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Managed decline? Muddling through with the sterling (dis)agreements, 1968-74

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Abstract

How do policy makers manage the decline of an international currency? This paper examines British policy towards the pound sterling's international role in the years 1968-74. Using previously uncited government archival sources, we revisit the view that the 'sterling agreements' of 1968-74, bilateral contracts made between the UK and governments holding sterling, formed a successful paradigm shift in British policy, towards deliberately managing sterling's international 'retirement'. Our research indicates that there was no settled consensus or strategic direction to British policy in this period, a case of 'muddling through'. Indeed, when feasible options presented themselves, British officials sought to maximise, not reduce, international sterling holdings.

Keywords: Sterling Area Agreements; international currency; sterling policy; disintegration.

JEL Classification: N10, F02, F22, F33.

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I. Introduction

The history of the international monetary system in the twentieth century is often presented as a new international currency – the dollar – replacing the old one – the pound sterling. As with most simplified narratives, the reality of this transition is more complex (Avaro, 2020; de Bromhead et al., 2022; Eichengreen and Flandreau, 2009; Schenk, 2010). Not least is there debate about how Britain managed the decline of sterling as an international currency after the Second World War, including changing attitudes of British policymakers towards sterling's international role. Prominent within this debate is the significance of the 'sterling agreements' of 1968-74, and whether these agreements constituted an important paradigm shift in the policy regarding international sterling, from one of maintenance to a policy of retirement, as argued by leading authors (Cohen, 2019; Schenk, 2010; Tomlinson, 1990) and post-hoc policy rationalisations provided by officials.

In this paper, we explore British policy towards sterling's international role during the life of the sterling agreements, calling into question this retirement narrative. Specifically, we describe and interpret the content and evolution of the sterling agreements, which have not previously received in-depth systematic study, and attempt to uncover the forces and motivations that shaped the policy. Were the sterling agreements a deliberate attempt by British policymakers to retire sterling, or alternatively, to resist and slow the diminution of sterling's international role? In fact, we find that policy lay between these extremes. It was altogether more muddled, passive (e.g. acquiescent to foreign demands), and reactive to short-term events.[1]

[1] Cohen's theory of currency statecraft uses the terms *reinforcement*, *relaxation* (i.e. passivity) and *resistance* to describe the orientation of policy towards an international currency in decline (Cohen, 2019).

Our analysis of the sterling agreements is based on archival sources. Forced to focus on policy in the new context of the sterling agreements, a narrow technical policy community comprising Bank of England, Treasury, and Foreign and Commonwealth (FCO) officials, guiding their departmental ministers and the Prime Minister, was brought together in various sterling committees, between 1968 and 1974, to debate the formulation and implementation of policy under changing external conditions. These debates produced a plethora of (many previously uncited) documents in The Bank of England Archive (BEA) and The National Archives (TNA), reflecting sometimes consensual, sometimes differing policy recommendations from the three agencies of government.[2]

Our study of this primary material leads us away from the idea that the sterling agreements were an active policy tool used to reduce sterling's international role. That perception assumes that British policymakers had considerable agency in adjusting the agreements and that contractors to the agreements – members of the sterling area – viewed the British promise, an implicit exchange guarantee, like a free lunch. In fact, sterling agreement countries increasingly came to regard the agreements sceptically as a doubtful form of insurance. The agreements were fraught by disagreements: there were non-negligible defections from them, bespoke renegotiations and several full rejections of British initiatives. In making generalised changes, the British had to offer concessions to keep the agreements in play.

The internal debates also reveal that, as had been the case throughout the postwar years, there was no settled British policy towards sterling's international role in this period. UK officials maintained that, as a key currency, sterling's retirement

[2] Alongside Bank and FCO sources, the more numerous Treasury files consulted were particularly those of the Overseas Finance Division (312 and 358 series) and the Sterling Agreements Committees (in 277 series), the latter series uncited by any previous study of this topic.

could only be contemplated through significant international monetary reform, including the dollar, with the voluntary agreement of the holders.[3] These exacting conditions effectively pushed retirement into a hypothetical future and arguably doomed such an exercise to failure.

The sterling agreements were, in theory, a flexible tool that could have been used to manage international sterling holdings downwards, for instance when sterling was relatively strong in 1970-71. However, whenever feasible policy choices for the agreements emerged, officials preferred the course that would maximise, not reduce, sterling holdings among the sterling agreement countries. They sought to maintain, not reduce, sterling's share of these countries' reserves, subject to the need to keep the agreements alive. With ever-present medium-term anxieties, they regarded the agreements as a useful protective bridging tool.

In short, British officialdom 'muddled through' with the sterling agreements. They did not rationally decide to retire sterling and then continuously use the agreements to achieve this end. Instead, they made small discrete adjustments to the status quo in response to changing external forces, a policy not of retirement but of maintenance directed at short-term control. In many ways the hesitant, patchwork management of the sterling agreements can be seen as emblematic of the ambiguous, reactive and conflicted approach to confronting the new realities of Britain's postwar international position.

The paper proceeds as follows. The next section reviews the relevant literature and context. After a section introducing the sterling agreements and policy settings, we study three phases of the agreements at the micro level, in order to determine the drivers of policy. Firstly, we consider British policy from September 1968 until the first

[3] See discussion in Section IV and associated references, BOE, OV44/122, and TNA, T312/2815.

renewal in September 1971, encompassing the EEC entry negotiations. Secondly, we examine the numerous problems that emerged between September 1971 and June 1973, during the break-up of Bretton Woods. Thirdly, we look at policy conflicts during the renewals of September 1973 and March 1974, and the decision to end the agreements in December 1974, as oil-producing countries came to dominate the holdings of sterling. A final section concludes.

II. Literature and context

Issuing an international currency has benefits and costs, economic and political. Costs, such as the responsibility to export capital and constrain domestic policy, come to the fore as a currency comes under pressure and contracts (Cohen, 2019; Papadia and Efsthathiou, 2018). The 1939 creation of the sterling area, a financial alliance of mainly Commonwealth countries, was a British supply-side response to these pressures, a collection of network effects and institutional incentives devised to support the international demand for sterling (de Bromhead et al., 2022).

The network effects arose from the actions asked of sterling area countries, to peg their currencies to sterling, align their exchange controls with those of the UK, and hold large amounts of sterling in their official reserves. Administrative arrangements, such as sterling settlement and London-based sterling trade finance (de Bromhead et al., 2022), were significant because the biggest network effects occur in these non-official sector activities (Papadia and Efsthathiou, 2018). However, confidence in sterling was shaken by the sterling crises of 1964-68, and, with the break-up of the Bretton Woods fixed exchange rate system in 1971-73, many sterling area countries abandoned their sterling peg – important because a currency peg is believed to be a key driver of the demand for reserves (Papaionnou et al., 2006; de Bromhead et al., 2022).

The sterling agreements were only offered to sterling area countries and only addressed official reserves, seen as the most troublesome part of the 'sterling balances' (international liquid sterling holdings). At the end of September 1968, the overseas sterling area held sterling totalling £1,506m in official reserves, and £1,023m in the non-official sector. Outside the sterling area, the figures were £208m official and £534m non-official. These sterling holdings increased steadily during the life of the agreements, most of the rise having occurred by end-May 1972, the increases to the latter date being £1,584m, £473m, £160m and £392m respectively.[4]

Cohen argued that, for the issuer of an international currency in decline, there is enough space to make a *political* choice about policy direction, whether *resistance* (maintenance), *relaxation* (permitting retirement) or *reinforcement* (actively accelerating retirement). He proposed that the decision would depend on national identity and geopolitical ambition. A downgrading in ambition, in 1968, led to both the UK's entry into the sterling agreements, and retrenchment from its defence commitments east of Suez (Cohen, 2019). Tomlinson also described these two events as being 'symbolic' of the end of the 'great power dream' of restoring sterling's role as an international currency (Tomlinson, 1990, p. 275).

If we adopt Cohen's framework, there are indications that UK policy in the years before sterling's 1967 devaluation was that of *resistance*, and conversely *reinforcement* from 1974-5. For instance, taking UK foreign exchange policy, in 1964-7 the Bank (traditional defender of the sterling area system) intervened to support the sterling exchange rate on a huge scale 'with close to total freedom' (Capie, 2010, p. 245). By contrast, there was a Treasury depreciation policy in 1975-76 (Burk and Cairncross, 1992, pp. 21-9). Similarly, in balance-of-payments financing policy,

[4] *Bank of England Quarterly Bulletin,* 1974 Q2, pp. 171-5.

resistance would logically involve preferring external sterling liabilities over other financing options, whereas reinforcement would lead a UK government to favour issuing non-sterling liabilities. Apart from emergency assistance, there was little non-sterling financing before 1967. From 1974, there was unprecedented public sector foreign currency borrowing, and in 1977, the UK received a US$3bn BIS facility specifically designed to replace official sterling balances with non-sterling holdings (Milner, 1980, pp. 233-6; Capie, 2010, pp. 756-7).

However, in the intervening years of the sterling agreements, 1968-74, there is uncertainty about the UK's intentions and actions towards sterling's international role. Arguing for reinforcement were Cohen and Schenk, the latter pointing out that Chancellors had been pushing for sterling to be retired through international monetary reform since the early 1960s (Schenk, 2010). However, although Cohen, in 2019, highlighted reinforcement, in 1971, he found the question ambiguous, noting that, in making the agreements, the Chancellor was determined to end sterling's reserve role[5] and the Treasury to continue it (Cohen, 1971, pp. 222-4). Other authors pointed to continued resistance. Strange said that UK officials should have done more to end sterling's role as an international 'negotiated' currency, only 'temporarily fossilized' by the agreements (Strange, 1971, p. 342). Capie found that the Bank of England did not want to reduce sterling's reserve role in 1968 (Capie, 2010, pp. 406-7). Similarly, Zis expressed puzzlement at the idea that the 1968-74 sterling agreements presented an opportunity for the phasing out of the reserve role of sterling, since the dollar guarantee provided an incentive for sterling area countries to increase their sterling holdings (Zis, 1991, pp. 109-11). Eichengreen, Mehl and Chitu argued that the UK enjoyed some success in managing sterling's decline, but this took the form of

[5] As the Chancellor himself claimed (Jenkins, 2006).

slowing a decline that, left to its own devices, would have proceeded too quickly. They classed these 1968 BIS-backed arrangements, and indeed all UK policy actions in the 1950s-70s, except the crises and devaluations, as supporting, rather than discouraging the international use of sterling (Eichengreen, Mehl and Chitu, 2018, pp. 137, 157). Most recently, John argued that British governments found a policy of increasing sterling balances too useful to abandon until 1976, when it became clear that the UK could no longer rely on support from an increasingly neoliberal USA (John, 2019).

Our thesis is that while most participants in the international monetary system probably favoured a reduction in sterling's international role in the long run, it was always short-term actions that drove policy. The question whether the sterling agreements were used to reinforce the retirement of sterling thus rests on examining closely the adjustments made to them during their life. In the short term, there were divergent interests. Parties such as the EEC, USA and BIS naturally favoured short-term stability. The British were broadly happy to see sterling balances increase to address balance-of-payments concerns. Finally, short-term pressure for diversification from within the sterling area was never far away, and ultimately it was this force that drove the evolution of the sterling agreements.

For this reason, our paper does not focus on the initial negotiation of the agreements themselves. There is detailed coverage of the initial negotiations in the literature (Schenk, 2010), and there are further complete studies in the archives.[6] The initial negotiation itself is not evidence of reinforcement, since the UK's unfulfilled aim was to *fix* MSPs for seven years. The above sources agree that the idea for guarantees and contractual agreements with the sterling area countries came, not from the British, but from members of the BIS, who then made these a condition of the

[6] TNA, T267/33, The sterling agreements 1968, Symons, June 1972; BOE, 1A50/1, 'The sterling arrangements 1968', Gilchrist, 1 December 1969.

emergency financing which was being sought by the UK. In other words, it was external forces that had driven policy, which had been forged in crisis. The serious internal debates about British short- and long-term policy began only afterwards.

Similarly, we do not focus on the multilateral negotiations over international monetary reform (for which see John, 2019; McCauley and Schenk, 2015; Schenk, 2002). In the early 1970s, British ministers and officials invested their hopes and efforts for easing the burden of sterling's international role into these hypothetical discussions. But, even apart from their future-conditional nature, the negotiations themselves do not support a story of reinforcement or well-managed decline. Firstly, they were framed in terms of removing both the dollar and sterling from their roles in the international monetary system. This was not a normal retirement. The British did not seem to engage seriously in removing sterling alone. Secondly, the negotiations led nowhere, largely due to American opposition.

While negotiating long-term international monetary reform, the British could have made practical short-term steps towards retiring sterling as an international currency. Indeed, the terms of the sterling agreements, evolving through phases associated with renewal of the agreements, gave that impression. The first renewal, in September 1971, saw a 10 per cent pro rata reduction in all countries' MSPs. The second renewal, in September 1973, saw the introduction of a new concept, limited MSP, which allowed countries to diversify to the extent that their official reserves were increasing. The third renewal, in March 1974, continued with this concept but now with a further 10 per cent pro rata reduction in the MSP levels (Schenk, 2010). Since the UK government was making these offers, this ostensibly looks like evidence of controlled action to reduce sterling's share of reserves within the sterling area. McMahon, later a Governor of the Bank, claimed when looking back that these changes

were made deliberately to wind down sterling's reserve role.[7] But, as we shall see, his claim is contradicted by the evidence of the actual policy development during the life of the sterling agreements.

III. The sterling agreements and initial British policy settings

Overview of the sterling agreements

There were 65 initial signatories to the agreements,[8] but half of these were tiny territories. Excluding these, we can divide participants into three size categories. Seven countries were large holders, with sterling reserves in the hundreds of millions. A dozen or so were medium-sized, with holdings in the tens of millions. Others had holdings in the millions. The large holders in 1968 were Hong Kong, Australia, Kuwait, Ireland, Malaysia, Singapore and New Zealand. Nigeria joined this category in 1974, by which time Malaysia, Singapore and Australia had defected from the agreements. For various reasons, South Africa, Oman, Southern Yemen and (in practice) Dubai did not participate.[9]

Most agreements with independent countries ran initially for three years, while others (including those with Hong Kong, Brunei, Bermuda, Belize, and Mauritius) were for five years. In order to benefit from the guarantee, each signatory had to submit a monthly advice proving compliance with its MSP. Some countries (e.g. Sri

[7] BOE, 1A50/1, photocopy of 'The United Kingdom's experience in winding down the reserve role of sterling', article by Christopher McMahon, extracted from 'Reserve currencies in transition', published by the Group of Thirty, New York.

[8] BOE, OV44/219, 'The Sterling Arrangements of 1968 (Continued), 1973 and 1974', Barber, January 1975, Annex 1. The signatories were national governments, and a few currency boards. Each agreement was bilateral with the UK. Schenk named 34 agreements (2010, p. 295) but this was not a complete list. Among reasonably sized holders, for instance, the list omitted Abu Dhabi, Brunei, Fiji, Kenya and Qatar.

[9] For reasons, see: TNA, T277/2166, C.F.M.(69)C2, 'Sterling and the sterling agreements', 11 September 1969 (South Africa); TNA, T295/860, Fenton to Mackay, 16 February 1971 (Oman); BOE, 1A50/1, The sterling arrangements 1968, Gilchrist, 1 December 1969, p. 28 (Southern Yemen); BOE, OV44/219, 'The Sterling Arrangements of 1968 (Continued), 1973 and 1974', Barber, January 1975, Annex 1; TNA, T312/2303; T312/2962, Littler to Rawlinson, 31 May 1972 (Dubai).

Lanka, Ghana) struggled with compliance due to reserve problems. There was a wide range of MSPs, the negotiations having been based around each country's June 1968 sterling holding position.

From archival sources, we have constructed a summary of the sterling agreements in Table 1. The underlying Basle facilities provided to the UK,[10] important in the genesis of the agreements, and discontinued in September 1973, proved not to be significant in their life. The facilities could only be drawn to the extent that aggregate sterling area sterling balances (official and non-official) fell below a threshold figure.[11] The limited drawings made in 1968 were fully repaid by 1969 and, as sterling balances increased, the ability to draw on the facilities became increasingly unavailable.

[10] This was the BIS's Second Group Arrangement, 1968, a medium-term loan facility to the UK, aiming to offset diversification of sterling reserves. The BIS made the signing of sterling agreements, limiting diversification, a necessary condition for providing this facility. See Schenk (2010, pp. 285-93).
[11] £3080m in 1968-71, £2881m in 1971-73.

Table 1: Sterling Agreements Summary

	Sep 68 – Sep 71	Sep 71 – Sep 73	Sep 73 – Mar 74	Mar 74 – Dec 74	Early exits
BIS facility	*Yes*	*Yes*	*No*	*No*	
Guarantee	*Agreement*	*Agreement*	*Declaration*	*Declaration*	
Exchange vs	US$	US$	US$	Index	
Strike rate	US$2.40	US$2.40	US$2.4213	81.65	
Calculation	30th day < US$2.3760	As in first period	Period average	Period average	
Implementation	No	US$2.3506	US$2.3335	No (81.85)	
Payable, from	-	£59m Nov72	£77m Mar74	-	
MSP evolution	*MSP (WSP) %*	*MSP %*	*Limited MSP %*	*Limited MSP %*	
Reductions	-	Down 10%	-	Down 10%	
Countries					
Miscellaneous	100	90	90	81	
Hong Kong	99	89	89->78	70	
Barbados	97	87	87	78	
Brunei	95	85	85	76	
Mauritius	95	85	85	76	
Belize	90	81	81	72	
Bermuda	85	76			Sep 73
Bahamas	80	72	72	64	
Sri Lanka	80	72	72	64	
Ghana	80	72	72	64	
Guyana	80	72	72	64	
Malawi	80	72			Sep 73
Trinidad & Tob.	80	72	72	64	
Malta	75				Sep 71
Bahrain	70	63	63	56	
New Zealand	70	63	63	56	
Sierra Leone	70	63	63	56	
Ireland	55->65->68	61	61	54	
Kenya	66	59			Sep 73
Zambia	65	58			Sep 73
Nigeria	60	54	54	48	
Jamaica	57	51	51	45	
Bangladesh		50 (Nov 72)	50	45	
W. Samoa			49	44	
Uganda	51	45			Jun 72
Abu Dhabi	50	45	45	40	
Cyprus	50	45			Sep 73
Dubai	50				Oct 68
Iceland	45	40	40	36	
Australia	40 (46.4)	36	36	32	Jun 74
Malaysia	40 (50)	36			Jul 72
Pakistan	40	36			Dec 71
Singapore	40	36			Sep 73
Jordan	30	27	27	24	
Qatar	45->27	24	24	21	
Tonga			24	21	
Kuwait	25 (53.5->50)	22	22	19	
Tanzania	25	22	22	19	
Libya	18				Sep 71
India	13	11	11	9	

Note: Shading reflects an early exit or bespoke MSP renegotiation different from the general pattern of MSP reductions.

The British guarantee was complex and conditional, involving a strike rate, (initially) a trigger threshold, and a formula for implementation, shown in the Table. The formula changed in September 1973, to reflect floating exchange rates. There were two implementations (payouts) following triggering of the guarantee in November 1972 and March 1974. In March 1974, the British switched the numeraire for the guarantee from the US dollar to sterling's effective (trade-weighted) exchange rate index (December 1971 = 100).

Table 1 shows the MSPs applying during the life of the agreements. For most countries, the trajectory of its MSP was determined by the initial negotiated MSP. This was because the UK's periodic proposals for MSPs, from the first renewal in September 1971, involved a formula applicable to all. Common percentage reductions in MSP, rounded downwards, helped the British to limit troublesome negotiations. But this automaticity was also a recipe for future problems, since countries with higher MSPs naturally wanted to catch up with their lower MSP peers.

Table 1 also shows the British 'muddling through' with divergences from the formula. For instance, in Qatar's case, the MSP had to be adjusted to correct initially wrong information.[12] Ireland's changes reflected its decision to centralise the sterling holdings of its commercial banks into the central bank. Ambiguity about how this should be handled led to protracted negotiations (Kennedy, 2018, pp. 292-6). Wishing to avoid conflict, the British also decided quietly to revise down Kuwait's best efforts 'Working Sterling Proportion' (WSP).[13] These early cases illustrate the incomplete nature of the contracts.

Underlining the agreements' complexity, there were different incentives arising from the guarantee for high- and low-MSP countries. It is usually said, shorthand, that

[12] TNA, T312/2840.
[13] TNA, T312/2638.

the UK offered 'to guarantee the dollar value of 90% of the sterling held in the reserves of sterling area countries' (Schenk, 2020, p. 786). To be precise, the UK guaranteed the dollar value of the defined sterling official holdings after deducting from those holdings an amount equal to the higher of sterling equity holdings[14] and ten per cent of *total* official reserves.[15] This meant that, for a country with a 10% MSP and holding no excess sterling above the MSP, in fact none of its sterling holdings were guaranteed. This probably explains why a low MSP country such as India,[16] Kuwait or Tanzania held sterling significantly above its MSP[17] – it was the only way to benefit from the guarantee. This formula was a deliberate ploy in 1968 by the British to incentivise higher sterling holdings. But it made the guarantee much weaker, for most recipients, than the historiography has supposed. And it became even weaker as MSPs declined over time.

The British policy impasse

The relevant British authorities were the Treasury, Bank, FCO and their ministers. The Bank was the technical expert on overseas finance, with its global network of financial connections. The Treasury's Overseas Finance divisions constituted the lead political actor, concerned with cost and risk and financing, but lacking the Bank's expertise and informational advantages. In 1968-74, the FCO emerged as a third participant, sensitive to diplomatic concerns, in discussions about the sterling agreements.

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[14] The sterling holdings monitored by the agreements differed from the normal international liquidity (reserves) criteria. For instance, as a concession to Kuwait, Qatar and others, sizeable sterling equity holdings, although not guaranteed, could count towards the MSP.
[15] Numerous references to this formula, see for example TNA, T358/151, St Clair to Walker, 27 December 1973.
[16] Noted by Schenk (2010, p. 355).
[17] See TNA, T312/2303, 'Sterling area agreements', September 1969, and T358/162, 'Size of sterling holdings', 21 October 1974.

What were the British policy settings? There were two separate aspects to internationally held sterling – its commercial trading role and its official reserve role. British policymakers saw the reserve role as more problematic, because of the risk that large official holders might diversify from sterling. However, when the reserve role was debated internally in 1968-69, there was no agreement about what to do. The Bank advocated attracting sterling balances through high interest rates and did not recommend any reduction of official sterling balances until late 1973.[18] By contrast, some Treasury reformers saw the sterling balances as an enduring problem.[19] From mid-1969, they sponsored two reports arguing, firstly, that the reserve role was costly and should be reduced,[20] and, secondly, how this might, with difficulty, be achieved through international monetary reform.[21]

The important point is that both reports were shelved, because they did not win a Treasury consensus.[22] Traditionalists in the Treasury saw the problem of the sterling balances as temporary, arising from the UK's weak balance of payments, and were content to see the balances increase.[23] The Bank, asked for its own views on these papers, responded: 'the conclusions make clear that the Treasury and Bank agree that there is no strong case for a U.K. initiative to reduce the sterling role, at least in the

[18] TNA, T312/2766, Sterling Area Working Party, Summary and Conclusions, Bank of England, 12 February 1969.
[19] TNA, T312/2304, Rawlinson to Figgures, 24 March 1969; Future policy for the sterling area, Hay, 7 February 1969. Rawlinson was an influential Treasury reformer.
[20] TNA, T312/2639, IM(69)31(Revise), Costs and benefits of the international role of sterling and its reduction, 24 October 1969.
[21] TNA, T312/2639, IM(69)24(Revise), Withdrawing from the reserve currency role, 24 October 1969.
[22] TNA, T312/2639, Hudson to Ryrie, 28 October 1969.
[23] TNA, T312/2305, Marshall to Williamson, 4 August 1969. Marshall, of the Sterling Area Division, was a traditionalist. See also, for the somewhat traditionalist leanings of Figgures, the Permanent Secretary, T312/2639, Hudson to Ryrie, 28 October 1969.

near future'.[24] A Treasury note also concluded: 'this is not really a live issue at the moment'.[25] In practical terms, it was a non-policy.[26]

By contrast, most officials saw sterling's trading role as beneficial. This view was strongly held within the Bank.[27] Though less well-informed,[28] it was also a widely held opinion in the Treasury and was reflected in the first report above, in which the invisible earnings from that role were estimated at £70m per annum. This *was* a consensus: in 1970 a junior officer's speculative suggestion about whether to extend non-sterling financing to sterling area trade was easily shot down by the Bank and his seniors.[29]

The impasse between traditionalists and reformers can be seen most clearly in debates, from 1968, about UK exchange control, an important pillar of sterling's international role.[30] Reformers proposed Operation Brandon, introducing light controls on capital flows to the sterling area, to save an estimated £100m in the annual balance of payments. Traditionalists in the Treasury, with the Bank's help, successfully prevented this.[31] However, from March 1969, the reformers managed to record 'mini-Brandon', a watered-down version, as a paper contingency plan for use in an emergency. Mini-Brandon 'would afford to the UK the most important advantages of extending Exchange Control, whilst preserving as far as possible the concept of the

[24] TNA, T312/2639, McMahon to Ryrie, 4 November 1969.
[25] TNA, T312/2839, The work of F(SA) Division, 30 October 1969.
[26] Our nuanced interpretation differs from that of Schenk, also referencing elements of this 1969 material, who argued that the Treasury wished to reduce sterling's reserve role from the early 1960s (Schenk, 2010, pp. 223, 271-2, 310).
[27] TNA, T312/2305, Fenton to Figgures, 22 August 1969.
[28] TNA, T312/2304, Mackay to Figgures, 13 March 1969.
[29] TNA, T312/2639, Payton to Mackay, 28 July 1970. Our finding about the Treasury consensus in 1969-70 contrasts with Schenk's view that the Treasury actively took steps to reduce sterling's trading role from the 1950s (Schenk, 2010, pp. 222-4).
[30] TNA, T312/2766, Sterling Area Working Party, Summary and Conclusions, p.1, Bank of England, 12 February 1969.
[31] TNA, T312/2766, Littler to Rawlinson, 18 December 1968; Rawlinson to Figgures, 19 December 1968.

Sterling Area'.[32] Although resisted until 1972,[33] it was precisely mini-Brandon that was implemented, with sterling's float, in June of that year.[34]

IV. Towards the first renewal of the sterling agreements

To explore the motivations of different actors, and to illustrate the lack of a plan to actively manage sterling's decline, we consider the renewal plans for the 3-year sterling agreements expiring in September 1971. Both Bank and Treasury produced papers, brought together in July 1970, which arrived at similar conclusions. The balance-of-payments position was strong, and sterling holdings were rising, but there was concern about repayment of official assistance, external deterioration and the costs of EEC entry. The recommendation to the new Conservative Chancellor, Anthony Barber, was for the easiest negotiating course, straight renewal for two years, without concessions on MSPs or the guarantee. The attraction of this to British officials was that, with reserves increasing in the sterling area, straight renewal would lead to a rise in the sterling balances, which was stated to be in the UK's interest.

However, sterling area countries were expected to press for MSP reduction, and so British officials prepared second- and third-best options. Second-best was to negotiate a 'limited MSP' arrangement, whereby increases in reserves from the starting level would not require increases in sterling holdings: the MSP would not be reduced but would apply only on the downside. Under this option, a rise in the sterling balances was less likely to occur. A renewal with MSP reductions of up to 10 per cent

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[32] TNA, T312/2766, Sterling Area Committee Report, p.2, 21 March 1969.

[33] See TNA, T312/2909 Sterling Contingency Planning, Operation Brandon, 1969-71; T295/961, Henley to Bailey, 3 March 1972.

[34] The exchange control changes of June 1972 matched those of mini-Brandon. Surprisingly, given its significance, Brandon/mini-Brandon was not covered in Oliver and Hamilton's review of six contingency plans in 1968-72 (Oliver and Hamilton, 2007). Schenk made brief reference to it (Schenk, 2010, pp. 221, 336). Yet it was named as one of the two 'major contingencies' being considered in mid-1969 (TNA, T312/3213, Hay to Gordon, 9 May 1969). The other was Hecuba, which Oliver and Hamilton identified as the precursor to sterling's 1972 float.

was seen as a third-best outcome. This initial hierarchy of preferences shows clearly that British officials did not want to concede lower MSPs and did want the sterling balances to increase.[35]

In October 1970, a Sterling Agreements Renewal Committee ('SARC'), comprising Treasury, Bank and FCO, was set up to supervise the conduct of negotiations. Australia was informally consulted on straight renewal in September and SARC awaited a reply. Momentum swung behind a recommendation for an early, rapid negotiation of straight renewal, subject to a favourable reply from Australia and distance from the timing of a government announcement about renewing arms sales to South Africa, which would cause problems with several African holders of sterling, notably Zambia. Although Australia eventually replied positively, SARC decided in December not to fast-track the renewal ahead of its due date.[36]

In the early months of 1971, with the EEC entry negotiations approaching, SARC continued to discuss negotiating positions. Sterling holdings had increased significantly, and this was attracting adverse comment in Europe, but the priority remained straight renewal, because SARC wanted to see further increase in the sterling balances between September 1971 and September 1973, to help with short-term financing. With straight renewal, the sterling balances were expected to rise by around £400-600m in the two-year period. A 10 per cent pro rata reduction in MSPs would reduce this increase by around £300m. Introducing limited MSP would reduce the sterling balances by £550-750m. Because of the calculation that it had the most adverse effect on the sterling balances, limited MSP now became SARC's least

[35] BOE, OV44/121, various.
[36] TNA, T277/2487, T277/2486, various.

favoured option. With the clear intention of increasing the sterling balances, the Chancellor sent out the proposal for straight renewal on 4 March 1971.[37]

The EEC developments are well known in the literature. The UK had hoped to keep sterling's international role out of the EEC negotiations, but France brought the issue forcibly to the fore in March, and it became an important element of Heath's crucial meeting with Pompidou in May 1971 (Campbell, 1993, pp. 353-61; Young, 1996, pp. 270-2). The UK concessions consisted of a commitment, post-accession, to a gradual, orderly run-down of sterling's reserve role, and phased removal of capital controls towards the EEC. The UK should also act to stabilise the sterling balances in the near term. However, in respect of the long-term commitment, the Chancellor made clear to the sterling area countries that nothing would be done without the consultation and acceptance of sterling holders. Although noting the decline in the 'relative importance' of sterling as a reserve currency, Barber had told the sterling countries in April 1971, 'We have no wish to reverse this trend, but to take steps to accelerate it would be another matter. We could not simply decide to run down the reserve role of sterling without having a clear idea of what to put in its place'. Statements in August/September repeated the sentiment.[38] In March 1972, the Bank advised that a successful multilateral international monetary reform solution was implicit in the UK's promises to the EEC, the long-term statement about run-down was 'an objective rather than a commitment', the UK was not in fact committed 'to an *absolute reduction* in the balances' and the Bank 'saw little that could suitably be done' to prevent a build-up of them.[39]

[37] TNA, T277/2649, T277/2648, various. See also Schenk (2010, p. 311).
[38] TNA, T312/2815, Text of message from the Chancellor to OSA Finance Ministers, 29 April 1971. Also see Heath to Lee Kuan Yew, 6 August 1971, and Chancellor's message to Commonwealth Finance Ministers, September 1971.
[39] BOE, OV44/122, Sterling Area Working Party report, 7 March 1972, pp. 6, 21, 50, 59.

By April 1971, however, the straight renewal proposal was already in deep trouble with the sterling agreement countries, with SARC recording the negative initial responses of Jordan, Malaysia, Singapore, Trinidad & Tobago, and Zambia. By the beginning of June, Libya had given a formal rejection, while difficult discussions, largely about demands for lower MSPs, were continuing with Malaysia, Singapore, Cyprus, Kenya and Zambia, and there were still no indications of acceptance from Malta, Nigeria and Tanzania. Unhelpfully, too, the agreements of Australia, New Zealand and Bahrain were conditional on general acceptance of the proposals by others.[40]

Obliquely noting a new objective, 'for other reasons' (in other words, the new short-term commitment to the EEC), to broadly stabilise sterling holdings at current levels, on 1 June, SARC recommended that the Chancellor now propose a 10 per cent pro rata reduction in MSPs.[41] On 17 June it noted that a concession was 'needed to pull in the countries which had not yet agreed to straight renewal' and there was a risk that even this might not be 'sufficient to get general acceptance'.[42] But it took nearly a month for the Prime Minister, Edward Heath, worried about French sensitivities, to agree. He initially wondered if a reduced volume of guarantees, brought about by defections, might be more acceptable to the French. He was persuaded by Barber, who claimed that MSP reduction would 'forestall future increases' in the sterling balances (Schenk, 2010, pp. 312),[43] but Barber's arguments were misleading: SARC had warned him that defections would produce a similar outcome, and simply preferred a route that would secure wider acceptance.[44] By mid-late August, there were still several

[40] TNA, T277/2649, T277/2648, various.
[41] TNA, T277/2649, SARC(71)12, 1 June 1971.
[42] TNA, T277/2648, SARC(71)4th Meeting, 17 June 1971.
[43] TNA, T277/2649, SARC(71)15, 16 July 1971.
[44] TNA, T277/2649, SARC(71)14, 16 June 1971.

negotiations unresolved,[45] and Kuwait and Malaysia now wanted to abandon their own secret Working Sterling Proportions. The UK conceded the removal of the WSPs, also for Australia.[46] In the end, as a result of British concessions, only Libya and Malta refused renewal of the agreements, leading to a Treasury discussion about whether either of them should be immediately expelled from the sterling area.[47]

During the first phase of the sterling agreements, then, there was no reinforcement policy, only an aspiration of eventual wind down, which never came fully into focus due to internal division and external events. The view in 1971 was expressed thus: 'The Treasury's position on decisions lying so far ahead is not yet settled. It is not clear to us that the sterling balances represent a 'problem' to which a 'solution' in the sense of somehow extinguishing them in their present form must be found'.[48] In discussing short-term policy choices, the UK authorities opted for those that would maximise, not reduce, the sterling balances. The UK offered a 10 per cent reduction in MSPs, not to reduce sterling's reserve role but to maintain it as far as possible, as this was the only way of securing general acceptance from the sterling area countries to a renewal of the sterling agreements.

V. Navigating the end of Bretton Woods

In the two years following the September 1971 renewal, the sterling agreements were rocked by the break-up of the Bretton Woods system. Hopeful that the new environment might yield a resolution to sterling's reserve role, Barber made international monetary reform the centrepiece of his long-term sterling policy. But three events created problems for the sterling agreements. The Smithsonian

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[45] TNA, T277/2649, SARC(71)16, 10 August 1971.
[46] TNA, T277/2649, SARC(71)17, 25 August 1971, T277/2648, SARC(71)6th Meeting, 26 August 1971.
[47] TNA, T277/2648, SARC(71)7th Meeting, 15 October 1971. Libya was indeed expelled in December 1971, after significant diversification from sterling.
[48] TNA, T312/2815, Marshall to Rawlinson, 20 January 1971.

realignment in December 1971, revaluing sterling's dollar parity from US$2.40 to US$2.6057, led to a major disagreement with sterling agreement countries about the level of the guarantee: some demanded that the strike rate be automatically increased from US$2.40 to US$2.6057, and the British refused. The UK's crisis decision to float sterling in June 1972 was then followed by a year of unsuccessful British attempts to renegotiate the agreements. Thirdly, there was the triggering of an implementation payment, in November 1972, based on an exchange rate of US$2.3506. The process of making the payments created yet more conflict with sterling agreement countries.

The dollar crisis of August 1971 came in the final stages of the sterling agreement renewal negotiations. The UK authorities decided to keep the official parity of US$2.40 but not to intervene as sterling floated upwards. Heath was disconcerted, and by 20 September asked Barber to consider unilaterally abandoning the agreements and to find ways to weaken sterling.[49] Barber rejected this on 13 October with a joint Treasury-Bank note stating that the agreements were needed as a cooperative framework to achieve long-term international reform and to prevent a speculative run against sterling.[50] Thus, even when short-term conditions arguably warranted action to weaken sterling, long-term concerns were used to justify not doing so.

Conflict with the sterling area over the break-up of Bretton Woods

The break-up of Bretton Woods created numerous problems for the sterling agreements, revealing how British policymakers were constrained by external factors, so that they were forced to 'muddle through' in their management of the agreements. In order to understand these problems and constraints, and their effect on British

[49] TNA, T312/2826, Armstrong to Ryrie, 20 September 1971.
[50] TNA, T312/2827, Bailey to Armstrong, 13 October 1971.

policy, we must direct attention to the reactions of sterling agreement countries. On 11 September, Tanzania specifically raised the concern that, if sterling's parity were to be revalued against the dollar, the guarantee exchange rate should be similarly increased. Avoiding a definitive external response, over the next two months, British officials debated the merits of this. On 22 November, SARC decided that the sterling area countries had 'no case in equity' for an increase in the guarantee rate, and, while there might be a need for concessions to keep cooperation going, the UK should stay silent and deal with enquiries bilaterally.[51]

British attempts to smother the issue proved unsuccessful, however. Within days of the Smithsonian realignment in December, Kuwait's Finance Minister wrote to Barber, saying that the strike rate should be revised upwards from US$2.40 to the new parity of US$2.6057. British officials tried to defuse the situation quietly through diplomatic channels. However, meetings in the Gulf in March failed to dissuade the Kuwaitis or others.[52] A Treasury report in May noted that Kuwait's sterling holdings were 'exceptionally high' and 'once it becomes possible for Kuwait to put her money elsewhere we must expect a fairly large run-down'.[53] Other Persian Gulf countries were similarly minded. When a Treasury official visited the Gulf in May, every country with an active sterling agreement complained about the guarantee rate: some questioned whether sterling's appreciation could be sustained.[54]

Malaysia and Singapore also wanted the strike rate increased (Schenk, 2010, pp. 348-9). So did Nigeria. Malaysia and Singapore were considering the issue from January, and in March Malaysia raised it as a formal matter with the British, while

[51] TNA, T277/2648, SARC(71) 8th Meeting, 22 November 1971, Minutes. See also TNA, T277/2741, Msuya to Barber, 28 June 1972; TNA, T312/2825, Mackay to Neale, 20 August 1971 (not sent); Douglas-Home to Canberra and other posts, 20 August 1971

[52] TNA, T312/2961-2.

[53] TNA, T312/2962, 'Kuwait: sterling agreement', 8 May 1972

[54] TNA, T312/2961-2, including T312/2962, 'Visit to Persian Gulf states', Littler to Rawlinson, 31 May 1972

Singapore even initiated a full review of its sterling agreement.[55] A later report in the archives noted that Nigeria 'have consistently argued for implementation from US$2.6057'.[56]

The unexpected sterling crisis of June 1972, attributed to UK Budget policy settings and seemingly triggered on Thursday 15 June by a dock strike, led to a rapid decision to let the pound float out of the new European narrow margins scheme, the snake, on Friday 23 June (Cairncross, 1996, pp. 131-3; Schenk, 2010, pp. 329-40). Schenk showed that the largely speculative sterling sales in June had three sources: London banks, the UK subsidiaries/associates of multinationals, and the sterling area countries. UK officials had particularly misjudged the risk coming from the sterling area (Schenk, 2010, pp. 338-9).

No doubt the sterling area's diversification had multiple drivers, but there is a strong correlation between sterling agreement countries disgruntled by the guarantee controversy and the sales of sterling in June. Kuwait was the biggest diversifier in June. Its gross holdings declined by £75m more than the Bank normally expected in a non-royalty month, and a £21m increase in its sterling liabilities (another way of hedging its position) was also exceptional.[57] In fact, the above dissatisfied countries, Kuwait and the Gulf states, Malaysia, Singapore and Nigeria, accounted for virtually the entire decline in the sterling area's net sterling holdings (a decline of £317m out of £324m) in June 1972.[58] Thus we can discern new links between the guarantee controversy, the June 1972 crisis and the British decision to float the pound.

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[55] TNA, T312/2961-2.
[56] TNA, T358/23, Ewbank to Barratt, 30 July 1973, 'Sterling Agreements', 'Nigeria'.
[57] BOE, EID1A129-7(8), June 1972 report. Schenk, from a different source, also noted the latter figure (Schenk, 2010, pp. 337-8). The Bank did not disclose the former figure to the Treasury.
[58] Net declines made up as follows: Kuwait £170.8, Other Persian Gulf £51.8m, Malaysia £50.4m, Singapore 29.8m, Nigeria 14.3m. By contrast the sterling area's net sterling holdings increased in May, by £0.4m (BOE, EID1A129-7(8), June 1972 report).

The crisis and decision to float sterling had, in turn, further consequences, each worsening the relationships with sterling area countries. Firstly, it led to the defection of Malaysia from the sterling agreements. Since September 1971, Libya, Malta, Pakistan and Uganda had defected (Libya had also been expelled from the sterling area) but there were political undercurrents in these defections (see de Bromhead et al., 2022). Malaysia was the first top-ranked sterling holder to exit the agreements.

Secondly, the plan for exchange control was implemented, the risk of speculative outflows to the reserves being too great, now that so many sterling area countries were no longer pegging to sterling (Schenk, 2010, pp. 335-40). The public reaction of the newly designated 'Overseas Sterling Area' was initially muted. But there was damage to relations both generally and with individual countries. There was no consultation, despite a side letter with Australia promising consultation if exchange controls were contemplated by the UK.[59] The personal capital changes to banking and residential property were problematic for countries with immigrant populations in the UK, such as Cyprus and Jamaica.[60] Dependent territories, such as Bermuda, The Bahamas, The Falkland Islands and Gibraltar, felt the slight keenly, and lobbied to be readmitted to fully-exempt 'scheduled territory' status, like Ireland – only Gibraltar achieved this, in 1973.[61] Most importantly, the change undermined the network effects arising from sterling area cooperation, by causing sterling area countries to look anew at their own exchange control arrangements. A casualty of this review process was the universality of the informal rule that trade between sterling area countries should always be settled in a sterling area currency. Some countries retained the practice, but others, for example, Australia and New Zealand, abandoned it.[62]

[59] TNA, T277/2741, SARC(72)14, 10 August 1972.
[60] TNA, FCO59/725.
[61] TNA, FCO59/725, T295/1067.
[62] TNA, FCO59/725, 'Sterling agreements: Australia', 21 July 1972; T295/856, 'Reserve Bank Press Notice: Exchange Control', 13 August 1972.

Floating sterling and first implementation: British efforts to navigate the new environment

The changes of June 1972 also obliged the UK to consult with the sterling agreement countries. The British negotiating approach reflected recent thinking on the agreements. The Bank had published a new Sterling Area Working Party report in March 1972, with policy recommendations for the next five years. The report forecast an increase in sterling balances during 1972 of £120m, and stated (obviously too complacently) that 'on the whole it is very unlikely that sterling will come under pressure much before the end of 1973'.[63] However, the outlook through the mid-1970s was cloudier, and the Bank wanted to keep sterling agreements in place after 1973, in order to stabilise the sterling balances, protect the reserves and offer a bridge to international monetary reform. It also recommended that the new agreements should offer limited MSP, in order to disincentivise increases in the sterling balances, and should concede a higher guarantee rate. Similar ideas e.g. a possible autumn renegotiation of the agreements, arising from the guarantee controversy, had also been circulating in SARC (now renamed the Sterling Agreements Review Committee).[64]

The British proposals to the sterling agreement countries in July 1972 thus sought new agreements, with a minimum life of three years, limited MSP, and provisions for floating, such as monthly settlements after the first implementation. Securing agreements through to September 1975, with an eye to international monetary reform, was the most important prize, but the British were also anxious to

[63] BOE, OV44/122, Sterling Area Working Party report, 7 March 1972, p. 53. Complacency about sterling was also evident in the March 1972 budget. In the budget preparations, the Treasury even considered reallowing sterling finance of trade between non-sterling countries, having closed this down in 1968 (TNA, T295/961, 'Voluntary programme and exchange control', Littler, January 1972, p. 9). This also contradicts the idea that officials were seeking to reinforce the decline of sterling's international role. Regarding sterling finance of trade between non-sterling countries, see Schenk 2010, pp. 216-9, 240.
[64] TNA, T277/2741, SARC(72)5, 18 April 1972; BOE, OV44/196, Morse to Governors, 6 June 1972.

avoid making repeat implementation payments for the same devaluation against the dollar and sought reverse payments out of suspense accounts if sterling were to strengthen again after an implementation.[65]

The sterling area response was lukewarm, particularly to reverse payments. In reply, some countries simply demanded compensation for the losses already suffered from US$2.6057.[66] SARC still hoped that offering a new guarantee rate of around US$2.45 and selective – but no generalised – MSP concessions might persuade most countries to switch to new agreements. However, Australia's response in late August showed that it had no desire to be bounced into new agreements. With such significant opposition, the negotiations were allowed quietly to lapse.[67] In early October, SARC was informed that 'there was frequent, and usually complaining, reference to the Sterling Agreements during the meeting of Commonwealth Finance Ministers' and 'a large number are in no mood to reach an early settlement with the United Kingdom on acceptable terms'.[68]

The third major event of this phase was the triggering of an implementation payment on 23 November 1972. The implementation rate was US$2.3506. The UK authorities now had to validate the eligible sterling balances, calculate the amounts owing, and pay the sterling area countries. They also had to consult about continuing arrangements. Another proposal for the floating rate implementation regime was sent out at the end of November. But by January few had responded positively. Reverse payments were continuing to prove controversial.[69] With no agreed basis for another implementation, the agreements were effectively inoperative from November 1972.

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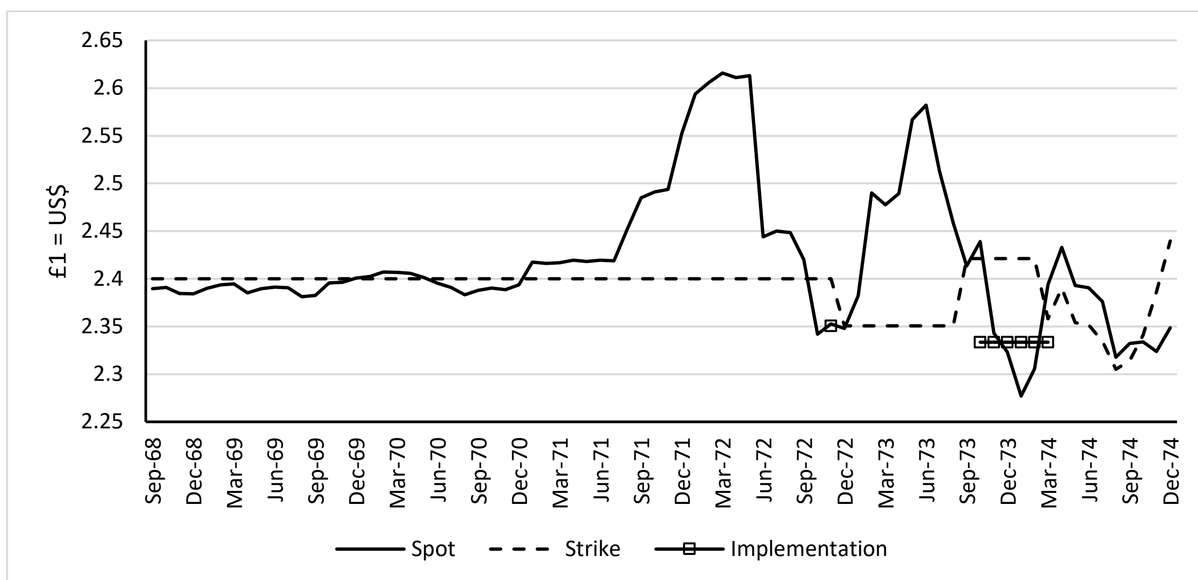
[65] TNA, T277/2741, SARC(72)9 Final, 12 July 1972.
[66] TNA, T277/2741, SARC(72)15, 14 August 1972.
[67] TNA, T277/2740, SARC(72) 7th-10th Meetings.
[68] TNA, T277/2740, SARC(72)18, 2 October 1972.
[69] TNA, T277/2859, SARC(73)1, 10 January 1973.

In the event, dollar weakness during the first half of 1973 made the guarantee out-of-the-money (see the spot-strike divergences in Figure 1). Questions over further implementation became irrelevant, since the UK's fixed position was that the new guarantee rate was US$2.3506. SARC was troubled by problems over the payout, and continued repercussions from the events of June 1972. Given that they were now pegged against the dollar, had been impacted by British exchange controls, and imported little from the UK, Bermuda and The Bahamas argued that they could not meet their high MSP levels (76% and 72% respectively), and asked for sharp reductions (to 50% and 40%).[70] Countries also complained about late implementation payments. Eventually, the UK paid out £59m for this first implementation.[71]

Figure 1: Sterling dollar exchange rate, spot, strike and implementation rates 1968-74



Note: In Mar-Dec 1974 the strike rate was against sterling's effective rate index (ERI), not against the US dollar. The strike rate shown in this period reflects the degree to which the ERI strike rate diverged from the ERI spot rate, the same divergence being expressed relative to the US dollar spot rate in Figure 1.

[70] TNA, T277/2859, SARC(73)3, 13 February 1973.
[71] TNA, T358/162, 'Official sterling balances', Treasury Press Office, 15 March 1974.

Singapore had a particularly bad experience over implementation. The initial valuation principle arising from the 1968 negotiations was that countries could use their normal accounting procedures. Singapore valued its UK government securities at nominal, not market, value, and its foreign exchange using parity, not market, rates. To British annoyance, this practice improved its degree of MSP compliance and increased its guaranteed sterling amount. In late October 1972, the Bank believed that Singapore was buying large amounts of undated 2.5% Consols (nominal value 100%, market value 26%) in a bid to further game the implementation system. The British sought legal advice and by December and January this had developed into a serious dispute. In February, Singapore's Prime Minister was complaining that the whole British official attitude to Singapore had changed, and that the Bank was trying to wriggle out of paying £4m when Singapore was £23m out of pocket from sterling's cumulative devaluation since December 1971.[72] There were further niggles over Singapore's past MSP compliance, and British payments did not begin until the end of March, the final instalment in May 1973.[73]

As a result of all these problems, by March 1973 the Treasury was recommending to SARC that the agreements should end in September 1973, assuming no joint participation in the guarantee from the EEC, which was not forthcoming. While noting that the agreements 'performed a useful role in 1968', the Treasury paper highlighted their costs: 'the financial cost involved in the guarantee liability, the administrative cost of keeping 60 agreements going, and the political cost of the friction which they have on occasion engendered with other governments'. It argued

[72] TNA, T358/17.
[73] TNA, T358/18.

that those costs had greatly increased under floating exchange rates, and now exceeded the benefits.[74]

VI. The end of the sterling agreements

The final phase of the sterling agreements covered further renewals (in September 1973 and March 1974), another implementation (in March 1974), a third implementation narrowly avoided (in December 1974), and the decision to end the agreements (in December 1974). There was conflict about the direction of policy among British officials, and conflict with the sterling agreement countries, resulting in defections and other flashpoints after September 1973. British policymakers continued to resist reductions in MSPs but were forced to concede.

In May-June 1973 the Bank and Treasury developed different recommendations. The dollar was now floating and the UK was planning to rejoin the European snake before the end of 1973. The Bank argued that sterling agreements would be needed to protect sterling when rejoining the snake, and the guarantee should be expressed against an EEC currency basket and involve implementation only if sterling fell out of the snake. But the risk was that sterling had not rejoined the snake by September, implying the temporary need for a dollar guarantee, which was problematic because the UK and sterling area countries could not agree about the guarantee exchange rate. Fearing the risk of not having sterling agreements at all, the Bank favoured negotiating with the top six countries, which accounted for three-quarters of the official sterling balances.[75]

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[74] TNA, T277/2859, SARC(73)6, 19 March 1973.
[75] TNA, T358/22, Payton to Hedley-Miller, 29 May 1973; McMahon to Allen, 4 June 1973.

By contrast, although there were divergent views,[76] most of the relevant staff in the Treasury's Overseas Finance, and also the Permanent Secretary, were for letting the agreements expire, arguing that much internationally-held sterling was unguaranteed, and the costs of negotiating realistic new agreements were too high.[77] Barber's letter to Heath on 9 July tried to combine these views. The choice proposed was between letting the agreements expire (the Treasury's preference) and engaging in some country discussions in order to establish new agreements later when rejoining the snake (a concession to the Bank).[78] However, on 12 July, Alec Douglas-Home, the Foreign & Commonwealth Secretary, wrote to Heath, arguing that both options would prove difficult for the sterling countries, which were expecting consultation about a definite extension of the guarantee. He suggested instead that the agreements 'continue for a short period… in order to permit a process of consultation'.[79]

The Foreign Secretary's recommendation, effectively to kick the can down the road for six months, was adopted. With Heath's permission,[80] the Chancellor wrote a holding letter to the sterling countries on 31 July, indicating the UK's interest in keeping sterling balances stable, but uncertainty about how to achieve this, and inviting views.[81] Meanwhile, among British officials, because of the risk of failure of new negotiations, a consensus emerged for a 'Unilateral Declaration' by the UK, not requiring an answer.[82] It was a significant change, fully consistent with the strategy of stratification the UK adopted to avoid the risk of failure in negotiating conflict in the sterling area (Seddon 2020). The idea was that the UK would unilaterally offer to

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[76] TNA, T358/22, Fogarty to Maughan, 30 May 1973.
[77] TNA, T358/22, Hedley-Miller to Fogarty, 31 May 1973; Allen to Mitchell, 1 June 1973; Sterling agreements, Note of meeting, 12 June 1973.
[78] TNA, T358/22, Barber to Heath, 9 July 1973.
[79] TNA, T358/22, Douglas-Home to Heath, 12 July 1973.
[80] TNA, T358/23, 'Sterling agreements', Armstrong, 23 July 1973.
[81] TNA, T358/23, Douglas-Home to Governor Hong Kong, 31 July 1973.
[82] TNA, T277/2858, SARC(73)9th Meeting, 2 August 1973.

continue to guarantee official sterling holdings, so long as sterling countries continued to meet their existing MSPs and submit monthly advices.[83]

The two major dilemmas for British officials remained reverse payments, and the level of the guarantee. Rather than persisting with the idea of monthly settlement, a lost cause, on 9 August, the Bank neatly proposed that any implementation payment could be calculated at the end of the renewal period, in March 1974, based on the average daily exchange rate against the US dollar during the six-month period.[84] In this way the UK would benefit from any subsequent strengthening of sterling after initial weakness, without setting up unworkable arrangements for reverse payments. Averaging could lead participants to game the system, which thus supported arguments for a limited MSP arrangement based on holdings at the start and end of the period (whichever was lower). By introducing limited MSP, the UK could simultaneously limit the amount of sterling covered by the guarantee.[85]

The Treasury also saw this as an opportunity to remove all the loopholes that had caused them problems in the past. Sterling held locally (an issue in Hong Kong) would now have to be matched by sterling held in London. Nominal valuation of securities would no longer be permitted. Exchange rates would be at market, not parity, rates. British exchange control changes would not trigger review of the agreement. Clauses requiring 'most favoured nation' treatment, in which a country would benefit from any concessions granted by the UK to others, would be removed.[86]

The Treasury had strongly opposed offering a guarantee higher than US$2.3506, but with the prognosis for sterling looking weaker, SARC, on 20 August, had to concede that a current dollar guarantee rate was needed if the Unilateral

[83] TNA, T277/2858, SARC(73)11th Meeting, 21 August 1973.
[84] TNA, T358/24, Payton to Owen, 9 August 1973.
[85] TNA, T358/24, various.
[86] TNA, T277/2860, SARC(73)20-29, August 1973.

Declaration was to succeed.[87] It was a bitter pill to swallow, as some in the Treasury were predicting that the decision to offer a guarantee at the current exchange rate would probably cost the taxpayer £200m.[88] The guarantee rate was set at US$2.4213. The Treasury was also determined that no reduction in MSP should be offered. The point of continuing the agreements was to stabilise sterling holdings and protect the reserves, and any material reduction in MSPs would defeat this object.[89]

Coming after two difficult years, the Unilateral Declaration, finally communicated on 6 September 1973, was the worst received of the renewals of the sterling agreements. At the meeting of Commonwealth Finance Ministers, there were general complaints, led by Mauritius and Cyprus, about the lack of notice and consultation.[90] Singapore, no longer prepared to accept restrictions on its investment freedom, and five medium-sized holders (Bermuda, Cyprus, Kenya, Malawi and Zambia) defected from the agreements, the latter a high MSP group demanding much lower MSPs now that they were no longer pegging to sterling.[91] Moreover, the valuation changes caused MSP compliance difficulties for Australia, Ireland and New Zealand, none of which were prepared to buy more sterling to resolve them. In the end, the British made special deals with these countries, allowing Australia and Ireland MSP compliance through their previous practices, and granting New Zealand a pass by calling it an 'accidental breach' of its MSP.[92] Desperate times, desperate measures: the British were now having to break their own rules in order to keep the agreements in play.

[87] TNA, T277/2860, SARC(73)26 (Revise), 20 August 1973.
[88] TNA, T358/24, Underwood to Gilmore, 10 August 1973.
[89] TNA, T358/23, SARC(73)14, 18 July 1973.
[90] TNA, T358/170, 'Discussion of the sterling agreements, 20 September'.
[91] TNA, T358/168 & T358/164; T277/2860, SARC(73)32.
[92] TNA, T358/164, T358/166 & T358/103.

The biggest dispute was with Hong Kong. In 1968, Hong Kong offered its banks a local exchange guarantee between sterling and Hong Kong dollars. This created an incentive for the banks to increase their sterling holdings, which reached a peak of £472m by July 1972, at which time Hong Kong switched its peg to the US dollar. In summer 1973, the Hong Kong government began to fear that its own sterling agreement would not be renewed in September and refused to commit to a renewal of the local bank guarantee. In response the banks made forward sales of sterling, taking their holdings down from £355m in June 1973 to around £20m towards the end of October. After this diversification, the Hong Kong authorities could no longer meet the MSP of 89% without large additional purchases of sterling, which they refused to contemplate, and a bitter private and public argument with the British ensued. It was finally resolved by the British accepting that the MSP should be lowered to 78% to reflect the removal of deposits with local banks from the guarantee.[93]

The six-month Unilateral Declaration was intended as a breathing space to allow negotiations. By October, SARC was considering the question of what to do in March 1974.[94] It became clear that the UK would then face very strong demands for lower MSPs given countries' desire to diversify from sterling.[95] As an alternative, the Treasury favoured ending the guarantee and negotiating 'gentlemen's agreements' with the remaining large holders, Hong Kong, Australia, Ireland and New Zealand, intended to control and contain their pace of diversification over a 2-3 year period.[96] The Bank wanted long-term sterling agreements, retaining the guarantee.[97] The FCO

[93] TNA, T358/164 & T358/85.
[94] TNA, T277/2858, SARC(73)12th Meeting, 12 October 1973.
[95] TNA, T277/2860, SARC(73)36, 23 October 1973; SARC(73)40, 10 December 1973; T277/2858, SARC(73)14th Meeting, 4 December 1973.
[96] TNA, T277/2860, SARC(73)38, 29 November 1973.
[97] BOE, OV44/215, McMahon to Governors, 7 February 1974; TNA, T358/152, Barratt to Mitchell, 5 February 1974.

was inclined towards another short-term extension.[98] Over December and January, the Treasury sought feedback from the above four holders, but none were content to constrain their diversification while losing the guarantee, and they were even lukewarm about a continuation of the sterling agreements.[99]

In March 1974, the end of the six-month period, there was a second implementation. The average daily exchange rate was US$2.3335,[100] resulting in a payout of £77m.[101] Again there were problems with late payments. The Bank found both implementations 'particularly burdensome'[102] and the British were accused of being 'slow payers'.[103]

After the dramatic increase in oil prices in late 1973, the UK faced a huge current account deficit in 1974. Against this background, SARC recommended a further 9-month renewal of the agreements until December 1974, in the form of a second Unilateral Declaration retaining the limited MSP and average exchange rate concepts. Another 10 per cent reduction in MSPs was needed to secure agreement. Fearing continued dollar strength, SARC settled on a guarantee based on sterling's effective exchange rate index (ERI), in order to limit the cost to the taxpayer.[104] Barber accepted these recommendations, but at Heath's suggestion, the final decision was left to the incoming Labour Chancellor, Denis Healey.[105]

[98] TNA, T277/2860, SARC(73)39, 7 December 1973.
[99] TNA, T358/151, T358/152, T358/154; T277/2961, SARC(74)2, 29 January 1974; BOE, OV44/215, 'Sterling arrangements', 5 February 1974.
[100] TNA, T358/162, Jones to Walker and Crosfield, 17 June 1974.
[101] TNA, T358/162, Jones to Page, 10 December 1974. This ex-post figure is lower than the approximate £100m cited by Schenk (Schenk, 2010, p. 351), which was based on a 19 February 1974 document. The calculation period terminated at the end of March 1974. £77m was revised down from £80m, the figure reported publicly on 1 April 1974 (TNA, T358/162, Jones to Walker and Crosfield, 17 June 1974). £77m, excluding unsettled payments to Ghana and Western Samoa in long-term dispute, was also confirmed in the Bank's private report on the agreements (BOE, OV44/219, 'The Sterling Arrangements of 1968 (Continued), 1973 and 1974', January 1975, pp. 13-14).
[102] BOE, OV44/219, 'The Sterling Arrangements of 1968 (Continued), 1973 and 1974', Barber, January 1975, p. 20.
[103] TNA, T358/162, Jones to Page, 10 December 1974.
[104] TNA, T358/152, Allen to France (Barber's Principal Private Secretary), 8 February 1974; Barratt to Allen and France, 14 February 1974; T277/2961, SARC(74)3, 8 February 1974.
[105] TNA, T358/152, France to Allen, 11 February 1974; Heath to Barber, 20 February 1974.

Healey reluctantly accepted the decision, and the sterling agreements continued until December 1974 (Schenk, 2010, pp. 352-3). But the new Labour government was a more hostile environment for sterling's international role. In its first days, Harold Lever, the Labour Cabinet Minister most closely associated with the original 1968 sterling agreements, addressed key Treasury officials. He was critical of the Treasury's management of the sterling balances, which had increased significantly, and he believed that interest rates had been kept at artificially high levels. He stated his determination to change this policy.[106]

In this last phase of the agreements, there were no plans made for further renewal of the sterling agreements. SARC, in its two forms,[107] had met 45 times between October 1970 and February 1974 under the Conservatives. SARC met only once under Labour, on 22 October 1974, to recommend termination of the agreements.[108] There were no initial defections after March, but the Australians had already expressed doubts about participating and, in June, confirmed their withdrawal.[109]

By the autumn, the oil crisis had produced major changes in sterling holdings, with those of oil producers increasing and those of oil consumers declining. Because of the limited MSP arrangement, which exempted new additions to sterling holdings, very little of the large sterling holdings of Nigeria and Kuwait was guaranteed, while those of Saudi Arabia, outside the sterling area, were not guaranteed at all.[110] SARC determined that 'the diminished relevance of the guarantees, together with the potential cost and international implications of any extension, made it desirable to

[106] TNA, T358/152, Walker to France, 12 March 1974.
[107] First as Renewal Committee, then Review Committee.
[108] TNA, T277 series: 2486, 2648, 2740, 2742, 2858, 2960.
[109] TNA, T358/165.
[110] TNA, T358/162, Hedley-Miller to Barratt, 25 October 1974.

abandon them',[111] and Healey agreed.[112] It is indeed doubtful that the agreements could have been renewed on acceptable terms. Following the announcement on 12 November, renewed weakness in sterling meant that a third payout was only narrowly avoided (see Table 1 and Figure 1).[113]

VII. Conclusion

This paper has argued that there was little strategic direction to the UK's international financial policy in the period 1968-74. Policy was driven by short-term concerns. Rather than using the MSP formula to manage down sterling holdings, British negotiators consistently fought to maintain existing MSPs, preferring increases in international sterling holdings, relative to alternative options. The British, with a weakening negotiating hand, were forced to make MSP concessions to secure continuation of the agreements, and there were significant defections. MSPs were thus largely endogenous to the wishes of the sterling countries, reacting to the break-up of Bretton Woods. Our finding supports those who argued that the sterling agreements were always a necessary restraining device (Eichengreen, Mehl and Chitu, 2018).

Nevertheless, faced with difficult international conditions, and despite disagreements – the Treasury worried about cost and financing, the Bank seeking long-term agreements for stability, and the FCO preferring short-term renewals – the multidisciplinary SARC managed the agreements with some tactical skill. The agreements proved useful in 1968-69 and were clearly still valued in summer 1972 and winter 1973. The use of side letters and WSPs in 1968, and the detailed variations

[111] TNA, T277/2960, SARC(74)4th Meeting, 22 October 1974.
[112] TNA, T358/162, France to Mitchell, 23 October 1974.
[113] TNA, T358/162, 'Official Sterling Balances', Treasury Press Office, 15 March 1974; Jones to Cassell, 21 October 1974; Barber to Jones, 31 December 1974; Treasury press cutting from *Financial Times*, 'Sterling guarantees level fixed', 4 April 1974; Healey to Wilson, 28 October 1974; BOE, OV44/219, 'Annual report: sterling guarantees', 20 January 1975. If a current or dollar strike rate had been chosen, there would have been a payout.

introduced in September 1973 and March 1974, reduced political and financial costs. Through such adjustments, employing flexibility and agility, British negotiators did well to keep the framework in place for so long. While there is no counterfactual allowing cost-benefit analysis of payouts and administrative-political costs against reserve protection, the Bank argued that the benefits exceeded the costs.[114]

Foremost among the negatives was the lack of a long-term strategy towards sterling's international role. This led to missed opportunities and misjudgements. Little was done to prevent the build-up of sterling liabilities in 1970-71 or contain sterling strength in 1971. There was complacency in 1972. Limited MSP was an obvious solution to this build-up, and the Treasury's failure to give it fair hearing in 1971 seemed to reflect a mixture of caution and arrogance. In fact, Jamaican negotiators first suggested the limited MSP concept in the 1968 negotiations: their British counterparts rejected it out of hand.[115] The dominant final impression of the agreements is an enormous administrative effort, with temporary protective benefits. The failure to address the long-term position of sterling perpetuated the pressures that led to reactive short-term policies.

Rather than being used flexibly in pursuit of a long-term objective, once established the agreements became a 'policy in search of a problem' (Kingdon, 1995), their continuation justified on changing grounds. In 1968-70, they were needed to repay external assistance; in 1971-72, they were a bridge of cooperation towards the goal of international monetary reform (not achieved); in 1973, they were to enable sterling to rejoin the European snake (not achieved); in 1974, they would restrain the rundown of sterling holdings by oil-consuming countries. Finally, after almost

[114] BOE, OV44/122, 'Report of the Sterling Area Working Party – March 1972', pp. 53-62; OV44/219, 'The Sterling Arrangements of 1968 (Continued), 1973 and 1974', Barber, January 1975, pp. 21-22.
[115] TNA, T312/2310, 'Jamaica and sterling', 'Sterling negotiations: problems encountered', September 1969, p. 4: 'This we of course rejected.'

everyone, ministers, officials and even many country participants, had run out of reasons for keeping them, in December 1974 the agreements were abandoned. The retirement of sterling took place naturally, without a British plan.

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