. It has been argued that although the Bank and Treasury were prepared to examine the feasibility of blocking the sterling balances, extending guarantees to sterling balance holders and floating the pound, they were not prepared to implement any of these crisis avoidance mechanisms because of the huge political and economic costs that they would have entailed. Instead, officials devised a plan for the devaluation of sterling. However, it would be wrong to suggest that when the decision to devalue was taken, in November 1967, it was forced upon the administration. Given the level of the foreign exchange reserves, it would have been possible, although not necessarily desirable, to maintain the existing rate of exchange at least into the early months of 1968. Furthermore, the importance of the devaluation has been overplayed. It only amounted to a (first order) setting change to the existing (second order) economic instruments. No attempt was made to devise a new second order instrument (blocking or guarantees) or to reshape the third order policy paradigm (floating). The devaluation's importance rests in its legacy and in the way in which it altered the structural context of the management of sterling. However, its legacy remains one of the greatest silences within the existing literature.

Chapter 4- The March Gold Crisis

This chapter examines the management of sterling in the period immediately after the devaluation. Primarily it focuses on the origins and consequences of the gold crisis that erupted in March 1968 and which had the potential to have more far-reaching implications for sterling than the devaluation itself. Although the crisis was resolved without recourse to drastic action, a successful resolution was not a forgone conclusion. Failure would have undoubtedly resulted in either second order (blocking) or third order (floating) change. In this sense, the crisis is of counterfactual significance. The chapter is broadly divided into four parts. The first begins by examining the state of economic policy in the aftermath of devaluation. Section two charts the gold crisis and its implications for sterling, whilst sections three and four examine the responses made by officials and politicians to the crisis.

Beyond the devaluation

The devaluation of sterling led to the resignation of Callaghan as Chancellor.[1] However, it is patent that Wilson, ever fearful of plots against his leadership, wished that Callaghan would stay in his post.[2] For if the Chancellor returned to the backbenches, he would no longer be bound by the doctrine of collective responsibility and there was the possibility that he might speak out against the premier. Yet Callaghan could not be dissuaded, he had come to view devaluation as a moral issue and believed that because he had been unable to prevent the shift in parity, his position was now untenable.[3] Consequently, Roy Jenkins was to replace him as Chancellor. Jenkins was not, however, the most logical choice. Although he held a first in PPE from Oxford and was certainly more economically literate than Callaghan, there were others in the government, most notably the academic Anthony Crosland, who would have

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[1] Callaghan, J. Time and Chance. (Glasgow: Collins, 1987), p.222.
[2] Dunne, A. 'The Pound in Your Pocket': A Study of the Economic Policy of the Wilson Government And the Devaluation of Sterling 1964-1970. (University College Dublin: Unpublished MLitt thesis, 2000), p.131.
[3] Callaghan, J. Time and Chance. p.222.

been more obvious contenders. However, it is clear that Jenkins was selected because Wilson wanted to keep Callaghan in the government and the move would allow a straight swap between the two ministers, with Callaghan moving to the Home Office. Had Wilson decided to transfer Crossland to the Treasury, a much larger and more far reaching reshuffle would have been required, if Callaghan were still to hold a senior position.[4]

Jenkins was something of a cool operator[5] and his appointment was to ruffle the feathers of Treasury officials. This was because of his tendency to exclude his Treasury knights from policy deliberations and instead surround himself with his own hand picked team. In particular he relied for support on David Dowler, who was brought in from the Home Office and acted as Principal Private Secretary.[6] However, the new Chancellor was to hit the ground crawling rather than running. It is arguable that Jenkins should have used the devaluation crisis as a justification to quickly push through a host of deflationary policies that would ensure that domestic consumption was reduced and that production was diverted to the export market.[7] This would have ensured that the competitive advantage that the devaluation provided was best capitalised on and that the balance of payments would quickly improve. It would also have sent a signal to the sterling balance holders that the UK was prepared to put its economic house in order and it is possible that the spate of direct diversification, into gold and dollars, would have been arrested. However, Jenkins took very few positive steps in this direction during his first two months in office.

Jenkins himself recognised this deficiency. However, he argued that the blame rested not with him but with Treasury officials who did not properly advise him.[8] With Christmas

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[4] ibid.
[5] Interview with Sir William Ryrie
[6] Interview with Sir Jeremy Morse; The fact that Dowler was brought in from outside, proved to be the main bone of contention. This was because the role of Principal Private Secretary was one that was earmarked for potential high fliers. The fact that someone from outside the Treasury filled it meant that internal promotion prospects had been reduced. Interview with Anthony Glover.
[7] Dell, E. The Chancellors: A History of the Chancellors of the Exchequer 1945-90. (London: Harper Collins, 1997), p.354.
[8] Jenkins, A. A Life at the Centre. p.221.

approaching, the Treasury argued that it would be politically difficult to check demand at a time at which it would have caused the 'maximum of inconvenience'.[9] It was not until January 1968 that the government was to consider the shape that economic policy should take post-devaluation. During a series of meetings held between Thursday 4 January and Monday 15 January, Jenkins was finally to present his economic agenda to the Cabinet.[10] He made it clear that his prime objective was to bring about a turnaround in the balance of payments. This would of course be accomplished by reducing home demand. However, the Chancellor rejected the possibility of raising taxation as a means of achieving this.[11] His reason for this dismissal was that it was highly probable that increased taxation would have an inflationary effect on wages and prices, thereby negating the competitive advantage that the devaluation afforded. Instead, he argued that the solution was to enact sizeable cuts to the government's public expenditure programme, at home and overseas. Although he was rather late off the mark, his choice of action was sensible. As I have argued in the introduction, deficits in the balance of payments, during the 1960s, were not caused by the tendency to over import. Instead, where they existed, it was because government overseas expenditure was spiralling out of control.

The Chancellor argued that the government should accelerate its planned military evacuation from its bases east of Suez by 1971 and that the order for fifty F-111 fighter aircraft, which had been placed with the Americans, should be cancelled. On the domestic front, he suggested that savings could be made if NHS prescription charges were restored and if the planned increase in the school leaving age were postponed for four years.[12] Of course, all of these proposals were to result in the traditional battle between the exchequer and the spending ministries, which resented having to make cuts. The Ministers for Social Security, Health,

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[9] Cairncross, A. Managing. p.199.
[10] Wilson, H. The Labour Government 1964-1970: A Personal Record. (London: Weidnefield and Nicolson, 1971), p.484; PRO CAB128/43 'Conclusions of a Meeting', 4/1/68; ibid 'Conclusions of a Meeting', 15/1/68.
[11] Dunne, A. 'The Pound in Your Pocket'. p.136-7.
[12] Wilson, H. The Labour Government. p.484.

Defence and Education all raised objections to the cuts to their respective departments.[13] However Wilson acted as an important counterweight to these protestations and the Chancellor's measures were eventually accepted and announced in Parliament on 16 January. Nevertheless, it is obvious that if the Treasury and the Chancellor had been quicker off the mark it would have been possible to hold these ministerial discussions in December and to implement them in January. Instead, the Budget, which would herald the initiation, was shelved until 19 March. From mid-January, the preparations for the Budget were to become the prime occupation of the Chancellor and his Treasury team and by Wednesday 13 March, they were 'in nearly final shape'.[14] However from this date forward, the proposals were relegated to the back burner, because an exchange crisis of monumental proportions erupted, which threatened to undermine the notion that £1=$2.40. Whilst the crisis primarily centred on the relationship between gold and the dollar the currency speculation that it provoked was extremely damaging to sterling.

The March Gold Crisis

Jon Davis has described the gold rush of March 1968 as 'the gravest economic crisis to affect Britain for twenty years'.[15] He asserts is that its significance was greater than that of the previous year's devaluation or for that matter any sterling debacle since the 1949 devaluation. He does however slightly overstate the case. The gold rush was *potentially* the most severe sterling crisis of the post-war era. Although the new $2.40 rate was maintained, the consequences of failure would have been horrific. Whilst the gold crisis is usually viewed in terms of its threat to the Bretton Woods accord and as paving the way for the forced floatation of the dollar,[16] its impact on sterling was grave to say the least. As Roy Jenkins, the incumbent Chancellor remarked 'As was invariably the case in the 1960s, whatever currency

[13] PRO CAB128/43 'Conclusions of a Meeting', 4/1/68.
[14] Jenkins, R. A Life at the Centre. p.227.
[15] Davis, J. 'Staring over the Precipice and Into the Abyss': An Anatomy and an Analysis of 'Operation Brutus' November 1967-July 1968. (University of London: unpublished MA thesis, 1999), p.4.

the gale was directed against the side-winds were devastating for sterling'[17] and this was especially true of the gold crisis.

Its importance for Britain was threefold. Firstly, its 'side-winds' virtually wiped out Britain's foreign reserves, prompting the possibility of a second devaluation four months after the previous one. Second, in response to the prospect of a further devaluation the British government seriously considered suspending the convertibility of sterling from the 18 March 1968 onwards.[18] Finally, even after the US government loaned London a significant sum of money to avert a shift in parity Harold Wilson's government authorised for the first time, full-scale sterling contingency planning.[19] In short, it was from this debacle that the seeds of Brutus were sown.

The origins of the gold crisis can perhaps be traced as far back as 1934, when President Roosevelt declared that the United States was prepared to sell gold to other central banks at the price of $35 per ounce, a decision that became the lynch-pin of the post-war Bretton Woods agreement[20]. Whilst this pledge was invaluable in the early post-war years, once Western Europe had recovered from the war and the United States had become embroiled in various Asian conflicts, the pledge came under continual attack. Much of the concern centred on the US financing of the Vietnam War and of the large scale capital exports which led to high and almost continuous balances of payments deficits for the US throughout the 1960s.[21] The worry was that these strains would only serve to weaken the US gold stock and ensure that there was not enough gold to back the dollar in its entirety. Therefore, the problem that beset the dollar was very similar to that that plagued the pound. In the case of sterling, one of

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[16] PRO T267/21 'Treasury Historical Memorandum No. 20: The March Gold Crisis 1968', undated.
[17] Jenkins, R. A Life at the Centre, p.234.
[18] PRO PREM 13/2051 Note by the Treasury 'Contingency Planning', undated but probably authored between 14 and 17 March 1968.
[19] Of course, this does not mean that this was the first time that the Treasury engaged in contingency planning under the Wilson government. Merely that it was the first time that it was done with the blessing of the Prime Minister.
[20] PRO T267/21 'Treasury Historical Memorandum No. 20: The March Gold Crisis 1968', undated.

the difficulties was that Britain's dollar holdings were insufficient to meet the requirements of overseas sterling balances. For the US, the problem was its dwindling stocks of bullion and the fact that it was widely believed that the dollar should be devalued in relation to gold.

In order to stabilise the dollar-gold parity the gold pool arrangement was instituted in 1961. Under this agreement, the Bank of England acted as controller of an international reserve stock of gold fed by the central banks of the US, France, Belgium, Germany, Italy, Britain, Switzerland and the Netherlands.[22] The function of this reserve fund was to stabilise the price of gold in the London market. However, by 1966 the ability of the gold pool mechanism to steady the price of gold receded.[23] Two problems thwarted its management. The first was speculation on the part of private investors. The second was an increasing demand for gold for commercial and industrial purposes.[24] By July 1966 demand for gold increased rapidly, just when new supplies were drying up.[25] For the first time since 1952, the USSR did not find it necessary to sell gold in the world market. This coincided with the fact that Western production also stopped rising, and for the first time since 1945, all newly mined gold went into private hands. Thus the Western central banks were not able to add to their official gold reserves, and in fact had to feed the gold pool with $95m in gold to keep the prices down.[26] The following year was worse than the previous. The price in the London market came dangerously near the upper limit of $35.20 per ounce and by the middle of 1967 rarely dropped below that figure. During 1967 as a whole, the countries operating the gold pool had to feed the market with $2,000m in gold, to keep the price down.[27] Between November and December 1967 alone, the US Federal reserve sold $1,600m from its gold reserves in a bid to

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[21] Roy, R. 'The Battle for Bretton Woods: America, Britain and the International Financial Crisis of October 1967-March 1968', Cold War History. Vol.2, No.2, 2002, p.51.
[22] PRO PREM 11/4203 Maudling to Hume 'Gold', 20/11/61. Note that the Bank of England files on the development of the gold pool (Bank G1/280-284) are still classified.
[23] PRO T267/21 'THM: March Gold Crisis 1968', undated; Bank OV31/125 Rickett to the Governors, 29/9/66.
[24] Bank OV53/56 Kessler 'The Gold Problem', 4/3/68.
[25] PRO T312/1735 Paper by Bank of England 'The Gold Pool', 10/8/67.
[26] Shonfield, A. International Relations of the Western World 1959-1971, (London: OUP, 1976), p.272.
[27] PRO T267/21 'T.H.M: March Gold Crisis 1968', undated.

maintain the gold-dollar parity.[28] Whilst the rush into gold slowed during January and much of February 1968 pressure resumed by March. Much of this was precipitated by the release of the US balance of payments figures for 1967, which revealed a glaring deficit of $3.6 billion.[29] This coupled with the fact that yet more troops were to be sent to Vietnam, triggered off a new bout of speculation in the gold market.

For Britain, the knock on effect of this crisis was terrible. The sterling balance holders, stung by the effects of the devaluation, had already concluded that diversification was a sensible and desirable policy. The gold crisis added further fuel to the fire, because holders had come to believe that a revaluation of the metal was inevitable and that gold would provide them with a speculative gain. Therefore, they sought to convert their holdings into dollars in order to buy gold. On Friday 23 February 1968, sterling took a sudden plunge. The rate fell by half a cent bringing it dangerously close to the $2.38 level that would trigger an automatic devaluation.[30] This occurred in spite of operations by the Bank of England to support the pound, which involved the use of over £100m of the foreign reserves. A week later the 'Friday pressure' repeated itself and on Friday the 8 March, a further £250m was lost from the reserves.[31] The US unfortunately added to the crisis atmosphere when it was announced that William McChesney Martin, the Chairman of the Federal Reserve, would attend at the central bank governor's meeting in Basle on Sunday 10 March.[32] This was a very unusual happening. However, nothing of significance came from it. During the first two weeks of March, there had been devastating losses for the Bank of England. Calculations made by the Treasury estimated the total spot loss on regular transactions to be in the region of £500m.[33] By far the greatest loss occurred on 14 March, when over £100m was converted into dollars. Apart from the fact that speculators anticipated a rise in the price of gold, the Treasury believed that some

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[28] Bank OV53/56 Kessler 'The Gold Problem', 4/3/68.
[29] PRO T267/21 'T.H.M: March Gold Crisis 1968', undated.
[30] Jenkins, R. A Life at the Centre, p.234.
[31] Cairncross, A. Managing the British Economy in the 1960s: A Treasury Perspective, (London: Macmillan, 1996), p.208.
[32] ibid

of the losses were directly attributable to the impending budget speech and the fear of 'wide exchange controls'.[34]

On paper, the reserves stood at £935m on 14 March.[35] This comprised £367m in gold, £112m in foreign exchange, a £167m Federal Reserve swap, an £8m Bank of France credit and the remaining £281m of the IMF's devaluation support package. However, because of the immediate requirement to cover £84m of market forwards, £34m of central bank orders and to contribute £202m in gold to the gold pool, the real reserves totalled no more than £615m. Although, even this figure is optimistic as the Bank calculated that the EEA would have to honour a further £982m in market forwards at the end of March. In strict accounting terms, the reserves were -£367m, although, as these debts had not matured the real figure was only a technicality. The Bank could still have used the remaining assets and it may have been possible to defer payment on the outstanding debts. Yet, in spite of all this the reserves were at a dangerously low level. When one recognises that the total resources available on the eve of the 1967 devaluation was £190m *higher* than those available by 14 March 1968, that fact becomes glaringly clear.[36] It was quite possible that if the pressure did not subside, all of the remaining foreign exchange would be exhausted by Monday 18 March, the day before the budget.

Contingency Planning

However, it seems that the Treasury was unprepared for the crisis, with no contingency plans on the shelf. This apparent lapse was serious and it worried Thomas Balogh, the Prime Minister's Economic Advisor.[37] In January 1968, he had made inquires and had discovered

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[33] PRO T318/189 Copeman to Goldman 'Reasons for Outflow from Reserves', 27/3/68.
[34] ibid
[35] PRO T312/189 'Reserve Position', 14/3/68.
[36] PRO T 318/183 'The Length of our Tether as at 16th November 1967'. Of course, after Callaghan's statement in the House, the reserves fell to half the level that they were at in March 1968.
[37] PRO PREM 13/2036 Balogh to Wilson 'Exchange Control', 10/1/68.

that 'little in the way of contingency planning has been initiated'.[38] He informed the Prime Minister that he regarded it as essential that a committee of economic advisors should be established immediately so plans might be prepared. Consequently, Wilson sent a memo to the Treasury asking them to update him on their current state of readiness.[39] The reply was that 'much thought is indeed being given to these questions' and a short paper on Treasury contingency planning, relating to the blocking of the sterling balances, was enclosed for Wilson's inspection.[40] Whilst this seemed to satisfy the Prime Minister, there is little evidence within the Treasury files that suggests any planning was occurring. Thus, it is tempting to conclude that the memo was designed to stop Wilson and the irksome Balogh intruding into Treasury affairs any further. In fact, the paper on blocking sent to Wilson was virtually identical to an undeveloped piece produced by the Treasury in 1965.[41] Another possibility is that the Treasury did in fact engage in systematic planning but that the documents pertaining to it were not preserved. Although given that when Sir Douglas Allen took over as Permanent Secretary in the aftermath of the gold crisis he set up a specialised planning division, it would suggest that he was unhappy with the arrangements that existed before.[42] As would the fact that in the aftermath of the crisis, Treasury officials working in the new division spent over four months honing the proposals devised during the crisis.[43]

In a recent interview Michael Posner, who took over from Robert Neild as Economic Advisor to the Treasury at the beginning of 1968, accepted that the Treasury could be criticised for its lack of planning.[44] However, he suggested that there were two reasons for the omission. The first is that in the aftermath of devaluation it was believed, even in spite of the J-curve effect,

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[38] ibid
[39] PRO PREM 13/2036 Dawe to Baldwin, 11/1/68.
[40] ibid Dyer to Dawe, 19/1/68.
[41] See PRO PREM 13/2036 'Blocking the Sterling Balances', 19/1/68; PRO T312/1398 'Blocking', 12/4/65.
[42] Interview with Lord Croham; PRO T199/1239 'Treasury Organisational Chart: May 1968'.
[43] PRO T295/604 Rawlinson 'Brutus 8', 16/5/68; PRO T295/495 Hughes to Allen, 'Brutus: Implications of International Trade', 17/6/68; PRO T295/510 Rawlinson to Figgures 'Cranmer: Telling Whitehall', 8/7/68 and PRO T230/1052 Posner to Cairncross 'The Future of Sterling', 19/3/68.
[44] Interview with Michael Posner.

that the balance of payments would improve much more rapidly than it actually did.[45] In other words, the Treasury was still optimistic about the future prospects of sterling and operated on the assumption that the currency's recovery would not be undermined. Secondly, officials had become preoccupied with the preparations for the budget and this meant that contingency planning was to be relegated to the peripheries.

Therefore, it was not until 14 March, during the very midst of the gold crisis, that any preparations were made. The committee of economic advisors that Balogh had long argued for was finally brought into existence. Its Treasury contingent was made up of William Armstrong (Permanent Secretary), Samuel Goldman (Second Secretary: Overseas), Alec Cairncross (Head of the Economic Section), Nicky Kaldor (Special Advisor) and Anthony Rawlinson (Assistant Secretary: Exchange Control).[46] Maurice Parsons (Deputy Governor) and Kit McMahon (advisor to the governors) represented the Bank. This was however a very ad hoc gathering and when the Treasury continued the planning exercise in the aftermath of the gold crisis, membership altered greatly.

During the discussions of this hastily convened group, the only course of action that was *not* advocated by anyone, was a second fixed rate devaluation. In fact, the option was not even discussed and it would seem that there was a tacit understanding that it was to be avoided.[47] In a recent interview with Kit McMahon, it emerged that there were three reasons for this.[48] Firstly, because the reserves were at such a low level, if the sterling exchange rate were further reduced, it would have been very unlikely that any new rate could actually be maintained.[49] Secondly, the previous devaluation had taken place only four months prior. To shift the rate again so soon would have been little different from moving to a floating rate. Thirdly, from the

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[45] ibid
[46] CAB 130/497 'MISC205 (68)- International Monetary Situation', 17/3/68 and interviews with, Michael Posner, Kit McMahon and Samuel Goldman.
[47] PRO T295/489 Goldman to Dowler 'Contingency Planning', 15/3/68; ibid 'Operation Brutus (edition 3)', 16/3/68.
[48] Interview with Kit McMahon.

Treasury's point of view, the 1967 devaluation had been a great blow to their morale and a second devaluation would have been doubly so.[50]

The group agreed that the preferred course of action was to attempt to extract further credits from the US and the Europeans so that the rate could be supported.[51] It was clear that if additional support was not provided the results would be disastrous. Whilst the Bank was initially against further borrowing, because £2011m in aid had already been drawn upon, without it the collapse of the currency would be inevitable and it would be the end for sterling as a major reserve currency.[52] It would ensure that the sterling area holders would dump their holdings en-mass and the rate could not be held.[53]

However, when the group turned its attention to the options that should be pursued if the US and the Europeans could not be counted upon to provide further assistance, it became clear that the Bank and the Treasury had gone through 'much the same analysis' on the possible courses 'but ended up rather differently.'[54] Whilst both institutions were able to agree internally on course they preferred, agreement between Bank and Treasury could not be reached. Treasury officials advocated devising a method that would *remove* the capacity of sterling holders to convert their balances into dollars. Therefore, they had come to favour the wholesale blocking of the sterling balances. This would prevent the drain from the reserves and in their view, do the least damage to the international monetary system. The net sterling balances stood at £3,893m and it was believed possible that up to £2,000m could be lost if the balances were not blocked.[55] By blocking, it might have been possible to conserve the

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[49] This is supported by PRO T312/189 'Reserve Position', 14/3/68.
[50] Interview with Kit McMahon; PRO T295/489 Goldman to Principle Private Secretary 'Contingency Planning' 15/3/68.
[51] Interview with Jeremy Morse; PRO T318/189 'Credits utilised and remaining facilities-end-March 1968'; Bank OV53/38 Morse to Governors, 14/3/68.
[52] Bank G3/287 O'Brien to Armstrong, 21/3/68. The governor recognised that in accepting credit the Bank would be putting itself into a situation where 'it might not be able to meet its repayment obligations on the due date'.
[53] PRO T295/489 'Guarantees', 15/3/68.
[54] Cairncross, *Managing*. p.285.
[55] PRO PREM 13/2051 'Blocking', 17/3/68.

remainder of the reserves and to maintain parity with the dollar. To the majority of the Treasury team, this seemed like an acceptable price to pay if it reduced the chance that the whole fixed rate system would collapse.[56]

However, the Bank was utterly opposed to the suggestion.[57] For unlike the Treasury, it had a number of client groups that would be directly affected by the policy. Firstly, it would be the accounts of *its* customers that would be blocked.[58] In a recent interview, Kit McMahon stated that Maurice Parsons, the deputy governor viewed blocking as a very delicate moral issue and he felt that the Bank could not be seen to be defaulting on its client's balances.[59] Secondly, blocking would undermine the position of the Bank's second client group, the city of London.[60] It would thwart the inflow of foreign capital to London, and undermine the sustainability of her investment banks.[61] There was also the possibility that it would affect the operation of the Euro-Dollar market, which was operated by Banks, who accepted short-term deposits in dollars and then re-lent them for short periods. The British Euro-Dollar market was valued at around $17.3 billion, during the first quarter of 1968.[62] It was possible that the blocking of the sterling balances would arouse suspicion that foreign currency balances would also be blocked, culminating in the withdrawal of the Euro-Dollar balances from the UK.[63] This would have been problematic for the British banks that operated the market, as they tended to lend out funds for longer periods than they had access to them, in the belief that new deposits would cover the shortfall. If new deposits did not materialise, British banks may have had to default in order to prevent their demise. Furthermore, in blocking, the Bank of England

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[56] PRO T295/489 Goldman to Dowler 'Contingency Planning', 15/3/68.
[57] Bank OV53/38 Morse to Governors, 14/3/68
[58] Interview with Jeremy Morse
[59] Interview with Kit McMahon
[60] PRO PREM 13/2051 Balogh to Wilson 'For the Record', 16/3/68.
[61] PRO T295/501 'The Euro-Dollar Market', 10/6/68
[62] ibid
[63] PRO T295/606 Rawlinson to Allen, 'The Euro-Dollar Market', 17/6/68.

would still have to honour its commitments to the sterling balance holders in the future and its officials wondered where the Treasury planned to conjure up the foreign exchange from.[64]

Instead, the Bank argued that the solution was to float the pound.[65] By moving to a flexible exchange rate, the Bank argued that neither it nor the Treasury would have to worry about the level of the reserves any longer. The Bank would no longer face the prospect of having to run roughshod over the interests of its domestic and international clients and the Treasury would not have to worry about how future drawings on the sterling balances would be funded. It would be the rate and not the reserves that would take the strain. Of course, floating would still have done a considerable amount of damage to the stability of the City of London.[66] However, it is arguable that from the point of view of the Bank blocking would have been far more hazardous to the City, because financial activity would all but cease.[67] Under floating rates, the City of London would continue to operate albeit at a greatly reduced level.[68] However, the Treasury did not agree with the Bank. Goldman in particular argued that by floating, there would be an 'immediate sharp fall in the rate due to diversification- possibly to $1.50'.[69] This would make it very difficult to manage the domestic economy, as there would be a severe inflationary effect due to the increased price of imports. Furthermore, it was obvious that the movement to a flexible rate would have a profound effect on the world monetary system. It was highly probable that pressure on the dollar would intensify, that it too would collapse, and that this would destroy Bretton Woods. It was obvious to Goldman that there was 'no doubt that we [the Treasury] shall get the blame'.[70] It was also evident to the Treasury that the UK would be in breach of its IMF articles, that it would be debarred from drawing on its IMF

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[64] PRO PREM 13/2051 'Blocking', 17/3/68. For the proposed solution see PRO T295/580 Rawlinson 'Brutus: Mobilising Private Overseas Portfolios', 13/6/68.
[65] Interview with Kit McMahon; Bank OV53/38 Morse to the Governors, 14/3/68; ibid. 'Note for the Record', 18/3/68
[66] PRO T295/489, 'Contingency Planning',15/3/68.
[67] Bank OV53/38 Morse to Governors, 14/3/68. Morse states that 'it [floating] would be unlikely to leave the same long-run scars as a blocking operation'.
[68] Ibid; Interview with Kit McMahon.
[69] PRO CAB130/497 'MISC 205 (68), International Monetary Situation', 17/3/68 andT295/489 Goldman to Dowler 'Contingency Planning' 15/3/68;
[70] ibid

standby credits, and would therefore probably have to consider blocking anyway.[71] To the vast majority of Treasury officials, floating was simply out of the question.

Although the Bank was unanimously opposed to blocking, it appears that it did not have access to enough strategic resources to make the Treasury bend to its will. Recognising that it had in effect been overruled, it argued that if the Treasury were to have their way then only the official sterling area balances should be blocked and that a conference should be quickly convened 'to negotiate the partial liquidation of the sterling area'.[72] It is arguable that the Bank pushed for this because it believed that it would do less damage to its overseas clients than a more draconian regime. However, the Treasury was not keen to compromise, because it believed that a partial block would not be effective and that the reserves would continue to diminish.[73] Therefore, the Treasury pushed ahead. Three schemes for blocking were devised and these were named Brutus One, Two, and Three by Anthony Rawlinson,[74] in honour of the *Ides of March*.[75] The outline that follows may seem somewhat scant but this is symptomatic of the fact that the initial Brutus schemes were drafted at breakneck speed and were thin on detail.

Brutus

The first proposal, Brutus I, cannot be properly described as a full blocking scheme in sense that assets are frozen or balances defaulted on. Instead, it must be seen simply as the return to sterling balance inconvertibility. Under it, the sterling balances of overseas holders would have been distributed into different types of holding accounts.[76] The first type of account, the Number 1 account, would have contained all the existing sterling assets of persons resident

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[71] ibid and T295/502 'Cranmer: Relations with the IMF and OECD', 20/6/68.
[72] T295/489 Goldman to Principal Private Secretary 'Contingency Planning', 15/3/68.
[73] ibid
[74] Interview with Anthony Glover
[75] Cairncross, Managing. p.209.
[76] PRO T295/489 'Operation Brutus', 14/3/68.

outside the United Kingdom. These accounts would only be usable to make payment *inside* the UK for British products and services either for export or consumption within Britain. It would have been quite impossible to present Number 1 account sterling to the Bank of England for conversion into a foreign currency. The second type of account would have been referred to as the Number 2 account and all future accruals of sterling, which were earned after the suspension of convertibility, would be deposited here. These accounts would however have been convertible. This would have stopped the diversification of the existing sterling balances but would have allowed the conversion of newly acquired balances. After all, if future sterling transactions were not convertible those who exported *to* the UK but did not re-import goods*from* the UK would have no use for sterling and would not accept it as payment. Instead they would demand dollars and add to the drain on the foreign reserves. Of course those who acquired Number 2 account sterling under the new regime, would still be able to convert their holdings and diminish the reserves but the fact that they would have had to go through the process of conversion might have slowed the practice down.

However, had Brutus I ever been implemented it would have provided an incomplete and short lived shield for the currency, a fact well known by Treasury planners.[77] The proposal did not involve the abolition of the Sterling Area and it could only block the transactions of overseas sterling holders. British investors would still have been free to move their assets out into the sterling area, thus exacerbating the drain to the reserves. Furthermore, it would have been likely that a market in cheap sterling would have developed. Those individuals who held Number 1 account sterling that were keen to dispose of their assets would be able to sell them on at a discount to foreign importers who wished to buy goods from the UK at reduced prices.

It is also likely that the UK would have found it difficult to stop the drain on the foreign reserves. It would have been unlikely that overseas sterling holders would have done nothing with their inconvertible sterling and far more likely that they 'would try to turn it into [British]

goods as quickly as they could....they would do this until their balances were exhausted'.[78] As a result, Britain would have gained no new foreign currency for its exports but would have had to pay for its imports with convertible sterling, most of which would be converted, leading to a reduction in the reserves. Therefore rather than protecting the reserves and the parity, Brutus I would have merely prolonged the inevitable and slowed the exodus. It would, however, have given officials the time to work out a more encompassing scheme that could have been built around the move to inconvertibility.

For this reason contingency planning continued and a second variation of the scheme was devised.[79] Under this version, only Number 1 accounts would have existed and they would have been completely blocked. In other words, instead of merely being able to use Number 1 account sterling to pay for UK goods, the funds held in these accounts would have been completely frozen and inaccessible. Still, if implemented this scheme would have faired little better than the previous one. Whilst the complete freeze would have removed both the problem of the cheap sterling market and would ensure that exporters would have had to pay for British goods in foreign exchange, there would have been no incentive for foreign exporters to deliver goods to Britain. After all, if they were to be paid in frozen Number 1 account sterling, they would have in effect been robbed. Therefore, Britain would either have to cancel the majority of imports or pay for them in scarce dollars. It may well have transpired after a time that the UK earned enough foreign exchange from exports to cover the cost of imports but nothing would be left to pay for the rundown of the sterling balances and these would have to have been left frozen indefinitely. Furthermore, under this variation of the plan, sterling holdings in the hands of British citizens would still have been freely convertible with potentially disastrous consequences. This coupled with the fact that the process of freezing the accounts of foreign holders would have been an administrative nightmare that could have potentially taken several weeks to enact by the banks, made the scheme look rather slapdash.

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[77] ibid
[78] PRO T295/489 E.W. Hughes 'Trade effects of the Brutus plans', 19/3/68

Planning therefore continued and a third variation of the proposal was developed.[80] The problem of UK residents transferring their funds to the OSA was considered in some detail and it was decided that the only way to stop this would be to abolish the sterling area and re-designate the scheduled territories as Britain and the Republic of Ireland solely. However, talk of dismantling the sterling area was not a new phenomenon that occurred simply because of the drastic situation during that Bank Holiday weekend. It had been considered as a standalone operation in its own right from as early as 1965 under the code name Brandon and in the context of Brutus it was merely *cut and pasted* in.[81]

Under this third scheme two accounts returned. The Number 1 accounts would have been blocked completely as would have been the case in Brutus II. However, funds in these accounts would have been usable to purchase goods that had already been dispatched by UK exporters. This was because it was felt that if concessions were not made here, once the goods arrived at their foreign destinations, they would not be paid for at all. Freezing the Number 1 accounts in this manner would stop holders running down their balances by purchasing*further* UK exports and would also help to stop a cheap sterling market developing. However Number 1 accounts would have been usable for the purchase of UK securities, the profits of which would be transferable to Number 2 accounts.

The Number 2 accounts would have been convertible and would have received all post-zero payments. However, it would not have been possible for balance holders to transfer their funds from Number 1 to Number 2 accounts. Although the blocking of these accounts was considered for a short time, it was thought necessary that they remained convertible; for if they were not, no one would contemplate accepting sterling as payment for goods.

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[79] PRO T295/489 'Operation Brutus', 14/3/68.
[80] ibid
[81] For an overview of Brandon see PRO T295/514.

Figure 4.1 Brutus 1, 2 and 3

Brutus 1

Number 1 account

- All pre-existing OSA and NSA balances placed here
- Cannot be converted into foreign exchange
- Can be used to make payments to the UK for trade purposes
- Funds can be transferred from here to other number 1 accounts but not to number 2 accounts.

Number 2 account

- All future accruals of sterling to be placed here
- Fully convertible

Brutus 2

Number 1 account

- Inconvertible and frozen- this means that funds held in these accounts cannot be for any purpose
- All pre-existing and future accruals of sterling would be placed here as no number 2 accounts operate under this proposal

Brutus 3

Extension of exchange control to OSA under operation **Brandon**. Note that this alteration applies to all subsequent Brutus proposals and is designed to stop capital outflow.

Number 1 account:

- Inconvertible and frozen.
- Usable only to (a) pay for goods that have been ordered by foreign importers pre-zero and (b) to buy British securities, the profits from which will be transferred to the number 2 account.

Number 2 account:

- Receives all post-zero payments.
- Completely convertible.
- However, funds cannot be transferred from No.1 to No.2 accounts.

This was about as far as the Treasury advisors took the initial exercise. Although they had considered some of the potential pitfalls involved in the implementation of Brutus 1 and 2, they did not have time, at this stage, to develop a full critique of the third plan. Although the planning was far from complete, the constraints of time demanded an agreed line from both the Bank and the Treasury. It was clear that of the non-Bank representatives, Cairncross 'opted

very reluctantly for blocking'.[82] Nevertheless, he preferred wait and to see how the markets operated on the following Monday and Tuesday before a decision was taken. Thomas Balogh seemed to be in favour as did Anthony Rawlinson, who thought that Brutus I could be called off after a short time.[83] However, it was decided that

> 'If forced to choose between a floating rate for sterling and the blocking of the sterling balances, on balance the second should be favoured. Some of us are doubtful about this conclusion and consider the main lesson of the paper is that it is vital at all costs to avoid either of these alternatives'.[84]

Thus, it was reluctantly agreed that Ministers should be advised that if no further funding was forthcoming, Brutus should be implemented. However, because of the obvious flaws with the plans the Treasury were 'backing Brutus I, the only version sufficiently advanced to be feasible'.[85] The hope was that if this terrible step had to be taken, planning could continue post-Brutus and the blocking effect tightened. Accordingly the official advice was that if Brutus had to be implemented it should be 'done so on Sunday night [17th March] no later that 9pm or in the course of the budget on Tuesday...as we would have 2 days experience of the markets in order to determine whether Brutus was necessary'.[86]

Ministerial Involvement

It was in the atmosphere of impending crisis that on 15 March the Chancellor, who had been briefed by Goldman on the outcome of the discussions, went the House of Commons to warn

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[82] Cairncross, A. Wilson Years. p.287.
[83] Interview with Sir Kit McMahon
[84] PRO T295/489 Goldman to Principle Private Secretary 'Contingency Planning' 15/3/68
[85] Cairncross, A. Managing. p.209.
[86] PRO T295/489 Goldman to Principle Private Secretary 'Contingency Planning' 15/3/68

the Prime Minister of how close to the edge sterling really was.[87] He also informed Wilson that he had heard that the US planned to hold an international conference in Washington over the weekend, at which they hoped to deal with the problem of gold. The meeting between Chancellor and Prime Minister took place at 6.00pm. By half past, Michael Halls the Prime Minister's principal private secretary formed an emergency office and alerted the appropriate Treasury officials.[88] At 9.00pm, Wilson met with his Chancellor again. Although no new information was available on the plight of sterling or the impending discussions in Washington both men were both optimistic and at the same time anxious. They were optimistic because they hoped that the UK could use the conference as a means to extract the desperately needed funding package from the Americans. Yet they were anxious because it was possible that the US might use the conference to announce far reaching changes to the nature of the relationship between the dollar and gold, and that such alterations would negatively impact on the already perilous sterling.[89]

To Wilson and Jenkins, it seemed that the United States had four options, each with their own potential reverberations on sterling.[90] The first was to suspend the convertibility of gold into dollars.[91] In the short-term, this option would have been favourable for Britain. It would have stopped the run on the pound that was principally caused by the flight into gold. After all, if dollars could no longer be converted into gold, speculators would see no incentive in cashing in their sterling holdings to purchase dollars. However in the medium to long term, the suspension of dollar-gold convertibility would be damaging to the Bretton Woods accord and would serve to undermine the regime of fixed currency rates which was backed by

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[87] Jenkins, R. A Life at the Centre. p.235; Jenkins, *Life*, p.235. Crossman states that the 'Bank of England utterly betrayed the government by leaving [it] in the dark to the very last minute and not foreseeing and warning them of the catastrophe.' MRC MSS.154/8/120, 21/3/68. However, Kit McMahon and Jeremy Morse both denied this in recent interviews. Their version of events is supported by the fact that daily EEA reports were supplied to the Treasury between February and March 1968. See PRO T318/184 'Daily Reports to the Chancellor on Sterling and the Foreign Exchange Market', 6/2/68-17/5/68.

[88] Wilson, H. The Labour Government. p.507.

[89] ibid

[90] See PRO PREM 13/2051 'Note For The Record', 15/3/68

[91] PRO T267/21 'Treasury Historical Memorandum No. 20: The March Gold Crisis 1968', undated.

gold.[92] It was for this reason that officials within both the Bank and the Treasury thought that this option would be unpalatable to the US.

The second alternative would be to give in to the speculators and re-value gold.[93] For Britain, this would be a mixed blessing. It would greatly delight the speculators, who had sought this end and thus the flight into gold would cease. It would also lead to the upward valuation of Britain's gold holdings, which could only be welcomed at a time when the reserves were almost exhausted and it was for this reason that the Bank favoured it.[94] Although Cairncross, the head of the economic section, also preferred this option,[95] other problems would emerge if it were pursued. The IMF had loaned Britain sizeable sums of money to bolster her foreign reserves, most of which had been used, and rather unfortunately the agreement pressed for repayment in dollars at gold value. Thus if gold were re-valued, the UK would find itself owing considerably more dollars to the IMF and this would greatly offset the rise in value of Britain's own gold holdings.[96]

However, no one within the Treasury or the Bank believed that revaluation would be the chosen policy stance of the United States. It would in effect be the devaluation of the dollar and would dent US prestige. Furthermore, every private buyer of gold in the market would reap an unearned reward and one that would undermine the authority of every central bank that took part in the gold pool. Gold producing states like South Africa and the USSR, which were not on friendly terms with the US, would also benefit from a revaluation.[97] Moreover, increasing the gold price would most likely be ill received by those in closest association with the US, who had helpfully agreed to hold dollars and not convert them into gold. They would find that their commitment to the US had left them much less well off in terms of the

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[92] ibid
[93] PRO CAB128/46 'CC(68) 21st Conclusions', 15/3/68.
[94] PRO T267/21 'Treasury Historical Memorandum No. 20: The March Gold Crisis 1968', undated.
[95] Interview with Sir Donald MacDougall
[96] PRO T267/21 'Treasury Historical Memorandum No. 20: The March Gold Crisis 1968', undated.
[97] Shonfield, A. International Economic Relations of the Western World. p.290-92.

purchasing power of their reserves when compared to countries with heavy gold reserves such as France.[98]

The third possibility was that the US would implement the Carli plan,[99] which would create a two-tier gold market.[100] The first tier would be operated by central banks that would trade gold with each other at the official price within a closed market and would not sell gold to private traders. The second tier would be the private market of gold buyers and sellers and this market would be allowed to reach its own level. The hope was that this second tier would provide a useful safety valve that would take the pressure off both the pound and the dollar as privately held gold would be allowed to increase in value without any impact on the currency markets. Treasury officials were convinced that this would be the policy proposal that the Americans advanced. However, the scheme would only work if European central bankers agreed to accumulate further large amounts of dollars. The suspicion was that they would not be prepared to go very far in this direction. It would have been likely that this view would have been shared by speculators who would have believed that the scheme would not endure and thus it was possible that speculation against both the pound and the dollar would resume after a time. Indeed, Wilson feared that the two tiered system 'could not survive the strains for long, perhaps not even for more than a day or so'.[101]

Whilst each of these three options would be potentially damaging to Britain in the short-term they would reduce the pressure on sterling and hopefully avert the impending crisis for a time. The fourth and most terrifying possibility was that the US might do nothing at all. This would signal the end of $2.40=£1. Speculation would continue unabated and the pound would be pushed over the edge. Thus, the greatest fear, among both officials and politicians

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[98] ibid
[99] As proposed by Guido Carli, Governor of the Bank of Italy.
[100] PRO T267/21 'Treasury Historical Memorandum No. 20: The March Gold Crisis 1968', undated.
[101] Wilson, H. The Labour Government, p.511.

in London, was that nothing new would emerge from Washington.[102] The hope in Whitehall was that, because the US gold reserves were reaching the $10billion mark, action would have to be taken. This was because this figure was widely regarded in the US as dangerously low; any lower was thought to be inconsistent with national security.[103]

In any case, at 10.40pm Henry Fowler, the US Treasury Secretary, telephoned Jenkins. The line was less than clear and Fowler seemed in some state of distress. All that Jenkins could understand was that Fowler had asked if the London gold market could be prevented from opening the following day.[104] It emerged that the US planned to use the Washington conference as a means to push through the two-tier gold market proposal. If the gold market stayed open after the conference had been officially announced, it was likely that speculation would intensify, as fund managers might believe that the conference would be used to announce an upward valuation of gold. For Jenkins, this was positive news for two reasons. Firstly, it signalled that the US was not prepared to let the drain continue but more importantly it presented the administration with a 'smokescreen' under which the foreign exchange markets could also be shut down.[105]

Indeed, one method of slowing a currency's demise is simply to close the foreign exchange markets in which it is traded, as this stops the possibility of spot market speculation. However, it sends signals to the international market that the currency is weak. Thus, if and when the markets are re-opened speculation will resume with a vengeance. However, if it can be made to look as though the markets have been closed because of the request of a third party then speculators will not suspect that there is anything amiss. The pressure on the home currency will be alleviated for the duration of the closure and valuable planning and

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[102] Interview with Michael Posner
[103] Shonfield, A. International Economic Relations of the Western World. p.290-92.
[104] Jenkins, R. A Life at the Centre. p.235.
[105] ibid, p.236.

bargaining time can be gained before the markets are reopened.[106] Jenkins seized this opportunity.[107]

Wilson readily agreed to the plan, which was 'an absolute sort of lifebelt to a drowning man'.[108] However, after consultation with officials it became clear that in order to close both the gold pool and the foreign exchange markets a bank holiday would be necessary. This in turn required an Order of the Council and a Privy Council that night in the presence of the Queen.[109] Thus the Prime Minister and the Chancellor were joined by Peter Shore, the Secretary of State for the DEA, and they made their way to Buckingham Palace in order to present the proposal.

George Brown and the Reformation of the Core Executive

However, a great political storm blew up. George Brown the Deputy Leader and unquestionably number two in the Cabinet had not been consulted and thus accused Wilson of

> 'introducing a "presidential" system into the running of the government that is wholly alien to the British constitutional system...but was so operating it that decisions were being taken over the heads and without the knowledge of Ministers, and far too often outsiders in his entourage seemed to be almost the only effective "Cabinet"'.[110]

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[106] PRO T230/997 'Parliamentary Debates', 15/3/68.
[107] PRO CAB128/46 'CC(68) 21st Conclusions', 15/3/68.
[108] Jenkins made this comment to Jon Davis, when he spoke to him about the March gold crisis. See Davis, J. 'Staring over the Precipice and Into the Abyss': An Anatomy and an Analysis of 'Operation Brutus' November 1967-July 1968. (University of London: unpublished MA thesis, 1999), p.14.
[109] Wilson, H. The Labour Government, p.509.
[110] Brown, G. In My Way. (Middlesex: Penguin, 1971), p.161.

However it is more likely that Brown was not concerned about decisions being taken without the approval of the whole Cabinet, but the fact that he felt he was no longer a part of Wilson's inner clique and that his influence was waning. Wilson had unquestionably attempted to contact Brown; the issue was how much effort he had put into it.[111] Wilson claimed that he had sanctioned several attempts to find Brown but that he seemed unobtainable, whilst Brown claimed that Wilson's attempts to locate him were half-hearted and that Wilson wanted to keep him out of the loop.[112] When the Brown was finally informed of the decision, he called Number 10 and expressed his deep displeasure. After gathering together all the available Cabinet Ministers in the House of Commons he descended onto Downing Street and launched into one of his famous tirades, which eventually resulted in his resignation from government.[113]

Whether or not Brown's exclusion from the decision making process on the night of the 14 March was a calculated move on the part of Wilson is difficult to discern. It is clear that both Wilson and Jenkins were operating under crisis conditions and that the closure of both the gold and foreign exchange markets seemed to be the only viable solution. Especially as it could be presented as a benevolent act on the part of the British government in response to an *American* financial crisis. One can only conclude that the decision taken by Wilson and Jenkins was the correct one but that Wilson's method of running the Cabinet was one that caused a great deal of agitation to its members. As Richard Crossman records in his diary

> 'If I was ever to resign it would be precisely because I can't stand the way Cabinet is run. It's because of Harold's inability to create a firm inner group with whom to work consistently and his determination to keep bilateral relationships with each one of us and arbitrarily to leave us

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[111] Davis, J. 'Staring over the Precipice and Into the Abyss': An Anatomy and an Analysis of 'Operation Brutus' November 1967-July 1968. (University of London: unpublished MA thesis, 1999), p.13-15.
[112] See Wilson, H. The Labour Government. p 509-10; Brown, G. In My Way. p.161-79.

> out of absolutely vital conversations just because we don't happen to be in No.10 or because we're out of favour that afternoon.
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> There was no earthly reason why on Thursday evening [14th March 1968] Harold shouldn't have quietly permitted Burke Trend [Cabinet Secretary] to organise a meeting of all available members of S.E.P or of Cabinet, including the deputy leader'.[114]

It is arguable though that Wilson's 'inability' to form an inner Cabinet was actually a calculated and central part of his leadership style. Bilateralism allowed him to play his ministers off one another and ensure that it was never possible for any of them to become powerful enough to threaten his leadership. In one sense, Brown's departure was a blessing. As Cairncross recalls, 'Fortunately attention was diverted from the gold market by other events: the resignation of George Brown, the appalling [anti-Vietnam war] riot in Grosvenor Square'.[115] However, in another sense it was damaging. It meant that Wilson had to be seen to be more inclusive and democratic in his leadership style. These changes began almost immediately.

The following day Wilson called a Cabinet meeting and everyone attended, except of course George Brown. The Chancellor explained the chronology of the previous night's events in an attempt to justify the lack of consultation. Barbara Castle, Minster of Transport, testified that it was the first occasion in the Wilson administration that such matters had been discussed before the full Cabinet. She felt 'absolutely fascinated, feeling I had been let into political adulthood for the first time'.[116] During the meeting, Anthony Crosland stated that whilst he agreed with the decision, during his three years as a Cabinet Minister the subject of sterling had always been something that the Cabinet were not allowed to discuss collectively. In fact, it

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[113] PRO CAB128/46 'Note of a Meeting at No.10 Downing Street,' 17/3/68.
[114] Crossman, R. The Crossman Diaries. p.410.
[115] Cairncross, A. Managing. p.210.
[116] Castle, B. Diaries. p.402.

was clear that all the important economic decisions took place merely between the Prime Minister and Chancellor. He went on to say that 'the rest of us were merely faced with the results when a crisis came and when the choice of action was invariably limited'.[117] He felt that the Prime Minister should establish an inner group of Ministers that could discuss these issues.

Whilst Wilson was not keen to do this because of the fear of leaks it seems that he conceded the point. Indeed, 'Douglas [Allen, Permanent Secretary at the DEA] explained that after the George Brown episode P.M. will have to summon five Ministers to discuss the situation tomorrow [Sunday].'[118] Wilson himself confirms this version of events 'To forestall criticism from certain of our colleagues, I had formed a small committee of the six ministers directly affected...'[119], although Wilson seems to have his numbers muddled. In any case, this was a concession that the Prime Minister had to make because with Brown gone, there was a chance the government might collapse. Indeed, Tony Benn was extra vigilant in completing his diary entries during this episode because 'if the Labour Government falls, as I now think quite possible, then at any rate I shall have documented the circumstances'.[120] Of course, whilst Wilson's resignation was not beyond the realms of possibility the collapse of the government was unlikely. Irrespective of how the crisis was resolved, the Labour Party would retain its parliamentary majority.

MISC 205

The group that Wilson called together comprised himself; the Chancellor; Secretary of State for Economic Affairs; the President of the Board of Trade and George Brown's successor at the Foreign Office, Michael Stewart. It became *ad hoc* Cabinet committee MISC 205 which

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[117] ibid, p.400.
[118] Cairncross, A. Wilson Years. p.288.
[119] Wilson, H. The Labour Government. p.513.
[120] Benn, A. Office Without Power: Diaries 1968-72. (London: Hutchinson, 1988), p.47.

was later described by Barbara Castle as 'this most secret and powerful of Cabinet groups'.[121] At that first meeting of MISC 205 at 3.30pm on Sunday 17 March, it became obvious that there were two over-riding and interconnected issues.[122] Firstly, the outcome of the Washington conference. If it were unsuccessful in halting speculation in the gold market, the pound would sink. Second, the fact that the reserves were either already exhausted or near that point. This issue was crucial. After all, had the reserves been larger during 1968, then the pound would have weathered better against speculation on the gold market. Furthermore, because the reserves were now so low, even if the Washington conference was successful and stopped much of the speculation, a minor flight from sterling would still be enough to trigger the meltdown of the currency.

Thus it was obviously imperative that whatever decision was taken by the Americans at the Washington conference, in terms of the relationship between gold and the dollar, that the outcome was able to restore calm to the world's currency markets. If confidence was not restored, the side winds of the crisis would continue to plague sterling. Furthermore, if calm was not re-established then it would be essential for the UK to gain more funds from the Americans and the G10 to plug the gap in the reserves, just as the Bank and Treasury had advocated.[123] In fact, even if the pressure did die down, the available resources in the EEA had become so inadequate that it would be difficult to maintain sterling's parity with the dollar, even under non-crisis conditions. However, the Chancellor was not confident that the Americans would provide the essential line of credit. During his previous conversations with Fowler, Jenkins had requested a large stand-by credit. Yet, 'He [Fowler] was non-committal, even unforthcoming'.[124] William Armstrong, Permanent Secretary to the Treasury, who had been dispatched to Washington, shared this lack of confidence in the chances of US rescue

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[121] Castle, B. Diaries. p.462.
[122] PRO CAB 130/497 'MISC 205 (68): First Meeting', 17/3/68.
[123] ibid
[124] Jenkins, R. A Life at the Centre. p.235.

package.[125] He informed Jenkins, via telephone, that it was most uncertain that Britain would get the financial support from the US that would allow smooth running when the markets re-opened and suggested that Monday and Tuesday should be proclaimed Bank Holidays too.[126]

This greatly worried Wilson's MISC 205 and it considered the Treasury's contingency plans very carefully. Wilson himself thought that 'information on the progress of the Washington conference was not yet sufficient to form the basis for firm decisions'[127] but that it was essential to become acquainted with the alternatives. However, it was obvious to the assembled Ministers that there were clear problems with blocking. The UK would accept a major catastrophe and risk being branded as a pariah state in order to avoid chaos. There was the very real possibility that other countries would retaliate and that Britain's overseas investments would be frozen in return. Furthermore, the plan's potential to destroy the sterling area was both unthinkable but at the same time strangely appealing. Yet, it was clear that if Brutus were implemented, international economic disorder would ensue. However, Wilson recognised that the scheme could potentially lead to some favourable outcomes.

Indeed the Prime Minister, who was still reeling from de Gaulle's second veto on Britain's membership of the European Economic Community, believed that the damage to the international trading community that would result from Brutus might cause further tension between the six members of the EEC.[128] To his mind, it was possible that the wedge created, could potentially grease the way for a third, and this time successful, British bid to join the community. However, this was an unlikely outcome. It was far more likely that the six would gang up on Britain, the cause of their misery, than each other.

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[125] Interview with Sir Samuel Goldman.
[126] Bank OV53/38 Armstrong to Jenkins, 17/3/68.
[127] PRO CAB 130/497 'Minutes of Misc 205(68) 1st Meeting', 17/3/68
[128] ibid

Obviously, the main advantage with the scheme, as far as ministers were concerned, was that it was designed to shield the reserves. It would protect Britain against a further run on the pound and put pressure on the US to develop a long-term solution to international monetary problems. As well as this, it would make the problem of the sterling balances an immediate priority for the international community and it might have been possible that some collective means of funding them would be found. I am bound to agree with this analysis, at least in part. It is undeniable that in blocking, Britain would have provided the long-overdue impetus for interested parties to reform the international system but it is unlikely that the ill conceived Brutus I would have provided an efficient shield to the reserves.[129]

However, the Ministers were still clear that their favoured option was be for the US to provide a funding package. This would ensure that international chaos could be avoided, at least for the near future. Of course, whether or not the US would agree to this was another matter. If they did not, Wilson believed that it might be possible to use Brutus as a mechanism to force them to make a U-turn. Not through implementation but as a threat that would make the US authorities recognise what the dangers to the international monetary system would be, if they failed to prevent sterling's demise. Wilson explained to his colleagues, that if the Americans were not forthcoming, then it would be necessary to

> '...use the arguments adduced about the consequences which would follow if we were driven to block the sterling balances in order to ensure adequate support for sterling...the President would be likely to be more responsive in this respect if it was made clear that the blocking of sterling balances would mean a serious threat to the dollar'.[130]

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[129] Readers might like to examine PRO T295/493 'Measures to deal with severe outflows including blocking of sterling accounts: Master plan (operation Cranmer)', 1968. This file contains the master plan to the blocking exercise and is far more complicated and rigorous than the early Brutus schemes.
[130] PRO CAB 130/497 'Minutes of Misc 205(68) 1st Meeting', 17/3/68.

In fact, Wilson had already begun the 'blackmail'.[131] He had made contact with President Johnson three days prior and stated 'if we [the UK] had to protect ourselves, we should be forced to take action which could have a grave effect on other currencies'.[132] One wonders then, why he felt the need to seek agreement from his colleagues, for a course of action that he had already embarked upon. One can only conclude that post-Brown, Wilson was ever mindful of the vulnerability of his position and any attempt on his part at paying lip service to the idea of collective decision making would aid his cause. However, before the weekend Wilson's threat to Johnson had been a hollow one. Now that some progress had been made on Brutus planning, the threat was credible.

Although it is ironic that at the Washington conference, Leslie O'Brien (Governor of the Bank of England) reported that 'various forms of partial blocking of sterling are being suggested to us but we are resisting these and stressing that blocking would have to be complete and would necessarily cause damage to others as well as ourselves'.[133] It is possible that O'Brien's rejection of blocking and his elucidation of its horrors at the conference made Wilson's ploy more effective. For the Americans and Europeans finally concluded that if sterling was not assisted then the consequences for both the dollar and the IMS would be grave.[134] Consequently, the two-tier gold market was adopted and Britain got its much-needed standby credit. The final sum that was acquired was $3975m.[135] It was not however quite the amount that was requested, nor quite the sum that was publicised, but the Prime Minister and Chancellor deemed that 'this was not sufficient grounds to justify immediate action to block,

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[131] ibid

[132] FRUS 1964-1968, Volume XII 'Telegram from Prime Minister Wilson to President Johnson', 18/3/68, p.617. This telegram refers to a copy of Wilson's March 14th message in which he sends this passage.

[133] Bank OV53/38 'Telegram No.925' 16/3/68

[134] Interview with Sir Samuel Goldman; FRUS, Vol.12 'Paper Prepared in the Department of State', undated; Bank OV53/38 Armstrong to Jenkins, 17/3/68.

[135] Bank OV53/38 Morse 'New Arrangements for Sterling', 18/3/68. This comprised existing standbys totalling $2,835m, plus an additional $1,100. Of the additional credits $700m came from the US, $50m each from Italy, Switzerland, Belgium, and Holland, $150m from Germany and $100m from the BIS.

which would lead to the complete dismantling of the sterling area'.[136] However, when the market reopened on Monday 18 March there was, rather thankfully, a highly uneventful day's trading. Attention therefore reverted to the preparations for the next day's Budget speech.

Summary

This chapter has analysed the origins and implications of the March gold crisis. It has been argued that the episode is important for the following reasons. Firstly, because it occurred during a time when the Treasury, which was pre-occupied with preparations for the budget, had put its contingency planning operation to bed. This meant that officials had not given as much thought as they could have to the various policy alternatives. Consequently, they had to develop proposals from scratch, under conditions of crisis. The result was that both the Bank and the Treasury were prepared to consider courses of action that they had rejected before the devaluation, under the auspices of the 'FU war book'.[137]

Secondly, the episode also marks a rift between the two organisations, with each coming to favour one of the two previously rejected policy options, namely blocking and floating. This rift did not occur because the Bank and Treasury had different ideas about the best means to achieve the public good but because of the particular vested interests that each organisation held. The Treasury opted for blocking because it feared that its prestige would be dented if the pound floated, although with hindsight it is arguable that its prestige would have been just as damaged by blocking.[138] Whilst the Bank, in choosing its preferred course, was conscious of the need to protect the interests of its client group, namely its overseas customers and the City of London. That the Treasury was successful in subjugating the Bank and foisting its own preferences on the Labour government suggests that the Bank was the junior partner in the

[136]PRO CAB 130/497 'Minutes of Misc 205(68) Second Meeting', 17/3/68. The amount requested was $5,000m and the publicised figure was $4050m.
[137] PRO T312/1636 Ryrie 'Fixed or Flexible Rates', 22/9/66; PRO T312/1398 'Blocking', 12/4/65.
[138] Interview with Samuel Goldman

relationship. Kit McMahon, an ex-deputy governor of the Bank, also supports this interpretation.[139] However, it is important to stress that the Bank was not totally subservient to the Treasury and that it still retained a great deal of autonomy, most notably in its internal management and in its relations with other central bankers and the sterling area.[140]

Thirdly, because the early Brutus scheme was so rudimentary, it is very unlikely that it would have provided an effective block.[141] If the additional credits had not been provided and ministers were forced to implement the plan, it would only have been effective for a matter of weeks at the most. Although the Treasury would most likely have attempted to improve the block, if they had been unable to do so quickly enough, they would have been forced to float the pound.

The episode also marks a transition in the way that Wilson organised his executive in terms of economic policy making. No longer were the Prime Minister and the Chancellor to conduct economic policy behind closed doors and then bump it through Cabinet. MISC 205 became a serious inner group of economic policy makers. Wilson may not have intended this to be so but after the Brown debacle there was little else he could do. The committee was also to take a serious interest in the Treasury's future contingency planning activities. This too was in marked contrast to the conduct of planning pre-devaluation. However, because the Treasury controlled the flow of papers to the committee, it is arguable that officials were still able to shape the context within which ministers operated. Furthermore, it is important to note that during 1969 MISC 205 met only five times.[142] This suggests that the scars resulting from Brown's departure had healed and that Wilson could return to bilateralism. It also suggests that power relations within the core executive are fluid and dynamic, rather than static.

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[139] Interview with Kit McMahon
[140] Bank OV44/160 'Extending the Basle Arrangements' 10/4/68; Bank OV44/164 'The Sterling Area and the Basle Negotiations', 19/6/68; PREM13/1402 Balogh to Wilson 'Bank of England', 20/5/66.
[141] PRO T295/489 'Operation Brutus', 14/3/68.

Finally, the crisis also had wider significance in terms of its impact on the IMS. The American decision to split the gold market in two, with one part controlled by the central banks who continued to trade gold at $35 per ounce, and the other part operated by the markets where gold was allowed to find its own level, marks the beginning of the end for Bretton-Woods.[143] The Bretton-Woods agreement had been established on the principle that the US would agree to buy or sell gold from anyone, irrespective of their status, at a fixed price of $35 per ounce. With the implementation of the two-tier system, this pledge was only to hold good for monetary authorities. The step also represented the partial devaluation of the dollar. This was because the currency would have two different values, depending on whether it was being used in official or non-official transactions. Furthermore, as the price of gold in the private market was constantly fluctuating, this meant that the dollar had in effect floated in that market.[144]

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[142] PRO CAB130/497 'MISC205 (69)', undated.
[143] PRO T267/21 'T.H.M.: The March Gold Crisis 1968', undated.
[144] ibid; Bank OV53/38 'Telegram No. 2603', 14/3/68.

Chapter 5 Operation Brutus

This chapter provides an in-depth account of the continued activities of the sterling contingency planning network. For although the immediate crisis had receded planning did not. It is arguable that the one lesson that officials and politicians, alike, learned from the debacle was just how unprepared they were.[1] Whilst the additional funding secured from the United States and the G10 would reduce the likelihood of a further flight from sterling in the coming weeks it clearly could not protect the pound indefinitely. The worry was that pressure on the free gold market would resume by the summer with disastrous consequences. If another crisis erupted during the US presidential election campaign or coincided with the fall of the Italian or German coalitions it would be possible that the Americans and the Europeans would be so obsessed with their domestic *politik* that they would not come to the aid of sterling.[2] Therefore, between March and July 1968, the contingency planning network continued to hone the Brutus scheme. Eight distinct versions of the operation were devised during this five-month period, with an ever-increasing degree of complexity. Broadly, the aim of this chapter is to reconstruct the deliberations of the contingency planning network. The first half of the chapter examines the development of the basic macro Brutus regime and the movement from Brutus 1 to Brutus 8. The second half of the chapter focuses on the micro planning conducted by the network, after it had agreed upon the more general Brutus regime. It will be argued that once officials embarked upon the more micro aspects of planning, they quickly came to realise that the full Brutus system would require import controls, rationing at home, a ban on foreign travel and the requisitioning of citizens' equity holdings in foreign corporations. Once the implications of implementing the Brutus scheme hit home, officials within the contingency planning network quickly concluded that this form of second order change should be avoided at all costs.

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[1] Interview with Sir Kit McMahon
[2] PRO T295/490 Michael Posner to Douglas Allen 'Brutus', 6/5/68.

The Continuation of Brutus

Sir Samuel Goldman recognised that, even with the fresh borrowing rights that had been accrued during the gold crisis, there would be the risk of a renewed crisis of sterling if the balance of payments did not improve and sterling balance holders continued to diversify. Therefore, he informed the Chancellor on 20 March

> 'that it is necessary to probe more in depth into the consequences for trade and the international banking system of blocking and to examine alternative courses of action such as borrowing or floating the pound'.[3]

Sir Douglas Allen, who was in the process of taking over as Permanent Secretary from Sir William Armstrong, agreed and urged Jenkins to put the matter before Wilson's MISC 205, which was meeting later that day.[4] Although there is no surviving record of the MISC meeting, it would appear that it was a request that the politicians conceded to or perhaps even welcomed. For as Allen later reported to his officials:

> 'The remit is to continue over the next few weeks to study the policy questions involved in Brutus with the aim of resolving them but not to make any physical preparation in terms of training staff and allotting accommodation'.[5]

Ministers were worried that if a large number of staff were taken off their regular duties and trained in the exchange control regime, it would only be a matter of time before a leak occurred. This would potentially undermine confidence in sterling, precipitating the need to

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[3] PRO T295/489 Goldman to Dowler 'Contingency planning: Operation Brutus Trade Effects'.
[4] PRO T295/490 Allen to Halls 'Contingency Planning: Operation Brutus' 20/3/68.

introduce Brutus. Consequently, Sir Burke Trend (the Cabinet Secretary) imposed severe security restrictions on the individuals involved in Brutus planning. Firstly only those who had been positively vetted by the security service were to be involved in the scheme and secondly only two copies of the plan were to ever be in circulation, one at the Treasury and one at the Bank.[6] To that end Anthony Glover, a Principal in General Finance, who was on secondment from Customs and Excise, set about destroying all but one of the eight copies of the first Brutus scheme 'in accordance with instructions relating to the disposal of top secret waste'.[7]

Douglas Allen decided that he would supervise the development of the project but put Anthony Rawlinson in charge of its day to day development.[8] Rawlinson was the Assistant Secretary heading the exchange control division and was in many ways the natural choice to lead the project. He had a wide-ranging knowledge of the issues related to Brutus, which essentially centred on exchange control. Furthermore, Rawlinson with the assistance Anthony Glover had devised the 1966 scheme to block the balances of the Rhodesians, which was something of a mini-Brutus.[9]

Therefore Rawlinson must be seen as the central figure in the world of blocking schemes or as Sir Kit McMahon so eloquently put it, he 'was the arch-commissar of Brutus'.[10] Rawlinson was the son of a Church of England Bishop, a devout Christian, and an Oxford graduate with a first in classics.[11] It was perhaps his love of the ancients that led him to christen the scheme Brutus, in honour of the *Ides of March*. He was also suited to his new role because he recognised the importance of this kind of planning. As Anthony Glover recalls:

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[5] PRO T295/492 Rawlinson to Goldman 'Brutus etc', 1/4/68.
[6] Interview with Sir William Ryrie and PRO T295/489 Goldman to Rawlinson 'Brutus' 21/3/68.
[7] PRO T295/489 'Note for the Record', 20/3/68
[8] PRO T295/489 Hay to Hawtin 20/3/68
[9] Interview with Anthony Glover
[10] Interview with Sir Kit McMahon
[11] Interview with Sir William Ryrie

> 'Rawlinson thought that plans were useless but that planning was essential. He meant that it was never likely that a contingency plan produced so far ahead of events would have much bearing on the situation as it unfolded. But by going through the process of planning we would be much more familiar with the various techniques available to us to control the situation than we would have been if no planning took place'.[12]

As the production of a workable Brutus scheme was likely to be very complicated and time consuming, Douglas Allen took Rawlinson off his normal duties and created a new division for him to head that focused solely on contingency planning. This new division was called *Finance: Planning* and for all intensive purposes Rawlinson was its only full-time member. In his previous post as chief of the Exchange Control division, Rawlinson had reported to David Hubback, the head of the General Finance Group. Although in his new role he had not been promoted and was still ostensibly a part of Hubback's group, he no longer reported to him and nor was Hubback kept up to date on the development of Brutus. Instead, Rawlinson officially reported directly to the Third Secretary heading the Home and General Finance Groups, who was at that time Goldman, but unofficially he reported straight to Douglas Allen.[13] This type of arrangement had been something Allen had authorised before when he was at the DEA but it was a novel organisational change for the Treasury.[14]

However, it would have been impossible for Rawlinson to complete the Brutus plan alone. Therefore, Allen assigned Michael Posner, the Economic Advisor to the Treasury, to work along side him.[15] Posner, like Nicky Kaldor and Tommy Balogh had been brought in as an outside advisor by the Wilson Government and was therefore one of the Treasury *irregulars*. He headed no division of his own and nor was he a part of any. Although between March and

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[12] Interview with Anthony Glover
[13] Interview with Lord Croham and T199/1239 'H.M. Treasury Organisation Chart', January 1968; May 1968 and July 1968.
[14] Interview with Lord Croham

June 1968, he was to spend a considerable amount of his time working on the project in collaboration with Rawlinson.[16]

With the consent of Douglas Allen, Rawlinson also enlisted the help of a number of part-time collaborators. These included Robert Armitage, from the Treasury Solicitors Department, who dealt with the legal aspects of imposing exchange control; William Ryrie and Geoffrey Littler, both Assistant Secretaries from the General Finance group; Sir Samuel Goldman, Rawlinson's immediate superior; William Hughes from the Board of Trade; Dorothy Johnston, a Commissioner at Customs and Jeremy Morse, Kit McMahon and Jasper Hollom from the Bank.[17] However with so many people involved, Douglas Allen also found it useful to establish a forum in which the various officials could meet to co-ordinate the distribution of work and discuss papers that had been produced. The forum was rather aptly named the Allen Group and Douglas Allen himself chaired it.[18] As planning progressed it was to meet on an almost weekly basis.

Brutus 1-3 Reviewed

By this stage, three different versions of the Brutus plan had been developed. The first scheme, Brutus 1, operated a system of partial blocking through the return to inconvertibility. Under it, all the existing holdings of both the sterling and non-sterling area would have been placed in Number 1 accounts which would have been completely inconvertible. However, those that held this form of sterling would still have been able to use it for the purchase of British goods and securities. The only sterling that would have been convertible under this system would be new accruals that were acquired post-zero. This scheme would not have entailed the abolition

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[15] ibid
[16] Interview with Michael Posner
[17] Interviews with Anthony Glover, Sir William Ryrie, Sir Samuel Goldman, Sir Kit McMahon, Sir Jeremy Morse and Lord Croham confirm this version of events.
[18] Interview with Lord Croham

of the sterling area and UK residents would still have been free to move funds out of Britain and into sterling area countries.

The second version of the plan, Brutus 2, attempted to deal with the problem of sterling holders running down their balances through the purchase of UK goods with sterling rather than foreign exchange by implementing a regime that allowed only one type of account, the number one account. All of the overseas sterling balances would have been placed into this account and not only would it have been inconvertible but also completely frozen. Exchange control would also have been extended to the sterling area to prevent UK residents from moving their assets offshore and exacerbating both the balance of payments deficit and the drain in foreign exchange.

At the time Rawlinson took charge of the Brutus project, somewhere between 20 and 23 March, Brutus 3 was in a very early stage of development. The formula for the operation of the numbered accounts had not yet been properly worked out and Brutus 3 existed in name only.[19] The only paper produced before the fully elaborated April version of Brutus 3 was devised, was put together on 19 March. In it, it was suggested that Number 1 accounts should be blocked but that Number 2 accounts should be fully convertible.[20] However, by this stage it was not clear what sterling holdings would be placed into the respective accounts or whether they would be made inconvertible or completely frozen. Nor is it clear what exceptions would be made to the general rules in the cases of hardship and the fulfilment of pre-Brutus export contracts.

However, William Hughes recognised the danger of simply making the Number one account sterling inconvertible. It was clear to him that the holders of such sterling would try to turn it

[19] The first fully elaborated version of Brutus 3 is not found on file until sometime in April 1968. See PRO T295/490 Rawlinson 'A Plan for Operation Brutus [3]', undated. Although Rawlinson's paper is undated, the file that it is held in was not commissioned until 17 April 1968.
[20] PRO T295/489 'Contingency Planning: Operation Brutus', 19/3/68.

into British goods as quickly as possible and export those overseas.[21] In his opinion, they would do this until their balances were exhausted. Where they were balance holders that did not want to buy into the UK export market, it would be possible for them to sell their sterling, probably at discount, to foreign importers who would make use of it. Therefore, the UK would have earned no new foreign exchange until the Number 1 account balances had been completely wiped out.

Figure 5.1
Breakdown of the Sterling Balances: December 1967 **£m**

	OSA Sterling Balances	**NSA Sterling Balances**
Official Holdings	1,747	267
Private Holdings	1,222	657
Total	*2,969*	*924*

Source: PRO T295/489 'Contingency Planning: Operation Brutus', 19/3/68

As the above table illustrates, the sterling balances of overseas holders were sizeable. When one combines the sterling and non-sterling area balances it becomes clear that if those balances were simply made inconvertible, overseas holders would have had somewhere in the region of £3,893m to dispose of in the purchase of British exports. As well as this, the convertible sterling paid into number two accounts in exchange for UK imports would most likely have been converted immediately because holders would have feared that it would only have been a matter of time before this sterling was also made inconvertible. Therefore the UK would make no new foreign exchange from its exports to bolster the EEA and at the same time number two account sterling would be gushing from it. Hughes recognised that this would be highly undesirable. After all, the principal aim of Brutus was to negate the need to float. If, however, Brutus could not ensure that British exports were paid for with dollars, sterling would be pushed to a floating rate very quickly. Hughes concluded that 'This could not be allowed to happen...we would have to restrict the uses of No1 accounts'.[22]

[21] PRO T295/489 William Hughes, 'Trade Effects of Brutus Plans', 19/3/68.
[22] Ibid

On March 28 Douglas Allen's group met for the first time. As no new papers had been produced, little in the way of substantive discussion took place.[23] However, the group concluded that any Brutus operation would have to be accompanied by some sort of import restrictions. After all, if the foreign exchange in the EEA was to be conserved, it could not be frittered away on inessential imports. Especially if it was likely that the UK would make little in the way of additional foreign exchange, as Hughes had suggested, once Brutus had been implemented. Even so, it was clear that any import-licensing scheme that was to be set up could neither be planned nor implemented secretly, because of the need to train customs officials in its operation. This posed a great problem, because it might mean that Brutus would become a self-fulfilling prophecy and at this stage, the group could find no way to square that circle.

The group also considered whether it would also be prudent to block number two accounts under Brutus 3. After all, money deposited here would be freely convertible and in all likelihood would be converted. However no conclusions were reached. The only thing that the assorted officials could agree upon was that they were a long way away from devising anything that could be administered at short notice. Without papers to discuss, it was difficult for them to make any headway. Consequently, Allen asked Rawlinson to go some way to developing a fully elaborated version of Brutus 3 for their next meeting and he requested a paper on the practicalities of limiting British banks involvement in the Euro-dollar market.[24]

Brutus 3 Formulated

During the first two weeks of April 1968 Rawlinson set to work. He believed that in theory it would be possible to begin with a complete block of non-resident sterling and to relax it in stages. However, it was likely that such a block would present major difficulties to other

[23] PRO T295/490 Rawlinson to Goldman 'Brutus etc', 1/4/68.
[24] ibid

countries, especially those that held their foreign exchange in sterling, as these balances would also be blocked. Unless some arrangement was made, several of the OSA countries would have no means of making payments to other countries until they had earned some foreign exchange.[25] Although the development of such arrangement was outside his current remit, it was clear to Rawlinson that a paper would have to be commissioned by the Allen group on the subject at a later date.

Figure 5.2

Brutus 3

Extension of exchange control to OSA under operation **Brandon**. Note that this alteration applies to all subsequent Brutus proposals.

Number 1 account:

- Inconvertible and frozen.
- Usable only to (a) pay for goods that have been ordered by foreign importers pre-zero and (b) to buy British securities, the profits from which will be transferred to the number 2 account.

Number 2 account:

- Receives all post-zero payments.
- Completely convertible.
- However funds cannot be transferred from No.1 to No.2 accounts.

Rawlinson's regime for Brutus 3 was as follows: Firstly, that number one accounts would be blocked completely. He accepted Hughes point, that inconvertibility would not be sufficient. However, Rawlinson felt that the balances in number one accounts should be useable to meet pre-zero commitments.[26] In other words, before the Brutus system was to be imposed, British exporters would have shipped a large number of goods for which they had received no payment. At the point at which Brutus was implemented, foreign importers' sterling holdings

[25] PRO T295/490 Rawlinson, 'A Plan for Operation Brutus [3]', undated.
[26] ibid

would be blocked and they would have no means to pay for the goods. Rather than these importers fulfilling their contractual obligations by paying for the goods in dollars, it would be more likely that they would simply default, arguing that the funds to pay for them were available in their blocked number one accounts.[27]

Therefore, to Rawlinson it was obvious that an exception had to be made in respect of the pre-Brutus contracts or British exporters would be left out of pocket. He believed that such an action would not preclude the possibility of the UK earning new foreign exchange in the way that making number one accounts inconvertible would.[28] After all, when the backlog of pre-Brutus contracts had been met from number one accounts, all subsequent British exports would have to be paid for in dollars. Rawlinson also felt that in order to placate the disgruntled number one account holders, the Treasury should allow them to invest their balances in British securities with the profits being credited to their number two accounts.[29]

Under the scheme, number two accounts would have been completely unfrozen and fully convertible. These accounts would receive all post-zero payments for UK imports. It was obvious that if the accounts had been either fully or partially blocked that no foreign exporter would accept sterling as payment for goods and would instead demand dollars.[30] Of course, once foreign exporters had received their number 2 account sterling, it would have been likely that they would convert it in any case. However, some respite to the British reserves might have been gained if (a) the conversion process took a few days or (b) if they decided not to convert at all.

However, Posner was not at all convinced that Rawlinson's Brutus 3 would work.[31] Firstly, he was doubtful whether it would be possible to allow sterling holders to use their number one

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[27] ibid
[28] ibid
[29] ibid
[30] ibid

accounts to pay for pre-zero imports, as Rawlinson had suggested. This was because at any one time, the UK had dispatched around £3,000m worth of exports that had yet to be paid for.[32] British exporters extended very favourable credit facilities to foreign importers and generally allowed them up to three months to pay for the goods. However, foreign exporters seldom offered such generous credit facilities to British importers. Therefore, if the Treasury allowed number one accounts to be used to pay for these pre-zero British exports, the EEA would potentially be robbed of a very large amount of foreign exchange. Furthermore, if Britain continued to offer credit to foreign importers post-Brutus the Treasury would have to wait several months before any new foreign exchange was earned. Whilst if the credit were denied, the foreign importers might move out of the British export market altogether.

Secondly, whilst Britain floundered in its attempt to gain new foreign exchange she would face bills from foreign exporters for immediate payment for imports to Britain. It would therefore only be a matter of time before the foreign reserves were exhausted.[33] Consequently, the Treasury would certainly have had to greatly reduce the amount of imports entering the country during the period in which foreign traders used their number one account sterling to pay for their imports. Yet, it had already been acknowledged that it would be difficult to prepare for this without months of open planning. To Posner it seemed that 'the pressure on foreign reserves may be so extreme that it will be difficult to hold the rate unless we allow a queue in exchange to develop'.[34] He was suggesting that instead of number two account sterling being immediately convertible there should be some sort of time delay whereby holders had to wait their turn before they were allowed to convert, thus reducing the drain on the reserves. Such a system would be far more complicated to plan and administer than the existing scheme but it was quite clear that the current scheme would not work.

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[31] PRO T295/490 Posner, 'Brutus', 17/4/68.
[32] ibid
[33] ibid
[34] ibid

Rawlinson's initial solution to the problems raised by Posner was to insist that all UK exports were paid for in dollars and to prevent pre-zero balances being used to pay for exports that were already dispatched. Even if this meant that British exporters were left out of pocket. However, he quickly recognised that where pre-zero exports had been invoiced in sterling it would be neither practical nor legal to insist on payment in dollars. Consequently, the Treasury might be forced to accept that exports that had already been dispatched would have to be paid for in sterling or not at all. He concluded that 'Brutus could only be implemented if the UK had a large amount of foreign exchange...but with such foreign exchange there would be no need for Brutus'.[35] Therefore, he was forced to agree that his Brutus 3 was not viable and on 25 April he reported as much Sir Samuel Goldman.[36]

However, at this stage it is clear that the Treasury mindset was still firmly against floating, in the midst of another crisis. Instead, officials favoured a solution that would bring about the minimum of disruption to the international monetary system and one that would maintain the parity of the pound.[37] Of course, blocking would cause chaos within the international markets, especially for those countries that held their reserves in sterling but it was a more favourable outcome than floating, which could potentially drag the dollar down too and precipitate the destruction of the global fix-rate system.

Brutus 4 and 5 Developed

Consequently, Rawlinson's work on Brutus did not end at this juncture and he strove to amend the plan to take account of these difficulties. He began work on Brutus 4 and 5 simultaneously, and completed them on 29 April. According to Rawlinson the new plans elaborated on ideas that were aired at a meeting of the Allen group, presumably some time in late April.[38]

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[35] PRO T295/490 Rawlinson to Goldman 'Brutus: Sterling Debts on Imports and Exports', 25/4/68.
[36] ibid
[37] Interview with Sir Kit McMahon
[38] PRO T295/490 Rawlinson, 'Brutus', 29/4/68.

However no record of that meeting exists and so it is impossible to know what was discussed. In any case, the two new plans produced by Rawlinson were rushed and somewhat scrappy, being compiled in less than four days.

Figure 5.3

Brutus 4

Number 1 accounts:

- Inconvertible and Frozen
- May be used only for minor personal post-zero payments
- May not be used for pre-zero export contracts
- Transferable between holders
- Not usable for purchase of UK securities

Number 3 accounts:

- All post-zero credit placed here
- Transferable between residents of the same country
- Both frozen and inconvertible- releases to be made only in accordance with bilateral clearing arrangements established with each country.

Brutus 5

Number 1 accounts:

- Inconvertible and frozen
- May not be used for pre-zero contract payments
- May be used for hardship
- In the long-term, the balances in these accounts will be financed by HMG's compulsory acquisition of UK citizen's private portfolio holdings under the codename **Bootstrap**.

Number 2 accounts:

- Will receive all post-zero payments and this sterling will be fully convertible.

Under the Brutus 4 regime, Rawlinson dispensed with the number two accounts and instead suggested the operation of number one and three accounts. Quite why he chose to call the account, in which post-zero sterling was placed, the number three account and not the number two account is unclear and needlessly complicates the hastily produced scheme. In any case, the plan would have operated in the following way.

Number one accounts would be both inconvertible and frozen. The only exception to this general rule would have been for minor personal payments in the case of hardship post-zero. The accounts would not be usable to meet payments for pre-zero contracts.[39] In other words, foreign importers would have been forced either to pay for their goods in dollars or to default. One supposes that Rawlinson's assumption was that even if only 10% of the goods were paid for, that payment would be in dollars and would bolster the reserves. As well as this, UK importers would not have been permitted to make payments for goods in any other currency than sterling. This too would have gone some way to limit the drain from the reserves. Rawlinson also revoked the entitlement of number one account holders to invest their frozen sterling in UK securities. He realised that once the Treasury had allowed that sterling to be invested, it would be possible for one holder to transfer the assets to another, at dollar discount, in order to get out of sterling.[40]

All post-zero credit would have been placed in number three accounts. These accounts, unlike the number two accounts in Brutus 3 would not have been convertible. They would have been transferable between residents of the same country but releases from them would only have been made in accordance of bilateral clearing arrangements established with every country.[41] Quite what those arrangements would have been is unclear but it is certain that they would have taken weeks, if not months to negotiate and in the meantime this sterling would have been frozen.

Whilst no critique of the plan exists on the files it is certain that it would have succeeded in stopping the drain from the reserves and maintaining the parity of the pound but only at very grave cost. It would have turned Britain into a siege economy in which the majority of pre-zero exports would have been defaulted on, potentially leading to the bankruptcy of Britain's exporters. Imports into the UK would almost certainly have ceased from the moment of

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[39] ibid
[40] PRO T295/490 Cleaver to Rawlinson, 'Brutus', 29/4/68.

inception as no foreign exporter in their right mind would have accepted number three account sterling as payment for goods. The sterling would have been completely unusable in the short-term and the foreign exporter would be taking a great gamble that the regime would unwind at a later stage and that they would eventually be able to convert their holdings.

It is perhaps because of these difficulties that Rawlinson simultaneously developed Brutus 5.[42] Under it, the number two accounts returned and would have received all post-zero payments in the same manner as Brutus 3. In other words, all new accruals of sterling would have been fully convertible. The number one accounts would have been unusable for post-zero contract payments, although it is not clear whether the same would have been the case for pre-zero. However number one account sterling would have been convertible in unofficial markets abroad, should anyone wish to purchase it. As well as this, Rawlinson suggested that the government should carry out the compulsory acquisition of UK citizen's private portfolio holdings in foreign securities.[43] It should then either sell them for dollars to fund the rundown of the number one accounts or offer to pass on the securities unsold to the number one account holders in lieu of payment.

However, this scheme was in no way an advancement on Brutus 4. It was little more than a reworked version of Brutus 3 that offered a way to run down the number one account balances in a controlled manner via the use of private portfolio holdings, thereby offering the hope that Brutus could be revoked at a later stage. The problem of the foreign exchange drain remained, because all new British imports would have been paid for in convertible sterling. It is likely that Brutus 5 would quickly have degenerated into a regime of floating rates. The generous credit that British exporters offered their customers would mean new foreign exchange would only appear sporadically and could not hope to offset the drain in reserves that occurred from imports.

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[41] PRO T295/490 Rawlinson, 'Brutus', 29/4/68.
[42] ibid

The Posner Plan

Posner, recognising the difficulties with Brutus 4 and 5, set to work on Brutus 6, which he completed on 6 May.[44] Although the Posner plan did not provide a wholesale solution to the problem of draining reserves, it must be seen as a turning point in the world of Brutus planning. This was because the finalised blocking scheme, developed over the summer of 1968, was based very much on it but in a more detailed and elaborated form.

Figure 5.4

Brutus 6

Number 1 accounts:

Restrictions

- Frozen and inconvertible except for:-
- Minor personal payments to UK
- Hardship payments to anybody
- Pre-zero contract agreements

Uses

- Transferable between holders and
- in long-term balances will be financed via mobilisation of UK's private portfolio holdings.

Number 2 [Alpha] accounts:

- These holdings are unconditionally convertible

Number 3 [Beta] accounts:

Restrictions

- Inconvertible but not frozen

Continued

- Holders must queue in order to attain convertibility rights. Once those rights have been attained the sterling is transferred to the No.2 account.

Uses

- Purchase of UK goods and services
- Transferable between holders

Number 4 [Gamma] accounts:

[43] ibid
[44] PRO T295/490 Posner to Allen, "Brutus", 6/5/68.

- Both inconvertible and frozen.
- Transferable between residents of the same country

British Imports

- Importers no longer to pay for goods in foreign exchange.
- Instead they will be issued with either an **Alpha**, **Beta** or **Gamma** import license depending on whether the import is essential or not.

- **Essential imports**- Alpha license with importer being directed to deposit funds in the foreign exporter's convertible No.2 account.

- **Desirable imports**- Beta license with importer being directed to deposit funds into the foreign exporter's No.3 queuing account.

- **Luxury goods**- Gamma license with importer being directed to deposit funds into the foreign exporter's frozen No.4 account.

Under Posner's Brutus 6, exchange control would be extended to all countries, in much the same way as would have occurred in all Brutus schemes from version 2 onwards. The proposal was far more complicated than any of its predecessors and envisaged the operation of four numbered accounts. The first, the number one account, would not be usable for post-zero payments but could be drawn upon for contracts agreed upon pre-zero.[45] As well as this, the account would be useable for minor personal payments to the UK and for hardship payments overseas. It is likely that Posner suggested such a weak block on the number one account as an attempt to appease holders. He also built Rawlinson's Brutus 5 suggestion into the account's operation. Namely that private portfolio holdings would be requisitioned and used in the medium to long term to fund the windup of the blocked accounts.

Whilst Posner recognised that his colleagues might have found his number one account scheme too liberal, in the sense that he would have allowed the use of blocked accounts for settling pre-zero contracts expressed in sterling, he believed that it was a necessary step.[46] Like Hughes, he felt that if holders were not allowed to use their number one accounts in London to pay for pre-zero British exports, they would not be paid for at all. He also felt that it was necessary to allow for the transferability of these accounts in order to reduce the level of

[45] ibid
[46] ibid

international uproar. Of course, that transferability came at a price: it would have led to the development of a cheap sterling market.

Under the proposal, number two [Alpha] account sterling would have been completely convertible but payments into this type of account would have been very small. The number three [Beta] accounts would have been freely transferable and convertible at the official rate but a queuing system would have operated.[47] In other words, those that held this form of sterling would have to have waited until they reached the front of the foreign exchange queue before they could have converted their holdings. This queuing system was a rather a novel innovation. For whilst Posner was prepared to concede the use of number one accounts for pre-zero contracts, the problem of the reserve drain that would have occurred from this concession under Rawlinson's schemes no longer applied. This was because foreign exporters would have to have waited until the UK had earned some dollars from post-zero exports before they would be paid for British imports.

In effect, the overseas exporters would have been coerced into extending credit to the UK in much the same way that British exporters extended credit to their customers. Once the holder of a number three account sterling reached the front of the queue for unconditional convertibility, the part of their balance in question would have been shifted to their number 2 accounts. However, the time taken for them to reach the front of the queue would be completely governed by the UK's liquidity position. It is perhaps best to use the analogy of a *tap and cistern* to describe the advance that Posner had made. When the cistern contained a reasonable amount of water, the tap would be turned on allowing some to be used, but when the supply was diminished the tap would be shut off. Thus, the number three account system would have provided a means to regulate the movement of reserves out of the EEA by simply switching off the supply.

In order to induce foreign exporters to accept number three account sterling as payment, Posner also suggested that it might be necessary to allow free transferability between holders and to make the holdings inconvertible but *not* frozen.[48] In other words, these funds would be usable for the purchase of British goods and services. This would mean that if number three account holders were not prepared to wait their turn for conversion rights, they would either use their sterling to purchase British goods or sell their holdings, probably at discount, to those who did want to buy UK exports. Whilst this would make foreigners more likely to accept sterling as payment it would also have meant that the UK would have to have tolerated a floating market in transferable sterling. To Posner this was a price that had to be paid if one wanted a workable scheme.

The plan also outlined the use of a fourth type of account, the number four [Gamma] account.[49] Although Posner accepted that it might not be desirable or necessary to use this category, he wrote it into the scheme in any case. This kind of account would have been completely blocked and would only have been transferable between residents of the same country. Releases from it would have been made in accordance with bilateral clearing arrangements that would have been established post-zero.

Three of the four types of account were also prefixed Alpha, Beta and Gamma. These corresponded to an import-licensing scheme that Posner planned to implement as part of the Brutus plan. British importers would have been prohibited from making payments for goods in foreign exchange. Instead, they would have been forced to deposit funds in either the foreign exporter's number two, three or four accounts.[50] Alpha, Beta and Gamma licenses would have been issued to British importers. Those who held Alpha licences would pay the foreign exporter sterling into their number two account. This would have been as good as paying them

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[47] ibid
[48] ibid
[49] ibid
[50] ibid

in dollars, as this form of sterling could have been converted immediately. Those importers with Beta licenses would have to pay the value of the imported goods into the foreign exporter's number three account and the exporter would have to queue for the right to convert. Finally, Gamma licences could also have been issued which would have paid foreign exporters into their number four accounts. However, it would have been extremely unlikely that they would have accepted completely blocked sterling as payment.

To Posner, the licensing system provided the means to totally regulate imports entering the UK. Indeed the best way to reduce the number of imports and conserve foreign exchange would have been to grant Gamma licences for luxury goods that were not essential to the smooth running of the British economy. As foreign exporters would refuse number four account payment, the goods would not be delivered and there would be no drain from the reserves. A small number of totally essential imports would be paid for with number two account sterling and for everything that fell in between these two extremes, the exporter would either have to queue or Britain would have to do without. As well as this, if the UK no longer extended credit to foreign importers, the speed at which foreign exchange flowed into the EEA would greatly increase. Therefore, Posner advocated removing the generous credit facilities that accompanied British exports and suggested that under Brutus, foreign importers would have to pay for the goods, in dollars, before they were shipped. After all, if the foreign importers did not pay the UK foreign exchange for British exports, it would have been impossible to operate the number three accounts, as there would be no funds in the EEA to offer to those who had reached the front of the queue.

Posner also recognised that there would potentially be a problem with post-zero contracts, as all purchasers of British goods would prefer to pay in sterling. There would also be pressure on the UK to pay for her goods in dollars because the pound would not be trusted as a means of payment. However, he felt that his version of the Brutus scheme went some way towards negating that problem. This was because those who purchased British exports post-zero but

who wished to pay for them with sterling would no longer be able to use their number one account balances. Instead, they would be forced to buy their sterling from the British authorities in exchange for foreign currency or to acquire it from the holders of number two or number three accounts.

In spite of all this, Posner regarded his Brutus 6 as both severe and complicated. He reported to Allen that 'it seems an awfully elaborate steam hammer to crack one single nut'.[51] Simply because it would present a very severe shock to the world financial system and might have very adverse trading consequences. As a result Posner was torn between his desire to start off with a simpler scheme reverting back to normal operations after a short period of time and the fact that it was always easier to relax exchange control than make it stronger. In other words, a weak system of control might lead to expectations that it will intensify at a later date. This would lead to a rapid drain from the reserves, forcing the hand of the Treasury.

Posner also had doubts about whether the queuing number three account system could be operated efficiently. After all, it might well have been the case that foreign exporters simply refused to accept to queue in order to make their sterling convertible, instead demanding dollars and refusing to supply goods until they were handed over. This would have certainly been the case if the queue became too long. Alternatively, even if the foreign exporters accepted the new regime, they might have attempted to raise their selling price in order to counter the inconvenience of having to wait several months for payment.

Under the regime, the UK would also have had to tolerate a floating market in number 3 account transferable sterling. When the aim of Brutus was to protect the official rate and prevent a move to a floating system, this version of the scheme could only succeed by creating a cheap sterling market which after a time could degenerate into complete floating. However

[51] ibid

Posner recognised that the 'risk of a fall in the rate would be greater without than with Brutus'[52] and in extremes he preferred blocking to barefaced floating.

Officials began to realise that the controls required to make Brutus work were both complicated and severe. As each new variant of the plan was devised, it became obvious that it contained features that would make it unworkable. Consequently, new versions of the scheme had to be continually forged, so that the problems could be ameliorated. Each new version solved many of the pre-existing problems, but only at the cost of creating new ones.

On 9 May the Allen group met to consider the Posner plan.[53] Allen himself recognised that the principal problem with the pre-Posner Brutus schemes for blocking the sterling balances was that 'they suffered from the disadvantage that they allowed exchange to leak out, leading to a situation whereby there was no free exchange left'.[54] Under such circumstances, he agreed that there might be no alternative than to implement comprehensive import controls in the Posner vein. He felt that once blocking was introduced it would be essential to achieve a tight control quickly, if the objectives of conserving the remaining exchange were to be met. He therefore recognised that 'blocking could never just be a short term measure to tide the UK over in a crisis'.[55] Jeremy Morse, representing the Bank, also accepted that if Brutus were to be implemented it would be difficult to avoid the need for elaborate import controls. He reported that the Bank would be in favour of 'a rigorous system of import controls at an early stage'.[56] Although, like the rest of his Bank colleagues he hoped it would never have to be put into action.[57]

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[52] ibid
[53] Present were Douglas Allen, Samuel Goldman, Michael Posner, Donald MacDougal, William Hughes, Thomas Balogh, Peter Thornton, Anthony Rawlinson and Jeremy Morse.
[54] PRO T295/490 M. V. Hawtin, 'Note of a Meeting Held in Sir Douglas Allen's Room on Thursday 9 May, at 5pm', 14/5/68.
[55] ibid
[56] ibid
[57] Interview with Sir Jeremy Morse

However, all agreed that Posner's Number three account system was an innovative way to overcome the asymmetry between the timing of payments for exports and imports to the UK. Yet, the attempt via the number three account to form a foreign exchange queue might have led to large scale reductions in imports to the UK which might have dislocated the home economy and perhaps destabilised the global financial system. However, it was also recognised that many developing countries had operated a queuing system in the past. In the case of Ghana, the scheme had be successful because those foreign exporters that were not prepared to queue for payment sold their currency at discount to those who were prepared to wait.[58] For that reason the consensus with regards to the number three account, was that it should become the new standard in Brutus planning but that consideration would have to be given to the effects of drastically curtailing the level of British imports.

Even so, none of the assorted officials shared Posner's desire that number one accounts should be usable to meet pre-zero contract payments. Although this might mean that UK exporters would not be paid during the life of the scheme and that the UK authorities would have potentially been pushed into providing them with compensation, it did have some potential advantages. The benefit that the Allen group collectively saw in pressing foreign importers to pay in foreign exchange for their pre-zero contracts, was the same one that Rawlinson saw when he devised his finished version of Brutus 3. Namely that whilst the majority of Britain's overseas customers would default, a minority would not. This would mean that foreign exchange would trickle into London at the very outset of the scheme; ensuring that both the UK's liquidity position was improved and the length of the number three account queue shortened.[59]

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[58] PRO T295/490 M.V.Hawtin, 'Note of a Meeting', 14/5/68.
[59] ibid

Brutus 7 and 8

As a consequence of the Allen group's discussions, Rawlinson made some minor modifications to Posner's plan. The changes were completed by 14 May and the new regime was christened Brutus 7.[60] It was almost identical to its predecessor, something that demonstrated how far Posner had come with his work. In essence, Rawlinson made only two changes. Firstly, he tightened up the usage of the number 1 accounts in accordance with the wishes of the Allen group. Secondly he abolished the number 4 [Gamma] accounts. Under Brutus 6, these accounts had been completely blocked in much the same manner as number 1 accounts. Rawlinson wisely realised that it would be far less complicated to merge the number 1 and 4 accounts and to place gamma licence payments into the former.[61] The Bank also felt that it would have been administratively difficult to operate such a complex system.[62]

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[60] PRO T295/490 Rawlinson to Posner, 'Brutus', 14/5/68.
[61] ibid
[62] PRO T295/604 Rawlinson to Allen, 'Brutus', 16/5/68

Figure 5.5

Brutus 7

Number 1 accounts [Gamma]:

Restrictions

- Frozen and inconvertible except for:-
- Minor personal payments to UK
- Hardship payments to anybody

Uses

- Transferable between holders and
- In long-term balances will be financed via mobilisation of UK's private portfolio holdings.

Number 2 [Alpha] accounts:

- These holdings are unconditionally convertible

Number 3 [Beta] accounts:

Restrictions

- Inconvertible but not frozen
- Holders must queue in order to attain convertibility rights. Once those rights have been attained the sterling is transferred to the No.2 account.

Uses

- Purchase of UK goods and services
- Transferable between holders

On 15 May the Allen group held another meeting to discuss progress. Allen himself hoped that Rawlinson and Posner would be in a position to put a progress report to Ministers in a matter of days.[63] Whilst little else was discussed, it was clear that the Bank thought that chaos would ensue if payments for British exports already dispatched could not be taken from blocked number 1 accounts.[64] However, there was general support amongst the Treasury cohorts for fully blocking these accounts. From their perspective, it would be problematic if countries with large sterling balances used them to pay for British exports. Almost in answer to Posner's dilemma, in his construction of Brutus 6, the consensus was that it would be far better to start

[63] PRO T295/490 M.V. Hawtin 'Note of a Meeting Held in Sir Douglas Allen's Room, Wednesday 15 May 1968, 4pm', 20/5/68
[64] ibid

with a general block and then to enter into negotiations for a gradual release of the balances. Furthermore, as the number two accounts would have been fully transferable, the negotiations post-zero would centre on the release of blocked number one and queued number three accounts. However, it was clear that countries that were in a balance of payments surplus with the UK might retaliate and attempt to apply similar queues for payment. Therefore, a central objective post-zero would have been to negotiate the funding of the balances by foreign bankers and/or to mobilise Britain's private portfolio holdings to meet that end.

With the meeting concluded Rawlinson formulated Brutus 8, in an attempt to bring the plan to some degree of completion, ready for the Ministerial report.[65] It was completed the following day.[66] Under it, exchange control would have been extended not only to the sterling area but also to the Republic of Ireland. However inflicting such a state of affairs on Ireland would have been problematic given the extent to which her banking system was intertwined with Britain's.[67] In any case, Rawlinson's elaboration of Brutus 8 was little different from version seven or for that matter the Posner plan, upon which both were based. Yet again, three categories of sterling were to have existed in the form of number one, two and three accounts. Broadly, their functions would have been the same. The only differences would have been that number one accounts would have been usable for *some* pre-zero contracts, namely, those that were expressed in sterling, in order to avoid legal complications. However where goods had been dispatched by Britain and not yet arrived at their foreign destination, even if the contract had been negotiated in sterling, number one account holdings would not be usable and the contracts would have to be re-negotiated in dollars.[68] The number two account system remained unaltered but some modifications were made to the number three queuing account.

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[65] T295/604 Rawlinson, 'Brutus 8', 16/5/68.
[66] On 16 May 1968.
[67] See T295/500 'Measures to Deal with Severe Outflows Including Blocking of Sterling Balances: Treatment of the Irish Republic (Operation Cranmer)'.
[68] PRO T295/604 Rawlinson 'Brutus 8', 16/5/68

Firstly, holders would have no longer been able to use their funds to purchase UK goods, although they would have been permitted to invest in British securities. Rawlinson felt that the problem of these securities being transferred between holders could be circumvented if they were stamped or marked in such a way as it make it clear they were not convertible.[69] This would ensure that British stockbrokers would refuse to transfer ownership. Secondly, Rawlinson devised a method to give the Treasury a tighter control over the *tap*. Under the number three account, holdings were transferable between holders and this offered a means for impatient foreign exporters to get out of sterling. However Rawlinson thought that if it could be arranged that once such queued sterling was transferred, the new holder went to the back of the queue it would take the pressure off the front and limit the foreign exchange drain.[70]

Figure 5.6

Brutus 8

Extension of exchange control to OSA **including** Republic of Ireland

Number 1 accounts [Gamma]:

Restrictions

- Frozen and inconvertible except for:-
- Minor personal payments to UK
- Hardship payments to anybody

Uses

- Transferable between holders and
- In the long-term balances will be financed via mobilisation of UK's private portfolio holdings.
- Pre-zero contracts expressed in sterling where the goods have already been dispatched.

Number 2 [Alpha] accounts:

- These holdings are unconditionally convertible

Number 3 [Beta] accounts:

Restrictions

- Inconvertible and frozen
- Holders must queue in order to attain convertibility rights. Once those rights have been attained the sterling is transferred to the No.2 account.

[69] ibid
[70] ibid

Continued

Uses

- Purchase of UK securities
- Transferable between holders but if such a transfer should take place then new holder returns to the back of the queue.

In preparation for the ministerial meeting that was to take place on May 31, the Allen group met on the 23 May in order to discuss Rawlinson's amendments to the plan.[71] Allen himself was becoming increasingly worried about the fact that Brutus would be very difficult to unwind, even if it was accompanied by the mobilisation of private portfolio holdings. As he expounded

> 'We could not expect to be able to wind up these [Brutus] arrangements for several years, although we could hope with the passage of time to make them more flexible'.[72]

However, much of the discussion centred on the problem of imports and the operation of Posner's licensing scheme. MacDougall, representing the DEA, felt that it would take a considerable time to bring into operation a full system of import licensing post-Brutus. In the meantime, he argued that there would be a tremendous incentive for British importers to increase the number of goods they brought into the country. Although, he recognised that this problem might be balanced out to some extent by the unwillingness for foreigners to supply goods in conditions where payment was uncertain. One possibility that McDougall foresaw, was to put in place a temporary import surcharge to plug the gap during the period in which the Posner import licensing machinery was being put into place.[73]

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[71] PRO T295/604 'Sir Douglas Allen's Group', 24/5/68. Present were Allen, Posner, Figgures, Glover, MacDougall, Balogh, Thornton, Hughes, Neale, McMahon, Leigh, Bennett and Hawtin.
[72] PRO T295/604 Allen to Dowler, 'Brutus', 16/5/68.
[73] PRO T295/604 'Sir Douglas Allen's Group', 24/5/68

Others suggested that a possible solution in the early days might be to get customs officers to mark the import documents with the appropriate alpha or beta classification when the goods arrived so that British importers deposited payment into the correct type of account. However, such a system would have been unsatisfactory for two reasons. Firstly, customs officers would not have been trained in its operation, in order to maintain secrecy, until after Brutus had been implemented. Consequently, for the first few weeks, during which time they would be learning how the new scheme operated, they would not be in a position to correctly identify which import should get which classification. As well as this, payments for goods imported to the UK were often made even before the goods had been cleared through customs and often even whilst they were still on the high seas.[74] Of course, where the goods had already been paid for, the drain from the reserves or the sterling balances would have already taken place and the function of Brutus was to limit a further drain. The important question therefore was what to do about goods that had been landed but not paid for? The obvious solution, and the least taxing for customs, was to treat them all as Beta imports and make all payments into number three accounts. Where overseas exporters felt that their goods had been wrongly classified they could later make an application to have their funds transferred into their number two account.

In the case of inessential imports, the Allen group thought that the choice was between giving them a gamma classification for payments into number one accounts or prohibiting their import entirely. If there were a prohibition, customs would not allow the goods to be landed. Although in practise they would have to be impounded in the Queen's warehouse, until the foreign exporter paid the shipping costs to have the goods removed. However, as the group was later to find out when it included a representative from customs in its planning, the Queen's warehouse was of limited size and it would have been physically impossible to

[74] ibid

impound all inessential imports.[75] However, without such knowledge the group could only conclude that a general prohibition was preferable to a system of Gamma licenses and the administrative problems associated with them.[76]

Nonetheless, it was recognised that if the Brutus system was to be maintained for any period of time, it would be desirable to give preferential treatment to imports destined for re-export, even if these would have otherwise been deemed as inessential.[77] After all whilst such raw materials and semi-manufactured goods would initially be a drain on the reserves, once exported they would aid both the balance of payments the UK's liquidity position. However it is important to recognise that a significant body of extra personnel would have been required to track down which imports were specifically for re-export and it would have taken time to train them.

In many ways, during the early stages of Brutus planning in spring 1968, the Treasury was totally unrealistic in the demands that they proposed to make on Customs, British importers, exporters, and on the British banking system. For example, banks were expected to train their staff in the operation of the numbered account system in the two-day Bank holiday period before Brutus was to commence.[78] If more direct consultation had taken place between the Treasury and those parties who were expected to acquiesce, a semi-workable version of the scheme might have been developed more quickly. This was probably a fact that Treasury planners well knew but the strong argument in favour of secrecy overruled these considerations.

The Allen group could only make an educated guess as to how foreigners would react to the scheme, as prior consultation of any kind was obviously out of the question. It was clear that

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[75] Dorothy Johnstone, a Commissioner at Customs, was not included or consulted about Brutus planning until 11 June 1968. See PRO T295/604 Memo by Rawlinson 11/6/68.
[76] PRO T295/604 'Sir Douglas Allen's Group', 24/5/68.
[77] ibid

the queuing system might have discouraged foreign suppliers from shipping goods, which would have made it difficult for Britain to obtain essential imports. However, it was recognised that if such a state of affairs ensued it would be necessary to move increasing numbers of imports over to the Alpha category thus speeding the reserve drain.[79]

The group also considered alternate means for limiting the queue on the number three account. One possibility was to put payments for pre-zero imports into the number one account and only place post-zero payments into the number three account. This would mean that those foreign exporters that had dispatched goods pre-zero but who had not already received payment would receive blocked currency once the goods arrived and that only contracts entered into after Brutus was implemented would be placed into the queued sterling category.[80] However, it was recognised that it would be very difficult to justify the different treatment afforded to pre and post-zero contracts. The general view was that a good amount of ill will on the part of foreigners would be avoided if both types of payments went onto the number three account. Still, the group recognised that it would be necessary to establish the amount of imports involved before any firm decision was taken.

The meeting of Misc.205, for which the Allen group's discussion acted as a preliminary, took place on May 31. The Chancellor took the opportunity to report to his colleagues on the progress that the Treasury had made in the development of the scheme. He explained to them that Brutus was not advocated as a policy in its own right. Instead, he argued that it must been seen as a reserve option that was to be used as a last ditch attempt to protect the currency in 'in a situation in which there was a substantial move out of sterling'.[81] Although he accepted that a floating rate would make Brutus unnecessary, he made it clear to the committee that there was a body of opinion within the Treasury that felt that 'the rate could fall a very long way,

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[78] PRO T295/604 Rawlinson 'Brutus 8', 16/5/68
[79] PRO T295/604 'Sir Douglas Allen's Group', 24/5/68
[80] ibid
[81] PRO T295/604 'Draft Note by the Chancellor of the Exchequer', 27/5/68.

leading to extreme pressures in the UK on price levels and on cost of living'.[82] However, it was obvious that it could not be known from the beginning whether or not Brutus was a sufficient step that would make it unnecessary to either float or devalue. He also explained that if Britain did decide to float or to depreciate the pound, it might be necessary to accompany such action with Brutus in order to protect the rate.[83] If events had turned out in this way, the operation would have resembled the Robot plan that was devised in 1952.[84]

The Misc. 205 committee approved the plan, although it is unlikely that any of them apart from Jenkins and Wilson actually fully understood it.[85] They concluded that 'floating was not an acceptable alternative to Brutus'[86] and if a serious crisis had erupted at this juncture it would be fair to say that Brutus would almost certainly have been implemented. As the committee had authorised the continuation of planning, Jenkins reminded his colleagues that

> 'it is imperative that no leak should occur of the fact that we have thought of such a step. But it will be prudent to continue preparations so far as this can be done without significantly widening the number of people who know about them'.[87]

The Irish Republic

With renewed ministerial authorisation, Brutus planning continued into June. Brutus 8 became the agreed standard and much of the planning from this point centred on the development of detailed technical arrangements for each aspect of the scheme. In early June, Posner, Rawlinson and the part-timers considered a number of issues related to the regime's micro

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[82] ibid
[83] PRO CAB 130/497 Jenkins to Cabinet/Misc 205, 29/5/68.
[84] For a discussion of Robot see Burnham, P. Remaking the Postwar World Economy: Robot and British Policy in the 1950s. (Basingstoke: Palgrave,2003).
[85] Both had studied economics before entering politics.
[86] PRO T295/604 Rawlinson to Allen, 'Brutus', 7/6/68.

development. Firstly, Rawlinson examined the problem of the Irish Republic.[88] The central issue here was whether to apply the same framework to Ireland as the rest of the OSA. It was recognised that the Irish banking system was so intertwined with Britain's that placing an effective barrier between the UK and Ireland would be difficult. In fact, it would have been nigh on impossible to police exchange control effectively between the two countries. The Irish banks kept most of their liquid assets in London, UK notes and coins circulated freely in Ireland as part of their regular currency and approximately 25% of the currency in Dublin at that time was sterling.[89]

If Brutus were to be successful, there would need to be prior consultation with the Irish government in order to give them time to ensure that their exchange control regime matched that of the UK's. However, Rawlinson accepted that such consultation would have to be ruled out for security reasons. Consequently, it would not have been possible to make the Irish Republic exempt from the rigors of Brutus, even though full application would potentially cripple its banking system. If, after Brutus had been implemented, the Irish agreed to co-operate then the restrictions could be lifted but not before.[90]

If the Irish had decided to co-operate post-zero, it would also have been necessary to ensure that British residents were not able to evade the new exchange control regime via the Republic of Ireland.[91] However, it would have been unlikely that the Irish would have obliged if the Brutus import embargo were also extended to them. The UK would have to have conceded to the continued admission of Irish goods but it would have been important that goods from other countries did not enter Britain through the Irish gap. In order to avoid this, it would have been essential to strengthen the presence of British customs.[92]

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[87] PRO T295/604 'Draft Note by the Chancellor of the Exchequer', 27/5/68.
[88] PRO T295/500 Rawlinson to Hoskin, 'Brutus: Position of the Irish Republic', 4/6/68.
[89] PRO T295/500 'Cranmer: The Problem of the Irish Republic', 25/6/68.
[90] PRO T295/500 Rawlinson to Hoskin, 'Brutus: Position of the Irish Republic', 4/6/68.
[91] PRO T295/500 'Cranmer: Irish Republic', undated.
[92] ibid

If the Irish refused to collaborate and the full brunt of Brutus was inflicted upon them, there would have been a grave risk of retaliation. Several of the London discount houses put money into Irish Exchequer bills and the Irish banks operated a branch network in Northern Ireland. These funds might have been frozen in revenge, forcing the Treasury to release to Ireland from frozen number one accounts, amounts equal to the funds frozen by the Irish Banks.[93]

Overseas Expenditure and British Tourism

Rawlinson also recognised that the new exchange control regime would be problematic from the point of view of government overseas expenditure.

Figure 5.7 Estimated Overseas Expenditure 1968[94] £m

Overseas expenditure	**Cost**
Military stations	250-300
Overseas aid	200+
Embassies	50-60
Subscriptions int. organisations	30
Overseas information	30
Debt interest	150
Total	710-770

The total government overseas expenditure for 1968 was estimated to be in the region of £710-770m and this would have represented a huge drain on the reserves. Therefore, the crucial question was whether there should be a fresh drive to curtail this type of expenditure. If spending continued, it would have to have been in the form of number two account sterling or foreign exchange.[95] In some cases, it might have been possible to push for garrison costs from number three accounts. This was something that Rawlinson felt that West Germany might have reluctantly agreed to, because a British military presence within German boarders was very much in its interests.[96] Nevertheless, in every other case, cuts would have to be made;

[93] ibid
[94] Source: PRO T295/507, Rawlinson 'Brutus: Government and Overseas Expenditure', 5/6/68.
[95] ibid
[96] ibid

some embassies might have to be shut down and subscriptions to international organisations like the UN, defaulted on.

Rawlinson also recognised that it would be necessary to restrict and probably prohibit all non-essential overseas travel on the part of British citizens.[97] British holidaymakers would have required foreign exchange in order to finance their overseas expenditure and this would represent a drain to the EEA. Although, this restriction was something that Rawlinson felt that the public might have been prepared to tolerate.[98] After all, the existing regulations were already fairly draconian. Holidaymakers could spend limitless sums in the OSA, but there was a maximum travel allowance of £50 per year in the NSA for holidays or £20 per day for business travel.[99] Even so, this was not quite the same thing as prohibiting all travel.

However it was felt that countries where British tourism was important, such as Spain and Italy, might have been prepared to sell limited amounts of currency in exchange for number three account sterling.[100] Although, this would be an arrangement that would have to be worked out post-zero and in the interim all British travel would probably have to be banned. Yet, even where some countries agreed to the arrangement, it would have been very likely that they would have wanted assurances that their foreign exchange would not be resold and used elsewhere. For example, the Spanish government might have demanded that any pesetas purchased could only be used for tourism in Spain and could not be resold to finance a British trip to France.[101] Nevertheless, even if such arrangements had been agreed to in the medium term, it would have been likely that in the early weeks of Brutus, British citizens would have been prohibited from leaving the country. Only as months and years went by, would they have been able to visit a very small number of European locations. As well as this, any change in the British travel regulations, accept liberalisation, would have caused huge administrative

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[97] PRO T295/508 Rawlinson, 'Brutus: Travel; Immigrants', 5/6/68.
[98] Interview with Anthony Glover
[99] PRO T295/508 Rawlinson, 'Brutus: Travel; Immigrants', 5/6/68.
[100] ibid

problems for the Treasury, the Bank of England, and the clearing banks. It would in all likelihood have also led to the bankruptcy of the majority of British travel agents.[102]

In many ways, June 1968 must be seen as a turning point in the world of Brutus planning. It was this attempt by Rawlinson and Posner, the chief *Brutocratics*, to work on the micro detail of the plan that led them both to doubt its merits, workability, and the public reaction to it. By 11 June Rawlinson expressed his concerns to Hawtin, the secretary of the Allen group. Stating that

> 'some of us who have been concerned with the operation have been led by detailed study to a considerable mitigation of the original enthusiasm. It could be useful to offer a hand to Ministers along the same path'.[103]

Whilst Posner commented that

> 'The heart had gone out of it [Brutus planning]. We went on because those were our instructions but it was clear it would just never have worked. It would have turned Britain into the equivalent of Russia during the 1930'.[104]

Imports, Exports and Misc 205

Nonetheless, the remit was that officials should continue with the planning exercise and continue they did. Much of the June work centred on the issue of imports and exports under the new system. Rawlinson was adamant that the UK should still extend six months credit to foreign importers as an inducement to them to continue to purchase British goods. In spite of

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[101] ibid
[102] ibid
[103] PRO T295/604 Rawlinson to Hawtin, 'The Horror of Brutus', 11/6/68.
[104] Interview with Michael Posner

this, the Allen group was non-committal.[105] Glover in particular was opposed to Rawlinson's position and was in favour of abolishing the credit.[106] He believed it could be assumed, firstly, that foreigners would still want to purchase British goods. Secondly, that they would be prepared to pay for them in a manner that was acceptable to the British government, unless they were prevented from doing so by their own government and finally, that it was unlikely that foreign governments would intervene. Whilst these assumptions were rather spurious, Glover was perhaps correct in asserting that the only way to get buyers to pay in foreign exchange would have been to demand payment before the goods were dispatched. Otherwise once their six months credit had elapsed, they would try to pay with frozen sterling or default and the UK would have no leverage to make them pay in foreign exchange.[107]

As Robert Armitage, from the Treasury Solicitor's office, confirmed, there would have been severe legal complications in forcing payment in foreign exchange after the goods had been dispatched.[108] If a foreign importer had refused to pay in dollars, the British supplier would be forced to issue a writ. However, under UK law the foreign importer would be able to pay what he owed straight into court from his frozen number one account. Yet, because that sterling would have been deemed unusable by the British authorities, the courts would be unable to pass it on to the British exporter who would still be out of pocket. Consequently, the foreign importer would have legally discharged his debt, the UK would have earned no new foreign exchange, and the British exporter would be unpaid. Therefore, to both Glover and Armitage, it was a choice between potentially not getting paid at all, verses introducing a system of pre-payment which would certainly lead to the delay of export, congestion at the docks and a very large administrative problem for customs.[109]

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[105] PRO T295/497 Glover to Hoskin, 'Brutus: Notice to Exporters', 11/6/68.
[106] ibid
[107] ibid
[108] PRO T295/496 'Cranmer: Certain Points on Imports and Exports', 17/6/68.
[109] PRO T295/497 Glover to Hoskin, 'Brutus: Notice to Exporters', 11/6/68.

It was against this backdrop of *Catch 22ism*, that on 13 June, the ministerial group Misc 205 re-examined the scheme's progress. The meeting also marked the ascendance of Barbara Castle, the Transport Minister, into 'this most secret and powerful of the Cabinet groups'.[110] Before the meeting, Balogh had asked Castle to watch carefully what Jenkins said as 'he feared it was "just and empty exercise" because the Bank would never agree to Brutus'.[111] Although, Balogh himself was adamant that blocking should be implemented in an emergency even if the Bank came out against. Whilst Castle could not see the British public accepting such a move from the Labour government, in its present state of unpopularity, she was

> 'heartened to find that Harold [Wilson] and Roy [Jenkins] had gone as far as they had done in preparing such far-reaching measures rather than face another bout of savage deflation'.[112]

Although little did she understand that Brutus was not an alternative to deflation but would probably have to be accompanied by it, if the UK was to avoid sucking in too many imports in its aftermath.

Whilst Jenkins was keen that his colleagues would agree to continued planning he recognised that it would be unrealistic to suppose that the group could decide in advance to automatically invoke Brutus should the reserves fall to a given level. To that, Castle asked whether in an emergency there could be 'any alternative to Brutus?'[113] For Wilson the answer was a guarded no, 'Only multilateral action which we hope will come when they [the Americans and Europeans] look over the brink and see what we must do otherwise'.[114] In that sense, Wilson had very much reverted to his old blackmail gambit. It was clear to him that Brutus was not a venture to be embarked upon whilst other options were still open. That it was only to be used

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[110] Castle, B. The Castle Diaries: 1964-70. (Weidenfeld and Nicolson: London, 1984), p.462.
[111] ibid
[112] ibid, p.463.
[113] Castle, B. Diaries. p.463.

in an emergency, when their backs were against the wall, where the threat of it (Brutus) did not open the wallets of the international community. To Wilson's mind, there would then be no alternative to it, even though it might have degenerated into floating.[115]

Wilson, as usual, was also preoccupied with the security implications of this type of planning. He advocated a tightening up of procedures so that the names of all those concerned would be held in one central list and he asserted that no departures from it would be permitted without specific prior authority.[116] Indeed, Sir Burke Trend had made him aware that the advances in planning had necessitated more consultation by the Treasury with other departments. Such consultation was required to ensure that the plan devised was as efficient as possible, but with it came increased risks of a leak. Trend suggested not only restricting the number of officials involved, but also limiting the number of Wilson's Cabinet colleagues that were aware of its development.[117] In fact, there was probably more likelihood of leakage from ministers than from officials. Trend also advocated a new codeword. For

> 'now that we have reached Brutus 8 (and, as I understand Bootstrap 8 as well!) there is something to be said for changing both code words which should mean nothing at all to anybody save those who are indoctrinated'.[118]

After all, Brutus was hardly a neutral codeword. Although Rawlinson chose it in honour of the *Ides of March*, it did have some rather awkward connotations. In many ways, it could be seen as Britain stabbing her sterling area allies in the back and it may have been possible that those who were not indoctrinated would guess what the operation entailed from the name alone.

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[114] ibid.
[115] PRO CAB 130/498 'Cabinet Misc Committees, Ministerial Group on Brutus, Meeting 1, June 1968', 13/6/68.
[116] ibid
[117] PRO PREM 13/2052 Trend to Wilson, 'Brutus Planning', 12/6/68.
[118] ibid

Wilson's Misc 205 were happy to endorse the new security arrangements, one supposes party out of practicality but perhaps because it would help to affirm the committee's role as the dominant economic policy forum and reduce the rest of the Cabinet to a glorified rubber stamp. Therefore, Brutus became Cranmer.[119]

The Euro-Dollar Market

Meanwhile, officials in the Treasury continued their planning. Rawlinson set about investigating the implications of Cranmer on the Euro-Dollar market and reported his findings to Allen on 17 June.[120] It is unclear why it took Rawlinson so long to attend to this aspect of planning, when the Allen group requested a paper on it at its very first meeting in March. One can only conclude that Rawlinson had decided that it was necessary to work initially on developing a practical version of Cranmer and that to focus on more detailed issues at an early stage would have been the planning equivalent of putting the cart before the horse.

The Euro-Dollar market was operated by Banks, who accepted short-term deposits in dollars and then re-lent them for short periods. Banks would lend dollars to other banks and private borrowers and the market was a useful method for redistributing surplus liquidity. The British Euro-Dollar market was operated by both British and foreign Banks and by April 1968 was valued at around $17.3 billion.[121] In the UK, the banks that operated the market earned their profit from the mark-up between the borrowing and lending rates and by switching dollars into sterling and thereby lending to the EEA.

In the context of Cranmer, there was the fear that the blocking of the sterling balances would arouse suspicion that foreign currency balances would also be blocked, culminating in the

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[119] This changeover formally occurred on 20 June 1968. Although some documents used the new code word before this time, others still used the old one after the 20 June deadline.
[120] PRO T295/606 Rawlinson to Allen, 'The Euro-Dollar Market', 17/6/68.
[121] PRO T295/501 'The Euro-Dollar Market', 10/6/68

withdrawal of the Euro-Dollar balances from the UK.[122] This would have been problematic for the British banks that operated the market, as they tended to lend out funds for longer periods than they had access to them, safe in the knowledge that new deposits would cover the shortfall. If there had been a failure in confidence amongst those that had deposited in the market there would almost certainly be a run on the banks. This would put the banks in the difficult position of having to meet liabilities when they had already lent on the dollars. This could very well have meant that British banks would have had to default in order to prevent themselves going under.

This curious problem can best be elaborated on by the use of a hypothetical example. If, for argument's sake, British banks had liabilities to overseas residents of $4,200m on a term of three months but had lent 20% of the money out for five months, they would be in tremendous difficulty post-zero. Under Cranmer it would have been unlikely for the banks to accrue any new dollar deposits that they could use to meet their liabilities, because potential investors would no longer have confidence in the British market. Consequently, the banks would have found themselves owing $4,200m at month three but they would by short by $840m until month five.

It was plain in the case of the Euro-Dollar market, that there would be two possible courses of action under Cranmer.[123] Firstly, to do nothing and simply note that its continued operation would be one of the many risks associated with blocking. The second alternative was to block Euro-Dollar liabilities at the moment of inception. For Rawlinson, the solution was to do nothing. A run on Euro-Dollars would not directly limit the success of the Cranmer block, as it would not precipitate the haemorrhaging of Britain's foreign exchange. Whilst it could have led to a number of British banks going under, Rawlinson recognised that there could be no

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[122] ibid
[123] PRO T295/606 Rawlinson to Allen, 'The Euro-Dollar Market', 17/6/68.

question of the Treasury bailing them out.[124] Instead, he considered whether it might be prudent for the Treasury to stop the imbalance in the Euro-Dollar market pre-Cranmer. After all, if blocking was to be implemented in the distant future, and the market had already been curbed, the problem would be gone. However, Rawlinson recognised that in the pre-Cranmer world, the Euro-Dollar business was very profitable for Britain and to remove it would greatly reduce Britain's invisible earnings. Furthermore, if the market was restricted, it may well have led to a reduction in confidence in sterling, resulting in the very situation that the Treasury was trying to avoid. The answer then, was to do nothing and to recognise that the problem of Euro-Dollars was one, on a growing list of difficulties, which could occur if Cranmer was enacted.

GATT, EFTA and the IMF

Meanwhile William Hughes, from the Board of Trade, simultaneously examined the Cranmer implications for the regulations governing international trade.[125] This was perhaps the only commissioned micro-study where the results did not all add to the already immense list of problems. For Hughes believed that Cranmer would not have conflicted with either the GATT or EFTA conventions, as both organisations allowed quantitative import restrictions to be imposed by countries that were in balance of payments difficulties.[126] However, in order to remain on good terms with GATT, Hughes believed that it would be necessary, as time went on, to introduce token quotas for goods that were completely prohibited at the start.

Yet, the fact that UK would have had a legal justification for her actions under both the GATT and EFTA articles would not have in any way diminished the fact that such action would have given 'a severe shock to both institutions which they might not survive'.[127] Furthermore Cranmer would almost certainly have led to the end of multilateral trade; instead, bilateral

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[124] ibid
[125] PRO T295/495 Hughes to Allen, 'Brutus: Implications of International Trade', 17/6/68.
[126] ibid

arrangements would have to have been implemented. This would have meant that the UK would have to use her bargaining power as one of the world's largest importers and exporters to kick start trade. Such bilateralism would have resulted in Britain being able to export less than she would have done under multilateral agreements, something that would not help either the reserves or the balance of payments.

Hughes also recognised that the implications of a British anti-import stance reverberated further than the potential demise of both GATT and EFTA. As British imports accounted for around 9% of the world total, it was clear that any sizeable reduction on the part of the UK could cause 'an upset in the world markets big enough to affect the course of world trade and perhaps the stability of some countries'.[128] Ideally, the Treasury should have conducted a detailed study of both the likely impact of a British import reduction on world trade and the possible effects of bilateralism on the British capacity to export. However, Rawlinson, who by now agreed with the Bank that Brutus was an empty exercise, concluded that

> 'It is a laborious exercise and I doubt whether we can carry it far as part of the current contingency planning, at least in the immediate future and with present resources'.[129]

It was also clear that whilst both GATT and EFTA might tolerate the Cranmer regime, if they continued to exist in its aftermath, it was very unlikely that the IMF would co-operate. This was because Article VIII of the Fund's agreement with the UK forbade restrictions on current payments and transfers without appeals to the Fund.[130] It would also have been an offence

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[127] ibid. It was possible that if the UK moved to bilateralism other countries including the US and France would move in the same direction and GATT would collapse.
[128] ibid.
[129] PRO T295/495 Rawlinson to Figgures, 'Post-Cranmer Bilateral Negotiations', 19/6/68.
[130] T295/502 'Cranmer: Relations with the IMF and OECD', 20/6/68.

against 'the spirit and letter of the IMF articles'[131] for Britain to have moved to a bilateral system of trade. The implications of this were quite serious for the Treasury. In order to gain IMF approval, it would have been necessary to court it in advance, something that was out of the question because of the immense security considerations. However, without IMF backing, the UK would surely have lost her rights to draw on the fund. This would have been disastrous in the early days of Cranmer when foreign exchange would have been in short supply.

The Number Three Account Reconsidered

The Bank's opposition to the Cranmer scheme had not in any way diminished as planning intensified. If anything, it had increased. It doubted the utility of the proposal and was unconvinced that it would be administratively practical. In particular, it had begun to develop grave reservations about the successful operation of the number three queuing accounts. Bennett was especially dubious, as the rate for number three account sterling would have depended on the rest of the world's view on the length of the queue and the exchange rate at the time of release.[132] It would have been very difficult for foreigners, in the early days, to form a judgement on which to base a rate for number three account sterling. The market in it might only have established slowly and speculatively. Under such circumstances, Bennett doubted whether foreign exporters would be prepared to accept this type of sterling as payment for goods. Their assumption would be that the UK would be unable to maintain the current sterling parity for long. Consequently, foreign exporters would be likely to either put their selling prices up, causing inflation in the UK, or to demand payment in foreign exchange thereby defeating the object of the account.[133]

Of course, the problem of confidence in sterling might have been reduced if the rate of number three account sterling could be guaranteed. This would have removed uncertainty in the minds

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[131] ibid
[132] PRO T295/498 Bennett to Rawlinson 'Cranmer: Number 3 Accounts', 20/6/68.

of foreign exporters, if it could be made to look credible, but it would not provide any assurances about the length of the queue.[134] Even so, the Bank doubted whether it would actually be possible to administratively operate the queuing system effectively. Under the pre-existing proposal, transfers from number three to number two accounts would have been allowed in *tranches* determined by the Treasury. Places in the queue would have been designated on a first come first served basis. However, in practise the Bank felt that it would have been very difficult to combine the queuing system with transferability.[135] This was because tens of thousands of individual accounts would have been involved and it would have been quite unmanageable for British banks to keep track of all the queued sterling.[136] One must remember that when the scheme was devised, banks were operating before the use of computers was widespread and would probably have had to track the funds manually with written ledgers.

If Cranmer was to be successful, the Bank felt that it would have to be greatly modified. They suggested a new and very complicated system that would have operated in the following way:

- **Number one accounts**: Fully blocked as under Brutus 8.

- **Number two accounts**: Fully convertible

- **Number three queuing accounts**: individuals and companies would be ineligible to hold these and foreign banks would hold a monopoly over them. Once a bank's holdings of this type of sterling reached the top of the queue it would be transferred to the number two account where it would be fully convertible.

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[133] ibid
[134] ibid
[135] When Posner devised the queuing account he believed that by allowing transferability between holders, foreign exporters would be more likely to accept this kind of sterling as payment, as they could jump the queue by passing their holdings on at discount to those who were prepared to wait for convertibility.

- **Number four accounts**: all pre-zero sterling would be paid into these accounts. They would be transferable between holders but this type of sterling would be frozen.

The main feature of this proposal was that only banks would be able to queue and not individual sterling holders. When a foreigner received payment from the UK that qualified for number three account entry, that money would be credited to their number four account. This account would be transferable between holders but its balances would not qualify for a place in the convertibility queue.[137]

The Bank envisaged that overseas banking institutions, who would be the only holders of number three accounts, would buy the number four account sterling from their customers and deal between one another. This would mean that individuals and companies that received number four account sterling would not have a place in the queue. Instead, they would either sell their holdings to a bank at discount, which would queue for conversion rights, or they would instruct the bank to hold the funds on their behalf as number three sterling. As a result the number four account holders would have had the opportunity of obtaining a discounted value at a time of their choosing by selling to the banks or else sharing in whatever sterling was released at the full rate to the bank at which they held their account.

At intervals, when the Treasury felt that releases could be made from the reserves, an announcement would have been made that a certain percentage of number three account sterling held by the banks could be transferred to the Number 2 account.[138] The system would have been simple to operate from the British perspective, as there would be no need for British banks to keep track of individual parcels of sterling as they moved around the market. The

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[136] PRO T295/498 'Cranmer: No 3 Accounts', 25/6/68.
[137] ibid

onus would have moved entirely onto the overseas banks. These Banks in turn might be glad to operate it, as it could potentially have been very profitable. After all, if number four account holders were not prepared to wait for conversion they could hand over their rights to the bank at whatever discount rate the bank cared to operate. All of this made these modifications attractive to the Bank. It would ensure that damage to its key support groups would be minimised if Cranmer was ever implemented: domestic banks would not be burdened by it and foreign banks would profit from it.

The main drawback with the Bank's proposal was it that would have involved serious modifications to the Cranmer scheme. Under the existing proposal, the number three account system was envisaged as a method of getting foreign exporters to supply the UK with goods on credit. The transferability between non-residents was not essential to its operation as it was intended simply as an added incentive to foreign exporters to accept the new system. It would have been far easier for the planners to remove the transferability rights than to completely restructure the scheme around foreign banks, when it could not be certain that they would ever undertake to operate it.[139] What was also clear was that the Bank of England system amounted to introducing an officially organised floating rate for UK imports whilst operating a fixed rate for exports.

For Rawlinson the new scheme was unworkable-

> 'Our position vis a vie foreign suppliers is uncomfortable- we should be saying- "We will pay for your goods in No.4 account sterling. This in itself is of little use to you. You must find a bank to buy it. If you cannot find a bank to buy it, or do not like the banks terms, there is nothing in our system

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[138] ibid
[139] ibid

which will ever make this sterling useful to you. No.4 sterling will never be convertible in your hands'.[140]

On 28 June the full Allen group considered the Bank's proposal.[141] Rawlinson accepted the Bank's objection to the number three account but instead of opting for the Bank's plan, had reformulated Cranmer so that it no longer allowed transferability between number three account holders. However, the Bank was keen to stress that even with transferability removed the volume of work that the existing scheme would entail would be enormous. Furthermore, it would have been very unlikely that foreign banks would have be prepared to undertake it and the brunt of it would fall on British institutions. However those that favoured the existing scheme, or perhaps more accurately those that had got to the stage were they felt that the whole exercise was pointless and could not stomach a complete re-write, were at pains to defend the existing number three account. They argued that the workload would only build up over time and that other systems could be put in place on an *ad hoc* basis if Cranmer was ever to be implemented.[142]

To Douglas Allen, the Bank's proposal was only ever likely to work if a guaranteed time limit for queuing was given for number three account sterling. Without a time limit, he could not see that foreign Banks would agree to the system. However, to his mind, it would have been difficult for the Treasury to contemplate giving such a guarantee, in unknown circumstances, and implementing it would undoubtedly lead to calls for its extension to number one accounts.[143] He recognised that whilst the existing system was flawed it was likely to work for a certain length of time and it would give the UK some breathing space in which to set up a comprehensive import quota system. Consequently, he urged that the existing queuing system,

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[140] ibid
[141] PRO T295/505 Hoskin 'P.G. (68) 2nd Meeting HMT Group on Contingency Planning', 28/6/68.
[142] ibid
[143] ibid

minus transferability should be adopted as part of the Cranmer plan. While post-Cranmer, he accepted that they would have to watch the situation very carefully.

July

By July 1968, most of the central issues relating to Cranmer planning had been aired if not resolved. Much of the work that occurred during the month focused on brining the whole plan together into one final draft. So that in the unlikely event that ministers called 'stand-to', blocking could be implemented in a matter of days. Moreover, because officials had become so horrified by the potential consequences of Cranmer, they wanted to put it to bed and instead focus their efforts on a more workable alternative. Even so, there were still some issues that had not yet been decided upon and it was necessary to work them through before they could leave the scheme to gather dust. The ability of the Treasury officials to plan for a course of action that they knew would be both disastrous and unlikely pays testament to their professionalism. As Rawlinson reported to Hoskin 'The likelihood that Cranmer will be needed in the near future has receded but HMT is still under firm instructions to complete it by the end of August and put the papers away.'[144] By this stage, the spirits of Rawlinson and his planning cohorts must have ebbed.

In early July, officials considered in more detail the sorts of import reduction methods that they might use in a Cranmer environment. It seemed that there were two broad alternatives. Firstly, to implement a comprehensive system of physical import restrictions, by putting together a list of prohibited imports and devising a quota system to limit the number of other types of non-prohibited goods entering the country.[145] The second alternative was simply to rely on the import-licensing scheme, with its Alpha, Beta, and Gamma classifications, for the duration of the block. Officials recognised that both schemes were technically feasible but that

[144] T295/605 Rawlinson to Hoskin 'Cranmer', 22/7/68.
[145] PRO T295/502 'Cranmer: Imports', 2/7/68.

both had potential drawbacks. The problem with implementing a system of physical restrictions was the same as it had always been. Namely that it was impossible to plan for it in secret and that the system would have to be built up around Cranmer post-zero. As well as this, customs would have to learn the new system quickly and would have to impound prohibited goods, leading to congestion at the ports.

However, it was recognised that in the long-term physical restrictions was a better bet than sticking with import licensing. This was because the licensing scheme would add to the amount that would eventually have to be paid off from the frozen number one account. As instead of the goods being impounded and/or returned, the foreign seller would receive payment under the Gamma license into his number one account. Officials also believed that foreign exporters were more likely to understand the physical restriction system. Therefore, less unwanted goods would arrive under it than would arrive under licensing.[146] It would also be fair to say that the planners preferred physical restrictions because it had been done before and it was easier to predict how it would operate and what potential problems would emerge under it. Hence, it was decided that licensing would be used only in the interim and once customs could be trained to operate the physical restriction scheme, that method would supersede it.

Androcles

During early July, the Treasury team also turned their attention to the problem of mobilising private portfolio holdings. Such mobilisation was central to the Cranmer scheme because the proceeds of sale were to be used to fund the rundown the number one account balances. At first sight, it seems a great omission that planners waited until such a late stage in the development of Cranmer before they turned their attention to this issue. Though, it must be remembered that the plan for mobilisation did not originate from Cranmer but was considered

as a contingency plan in its own right, firstly under the codename Bootstrap and latterly Androcles, from as early as 1965.[147] Furthermore by July, both Rawlinson and Posner had come to view it as an acceptable standalone alternative to Cranmer in its own right.[148]

However, within the Cranmer context it was recognised that there were three potential methods that could be used to bring about mobilisation. The first was to abolish the existing investment currency market and create a new one in which UK residents *may* sell their overseas securities or foreign exchange proceeds of sales to non-resident number one account holders.[149] This proposal could have been implemented without fresh legislation and UK citizens might well have made a profit from the sale because those who were desperate to get out of sterling might have sold their number one account holdings to UK residents at substantial discount.

Nevertheless the scheme, if enacted, would have been very slow acting because the UK authorities would not have been forcing their citizens to sell their holdings but instead requiring them to sell *only* to number one account holders *if* they ever decided to divest themselves of their securities.[150] Equally, the fact that number one account holders would be selling at discount would mean that the scheme could never have been regarded as a complete and proper solution. Instead the Treasury felt that if Cranmer were implemented, it could be used as an interim measure to let holders get out of sterling if they could not wait long enough to get a full refund.

The second alternative was for the UK authorities to compulsory acquire all of the foreign securities held by its residents, with a view to selling them.[151] Whilst this would give the

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[146] ibid
[147] PRO T295/256 'Redeployment of Overseas Assets (Bootstrap)', 19/3/65-6/6/67.
[148] PRO T295/580 Rawlinson 'Brutus: Mobilising Private Overseas Portfolios', 13/6/68.
[149] PRO T295/502 'Annex: A Selection of Androcles Schemes', 10/7/68.
[150] ibid
[151] ibid

government complete control over the operation it would have required fresh legislation and a great deal of administration. Consequently, it would have taken several months to put in motion. However, when the government came to sell the securities there would have been trouble in terms of both the price that the government would pay its citizens and the amount of money that could hope to be generated from the sale. After all, when one places £4,000m[152] of securities onto the market for sale simultaneously, there will be a considerable depreciation in value. Consequently, a second variation of this proposal was envisaged, whereby instead of selling the securities, HMG would use them as collateral for a loan, although, this could only postpone the debt and substitute the creditor.[153]

To my mind, a more workable alternative would have been to pool the securities once acquired and offer them to the number one account holders instead of payment. This would mean that it would be the sterling holders and not HMG that would have suffered when large amounts were simultaneously cashed in. Indeed the fact that large-scale encashment would have reduced the returns might well have induced the new owners to hold onto the securities.

The third technique was similar to the first in which UK residents voluntarily sold their holdings abroad. The principal difference would be that the government would take fresh legislative powers would enforce the sale. Citizens would be instructed to sell either all of their holdings or a proportion of them, with the proceeds being repatriated to the UK.[154] Whilst a system of compulsory registration would be required to enforce the scheme the administrative workload would be reduced; it would be the citizens themselves that sold the securities, and not Whitehall officials.

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[152] This amount is based on the December 1965 Bank of England Review of Private portfolio holdings which put the figure at £3,600m-£4,000m. See PRO T295/256 'Redeployment of Overseas Assets (Bootstrap)', 19/3/65-6/6/67.
[153] PRO T295/502 'Annex: A Selection of Androcles Schemes', 10/7/68.
[154] ibid

The planning group did however recognise that there were some serious problems that would emerge with the enactment of Androcles, irrespective of the version chosen. First was the obvious political fallout. No such operation had been embarked upon in peacetime and there would have been a great deal of discontentment amongst British citizens, who would be far from overjoyed that their assets had been compulsorily purchased. All the more so because few outside economic circles understood the nature of the crisis that Britain faced. Even much of the Cabinet was ignorant of the true plight of sterling.[155] Second, there would also have been severe political criticism abroad. Massive sales of overseas securities if done quickly would, as I have already mentioned, have an adverse effect on the world market. This point cannot be emphasised enough; British dollar securities represented 1/20 of the entire US stock market.[156] Third, at that time the dividends from the securities amounted to approximately £150m per annum.[157] The mobilisation of the portfolio would provide the British government with a lump sum of foreign exchange but only at great detriment to future invisible earnings. However, all of the officials were agreed that 'these objections are outweighed by the need to do something towards repaying No.1 accounts'.[158]

On the other hand, officials were in no hurry to decide which of the three proposals should be implemented under Cranmer. This was because it was not essential to the successful operation of the blocking regime to have worked out the mobilisation technique in advance. It was enough at this stage simply to outline a number of alternative proposals and then examine the issues in more depth post-Cranmer. They also advocated requisitioning more expert help once blocking had been implemented, as the security implications would not be so grave. Furthermore, post-Cranmer all of the Treasury's administrative resources would have been devoted to implementing the block and if some sort of public committee or commission could

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[155] Castle, B. Diaries. p.545.
[156] PRO T295/502 'Cranmer and Androcles', 10/7/68.
[157] ibid
[158] ibid

be established to deal with the Androcles aspect, it would take a great deal of pressure off the Treasury's workload.[159]

Telling Whitehall

By the middle of July, much of the detailed Cranmer planning had been concluded. From now on, it was simply a process of tying up loose ends. The final issue that the planning group concerned themselves with was the process by which they would indoctrinate their Whitehall colleagues into the operation of the system post-zero. After all, there were great differences between Cranmer and the devaluation. The devaluation had been quite a simple operation that was easily explained. Much of the planning in preparation for it centred on its presentation to the rest of the world. With Cranmer, presentation would again be important but the scheme itself was very complicated and officials that were not involved in its development would have required a great deal of explanation at every stage.[160] Rawlinson believed that when and if new officials were indoctrinated, they would need something in writing proceeded by an oral explanation. He also anticipated that the present small circle of planners would have been the only ones who knew of the scheme's existence until stand-to was ordered. However, he was prepared to advocate the inclusion of the Foreign Office at a much earlier stage, as they would play a pivotal role in presenting Cranmer to the world.[161]

It was also essential to consider how news of the plan would be communicated to the British posts overseas in the build up to the operation.[162] Broadly, there were two means of transmitting such information. The first was to send ciphers to all the relevant posts. However because of the large number of embassies and consulates that would have to be informed the Foreign Office would have required four days notice, in order to make the necessary

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[159] ibid
[160] PRO T295/510 Rawlinson to Figgures 'Cranmer: Telling Whitehall', 8/7/68.
[161] ibid
[162] PRO T295/605 Rawlinson to Hoskin 'Cranmer', 22/7/68.

preparations. This would mean that some posts would be informed earlier than others and if the operation was called off at the last minute a large number of people who did not need to know of Cranmer's existence, would.[163] The second alternative was to send sealed envelopes to the posts. However, this carried even more disadvantages. It was possible that they could go missing in transit and it was unclear whose responsibility it would be to guard them. More importantly, it was likely that if Cranmer was implemented at a much later date, the plan would have altered and the contents of the envelopes would have been out of date.[164] It seemed, therefore, that the first option was the least worst.

There was also the problem of informing Ministers to consider.[165] It was probable that if the decision to implement Cranmer were taken, it would be Misc.205 that gave the order to *stand-to*. Nonetheless, it would almost certainly have been necessary for the entire Cabinet to ratify their decision. However, as has already been stated, the scheme was not one that would be easy to grasp from a brief oral exposition. If the Cabinet as a whole were to do anything more than rubber-stamp it, they would have to have a copy of the master plan sometime before the meeting. This however came with risks, because any paper circulated would be seen by a large number of officials and might result in leaks. Therefore, Rawlinson was forced to conclude that 'in practise it may still be that only Misc.205 would really grasp the scheme as a whole'.[166]

On 17 July, Allen ended the planning aspect of the exercise stating that he 'did not think any future meetings of the group would be needed until September'.[167] To his mind all of the various micro-issues involved in Cranmer planning had been aired. Although the attempt to tie up the loose ends created more ends than there had originally been, it was time to end the exercise. Allen had never been enamoured by the scheme and those that had been, were no

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[163] ibid
[164] ibid
[165] PRO T295/510 Rawlinson to Figgures 'Cranmer: Telling Whitehall', 8/7/68.
[166] ibid

longer favourably disposed to it.[168] The change in heart of those on the ground can be traced to point at which Brutus 8 was completed and the focus shifted to micro planning. It was from this moment onwards that Rawlinson and Posner began to consider the implications of the scheme for Britain and the international system in detail and that the horrors of it became apparent. This does not mean that they had, by this stage, decided that floating would be the only viable alternative. Instead, they hoped that it would be possible to implement an alternative second order instrument that was more palatable and which reduced the likelihood of being forced into Cranmer in the first place. The possibilities included implementing Androcles by itself as a means of bolstering the reserves; winding up the sterling area to stop capital outflows but above all else getting the sterling area countries to *voluntarily* agree to freeze their own holdings. In short, they were banking on Basle.

Summary

This chapter has sought to reconstruct the deliberations of the sterling contingency planning network in its attempt to craft Operation Brutus. The plan was a complicated and highly technical second order instrument that was designed to preserve, under emergency conditions, the third order goal of fixed exchange rates by blocking the sterling balances, in order avoid both the devaluation and/ or floatation of sterling. Although officials from the Bank still regarded Brutus as non-viable, because of the implications for its key client groups, its officials still collaborated with the Treasury in the production of the plan. It is arguable that the reason that the Bank was so keen to maintain network relations was that it would enable it to scupper the exercise from the inside. However, this proved unnecessary. As planning progressed, Treasury officials quickly came to realise the true implications of the full Cramner scheme, which would require a ban on foreign travel, rationing at home and the vesting of citizens private portfolio holdings. Furthermore, given that the OSA used sterling

[167] PRO T295/505 'PG(68) 4th Meeting HMT Group on Contingency Planning', 17/7/68.
[168] Interview with Lord Croham

as its reserve asset it was likely that world trade would break down, as its balances would be blocked. Consequently, the Treasury came to doubt the merits and workability of blocking. It was, however, recognised that unless a crisis avoidance network could be formed which was able to devise a second order instrument that made blocking redundant, if a future sterling crisis materialised there might be no alternative to Cramner.

Chapter 6- The 1968 Basle Agreement

In chapter two, I explained that the policymaking process within the core executive was best viewed in terms of policy networks. I also stated that within the realm of external economic policy, two types of network appeared to exist. These were (a) the crisis avoidance and (b) contingency planning networks. The former attempted to manipulate policy instruments in order to ensure that a crisis of sterling would not materialise, whilst that latter planned for emergency action in circumstances where crisis avoidance had failed. Thus far, this thesis has mainly focused on the work of contingency planning networks. It has done so in terms of an analysis of the FU group's [first order] plan to devalue the pound and the Allen group's [second order] scheme to block the sterling balances. In this chapter, I propose to examine the work of one of the crisis avoidance networks that operated during 1968. In the analysis that follows, it will become clear that both types of networks operated in a context of path dependency. That the output of the crisis avoidance networks shaped the context within which the contingency planning network operated and vice versa. However, it is important to stress that this chapter does not begin at the point at which the last one left off. This is because the activities and membership of the crisis avoidance network greatly overlapped with those of the Allen group and for a time, both operated simultaneously. However, it would have been too difficult to weave a discussion of this network's behaviour into the preceding chapters without creating confusion. Therefore, the chronology must be skewed in order to preserve the argument.

In this chapter, I intend to outline the origins and development of the 1968 Basle agreement, which was crafted by an avoidance network where the Bank acted as hegemon. The scheme was designed to ensure that the official sterling balances of the OSA would be protected against the ravages of further devaluation and in so doing actually prevent the necessity of devaluation. This is because with the agreement concluded, one of the threats to the stability

of the currency would be neutralised and confidence in sterling would increase. The agreement itself was successfully negotiated during the summer of 1968 and comprised two parts. The first was an undertaking by a large number of central banks, with the BIS acting as an intermediary, to provide a $2 billion medium-term loan. This facility was to be used only to cover foreign exchange loss to the EEA incurred through the direct diversification of the OSA's official and private balances and could not be used to finance a British trade deficit. The second part comprised a pledge by the OSA, that it would halt the direct diversification of its official balances, which had begun after the devaluation. In exchange, the UK extended a dollar value guarantee to 90% of its balances. This meant that if the pound was again devalued, the balances would be written up in order to maintain their dollar purchasing power. Of course, it was not benevolence that drove British policy-makers to negotiate such a settlement, but practical considerations about the best way to stabilise the currency. For if the sterling area's accounts could be made inert through the judicious use of carrot and stick, one of the sources of pressure on sterling would be neutralised.

Preliminaries

Whilst ministers in the Labour government were kept apprised, they were in no way the architects of the Basle agreement and they did not take an active part in the dialogue. In total, ministerial involvement was limited to the decision to authorise the negotiations in the first place and to report on the success of them, to the House of Commons, in the aftermath. The Treasury's involvement in the development of the proposal was also limited, at least in the early stages. In truth, the Bank masterminded the whole operation. It devised the plan, examined its feasibility, conducted preliminary negotiations with other central banks at the BIS and only when it concluded that there might be some chance of success, did it begin consultations with the Treasury. At the Bank, the key players were Kit McMahon, advisor to the governors, Jeremy Morse, Executive Director, Rupert Raw, Head Dealer, John Fford,

Executive Director, Maurice Parsons, Deputy Governor and of course the Governor himself, Leslie O'Brien.[1]

Initial discussions within the Bank can be traced back at least as far as January 1968.[2] Both Raw and McMahon worked together, during this period, and produced the Bank's first paper on the subject. They recognised that, in the immediate aftermath of devaluation, with £2 billion of assistance already outstanding and with little likelihood of improvement in the balance of payments during 1968, the situation was perilous. It was made all the more so, by the fact that this was accompanied by 'substantial moves out of sterling by both private and official OSA holders'.[3] They recognised that it would be essential to improve confidence in the currency in order to attract inflows of private funds, to try to contain OSA diversification, and to consolidate and rephrase official debt. Therefore, as a minimum objective they advocated attempting to renew the pre-existing Basle arrangements, negotiated in 1966, for a further 12 months.

However it was recognised that because the Bank had drawn on all its available facilities, and would in time have to repay them, the renewal of the Basle arrangements would not actually provide further assistance, but would instead have to be used to finance existing liabilities. Furthermore, in the wake of the devaluation, it was not thought out of the realms of possibility that the EEA would have to finance as much as £750-£1000 million of diversification. Consequently, Raw and McMahon argued that it would be best to push for some additional credit, from wherever it could be obtained.

In principle, they felt that there were three possible means with which to gain the urgently needed additional resources. The first was to engage in bilateral negotiations with a number of central banks and foreign governments. The second was to approach the IMF and the third,

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[1] Interviews with Sir Jeremy Morse, Sir Kit McMahon and Lord Croham
[2] Bank OV44/159 Raw and McMahon, 'Extension of the Basle Arrangements', 16/1/68.

was to use the BIS as an agent, through which participating governments would provide credit. This third alternative was of course the method that had been used in 1966 to raise support to help offset fluctuations in the sterling balances. O'Brien welcomed the initiative and his preference was for it to be conducted under the umbrella of the BIS, rather than bilaterally or via the IMF.[4] This was because he believed that it was unlikely that participating countries would be prepared to proceed on a bilateral basis and that the IMF route was a non-starter. The Fund was already overburdened and O'Brien believed it unlikely that they would be able to launch such a support operation in less than a year.[5]

However, one issue that the Bank, and McMahon in particular, found it difficult to decide upon was the use to which any new funding would be put. Was it to be used as a mechanism to *halt* diversification or to actually *fund* it?[6] Up until 1968, UK policy had centred on the first objective. Credits had been sought from the BIS in order to improve confidence in the currency, thereby reducing the propensity of OSA holders to divest. Yet, if a facility of monumental proportions could be gained, it would in theory be possible to fund the wholesale windup of the currency's reserve role and to bring about 'a controlled and moderate withdrawal into a financial Little England'.[7]

This was however as far as the discussions advanced in the Bank and for some unfathomable reason the issue was put on hold until early March, when a draft of McMahon's paper on 'The Future of the Sterling Balances' was circulated within the Treasury.[8] In that paper, the problem of sterling post-devaluation, was outlined. McMahon argued that the difficulty did not centre on the NSA balances, because they now stood at £900m, were comprised almost entirely of working balances, and therefore the scope for further diversification of them was

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[3] ibid
[4] Bank OV44/159 Morse 'Note for the Record', 22/1/68.
[5] Bank OV44/159 Raw and McMahon, 'Extension of the Basle Arrangements', 16/1/68.
[6] Bank OV44/159 McMahon 'The Future of the Sterling Balances', February 1968.
[7] PRO T312/1953 Posner to Allen 'Funding Sterling', 5/6/68.
[8] PRO T312/1953 McMahon 'The Future of the Sterling Balances', March 1968.

limited. Therefore, he concluded that the existing 1966 BIS facility remained an 'appropriate form of stabilising mechanism'.[9] On the other hand, he reported to the Treasury that the same could not be said about the balances of the OSA. The declining confidence in sterling, in the wake of devaluation, had in his view triggered a move from indirect to direct diversification. As well as this, because of the Labour government's decision to reduce its defence commitments East of Suez, a large number of OSA countries would have to increase their military funding, and it was likely that this would be accomplished, in the short-term, by drawing on their balances. He believed that it was also unlikely that the OSA private balances would continue to grow in size, because the lack of confidence in the currency had reduced the will of depositors to hold sterling. Consequently, McMahon argued that an increase in the private balances could not be counted on to offset the diversification of official balances, as had previously been the case. The worst case scenario was that the sterling area's holdings might fall by as much as £500m during 1968. This was not a strain that the EEA could have borne, even if by some miracle there was a turnaround in the balance of payments. Therefore there was a danger that the new 'sterling parity could not be maintained'.[10]

McMahon therefore advocated pushing for further international monetary co-operation, just as he and Raw had done in their preliminary Bank discussions. Whilst the existing BIS arrangement was designed to deal with fluctuations in the balances they could not finance a long-term downward trend. As the threat from NSA movements was deemed small, the solution was to devise new arrangements that would finance the run-down of both the official and private OSA balances. It would be necessary to obtain *at least* $1.5 billion and preferably $2 billion worth of support, because of the potential scale of the withdrawals. Such credits could not be short-term in nature, as they would be used to cope with a permanent, irreversible movement on a substantial scale.

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[9] ibid
[10] ibid

The Treasury was broadly supportive of the Bank's proposal.[11] Ryrie in particular agreed with the Bank's decision to come down in favour of a BIS scheme, rather than one backed by the IMF. If the Fund route was to be pursued it would have been necessary to establish a new framework whereby the UK was entitled to draw new credits above the normal 200% limit, but without any special restrictions being applied to the way that British economic policy was conducted. However it was felt unlikely that the Fund's directors would be so obliging, as extension of credit on this magnitude would likely have provoked ill feeling from other countries. It is arguable that they would have resented Britain's special treatment. The BIS route offered greater flexibility. The Bank of International Settlements could act as an agent to a group of central banks, keeping the books of the scheme and helping to get it started in the first place.[12] Alternatively it could act as a principal; borrowing in its own name and lending the funds accrued to the UK. Such a scheme would also represent the continuation of the system of credits that was put in place in 1966.

With Treasury approval of the proposal, O'Brien put the issue in a very preliminary manner to the other central bank governors that made up the Basle club, on 7 April 1968. He covered much of the same ground that McMahon and Raw had done in their examination of the issue. However he made it clear that he did not wish any financing of the sterling balance problem to be contingent on the UK 'issuing guarantees on..[the]..sterling holdings to the sterling area central banks'.[13] The Bank's predisposition against offering guarantees had not weakened any since it had first rejected the possibility, during the contingency planning for the devaluation in the mid 1960s. The arguments against, in April 1968, remained the same. Namely, that instigating guarantees from a position of weakness would reduce rather than increase confidence. Furthermore, it would not be possible to extend the cover to all sterling holders.

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[11] PRO T312/1953 Ryrie to Goldman 'Building on Basle', 6/3/68.
[12] ibid
[13] Bank OV44/160 'O'Brien's Speech to BIS' 29/3/68.

Those that were excluded would be inclined to diversify, even if they had in the past remained loyal.[14]

At the meeting only Brunet, governor of the French central bank, questioned O'Brien's stance against guarantees.[15] There was however, general agreement amongst the other governors that the deterioration in confidence in sterling had become a dominant factor in the wish for diversification and that this made the problem both immediate and important. As well as this, the preference for gold, as opposed to sterling or dollars, had also increased within the OSA. Especially as the US move to a two-tier gold market meant that many bankers thought that the possibility of a revaluation of the metal was highly likely in the near future.[16]

The governors at Basle were generally supportive of the British proposals. Although, they recognised that their governments would ultimately have to be brought into the negotiations. However if this was done too soon, there was every likelihood that the plan would be leaked, especially as so many would be aware of it. If news came out at such an early stage, and nothing came of the negotiations, then the collateral damage for sterling in terms of confidence would be high. This placed the central bankers in something of a quandary; they could not very well withhold details from their governments whilst they negotiated the particulars. The solution was for the Bank of England to engage in bilateral negotiations with the BIS, in order to devise an elaborated version of the scheme. This would greatly reduce the guilt of the central bankers; whilst they were aware of the proposals they would not have been actively involved in shaping them. Only after the scheme had been well worked out would it be presented to the governors in May or June 1968. As the central banks would not be discussing the proposal until then, 'they would not have to inform their governments'.[17]

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[14] Bank OV44/160 'Should We Give Guarantees?', 16/4/68.
[15] Bank OV44/160 'Extending the Basle Arrangements' 10/4/68.
[16] ibid
[17] ibid

However, it seems that there was another lull in the Bank's efforts to develop a workable proposal. One supposes that the Bank's attention was diverted to the preparation of papers for Douglas Allen's group on Operation Brutus. Or more specifically, to the attempt to dissuade the Treasury from taking the blocking exercise any further. For the Bank were very strongly of the view that the idea of blocking was

> 'an act of hostility and betrayal towards countries which have built up holdings of sterling through normal international trading...There are effectively no half measures with blocking. Any measure of interference with convertibility would have disastrous effects. In the short-term, it would be bound to provoke a flight from the non-blocked balances; in the long-term we should have to expect to liquidate all of the sterling balances even if we only blocked part of the balances for a short time'.[18]

It was not then, until 1 May that attention returned to Basle, when Ferras, the Managing Director of the BIS, and MacDonald, Head of its Banking Department, visited the Bank to begin their discussions.[19] The object was to produce a detailed blueprint that could be presented to the central bank governors at their next meeting on 10 May. It seems then, that both the BIS and the Bank were very *last minute* in their approach to the whole exercise. However, the talks appeared fruitful and O'Brien reported to the Treasury that he expected that an outline of the scheme would be ready by the middle of the next day and in fact was able to provide them with a sketch of the proposal by 3 May.[20]

The facility was to be for an amount equivalent to $2 billion, subject to the agreement of all concerned. The Bank would have preferred to push for $3-4 billion, but recognised that this

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[18] Bank OV44/161 'Blocking', 9/5/68.
[19] PRO T312/1953 Goldman 'Sterling Balances: Building on Basle', 1/5/68
[20] PRO T312/1953 Morse to Goldman, 3/5/68.

was impossible.[21] The $2 billion would be raised by a group of central banks, under the co-ordination of the BIS. The aim would be to provide a 'safety net' for the UK to protect the reserves from future falls in the sterling area balances, below the £3,080m benchmark.[22] Once the facility came into being, the UK would be entitled to draw on it to meet reductions in the balances below that benchmark. It was proposed that the funding would be made available for a period of three years, but that the Bank would not have to make repayments for a further two years. After which, repayments would be spread over a period of five years, in equal quarterly instalments. Of course the Bank would only be obliged to repay the portion of the facility that was used and would have the right to make payments earlier than the suggested schedule, if this was to its advantage. However, the 3+2 year facility proposed by the BIS was not considered long enough by the Bank for the UK's requirements.[23] A ten-year drawing right would have been greatly preferred, and at the very least one lasting five years. Nonetheless, the Bank recognised that three years was better than nothing at all, and that in practise the date of termination was effectively the date for re-negotiation.

Under the proposal, the participating central banks would enter into agreement with the BIS and would consent to make funds available up to the amount of the facility, for the purpose of financing it. However, Ferras and MacDonald concluded that the arrangement would be more palatable to the central banks, if the scheme could be designed so that drawings from their funds could be minimised.[24] One way of accomplishing this was to call on OSA central banks to deposit some of their NSA currencies with the BIS. If the UK needed to draw on the facility to fund the conversion of some of the OSA's balances, it would initially be the OSA's non-sterling currencies, deposited at the BIS that would be made available to the Bank to cover the costs of conversion.[25]

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[21] Bank OV 44/160 Fenton to McMahon 'The MacDonald Scheme', 18/4/68.
[22] PRO T312/1953 'Outline of a Possible New Facility for the Bank of England', undated.
[23] Bank OV 44/160 Fenton to McMahon 'The MacDonald Scheme', 18/4/68.
[24] ibid

If this proved to be negotiable, it would mean that the OSA would in effect finance the facility themselves through their dollar deposits to the BIS. The Bank promised to 'use its best endeavours to persuade OSA central banks to make such deposits'.[26] It recognised that if it proved negotiable, the Basle club would be more likely to co-operate, as its fear that the facility would be used up in a matter of weeks would be greatly allayed. However, it is difficult to see what could have induced the OSA to comply. It was not as if the Bank was going to offer to guarantee their balances as a sweetener. Even when the offer of a guarantee was extended as part of the proposal, many of the OSA countries still greatly resented the UK's request.[27] In that sense, the Bank was overly optimistic in its initial assumptions. Goldman, at the Treasury, also recognised that if the involvement of the OSA were to be requested, it would mean that they would have to be brought into the UK's confidence at an early stage.[28] With this came the risk of a leak and the possibility that the OSA would want to have some input in the formation of the initial blueprint. If the sterling area was able to muscle in on the preliminary negotiations, there was the potential for the balance of any settlement to be tipped heavily against British interests.

The Move to Guarantees

These were not the only objections to the proposal. By the beginning of May, Dudley Allen, the official at the Bank responsible for liasing with Australia, had begun to have further doubts of his own.[29] He anticipated that if the Bank were successful in obtaining the safety net at Basle, the facility might actually *encourage* OSA countries to move out of sterling. He argued that the size of the facility would significantly influence the attitudes of the OSA. If it were not large enough to fund all of the sterling area's balances, all of the holders would

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[25] PRO T312/1953 'Outline of a Possible New Facility for the Bank of England', undated.
[26] ibid
[27] PRO T312/1963 'Sterling Area Negotiations: Report on Progress', 25/7/68.
[28] PRO T312/1953 Goldman to Allen 'Building on Basle', 3/5/68.
[29] Bank OV44/161 'Sterling Balances: Approaches to the OSA- Exchange Guarantees', undated.

'jump off quickly in order to ensure that they can freely convert'.[30] The facility would therefore be quickly exhausted, Britain would have further indebted herself to the tune of $2 billion, and half the sterling area balances would still be in existence.[31] Indeed, several of the central bank governors, at the Basle negotiations, made it clear that they could 'not envisage any further support operation for the UK going beyond the one now under negotiation'.[32] Therefore, once the facility was used there could be no hope of getting additional credits to finance the windup of the remaining balances. The only way to avoid this problem would have been to ration convertibility and place strict limits on the portion of each OSA balance that could be converted into dollars. However, 'rationing convertibility' was another way of saying that part of the sterling area's balances would be blocked.

If this route were taken, the flight from the non-blocked OSA balances would have to be financed by the Basle facility. However, it was extremely likely that the partial blocking of the OSA's balances would greatly reduce confidence amongst NSA holders. Although the NSA's sterling holdings were at an historic low after devaluation and was mainly comprised of working balances, the partial blocking of OSA funds could induce the fear, amongst NSA holders, that it would not be long before their balances were also made inconvertible. This could again destabilise them and place intolerable pressure on the EEA.

To Dudley Allen, the solution was for the Bank to guarantee a portion of the OSA's sterling holdings from the start, rather than to use the facility to fund diversification.[33] For if the balances were guaranteed the scheme would no longer be a safety net to fund diversification, but a scaffold to stabilise the balances. After all, if the OSA could be assured that their balances would be protected against the effects of a possible future devaluation, this would increase the confidence of holders and reduce their propensity to divest. Furthermore, if the

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[30] ibid
[31] Bank OV44/161 D.W.C.Allen 'Sterling Balances: Approaches to the OSA', 9/5/68.
[32] PRO T312/1953 'Sterling Area Working party', undated.
[33] Bank OV44/161 D.W.C.Allen 'Sterling Balances: Approaches to the OSA', 9/5/68.

guarantee were offered only in return for an undertaking by the OSA not to diversify any further, the balances would not only be stabilised but would become completely inert.

However, it was clear that such a guarantee could not be gold-value in nature, for if there were a revaluation of the metal, the Bank would be forced to make large payouts.[34] The solution was to guarantee to maintain sterling's purchasing power in relation to the dollar, if the pound was devalued. This could be accomplished in two ways. The first would be for the Bank to offer foreign exchange to the OSA to make up for any shortfall in the purchasing power of sterling after a devaluation. If this option were pursued, then the Basle facility would be drawn upon to make the payments. The second and more promising possibility was simply to offer to write-up the sterling balances to maintain their dollar purchasing power. This would involve no call on the facility, as no foreign exchange would be offered as part of the arrangement.[35] It offered the possibility of stabilising the sterling balances without having to make any use whatsoever of the Basle facility and it was therefore the course of action that Dudley Allen advocated. In theory, it would have been possible to pursue the strategy without gaining any additional credits from the Basle club. However, it was recognised that in practise, it would probably prove necessary to make certain concessions to the OSA in order to get the proposal off the ground. It was likely that the OSA would demand, as the price for its participation, the further liquidation of a significant proportion of its sterling holdings. If this price had to be paid, the Basle facility would finance it.

Allen's departure was however, rather a bold one. This was because it flew in the face of the Bank's pre-established line on guarantees. Since the Bank had dismissed the arguments in favour of guarantees in the mid-1960s, the well-rehearsed arguments against them became part of the fabric of the Bank view. However, it was clear that it was the Bank view that needed revision and not Allen's. In fact it is arguable that if the Bank had not been so quick to

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[34] ibid
[35] Bank OV44/161 'Sterling Balances: Approaches to the OSA- Exchange Guarantees', undated.

reject the possibility of guarantees pre-devaluation, the change in parity and the contingency planning that came in its aftermath would have never have been on the agenda.

John Fforde agreed, at least with Allen, that if the choice was between a safety net or a guarantee, it was the latter that should be embraced.[36] He accepted that if the UK opted for a safety net, it would simply be a matter of displacing the liabilities to the sterling area with a debt to the BIS creditor countries. Although the Bank had been in the past loath to advocate a system of guarantees, Fford recognised that a credible guarantee would avoid the need to actually get into more debt, as it would not actually be drawn upon.[37] He argued that the Bank's opposition to guarantees had been conditioned by a number of arguments relating to the circumstances that prevailed *before* devaluation. However

> 'the present situation is quite different. Devaluation has occurred and we are confronted with massive diversification after devaluation, which we are trying either to "refinance" or reverse in order to avoid descent into total disorder'.[38]

By opting for a guarantee, it was possible that Britain's reserve currency role could be maintained. The Basle club had come to similar conclusions at its meeting on 10 May, and argued strongly that Britain should review its opposition to the extension of exchange guarantees. The Treasury's historical memorandum on the Basle Agreement argues that it was this pressure that made the Bank reconsider its view.[39] Of course, Dudley Allen must really be credited. In any case, discussions continued in the Bank. Some argued that the guarantee proposed could never be acceptable to the OSA: because in return for its extension, the

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[36] Bank OV44/161 Fforde 'Safety Net' ,17/5/68.
[37] ibid
[38] ibid
[39] T267/29 'Historical Memorandum on the Sterling Balances', undated.

sterling area would have to pledge that it would refrain from further diversification.[40] This would mean that it would in effect be agreeing to voluntarily suspend convertibility on some portion of its assets. The doubters argued that liquidity was an essential constituent of a reserve currency and that it was therefore unlikely that the OSA would welcome the proposal with open arms.

However, those that had come the favour the approach, argued that although in theory the sterling balances, pre-guarantees were fully convertible, in practise they were not. The sterling area was well aware that if all its members pressed for full conversion rights simultaneously, the UK would have to refuse because the EEA could never meet the bill. Therefore, the offer of a guarantee might be accepted because under the present situation holders were at risk both in terms of devaluation and convertibility. With a guarantee, 'they could at least be assured they would be protected against further devaluation'.[41] The supporters argued that the UK should seek to limit OSA diversification to the extent that sterling made up at least 50% of the sterling area's reserves. The facility, provided by the Basle club, could be used in order to fund the reduction in the balances to that level. The remaining sterling would be locked in and guaranteed. However, the mechanics of the lock in mechanism were yet to be decided. In principle, there were two possibilities.[42] The first was simply to ask the OSA to enter into a formal undertaking not to diversify any further, in other words to extract a solemn promise. The second was to formally embody the agreement, by issuing long-term bonds that would be both illiquid and non-transferable.

On 24 May, O'Brien reported the change of heart, with respect to guarantees, to Douglas Allen.[43] He argued that the proposal had many advantages from the UK's point of view. The funds involved would cease to be liquid and consequently their volatility would be removed.

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[40] Bank OV44/161 'Sterling Balances of the Overseas Sterling Area', 21/5/68 and PRO T312/1953 'Sterling Balances of the Overseas Sterling Area', 23/5/68.
[41] ibid
[42] Bank OV44/162 Morse to O'Brien, 24/5/68.

There would also be a corresponding reduction in the amount of sterling that was available in the market for speculative use.[44] Furthermore, he argued that a guarantee with corresponding obligations on the part of the OSA would be preferable to one without strings attached. For under the later scenario, if a new crisis erupted even with guarantees in place, it would be likely that the OSA would switch out of sterling.[45] However, if the proposal was accompanied by some measure of locking in, it would not be possible for the OSA to convert their holdings and the effect of the crisis would be greatly reduced. The price for negotiating the lock-in would probably be that the OSA would wish to diversify some of its funds before the new system was implemented. If all of the countries concerned reduced their sterling balances to 50% of their reserves, the cost would be £700m and this could be financed by the Basle facility.[46]

By this stage, O'Brien and his colleagues at the Bank had come to favour the issuing of long-term bonds and thought them the best means of locking in the remaining sterling.[47] Such bonds would be expressed in sterling, with a maintenance of value clause in terms of the US dollar. The bonds would be repayable to the OSA seven years after they had been issued, in ten equal instalments over a number of years. The rate of interest payable on them would have to be high in order to make them an attractive prospect and it was thought that some limited transferability between holders might also be desirable.[48] Only the OSA's official balances would be eligible for the scheme, as the costs of extension to private holdings would have been too high. In any case, local exchange control restrictions prevented the conversion of private holdings in a large number of the sterling area countries.[49]

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[43] PRO T312/1953 O'Brien to Allen, 24/5/68.
[44] PRO T312/1953 'Sterling Balances of the Overseas Sterling Area', 23/5/68.
[45] Bank OV44/162 'Sterling Balances and the Overseas Sterling Area', 27/5/68.
[46] PRO T312/1953 'Sterling Balances of the Overseas Sterling Area', 23/5/68.
[47] ibid
[48] ibid
[49] Bank OV44/162 'Sterling Balances of the Overseas Sterling Area', 30/5/68.

By 30 May, the Bank had also begun to consider how it would go about negotiating the settlement with the OSA.[50] The general line devised was that because the UK was heavily in debt and in balance of payments deficit, it could not afford any extra pressure on the reserves from the sterling area. Consequently, the UK was asking for co-operation from the OSA in the halting of diversification. As the OSA might not be happy at having to hold sterling, the UK would be prepared to extend exchange guarantees. Some in the Bank also argued that a sterling area conference should be called in order to conduct the negotiations. It would ensure that progress could be made more swiftly, as there would be no need for the UK to send delegations to each of the OSA countries. However, this line was quickly dropped because it would 'have the drawback of facilitating some "ganging up" against Britain'.[51] In other words, if multilateral talks were held, the agreement that was hammered out might be less favourable for Britain, because the OSA countries might work together in order to improve their respective bargaining positions.

By 6 June, Douglas Allen had concluded that the proposals had been developed enough to put them to the Chancellor for consideration.[52] This was made all the more urgent because, on 9 June, O'Brien would again meet with the central bank governors in Basle, to order to further refine the proposal. Without Jenkins' consent, it would have been impossible for the governor to express the Bank's fresh view, on the desirability of guarantees. The Chancellor however, recognised the sense of the proposals and whilst he would not allow O'Brien to positively endorse the change in strategy he authorised him to state that the government did 'not rule out the possibility of some form of exchange guarantee'.[53]

The response of the central bank governors, at the meeting on 9 June, was mixed. Whilst the bankers were positive about the scheme itself and the UK's 'new position on guarantees had

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[50] ibid
[51] ibid
[52] PRO T312/1953 Allen to Dowler 'Sterling Balances: Guarantees', 6/6/68.
[53] PRO T312/1953 Armstrong to Hubback 'Sterling Balances: Guarantees', 7/6/68.

been well received' other difficulties emerged.[54] The biggest hurdle, as far as the Basle club was concerned, was the fact that governments would have to be involved in the negotiations, in order to authorise the participation of their respective central banks. Whilst the Scandinavians, Germans, Italians and the Dutch reported that they expected little difficulty the Federal Reserve had made little progress with the US Treasury. This was because of the latter's preoccupation with taxation policy. The Japanese had difficulties with respect to lending long-term and could only agree to lend renewable short-term loans. The French were unlikely to participate at all, because of their balance of payments difficulties and the Belgians were positively obdurate.[55] However, it was recognised that by the end of July 1968, it would be necessary to open bilateral discussions with the OSA and that it would therefore be crucial for the central banks to obtain, by the beginning of July, assurances that the facility could be negotiated.

Yet, by 13 June, the prospects looked much improved, at least with respect to the Unites States. The President was taking a considerable interest in the scheme and saw no difficulty in terms of gaining congressional approval.[56] Furthermore, US officials suggested that Harold Leaver, the Financial Secretary to the Treasury and Jenkins' second in command, should visit Washington for further discussions.[57] Nevertheless, work at the Bank and Treasury on the broad blueprint continued. Both organisations again turned their attention to the precise mechanics of the guarantee operation. The familiar alternatives of *bonds* verses *undertakings* were considered at great length and became known as Plan A and Plan B respectively.

Bonds verses Undertakings

Up until this point, the Bank had favoured proceeding on the basis of bonds (plan A). This was because it would achieve a greater degree of locking-in and from a presentational point of

[54] PRO T312/1953 Dowler 'Note for the Record', 11/6/68.
[55] ibid
[56] PRO T312/1953 Goldman to Allen 'Building on Basle: Discussions in The Hague', 13/6/68.
[57] PRO T312/1953 Dowler 'Note for the Record', 17/6/68.

view, it would greatly increase confidence in sterling. However, by 19 June it had begun to have some serious doubts.[58] It was clear that there would be considerable administrative difficulties for the departments that would have to control the stock. This was because they would have to gather a large portion of the sterling balances, held cash, equities, and securities and replace them with bonds. As well as this, it was obvious that if the bonds were to be designed in a form that was to be attractive to the OSA, interest rates would have to be high. These interest payments would significantly increase the amount that would have to be paid back to the OSA at the end of the life of the bonds. Further research also revealed that even with high rates of interest, a large number of sterling area countries would be incapable, under their existing laws, of holding such a security, as they required a minimum liquid reserve level as backing for their domestic currency.[59] It was also likely that the OSA would regard an attempt by the UK to replace a liquid with an illiquid asset as a partial blocking operation.[60]

The Bank concluded that *undertakings*, also known as plan B, would be more negotiable. Under the plan, 80% of the OSA's sterling holdings would be guaranteed against a further devaluation of the pound. Although the percentage chosen seems almost arbitrary, the Bank decided upon it because roughly 20% of the OSA's sterling holdings comprised working balances. Even if the sterling area continued in its bid to diversify it would have been impossible, because of its need to pay for British imports, to hold any less than this figure.[61] Therefore the British authorities would be providing guarantees as an incentive to hold onto the remaining 80%, and only that remainder would be eligible for compensation in the event of another devaluation. The guarantee would be given with the provision that it would be activated 30 days after a devaluation. This was because if it was given on the first day, the

[58] PRO T312/1953 Goldman to Allen 'Building on Basle: Next Steps', 19/6/68.
[59] PRO T312/1960 'Record of a Meeting in Mr Goldman's Room', 19/6/68.
[60] PRO T312/1953 Goldman to Allen 'Building on Basle: Next Steps', 19/6/68.
[61] PRO T312/1953 'Sterling Area Working party', undated. Bank OV44/166 'The Basle Scheme and the Sterling Area: General Negotiating Brief', 2/7/68.

British authorities might have subsequently found that the dollar also devalued and that funds were needlessly wasted.[62]

In return for the guarantee, the sterling balances would not be locked into bonds but instead each country would undertake not to reduce the total sterling proportion of its reserves below a minimum percentage.[63] Ideally this undertaking would be met for a total of seven years and the guarantee would either expire or be renegotiated during the summer of 1975. The precise percentage of sterling that each country held would be decided upon during negotiations. Ideally, it would be the pre-existing one, but if this could not be agreed upon then British negotiators would be authorised to lower it to 50%. The undertaking would mean that OSA countries could only draw on their sterling in the same proportion as they drew on their NSA currencies. Whilst if they decided to increase the size of their reserves, they would have to ensure that their minimum sterling proportion (MSP) was not breached and this would actually involve increasing their sterling holdings.[64] So whilst the funds would not be locked in, it would be impossible for sterling area countries to simply move out of sterling at a whim, because they would not be able to discriminate against it. Of course, where reductions in the balances had to be made the Basle facility and not the EEA would fund these.

All of the guaranteed sterling could either be held in special G[uaranteed] accounts, which would make policing possible, or they could stay in the form they were already in, providing holders declared their reserve levels monthly.[65] A charge would however be made for the facility, based on the differential in interest rates between the London and New York markets.[66] There was no doubt, as far as the Bank was concerned, that Plan B would not only offer fewer administrative problems but that it would also be preferred by the sterling area.[67]

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[62] Bank OV/44/167 'Maintenance of Value Guarantee', 9/7/68.
[63] PRO T312/1953 Goldman to Allen 'Building on Basle: Next Steps', 19/6/68.
[64] ibid
[65] Bank OV44/164 'Record of a Meeting in Mr Goldman's Room', 19/6/68.
[66] PRO T312/1953 'Sterling Area Working party', undated.
[67] Bank OV44/164 'The Sterling Area and the Basle Negotiations', 19/6/68.

It was recognised that whilst it would be more difficult to police the scheme, especially if G accounts were not used, it would involve less actual diversification. This was because the funds were not actually locked in. As a result, OSA countries would not have to convert any of their sterling into NSA currencies to meet their balance of payments needs, as they would have needed to do under Plan A. Hence, there would be fewer calls on the Basle facility. Plan B would also mean a lower interest rate burden on the Exchequer and the balance of payments over the years.[68] It would be easier to negotiate with the OSA because 'it had a less ridged and more voluntary appearance and would retain the liquidity of their reserves'.[69] However unlike the parallel discussions that were taking place between Treasury and Bank on Operation Brutus, agreement was easy to come by and the Treasury were happy to accept the Banks preferred course.[70]

Preparations for the OSA Negotiations

Both the Bank and the Treasury also recognised that although they had not yet received firm undertakings from the Basle group that the facility would be provided, it would be prudent to continue planning for the second stage of the negotiations with the OSA. This was because O'Brien would, in a matter of weeks, return to Basle to formally seek the facility. If agreement was reached at that meeting in early July, bilateral negotiations with the OSA countries would have to begin immediately, if there was any hope of minimising concern in OSA countries and concluding the settlement by September.[71] It was clear that once the creditor countries had in principle accepted that the new arrangement could be worked out, negotiating teams would have to travel to each OSA country in order to obtain agreement to plan B. The negotiations would be started via a message from the Chancellor, which would

[68] PRO T312/1960 'Record of a Meeting in Mr Goldman's Room', 19/6/68.
[69] PRO T312/1953 'Sterling Area Working party', undated.
[70] Bank OV44/164 'Note of a Meeting in Mr Figgures Room at the Treasury', 20/6/68; PRO T312/1960 'Record of a Meeting in Mr Goldman's Room', 19/6/68; Bank OV44/164 'Record of a Meeting in Mr Goldman's Room', 19/6/68.

be sent to all OSA governments. The message would extend an offer to send a negotiating team, which would comprise a Bank and a Treasury representative.[72] It was likely, that in each case, the Bank's representative would hold more sway with the sterling area country in question than the Treasury man would. This was because the Bank, unlike the Treasury, cultivated close links with the sterling area member countries.[73] It employed a number of officials to act as its servicing agents to foreign central banks and these individuals would have a greater intimacy with the local officials. Because of the importance the Bank attached to ensuring that its representatives took part in the negotiations, it decided that these officials would be allowed no summer leave and those that had already booked holidays were compensated for their loss.[74] It was anticipated that the negotiations with the OSA would take place between 15 July and mid-August, with the hope of presenting the completed exercise to the BIS on 7 September.[75]

On 26 June, an inter-departmental meeting was held to further discuss these issues. Goldman chaired it and representatives from the Treasury, Bank, Commmonwealth Office and Foreign Office attended.[76] It was agreed that British posts, in all of the OSA countries where negotiations would take place, would be informed of the guarantee scheme. Plan A and B were again reconsidered and it was concluded that the OSA countries would be offered a choice between the two.[77] One supposes that this was decided upon because although the OSA would not look favourably upon plan A, the UK by pretending to negotiate for it, would soften up resistance to plan B, the intended scheme. It was also decided that negotiators should attempt to press for an agreement lasting seven years but that one lasting five would be adequate. Whatever length was negotiated clearly had to be uniform, because the agreement

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[71] Bank OV44/164 'Note of a Meeting in Mr Figgures Room at the Treasury', 20/6/68; PRO T312/1960 Morse to Goldman 'Sterling Balances', 25/6/68.
[72] Bank OV44/164 'Negotiations with Sterling Area Countries', 20/6/68.
[73] Interview with Dudley Allen.
[74] Bank OV44/164 'Negotiations with Sterling Area Countries', 20/6/68.
[75] Bank OV44/164 'Sterling Balances: Programme for Negotiation', 25/6/68.
[76] PRO T312/1960 'Record of a Meeting', 26/6/68.
[77] ibid

would appear rather ramshackle if different countries negotiated different durations. Equally, it was deemed important that negotiators should avoid giving offence by 'presenting the proposals too much as a "take it or leave it" proposition'.[78] It was also felt vital to avoid giving the impression to the OSA that the proposals were being imposed upon the sterling area because the Basle group required them in return for providing the facility. Of course, the reality was that they were. It would have proved impossible to negotiate with the Basle countries if the UK had not made some moves towards a guarantee system.

It would not however prove possible to talk to all countries simultaneously, in the way it would have been if a multilateral conference were convened. Still, the group recognised that it would be imprudent for the negotiators to simply get the OSA countries to sign the agreement in a conveyor belt manner.[79] It had been decided that whatever agreement was reached would be uniform and this uniformity could not be maintained if countries approached later in the negotiations would not accept the terms that had been agreed by other countries in earlier negotiations. Consequently, it would be necessary to hold two rounds of talks with each country. During the first round, the UK would be able form a general picture of the sort of agreement that all of the countries were prepared to accept and during the second round, that agreement would be ratified.[80]

The Basle Facility is Offered

Of course, all of these discussions and preparations would have been in vain if the Bank was unable to extract the funding from the Basle club in the first place. On 7 July, O'Brien met with the other central bank governors, at the BIS, in an attempt to negotiate the facility. He again reiterated the Bank's revised position regarding guarantees and confirmed that if the facility was made available, representatives would be dispatched to the various OSA countries

[78] PRO T312/1960 'The Basle Scheme and the Sterling Area: General Negotiating Brief',undated.
[79] ibid

in order to obtain their co-operation.[81] However Ansiaux, Governor of the Belgian National Bank, again voiced his objections and in particular he argued that he did not think it was wise for the central banks to place themselves under such a credit risk. One supposes that he doubted Britain's balance of payments would improve enough to allow her to pay back, to the central banks, her drawings under the scheme. In any case, he concluded that the risks would be too great unless the OSA central banks placed all of their future accruals of NSA currency into a BIS account and that they did not make withdrawals from these accounts, except for balance of payments purposes. This would ensure that a large part of the Bank of England's drawing on the facility would be met by the OSA's NSA holdings.

However, this was not something that O'Brien could agree to. It would be difficult enough to get the OSA to forgo their sterling conversion rights, but quite impossible to get them to agree to deposit all of their NSA currency with the BIS. All that O'Brien could do was to pledge that he would put the proposal to the OSA in the hope that several of them would deposit at least some of their funds. Ferras however leapt to O'Brien's defence, as did Stopper, who was representing Switzerland.[82] They both reminded Ansiaux that it was more important to convince the OSA not to diversify any further, than to make it put NSA currencies on deposit at the BIS. After all, the aim was to ensure that the present structure of the OSA reserves was maintained and not to alter it further by forcing the sterling area to change who they deposited with.

From this point onward the mood of the meeting changed. Although the French were not prepared to participate, all of the other central bank governors were positive. In some cases their governments had not yet authorised participation but the Bank was assured that gaining it would be a mere formality. Zijlstra, acting in his role as President of the BIS, concluded that in principle the facility could be raised but that nothing could be finalised until after the

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[80] ibid
[81] Bank OV44/167 'Meeting of the Central Bank Governors at the BIS', 7/7/68.

UK had concluded the negotiations with the OSA. At which point, it would be possible to judge whether, and to what extent, these visits had been satisfactory. However no agreement of undertaking was signed by the Basle governors and the Bank had to be content with spoken assurances. To the modern day observer, this does seem like something of a risk. Without a signed agreement, it was possible that the Basle club could go back on its word come September. However, it is important to remember that within banking circles 'the spoken word retains, or used to retain, a higher status and the written word remained less formal'.[83] This would certainly add credence to the old adage that *a banker's word is his bond.*

It appeared that the word of the central bankers was also enough for Jenkins. The following day he reported to the House of Commons, on the success of the negotiations. In particular he stressed that the facility 'offer[ed] the prospect of greater stability in the functioning of the international monetary system'.[84] Although he stated that consultations with the OSA would take place, he did not make it public that a guarantee scheme was to be negotiated. It would appear though that O'Brien was not quite so reticent. When he returned to London, on the same day, he made clear to financial journalists that it was a guarantee scheme that was to be negotiated with the OSA.[85]

Exchange Control and Operation Brandon

Now that the Basle group had agreed in principle to provide the facility, certain members of the Treasury had concluded that the negotiations with the OSA could effectively be used to kill two birds with one stone. Rawlinson in particular was of this view. He had for some time, been alarmed at the amount of British private portfolio investment that was leaving the

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[82] ibid
[83] Fforde, J. The Bank of England and Public Policy: 1941-1958. (Cambridge, CUP, 1992), p.xv. Fforde was referring to the status of the spoken word *within* the Bank of England but one supposes that his comments are equally applicable to agreements *between* central banks.
[84] PRO T312/1961 'Extract from Hansard: Sterling (B.I.S. Discussion)', 8/7/68.
[85] 'Foreign Bankers Finally Take Over Sterling Area', Telegraph. 9/7/68.

country and moving into the OSA, and in particular to Australia. Some steps had already been taken to thwart the outflow, most notably the Voluntary Programme being operated in conjunction with the Australian government. Under it, the Australians entered into agreement with the UK to voluntarily restrain the amount of British capital that entered their boarders. However, Treasury calculations suggested that the outflow was still exacerbating the balance of payments deficit, to the tune of £50-100m per year.[86] Rawlinson had, since at least January, considered more radical ways of tackling the problem. In particular, he had in mind a proposal code named Operation Brandon, which had formed an integral part of the Cranmer exercise. The object of Brandon was to reduce the scheduled territories to the British Isles and extend exchange control to the sterling area. This would mean that the regime that was being applied to the NSA would be extended to the OSA and it would become impossible for British citizens to move their capital offshore. Of course if Brandon were implemented, the sterling area would cease to exist.[87]

In the past, the idea had been rejected because there was the fear that its implementation would provoke the diversification of OSA sterling reserves.[88] However, if the guarantee system could be put into place, the prospects of retaliatory diversification would be reduced to nil. Rawlinson believed that the OSA negotiations that were to take place to bring about agreement on guarantees could also serve as a useful vehicle through which to implement Brandon. As it was clear that very few of the sterling area countries would loose much if exchange control was extended.[89] Nonetheless, the fact that the Treasury was considering Brandon was something that greatly alarmed the Bank. When Morse got wind of what was to be considered he quickly informed the governor. Stating that

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[86] PRO T295/514 Rawlinson to Figgures 'Brandon and Androcles', 18/6/68.

[87] It is important to note that it would have been impossible to selectively apply Brandon to only a small number of OSA countries. For example if Britain extended exchange control to Australia, it would only prove an effective barrier to outflows if all other OSA countries implemented similar restrictions. If they did not it would be possible for British funds to enter Australia via one of the OSA countries that did not mirror Britain's exchange control regime. Therefore, the only solution was to apply Brandon to the whole of the sterling area. See PRO T312/1962 'Extent of Application of Exchange control', undated.

[88] ibid

> 'We have said, and I thought Douglas Allen accepted, that once we have struck our bargain on guarantees and undertakings with the sterling area we cannot...impose exchange control on them, except possibly as part of a package of total crisis measures'.[90]

However, Posner, Figgures and Hubback had all independently come to the conclusion that to introduce Brandon to the negotiations would complicate and possibly endanger any chance of agreement with the OSA.[91] Posner thought that it would 'also look very odd' if the UK approached the OSA soon after the guarantee issue had been settled and told them that the Treasury was 'considering the virtual abolition of the OSA'.[92] Figgures was rather more optimistic on this score. He accepted that 'a decent interval should elapse but need it be more than a few months?'[93] Therefore whilst the majority of Treasury officials rejected Rawlinson's suggestion that Brandon should be added to the Basle agenda, there was still the possibility that it could be put into operation quite soon after the guarantee scheme had been enacted.

If the UK were to have any chance of implementing Brandon in the aftermath of Basle, it was clearly essential for the British negotiators to avoid discussing exchange control with the OSA during the talks.[94] If however, the OSA broached the issue the UK would be put into something of a quandary. If the negotiators denied the possibility and Brandon was later implemented the whole thing would 'smack of blatant deceit' and the OSA might renege on the Basle Agreement.[95] Yet, if negotiators confirmed that the British authorities had not ruled

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[89] PRO T295/514 'Brandon and Androcles: Note of a Meeting', 27/7/68.
[90] OV44/167 Morse to O'Brien, 9/7/68
[91] PRO T295/514 'Figgures to Goldman 'Brandon and Androcles', 25/6/68; ibid, Posner to Figgures 'Brandon and Androcles', 20/6/68; ibid, Hubback to Figgures 'Brandon and Androcles', 26/6/68.
[92] PRO T295/514 Posner to Figgures 'Brandon and Androcles', 20/6/68.
[93] PRO T295/514 'Figgures to Goldman 'Brandon and Androcles', 25/6/68.
[94] PRO T295/514 Littler to Figgures 'Exchange Control and the Sterling Area', 10/7/68.
[95] ibid

out the possibility, it would be possible that certain countries, including Australia, would refuse to sign altogether. The rather optimistic hope amongst Treasury officials was that the OSA would not raise the issue during the negotiations. This would give the British authorities the freedom of movement to impose Brandon in the aftermath.[96] Jenkins himself thought that it would be 'wrong and dangerously imprudent to tie our hands here and now by ruling out the possibility of Exchange Control, and saying in the negotiations that we have done so'.[97] He too recognised that whilst it would be desirable to make the ending of the sterling area a part of the Basle negotiations it was not a practical course. His considered view was that the aim of negotiators should be to keep the government uncommitted about the future possible imposition of exchange control, even if price of this was a less satisfactory agreement with the OSA.

If this stance was not possible and agreement seemed unlikely with certain countries unless the UK committed itself to maintaining the sterling area, then Jenkins suggested a fall back position. This would involve the insertion of a review clause into the agreement, which would be activated if Britain implemented Brandon.[98] It would give OSA countries the right to reconsider their participation in the scheme, and in all probability, the UK would have to reduce the minimum sterling proportions in order to keep Basle alive. However, if countries like Australia were still prepared to renege on Basle then it would have to be Brandon that was abandoned. As Ryrie pointed out 'the success of Basle is essential and the extension of exchange control is merely highly desirable'.[99]

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[96] PRO T312/1963 Allen to Dowler 'The Basle Negotiations and Exchange Control',16/7/68.
[97] PRO T312/1962 'Memorandum by the Chancellor of the Exchequer', undated.
[98] PRO T295/514 'Memorandum by the Chancellor of the Exchequer', 12/7/68.
[99] PRO T295/514 Ryrie to Figgures 'Exchange Control and the Sterling Area', 15/7/68.

OSA Negotiations

By 25 July, negotiations were well underway with 17 of the 41 countries concerned.[100] By which point only the Bahamas had declared its willingness to be a signatory. Fiji had accepted the undertaking to remain in sterling but would not sign the agreed minute, because it did not want the guarantee on the terms offered. The discussions with the rest of the 17 produced no concrete results and the negotiating teams had moved on to their next ports of call. However, it was apparent that none of the countries approached had declared themselves as opposed to the general line of the British proposals. The Bank was optimistic that each of them would eventually sign the agreement and their delay was thought simply to be a means for them to strike the best possible bargain.[101] After all, it would have been foolish for them simply to sign up until they knew more about what the UK would agree with other countries.[102]

However, the requirement that 20% of reserves should be held in non-guaranteed sterling had given quite a lot of difficulty in a number of countries. Although there was no doubt that a concession on this point would help towards agreement and that it would not prove costly, provided sterling was not devalued.[103] On this issue of the OSA depositing some of its NSA funds at the BIS, little concrete progress was made. However, a number of OSA countries did indicate a willingness to investigate the possibility.

Yet, the one issue on which there was general criticism from the OSA was that of the charge. In a small number of countries, this took the form of opposition to any form of charge but in the majority of cases, the objections were simply to the level of the charge. Those in London co-ordinating the exercise came to the conclusion that if the principal reservation to the

[100] PRO T312/1963 'Sterling Area Negotiations: Report on Progress', 25/7/68.
[101] ibid
[102] PRO T312/1963 Ryrie to Dowler 'Sterling Area Negotiations', 26/7/68.
[103] PRO T312/1963 Ryrie to Hubback and Goldman 'Sterling Negotiations', 29/7/68.

scheme were the charge, then it would have to be lowered or possibility removed.[104] For Ryrie, the choice was between making the concessions before the first round of discussions had been completed, verses waiting until the second round had begun before yielding.[105] If the concession were granted immediately, there was the chance that potentially difficult countries, like Australia, would sign up during the first round. However, it was possible that if the concession was made too soon, Britain's bargaining position would weaken. After all, it was possible that even if the idea of the charge was dropped altogether, the OSA would use the second round as a vehicle to push for concessions on more important issues, namely the MSP.[106]

Indeed, some countries, most notably New Zealand, had already pressed for a lower MSP than the one being prescribed by London. Although, this was not a concession that London could tolerate. For if all of the OSA was to press on this issue, much of the Basle facility would be wiped out in the financing of it. Many of the countries were also pushing for more frequent reviews of the agreement but again this was something that London was not predisposed to. The hope, of course, was that the scheme could be negotiated for seven years and not a day less.

However Kenya, New Zealand, and Ireland had all, as part of the negotiations, asked for assurances that the UK would not impose exchange control at a later date.[107] It would seem then, that the Treasury's optimism during the Brandon discussions had been greatly misplaced. The hope had been that the OSA would not broach the issue, thereby leaving the British authorities with a free hand to extend exchange control in the aftermath of the negotiations. The only possible line that could be taken was that 'this question had nothing to

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[104] Bank OV44/168 'Minutes of a Meeting', 24/7/68. The Bank however favoured a reduction rather than whole scale removal.
[105] PRO T312/1963 Ryrie to Hubback and Goldman 'Sterling Negotiations', 29/7/68.
[106] ibid
[107] PRO T312/1963 'Minutes of a Meeting', 24/7/68.

do with the negotiations'.[108] However if countries like Kenya and New Zealand, which had little to loose from the imposition of Brandon, were asking for assurances, it was very likely that Australia which had a great deal to loose, would also broach the issue. In her case, she was very unlikely to accept the line that exchange control had nothing to do with the present negotiations and it was possible that she would not sign without some very firm undertakings on the part of the UK.

Australia

Australia's disposition against exchange control was made overt when William McMahon, the Australian Chancellor, wrote to Jenkins in July. He stated that

> 'it would be wholly unfortunate if your government were to take further action to restrict the outflow of capital to Australia...I fear too that it would add strength to the considerable body of opinion in this country which favours an early and substantial shift of our overseas reserves out of sterling'.[109]

In short, the message was that any move by Britain, towards Brandon, would be accompanied by rapid retaliatory diversification on the part of Australia. It would seem then, that the British negotiating team in Australia would have their work cut out for them. Furthermore, it was recognised that the successful conclusion of discussions with the Australians was critical. Many OSA countries regarded the Australians as the 'leaders' of the sterling area.[110]Consequently, several of the smaller countries were waiting to see what the Australian reaction would be before they signed up themselves. Without the backing of the Australians, it was clear that the scheme would never get off the ground.

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[108] ibid
[109] PRO T312/1926 Message from William McMahon to Roy Jenkins, undated. However, it is clear that the communiqué was sent before the negotiating team from Britain was dispatched to Australia on 29 July 1968.

The negotiating team arrived in Canberra in late July. Because of the importance of the negotiations, Sir Frank Figgures, the Head of Home and General Finance, represented the Treasury. Francis Cumming-Bruce accompanied him from the Foreign Office and Dudley Allen from the Bank.[111] Allen himself admits that he and Figgures were little more than amateurs, that they had no real training and that it was 'ludicrous to call what went on, negotiations'.[112] In any case, the first full day of talks began on 29 July and it became immediately apparent that the Australians were dragging their heels.[113] They argued that their pattern of payments and the decentralisation of decisions meant that they did not know what percentage of sterling they held at any one time. Therefore, in order to be sure that they were not breaching their MSP it would have to be set at a very low level. In fact, the Australians wanted their MSP to be at least 5% lower than what was being suggested by the British.[114] This would mean a move from 52% of reserves held in sterling to a maximum of 47%.[115] The discussion highlighted the fact that Phillips, the governor of the Reserve Bank of Australia, and Wright, one of its most powerful economists, very much disliked the idea of being locked into sterling and loosing the freedom to arrange their reserve assets.[116]

The preliminary negotiations continued into 30 July and whilst the Reserve Bank of Australia did most of the negotiating, the Australian Treasury struck out a clear line on several issues. Firstly, Sir Richard Randall, its Permanent Secretary, made it clear that an agreement of seven years was far too long. This was because much could change in that time. The fact that Britain was greatly reducing its overseas defence commitments meant that Australia would have to greatly increase its own military budget and some of the costs of this would have to be met

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[110] Interview with Dudley Allen
[111] ibid
[112] Interview with Dudley Allen
[113] PRO T312/1926 'Telegram No. 966', 29/7/68.
[114] PRO T312/1926 'Telegram No. 975', 30/7/68.
[115] PRO T312/1926 'Telegram No. 1000', 1/8/68.
[116] PRO T312/1926 'Telegram No. 966', 29/7/68 and Interview with Dudley Allen.

from the reserves.[117] The Australian Treasury also objected to the charge and argued that it was actually more reasonable for Australia to charge Britain than vice versa! As the Reserve Bank's sterling holdings would, to all intensive purposes be made inconvertible, it was felt only right and proper that Britain provided a compensatory package. Of course, to the British, that compensation was being provided in the form of a dollar value guarantee.

After the meeting was concluded, Figgures spoke privately with Randall. The latter confirmed that in Banking circles there was 'a large and powerful group urging for a massive diversification into gold'.[118] Furthermore, the Reserve Bank's policy was to reduce their sterling proportion to 35% of their total reserves.[119] The present governor, Philips, had only taken office recently and was not in a position to challenge this policy even if he wished to. The Australian's were also anxious not to be 'done' by Britain.[120] However, the success of the negotiations would depend very much on the response of Gorton, their Prime Minister. Yet Gorton was impulsive and unpredictable, he 'was not particularly interested in sterling and didn't understand it'.[121] This would make the negotiations with the political class tricky. However, Randall was conscious of the fact that the rejection of the scheme by Australia, one of the largest sterling holders, would make the whole thing unworkable. He was therefore torn between promoting Australia's national interests and carving out a compromise that would free his country from the odium of being seen as the wreckers of Basle.[122]

Back in London, Goldman had been kept apprised of the situation. Both he and his sterling negotiations group recognised that concessions would have to be made in order to bring about Australian agreement to the plan.[123] One possibility was to remove the charge for the scheme

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[117] PRO T312/1926 'Telegram No. 975', 30/7/68.
[118] PRO T312/1926 'Telegram No. 977', 30/7/68.
[119] This figure of 35% was a bedrock below which it would have been impossible for the Australians to move. They still conducted a large volume of trade with the UK and needed some sterling to finance it. Interview with Dudley Allen.
[120] PRO T312/1963 'Note of a Meeting', 12/8/68.
[121] Interview with Dudley Allen
[122] PRO T312/1926 'Telegram No. 977', 30/7/68.
[123] PRO T312/1963 'Sterling Negotiations Group', 1/8/68.

altogether. The Bank was however not happy for this to occur and could only be pushed to accept a reduction in it. The group was also loath to allow the Australians to reduce their MSP by 5%. Although the Basle facility could easily fund such a movement, the group argued that the scheme was devised on the basis that no OSA country would hold less than 50% of their reserves in sterling.[124] As I have already established, a 5% reduction in MSP would have taken the Australians below this threshold. Goldman argued that because the Australian's desire for such a reduction stemmed from their fear that they might accidentally breach a higher MSP, the solution was for the negotiators to continue to press for 50%, on the understanding that if their reserves accidentally fell below this figure, the UK would not regard this as an infringement on the agreement.[125] On the issue of the scheme's duration, the group was still adamant that no ground could be yielded. The seven-year life cycle had not proved problematic to other countries. It was therefore suggested that the negotiators should press the Australians to agree to the full length, but on the understanding that they would have the right to a review after three and a half years.

These concessions did have some effect on the Australian position, but not the desired one. Instead of calling for a 5% reduction in MSP, they were now demanding one of 17%, which would bring their total sterling holdings down to 35% of their reserves.[126] Furthermore, it was proving to be impossible to negotiate any further with the Reserve Bank, because Philips had left Australia on business and would not return until 26 August.[127] This was problematic for Britain. Although a large number of OSA countries had agreed to the guarantee scheme in principle, they were refusing to sign until Australia had been brought on board. Although discussions with the Reserve Bank had halted, the negotiators continued to court the Australian Treasury. Randall did not, however, help any to dispel the deadlock. He stated that

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[124] Harold Lever, the Financial Secretary, was however more prepared to contemplate a much lower MSP in the case of Australia, if it would help to bring about a long-term agreement. See PRO T312/1963 Lever to Jenkins, 5/8/68.
[125] PRO T312/1963 'Sterling Negotiations Group', 1/8/68.
[126] PRO T312/1926 'Telegram No. 1000', 1/8/68.
[127] ibid

the only conditions under which Australia would accept a 50% MSP was if the agreement lasted one year or until the end of 1969 at the latest. At which point the Australians would be able to reappraise the situation and perhaps extend the scheme until 1971, if their MSP could again be lowered.[128] This of course was not in the spirit of the proposal that had been worked out in Basle, and it was extremely unlikely that the Basle club would extend the facility on such terms.[129] Even if they did, the scheme would no longer be one that would stabilise the sterling balances in the medium term, but one that would bring about a disorderly retreat. For it was clear that the facility being offered by the Basle bankers was to be the last of its kind. If in 1969, the UK had not made a monumental recovery in her balance of payments, she would have no means with which to fund the further reductions in MSP that the Australians were calling for. As well as this, because of the need for a uniform agreement, a one-year scheme would also have to be negotiated with the rest of the OSA and come 1969 further reductions in their MSP's would have to be financed.

The negotiators in Australia were therefore in quite some difficulty. This was exacerbated by the fact the Australian ministers and officials were 'allegedly'[130] pre-occupied with preparations for their budget and were therefore unable to devote their full attention to the negotiations. It also seemed that they did not understand the significance of the proposal. The only solution that the negotiators could devise was for a British Minister to visit Canberra, in the hope that it would bring about a more satisfactory outcome.[131] However, it was recognised that a visit by a junior minister would, in all probability, not have the desired effect. But that the presence of the Chancellor 'would surely be welcomed and would probably be successful'.[132]

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[128] PRO T312/1926 Johnston to Commonwealth Office 'Telegram no.1031', 6/8/68.
[129] PRO T312/1963 Goldman 'Governor's Conversation with Mr. Philips', 9/8/68.
[130] PRO T267/23 'THM on the 1968 Basle Agreement'.
[131] PRO T312/1926 'Telegram No.1010', 2/8/68.
[132] ibid

On 7 August, Jenkins himself considered the issue.[133] Whilst he recognised that 'the Australians were the key to the success of the sterling area negotiations' and that it was crucial to reach agreement with them in time to have the negotiations completed before the September Basle meeting, he was not convinced that a visit by him, to Australia, would be wise.[134] This was because it would be difficult for him to make the trip without attracting publicity and it would be likely that the world media would guess, correctly, that the negotiations were not going to plan. This could only serve to further reduce confidence in sterling. Furthermore, he doubted that the Australians would co-operate with a Chancellor that had masterminded the withdrawal of British forces from the region.[135] The solution was for someone else to go. The prime candidate was the governor of the Bank of England, Leslie O'Brien: because he was not politically connected with the British government. However, if it proved necessary to dispatch him, it would be essential that he attracted as little attention as possible.

O'Brien agreed with the strategy but believed that it might be possible for him to intervene in a manner that would have no chance of attracting media attention and on 9 August he attempted a bout of telephonic negotiation with governor Philips. However Philips'

> 'reaction to all this was apparently not very favourable...he stuck obstinately to the early Australian view of the undesirability of strict formal agreements and of their tying themselves up for as long a period as we would wish...the governor therefore was not to please with the outcome of his talk'.[136]

In the meantime, the Chancellor authorised the negotiators to make further concessions to the Australians. They were to offer to abandon the charge altogether, to be prepared to guarantee

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[133] PRO T312/1926 'Note of a Meeting Held in the Chancellor of the Exchequer's Room', 7/8/68.
[134] ibid
[135] PRO T312/1927 'Note of a Meeting in the Chancellor of the Exchequer's Room', 29/8/68.
[136] PRO T312/1963 Goldman 'Governor's Conversation with Mr. Philips', 9/8/68.

100% of sterling holdings rather than 80% and to push for an agreement of five years duration, with the right to terminate in 1971.[137] In exchange for these concessions, it was hoped that the Australians would agree to an MSP of 50%. However, negotiations did not progress any further. The final decision lay with Prime Minister Gorton, who had become ill with flu and he was unlikely to be well enough to consider the proposal before 19 August.[138]

Basle Contingency Planning

The lack of success concerning Australia led to heightened tension in London and officials began to doubt whether it would be possible to conclude the scheme. Therefore, both the Treasury and the Bank began to independently develop contingency plans. Ryrie, in the Treasury, recognised that if agreement had not been reached with Australia in time for the Basle meeting on 7 September, there was the potential that it could 'deal a heavy blow to confidence.'[139] However, because the press had not been told that the final agreement was expected at the September meeting, Ryrie thought that it would be possible to salvage the situation. Of course, some sort of public statement would have to be made but it might prove to be enough simply to report that the OSA negotiations were progressing smoothly and that the precise date of commencement would be fixed as soon as the negotiations had been completed.[140] The Bank however recognised that if such a line were taken, the press would probably push the British authorities into providing a firm date at which they expected the agreement to be in force.[141] If no such date were offered, confidence would suffer because the press would presume the negotiations were going badly and report this. Yet, in offering a

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[137] PRO T312/1926 'Note of a Meeting Held in the Chancellor of the Exchequer's Room', 7/8/68.
[138] PRO T312/1927 'Note for the Record: Sterling Negotiations', 15/8/68.
[139] PRO T312/1964 Ryrie to Hubback 'Sterling Negotiations', 16/8/68.
[140] ibid. Although by 29 August many of the British newspapers had been prematurely informed by Schiller, the German Finance Minister, that the agreement was to be ratified at the September BIS meeting and that the UK was having difficulty in reaching agreement with some of the OSA countries. See 'Insurance Scheme for Sterling Still Unresolved', Telegraph. 28/8/68.
[141] Bank OV44/170 'Sterling Negotiations: Contingency Planning', 23/8/68.

date, it was possible that Britain would make herself a hostage to fortune, if agreement had not been reached by it.

The main worry in the Bank was not that agreement would not be reached by September but that no agreement would be reached at all.[142] It was essential to get the OSA to agree to at least a three-year deal in order to be able to obtain the facility from the BIS, and this was proving to be a sticky issue with Australia. If no accord was reached with her before the September meeting Britain's bargaining position would be greatly reduced. The Australians would become aware that the success of the whole scheme depended on their assent and they would likely negotiate for a ridiculously low MSP. Kit McMahon in particular was greatly worried about the consequences of failure. He believed that if the negotiations collapsed completely there would be such a blow to confidence that the pound would probably be forced to float.[143]

However as Anthony Glover, secretary to the sterling negotiations group pointed out 'it would never have been the case that the agreement fell through. Instead, it would have been a matter of offering yet more concessions until the stragglers were brought back on board'.[144] In short, Britain would have to have accepted Australia's MSP demands and pushed the agreement through in October rather than September. Of course, the danger remained that by agreeing to such a low MSP, so much of the Basle facility would be used up in the financing of it, that it would be impossible for the UK to make the scheme last the full five years. However Roy Fenton, in the Bank, made it clear that 'it is extremely unlikely that, even if the negotiations end as badly as can be imagined [and very low MSP's have to be agreed to], there would be a call for more than $2,000 million'.[145] Furthermore, it would not actually have been that problematic if the UK had to use up the full facility in order to bring about the

[142] Bank OV44/170 'Sterling Negotiations: Contingency Planning', 27/8/68.
[143] Interview with Sir Kit McMahon
[144] Interview with Anthony Glover.
[145] PRO T312/1964 'Sterling Negotiations: Contingency Planning', 28/8/68.

agreement. The guarantee itself did not require a dollar backing. If there was a further devaluation of sterling, it would simply have been a matter of writing up the sterling balances and there would be no requirement to use foreign exchange.

Australian Negotiations Continue

By 26 August, both Jenkins and Wilson had become personally involved in the negotiations. Wilson had written to Prime Minister Gorton and Jenkins had spoken with his opposite number, Treasurer William McMahon, over the telephone.[146] These interventions seemed to have the desired effect and the Australians promised a decision, one way or another, by 4 September.[147] William McMahon gave the Chancellor the impression 'that the Australian reply, when it came, would not be unfavourable'.[148] It emerged that the whole issue was to be discussed by Gorton and McMahon on 28 August and the hope was that if agreement could be reached quickly, it would no longer be necessary to send O'Brien over to Canberra, and that the possibility of adverse publicity would be negated.

After the Australian Ministerial meeting took place, the British negotiators were able to glean the details of it from various sources and pass them onto London. It emerged that the Australians were calling for an MSP of 40% but that in practise they proposed to hold 45% of their reserves in sterling.[149] This in itself was not problematic and could easily be financed by the Basle facility. However the Australians still objected to being locked into sterling for such a long period and it emerged that they would only sign the agreement if they had the unilateral right to terminate, with three months notice, at any point during the five-year duration.[150] Officials in London were greatly disappointed by this turn of events. For in many

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[146] PRO PREM 13/2053 Chief Secretary to the Treasury to Wilson, August 1968; Bank OV44/170 'Note of a Meeting in the Chancellor of the Exchequer's Room', 26/8/68.
[147] Bank OV44/170 'Note of a Meeting in the Chancellor of the Exchequer's Room', 26/8/68.
[148] PRO T312/1964 Christofas to Snelling 'Sterling Balance Negotiations', 26/8/68.
[149] PRO T312/1965 'Sterling Negotiations Group: Australia', 29/8/68.
[150] ibid

ways 'the Australian attitude was now more negative than it had been before the discussion was raised to Ministerial and Prime Ministerial level.'[151] It seemed that O'Brien would, after all, have to travel to Canberra.

Whilst Wilson recognised that the visit was necessary, he was worried about the adverse publicity that it would draw.[152] Prof. Schiller, the German Finance Minister, had already leaked to the press that the negotiations were not progressing smoothly and the press was now well aware that the discussions were supposed to be wrapped up in time for the September Basle meeting.[153] O'Brien's visit, if detected, would only add further fuel to the fire. Wilson decreed that the official line, upon press reports of the governor's visit, would be that 'the general position was alright but that there were one or two points which we and the Australians wanted to discuss'.[154] However, O'Brien's trip went completely unnoticed and later the story emerged that he travelled in disguise.[155]

O'Brien's discussion with the Australians took place between 31 August and 1 September. During the talks, he stressed how important the negotiations were, because this was something that the Australians did not seem to realise. He also made it clear that Australia would be blamed if it became known that it had stood in the way of an agreement.[156] His main objective was to obtain an agreement not lasting less than three years and he was authorised by Jenkins to lower the prescribed MSP for Australia to 33.5% as opposed to the previous 50%.[157] He was also authorised to forgo the charge for the scheme and to extend the guarantee to not 80% but 100% of the sterling balances. However, he was not allowed to forfeit to

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[151] ibid
[152] PRO PREM 13/2053 'Note of a Telephone Conversation Between the Prime Minister and the Chancellor', 29/8/68.
[153] See 'Insurance Scheme for Sterling Still Unresolved', Telegraph. 28/8/68.
[154] PRO PREM 13/2053 'Note of a Telephone Conversation between the Prime Minister and the Chancellor', 29/8/68.
[155] Sir Sam Goldman retold this story when I interviewed him, although he could not vouch for its accuracy. Interview with Sir Sam Goldman.
[156] PRO PREM 13/2053 'Note of a Telephone Conversation between the Prime Minister and the Chancellor', 29/8/68.

Australia the right to *terminate* the agreement if the UK decided, at a later date, to impose Brandon. Instead, all he was prepared to concede was that the Australians would have the right to *review* the agreement, if exchange control was extended.[158] This would, with further negotiation, leave the way open to implement Brandon if the drain on the reserves continued.

The visit was relatively successful and although the British authorities had prepared a contingency plan, in the form of getting the US to put pressure on the Australians, it turned out to be unnecessary.[159] The decisive factor proved not to be O'Brien's negotiating skills, but the fact that he had asked Rupert Raw to accompany him. For Raw and Gorton had been friends at university and had rowed in the same boat at Oxford. It seemed that the presence of an old comrade at the negotiating table was enough to make the unpredictable Gorton reconsider.[160] In exchange for a 40% MSP, Gorton undertook to enter into agreement for a period of three years, with possible extension to five.[161] Whilst there would be no charge for the facility, O'Brien did not have to undertake to extend the guarantee cover to 100% of sterling holdings as the Australians were happy with protection for 90% of their balances. However, both Gorton and Treasurer McMahon made it clear that they wished the right to terminate the agreement, if the UK extended exchange control. This was something that had to be conceded by the British; it did however make the possibility of Brandon more remote. Of course, as Ryrie had already pointed out, the successful conclusion of Basle, which would in effect make over £2,000m of the sterling balances inconvertible, was far more important than paving the way for Brandon.[162] The latter would only aid the balance of payments by £50-100 million per year. In any case, now that the negotiations had been successfully

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[157] PRO T312/1927 'Basle/ Sterling Area Negotiations: Brief for the Governor of the Bank of England', undated.
[158] ibid
[159] PRO T312/1965 'Telegram No. 6838', 30/8/68.
[160] Interview with Sir Jeremy Morse.
[161] PRO T312/1928 Canberra to Commonwealth Office, 2/9/68.
[162] PRO T295/514 Ryrie to Figgures 'Exchange Control and the Sterling Area', 15/7/68.

completed, Figgures and Allen, who had in effect been 'held hostage'[163] in Australia throughout the whole of August, could return to London.

With Australia as a signatory and the charge for the guarantee dropped, the vast majority of sterling area countries that had not already signed did so.[164] Although agreement had not yet been reached with all countries, the Governor was confident that with the majority now on board, the BIS 'would find it difficult to withhold the facility'.[165] His optimism proved well founded, because the Basle club declared themselves as satisfied and the facility was extended on 9 September.[166]

Conclusion

It is clear that the successful conclusion of the 1968 Basle agreement represented the Bank's finest hour. This is all the more apparent, when one considers the sheer size and scope of the negotiations. It was necessary for the Bank to court twelve central banks in order to gain the facility in the first place, and then it negotiated the guarantee scheme, with the help of the Treasury, in forty-one sterling area countries.[167] In short, the Bank was able to develop a trans-national policy network in order to bring about its objectives. Furthermore, the implementation of the guarantee system amounted to second order change. This is because a new instrument was crafted in order to protect and stabilise sterling within the fixed rate Bretton Woods system.

However, Roy Jenkins, in his memoirs, argues that the Basle agreement 'provided a $2 billion credit under cover of which we could set in train the overdue dissolution of the sterling

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[163] Interview with Lord Croham
[164] PRO T312/1965 Symons to Goldman 'Group Meeting', 3/9/68; ibid, 'Sterling Area Negotiations: Assessment of Present Position', 4/9/68; ibid, 'Note of a Meeting in the Chancellor of the Exchequer's Room', 4/9/68.
[165] PRO T312/1965 'Note of a Meeting in the Chancellor of the Exchequer's Room', 4/9/68.
[166] HMSO Cmnd. 3787 'The Basle Facility and the Sterling Area', October 1968.

area'.[168] Yet, the suggestion that Basle in any way represented the wind up of the sterling area or the reserve currency role is patently absurd. The facility was not intended to fund the run down of the balances and in truth, the extension of guarantees to the OSA served to stabilise the reserve role of the currency. In fact, after Basle had been concluded the volume of the sterling balances was to increase rather than retract.[169] Therefore the operation did not represent the swansong of the area, but instead injected into it a new lease of life.

Equally absurd is the suggestion by Shonfield that Basle was adopted as an easy option.[170] His argument is that the British authorities were not prepared to bring about the managed decline of sterling area or the reserve currency role and therefore they opted for Basle. The truth of the matter is that both the Bank and the Treasury were more than prepared to oversee the dismantling of sterling as an international currency, and to beat the retreat into a financial little England. The early Bank papers, drafted by McMahon and Raw, envisaged that the Basle facility would be used for just this purpose. It was only when it became apparent that any facility provided, could neither be of long enough duration nor large enough size, to fund the windup of sterling's reserve role that the Bank opted for the guarantee scheme. Even after this change of attitude had been brought about, a significant body of opinion within the Treasury had come to the conclusion that if the reserve role could not be removed, then at the very least it might be possible to use Basle as a vehicle to extend exchange control to the sterling area, thereby dismantling the distinction between the NSA and the OSA. However, as has already been demonstrated, this proved incompatible with the objective of securing the Basle agreement. The irony is that official opinion in Whitehall had come to favour the bringing about of 'an orderly retreat of the international currency role'.[171] Nevertheless,

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[167] Interview with Sir Jeremy Morse.
[168] Jenkins, R. A Life at the Centre. p.255-6.
[169] See Chapter 1.
[170] Shonfield, A, International Economic Relations of the Western World, 1959-1971, (London: OUP, 1976), p.161.
[171] Interview with Sir Jeremy Morse

because of forces beyond their control, they were instead pressed into implementing an agreement that would actually reinvigorate the currency.

Chapter 7- Hecuba and Priam

The successful completion of the Basle agreement marked an important watershed both in terms of the operation of the sterling area and the way that contingency planning was conducted. Many of the ramifications of the agreement in relation to the sterling area were discussed in the previous chapter. In this chapter, I shall focus on its implications for policymakers working in the sterling contingency planning network. The principal argument is that the implementation of the Basle agreement by the crisis avoidance network significantly altered the context in which the contingency planning network operated. The guarantee scheme actually met many of the Cranmer objectives. Consequently, contingency planners were to consider courses of action, to be implemented under conditions of crisis, that had hitherto been thought taboo. Courses that amounted to third order change.

By the summer of 1968, those that were involved in the development of the Cranmer scheme had come to the conclusion that for various reasons the plan, which blocked the sterling balances by force, would have been unworkable.[1] However, before the successful conclusion of the Basle agreement in September 1968, there was a distinct lack of viable alternatives. It was rather fortuitous then, that the Bank was able to get the sterling area *en masse* to agree to the implementation of the guarantee. For the guarantee was blocking by other means. This was because in return for its extension, the balance holders had to undertake not to diversify their funds any further.[2] In effect, they had chosen to block their balances voluntarily, in exchange for compensation should the rate again plunge. As an official from the Bank put it, we 'would be right in saying that under the proposed [Basle] agreements the countries concerned would be voluntarily forgoing conversion'.[3] Of course, Basle did not represent the implementation of the full Cranmer scheme. Firstly, the settlement was not reached by force.

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[1] PRO T295/604 Rawlinson to Hawtin, 'The Horror of Brutus', 11/6/68
[2] Government Command Paper: 'H.M. Treasury: The Basle Facility and the Sterling Area', (Cmnd. 3787, October 1968), p.6.

Secondly, in reality many of the official sterling holders kept sterling in excess of their prescribed minimum sterling portions and would have been free to reduce their holdings until they reached their MSP. Finally, holders were also able to draw on their balances to meet trade deficits, providing that they drew in equal measure on their NSA holdings. This means that the operation was an attempt, via partial blocking, to stabilise the balances of the sterling area and to reduce the likelihood that the balance overhang could undermine the strength of the currency.

Whilst the private OSA balances and all of the NSA balances were exempt from the guarantee the former proved to be resilient to tremors in confidence, having remained remarkably stable even after the devaluation.[4] Although these balances amounted to some £1,300m, throughout much of the OSA, local exchange controls prevented the possibility of significant switching out of sterling.[5] Only in Kuwait and other Middle East states were the private balances thought vulnerable. However, if a crisis emerged, the Bank felt that there was only scope for a loss of £100m from this source.[6] The NSA balances were valued at £803m in September 1968 and were more problematic because they had stood at £1220m during the summer.[7] They were extremely volatile and much more of a cause for concern. Even so, it is important to remember that Britain's holdings in NSA securities far outstripped the value of the NSA liabilities and that even if there was further diversification from this source it was unlikely to be more than £200m.[8] Furthermore in a time of crisis, where NSA diversification was the source or a contributing factor, it might have been possible either to extend the guarantee to its holdings or, if this was not successful, to block *only* its balances.[9] Therefore, if another sterling debacle did materialise, it would have been likely that somewhere in the region of

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[3] Bank OV44/168, 'Sterling Balances', Fenton to Hubback', 24 July 1968.
[4] PRO T321/2544 H. Copeman to Hawtin, 'Holdings of NSA Sterling', 13/1/69.
[5] PRO T312/2132 'Contingency Planning: Priam', 11/10/68
[6] ibid
[7] PRO T321/2544 H. Copeman to Hawtin, 'Holdings of NSA Sterling', 13/1/69
[8] ibid
[9] Of course, both types of action were inherently risky. To extend the guarantee might well have diminished its credibility, whilst blocking the NSA balances would probably have unnerved the OSA

£300m would be wiped from the reserves. If the balance of payments had recovered this figure could have been manageable, if it had not it would have been crippling.

Under crisis conditions, the strengthening of the exchange control regime by reducing the scheduled territories would have been the only mechanism apart from the blocking of the NSA balances that would have been required to bring about full Cranmer. Nevertheless, to do the former would have incurred the wrath of the Australians, probably culminating in them reneging on Basle, something that has already been made clear in the previous chapter.[10] Therefore, Cranmer was no longer relevant. Its implementation by force would only serve to bring about the undoing of an agreement that had been so tricky to get off the ground in the first place and one that met the central Cranmer objective.

If a crisis still erupted under the Basle regime of partial voluntary-Cranmer the only viable alternative would have been to float. This was because any exchange crisis that did occur would have done so under conditions similar to blocking in any case. As far back as March 1968, officials had recognised that if blocking had failed to hold the rate, then floating would be inevitable.[11] If however, once floating had been embarked upon, Basle did not succeed in stopping the rate from falling too far, its usefulness would be diminished and it would have been likely that it would have been replaced with the full Cranmer system. As Posner reported to Douglas Allen:

> 'If we are ever forced to choose between Cranmer and Hecuba [floating], I am tempted (post-Basle) to choose Hecuba: but I fear that

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as it would have feared that it would only have been a matter of time before blocking was also extended to its balances.

[10] PRO T312/21/31 Rawlinson to Allen, 'Hecuba/Priam', 12/11/68.

[11] PRO T312/2549 'Contingency Planning', 15/3/68.

the risks of being forced to move from Hecuba to Cranmer are great'.[12]

Hecuba

It was because of this altered context that from September 1968, contingency planning centred on the techniques for floating sterling under the codename Hecuba. This was not the first time that the Treasury team had devoted their attention to planning for the possibility of a float. William Ryrie and Kit McMahon had looked into it as early as a month after the devaluation[13] and the codename Hecuba had itself been applied to floating discussions from as early as mid-July 1968.[14] However, it was not until the conclusion of the Basle agreement that the Treasury team gave the issue their undivided attention and began to plan for it seriously.

The administrative organisation of the planning process was very similar to that of Cranmer. Yet again Sir Douglas Allen chaired the group whilst Rawlinson, and to a lesser extent Posner, dealt with the plan's operational development. William Ryrie, an Assistant Secretary in General Finance, also participated as did Sir Frank Figgures who had taken over from Goldman as the head of the Finance: Home and General group. Although Goldman had been promoted to the rank of second secretary and was responsible for the entire overseas section of the Treasury, he too took a close interest. The Bank was also heavily involved in the deliberations and was represented by its deputy governor, Maurice Parsons, along with Jeremy Morse and Kit McMahon.[15] The group involved in this planning exercise was much

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[12] PRO T312/2131 Posner to Allen 'Contingencies', 11/9/68.
[13] PRO T312/2549 McMahon and Ryrie, 'The question of planning for floating', 20/12/67.
[14] PRO T312/2130 Hoskin, 'The Hecuba Group', 22/7/68.
[15] Nicky Kaldor had expressed an interest in joining the group but Sir Douglas Allen refused him access (PRO T312/2131 Rawlinson to Allen, 24/9/68) because he found that Treasury irregulars did not work well together and Posner had already been assigned (Interview with Lord Croham). See also PRO T312/2131 'Hecuba/Priam Group: Note of a meeting', 6/11/68 for a full list of those involved in Hecuba planning.

smaller than that for Cranmer. No longer were officials from the Board of Trade and Customs consulted. The group was made up almost entirely of Treasury and Bank representatives.

The fact that the Treasury only compiled nine files on Hecuba when they produced twenty-four on Cranmer is not a sign that they took the operation any less seriously. Instead, it is an indication that planning for a float was a much less complicated business when compared with the blocking exercise.[16] Its simplicity also explains the reduced number of officials involved and the lack of inter-departmental co-ordination. The actual process of implementing a floating rate was and is very straightforward. All that was required was for the Treasury to signal the Bank that it should no longer use the foreign exchange held in the EEA to protect the rate.[17] Therefore planning did not centre on the technicalities of pulling the operation off but instead on tactics and accompanying measures. Thus, Hecuba is in many ways less interesting than Cranmer from a planning point of view. Its development was straightforward. Officials did not have to devise and apply innovative techniques to bring about a workable scheme and learning on the part of officials was made conspicuous by its absence. There was no attempt on the part of the Bank to scupper the exercise, because they regarded it as a lesser evil and it was their preferred course of action in an emergency.[18] Therefore, both the Treasury and the Bank were able to work together harmoniously.

There is perhaps only one sense in which Hecuba was more interesting than the blocking exercise. For unlike Cranmer it was not simply left to gather dust. As Rosalind Gilmore, the Principal who acted as secretary to the Hecuba group from November 1968 points out, 'I recall something of Hecuba since it was a plan which ultimately was used'.[19] Hecuba was dusted off and drawn on as the basis of the float during the subsequent Heath administration.

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[16] PRO T312/2544 'Contingency Planning: Hecuba', undated.
[17] ibid
[18] PRO T312/2130 Goldman to Principal Private Secretary, 1/5/68.
[19] Correspondence with Rosalind Gilmore, 3/2/03.

Therefore whilst it was a less interesting exercise it was one that was actually implemented and one that amounted to third order change.

Hecuba itself was not designed for a deliberate move to a floating rate as a policy objective in its own right.[20] Like Cranmer but unlike Basle, it was very much a contingency operation. It was designed to be implemented in an emergency in which floating was forced upon the UK because of a lack of foreign exchange to protect the fixed rate. The scheme, whilst in many ways related to Cranmer, was seen as distinct from it. This was because the implementation of Hecuba would not have automatically entailed a move to full blocking, especially now that Basle had been concluded.[21] However, it was recognised that under Hecuba it might become necessary to block as well and thereby introduce the whole Cranmer regime.

The Treasury anticipated that three types of event could trigger a move to floating rates between October 1968 and the spring budget of 1969. The first was the balance of payments weakness.[22] The expected turnaround in exports had not materialised and the Treasury could not predict when and if this would occur. In the meantime, the continuing trade deficit would drain both the reserves and confidence in the currency, perhaps culminating in an insurmountable speculative attack. The second was the possibility that British unions would engage in serious strike action, undermining both confidence in the economy and the physical capacity to export. In short, the very thing that had caused the 1967 devaluation.[23] Third, it was possible that the side winds of another currency crisis, that had little to do with the relative position of sterling, could affect the currency.[24] Ostensibly, this had been the cause of the March crisis.[25] It had been the belief amongst speculators that there was to be a revaluation of gold, which had triggered it. In the autumn, it was possible that more of that

[20] PRO T312/2544 'Contingency Planning: Hecuba', undated.
[21] PRO T312/2544 Paper by the Bank of England 'Management of a Floating Exchange Rate', 13/12/68.
[22] PRO T312/2544 'Contingency Planning: Hecuba', undated.
[23] ibid
[24] ibid

sort of pressure could resurface. In particular it was widely held that the German mark was undervalued and the French franc overvalued. If it was believed that Germans would revalue, sterling holders might well switch into marks in order to make a speculative gain. Conversely, if the franc was devalued speculators might conclude that the pound would follow suit thereby triggering a dash out of sterling.[26] However, this third type of pressure was to be planned for separately by the Treasury under the codename Priam. Its development will be discussed in some detail in the latter half of this chapter.

Under the circumstances outlined, sterling would have been forced onto a floating rate because of the lack of resources to defend the existing rate or even a new devalued one. However floating under these conditions would have been unfavourable because without any resources it would have been impossible to manage the rate or slow its demise.[27] Therefore, if such a crisis materialised, the first question was whether it would be possible for the British authorities to add to the already enormous short-term debts by engaging in further borrowing. The central issue was whether funding would be made available on acceptable terms and even if it was available, was it in the UK's interest to continue borrowing its way out of trouble?[28] If, like during the March gold crisis, additional support was provided the situation would have been made manageable and the need to float would have been negated. Under conditions where international support could not be garnered, there would be no alternative to floating.

If once floating had been embarked upon, the rate fell only to $2.30, it might have been possible to preserve the global fixed currency system. On the other hand, if floating resulted in a tremendous drop in the rate, many other countries including the US would probably have

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[25] Jenkins, R. A Life at the Centre. p.234.
[26] PRO T312/2131 'Hecuba Priam Group', 6/11/68; PRO T312/2544 'Hecuba: Note of a Meeting in the Chancellor of the Exchequer's Room', 22/1/69.
[27] PRO T312/2544 Paper by the Bank of England 'Management of a Floating Exchange Rate', 13/12/68.
[28] T312/2130 Paper by the Bank of England 'Contingency Planning' 24/5/68; PRO T312/2130 'Contingency Planning for Floating: Note of a Meeting', 16/7/68.

been forced to devalue or float themselves.[29] One possibility that the Treasury planners envisaged was that if the decision to float was taken, an international conference could be convened with the markets closed for the duration. The conference could be utilised to discuss the wider questions of the global economy and not just the UK rate.[30] In other words Britain, by floating, could act as the central player in the destruction of the ailing Bretton Woods system and negotiate the formation of a New World order. However, all were not agreed on the benefits of holding such a gathering. For if the conference was unsuccessful in bringing about a new global regime it could have resulted in diminished confidence in sterling, thus pushing the rate down to a very low level.[31]

However, if sterling had floated, the rate would almost certainly have moved downwards, irrespective of the actions of its managers. The Treasury itself recognised this but hoped that over time the fall would be self correcting and that the currency would rise to $2.20-$2.30.[32] Nonetheless, it was possible that the OSA would regard the Basle agreement null and void, under a system of floating rates, and resume in its bid to diversify. If this occurred it was quite probable that the rate would have fallen to well bellow $2.00.[33] It was also anticipated that if the rate floated, the adverse effects on import prices would have appeared much more quickly than the benefits to exports through enhanced competition.[34] This was because British importers, fearing that the rate would go into uninterrupted decline, would probably have attempted to purchase large amounts of foreign goods at the point of floatation, before the value of the currency diminished too much. This would only have served to worsen the British trade figures, which in turn could only damage confidence yet further, bringing about another reduction in the rate. Ironically, the importers would have been in the position of

[29] PRO T312/2544 Paper by the Bank of England 'Management of a Floating Exchange Rate', 13/12/68.
[30] PRO T312/2544 'Contingency Planning: Hecuba', undated.
[31] ibid
[32] PRO T312/2544 'Management of a Floating Exchange Rate', 13/12/68; PRO T312/2544 'Hecuba: Note of a meeting in the Chancellor of the Exchequer's Room', 22/1/69.
[33] PRO T312/2544 'Contingency Planning: Hecuba', undated.
[34] PRO T312/2544 'Hecuba- Part II: A Programme of Action', undated.

bringing their fears into reality. Although, in the long run, the decision to float would actually have aided the balance of payments. This is because the fall in the exchange rate would have made foreign goods more expensive and so less would have been imported.[35]

The mechanics of floating

If during a sterling crisis where no additional funding was made available by foreign governments and MISC 205 took the decision to float, the programme of action would have resembled the following. The Foreign Office would have sent messages explaining the decision to the IMF, GATT, G10 and the OSA *prior* to the event.[36] Clearly, informing such a large number of organisations in advance would have borne great risk of a leak, perhaps resulting in greater speculative pressure. Nevertheless, it was recognised that to offer forewarning would bring certain advantages. Firstly, it might have served to scare the international financial community into providing additional support under acceptable terms, thereby removing the need to float. If it did not, then the advanced notice may have increased the chance that foreign governments would co-operate with Britain under the new system. Indeed, for the move to a floating rate to be successful, the acquiescence of both the IMF and the OSA would have been essential.[37] In the case of the former, the UK would have been in breach of its IMF articles at a time when it was already heavily in debt to the fund. As for the latter, the UK would have to have appealed for solidarity and support in order to ensure that they continued to uphold their side of the Basle agreement under floating rates.

Once diplomatic courting had been embarked upon, the UK authorities would implement the float. As has already been stated, the actual executive action would have been straightforward. The Bank would simply have ceased to use the EEA to hold the sterling exchange rate. Of course, the decision to float would not in any way have excluded the

[35] ibid
[36] ibid

authorities from further intervention in the exchange markets in order to moderate and manage movements in the floating rate. However as the decision to float would have been taken as a direct consequence of limited foreign exchange, the UK's scope for intervention and management would probably have been extremely limited.[38]

The decision to float and its implementation could have both occurred instantaneously, unlike the more long-winded Cranmer. As the float would have been from a position of weakness, the first step after initiation would have been to stand back from the market and see where it took the rate. It would also have been essential to have at hand a range of measures for speedy introduction should the pattern of events have demanded them. Such measures would have helped to steady confidence and check the first fall in the rate. Although, it was recognised that it would have been an error to implement too many deflationary policies too soon, as there would have been nothing to fall back upon if the rate took a sudden plunge in later months.

In order to improve confidence abroad the Treasury considered the following accompanying measures. First, that the initial announcement of the decision to float should also contain references to an increase in the Bank's base rate, in order to attract hot money to London.[39] Second, that credit policy should be tightened. Although, at this stage, it was not possible for the Treasury to outline how this should be accomplished, as this would depend on the credit measures that would already have been in place at the time a decision to float was taken. Third, that it would be desirable for the government to declare the intention of cutting public expenditure.[40] It was also recognised that one of the main domestic policy aims would have been to '...destroy peoples notion that all prices and factor incomes will rise proportionally to

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[37] ibid

[38] PRO T312/2544 Paper by the Bank of England 'Management of a Floating Exchange Rate', 13/12/68.

[39] Although the Treasury felt that increasing interest rates would have no effect (PRO T312/2130 'Contingency Planning: Note of a Meeting', 1/7/68) the Bank did not agree (PRO T312/2544 Paper by the Bank of England 'Management of a Floating Exchange Rate', 13/12/68).

the fall in exchange rates.'[41] Of course without intervention, they would have done. The move to a floating rate would certainly have led to inflation through the increased price of imports. The Treasury had calculated that for each 10% reduction in the sterling rate, there would be a 3% domestic price rise.[42] However, to stop a wage price spiral under Hecuba it might well have been necessary to

> '..impose a straightforward freeze on all wage rates for six months from the moment of the float, followed by a further six months of severe restraint'.[43]

Floating rates and the sterling area

Under a regime of floating rates, it would still have been possible for British citizens to move their holdings offshore and into the sterling area. Such capital outflow would have been disastrous and ideally would have been prevented via the implementation of operation Brandon.[44] However, it was recognised that the execution of a system of exchange control restrictions would not have been in the spirit of the Basle agreement.[45] Therefore, under a system of floating exchange rates, the Treasury would have had to choose between Brandon and Basle. It is likely that they would have stuck with Basle initially but that they would have attempted to convince their sterling area partners, and Australia in particular, to voluntarily agree to the imposition of exchange control in the weeks that followed.[46] Whether or not Australia would have co-operated is debatable. For whilst the vast majority of the sterling area

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[40] PRO T312/2544 'Hecuba- Part II: A Programme of Action', undated.
[41] PRO T312/2544 J. Williamson to F. Figgures 'Exchange Rates', 13/12/68
[42] PRO T312/2544 'Hecuba- Part II: A Programme of Action', undated.
[43] ibid
[44] Before the conclusion of the Basle agreement Rawlinson was in favour of the extension of exchange control as an accompaniment to Hecuba or even as an exercise in its own right (PRO T312/2130 Rawlinson 'Floating: Exchange Control', 20/6/68). After Basle was put into operation he recognised that Brandon would not be compatible with it (PRO T312/2131 Rawlinson to Allen 'Hecuba/Priam Group', 5/11/68).
[45] ibid
[46] PRO T312/2544 'Hecuba Part II: A Programme of Action', undated.

would not have been inconvenienced by such a step, Australia's balance of payments was greatly aided by the outflows of sterling to her shores. However, Australia would have suffered even greater inconvenience should Britain have been forced to implement the full rigours of Cranmer, something that Harold Wilson would undoubtedly have gone to great lengths to convey.

However, the most important objectives in Hecuba planning were that (a) the OSA would continue to abide with the terms of Basle and (b) that a method could be devised for operating the guarantee, which had been intended for a fixed rate devaluation, under conditions of perpetual floatation. The former was not really within the bounds of contingency planning and could only be assured through thorough diplomatic negotiations at the point of floatation. The latter was an important and technical issue that took up a great deal of the planners' time, particularly the representatives from the Bank.[47] For if a method for operating the guarantee under floating rates could not be devised, the objective of continuing with Basle could not have been adhered to. This would have been disastrous. For with the voluntary partial block gone, the rate would undoubtedly have fallen far further, possibly to the level that it is at in the present day. Under such circumstances, the only recourse would again have been to introduce an undiluted dose of Cranmer.

It was recognised that floating would produce a further weakening in confidence in sterling as a reserve currency and a loss of trust in the UK from the sterling area.

> 'It would be thought that the UK, having got the OSA committed to the sterling agreements on the understanding that these were to provide support for the existing system of fixed parity

[47] As Rawlinson reported to Allen 'The Bank have it in hand but seem to be finding it difficult' PRO T312/2131 Rawlinson to Allen 'Hecuba/Priam', 12/11/68. See also PRO T312/2544 'Sterling Agreements: Floating Rates', 30/12/68.

> convertibility...had abandoned complete responsibility – in a way even less acceptable than blocking'.[48]

Thus, the Treasury concluded that it would be the aim of the sterling area, under such circumstances, to reduce its sterling assets as much as possible without incurring excessive loss. The move to a floating rate might also have fuelled concern within OSA governments for the private balances held by their citizens culminating in a loosening of exchange control in order to allow private balance holders to switch from sterling into other currencies.[49]

However, while it was recognised that the vast majority of the OSA would no longer wish to hold sterling, it would have been almost impossible for them to get out without seriously depressing the rate.[50] In short, they would be obliged to continue to hold the currency; if they did attempt to diversify, they would be cutting off their own noses to spite their faces. Those that did wish to take the risk would probably have waited until they received their first payment under the terms of the guarantee before they moved out. But those that held sterling in excess of their prescribed MSP could easily have disposed of the surplus without any repercussions, except of course to the rate.[51] It is likely that only those countries with very small holdings that could be converted quickly would move out of the currency straight away, because the gains that they would make from the guarantee would have been insignificant. Indeed, if any single country breached its MSP level, it would have had a vested interest in getting out of sterling as quickly as possible;[52] its balances would no longer be guaranteed and it would be essential to divest before the rate plunged too far.

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[48] PRO T312/2552 R.Hay 'Floating and the Sterling Area', 19/12/68.
[49] ibid
[50] ibid
[51] ibid
[52] ibid

In order to keep the OSA on board and to prevent the Basle agreement from unravelling, the assorted Hecubites concluded that after the float there should be a series of round table talks in London to which all the sterling area countries would be invited.[53] It was also recognised that it would be necessary to court the Australian's, before the full sterling area was consulted.[54] If Hecuba had been implemented during the latter half of 1968, it is certain that the round table discussions would have primarily been concerned with the settlements to be made to the OSA at the end of the first 30 day period and the methods for transacting future payments.

Under the Basle agreement, the guarantee was to be implemented if the sterling-dollar rate fell and remained for a period of thirty consecutive days below its present parity by more than a margin of 1%.[55] However, no provision was made for the operation of the agreement under further changes in the rate after that period and no system had been devised to deal with the possibility of a rise in the rate.[56] One must of course remember that a floating rate must be expected to rise as well as fall. If the rate did rise, the existing agreement would not have obliged the sterling holders to repay the corresponding amount of compensation that was paid to them by the UK for the original fall.[57]

Therefore, the over-riding objective of the consultations would have been to ensure the continued adherence of the OSA countries to the Basle agreement. The essential ingredients of which would have been the holding of a minimum percentage of their reserves in sterling in exchange for the dollar-value guarantee. If this could be attained then it would have been important that the OSA also agreed to reverse payments when and if the rate rose. If this were all agreed to, under a floating rate there would have been a settlement between the contracting parties on the last day of each calendar month, based on the average rate for the whole of the

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[53] PRO T312/2544 'Operation of the Basle Agreement Under Hecuba- Minute of a Meeting in Mr Figgures Room at 3.30pm on 17th December 1968', 18/12/68.
[54] ibid
[55] PRO T312/2544 'Sterling Area Agreements: Floating Rates', 30/12/68.
[56] PRO T312/2552 'Sterling Agreements: Implementation of the Guarantee', June 1969.
[57] PRO T312/2544 'Operation of the Basle Agreement under Hecuba', 18/12/68.

month. If this average rate were below the previous months, then the UK would have made payment on all eligible balances, to restore their sterling value in terms of the US dollar.[58] If the rate was above that of the previous month, it was hoped that the countries of the OSA would make a sterling payment equivalent to the rise in the dollar value of the eligible balances to the UK. For without such repayment the sterling balances would grow greatly beyond their original size, being bolstered by payments from the UK every time the rate fell, even if it again rose.[59]

To the Treasury, the system of writing up the balances based on the average fall or rise in the rate over each thirty-day period was the most fair and equitable method. Perhaps the least just would have been to demand that the guarantee would only be written up at the time that sterling returned to a fixed rate.[60] Although it is unlikely that the sterling holders would have accepted such a proposition through choice. In fact, if it was forced upon them, it is almost certain that the vast majority of them would have disposed of their holdings as quickly as possible. It is probably for this reason that the Treasury ruled against such a system and not on the grounds of justice.

The most equitable system, from the perspective of the OSA, would have been to make both the payments and reversals on a daily basis.[61] It would have ensured that the balance holders had an up-to-date dollar value and not one that was up to a month out of date. However the operation of such a system would have proved administratively difficult as it would have been necessary to track the balances of thirty-one major balance holders daily, in order to ensure that they did not breach their MSP's and then make the correct level of payment. Furthermore, under a system of floating rates, the rate does not just change from day to day but also from hour to hour and minute to minute. It would have been impossible to increase and reduce the

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[58] ibid
[59] PRO T312/2544 'Sterling Area Agreements: Floating Rates', 30/12/68.
[60] PRO T312/2130 'Contingency Planning for Floating: Note of a Meeting', 1/7/68.
[61] PRO T312/2544 'Sterling Area Agreements: Floating Rates', 30/12/68.

amount of sterling credited to the balances in line with the continual fluctuations in the exchange rate throughout the day.[62]

Thus the operation of the payments system on a monthly basis, seemed to the Treasury, to strike the appropriate balance between administrative practicality and the provision of an equitable and seemingly legitimate guarantee system. Of course, it would have been administratively easier to simply make payment based on the rate on the 30th day of each month rather than the average rate for the whole month.[63] It would have saved the valuable hours that were to be employed in calculating an accurate average from the thousands of fluctuations that would have occurred in the rate. Yet, it was recognised that if settlements were to be based on the market rate on the last day of each month, rather than the average for the whole month, problems would arise. There would be incentive for both parties to the agreement to intervene in the market to influence the rate on the last day, to their respective advantage. Equally, the guarantee's method of implementation would likely have been leaked to the press, resulting in private speculation against the assumption that the UK would have to intervene to reduce its costs.[64] Therefore, the adoption of the average rate system seemed both fairest and most practical.

It is likely that the vast majority of the sterling balance holders would have seen sense and recognised that it was in their interest to continue the agreement. However, it is also extremely probable that they would have used their not inconsiderable bargaining leverage to bring about some concessions on the part of the UK. Firstly, it is probable that they would have claimed that the MSP's imposed upon them were more onerous, because at the first implementation of the guarantee only 90% of their balances would have been written up. Consequently, they would be making losses on 10% of their holdings.[65] However, if the UK had allowed the OSA

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[62] ibid
[63] PRO T312/2552 'Sterling Agreements: Implementation of the Guarantee', June 1969.
[64] ibid
[65] ibid

to reduce its sterling holdings the diversification would have placed a great deal of strain on the rate, perhaps nullifying the effect of the guarantee. Therefore, this was not a point that Britain could afford to concede.

Secondly, the OSA would rightly have argued that under a system of floating exchange rates the 10% of their holdings that was not covered by the guarantee would again be reduced in value if the sterling parity continued to fall.[66] It is likely that they would have pushed for the extension of the guarantee to the entirety of their holdings and it is almost certain that the British authorities would have granted such a concession. This would have been an acceptable price to pay to keep the agreement in place and might well have reduced the grumblings of discontentment amongst holders who felt that their prescribed MSP levels were crippling.

Thirdly, the Treasury whilst hopeful that the OSA would accept that the principle of reverse payments was fair and equitable conceded that this might not be the case. If it was not, then it is likely that it would have negotiated for one of two fallback positions. The first and least unfavourable of the two being that the reference rate for reverse payments would be the exchange rate at the end of the first thirty day period.[67] In other words, if the pound initially fell to $2.20 this would be the base rate and the agreement for reverse payments would begin this level and not $2.40. Under such an agreement, if the value of the pound rose to $2.35 the UK would get no reverse payments. If however it fell to $2.10 but then rose back to $2.40 the UK would get a 10% rather than a 30% reverse payment. This would mean that the increased funding from the guarantee that the OSA received at the end of the first thirty days would not have to have been paid back even if the rate recovered. Only if the rate again fell and then rose would any reverse payments be required and this would only be up to the level of the rate at the end of the first thirty-day period.

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[66] PRO T312/2130 'Contingency Planning for Floating: Note of a Meeting', 16/7/68.
[67] PRO T312/2552 'Sterling Area Agreements: Implementation of the Guarantee' June 1969.

If the OSA had refused this more generous settlement and was not prepared to accept the operation of a reverse payment in any form, it is clear that the agreement would not have lasted very long. Although, I am almost certain that the OSA, whilst suspicious of British motives and interests, would have recognised that it was in its collective interest to sign up to *New* Basle. For no one would have been able to predict to what level the pound would have fallen and the agreement, whilst constraining, would have afforded the balance holders a great deal of protection. I am sure that whilst the OSA would have pressured the British authorities for a lower MSP they would have accepted the existing levels when the UK offered to extend the guarantee to 100% of holdings. It is difficult to discern the outcome of the discussions on reverse payments but it is unlikely that the sterling area would have refused them directly. At worst, the UK would probably have to have made concessions concerning the reference rate for such payments.

However, new Basle would not have provided a long-term solution to the problem of the sterling balance overhang. Whilst it would have stabilised the balances it is unlikely that the holders would have agreed to hold them *ad infinitum*. In the medium-term, the OSA would have undoubtedly called for substantially lower MSPs or perhaps even reneged on the agreement. With no resources to fund the once and for all windup of the balances, it would probably have been necessary at a later stage for Britain to negotiate a controlled diversification over several years. If, as under Robot, the OSA had been given a yearly quota of balances that they could convert, an 'orderly retreat'[68] could have been brought about and this would have done the least damage to the rate. Whether or not the OSA would have agreed to such a settlement is however another matter.

It is also difficult to discern precisely what impact Britain's fluctuating exchange rate would have had on the global fixed system. To a great extent, the effect of the move would be totally

[68] Interview with Sir Jeremy Morse

dependent on the level of the exchange rate that Britain was able to attain.[69] However, whilst we can be certain that the rate would have fallen it is difficult to determine to what level. The specific rate achieved would have been dependant on the following variables. First, the degree to which the OSA diversified those holdings that were in excess of its prescribed MSPs; Second, whether or not the OSA private balances continued to remain stable; Third the extent to which the NSA converted its holdings and finally, the position of the balance of payments.

It is possible that if there was little movement from any of these sources that the rate would remain stable and would not fall below $2.30. But given the already low level of confidence in sterling during the fixed rate regime it is improbable that the balances not covered by New Basle would have remained stable under a floating system. What is certain is that a move below $2.30 was very possible and this would have had damaging repercussions. Whilst it would not have automatically entailed that the other currencies would also have had to move to a floating rate, it would have been a wrecking move that would have, at the very least, triggered competitive devaluations on a global scale. It is likely that other countries would only have floated if either the pound moved so erratically that numerous competitive devaluations and revaluations were required or where confidence in the international system had completely ebbed. Neither possibility would have been outside the realms of probability.

The Bank recognised that a

> '...floating pound without resort to blocking would be very likely to precipitate other exchange rate disturbances- in particular a US embargo. Out of such a situation we might possibly get fairly quickly a new international monetary arrangement with new parities across the Atlantic,

[69] PRO T312/2544 Paper by the Bank of England 'Management of a Floating Exchange Rate', 13/12/68.

> perhaps a new price of gold and perhaps ultimately a more stable prospect for sterling'.[70]

By the winter of 1968, many in the Treasury had also come around to this point of view. The continual currency crises of sterling and the dollar led to a change in ideas. Although floating was never to be advocated as a positive policy option, the Treasury would no longer shrink from it if their backs were against the wall. Posner in particular had concluded that floating would not necessarily have been the worst possible outcome. For it would bring about

> '..a system where rates move more frequently, by smaller amounts, upwards as well as downwards and without political crises'.[71]

Priam

As has already been alluded to, Hecuba was not the only contingency plan that was devised during the autumn/winter period. The other major operation that was planned for was known as Priam. Although it was developed simultaneously to Hecuba and is in many ways indistinguishable from it, it has been decided for the sake of clarity, to examine it separately rather than to weave it into the preceding discussion.

Priam was devised in order to prepare for the possibility that were would be a devaluation of the French franc, by a margin of 10-15% during the coming months.[72] The Treasury recognised that if this occurred under conditions where the balance of payments and confidence in sterling had not improved, the repercussions on the currency would be disastrous. This was because a move on the part of the French would represent a 1%

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[70] PRO T312/2130 Paper by the Bank of England 'Contingency Planning' 24/5/68.
[71] PRO T312/2131 Posner to Figgures 'Flexible Exchange Rates', 4/12/68.
[72] PRO T312/2132 Ryrie to Hubback 'Contingency Planning for a French franc Devaluation: Questions to be Considered', 22/7/68

revaluation of the pound at a time when confidence in it was ebbing and result in a £50m per year adverse effect on the UK's balance of payments.[73] It was thought likely that those balance holders that were not bound by the Basle agreement, who already believed that the pound was overvalued, would come to the conclusion that the UK would also be forced to devalue in order to maintain Britain's competitiveness and to bring about the long overdue improvement in the balance of payments. Under such conditions, it is likely that a massive speculative outflow from London would have resulted.

For the Treasury, it was difficult to determine where the outflow would go. One possibility was that sterling balances would be converted into francs as holders might have believed that in the aftermath of a franc devaluation the currency would now be safe from further tremors.[74] Although it is more likely that the funds would have been moved into Germany because for quite some time the Deutchemark had been considered undervalued.[75] Therefore the chances of the mark being devalued were negligible and if it were re-valued, holders would have made a speculative gain.

It was, however, just possible that the markets might regard the adjustment as an inevitable one and that if the pound had by then picked up some strength and the balance of payments was seen to be improving, it might just weather the storm. However, this optimistic outcome could not be counted on. The practical question was what defensive measures should the UK authorities employ to defend the currency under such conditions?

One possibility would have been to take no immediate action affecting the exchange markets but to move immediately in the field of import controls or exchange control in order to protect

[73] PRO T312/2132 Posner to Allen 'Priam', 7/10/68
[74] PRO T312/2132 Ryrie to Hubback 'Contingency Planning for a French franc Devaluation: Questions to be Considered', 22/7/68.
[75] PRO T312/2132 Rawlinson 'Contingency Planning: Priam', 19/9/68.

and improve the balance of payments.[76] However, it was recognised that this kind of action alone might simply have served to confirm the suspicions amongst sterling holders that the currency was about to collapse.[77] A second possibility was that the UK authorities should consider implementing a further devaluation themselves.[78] Such a course would probably have aided the bid to improve the balance of payments in the long-term, and unlike during the March gold crisis it was no longer out of the question. Nearly a year would have passed since the preceding devaluation in November 1967 and any subsequent devaluation would no longer be so close to it in time as to make it indistinguishable from a move to a floating rate. In spite of this, it is extremely unlikely that a further devaluation would have been a viable policy option. This was because it would have been forced under conditions in which the reserves were either very low or in fact exhausted and it would have been impossible to hold the new rate.[79] The third and least desirable alternative would have been to implement a full Cranmer regime, though this option had all but been discounted by the Treasury at this stage, much to the relief of the Bank.[80] This only left floating and the implementation of some form of Hecuba.

Therefore, in many ways the hypothetical French crisis greatly resembled the actual crisis that took place the previous March. The courses of available action were similar if not identical; the main difference being that it was probably Hecuba and not Cranmer that would have been implemented if the situation became uncontrollable. As with March, the Treasury were keen that no extreme measures should be taken at the outset and that the object in the first day or two would be to buy additional time and use it to get further financial support for the pound, if it was still available. The obvious gambit was again, the one used during the March crisis, namely that the markets should be closed (by the now traditional bank holiday) and that the

[76] PRO T312/2132 'Contingency Planning for a devaluation of the French franc', 22/7/68.
[77] ibid
[78] PRO T312/2132 'Contingency Planning: Devaluation of the franc', 11/9/68.
[79] ibid
[80] PRO T312/2132 Hoskin to Rawlinson "Priam', 25/9/68.

time gained should be used to persuade the Americans to provide further support.[81] The second alternative would have been to use exchange control powers to stop any new foreign exchange contracts whilst allowing pre-zero contracts to be completed.[82] In short, it would have meant the temporary suspension of convertibility.

The main advantages of the former method are that it would have completely stopped any outflows from the UK for the duration of the bank holiday and that it least resembled blocking.[83] However, it could not be done without some potential side effects. For if it was to be resorted to again, the British authorities would not necessarily have had the excuse of an American request the close the markets to justify their actions. It would have been obvious to the speculators that it was sterling's weakness and not the dollar's that triggered the action. As well as this, it is doubtful whether it could have been continued for more than a few days without reducing domestic confidence in the banking system and this may not have been long enough to negotiate further support from the Americans.[84] There were also some serious questions about its legality. For with hindsight it was recognised that the previous March bank holiday was not in the spirit of the 1871 Bank Holiday Act, because the banks had remained open for domestic business.[85] If the operation were to be legal, the Banks would have to be completely shut down. Furthermore, the previous closure had brought about some tiresome side effects with respect to wage negotiations. This was typified by the attempt of a police constable to claim double-time for working during a public holiday![86]

The temporary suspension of convertibility would have negated many of the side effects of implementing a bank holiday, including the risks to domestic confidence. The procedure would have been simpler and quicker to bring about, as it did not necessitate the convening of

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[81] PRO T312/2132 'Priam: Stopping an immediate outflow', undated.
[82] ibid
[83] PRO T312/2132 Thompson to Painter 'Closing the Banks', 13/9/68.
[84] PRO T312/2132 'Priam: Stopping an immediate outflow', undated.
[85] ibid
[86] ibid

the Privy Council or the signature of the Queen. It did not involve any intervention with domestic business and it could probably have been operated for longer.[87] Of course, it most resembled blocking. Whilst the Treasury might have called it the 'temporary suspension of full convertibility' it would have in effect been the implementation of Brutus I. Although unlike during March, it is very unlikely that the regime would have been intensified to a full block if the US failed to co-operate. Instead, as has been stated several times, the move would have been to some form of Hecuba. However, the main difference between Priam and full Hecuba was that under Priam

> 'If we were forced to float we should envisage this as being temporary, to be followed by immediate further international discussions to settle as quickly as possible the future pattern of exchange rates and measures to support and maintain them'.[88]

The expectation was that the period of floating would be short and that once the pound re-pegged it would be at the $2.40 rate.[89] However, I am inclined to agree with Sir Jeremy Morse when he states that 'once we float its plain Hecuba and that's it'.[90] For as I have already argued, the balance of probability pointed to the fact that if Britain floated other currencies would have followed. If they did not, I accept that it would have been slightly easier for sterling to return to a fixed rate, assuming of course that the international financial community was prepared to back the pound. However, it is doubtful that confidence in the re-pegged pound would have been high and it might again have been pushed off its peg by overzealous speculators. If other currencies had followed Britain, I believe that it is more likely that the general regime of floating rates would have begun. This is because, for the politicians, the more difficult decision would have been to un-peg the rate. The fact that it was only supposed

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[87] ibid
[88] PRO T312/2132 'Contingency Planning: Devaluation of the Franc', 11/9/68.
[89] ibid
[90] ibid Morse to Rawlinson, 10/9/68.

to be temporary would have helped them to make the decision. Once the course of action had been embarked upon, it is likely that they would have welcomed the fact that currency management had been depoliticised and that they were free from agonising over the balance of payments.[91] They would therefore have little incentive the reverse the decision. This would be true both in Britain and abroad. However, if the UK authorities were successful in their quest to gain additional support, in the early days of a crisis and before the decision to float had been taken, they could have contemplated reopening the markets without any major change in policy.[92] Although, if, even with the added US support the rate could not be maintained then the Treasury would yet again have had to fall back to their contingency plans.

The Priam Network

Priam, like Hecuba, was not punctuated with any degree of policy learning or innovation on the part of the officials involved in its development. For the most part, the same group of officials developed both plans and Priam in its operation would have, if things turned out for the worst, turned into Hecuba. However, the fact that the Treasury was devising the plan gave them a useful pretext to continue dialogue with their opposites in number in the US and expand the policy network. During the Chancellor's visit to the US in the middle of October, he broached the subject with Fowler, the US Treasury Secretary.[93] However, it was clear that the US had not realised the likely difficulties that would emerge for sterling from a devaluation of the franc or the urgency with which counteraction would need to be considered. For Douglas Allen, there seemed to be an opportunity in including the Americans

[91] For a discussion of depoliticisation see Peter Burnham, 'New Labour and the politics of depoliticisation', British Journal of Politics and International Relations, Vol. 3, No. 2, June, 2001, pp. 127-149.
[92] PRO T312/2132 'Contingency planning for a devaluation of the French franc', 22/7/68; PRO T312/2132 'Contingency planning: Devaluation of the franc', 11/9/68.
[93] PRO T312/2132 'Contingency planning: Priam and Hecuba- Note of a meeting', 15/10/68.

in their discussions.[94] Firstly, as I have already stated, it would ensure that the channels of communication stayed open. Secondly, it would mean that the US was alerted to the dangers and could prepare contingency plans of their own, so that unlike during March there would be no delay their decision to back the pound.[95]

When Fowler passed through London on his whistle stop tour of Europe in early November, Priam was the main subject that he discussed with the Chancellor.[96] Although, this did not imply that the Americans regarded an early move on the part of the French as more probable than it had been in the past. In fact, the Americans thought the likelihood of a French devaluation in the coming months to be negligible.[97] However, they conceded that if the French did devalue they were likely to do so by an excessive amount, possibly by up to 20%. For Fowler believed that

> 'The French would do this as a wrecking tactic designed to bring about a collapse of the international monetary system, thus increasing the chance that in the end the price of gold would be raised'.[98]

This was because for de Gaulle, devaluation would represent a defeat of the highest order. Therefore, if it seemed inevitable he might seek to deflect opinion by bringing down the whole international monetary system.[99]

Furthermore, Fowler felt that if a crisis did materialise there would be the need for multilateral consideration on any change in parities. This could have been accomplished by

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[94] PRO T312/2548 Rawlinson to Goldmand 'Priam', 22/10/68.
[95] PRO T312/2548 Allen to E.W. Maude 'Priam', 30/10/68.
[96] PRO T312/2548 'Priam: Brief for Chancellor's meeting with Mr Fowler', undated.
[97] PRO T321/2548 Goldman 'Note for the record- Priam: Discussions with the US', 11/11/68.
[98] ibid
[99] ibid

the convening of an international conference at which a common course of action could be hammered out. For the Americans, the principal aim of such a conference would be to encourage the French not to move at all, and if this could not be achieved, to ensure that they did not move too far. However, Fowler was clear that if the French did make a wrecking move

> 'The US would give up gold and float. In his view there was no question whatsoever of a rise in the price of gold. This required an act of Congress and neither the present Congress nor the Congress which has just been elected would agree to a rise in the price of gold'.[100]

Although if the French moved by only 10% this would not have been enough to pressure the US into floating but it might have been enough to force Britain to take such action. Therefore, for Jenkins, it was imperative that if any conference took place, the exchange markets should be closed for the duration in order to avoid pressure on sterling.[101]

It was evident from the discussions that the Americans remained extremely suspicious of the French and that even if they did not expect the worst; they thought that it was prudent to plan for it.[102] However, this was not a view shared by Kit McMahon at the Bank. For him Priam was a pointless exercise. Perhaps he was also speaking for his colleagues when he stated

> 'I think we all believe that the chance of Priam being touched off in the next two or three months is pretty negligible: hence it does not seem worth wasting much time on it'.[103]

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[100] ibid
[101] Jenkins, R. A Life at the Centre. p.262.
[102] PRO T312/2548 Goldman to Dowler 'Priam: Talks with the Americans', undated.
[103] PRO T312/2548 McMahon to Posner, 23/10/68.

Although Rawlinson was initially scathing of McMahon's sentiments, by the middle of November he too had come around to this point of view. For on 13 November General de Gaulle had publicly stated that the devaluation of the franc would be an 'absurdity'.[104] However, it was wise of Rawlinson to continue with the exercise in spite of this because by 18 November it seemed that the General had changed his mind.

In many ways, de Gaulle's public declaration that there would be no devaluation was not out of line with the tactics that Callaghan should have pursued before the British move. The decision to move days later did not necessarily represent a U-turn on the part of the General or his government. As Sir Kit McMahon pointed out, in the run up to any devaluation it is often necessary for politicians to tell bare faced lies.[105] If they did not and the markets guessed what was to happen before the fact, the speculative pressure would have been unbearable.

For, in the case of the French, the remarks were uttered the day after they had raised their bank rate and restricted credit as a response to mounting speculative pressure.[106] Of course de Gaulle might have been attempting to quell that strain but his speech and the deflationary package backfired, alerting markets to the deteriorating situation.[107] Consequently, gold sales in Paris increased and the German mark broke through its ceiling in Paris. Speculators believed that there would be a chance of revaluation for the mark and this attracted funds out of London and into Bonn.[108] According to Jenkins, on Friday 15 November alone, the British authorities had to spend more than $250m in order to keep the pound from the floor.[109] In fact, the total loss recorded between 13 and 27 November amounted to £337m [$808m].[110] By contrast, the total reserves stood at £1520m [$3650] or £270m [$650] when debts to the EEA

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[104] PRO T312/2548 Rawlinson to Allen 'Priam', 14/11/68.
[105] Interview with Sir Kit McMahon
[106] Cairncross, A. Managing the British Economy in the 1960s, p.223.
[107] ibid
[108] ibid
[109] Jenkins, R. A Life at the Centre, p.262.

are taken into account.[111] The true reserves were in minus figures and the situation was, again, far worse than during the build up to the devaluation.

The November Crisis

On Sunday 17 November, Douglas Allen was 'thrice rung up...from Basle by the Governor on an open line'.[112] What emerged was that the French, quite to everyone's surprise, had decided that borrowing their way out of their financial difficulties was not an acceptable proposition and that 'the General was prepared to eat his words on devaluation.'[113] They intended to move their rate down by some 15% unless the Germans were prepared to revalue part way to meet them.

Such a state of affairs was awkward for Britain for a number of reasons. Firstly, if the franc devalued by such an amount it would have been the equivalent of a sterling revaluation of 1.5%.[114] This would have been problematic because many in the financial community still lacked confidence in sterling at its current rate. It is likely that fears would have surfaced amongst them that the pound would have to follow the franc down so that Britain could compete with French exports. Whether or not the British government intended to embark on such a course of action, it was possible that they would be forced to because of the mounting speculative pressure on the pound in the days and weeks after the French had moved.[115]

Secondly, the situation was confounded by the fact that a rumour of a mark revaluation was already attracting funds out of London.[116] In short, there were two sources of pressure that

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[110] PRO T312/2135 Posner to Allen 'The Potential Drain on the Reserves', 6/12/68.
[111] PRO T312/2132 Paper by the Bank of England 'Potential Drain on the Reserves and facilities to meet it', 11/11/68.
[112] Cairncross, A. The Wilson Years. p.342.
[113] ibid, p.343.
[114] PRO T312/2132 Cassell to Posner, 4/10/68.
[115] Wilson, H. The Labour Government: 1964-1970, p.582.
[116] ibid, p.582-585.

plagued sterling at this point. Of the two, only the German problem really afflicted sterling at this stage. However, after a French devaluation money would not have been leaving London simply because there was a chance of making a quick gain in Germany. It would be leaving because balance holders would fear that it would only be a matter of time before Britain, with her ailing balance of payments, made further adjustments of her own.

In the face of such pressure the Treasury believed the ideal solution for Britain would be for the franc to devalue by 10% and the mark to revalue by no less than 5% but possibly as much as 10%.[117] This would have been advantageous for two reasons. Firstly, if the two currencies moved simultaneously, their new rates would balance one another out thus avoiding the disequilibrium of a solo French venture.[118] This would mean that the French would gain no competitive advantage over the UK and few would think that the pound would have to follow the franc down. In fact, if both the franc and mark moved by 10% it would actually have amounted to a British devaluation of 1%.[119] Second, the revaluation of the mark would stop the movement of funds from London to Bonn. It was also possible that the higher interest rates in London would have attracted back much of the currency that had left in the first place.

On Monday 18 November, the Chancellor held a series of meetings with his officials to discuss the situation. At the first meeting, held during the morning, Sir Douglas Allen reported that the German Cabinet was not to meet until the afternoon and that it was unlikely that they would announce their decision, either to revalue or maintain the present parity, until the following day.[120] If the French intended to wait for a German decision before implementing their devaluation, they would not have been able to move until at least Tuesday. Furthermore

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[117] Cairncross, A. The Wilson Years. p.341.
[118] PRO T312/2133 'Note of a meeting held in the Chancellor of the Exchequer's room: 10.30am', 18/11/68.
[119] PRO T312/2132 Cassell to Posner, 4/10/68.
[120] PRO T312/2133 'Note of a meeting held in the Chancellor of the Exchequer's room: 10.30am', 18/11/68.

the Germans had a regular bank holiday on Wednesday 19th and to the Treasury this pointed to changes in both parities on the Tuesday night.[121]

There was no information available on the US attitude, though Jenkin's officials felt that Fowler would be very disturbed if the French moved by 15% and the Germans made no move at all.[122] For such a situation would have been remarkably close to the conditions that Fowler referred to as a 'wrecking devaluation'. Of course, the Americans would have been even more concerned if the UK had decided to move as well, as this would have undermined the whole fabric of the fixed rate system. However, Posner was attracted to the idea of using a move on the part of France and Germany as an excuse for Britain to implement a further 5% devaluation of its own.[123] Cairncross also 'had a sneaking inclination to do this'[124], which his deputy at the Economic Section, Fred Atkinson, shared.[125] This course was advocated because it appeared that the steam had gone out of the recovery in exports. If the Treasury planned to take action to correct the balance of trade in the near future, a devaluation had a lot to recommend, especially as an alternative to quantitative import restrictions.[126] If France and Germany moved Britain would have had an excuse to do the same and could have dressed the decision up as a response to changes in the wider international system rather than as British weakness.

However, like Rawlinson in his discussion of the possibility of a further devaluation in his elaboration of Priam, the Chancellor rejected devaluation as a viable course of action.[127] Firstly, whilst in the long-term devaluation would aid the trade balance, in the short-term it would do the opposite. In fact, it would merely have exacerbated the J-Curve effect. Secondly,

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[121] ibid
[122] PRO T312/2548 Ryrie 'The possibility of counteraction against a wrecking devaluation by the French', 18/11/68.
[123] PRO T312/2133 'Note of a meeting held in the Chancellor of the Exchequer's room: 10.30am', 18/11/68.
[124] Cairncross, A. The Wilson Years. p.343.
[125] ibid
[126] PRO T312/2133 'Note of a meeting held in the Chancellor of the Exchequer's room: 10.30am', 18/11/68.

it is highly probable that balance holders would have seen through the pretext of the move as a process of wider realignment and perhaps have regarded it as merely the first instalment.[128] Therefore, devaluation as an act of policy had the potential to reduce confidence further and aggravate the situation.

However by that lunchtime it had become clear that Herr Blessing, the Governor the Bundesbank, was extremely doubtful about getting his political masters to agree to a revaluation of the mark of as much as 10% and he was in fact doubtful about any move at all.[129] In short, even if the British authorities had wanted to use the realignment of the French and German currencies as a ploy to devalue the pound, it was unlikely that such a tactic would have worked for it seemed that France would be moving alone. In the afternoon, Jenkins reconvened his officials to discuss tactics in light of the new situation. It was agreed that if the French acted unilaterally that evening then the British foreign exchange markets should be closed on the Tuesday.[130] However if the French only announced that they were to close their market on Tuesday, further thought would have to be given to British action because there was a risk that any pre-emptive action on the part of the UK would only serve to reduce confidence.[131] The gathering discussed the techniques for closing the market, as had been outlined by Rawlinson in the development of Priam. It was decided that if the markets were to be closed, unlike during the March gold crisis where they used the Bank Holiday tactic, they would act through use of foreign exchange regulations to temporarily suspend convertibility.[132]

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[127] Jenkins, R. A Life at the Centre. p.267.
[128] ibid
[129] PRO T312/2133 'Note of a meeting held in the Chancellor of the Exchequer's room: 4.15pm', 18/11/68.
[130] ibid
[131] PRO T312/2133 'Note of a meeting held in the Chancellor of the Exchequer's room: 10pm', 19/11/68.
[132] ibid

From then on the tactics decided upon, in a situation where the Germans could not be persuaded to revalue, mirrored the Priam scheme. For as Jenkins reported to the hurriedly convened meeting of Misc 205 later that evening:

> 'If the French devalued on their own, he [Jenkins] believed our only course would be to 'float' plus 'tough measures'. We had suffered a heavy run on sterling. Couve de Murville [the French Prime Minister] was broadcasting that night and we might have to meet later that evening, though none of us should create a crisis atmosphere by cancelling our engagements. The very fact that we had met must be kept deadly secret'.[133]

To Cairncross it seemed that events were now accelerating out of control, for in his diary he recorded

> 'What is it like to be at the eye of a hurricane or in a boat accelerating as it nears Niagara? I suppose that if there were lots of ordinary things and people around to occupy one's thoughts, it might pass almost unnoticed. At any rate it seems hard to believe that within a couple of days we may be floating and that, apart from some words from the Governor to Blessing and from the Chancellor to Schiller, we've been powerless to intervene'.[134]

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[133] Castle, B. Diaries. p.551.
[134] Cairncross, A. The Wilson Years. p.344.

Political Intervention

Wilson, however, was not content to simply passively react to the events as they unfolded. It seemed to him that if the French were to devalue it was imperative that the Germans were *forced* to change their minds and make a move of their own. His strategy in achieving that end was the very same as during the gold crisis. It comprised two parts. The first was a rather ill timed message to the US president urging him to put pressure on the Germans. In it he stated that the US must bring about a policy reversal on the part of the Germans, for without it, it would be impossible for Britain to hold the sterling rate. He went on to state that 'we should have no option in these circumstances but to let our rate float'.[135]

President Johnson did not take too kindly to Wilson's position; the Americans had already concluded that it would be futile to place pressure on the Germans.[136] Whilst Herr Blessing at the BundesBank was favourably disposed to a change in the rate, Johnson was well aware that the German leader, Keisinger, would be faced with the resignation of Strauss, the economic minister, should he give in and revalue. Furthermore there was great pressure from German agricultural interests and 'the native German dislike of throwing away a strong financial position' to contend with.[137]

To Johnson, what was more crucial was what happened to the franc. He believed that the US was likely to have more success in pushing the French away from devaluation than pressurising the Germans into revaluation.[138] In other words, Johnson was suggesting that through the judicious use of carrot and stick it might have been possible to get the French to borrow their way out of their current predicament.

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[135] PRO T312/2133 Wilson to LBJ 'Draft Telegram', 18/11/68.
[136] PRO T312/2133 'Telegram Number 3368A', 19/11/68.
[137] PRO T312/2133 'Telegram Number 3359A', 19/11/68.
[138] ibid

Wilson, on the other hand, did not share the President's optimism in the possibility of making the French see sense. Instead, he continued to obsess over the possibility of forcing the Germans into line. Two things illustrate this. The first is the fact that in Wilson's account of the episode, in his published record of the 1964-70 government, he refers to it as a crisis emanating from the failure of the Germans to revalue and hardly mentions the pending French devaluation.[139] Second, is that towards the end of Tuesday 19 November Wilson summoned the German ambassador, Herr Blankenhorn, to Downing Street in order to continue the arm-twisting. Jenkins, in his memoirs recalls that he was opposed to the idea because he thought that Wilson 'was too excited'.[140]

At that meeting, at which Jenkins and Michael Stewart were also present, Wilson conveyed to the German Ambassador the degree to which the British government was dissatisfied with Germany's position.[141] Wilson was particularly incensed because he had been made aware, some hours earlier, that instead of revaluing the Germans were only prepared to make modifications to their tariffs and to lower tax rebates on exports so as to achieve results equivalent to those produced by a 4% revaluation.[142] Such moves would not be anywhere near as fast acting as an actual revaluation and it would take several months before any change in Germany's balance of trade was noticed.

Therefore he rejected this meagre offering stating that it was 'the equivalent to barely a third of what was required' and again demanded that Germany revalue, arguing that if it did not, Britain would be forced to take unfortunate measures.[143] However, unlike during the March gold crisis where he did not spell out what those measures would be, Wilson left Herr Blankenhorn in no doubt. He stated that

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[139] Wilson, H. The Labour Government: 1964-1970, p.582-585.
[140] Jenkins, R. A Life at the Centre. p.264.
[141] PREM 13/2054 'Record of a Conversation between the Prime Minister, the Foreign and Commonwealth Secretary, the Chancellor of the Exchequer and the German Ambassador', 20/11/68.
[142] Cairncross, A. Managing. p.226-227.

> 'During the recent NATO meeting in Brussels, the Foreign and Commonwealth Secretary and the Defence Secretary had re-affirmed the British Government's determination that the defences of the West should be strengthened and our offer to contribute further to that end. But military defences were meaningless without adequate economic foundation. If the deterioration in the present international monetary situation continued, the British Government- and perhaps other governments as well- would find themselves obliged seriously to re-apprise their present attitude...They could only hope that the German Government would play their part in ensuring that such a re-appraisal did not become inevitable'.[144]

One supposes that in the phrase 'other governments as well' Wilson was suggesting that he was also speaking for the Americans, which of course he was not. At this point Jenkins interjected. He explained to Blankenhorn that the British government had originally favoured a meeting of the Group of Ten in order to bring about a mutually agreeable resolution.[145] Indeed the holding of such a meeting had been an essential part of the Priam plan.[146] However, Jenkins had come to the realisation that a meeting would no longer be appropriate given the fact that the Germans had already taken their decision, as the decision would have preceded the meeting. It was therefore rather unfortunate, from his perspective that the German Finance Minister Herr Schiller had called one for the following day, Wednesday 20 November.[147] Jenkins stated that whilst he would attend the session he was doubtful of its desirability and feared that it might simply increase international speculation. For although the major money

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[143] T312/2133 'Record of a Conversation between the Prime Minister, the Foreign and Commonwealth Secretary, the Chancellor of the Exchequer and the German Ambassador', 20/11/68.
[144] ibid
[145] PRO PREM 13/2054 'Record of a Conversation between the Prime Minister, the Foreign and Commonwealth Secretary, the Chancellor of the Exchequer and the German Ambassador', 20/11/68.
[146] PRO T312/2548 Goldman 'Note for the Record- Priam: Discussions with the US', 11/11/68.
[147] PRO PREM 13/2054 'Record of a Conversation between the Prime Minister, the Foreign and Commonwealth Secretary, the Chancellor of the Exchequer and the German Ambassador', 20/11/68.

markets would be closed while the conference was taking place, there was a danger that if it failed to reach conclusions in line with the expectations that it aroused, an even more dangerous situation would be created.[148]

In fact earlier that day Jenkins had urged Joe Fowler to pressurise the Germans into cancelling the meeting, on the advice of Sir Frank Figgures and Leslie O'Brien.[149] However, Fowler failed to see how circumstances had been changed for the UK by the German decision and was rather bemused at the reversal in policy on the part of Britain, as it was Jenkins that suggested in early November that if this sort of crisis ever materialised it would be crucial to hold such a meeting. The Bank however strongly urged Jenkins both not to attend and not to close the markets. However, to keep the markets open when the reserves were dwindling was to Jenkins 'perverse'.[150]

It is likely that Jenkins hoped that the confrontation with the German Ambassador would lead to a change of heart within the German government and ensure that the meeting was more useful for Britain. He concluded by reiterating what Wilson had already said and in so doing acquiesced with the Prime Minister's tactics. He explained that

> 'In the light of the speculative pressure arising from the Deutschmark French franc position, it might not be possible for the British Government to sustain the exchange rate of sterling. In such circumstances, they would have to allow the sterling rate to float, though they recognised that the consequences of this would be grave both for Britain and for the other major currencies, including the dollar....it could become difficult for them [the

[148] T312/2133 'Record of a Conversation between the Prime Minister, the Foreign and Commonwealth Secretary, the Chancellor of the Exchequer and the German Ambassador', 20/11/68.
[149] Jenkins, R. A Life at the Centre. p.263-264.
[150] Ibid, p.264.

> UK] to maintain a military presence in Germany. It was therefore essential that, by the end of the Group of Ten meeting, there should have been a redefinition of the German position'.[151]

The Bonn Conference

The next morning Jenkins flew to Bonn in a RAF Comet. It appeared though that the Germans had leaked the details of the confrontation with Blankenhorn to the press. For Jenkins was faced with a group of demonstrators with placards bearing such legends as 'Wilson-hands off our D-mark', when he arrived at the British Embassy in Bonn.[152] The conference itself proved to be a complete waste of time, comprising a series of lengthy meetings 'under Schiller's increasingly inept chairmanship' that produced no notable change in Germany's position.[153] As Jenkins recalls, 'The verbal diarrhoea of Professor Schiller was indeed the most constant and maddening feature of the conference'.[154] In total, he talked from the chair for twelve of the fifty hours of the meeting. The fact that Germany would not consider revaluation at any price was also problematic for the negotiations with the French. They were not prepared to devalue by a figure of less than 15% unless they could be satisfied that if they did so the Germans would meet them part way. Therefore, the majority of the discussions centred on attempting the break the German deadlock so that the French could devalue by an amount that the Americans would not regard as wrecking.[155] The fact that the Germans would still not move was something that astonished the rest of the delegates. For they found it hard to believe that the Germans, having summoned the conference in the first place, continued to remain obdurate.[156]

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[151] PRO PREM 13/2054 'Record of a Conversation between the Prime Minister, the Foreign and Commonwealth Secretary, the Chancellor of the Exchequer and the German Ambassador', 20/11/68.
[152] Jenkins, R. A Life at the Centre. p.266-267.
[153] PRO T312/2134 'Telegram Number 1635', 22/11/68.
[154] Jenkins, R. A Life at the Centre. p.266-267.
[155] ibid

When it became clear to the French that the Germans would not move, Ortoli, the French Finance Minister approached Jenkins to discover whether 'there was any chance of our covering French devaluation with a small fig-leaf, in other words a little voluntary devaluation of our own'.[157] Jenkins refused Ortoli for the very same reasons as he had refused Posner. The conference however was to drag on into a second day, where discussions centred wholly on what would be considered an acceptable amount for the French to devalue by. The parameters were that if the French could accept a figure agreed at the conference and one that was not considered by the Americans as wrecking, then they would receive a line of credit worth $2.6billion to help them sustain the new rate.[158] The Bank of England and the Treasury had calculated that sterling could tolerate at 12.5% devaluation and possibility one of 15%.[159] Although if they were to move down by 20%, it would have amounted to a sterling revaluation of 2% and the British authorities would have had to make some adjustments of their own.

Ortoli opened the new phase of the discussions by stating that he had been authorised to propose a devaluation of 13%, but to go below that if the Germans would offer something on their side. However, both the Americans and the IMF were loath to accept anything above 10%.[160] With the American offer of a standby credit the French were prepared to meet them half way and agreed in principle that they would devalue by 11.11%, even though the Germans made no new concessions.[161]

In his telegram to Wilson outlining the events in Bonn, Jenkins concluded that

> 'Nothing which has occurred has caused me to change my opinion that it was a serious mistake to call the conference in the first place.

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[156] PRO T312/2134 'Telegram Number 1635', 22/11/68.
[157] Jenkins, R. A Life at the Centre. p.267.
[158] ibid
[159] ibid
[160] PRO T312/2134 'Telegram Number 1635', 22/11/68.
[161] Jenkins, R. A Life at the Centre. p.268.

> German obstinacy, and Schiller's tactics and personality, have made it an extremely trying experience for all of us. But we have to put a brave face on the outcome and do everything possible to convince people that we are satisfied with it. At least, now that the Germans have resisted all this pressure, speculators should be convinced that revaluation is out of the question'.[162]

Jenkins was correct in his last statement. The fact that the conference resulted in no move by the Germans even though the whole affair was 'billed as the biggest thing since Bretton Woods'[163] drove home to the speculators the message that the Germans had no intention of revaluing. And that they could not be coerced into doing so, even when they were being pressured by the vast majority of the Group of Ten. Therefore, it became clear that no speculative gain was to be made and the movement of funds from London to Bonn ceased.

The French

In actuality, and much to everyone's surprise, the French decided not to devalue after all! It is difficult to discern the reasons for this U-turn. Cairncross speculates that that they never intended to move at all. Instead, the threat of devaluation enabled them to extract a large line of credit from the Americans and to justify at home the imposition of drastic fiscal measures.[164] Cairncross also believed that if the French had devalued, their unions would have demanded, and won, a 10% increase in wages that would have offset much of the gain in competitiveness.[165]

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[162] PRO T312/2134 'Telegram Number 1635', 22/11/68.
[163] Carincross, A. The Wilson Years, p.347.
[164] Carincross, A. Managing. p.228.
[165] ibid

However a 'good source' was able to give officials at the British Embassy in France an account of French Ministerial thinking before and during the franc crisis. It seemed that Ministers had been considering devaluation from July 1968, when some in the Cabinet had called for a 7% reduction in parity.[166] However it was decided by the majority of the Cabinet not to pursue this and up until November 1968, French ministers believed they had avoided the need for devaluation. When the speculative movements resurfaced in early to mid-November, the Cabinet divided into three main groups. Those who wanted a wrecking devaluation of 20-25%, in the hope that it would bring down the other currencies and lead to the revaluation of gold. Those who favoured a relatively small devaluation of between 9-11%, and those who wanted no devaluation at all.[167]

At the beginning of the Bonn discussions, Ortoli, the Finance Minister, apparently believed that the French with Anglo-American support would succeed in bringing about a revaluation of the mark. When it became clear that this was impossible the French Prime Minister M. Couve de Merville's main anxiety was that France would be unable to obtain a large international loan without a commitment to devaluation. However, when the French negotiators reported that they could get their loan without this commitment the Prime Minister came down firmly against devaluation.[168]

Whilst this was occurring there was a leak from a member of the French delegation at Bonn and the press were reporting that a franc devaluation was a certainty. It appeared that ministers bitterly resented having their hand forced by the press and de Gaulle himself decided that the rate would be held.[169] It also seemed that the French government believed that

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[166] PRO T312/2135 'Telegram number 1174', 25/11/68.
[167] ibid
[168] ibid
[169] ibid

> 'Big business had organised a conspiracy to bring down the franc. Ever since the events of May, businessmen had wanted the competitive advantage devaluation would give them, and had made their dispositions accordingly. This was intolerable from every aspect, and the government would now be master in its own house'.[170]

Conclusion

Even though the November crisis blew over it was a significant episode for two reasons. Firstly, it gave the Chancellor 'the opportunity to make our necessary changes on the home front and cover them up with the international crisis'.[171] In other words Jenkins was able, one year after the sterling devaluation, to enforce his final tightening of the screw and inflict on the home a economy a severe deflationary package and one that would hopefully bring an improvement in the balance of trade. On the afternoon in which he returned from the Bonn conference the Chancellor held a mini budget in the Commons in which he unveiled his proposals. The Measures were designed to raise an additional £250m per year in taxation. Indirect taxes were raised by 5d. on a gallon of petrol, 5d. on a packet of twenty cigarettes and 4s. on a bottle of spirits.[172] All rates of purchase tax were increased by 10% and bank credits were to be severely curtailed.[173] Most significantly, Jenkins also introduced a system of import deposits, requiring traders to deposit for six months 50% of the value of prescribed imports, before customs would release the goods.[174] The measures were intended to deflate the domestic economy and to prevent it from sucking in an excessive amount of imports, so that the balance of trade could be improved upon. It was to be the last set of deflationary measures

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[170] ibid
[171] Crossman, A. The Crossman Diaries: 1964-1970, p.485-486.
[172] PRO T312/2134 Note by the Economic Section 'The General Economic Setting', 21/11/68.
[173] Wilson, H. The Labour Government: 1964-1970, p.583.
[174] Crossman, A. The Crossman Diaries: 1964-1970, p.485.

implemented by the Labour government 'before it became apparent that the devaluation was succeeding'.[175]

Second, the crisis itself formally signalled the change in the Treasury mindset. Although few relished the possibility of a floating pound the Treasury were now mentally equipped for it and were prepared to recommend it as a course of action if the speculative pressure became too much to bear. By this stage, no one in the Treasury advocated blocking as a policy option should it have become impossible to hold the rate. In fact, the only person that even contemplated such a course of action was Andrew Graham, the assistant to Tommy Balogh in Number 10.[176] However, there is no evidence to suggest that anyone took Graham's recommendations seriously.

[175] Cairncross, A. Wilson Years. p.341.
[176] PREM 13/2055 Graham to Halls 'Exchange Rates', 22/11/68.

Chapter 8 Conclusion

In works of this size, it is customary to divide the structure of the analysis in the following way, theory: data: theory revisited. With the aim of providing a set of theoretic premises, subjecting them to the data and then reformulating them to make a more precise fit with empirical reality. Usually the process of reformulation takes place within the conclusion. However, in this case, this is not an appropriate way to proceed. Firstly, because many of the theoretical propositions were devised inductively and secondly, those premises that were deduced are ontological in nature and there is no way in which the data can impact on them. Instead, it is the ontological assumptions that impact on what is regarded as data. Consequently, the conclusion will be organised in the following manner. Firstly, it will attempt to summarise the argument developed throughout the thesis and to place it more firmly within the context of the theoretical framework. This will ensure that we have the best available vocabulary to make sense of the data. Secondly, whilst chapter three provides a useful backdrop to the management of sterling prior to 1968, it is also important to consider the way in which decisions made in 1968 impacted on the currency after that period. The second part of the conclusion will attempt this task in terms of an analysis of both the break-up of Bretton Woods and the collapse of the sterling area.

The Argument

The principal argument has been that the scholarly analysis of sterling in the 1960s is too devaluation centric. Little attention has been paid to the aftermath of the parity change and too much attention has been focused on its build-up. Furthermore, the devaluation is in itself of little significance. This is because it represented only first order change. It did not constitute a (third order) paradigm shift or even the (second order) crafting of *new* policy instruments. Instead, it only amounted to the tweaking of *existing* instruments. However, in

the aftermath it became clear to sterling's managers that the currency was still not working within normal tolerances and that the situation was far more severe than it had ever been before. Firstly, because the balance of payments had worsened as a result of the J-curve effect and secondly, because the sterling area began the process of *direct* diversification. This, combined with the prospect of NSA speculation, meant that the currency faced pressure from three sources simultaneously. In spite of this, the Bank, Treasury, and ministers made no attempt in the first few months of 1968, to engage in network relations. Instead, all parties hoped that with time the currency would begin to work within normal tolerances. By March 1968, it became glaringly obvious that this would not occur. The gold crisis that erupted severely drained the already meagre foreign reserves to such a degree that it seemed unlikely that the new $2.40 parity could be maintained. It was only during the midst of the crisis that economic policymakers recognised that the existing first order techniques of amelioration had become exhausted and that fresh action would have to be taken. It was impossible for any one actor to work alone, because the Treasury, Bank, and ministers each had resources, required by the others, for any action to be successful. The Treasury, recognising this, acted as a network hegemon and sought out other players. It required the expertise of the Bank and the authority of ministers in order to implement policy. Although the resultant policy network could agree on their first preference, namely securing international financial assistance, they could not agree on the course of action that should be embarked upon if this failed. The Treasury advocated the crafting of a new second order instrument in the form of operation Brutus. The new instrument would have amounted to the blocking of the sterling balances and Treasury officials decided upon it because of their *attenuated self-interest*. There was the collective realisation that if sterling were either devalued or floated it would undermine the stability of the IMS to such a degree that it would probably unravel. The Treasury feared that they would be dubbed the wreckers of Bretton Woods and that their domestic and international prestige would be dented. Hence, they opted for the blocking, in the belief that this would do least damage to the IMS.

The Bank, by contrast, derived its legitimacy and prestige from the fact that it operated the world's second reserve currency and it was closely allied to both the City of London and its sterling area customers. It recognised that blocking would harm both of these groups. The former would see the flow of funds into London cease, as Britain descended into the status of a siege economy and in the case of the latter, the Bank would be defaulting on its client's balances. Instead, the Bank argued vehemently in favour of third order change and suggested the sterling should be floated. The Treasury objected, not only because of the damage that it would do to the IMS but because a floating pound would likely intensify the OSA's diversification bid, thereby pushing the rate to a very low level.

Though the Bank was a valuable networking partner because of its knowledge and expertise, the Treasury was able to override it and foist its preferences on the Labour government, thereby shaping the context in which Wilson's Misc 205 made its decisions. The dossier that the cabinet committee consulted played down the option of moving to a floating rate and because of this the ensuing ministerial discussion was couched in terms of international support verses Brutus. It is almost certain that if Britain had not obtained financial assistance, the sterling balances would have been blocked. It is also very likely that Brutus I would have failed, because its simplistic nature meant that the balances would still have been run down, albeit at a slower rate. Certainly, the Treasury would have attempted to improve the block, but it is doubtful that they would have been able to do so quickly enough. This would have left no choice but to float the pound and it is likely that Bretton Woods would have collapsed in 1968 rather than 1972. In fact, it was probably this prospect that made the US dig deep into its coffers and rescue sterling.

In the aftermath of the debacle the Treasury took stock and noted four things. Firstly, that it was possible that sterling would continue to operate outside tolerable parameters for many months and potentially years. Secondly, it was unlikely that first order setting changes would become any more efficient and hence stabilise the currency. Thirdly, that during the gold

crisis they had been caught unawares and because of this the prospect of implementing a successful block would have been slim. Finally, because the likelihood of further crises was high, it was essential to form a contingency planning network, so that fresh second order instruments would be prepared if first order setting changes failed. Again, the Treasury recognised that it could not complete such a task alone because it would require the knowledge and authority of other actors. Consequently, it sought, and received, ministerial authorisation to continue with its planning exercises. By the end of March 1968, the Treasury had formed a large policy network that encompassed players from the Board of Trade, Customs and Excise, the Cabinet Office, the Bank, as well as from the Treasury's own ranks. These institutions co-operated because in exchange for their expertise, they would have the chance to influence the shape of the Brutus proposal. It is interesting that the Bank, with its intense aversion to blocking should play such a central part in the discussions. This can be explained in terms of the fact that it was subordinate to the Treasury, and possibly because it recognised that if it was to scupper the exercise this would best be accomplished from the inside. Furthermore, if the Bank could not discourage the Treasury from blocking, it was possible that it could convince it to develop a version that was less harmful to the interests of the Bank's client groups.

The planning exercise, which took place between March and July 1968, was punctuated by a high degree of learning on the part of officials. It soon became evident that blocking would require a high degree of skill and precision. Consequently, the Cramner proposal was elaborated and developed in such a way that it bore little resemblance to its father, Brutus. New versions of the plan were developed in order to counteract disadvantages with previous versions, but they brought with them disadvantages of their own. In total eight blocking schemes were devised. However, by June 1968, the Treasury had come to agree with the Bank that blocking was not necessarily more advantageous than floating. It was quickly recognised that the step would have severe domestic and international ramifications. Domestically, it would have to be accompanied by import controls, rationing, the mobilisation

of citizens private portfolio holdings and a complete ban of foreign travel. It would mean the imposition of a draconian and isolationist economic regime. Internationally, it would result in the abolition of the sterling area. It would also severely curtail world trade, because the sterling area would have no foreign exchange with which to purchase goods. Its only advantage was that it would preserve parity with the dollar and prevent the unravelling of Bretton Woods. Therefore, by the summer of 1968, the Treasury had come to see the horrors of the proposal. However, they still balked at the prospect of enacting third order change, in floating the pound and unilaterally destroying the IMS.

Meanwhile, a small group of officials within the Bank, recognising the severe danger that the OSA balances now posed to both the currency and their own managerial competence, began to consider ways to neutralise them. Their aim was to build an internal coalition so that the Bank could act as a unified network hegemon and seek out other interested external players. With the governor's approval, McMahon and Raw began to devise a strategy that would make the balances inert. The initial proposal was for an international package that could be used to fund the windup of the balances and hence Sterling's reserve currency role, though not the sterling area. However, it soon became evident that if funding were used to run down the balances, the Bank would simply be replacing its liabilities to the sterling area with liabilities to the central banks that funded the scheme. Furthermore, the initial consultations with interested international funding bodies revealed that it would not be possible to garner enough credit to allow the rundown of the balances in their entirety. This would leave a residue and it would have been likely that holders would quickly dispose of this, exacerbating the strain on the currency. Therefore, certain officials within the Bank considered the possibility of using a funding package as a scaffold to stabilise the balances rather than as a mechanism to drain them. Dudley Allen, in particular, was of this opinion and he argued that the Bank should attempt to get the sterling area to agree to hold a set percentage of their reserves in sterling. Furthermore, as the OSA would probably be reluctant to do this, because they would be voluntarily forgoing their right to conversion, the Bank should undertake to guarantee a large

percentage of the OSA's balances and agree to write them up if the pound were devalued. What Allen advocated would require the building of an international policy network, because the Bank would have to court western central banks in order to fund the proposal and then sell it to its sterling area customers. Although not everyone in the Bank agreed on the desirability of offering guarantees, their hand was forced because the central banks that would fund the scheme were also calling for them.

That so many central banks were prepared to involve themselves is attributable to the fact that they recognised the danger that sterling's instability presented to the IMS. In short, they understood that it was in their collective interest to aid the Bank. The Treasury was supportive of the Bank's initiative and willingly joined the policy network, because it shared the Bank's perception of the sterling balance problem and the proposed solution did not in any way undermine the Treasury's interests. However, certain elements within the Treasury were keen to reshape the proposal so that it actually benefited their interests. Rawlinson in particular was concerned about the large-scale capital flights from Britain to the sterling area. This was because these flights undermined the balance of payments. He suggested that the negotiations should also be used to bring about windup of the sterling area. For if the sterling area were abolished, British residents would not be able to move their capital offshore and the drain would be stopped. The Bank however balked at the prospect, partly because it believed that it would needlessly complicate the negotiations and reduce the chance of success and also because the abolition of the sterling area would greatly dent its prestige. Although the Treasury accepted the Bank's position, it still hoped that it would be possible to dismantle the sterling area after the negotiations had been completed. In actuality, no step was taken in this direction until the pound floated in July 1972.

By September 1968, the negotiations with the sterling area countries had been completed. It is impressive that the Bank and the Treasury managed to obtain consent from the majority of OSA countries for the implementation of the scheme. It is however surprising that the 1968

Basle agreement should receive such scant treatment in the analysis of economic policy during the 1960s. For in many ways it was far more significant than the devaluation. This was because it did not represent the mere tinkering with first order settings but the actual development of a new second order instrument. Furthermore, the agreement reinvigorated, for a short time, sterling's reserve currency role. After implementation direct diversification stopped and the sterling balances actually increased in size. Therefore, although the Bank had set out to remove the reserve currency role, because it could not gain a support package of large enough size to achieve its aims, it ended up doing quite the opposite.

The successful conclusion of the 1968 Basle agreement is also significant for another reason. Namely, that it altered the context in which the sterling contingency planning network operated. Before the agreement was completed, Treasury planners recognised that under the circumstances of an insurmountable sterling crisis, the only course would be to block. Of course, as time went one, they became increasingly reluctant to countenance such a move. However, with Basle concluded the desirability of forced blocking receded. This was because the agreement actually met many of the central objectives of Brutus-Cranmer. Whilst Basle did not represent the forced blocking of the sterling balances it amounted to a partial voluntary block. The official sterling area holders had to agree to hold a minimum portion of their reserves in sterling, in exchange for the guarantee. Although the OSA would be free to use the currency for balance of payments purposes, they would have to draw in equal measure on their non-sterling holdings. This meant that they could not simply run down their balances. Furthermore, where the balances were reduced, it would be the Basle facility rather than the reserves that would take the strain.

The Treasury now recognised that the sterling area was no longer a source of pressure on the reserves. If another sterling crisis materialised it would be because of balance of payments difficulties or shifts in hot money and Brutus-Cranmer would not alleviate these any more than Basle would. Consequently, a significant body of opinion, in both the Bank and the

Treasury, had come to recognise that a move to floating rates should no longer be discounted. Firstly, because there would be little alternative. Even during the March gold crisis discussions, officials accepted that if blocking failed to hold the rate there would be no alternative but to float. Given that a system of partial blocking had now been put in place, floating was the only available mechanism for use in crisis conditions. Secondly, the move to a flexible exchange rate was not incompatible with the successful operation of the Basle agreement. Finally, because of this it was likely that the rate would not fall too far, because the sterling area, with its guarantee, would not dispose of the currency. This meant that the only objection to floating rates was that it represented third order change and that it would undermine the IMS. It was this objection that prevented officials from advocating it as a policy option in its own right, but with the sterling area problem now negated, they were prepared to consider it as the option of last resort in place of Cranmer.

Therefore, officials began to plan for a move to floating rates under the code name Hecuba, during the autumn and winter of 1968. The Treasury acted as hegemon but sought out fewer players than it had done during the blocking exercise. This was because a move to flexible exchange rates was technically much simpler than blocking. In fact, the only other player to participate was the Bank, because its knowledge and expertise in the management of the EEA made it a useful partner. Furthermore, the Bank shared the Treasury's view on the importance of this kind of planning and had argued all along that it should be floating rather than blocking that should be enacted during a severe crisis. Although Hecuba was not implemented during the Wilson government's term of office, the fact that it was planned for is significant for two reasons. Firstly, it marked a watershed in official thinking. It signalled that the Treasury had undergone a radical transformation in its mindset and was finally prepared, under extreme circumstances, to embark on third order change and jettison its adherence to the existing rules of the game. Secondly, it is clear that Hecuba was not an empty exercise. For although the move to a floating rate was not made until 1972, it was Hecuba (by then renamed Palinurus) that formed its basis.

Hecuba was not however the only contingency plan devised by the Bank-Treasury network during the autumn at winter of 1968. They also developed a proposal called Priam. This was designed for implementation under conditions where pressure bore down on sterling because of either the weakness or strength of another currency. In other words, it was possible that hot money would leave London if a weak currency, such as the French franc, devalued because holders might fear that the pound would be forced to follow her down. Equally, there was also the risk of capital flight if it was believed that a strong currency, such as the German mark, was to be re-valued. In this case, balance holders would switch into marks, so that they would make a speculative gain. As the sterling balances had been neutralised, it would only be possible for movements in NSA holdings to damage the reserves. Although by the autumn these were not substantial, in combination with the balance of payments deficit, they could still wipe out all of the remaining reserves. Whilst both the Bank and Treasury doubted the likelihood of a Priam type situation emerging they still planned for it, partly because they recognised that it would be prudent to do so but mainly because it provided a useful pretext to engage in dialogue with their opposites in number in the United States.

In implementation, Priam would have amounted to a mini-Hecuba. This meant that if the side winds of another currency crisis impacted on sterling and the reserves looked near exhaustion, the pound would have been floated so that the rate rather than the reserves took the strain. Unlike Hecuba, the move was not intended to be permanent. After the crisis rescinded, sterling would be re-pegged at the pre-existing rate. However, as the development of the Priam scheme progressed, officials became increasingly convinced that they were engaging in an empty exercise. For although the mark was clearly undervalued, it was improbable that the Germans would re-value as this would undermine their competitive export position. Furthermore, the devaluation of the franc appeared unlikely because the French government also appeared totally opposed to any change in parity.

However, by 15 November 1968 it seemed that that the improbable contingency was about to become a reality. The French franc came under intolerable strain and it appeared that the French government was to consider devaluation. Furthermore, the German mark had broken through its ceiling and speculators believed that it would be re-valued. Over £337m was lost from the British reserves as speculators herded out of the currency, believing that sterling would most likely follow the franc down and that a speculative gain could be made by switching into marks. The Treasury hoped that both currencies would change their parities. If they did so, the mutual adjustments would cancel one another out and negate the need for a competitive sterling devaluation. Furthermore, the re-valuation of the mark would halt the shifts in hot money to West Germany and it was possible that holders would switch back into sterling. If the Germans could not be persuaded to re-value then the Bank, Treasury and Misc 205 accepted that there would be little alternative to Priam. Although the crisis was quickly contained, because both the French and Germans maintained their parities, it formally signalled the change in the Treasury's mindset. Although few officials at Great George Street actively embraced the prospect of a floating pound, they were prepared to plan for it and in certain circumstances recommend it.

Beyond 1968

Obviously, the story of sterling and its managers does not end in 1968. The remainder of this chapter will briefly attempt to chart the management of the currency between 1969 and 1972 so that the events of 1968 can be placed in a wider context. Although Treasury and Bank officials solemnly continued to pursue contingency planning beyond 1968, the timing was not yet right to deviate from the rules of the game. Instead, they chose to increase their debts. By January 1969, Britain's medium and short-term debts were greater than £3,400 million, officials envisaged another serious crisis costing £500 million, which would place the

Treasury in a hole from which they were unwilling to borrow their way out.[1] Later that year they recanted and the British government began negotiating with the IMF in order to obtain a credit of $500 million received at the end of June 1969, and another $500 million that would be spread out over the following period to May 1970. It was thought that without these credits, there would be serious repercussions on sterling.[2] Throughout the planning exercises, the condition of sterling never deteriorated to an extent that demanded immediate action, because the balance of payments had finally swung into surplus. Instead pressure on sterling simply sustained itself, and worked slowly to undermine the stability of the pound, and thereby the stability of the IMS.

Now, fully understanding the weaknesses of Bretton Woods, HM Government intended to pursue change without conflict. This was because British policymakers were not prepared to take any unilateral action that would undermine the IMS. Instead, during 1969 the Treasury attempted to devise a multilateral solution to their problems that would loosen, although not remove the Bretton Woods straightjacket. On March 3, 1969, US Treasury Under-Secretary for Monetary Affairs, Paul Volcker, and Frank Figgures, working under HM Treasury, agreed in Washington to set up bilateral talks between the United Kingdom and the United States in order to exchange ideas that were being canvassed for a more flexible exchange rate system.[3] A US team arrived in London on 25 March and began the first of a series of discussions, which intended to establish a continuing dialogue between the USA and UK regarding the restructuring of Bretton Woods. During the ensuing discussions, the Treasury proposed two alternatives for reform.

The first was to widen the dealing margins for currencies. Under Bretton Woods, currencies were only permitted to fluctuate in terms of their exchange value by 1 per cent either side of official parity values. The Treasury believed that if these margins were multilaterally widened

[1] PRO T 295/607, 'Hecuba: The Question of Further Borrowing', Ryrie to Rawlinson, 27/1/69.
[2] PRO CAB 130/497, MISC 205 (68) 10th meeting held on 13/11/68.

to 5 per cent, above and below, then it would improve their ability to manage spot and forward market rates for sterling. Such a move would also secure some of the advantages of floating exchange rates as a component of balance of payments adjustment, without altogether sacrificing the confidence and stability of fixed exchange rates.[4] However, in the discussions with the United States, it became clear that it would be impossible to gain international approval for such a change. This was because wider dealing margins might result in exchange rate competition, which was a feared consequence Bretton Woods was intended to avoid; it was also likely that the European Economic Community countries would reject such a move because their Common Agricultural Policy (CAP) would become skewed under it.[5] Under CAP, food prices were fixed in terms of a gold unit of account and any intra-EEC exchange rate movements would undermine this.

After ruling out wider margins, the two teams began discussion on a crawling peg scheme. At heart, the proposal involved fixing all convertible currencies within a narrow range of fluctuation and implementing par changes gradually over time, in a number of small steps so the process of exchange-rate adjustment was continuous.[6] The Americans seemed to favour it because it would make it easier to avoid situations in which rates that become unrealistic were defended against devaluation, which put considerable costs on both output and reserves.[7] The EEC also preferred the plan because it would do less damage to their CAP. Yet the British officials were adamant that it was impractical, on the grounds that it 'would clearly be impossible to apply even qualitative principles on a day-to-day basis and the only possible criterion of judgement would be to consider post facto the movement of a country's exchange

[3] PRO T312/2334, 'Discussions with Americans about Monetary Reform', Rawlinson to Ryrie, 3/3/69.
[4] PRO T 312/2334, IM (69) 16, 'Anglo-US Talks on the International Monetary System May 13-14, 1969', 27/5/69.
[5] ibid
[6] Williamson, The Crawling. p. 2.
[7] PRO T 312/2334, 'Talks with the Americans', Ryrie to Figgures, 19/3/69.

rate in relation to the change in its reserves so as to judge whether or not intervention policy had been of the kind which appeared to frustrate the objective of the system.'[8]

The UK could not act unilaterally or she would be damned by the world community and it was clear that no multilateral solution could suit every player whilst at the same time preserving the system of international rules that had been established in 1944. Although no agreement had been made with the US, it was clear that the UK had to prepare for the collapse of Bretton Woods. Firstly, because of the difficulties of managing sterling within it and secondly, because the system itself had become inherently unstable. The success of Bretton Woods relied on the US commitment to sell gold to both the private market and central banks at a rate of $35 per ounce. By March 1968, the US gold stocks had become so depleted that the pledge was only to hold good for central banks. Furthermore, the continual US trade deficits meant that central banks now held an excess of dollars. If they attempted to convert them, the US gold stock would be wiped out in its entirety. Consequently, the IMS faced the possibility of demise because of the inherent instability of both of its reserve currencies.

During the second half of 1969, the contingency planning network began to prepare for the demise of Bretton Woods under the code name Palinurus.[9] Operation Palinurus, the floating of the pound, was essentially based on Hecuba. The key difference between the two schemes was that Hecuba was intended for implementation in a severe crisis, whilst Palinurus presupposed using discretionary measures to float. Planners also devised another plan, operation Baytown, based on Patriarch, which amounted to a fixed rate devaluation.[10] During crisis conditions, the two operations were designed to be run side by side, until ministers could decide on the most appropriate course. Baytown would have preserved Bretton Woods

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[8] ibid.
[9] PRO T 312/3215, Rawlinson to Allen 'Palinurus', 10/6/70.
[10] PRO T 312/3215, 'Baytown', draft paper, 12/12/70.

by simply decreasing sterling's parity, whereas Palinurus would result in the termination of the IMS.

Within the context of Britain's third bid to join the EEC, the Treasury appeared to be more disposed to Palinurus.[11] For the UK's desire to enter the community made a step change less desirable because it would likely signal another such change later down the road, and a step change might have had to be larger than necessary to be credible.

Unknown to the Treasury, the US government undertook contingency planning exercises of their own in the wake of the Anglo-American discussions. By August 1971, the true extent of US planning became evident. On 6 August, the US Congress Joint Economic Committee's Subcommittee on International Exchange and Payments issued a report titled 'Action Now to Strengthen the US Dollar'. It presented the 'inescapable conclusion' that 'the dollar is overvalued' and that this 'overvaluation leads to the perpetuation of US deficits and thus increases the risk of an international crisis that would break the system apart'.[12] One week later a new wave of dollar selling began on international currency markets. The US was facing three simultaneous problems for which a cure for any one would have counter-productive side effects for the others: high unemployment, continued inflation, and a weak balance of payments.[13] The suspension of dollar convertibility into gold, the adoption of protectionist policies (an import surcharge) – a form of coercion with the hopes of inducing the EEC and Japan to adopt more liberal trading policies – was the comprehensive program the US administration chose. The package amounted to the termination of Bretton Woods.

In response to this, on 20 August 1971, it was agreed by ministers, the Governor of the Bank and the Chancellor, that the official parity of the pound sterling would remain unchanged at

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[11] ibid
[12] James. International, pp. 217-218.
[13] PRO PREM 15/309, 'US Economy President Nixon's Announcement' Telegram, Washington to London', 16/8/71.

$2.40 = £1. However, the market rate would be free to rise above its existing ceiling of $2.42, allowing for the rate to reach $2.46 before the Bank started intervening, with hopes that the rate would not rise above $2.50 – an unofficial 'snake in the tunnel'.[14] What this amounted to was a managed float for sterling. In the days following this agreement, the pound was trading at $2.4375 on August 23, on the 24, $2.4435, and from August 26 to 27 the pound went up from $2.4645 to $2.4740.

What is difficult to understand, is why Britain's initial experiment with floating exchange rates was so short lived and why economic policymakers aborted it in preference to the return to a deformed version of Bretton Woods. But abort they did and in December 1971 the UK became a signatory to the Smithsonian agreement which attempted to resurrect Bretton Woods in an attenuated form via a revaluation of gold and the widening of dealing margins from 1 per cent to 2.25 per cent either side of parity. One can only conclude that British policymakers had become so used to the rigidity of the Bretton Woods system that they had over time come to treat it not as a straightjacket but instead as a comfort blanket. Like prisoners they had become institutionalised into the routine of the flawed international monetary paradigm and preferred to rebuild an imperfect replica of their prison than to adjust to life on the outside.

It was not until 23 June 1972, that the pound was eventually allowed to float. The decision was taken because an exchange crisis had erupted that had seen over $2billion flow out of the foreign exchange reserves between 16 and 22 June. [15] This occurred in spite of the fact that the British economy was on a sound footing and the current account was in surplus.[16] Under such circumstances and with no likelihood of the 'irrational speculation'[17] ending, policymakers recognised that it would be necessary to act in order to conserve the remaining

[14] PRO PREM 15/309, 'International Monetary Situation', Note of Meeting, 20/8/71.
[15] PRO PREM 15/813 'Note for the Record: Floating the Pound', undated.
[16] Ibid 'Note of a Meeting Held in Two Parts in the Prime Minister's Room at the House of Commons on Thursday 22 June 1972', 23/6/72.

reserves. To devalue would make little sense because it was clear that the pound was not actually overvalued and it would be impossible to choose a new fixed rate. The solution was to float. Although the Bank and Treasury envisaged the move only as a temporary expedient, it quickly became evident that it would be permanent. The move to floating rates was also accompanied by the extension of exchange control to the OSA [Brandon] and the sterling area, though not its balances, ceased to exist. Therefore, the events of 1968 are important not only because they were more significant than the devaluation of 1967 but also because they paved the way for the break up of Bretton Woods and hence the initiation of third order change.

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[17] ibid

Appendix

The Research Process

This appendix provides an account of how the thesis was produced. It is divided into four sections. Section one outlines how the research topic was chosen. Section two assesses the problems related to gathering archival and interview data, whilst sections three and four examine the process of writing up and the development of the theoretical framework.

Choice of Topic

The choice of research topic was conditioned by the fact that, like Jim Bulpitt, I believe that political science should embrace the past and engage in more historical research.[1] I do however accept that there are difficulties in delineating between the present and the past. It is arguable that all inquires, bar those that attempt to predict future outcomes, are in essence assessments of the past, because they are analysing action that has already taken place (whether this be the management of the economy in the 2004 or 1904). It is, however, arguable that the analysis will be more rigorous the further into the past that the object of inquiry rests. Firstly, the more distant the event, the more likely it will be that the researcher is able to distinguish the wood from the trees and determine whether they are analysing events that have long-term, rather than passing, significance. Secondly, when at least thirty years have elapsed there is a greater body of data available to the researcher. This is because it is no longer necessary to rely on memoirs, interviews and newspaper reports, as declassified state papers can also be consulted.[2]

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[1] Bulpitt, J. 'Historical Politics: Macro, In-Time, Governing Regime Analysis', paper given at the PSA Annual Conference, University of York, Easter 1995, in the Political Science Specialist Group Panel on 'Politics, Contemporary History and History'. See also Johnson, N. The Limits of Political Science. (Oxford: Clarendon Press, 1989), p.35-56.

[2] However, the provisions of the 2002 Freedom of Information act (FOI) saw the disappearance of the 30-year rule from January 2005. Instead, records will be accessible on transfer to the National Archives

Furthermore, given that I also have a long-standing interest in the politics of economic management in Britain, it seemed that this interest could be nicely combined with my predisposition for historical research. Consequently, I originally proposed to investigate the 1955-59 Conservative government and the policies that it pursued in order to control inflation during the summer of 1957. It soon became apparent, however, that this would not be a viable research theme. The case study proved too narrow and the archival documents did not allow for a re-interpretation of events that differed to any great degree from the existing accounts. Thus for a few months, I had no clear research topic and my time was spent examining the literature on British economic management in the post-war period.

By the end of the second term of the first year, I had decided to focus on the Wilson government's management of sterling in the aftermath of the 1967 devaluation. This change of direction occurred after I stumbled upon the files relating to post-devaluation sterling contingency planning at the National Archives. It quickly became apparent that this was both a highly interesting and under-researched episode.

The Process of Data Collection

Given that this thesis is historical in nature, the main source of data was declassified archival documents held that the National Archives and the Bank of England. Whilst these files provide a useful alternative and/ or addition to memoirs and newspaper accounts, four issues must be considered. Firstly, not all archival papers actually reach the National Archives; the

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unless they contain information covered by an exemption. It is likely that the new regulations will herald the introduction of a *de facto* 20 or 25-year rule. However, it will also be possible to put in FOI requests for documents that are still in use by departments and complain to the Information Commissioner if they are not provided. Although in reality, it is likely to prove difficult to obtain information on business in progress, because of issues relating to national security. See http://www.legislation.hmso.gov.uk/acts/acts2000/20000036.htm#aofs for the provisions of the FOI act.

vast majority of papers are destroyed during the initial selection procedure.[3] Secondly, in spite of the 'thirty year rule' which was in operation for much of this project, the core executive was still able to deny access to important papers, even when three decades had elapsed. This could be accomplished by restricting access for 75 years or by departments refusing to hand over files to the archive, on the grounds that they were still in use. Thirdly, with the advent of the telephone, it has been suggested that less and less of the business transacted is actually recorded in the documents.[4] This means that those documents that have been preserved form only a partial data set. Our interpretation of the past might be different had alternative documents been earmarked for preservation and had officials kept a more accurate record in those files that do remain. Fourthly, in spite of this, archival documents still remain a valuable source of evidence. In fact, without access to the state papers it would have been impossible to garner sufficient data with which to produce this thesis. The available press reports for the period shed little light on affairs of economic management and almost entirely concerned themselves with political infighting, rather than the substance of policy deliberations. Many of the officials publications also proved to be suspect. For example, it emerged that the Bank of England regularly doctored the foreign exchange figures in order to improve confidence in sterling.[5] The available memoirs tended to be thin on detail, at times contradictory and they often overemphasised their author's role in the events. In short, it is difficult to understand how practitioners of political science can engage in meaningful analysis without the relevant papers.[6]

Indeed, the principal problem that I faced during the research problem was not a shortage of archival documents but a glut. During the course of this investigation, I examined more than two hundred individual files, most of them book length. The actual mechanics of the research

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[3] See www.nationalarchives.gov.uk/recordsmanagement/selection/acquisition.htm accessed 4/9/04; Report of the Committee on Departmental Records. Cmd 9163, (HMSO, 1954) and Mowat, C. Great Britain since 1914. (London: Hodder and Stoughton, 1971), p.68.
[4] Lord Greenhill of Harrow, letter to The Times. 7/5/1977 and interview with Anthony Glover.
[5] Interviews with Sir Jeremy Morse and Sir Kit McMahon
[6] See Elton, G. The Practise of History. (London: Fontana, 1969).

undertaken in the National Archives and the Bank took the following form. Firstly, I spent several weeks familiarising myself with the procedures, cataloguing systems and holdings of the respective archives. After a thorough examination of the catalogues, I produced a 'master list' of useful documents based on the descriptions compiled by the archivists. I would then order the documents and determine whether they were relevant. Where the files were of use, I would transcribe them and enter a short summary of contents and usefulness on the master list. I would also search for additional keywords within the documents that would allow me to lengthen the master list. To ensure that the transcriptions did not go astray I found it useful to devise a cross-referenced filing system. The process of transcription was, however, laborious and in general, it was not possible to transcribe more than three files per day.

Of the two principal archives that were utilised, the Bank proved to be the least user friendly. Visits had to be booked weeks in advance, the cataloguing system was confusing and could not be accessed off site and Bank employees tended to sign documents with their initials, making it difficult to trace authorship. Furthermore, part way into the project the National Archives began to permit the use of digital cameras in its reading rooms. This advance allowed for the abandonment of transcription; instead, I was able to photograph entire files at a rate of fifteen per day. Sadly, because of security restrictions, the Bank was not to make the same concession until after the research gathering stage of this project had ended. However, the change in policy at the National Archives significantly speeded up the process of gathering data and allowed me to greatly expand the entries on the master list.

Archival analysis was complemented with a number of semi-structured interviews.

Generally, political scientists complain that three problems emerge when attempting to conduct elite interviews. Firstly, they must determine who the important actors are. Usually this is accomplished via a snowball sample.[7] Secondly, they must gain access. As potential

[7] Grant, W. 'Elite Interviewing: a Practical Guide', (University of Birmingham: Discussion Paper in German Studies, no.2000/11), p.3

respondents are still active, it can be difficult to find a window of opportunity and it is often necessary to skilfully bypass gatekeepers.[8] Thirdly, where access is granted, much of the information given will be 'off the record'; the respondent will be fearful of breaching confidences and /or the Official Secrets Act.

In my research, I did not encounter any of these problems. The important actors could be traced by examining the minutes of meetings held on file in the National Archives and at the Bank. Consequently, the need for a snowball sample was made redundant. With the relevant names, it was relatively easy to make contact. Home addresses and telephone numbers were obtained from Who's Who and letters requesting interview dispatched. Furthermore, because many of the individuals in question had retired from public life, they did not have busy schedules to juggle and were often keen to meet at short notice. Respondents were also happy to talk on the record and to be taped.

Before I interviewed my respondents, I produced a list of questions with which to guide the interview. However, in practise, I found best to allow the respondents to talk at length about the issues that they felt were important, as this often provided new lines of inquiry. When interviewees dried up I returned to my list of questions and worked through issues that had not been covered. Each interview was taped (almost thirty hours in total) and I made backup notes.

Of course, since the episodes these individuals were involved in took place in the distant past, there was the very real possibility that their recollections of events would be inaccurate or that they will project their current belief systems onto their younger selves. There was little way to guard against this, except through triangulation and comparing their oral comments in the present with their written comments in the past, in order to check for consistency. However,

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[8] Goldstein, K. 'Getting in the Door: Sampling and Completing Elite Interviews', Political Science and Politics. Vol.24, 2002, p.669.

even when respondents were poor on detail, they were still able to provide useful background to an episode, explain the organisation of their department, its links with other bodies, and provide some insight into mental processes of their colleagues. Nevertheless, with hindsight, I would recommend that future researchers send interviewees copies of relevant archival documents before meeting them, as an *aide memoir*.

The Process of Writing Up

Many researchers draw a distinction between the 'research stage' and the 'writing up stage'. In other words, they begin by harvesting all of the available data and once this has been collected, they proceed to write up their findings. However, I never worked in this manner. Although my research area was relatively uncharted, I was able at an early stage to view the period from a macro perspective. This was because I began by examining the Cabinet Office (CAB) and Prime Minister's (PREM) files. These papers contained summarised briefs of the important discussions relating to the management of sterling post-devaluation. Had I began with the departmental files my ability to develop a macro overview, early on, would have been hampered, because Treasury and Bank files tended to provide detailed and highly technical accounts of much smaller pieces of the jigsaw. My examination of the CAB and PREM files enabled me to divide the research exercise into discrete compartments, which correspond with the chapter breakdown of the thesis. Once I had decided on this breakdown, I gathered all the necessary information for a particular chapter. After I had garnered the data, I found it useful to re-order my transcriptions and digital copies and weave them together chronologically, rather than view them file by file. With this accomplished, I would write a chapter draft in narrative form, in an attempt to reconstruct the past. On average, this took three to four weeks. I found it difficult to fit my writing around other activities, like teaching, and tended to leave it until I had a significant block of time that I could devote to it. However, this meant that several weeks could go by without me writing anything. Thus the prospect of resuming work on the thesis was often daunting and I found that the first few paragraphs of a

new chapter could take several days to produce. Although, once this hurdle had been overcome I found the writing process to be immensely enjoyable. When a chapter was completed I would make revisions and submit it to my supervisors for discussion. This usually resulted in more research and in restructuring, before the chapter would again be submitted for comment. This procedure was followed for each chapter, so that by early on in the third year I had a series of rough chapters that provided a narrative of sterling's management in the aftermath of the 1967 devaluation.

The process of editing these chapters was a difficult one, given that I had been so close to the material for the previous two years. Therefore, once a chapter had been accorded the status of a working draft I would not re-examine it for a period of at least two months. This ensured that when I re-worked it, it was with a fresh eye. I found that the early chapters required the most revision, in terms of their phraseology. For as the thesis progressed and my writing style developed, these chapters looked ill conceived and immaturely written.

The Development of the Theoretical Framework

The process of theory construction occurred in two stages. During the first stage, which came early on in the research, I outlined the deductive premises upon which the research would be founded. These were:

- Firstly, that the world exists independently of our perceptions of it.
- Secondly, that we only come to understand and make sense of the world through language, perception and beliefs and that through human interaction we come to construct our understanding of the world.
- Thirdly, that the aim of the research should be to reconstruct the constructions of sterling's managers so that they could be described in great detail.

These premises, and especially the third one, guided the process of data collection and the writing of the narratives. My aim was to become immersed in the data and to attempt to acquire the worldview of those I observed. I found the elite interviews to be a useful way of bringing the documents to life and allowing fuller immersion. Initially the narratives that I produced were devoid of any explicit theorisation. However, after each of the main chapters had been completed, I began stage two of theory generation. I examined as much political science literature as I could, in the search for conceptual vocabulary that would aid the process of reconstruction and enable me to place the narratives within a more intelligible framework. This took more than three months, but once it had been completed I wrote the theory chapter and wove the conceptual vocabulary, that had been outlined within it, into the previously atheoretical narratives. After I had accomplished this, I wrote the introduction and conclusion, re-edited the thesis, produced the bibliography and prepared the work for submission.

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