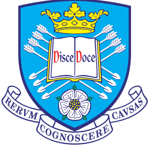

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The role of competition and ideas in Britain's abolition of capital controls, 1977-9.

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About the Author

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Introduction

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

International Political Economy (IPE) accounts of capital control liberalisation have also relied chiefly on two factors to explain this deregulatory trend: (1) the competitive dynamics unleashed by increasing global capital flows, expressed either as the threat of capital flight or the incentive of promoting domestic financial centres (Andrews 1994; Bhagwati 1998; Goodman and Pauly 1993); and (2) and the rise of neoliberal economic ideas, both at the national scale and within international organisations (Best 2004; Chwieroth 2007, 2010; Moschella 2010). Within this literature, the case that is said best to exemplify the interaction of these competitive and ideational pressures is Britain's 1979 abolition of exchange controls (a subset of capital controls). Margaret Thatcher's government was motivated, it is argued, by both a desire to boost the prospects of the City of London (referred to here as the City) at the expense of domestic industry and a commitment to neoliberal policy norms (Helleiner 1994; Germain 1997).

This paper will seek to challenge this conventional wisdom regarding the role of competition and ideas in capital control liberalisation through a close historical examination of Britain's abolition of exchange controls. These controls were scrapped in four stages, involving both the Thatcher administration and its Labour predecessor over the years 1977-9. By examining primary archival sources, this paper will argue that the British state was not chiefly motivated by a desire to promote the City's interests nor by laissez-faire ideological commitments. Although there is some evidence that certain civil servants believed that this liberalisation would benefit the City's global operations, the key driver of this deregulation lay in the intensifying 'stagflation' crisis. In the context of an appreciating pound, following the 1976 International Monetary Fund (IMF) bailout and rising revenues from North Sea oil, the British state was confronted with a governing dilemma: the strong pound acted to combat inflation, yet it simultaneously pushed the competitiveness of the struggling industrial export sector to dangerous lows. The governments of both James Callaghan and Margaret Thatcher prioritised the export competitiveness goal and thus sought to depreciate sterling by relaxing exchange controls and encouraging an investment outflow. Yet two obstacles stood in the way of this strategy. Firstly, the trade union movement was vehemently opposed to any capital control liberalisation. Secondly, in a context of floating exchange rates, any attempt to manufacture a currency depreciation could spook currency markets and provoke a sterling crisis. While these hurdles ultimately impeded the Callaghan administration from pursuing full exchange control liberalisation, the Thatcher government faced a weakened

union movement (following the so-called 'Winter of Discontent') and constructed a rhetorical strategy that attempted to placate currency markets by emphasising that exchange control abolition was a responsible and internationally credible policy driven by laissez-faire ideology. This provided the Thatcher administration with the confidence to abolish exchange controls completely in October 1979.

This paper will thus suggest that IPE scholars rethink the role of competition and ideas in capital control liberalisation. While conventional IPE accounts insist that deregulation was a strategy to boost the competitive position of national financial sectors in a world of cross-border capital flows (Andrews 1994; Helleiner 1994), the evidence presented here suggests that the key aim of successive British governments was to boost the competitiveness of ailing *industrial* exporters. Crucially, this policy was not a blueprint to secure the City's future dominance, but was rather intended to be a palliative measure, designed to postpone the effects of the crisis of British industry. This lends support to critical work that characterises neoliberal financial liberalisation as a series of *ad hoc*, pragmatic responses to immediate governing dilemmas associated with the decline of post-war affluence (Krippner 2011; Streeck 2014; Copley 2017). Furthermore, in contrast to the IPE orthodoxy's emphasis on the role of neoliberal ideology in stigmatising capital controls (Chwieroth 2010; Germain 1997), this paper suggests that ideas were deployed in the British case primarily as *rhetoric*. By crafting a rhetorical strategy that publically exaggerated the administration's commitment to free-market principles, the Thatcher government believed it could pursue this palliative measure in a covert manner and thus avoid provoking a damaging run on the pound. This argument thereby contributes to literatures that focus on the role of ideas as rhetoric in the construction of national economic credibility and the way these discursive strategies can create space for governments to pursue potentially controversial policies (Hay and Rosamond 2002; Baker 2006; Clift and Tomlinson 2006). Yet, rather than proposing a new IPE theoretical orthodoxy through which to understand the role of competition and ideas in the dismantlement of capital controls, this paper calls instead for further close historical analyses of specific case-studies.

IPE perspectives on capital control liberalisation

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

For accounts that emphasise the role of competitive deregulation in spurring capital control liberalisation, of critical importance was the increase in capital mobility during the post-war period, and the pressures this began to exert on states' policy toolkits. These approaches point to the role of events such as the move to current account convertibility in 1958, the rise of the Euromarkets and the shift to floating exchange rates in 1972 in provoking an intensification of capital flows (Watson 2007; Green 2016). This heightened

capital mobility pressed states to liberalise their capital controls through both the threat of sanction and the lure of incentive. With regards to the potential sanction, John Goodman and Louis Pauly (1993, 79) showed that the growth of offshore financial markets and firm-level evasion strategies 'eroded national financial barriers', forcing governments either to tighten continuously capital controls and face declining national competitiveness or to abandon controls. The heightened 'capacity of capital asset-holders to evade the jurisdiction of unfriendly regulators', David Andrews (1994, 199) argued, forced states to be 'increasingly sensitive to changes in the regulatory policies of their neighbors', as they were 'effectively competing for the right to regulate capital'. Certain scholars have insisted that the sanctioning power of capital flows has been exaggerated by pointing to the mixed evidence regarding the effects of capital control on borrowing costs in developed countries (Garrett 1995; Mosley 2003); yet Kathleen McNamara (1998, 52) points out that 'a government seeking to ensure politically acceptable levels of economic growth may eschew capital controls in the fear that they will dampen economic activity', demonstrating the pre-emptive sanctioning power of capital mobility.

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

Without discounting the role of growing capital flows in provoking a dynamic of competitive deregulation, constructivist accounts have placed greater emphasis on the importance of ideational transformations in stigmatising capital controls. Jacqueline Best (2004) argued that the gradual 'hollowing out' of Keynesian norms in the post-war period transformed how US policy-makers came to view speculative capital flows. Instead of conceiving of such flows as 'psychologically-driven and structurally dangerous', they came to be seen as 'natural ... expression[s] of a healthy market economy', thus delegitimising the use of capital controls as anything other than a temporary measure (ibid, 401, 400). In a similar vein, Geoffrey Chwieroth (2007) drew on the concept of epistemic communities to analyse how the formation of coherent policy-making teams in emerging markets made up of neoliberal economists thereby encouraged capital account liberalisation in the Global South.

In addition to this focus on the role of ideas in propelling capital control abandonment at the national level, several scholars have explored such ideational transformations amongst international organisations. Ralf Leiteritz (2005) argued that the IMF's promotion of capital account openness resulted in large part from important 'norm entrepreneurs' within the Fund establishing a liberal policy consensus through communicative action. Chwieroth (2010) advanced a 'strategic constructivist' approach to explain capital controls' informal fall from grace within the IMF since the 1980s, arguing that the IMF's attitude towards

capital controls resulted not only from pressure by powerful member-states, but from the changing beliefs and strategic manoeuvrings of its staff. Similarly, Manuela Moschella (2010) analysed the 'co-evolution' of ideas about capital controls within the IMF and the economic context in which such ideas are embedded. In sum, the constructivist literature emphasises that, in addition to external market forces, a key factor motivating capital control deregulation was the gradual stigmatisation of these tools in policy circles.

Britain's 1979 abolition of exchange controls occupies a special position within the IPE literature. Exchange controls – a subset of capital controls that had been in place since 1939 – constituted a system of limits on the use of British funds for overseas investment and rules for the repatriation of profits earned overseas (Shepherd et al. 1985, 156). Alongside the scrapping of capital controls in the US in 1974, this event is seen as one of the 'crucial turning points' in the history of capital control liberalisation (Best 2005, 126). As Paul Langley (2002, 112-3) argues, the 'zeal' with which the Thatcher government pursued this deregulation 'had considerable ramifications for the making of the contemporary financial order'. Furthermore, this particular liberalisation perhaps best demonstrates the manner in which the IPE literature has weaved together the competitive deregulation and ideas narratives to explain capital control abolition. Indeed, the notion that Thatcher's pro-City stance and her administration's ideological commitment to laissez-faire principles lay behind this policy has reached the level of near truism.

In *States and the Reemergence of Global Finance*, Eric Helleiner (1994, 150-1) argued that the 'key explanation' for exchange control abolition 'was the neoliberal orientation of the new Thatcher government, which perceived exchange controls as preserving outdated Keynesian strategies', combined with the fact that 'the Bank of England saw the abolition of exchange controls as a way of attracting more financial business to London'. This echoed Henk Overbeek (1990, 196), who had claimed this policy was the first act of the Thatcher administration that demonstrated its 'dedication to the "free market"', while Ronen Palan et al. (1996, 52) later concurred that it represented an attempt by the British government to avoid the marginalisation of the City, following US capital control liberalisation. Recently, Jeremy Green (2016, 447) has lent more support to the competitive factor, arguing that this deregulation resulted chiefly from the Bank's desire to respond to Wall Street's 'competitive challenge'. This promotion of the City's competitive position is often seen as directly to the detriment of British industry. As Coakley and Harris (1992, 37) argued, this liberalisation demonstrated that 'a central pillar of the whole Thatcher enterprise' was to 'strengthen the position of the financial sector; whatever happened to manufacturing, the City was intended to flourish'. Capturing the broad IPE consensus, Randall Germain (1997, 147) summarised the causes of UK exchange control abolition as 'the ideological predispositions of the newly elected Thatcher government and the clear desire to maintain London's position at the center of the Eurocurrency market and European finance'.

If IPE explanations of capital control liberalisation in the neoliberal era have been dominated by two key factors – competition and ideas – then Britain's 1979 abolition of controls has been understood as the archetypal case of these two factors in action. The British state was motivated, it has been argued, by a desire to boost the global position of the City and, interrelatedly, by an ideological opposition to capital controls. This paper intends to challenge this conventional understanding of the role of competitive dynamics and ideational change in motivating this liberalisation by the means of careful historical analysis. As Matthew Watson (2007, 91) points out, '[i]nternational financial orders … are

created through direct political interventions', the political processes that give rise to which are – to varying degrees – a matter of documentary record. The remainder of this paper will explore the Britain's abolition of exchange controls and discuss the implications of this case for IPE's understandings of competitive deregulation, ideational change and the politics of neoliberal restructuring more broadly.

Rethinking competition and ideas in the British case

The first sign that the conventional IPE explanations of British exchange controls liberalisation may be less than satisfactory is the timeline of this deregulation. While it has generally been accompanied by words like 'overnight', 'unexpected' and 'radical' (IMF 1992, 7; Johnson 1991, 37; Jenkins 2006, 58), exchange controls were actually removed in four stages over the space of three years by the Callaghan and Thatcher governments: October 1977, January 1978, July 1979 and October 1979. The final deregulation was the most extensive, but the previous three were by no means trivial. Yet the shortcomings of the existing literature do not end with questions of chronology. Instead, rather than focusing on the City's competitiveness or the influence of laissez-faire ideology, the motivations behind this four-part liberalisation can only be understood by examining the specific dynamics of the stagflation crisis in the late 1970s.

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

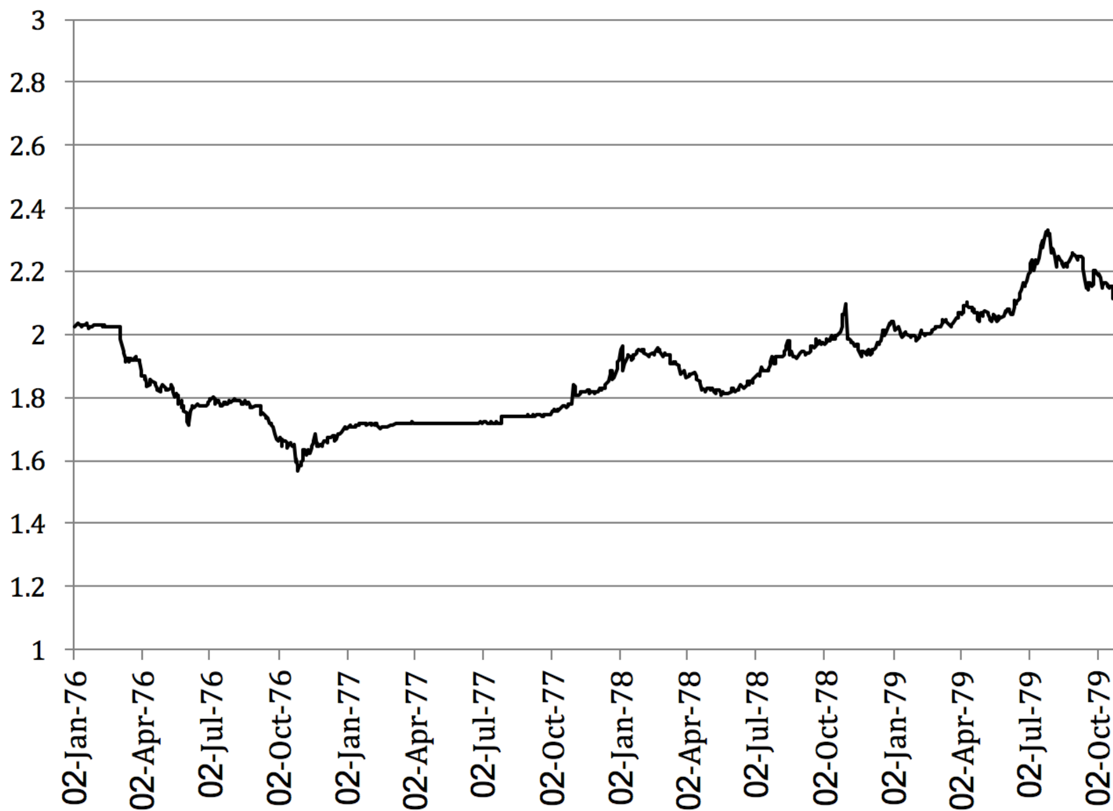

Figure 1. The sterling exchange rate (spot exchange rate, US dollars into sterling), 1976-1979 (Bank of England, Interactive Database).

In this context, the rise of sterling shown in Figure I presented the Callaghan and Thatcher governments with a dilemma (Dow 2013, 279-82). On the one hand, the strong pound aided the state's attempts to temper unions' wage demands and bring down inflation. On the other hand, it further eroded the competiveness of Britain's already struggling export sector. It appeared that one policy objective had to be sacrificed to meet the other. This paper will demonstrate that both the Callaghan and Thatcher governments prioritised rescuing Britain's non-oil industrial exporters over tackling inflation, and that both governments viewed the relaxation of exchange controls as a strategy to effect a depreciation of sterling for this purpose.

However, there were two important obstacles that had to be overcome before this strategy could be pursued: it was not at all clear how exchange control relaxation could be sold to a powerful and opposed trade union movement, nor how an orderly depreciation of sterling could be brought about in the context of volatile floating exchange rates. The first problem arose from the fact that Britain's Trade Union Congress (TUC) favoured a strong pound because of its downward pressure on the cost of living and supported the *extension* of exchange controls as part of a proactive industrial strategy. As the unions were bearing the brunt of Callaghan's anti-inflation incomes policy, Labour policy-makers were wary of further incensing them. The second problem was a direct result of the move to floating exchange rates in 1973. The onset of this currency regime entailed an increase in speculative activity and a consequent rise in exchange rate volatility. As a result,

governments struggled to reconcile their political and economic objectives with the 'imperatives of exchange rate stabilization' (Eichengreen 2008, 142). As such, any attempt to manipulate the value of sterling required extremely careful public presentation, so as to avoid provoking speculative attacks against the pound.

Therefore, in order to boost the competitivity of UK exporters through exchange control relaxation, politicians required an appropriate strategy that would both disarm the unions' opposition and avoid spooking global financial markets. This paper will argue that the Callaghan and Thatcher governments' different degrees of success in developing such a strategy is what best explains the dynamics of exchange control liberalisation in the years 1977-9. The Labour administration was ultimately constrained by union opposition and its unfamiliarity with exchange rate policy in a system of floating rates, resulting in its moderate easing of exchange controls. On the other hand, the Conservatives not only faced a much weakened labour movement, following the public sector unions' public relations defeat in the 1979 'Winter of Discontent', but they were also able to craft a rhetorical strategy that would convince financial markets that their policy of competitive currency devaluation was in fact an expression of their laissez-faire beliefs. The Thatcher administration believed that this discursive strategy would allow it to bring about a managed sterling depreciation through complete exchange control abolition without provoking a collapse in the pound.

This paper thus argues that the role of competition and ideas was crucial in motivating Britain's capital control liberalisation, but not in the way that these explanations have traditionally been deployed in the IPE literature. While the conventional IPE wisdom indicates that Britain scrapped exchange controls in order to boost the City's competitiveness (Helleiner 1994; Germain 1997), this paper calls this narrative into question. Although there is some evidence that certain Treasury and Department of Trade (DoT) officials considered exchange control liberalisation to be beneficial to the City's global prospects, this policy was chiefly implemented as a short-term strategy to boost the competitivity of Britain's emaciated industrial exporters. This finding chimes with Greta Krippner's work on financialisation, which stresses that the US deregulatory agenda in the 1970s and 1980s should be understood as an *ad hoc* strategy to alleviate or suspend the stagflation crisis without addressing its underlying causes (2011). In a similar manner, Wolfgang Streeck (2014) uses the concept of states' 'buying time' through a variety of delaying measures – such as inflation, rising public debt and private credit expansion – in order to postpone the deep-rooted crisis that had undermined the post-war growth model. These palliative measures should be conceived of as temporary attempts to rescue the competitiveness of the national economy in place of a longer-term solution (Copley (2017)).

Ideas also played an important role in the passing of this liberalisation, yet not in the manner that the constructivist IPE orthodoxy insists (Chwieroth 2010; Moschella 2010); that is, this deregulation did not primarily arise due to the ideological stigmatisation of capital controls in British policy-making circles. While certain Conservative politicians were genuinely driven by laissez-faire convictions, the Thatcher government also publically exaggerated its perceived commitment to neoliberal principles as a rhetorical strategy that would grant it the policy space to pursue currency depreciation without spooking financial markets. This points to the importance of ideas as rhetoric in the politics of economic credibility. As Ilene Grabel (2000, 4) writes, 'neoliberal reform programmes themselves are not intrinsically credible' – governments must convince

global markets that such policies are sustainable, rather than designed to meet short-term political objectives. Similarly, Andrew Baker (2006, 32) argues that in order to avoid 'excessive movements in major currencies', governments carefully choreograph 'the release of public statements calling for market corrections – in other words, declaratory policy'. Such an approach was exemplified by New Labour, Colin Hay and Ben Rosamond (2002, 153, 152) insist, whose 'invocation of globalization as [a] non-negotiable external economic constraint' was a purposeful discursive strategy to 'legitimate specific courses of action'. These accounts suggest that, in addition to examining how changing policy norms influence governments' attitudes on liberalisation, IPE should also focus on politicians' strategic inflation of their neoliberal credentials in order to garner credibility with financial markets and ultimately create greater 'room for manoeuvre' (Clift and Tomlinson 2006, 59). Importantly, this challenge to the existing IPE literature should not be understood as the proposal of a new general theoretical lens through which to view discrete national liberalisations, but should instead be taken as a call for further careful empirical analysis of specific cases of capital control dismantlement.

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

Abolishing exchange controls, 1977-9

The Callaghan administration

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

The competitive pressure that motivated a Labour government to enact the most significant dismantling of exchange controls in nearly 40 years was not immediately apparent. At first glance, it appeared that in 1977 Healey could 'boast that he was one of the few post-war Chancellors to preside over a growing economy, falling inflation, falling unemployment, and a balance of payments surplus' (Needham 2014, 109). Yet, in private discussions, government officials had a greater awareness of the underlying problems veiled by the IMF's endorsement and North Sea oil. An inward surge of capital was causing sterling to appreciate steeply. This aided the government's attack on inflation, but exacerbated non-oil exporters' dire lack of competitiveness. It was in this context that exchange control liberalisation became a key discussion topic within the Callaghan administration.

On 19 October 1977 Healey circulated a proposal that outlined various possible exchange control relaxations. His motivations for proposing the consideration of these changes, he explained, were threefold: the difficulty in justifying exchange controls during a period of sustained current account surplus; the need to give some indication to the EEC that the government took its stance on free capital mobility seriously; and the more immediate need to offset inflows of capital that were destabilising the exchange rate and money supply.[2] The responses Healey received from various government departments generally

focused on his third concern as the most important. Roy Hattersley, Secretary of State for Price and Consumer Protection, urged Healey *against* relaxing controls. Hattersley argued that, '[f]or exporting industries, a policy of depreciation would represent the abandonment by Government of an important sanction in our fight against inflation'.[3]

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

Similarly, the DoI informed Callaghan that it 'very much welcome[d]' Healey's proposed deregulation, on the grounds that 'there is scope for certain selective relaxations of controls on outward investment that could benefit UK industry directly in the medium term'.[6] The Secretary of State for Industry, Eric Varley, further emphasised the gravity of the situation at a meeting with Callaghan, Healey and Richardson, when he explained that, while he understood the counter-inflationary benefits of the strong pound, 'the effects on manufacturing industry could not be ignored':

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

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

With regards to lobbying pressure, there is much more evidence of pressure from domestic industry than the financial sector in marked contrast to the assumptions of much of the IPE literature. The Confederation of British Industry (CBI) launched a campaign in 1976 to convince the government of the benign effects of overseas investment, so as to hasten the removal of exchange controls. This included commissioning a consultancy firm to produce a favourable report on overseas investment, as well as lobbying the government through the National Economic Development Council and directly through meetings with the Treasury.[8] The City's lobbying efforts were much more limited. In July 1977, Treasury Permanent Secretary Leo Pliatzky went for dinner with London Stock Exchange Chairman Nicholas Goodison, who argued that a relaxation of exchange controls could help the City become the center of securities in Europe.[9] Yet Goodison displayed none of the fervent

hurry or systematic strategising of CBI lobbyists, claiming that he would be satisfied to see some action on exchange controls within a timeframe of three years.

Nevertheless, certain officials did support exchange control relaxations because of the advantages for the City and Britain's invisible earnings. The Treasury's Deputy Secretary, F.R. Barratt, argued in May 1977 that it was 'very much in the national interest that the general capacity of the City to engage profitably in international financial business should be sustained and enhanced', which was dependent on the ability to operate freely in foreign currencies.[10] This sentiment was echoed by the DoT's sponsoring Minister for the Stock Exchange and the insurance industry.[11]

The creation of a consensus within the Callaghan government and the Bank in favour of some degree of exchange control liberalisation was primarily the result of political concerns over the dangerously low competiveness of British industrial exports. While there is some evidence as to the need to comply with EEC guidelines on capital controls, the presentational discrepancy of maintaining controls despite the positive balance of payments outlook, and a desire to boost the City's global prospects, the overwhelming motivation for pursuing exchange control relaxation was to provide a palliative response to exporters' woes by depreciating sterling. This directly challenges the accounts of Helleiner (1994), Germain (1997) and Green (2016), all of which emphasise the centrality of the British state's pro-City agenda in motivating this liberalisation. The next section will examine why, despite this competitive pressure, the Callaghan administration did not go further in liberalising these controls.

Market uncertainty and union militancy

There is no single reason why the Callaghan government did not completely abolish exchange controls. One important factor was that the deregulation of controls on investment was counterintuitive to a Labour government that had come to power promising an interventionist industrial strategy.[12] Yet of greater importance were two more immediate problems: the difficulties of managing currency depreciation and the political constraints upon the Chancellor and Treasury ministers exerted by their fractious relations with the trade unions. The Callaghan administration was unable to craft a strategy to assuage financial markets through declarative signals, nor disarm the labour movement, resulting in the moderate exchange control liberalisations of 1977-8.

In May 1977, when talks about exchange control relaxation began in earnest, the Bank was split on the issue of the best way to devalue sterling. Bank advisor Kit McMahon thought a step-change was the least risky option, while officials David Holland and John Sangster preferred to move gradually.[13] The Treasury was similarly divided.[14] This disagreement was symptomatic of an institutional unfamiliarity with exchange rate policy in the context of floating rates. By October, on the eve of Healey's first exchange control liberalisation, Treasury Permanent Secretary Douglas Wass admitted that there was still 'no effective means for bringing the rate down in the current situation. A step devaluation, always difficult in a floating rate regime, would in the current circumstances lead to a chaotic market'.[15] Yet a gradual 'engineered slide would require a change in market sentiment' with regards to sterling that was equally difficult to manufacture without causing outright panic.[16] After meeting Treasury officials in October to discuss exchange control relaxations, CBI Deputy Overseas Director explained: 'I can characterise the attitude of the Treasury officials as exceedingly cautious … They were clearly not confident that the large inflow of currency into our reserves of late is here to stay'.[17] This anxiety about rapid

changes in market sentiment leading to a collapse of sterling contributed to the general apprehension within the Callaghan administration towards exchange control relaxations, as these liberalisations were designed precisely to exert a downward pressure on the pound.

The second problem faced by the Callaghan government was even more debilitating. Labour had come to power in 1974 promising a 'social contract', in which the unions would voluntarily moderate their wage demands in return for greater welfare provisions and a favorable industrial policy. However, this compromise was quickly abandoned, as Harold Wilson's government forced the unions into negotiating a strict incomes policy in July 1975 (Gourevitch et al. 1984, 53; Rogers 2009). The following year, under Callaghan's premiership, the government proceeded to hold earnings below the rate of inflation while cutting £1 billion in public spending, justified by appeals to IMF loan conditionalities (Rogers 2009). By 1977, Labour – now a minority government – was chiefly relying on a reduction in living standards to combat inflation.

In the context of the government's frayed relations with the unions, an extensive relaxation of exchange controls appeared to be domestically unsaleable. The TUC made clear that it was categorically opposed to any dismantling of capital controls, due to the damaging impact of outward investment on British jobs. In fact, the TUC lobbied the government in 1977 and 1978 for the creation of a new agency that would monitor *all* outward investment on a case-by-case basis.[18] As Barratt argued in a meeting with Treasury and Bank representatives in May 1977, 'the need to move gently in such a politically sensitive area … had deterred the Treasury from putting forward definite proposals for relaxation at this stage'.[19] Indeed, Joel Barnett, Chief Secretary to the Treasury, explained to Callaghan's Principal Private Secretary, Kenneth Stowe, in September 1977 that 'we cannot ignore political considerations, and in my judgement the inevitable (if ill-informed) outcry there would be is not worth provoking for a comparatively modest [exchange control] relaxation'.[20] Thus, when Healey finally announced his exchange control proposal in October, he acknowledged that the more radical measures like abolishing the 25% surrender rule 'might cause some political difficulty, especially with the TUC'.[21] Callaghan echoed this concern, insisting on delaying any extensive relaxations 'until there has been the discussion in the TUC/Labour Party Liaison Committee'.[22]

There undoubtedly existed a consensus within the Callaghan government in favour of a significant degree of exchange control relaxation, primarily to check sterling's appreciation and therefore boost the competitiveness of British exporters. Yet there was also considerable apprehension as to the external economic and domestic political consequences. Labour lacked a rhetorical strategy that would convince markets that exchange control abolition was *not* a cynical strategy to boost exports and was unable to disarm the opposed trade union movement. This confluence of pressures for and against the dismantling of exchange control resulted in the moderate liberalisations of October 1977 and January 1978.

The Thatcher administration

On 12 July 1979 Conservative Chancellor Geoffrey Howe announced extensive relaxations of exchange controls on outward direct investment and minor relaxations on outward portfolio investment. The remaining controls were completely abolished on 23 October. In contrast to the arguments of the IPE consensus, this bold move did not result primarily from a desire to propel the City's competitive position nor from the neoliberal predisposition of Thatcher and her acolytes. While key Conservative politicians were certainly motivated by a radical laissez-faire vision, the Thatcher government's exchange control liberalisation was driven chiefly by the need to rescue the competitiveness of British industry by putting downward pressure on the pound.

Despite the Callaghan administration's inability to implement further measures on exchange controls, following the government's paralysis during the industrial action of the 1978-9 'Winter of Discontent', preparations for further liberalisation carried on in Whitehall. In early March 1979, the Cabinet's Official Committee on External Economic Affairs wrote: '[D]espite our common concern about inflation, we are beginning to be worried about the effect of the continued strength of sterling on manufacturing industry competitiveness and that some [exchange control] relaxation may help to ease the rate down a little'.[23]

After the Conservative victory, Financial Secretary Nigel Lawson set up a team to investigate the possibility of further exchange control liberalisation, which was led by Treasury Under-Secretary David Hancock and Dawkins, the Bank's Chief of Exchange Controls (Capie 2010, 769). This team in turn set about consulting the relevant departments. As in the Callaghan years, there was some division as to which policy goal should be prioritised: inflation targeting or export competitiveness. As Hancock succinctly explained (in patronising language), officials would of course prefer to increase competitiveness by reducing inflation below that of Britain's competitors, yet in current circumstances this was wishful thinking:

> Like the Irishman, we would prefer not to start from where we find ourselves. The controversial question is what we should do given our present situation. In particular, given that we significantly lost competitiveness over the past winter, is it better: (i) to pursue policies which help to get our rate of inflation down and thus keep the rate high; or (ii) to encourage the nominal exchange rate to fall (if we can) in the hope that this will increase output in the short term and thus possibly mitigate the damage that is being done to our industrial base?[24]

Wass believed that Conservative Ministers would favour the high exchange rate, 'partly because of the beneficial price effects it will have and partly because, by reducing corporate profit margins, it will put increasing pressure on private employers to bargain toughly in the next pay round'.[25] This line of reasoning was adopted by P.V. Dixon of the Treasury's Industrial Economic Division. Industry, he explained, was 'caught between the upper millstone of monetary policies/exchange rate and the lower millstone of wage costs … firms will go bust if there is not a very substantial deceleration of wage costs'.[26] For this reason, Dixon urged Lawson *not* 'to move too quickly to industry's rescue' through exchange control abolition.[27]

However, the majority of voices within the government viewed this recessionary strategy as unacceptably risky. British industry's profits had fallen by 13.5% in the first three months of 1979 (Riddell, 1979a). When Howe arrived in office in May, Bank Governor Richardson advised him that the government should respond to the overvaluation of sterling with 'significant relaxation of exchange control'.[28] The nature of the dilemma was captured best by Treasury official G.M. Gill, who explained to Hancock in late June that 'we may well be moving into an area now where the benefits to inflation from a higher rate may be obtained at too great a cost in terms of output and the current account of the balance of payment'.[29] There was a great difference, Gill argued, between an 'organically' high rate based on a strong economic performance and a high rate 'imposed on industries which were inherently weak'.[30] '[T]oo fast a rise in the rate', he argued, 'will cause immediate damage to the viability of these industries before the counter-inflation benefits have had time to come through'.[31] For this reason he encouraged Lawson to push forward with exchange control liberalisation.

The DoT and the DoI also positioned themselves firmly against exchange controls for this reason. The DoT Under-Secretary explained in early May that 'we have been losing competitiveness ... Despite the inflationary disadvantages I think from the Department's point of view there is a strong case for supporting *some* relaxation'.[32] Hancock was also contacted by a top DoI official in early May, who urged the Treasury to address the 'serious and general lack of competitiveness ... in British industry'.[33] Advising against monetarist penance, he wrote: 'I do not believe that the adjustment that is necessary in our economy will come about through an overvalued pound, Germany and Japan did *not* attain their virtuous circles in that fashion'.[34] Finally, at a May meeting with officials from a variety of government departments and the Bank, the Foreign Office representative, M.D. Butler, explained with great clarity that there was a 'case for relaxing exchange controls completely over the next three years, in order to stimulate large outflows ... and thus to keep the exchange rate competitive'.[35] Summarising the various discussions taking place on this topic, Hancock wrote to Lawson that, while depreciating sterling through exchange control abolition could damage the fight against inflation, it was likely a less inflationary strategy for effecting a competitive depreciation than direct intervention in the exchange rate.[36]

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

The 'Winter of Discontent' and spooking the market

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

Regarding the domestic constraint, Thatcher faced a vastly different political landscape than her predecessors. The fractious relations with the unions that crippled the Callaghan administration acted to give the Thatcher government more freedom of manoeuvre. This was largely due to the Conservatives' success in shaping the narrative of the wave of industrial action that occurred during December 1978 and January 1979. As Andrew Gamble (1994, 94-95) observed, the 'myth of the Winter of Discontent, with its images of closed hospitals, rubbish piling up in the streets, and dead bodies rotting unburied in graveyards', reinforced the idea of the bankruptcy of benign state collaboration with the labour movement. Whereas Labour's close historical relations with the TUC had served it well in the 1974 election, following Conservative Prime Minister Edward Heath's mismanagement of industrial relations, it now undermined its legitimacy (Keegan 1984). Polls that gave Labour a small lead in December 1978 were giving the Conservatives an 18% lead by January 1979, contributing to Thatcher's 43 seat majority victory in May (Hay 1996, 254). As such, a directly oppositional policy towards the union movement was now not only possible but electorally savvy. As such, John Nott, Secretary of State for Trade, argued at a Downing Street meeting in October that the abolition of exchange controls would 'help the Government's position vis-a-vis the trade unions, by showing that the Government were determined that investors should be allowed to put their money where they can earn the best return'.[37]

The external constraint, however, remained. The attempt to affect a currency depreciation via exchange control relaxations in the context of a floating exchange rate system was, as Lawson admitted in October 1979, 'bound to be a leap in the dark'.[38] There remained a sense of unease throughout the different branches of the government about the proper tools for managing a floating rate. The Official Committee on External Economic Affairs – memories of past sterling crises fresh in their minds – insisted that exchange control liberalisation measures should be gradual 'in order to avoid the risk of a foreign exchange crisis'.[39] The Overseas Trade Board concurred, arguing that government intervention to lower the rate 'could easily get out of hand because of speculative action'.[40] Despite the accumulation of foreign reserves in recent years, the authorities still feared that the floating rate system ruled out 'an orderly devaluation of sterling because any *overt* action by the government would have the potential to provoke a diversification out of the pound' (my emphasis; Rogers 2012, 203).

The Thatcher administration concocted a rhetorical strategy to neutralise these dangers. By justifying the abolition of exchange controls under the banner of 'good housekeeping' – which meant a combination of responsible, forward-looking policies and a commitment to laissez-faire principles – it could manufacture a currency depreciation in a seemingly

unintentional manner. This would reduce the chance of depreciation ultimately spooking the markets. In June, Hancock wrote to Lawson: 'it is risky for Government spokesmen to *say* that it [exchange control relaxation] was intended to secure a depreciation in the exchange rate. Once that feeling got abroad, the short term consequences for the exchange rate could be very destabilizing'.[41] For this reason, the government should avoid 'the argument that exchange control relaxation is intended as a means of increasing competitiveness'.[42] Lawson agreed that

> reasoning based on the premise that the exchange control relaxations would help prevent this country catching the "Dutch disease" should be avoided; *while the Financial Secretary sees some merit in the argument, it is not one that he would want to use publicly* and prefers instead to contend that the revenue from north sea oil should be used to build up overseas investments whose future earnings can provide a stream of foreign-generated income ... *In this way the exchange control relaxations can be presented as good housekeeping*.[43]

In August Lawson explained to Howe that, while he favoured a strong (yet not inexorably rising) pound for anti-inflation purposes, he proposed 'a bonfire of most (if not all) of the remaining exchange controls this autumn'.[44] This deregulation '*might*' slow sterling's rise without overtly signalling that 'we are unhappy at the strength of the £', which 'would quickly lead to a very serious loss of confidence in our resolve to stick to [anti-inflationary] policy'.[45]

Nott demonstrated this strategy in an interview with BBC Radio 4 after the first round of relaxations in July. In response to a question about whether this relaxation was an attempt to depreciate sterling, Nott said:

> it's very difficult to say whether overseas opinion will take this further measure of liberalism, liberalisation with exchange control, in such a way that it thinks that the pound is all the more worth-while buying, because it is an act of self confidence, or whether they will say "well, this means there's going to be a little bit more money going out of the country into overseas investment and therefore, we must sell the pound" ... What the strong pound has enabled us to do is pursue what I regard as the correct policies in themselves.[46]

This strategy was also visible following the final abolition of controls in October. Speaking to the House of Commons, Howe insisted that the aim was not to weaken the pound, but rather to build up overseas income streams for the future and to provide greater 'freedom of choice' to 'companies and individuals'.[47] At a later press conference, Lawson was questioned on the relationship between exchange control abolition and the value of sterling, but he 'refused to speculate about the possible outflows or impact on sterling from the changes' (Riddell, 1979c).

This rhetorical strategy was convincing because of the perceived sincerity of the Thatcher administration's commitment to free-market principles. Key figures in the administration had previously denounced exchange controls as a matter of principle. In a November 1978 Commons debate, Howe had decried the controls as 'a bureaucratic hallmark of a society that has no confidence in itself', while in his autobiography he characterised them as 'totalitarian' and kept in place by 'forces of ignorance, timidity and inertia' (1994, 140-1). Lawson – perhaps the minister who was most ideologically opposed to controls[48] – had

also publically expressed his disdain for exchange controls, condemning them first in his 'maiden speech' as Opposition Treasury Spokesman in November 1977 and then in a *Financial Weekly* article at the height of the 1979 election campaign (Lawson 1992, 38). Immediately following both the July and October 1979 deregulations, the *Financial Times* published front-page stories that repeated the government's rhetoric. Peter Riddell reported on 19 July that 'the latest moves are not designed as a response to the recent sharp rise in the rate' (1979b). In October he went further, arguing that the 'Government has decided to go all the rest of the way now because Minsters believe it is right on its own merits to give additional freedom to investment' (1979c).

Ideas, then, played a crucial role in British exchange control liberalisation, but not in the manner that conventional IPE accounts have stressed. Rather than acting as a primary causal impetus motivating deregulation, through the stigmatisation of capital controls amongst policy-makers (Chweiroth 2010; Helleiner 1994), neoliberal, laissez-faire ideas were deployed as rhetoric by the Thatcher administration in order to facilitate what was chiefly a pragmatic, palliative strategy to promote British exports. By inflating their own neoliberal ideological credentials, the Conservatives felt that they could overcome the barriers that had hamstrung their predecessors' efforts to relax these controls, and thus boost export competitiveness through currency depreciation.

Conclusion

IPE accounts have generally emphasised two factors as key for understanding the abolition of capital controls in advanced capitalist economies since the 1970s: dynamics of competitive deregulation, experienced either as the sanctioning power of mobile capital flows or the incentive to promote national financial centres; and the stigmatisation of capital controls through the diffusion of laissez-faire ideas amongst national policy-makers and international organisations. This paper sought to challenge this literature through an in-depth archival analysis of Britain's scrapping of exchange controls. The evidence presented suggests that, more important than concerns about the City's competitiveness or laissez-faire ideological principles, this liberalisation can only be understood by focusing on Britain's faltering *export* competitiveness and the role of ideas *as rhetoric* in constructing economic credibility.

In the context of inflationary pay settlements and poor export competitiveness, sterling's appreciation from late 1976 presented the British state with a contradiction. The rising exchange rate aided in tackling inflation by lowering the cost of living and discouraging large wage settlements, while placing further pressure on critically uncompetitive industrial exporters. The archival evidence demonstrated that the Callaghan and Thatcher governments prioritised the latter goal, recognising its immediate threat to economic performance and social stability, and thus endeavoured to depreciate sterling by relaxing exchange controls and allowing an outflow of investment. Yet two key obstacles stood in the way of this deregulation: an opposed trade union movement and the volatility of currency speculation in a floating-rate system. The Callaghan administration was unable to forge a strategy to overcome either of these barriers, resulting in its relatively weak relaxation of controls in 1977 and 1978. The Thatcher administration, on the other hand, used the narrative of the 'Winter of Discontent' to disarm the unions, while devising a rhetorical strategy that veiled its intended competitive devaluation with appeals to laissez-faire notions of responsible economic management.

In sum, this paper suggests that IPE reconsider the role of competition and ideas in motivating capital control liberalisation. The purpose was not to advance a new theoretical orthodoxy – a single conceptual lens through which to understand specific national deregulations – but rather to encourage further careful historical analyses of capital control liberalisation. Whether the lessons from the British case can be extrapolated to other cases is a matter of empirical analysis. The evidence presented here demonstrates that British liberalisation was not driven chiefly by a desire to promote the City's global competitive prospects, but was rather an attempt to boost the short-term competitiveness of exporting industry by bringing about a managed depreciation of sterling. This contributes to literature that conceives of financial deregulation as part of a pragmatic, palliative response to economic crisis (Krippner 2011; Streeck 2014). Furthermore, in opposition to IPE's focus on the role of changing policy norms in transforming the perceived legitimacy of capital controls, this paper argues that the Thatcher government publically promoted its own neoliberal ideology as a rhetorical strategy to mask the fact that exchange control abolition was primarily an attempt to depreciate sterling, by this means seeking to avoid the risk of provoking a damaging run on the pound. This finding lends support to literature that examines policy-makers' deployment of ideas as rhetoric or declarative strategy in order to boost a government's policy credibility in the eyes of global financial markets.

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Notes

1. Modern Records Centre (MRC) MSS.200/c/3/dg2/23, *Trade and Industry* magazine, 22 September 1978.
2. The National Archives (TNA) FV 89/2, Healey to Callaghan, 19 October 1977.
3. TNA FV 89/2, Hattersley to Healey, 19 October 1977.
4. TNA FV 89/2, Leisner to Secretary of State, 20 October 1977.
5. TNA PREM 16/2108, Note of a Meeting, 28 October 1977.
6. TNA FV 89/2, EGV to Callaghan, 24 October 1977.
7. TNA PREM 16/2108, Note of a Meeting, 28 October 1977.
8. MRC MSS.200/c/3/eco/11/24, Memorandum, 1 February 1978; MRC MSS.200/c/3/eco/11/25, Minutes of a Meeting, 6 July 1977; MRC MSS.200/c/3/eco/11/26, Memorandum, 11 October 1977.
9. TNA PJ1/91, Pliatzky to Wass, 6 July 1977.
10. TNA T 388/154, Barratt to Payton, 27 May 1977.
11. TNA FV 89/2, EGV to Callaghan, 24 October 1977.
12. TNA FV 89/2, Healey to Callaghan, 19 October 1977.
13. TNA T 388/154, Note of a Meeting, 31 May 1977.
14. TNA T 388/154, Note of a Meeting, 31 May 1977.
15. TNA FV 89/2, Note of a Meeting, 21 October 1977.
16. TNA FV 89/2, Note of a Meeting, 21 October 1977.
17. MRC MSS.200/c/3/eco/11/26, Memorandum, 11 October 1977.
18. MRC MSS. 292D/462/3, TUC Comment on NEDC Paper, 1 July 1977; MRC MSS.292D/40.2LPMR/2, Report of TUC-Labour Party Liaison Committee Meeting, 25 April 1978.
19. TNA T 388/154, Note of a Meeting, 31 May 1977.
20. TNA T 364/211, Smith to Stowe, 30 September 1977.
21. TNA FV 89/2, Healey to Callaghan, 19 October 1977.
22. TNA PJ 1/92, Stowe to Battishill, 26 October 1977.
23. TNA PJ 1/92, Meeting of OXE, 2 March 1979.
24. TNA T 388/203, Hancock to Butler, 23 May 1979.
25. TNA T 388/154, Wass to Couzens, 19 July 1979.
26. TNA T 381/145, Dixon to Airey, 31 May 1979.
27. TNA T 381/143, Dixon to Lawson, 29 July 1979.
28. Bank of England G 3, accessed: http://www.margaretthatcher.org/document/113156.
29. TNA T 388/204, Gill to Hancock, 25 June 1979.
30. TNA T 388/204, Gill to Hancock, 25 June 1979.
31. TNA T 388/204, Gill to Hancock, 25 June 1979.
32. Emphasis in original; TNA PJ1/93, Lanchin to Gray, 8 May 1979.
33. TNA PJ1/93, Lippett to Hancock, 3 May 1979.
34. Emphasis in original; TNA PJ1/93, Lippett to Hancock, 3 May 1979.
35. TNA PJ1/93, Note of a Meeting, 17 May 1979.

36. TNA T388/203, Hancock to Lawson, 4 June 1979.
37. TNA T 388/207, Note of a Meeting, 17 October 1979.
38. TNA T 388/207, Note for the Record, 4 October 1979.
39. TNA PJ 1/92, Note of a Meeting, 2 March 1979.
40. TNA PJ 1/92, Wilks to Pliatzky, 5 April 1979.
41. Emphasis in original; TNA T388/203, Hancock to Lawson, 4 June 1979.
42. TNA T388/203, Hancock to Lawson, 4 June 1979.
43. Emphasis added; TNA T 388/203, Diggle to Hancock, 11 June 1979.
44. TNA T 388/59, Lawson to Howe, 28 August 1979.
45. Emphasis in original; TNA T 388/59, Lawson to Howe, 28 August 1979.
46. TNA PJ 1/94, BBC Radio 4 interview, 19 July 1979.
47. Hansard, House of Commons, vol. 968, cc235-264, 12 June 1979.
48. There is evidence to suggest that Lawson was committed to liberalisation regardless of the effects on export competitiveness. In early July 1979, Lawson observed: 'the case for further exchange control relaxations had to be considered on merits without regard to the arguments about competitiveness and counter-inflation' (TNA T 388/204, Record of a Meeting, 2 July 1979). This position was not widely shared in the Thatcher government, however, and the balance of opinion favoured liberalisation for the purpose of facilitating a depreciation of sterling.

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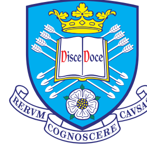

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