

# The Political Economy of the Special Relationship: British Development and American Power

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## **Abstract**

Breaking from the traditional understanding of Anglo-American relations in terms of the cultural, diplomatic and military 'Special Relationship', this thesis explores the interdependent political-economic development of Britain and the United States. I argue that this interdependence has generated a specifically Anglo-American field of capitalist development that has been crucial to the transformation of the global political economy, particularly with regard to the creation and eventual undermining of the Bretton Woods monetary order.

Reflecting the imbalance of power between Britain and the U.S., the thesis focuses principally upon the role of American power in shaping the transformation of Britain's political economy and affecting Britain's position within the global political economy. Moving away from the narrow preoccupation with decline that has dominated studies of British capitalism, I open up the study of British development within a broader transatlantic horizon that enables an alternative analysis which reveals important aspects of the politics of financial globalisation and the transformation of the U.S. political economy.

I argue that the financial relationship between the two states and the key role of interaction between bankers in London and New York, in collaboration with their respective Treasuries and Central Banks, was crucial to the post-war transformation of the global political economy. The interactive development of Anglo-American finance was central to the development of financial globalisation, undermining the Bretton Woods order in the process. Anglo-American bankers alongside their respective Central Banks and Treasuries formed the basis of enduring economic orthodoxy within both states and

presided over financial deregulation that critically undermined the basis of the Keynesian state in Britain. In the U.S., these transatlantic deregulatory dynamics eroded the basis of financial regulations that had been central to the politics of the New Deal. In both countries, the financial communities supported monetarism and the neoliberal central banking regimes of the Thatcher-Reagan era, which spurred a wider endorsement of the politics of price stability throughout the global political economy.

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## Introduction

*'Little by little, the two countries established an instinctive conjunction of financial interests, so that it seemed impossible on either side, to imagine life without it. This, and not sentiment and language, was the innermost guts of the 'Special Relationship' (Strange, 1971: 71).*

The close post-war association between Britain and the United States has come to be known by a single mnemonic, the 'Special Relationship'. The term refers to an unusually close and cooperative relationship, encompassing diplomatic, military- strategic, political, economic and cultural spheres, between two independent nation states. For Britain, the Special Relationship has offered a means to preserve Great Power status even though its capacity for unilateral action in pursuit of foreign policy objectives has been greatly diminished (Curtis, 1998: 19). While for the U.S., Britain's possession of nuclear weapons, its access to political and military intelligence and its position on the United Nations Security Council to name but a few factors, have served as valuable appendages to American power (Watt, 1986: 10). Diplomatic relations between the two states have, despite the occasional spat and periods of cooling, remained extraordinarily close, perhaps never more so than during the so-called 'War on Terror' marshalled by George Bush and Tony Blair to devastating and tragic effect in the aftermath of 9/11 (Dumbrell, 2006: 4).

Yet for all that the concept of the Special Relationship has illuminated, there is also a great deal that it has obscured. The *political economy* of Anglo-American development has

been buried beneath more fashionable scholarly preoccupations with diplomacy, grand strategy and the cultural and sentimental linkages between these two states. That is a great shame because, as Susan Strange so aptly noted, it was the exchange of roles between the dollar and sterling and the deep financial ties between the two countries that ultimately formed the bedrock of Anglo-American unity and integration (Strange, 1971: 71).

It is with this oft-neglected political economy dimension of Britain's relationship with the U.S. that this thesis, in the chapters that follow, is principally engaged. Steering away from the traditional preoccupations of enquiries into Britain's relationship with the U.S., I explore the modern transformation of British capitalism through the lens of Anglo-American development, focusing upon the financial relationship between the two states and the key role of interaction between bankers in London and New York, in collaboration with their respective Treasuries and Central Banks, in driving these processes of Anglo-American development. But this is not another treatise on British decline. The emphasis upon Britain's 'development' is an intentional departure from the preoccupation with decline, which has dominated the narrative of the modern transformation of Britain's political economy. That narrative has led to a fixation upon questions of national competitiveness and economic growth that obscured the analytical potential that a focus upon Anglo-American development opens up.

Through a long-term historical study and the use of original archival material, which examines key episodes of Anglo-American interaction that were central not only to British development but to the wider global political economy too, this thesis explores the manner in which the development of British capitalism has been articulated in and through a

broader field of Anglo-American development.<sup>1</sup> The thesis engages with three main research questions: How did Anglo-American developmental dynamics shape the transition from Keynesianism to monetarism in Britain? How did these processes feed back into the development of the U.S. political economy? And finally, in what ways did Anglo-American development both shape and reflect the broader political economy of the international monetary system?

Anglo-American development has not been a one-way street, despite being decidedly and increasingly uneven in the post-war period. What the following chapters demonstrate is that not only has American power been fundamental in shaping the institutional landscape of modern British capitalism, but also that America's relationship to Britain has, at different points, fed-back into the development of American capitalism. The positioning and repositioning of British capitalism within the global political economy has also been extremely significant for the endeavour to refashion the global political economy, which the U.S. energetically undertook after the Second World War.

That endeavour should not, at least in relation to Britain, be viewed simply as a case of hegemony or indeed 'imperialism'. Instead, it should be viewed as a complex and uneven co-articulation of capitalist development that gave rise to a specific Anglo-American field of developmental interaction. American ascendance did not, however, occur through a straightforward subordination of Britain. It actually took on a much more integrative form, particularly in the post-WW2 era. Underway here was not simply the passing of leadership from one phase into the next, but a complex and uneven co-articulation of capitalist

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<sup>1</sup> Regarding British and American capitalism, I refer to the broad totality of state and societal relations pertaining to matters of 'political' and 'economic' power.

development. Over time, Anglo-American financial integration produced a specifically Anglo-American field of capitalist development, centred upon the international roles of London and New York. These developments involved the recalibration of national sovereignty, with increased interdependence between private and central banking in London and New York transforming the way that national economic policy was conducted.

These two states, Britain and the U.S., often in conjunction but also through competition and contestation, played a crucial role in the advancement of financial globalisation. Having been the architects of the Bretton Woods international monetary system, Britain and the U.S., through their interdependent development, were central to the subsequent decomposition of the Bretton Woods system and the emergence of financial globalisation. Although scholars have recognised the important role of Britain and the U.S. within the politics of the international monetary system, they have not identified or delineated the emergence of a specific field of Anglo-American development that was central to the political economy of the post-war period.

Theoretically, this thesis builds from the identification of the key nexus of financial power within the capitalist state: that between the Central Bank, Treasury and private banking. Within Britain, it is the City-Bank-Treasury nexus that has represented the intersection between private and public financial power. In the U.S. the Federal Reserve-Wall Street-Treasury nexus performs a comparable role. In both countries, the integration of private banking power with the key financial components of the state has been central to their modern development. It is through this central nexus between private finance, Treasury control and Central Banking that capitalist power is principally instituted within

the state. The Treasury and the Central Bank function as two related components of the government account. The Treasury is empowered with the capacity to spend, tax and issue public debt, while the Central Bank sets interest rates, regulates credit supply, governs the exchange rate and pursues price objectives while also serving as the lender of last resort to private banks. Through these interrelated processes, the behaviour of Treasuries and Central Banks are crucial to regulating and shaping the overall flow of national economies and their situation within the broader world market.

The central authoring power of state institutions within capitalism, which is exercised in close conjunction with private banks, is grossly understated in contemporary neoliberal discourse, which tends to portray business and the state as antagonistic interests. In reality there is a fundamental ontological proximity between the central financial institutions of the state and the banking system that underpins economic activity at large. Public debt, for example, provides a major interest-earning asset to the banking system and the holding of accounts with the Central Bank by major private banks is foundational to the monetary system in capitalist states.

This thesis examines the interactions between these centres of instituted financial power within the capitalist state across time and space, by fixing the study of Anglo-American development upon the basis of the interactions and co-constitution of instituted financial power on both sides of the Atlantic. These concentrations of financial power within the state have been, I argue, central to Anglo-American development and the political economy of the Special Relationship.

As this thesis demonstrates, an Anglo-American development field centred upon increasing financial interdependence between the two states began to emerge in earnest during the 1920s, with the disastrous attempt to restore the gold standard in which Anglo-American financial cooperation was key. After the interwar years, this interdependence began, tentatively, to re-emerge. But it was with the development of the Euromarkets and the Americanisation of the City from the late 1950s that Anglo-American development began to reach a much fuller expression, shaping the crisis years of the Bretton Woods regime in the process. In the longer term, these processes came to undermine the national monetary systems and regulatory orders in Britain and the U.S., driving the financial liberalisation and development of new Central Bank practices that ushered in the Anglo-American transition to neoliberalism in the early 1980s.

### **Synopsis:**

In chapter one, I set out the theoretical framework required for conceptualising the political economy of the Special Relationship by establishing a methodological basis suitable for studying Anglo-American development. I critique the way that IPE has tended to overlook Anglo-American development due to a fixation with hegemonic cycles of rise and decline. I argue that as a consequence, British development has been understood in terms of a 'decline' narrative that has foreclosed alternative analytical strategies. Similarly, the projection of American power within the global political economy has been rendered ambiguous by the debate over whether or not the U.S. has experienced a decline from its

post-war peak of hegemonic power. Accordingly, the analytical potential of Anglo-American development for understanding the transformation of Britain and the U.S. within the context of the international monetary system has been obscured. I propose an alternative approach that conceives of Anglo-American development in terms of the interdependent and co-constitutive relationship between the 'Federal Reserve-Treasury- Wall Street' complex at the heart of American financial power, and the central nexus of instituted financial power within the British state; the City-Bank-Treasury nexus.

By conceiving of American power in terms of an active set of constitutive processes, rather than the conventional structural power approach, I argue that we can begin to uncover Anglo-American developmental dynamics that were key to the transformation of both Britain and the U.S. Anglo-American development was also central to the rise and fall of the Bretton Woods financial order.

As I explain in chapters two and three, America's transcendence of British dominance was accelerated greatly by the two World Wars, which sapped the strength of the British Empire and gave the American's the leverage power of creditor over Britain's spiralling national debt (Hudson, 1972: 9). It was a power that they wielded with gusto in order to displace Britain's standing. But although this dynamic of displacement was often beset with friction and rivalry, it was also marked by an underlying and developing compatibility of interest between key players on both sides of the Atlantic, none more so than the banking communities in London and New York.

Chapter two examines Anglo-American development from the nineteenth century up to the outbreak of WW2. I focus upon the great reversal in power that occurred during this

period, during which the U.S. caught up with Britain. That process was encapsulated within the ill-fated attempt to resuscitate the gold standard after the First World War. The War weakened Britain and strengthened its U.S. creditor. With sterling and the British economy weakened, the City was forced to draw upon American financial support, from both private and central bankers, in order to re-launch the gold standard and restore sterling convertibility. This foreshadowed the Anglo-American development interdependence that would find fuller expression from the 1950s, with the birth of the Euromarkets.

The role of the private House of Morgan banking dynasty was central to the attempt to put sterling back on gold, with Anglo-American financial ties built up before and during the war key to the pattern of cooperation that emerged in the 1920s. This Anglo-American financial cooperation was also reflected in broader attempts to manage the international monetary system during the 1920s. But while cooperation between bankers occurred successfully, the issue of war debts damaged the relationship between the two states. Anglo-American cooperation was ultimately undermined by the lack of U.S. willingness and capacity to play a greater leadership role and respect its duties and obligations under the gold standard system, leading to the collapse of the gold standard and the increasing rivalry and protectionism of the 1930s. The failure of Anglo-American management of the international monetary system in the inter-war years had a formative impact upon the priorities instituted at Bretton Woods during the 1940s.

The Anglo-American crux of the international economy was reflected in the creation of the Bretton Woods framework that heralded the end of WW2 and the birth of the post-war financial system. In chapter three, I contest the dominant interpretations of Britain's



post-war relationship to the U.S. and provide an alternative interpretation, characterising the post-war Anglo-American relationship in terms of 'contained rivalry' and 'uneven interdependence'. By disaggregating the state, I trace the way in which the struggle between economic orthodoxy and Keynesian ideas shaped the interactions between Britain and the U.S. during the early post-war period. Britain needed financial support from the U.S. in order to support sterling and finance reconstruction, while the New York banking community looked to London to help foster the recovery of international trade and banking by re-launching sterling convertibility. American ambitions were initially thwarted by the Bank's preference for bilateralism, but as the forces of economic orthodoxy within the British state reasserted themselves during the late 1940s and early 1950s, they aligned with the interests of the Fed and American bankers once more in a common commitment to multilateralism. This would form the basis for deeper Anglo-American financial integration later in the 1950s.

In chapter four I explore the way in which restrictions upon the use of sterling, imposed in response to periodic balance of payments crises during the 1950s, prompted British merchant bankers to develop an innovative method for financing international trade. They tapped in to the large volume of offshore dollars that had developed as a consequence of massive overseas American spending through military aid and the Marshall Plan, using these dollars to finance trade between third parties. So was born the offshore 'Eurodollar Market'. By switching their allegiance to the dollar, British bankers were able to restore the City's international role and reassert their privileged position within the British state.

However, this development came at a price. The growth of the Euromarkets further entrenched the hegemony of the dollar and led to a massive influx of American banks into London during the 1960s. By the end of the decade the money markets in New York and London had become intimately connected, with interest rate shifts on each side of the Atlantic closely linked. The City's role had been restored, but it was now a nodal point within the global expansion of American finance and the dollar.

Through the Euromarkets, a specifically Anglo-American field of development was emerging. As American banks integrated the Euromarkets into their business strategy, attempts by American monetary authorities to control credit were undermined by inflows of Eurodollars. The integration of Anglo-American finance undermined the policy autonomy of state officials on each side of the Atlantic. In doing so it aggravated the contradictions of the Bretton Woods system, unleashing a global capital market that undermined the system of capital controls and fixed exchange rates. Increasingly, the Fed-Treasury-Wall Street nexus was transmitting its growing influence through the City-Bank-Treasury nexus within Britain.

Embracing American power in this manner also had a crucial domestic importance for Britain. It enabled the City's bankers and the Bank of England to maintain their predominance within British capitalism at a time when many in the business community were calling for a rethink of British industrial strategy. In accepting the dollar, British bankers insulated themselves from the fate of sterling. International banks in the City were now increasingly independent from the fortunes of the British currency and the British economy, tapping in to a wider circuit of global business. For the Americans, the City and

the Euromarkets enabled the sidestepping of New Deal regulations and a window for expansion into Europe.

After the collapse of Bretton Woods the global economy entered a period of sustained turmoil.<sup>2</sup> The oil shock of 1973 contributed to a severe 'stagflationary' crisis: the combination of high inflation and low growth. Britain suffered more than most advanced capitalist states during the 1970s. In chapter five I focus upon the IMF crisis of 1976. I argue that conceptions of the internationalisation of the state tend to overlook the privileged power of the U.S. in encouraging, directing or sometimes unwittingly affecting these transformations at key moments; especially during the negotiations over Britain's IMF loan in 1976. Of particular significance here are the relationships between financially oriented state institutions, for example the relationship between the Bank of England and the Federal Reserve. But as well as American power pushing in on Britain (with notable resistance from members of the Labour Cabinet), it was also very much a case of powerful class interests within Britain, particularly in the City, pulling in American discipline by voraciously attacking the foundations of the post-war consensus through the frequent pro-monetarist salvos launched in the financial press.

Coming after several decades of British balance of payments difficulties and the preceding inflationary expansion of the Heath government, the 1976 crisis drew the British state into the disciplinary embrace of the United States to a degree not seen since the early

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<sup>2</sup> By the collapse of the Bretton Woods system I refer to the unilateral termination of the dollar's fixed convertibility to gold by the U.S. in 1971. Despite the shift to floating exchange rates, the pillars of the Bretton Woods order, the dollar and the IMF, continued to play a central role in international monetary politics after 1971 (Gill & Law, 1988: 177).

post-war negotiations over the Washington Loan Agreement. It also signalled the symbolic termination of Britain's ill-starred Keynesian project.

That project had been gradually undermined, notably by the liberalisation of global finance anchored in the City's international restoration, but also by the incompatibility of defending sterling and stimulating economic expansion. The leverage of the American state played a crucial role in 1976. The Americans wanted to make an example of the British that sent a clear message internationally and within America about the future direction of the international economy.

The key financial institutions of the American state, with their influence veiled by the IMF, aligned themselves directly behind the IMF conditionality dictates and used their power to shape Britain's development. This was a key moment in what would come to be known as the 'internationalisation' of the state, with domestic policy increasingly reconfigured to suit the needs of international markets rather than national welfare. In Britain, it was the Treasury that was the key focal point of the process. The crisis of 1976 demonstrates, I argue, the degree to which the British state has been 'Atlanticised' as much as it has been 'internationalised'.

By the end of the 1970s, with spiralling inflation in the U.S., Paul Volcker, as head of the Fed, adopted a radical monetary stance, pushing interest rates up to record highs in order to break inflation and undermine the wage militancy of American workers. In the U.S. this restoration of class power, underpinning the neoliberal political project, relied upon high interest rates, recession and market liberalisation.

Across the Atlantic, the formula for capitalist restructuring under Thatcher exhibited remarkable parallels, something that, as I show in chapter six, must be understood as a consequence of the way that both the United States and Britain had positioned themselves as lynchpins of the global financial system; they intended to signal that the 1980s would be nothing like the crisis decade of the 1970s. The synchronicity of the transformation towards neoliberal austerity and unconventional Central Bank policies was not merely a product of ideological convergence, as it has predominantly been understood, but rather a consequence of institutional symbiosis and the co-development of central banking practices that emerged from Anglo-American developmental dynamics.

Embracing the credo of monetarism, Thatcher and Reagan made clear that price stability would be restored and working class power broken. In the absence of the Bretton Woods framework, both states demonstrated their commitment to internalising discipline through extreme applications of monetary policy and direct confrontations with the labour movement. Developments in Britain and the U.S. led the way for the broader adoption of neoliberalism within the global political economy and the further development of financialisation that fed into the global financial crisis of 2008. The pursuit of price stability over and above the Keynesian commitment to full employment helped maintain the roles of London and New York at the heart of global financial markets.

Finally, I conclude by examining the enduring economic orthodoxy of fiscal austerity and price stability, linking it to the pervasive interests of finance within Anglo-American capitalism. Ultimately, I conclude that the Keynesian transformations of Anglo-American capitalism did not go far enough. Private finance was given too much freedom and the core

institutional complexes within the state were not transformed in a manner that might enable a lasting commitment to full employment and the pursuit of more equitable and democratic social goals.

### **A note on archival sources**

From chapter's four to six, much of the supporting evidence employed within this thesis is based upon original archival material. Those materials were drawn from two sources; the Bank of England Archives at the Bank of England in Threadneedle Street London and the National Archives in Kew, Surrey. The research was conducted primarily across a two-week period during which I visited both the Bank and the National Archives in July 2012, and an earlier visit to the Bank of England to carry out initial research on the Euromarkets during December of 2011.

It is only in recent years and during the researching of this PhD that access to the entirety of this wide range of archival material has been possible, with many of the documents pertaining to the early years of the Thatcher government only becoming available since 2009. With those documents on the early years of the neoliberal revolution now available, it has become much easier to examine the development of key state institutions during both the post-war period and the beginning of the neoliberal era. This, of course, affords a much better opportunity to examine the transformation of the British state, tracing the collapse of Keynesianism and the ascendancy of monetarist principles during the transition towards neoliberalism. These new archival sources dealing with the

early years of the Thatcher government, which have yet to be examined in published literature, inform much of the analysis in chapter six. That chapter draws largely upon the Bank of England's archives in order to shed light upon the development of monetary policy during the first term of the Thatcher government.

Archival information on the origins of the Euromarkets has been available for longer, but there has been little research conducted on the basis of these documents. Importantly, the Anglo-American dimensions of the development of the Euromarkets had, prior to this study, largely been unexplored. These sources from the Bank of England are used extensively in chapter four, while I also make use of Treasury archives that link the development of the Euromarkets to the transformation of the fiscal basis of the British state. Similarly, while the archival records dealing with the IMF crisis have been available since the mid-2000s, researchers have tended to focus on different questions and made use of different archival content than that which I explore in chapter five. Chapter five primarily makes use of documents from the Treasury archives in order to explore the role of Anglo-American dynamics during the IMF crisis and Britain's role within the collapse of the Bretton Woods system during the early 1970's.

# 1 Conceptualising the Political Economy of the Special Relationship

The post-war international economic order constructed at Bretton Woods was at heart an Anglo-American project (Helleiner, 1994; Burnham, 1990; Cox, 1987; Ruggie, 1982). John Maynard Keynes and Harry Dexter White, leading the British and American negotiators respectively, provided the principal intellectual synergy behind the agreement. Indeed, in terms of the role played by states in the reconstruction of the international economic order and then in driving the politics of financial globalisation that gradually came to undermine the Bretton Woods framework, Britain and the U.S. were crucial players. But despite the centrality of Britain and America to the foundation of Bretton Woods and the politics of financial globalisation, the longer-term developmental connectivity between the two countries has been overlooked.

Any attempt to trace this connectivity by identifying and delineating a specific sphere of Anglo-American development, as this thesis does, must be contextualised within the creation, continuation and collapse of the Bretton Woods system of international monetary relations.<sup>3</sup> The important roles of Britain and the U.S. in the creation and eventual collapse of Bretton Woods have not been lost on scholars of IPE (Block, 1977; Helleiner,

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<sup>3</sup> Kees Van der Pijl's outstanding work (1998; 2006) on the role of the 'Lockean heartland' in driving capitalist globalisation and the unfolding of global rivalries captures important elements of Anglo-American development, but Van Der Pijl's work engages a much broader problematique than this thesis by attempting to understand the historical transformation of global capitalism and international relations over a number of centuries. Van der Pijl also fails to disaggregate the state and its component institutions beyond the schism between 'Lockean' and 'Hobbesian' states. This leaves the analysis at too great a level of abstraction to capture the specific institutional interactions of post-war Anglo-American development and their interrelation with the international monetary system.



1994; Eichengreen, 2008). Within this literature, Eric Helleiner (1994: 5-14) has made perhaps the most important and influential contribution to our understanding of the politics of the rise and fall of the post-war international monetary system by identifying the centrality of Britain and the U.S. as key actors in the construction and eventual deconstruction of Bretton Woods. Helleiner draws attention to the role of bankers in New York and London, in cooperation with state agencies, in pushing for the liberalisation of international capital markets and helping undermine the Bretton Woods order.

Unfortunately however, Helleiner never takes the step from simply acknowledging the centrality of Britain and the U.S., to identifying what exactly the mechanisms that interlinked the development of these two states were and how those mechanisms interacted with the development of the international monetary system. His failure to do so is symptomatic of a broader myopia within IPE that has disguised the centrality of Anglo-American development to the transformation of the global political economy. Like so many other works within IPE, Helleiner's analysis remains trapped within the dominant narrative of hegemonic transitions. Accordingly, Britain's commitment to liberalised international finance and the City's role in eroding the Bretton Woods restrictions are understood in terms of a 'hegemonic lag' (Helleiner, 1994: 14). This concern with hegemonic leads, lags and transitions obscures the complex co-development of Anglo-American capitalism, which realised a new form and intensity after the emergence of the Euromarkets in the late 1950s. Rather than cyclically differentiated moments of hegemonic rule, American financial ascendance was articulated in and through the retrenchment and redefinition of Britain's global role. The bankers of the City were not simply the agents of an archaic hegemonic

commitment to international finance. They were, in fact, re-articulating their national dominance by integrating Britain into a specific Anglo-American developmental sphere centred upon the competitive and collaborative interaction between London and New York. In doing so, they tied Britain's developmental trajectory more closely than ever into the fate of American capitalism.

Helleiner's focus upon the role of states in the re-emergence of global finance and his commitment to hegemonic stability theory neglect the crucial intersections between public state power and private market power that have been central to Anglo-American development and the politics of financial globalisation. In this chapter, I argue that the failure of Helleiner and IPE scholarship more broadly to convincingly problematise and identify patterns and processes of Anglo-American development, and their impact upon the transformation of global capitalism, is rooted in the way that British and American development have been approached as separate analytical problematiques. Indeed, because of the predominance of the narrative of hegemonic cycles of rise and decline within IPE the study of both states has been mired within contention over the extent, causes and consequences of their decline from peak power. Scholars have identified different reasons for the rise and decline of hegemonic powers, but the commitment to a cyclical view of the historical development of the global political economy, punctuated by different moments of hegemonic order under the leadership of a dominant state, is common to these approaches (Gilpin, 1975, 1983; Krasner, 1976; Olson, 1982; Keohane, 1984; Cox, 1987; Arrighi, 1990).

Within these studies, Britain and the U.S. are taken to be exemplary of the modern rise and decline of hegemonic powers.<sup>4</sup>

Whereas for Britain, that pattern of decline is often discerned as far back as the later nineteenth century, for the U.S., the concern with decline began to emerge during the late 1950s and early 1960s. Despite the historical proximity and closely interrelated processes that link the exhaustion of British imperial power and America's rise to pre-eminence, the two phenomena have been examined as analytically distinctive processes. Instead, I suggest that we need to examine British and American development within a unified analytical lens that allows us to examine the complex dynamics of 'Anglo-American development' outside of the confines of the hegemonic rise and decline narrative that has shaped our understanding of British development and framed the debate over America's post-war power. This chapter sets out to construct a methodological basis that enables us to define and explore the problematique of Anglo-American development that has been buried within existing IPE scholarship. In order to do this, I propose that we break from the preoccupation with American 'structural power' and instead consider Anglo-American development in terms of a dynamic set of power processes in which American predominance was articulated within a relationship of uneven interdependence between Britain and the U.S. that had significant ramifications for the wider global political economy.

The first section of this chapter critically reviews the literature dealing with British decline. I suggest that the decline debate has obscured crucial facets of Britain's post-war development and shackled our understanding within a narrow conceptual lens. This

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<sup>4</sup> A good example of this is Robert Gilpin's comparison (1975: 63) of the relationship between foreign investment and the decline of economic predominance in the cases of Britain and the U.S.

declinist lens contains distorting preconceptions and purposes that obstruct a more sober analysis of the transformation of British capitalism in the post-war period. In the second section, I draw out the potential for an alternative methodological approach that provides a foundation for understanding Anglo-American development, by building from the identification of the City-Bank-Treasury nexus within British capitalism. That methodological basis, I argue, needs to be internationalised, or more specifically 'Atlanticised' in order to form the basis for a study of Anglo-American development. In the third section, I demonstrate that the failure to Atlanticise the City-Bank-Treasury nexus is reflective of a broader limitation of the literature on British development, which has acknowledged the centrality of Anglo-American dynamics to the transformation of British capitalism, but has failed to make the methodological adjustments required to tease out the analytical substance and generative impact of these dynamics upon Britain, the U.S. and the global political economy. The chapter then moves on to explore the way in which ambiguity over the status of American power within the global political economy has limited the potential for scholars to explore the long-term impact of American development upon other states. Because of the ambiguity over American power, scholars of British development have been unable or unwilling to offer a fuller exposition of the long-term tendencies and consequences of Anglo-American development. Finally, I argue that we must shift from conceptions of US 'structural power' towards a more dynamic notion of 'power as process': constitutive and continual creation and re-creation of instituted political-economic orders that involve the negation of alternative developmental possibilities.

## The decline paradigm

Over the last forty years a prodigious amount of literature has emerged heralding Britain's decline (Burnham, 1990; Glyn & Harrison, 1980; Gamble, 1990; Strange, 1971; Overbeek, 1990).<sup>5</sup> In absolute terms, Britain's decline from its imperial pinnacle is undeniable. It began in the latter part of the nineteenth century and accelerated rapidly after the end of the Second World War. The two World Wars took an enormous toll on the resources of the British government and British capital. By the end of WW2 Britain had amassed the largest external debt in history, with almost twenty five per cent of pre-war national wealth destroyed (Burnham, 1990: 18). It was within this context of British exhaustion that the U.S. emerged as the preeminent force in the global political economy. By the late 1960s, conscious recognition of British decline had become widespread (Overbeek, 1990: 1). Despite the obvious reality of decline however, the causes remain keenly contested (Gamble, 1990: 32; English & Kenny, 2000: 279-300).

Nevertheless, there are a number of recurrent themes within the decline literature. David Coates (1994: 28-55) divides theses on decline into those focusing upon the role of labour and unions in frustrating modernisation, those that lay the blame at the feet of capital, and finally arguments that identify the British state as the prime suspect in the search for the chief perpetrator of British decline. Jim Tomlinson (2000: 3) suggests that contributions to the debate can be categorised as either; focusing upon decline from *Great Power status*, or understanding decline in terms of *economic performance*. Finally, Andrew

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<sup>5</sup> For a good overview of the debate cf: English R. & Kenney M. (2000), 'Decline or Declinism?' in, English R. & Kenney M. (eds) *Rethinking British Decline*, London: Palgrave: 279-300.

Gamble (1990: 30-33) opts for a fourfold typology of imperial, cultural, supply-side and democratic theses, with each type identifying the primary cause within a distinctive aspect of Britain's social structure.

If the causes of British decline are so varied and contentious, perhaps it is the very question of decline itself, as a starting point for analysis that is the problem? This is the view held by English and Kenny (2000: 291) who question whether decline is really the most appropriate conceptual lens through which to consider British politics. A number of factors prompt us to re-evaluate the validity of the decline paradigm. Approaching British development under the rubric of decline has obscured many other important questions. The analysis has tended to be preordained in a negative manner that occludes broader transformations of British capitalism. For example, our understanding of the transition from Keynesianism to monetarism in Britain remains analytically ambiguous. Who drove this process? Which groups benefited most and what was the role, if any, of American power in shaping this transformation?

The focus on decline also contains implicit assumptions about what studies of British development should aspire to. Within the decline paradigm the project of critical scholarship is, often implicitly, limited to the arresting or reversal of decline. But given Britain's imperial history these assumptions are troubling. Not only do they colour the sort of palliative measures that we are likely to propose in response to the problems of British development, they also introduce the legacy of empire in a way that clouds the ethical possibilities of critical scholarship. Our evaluations of British development risk becoming locked within two equally unsatisfying frames of reference. Either we think of British

development in terms of the extent to which it matches up to Britain's former national primacy, or we remain trapped within a statist discourse principally concerned with judging British development in terms of its relative standing vis-a-vis other existing capitalist states.

In the first instance, we risk employing Britain's imperial past as the yardstick for contemporary development. In the second, we encounter the pitfall of an often uncritical and unrealistic elevation of other capitalist states that are considered to have developed more effectively than Britain. While the utility of a comparative framework for judging British development is undeniable, we must not lose sight of a broader critical consideration of capitalist development *sui generis*. All too often, decline arguments simply accept the necessity of national competitiveness within a global capitalist system. Instead, critical scholarship should be guided first and foremost by a normative consideration of the good society.

The predominant frameworks for evaluating British development also present methodological obstacles to the study of the global political economy. The debate over decline began during an era in which it was still commonplace to talk about discreet national economies. Yet contemporary global political economy has been transformed enormously by globalisation, casting doubt over whether we can even speak of Britain as a self-contained national economy. In a globalised world, we need to understand Britain's development not simply as a transformation of Britain within the international system, but rather as part of a process of global transformation (Overbeek, 2000: 232).

Here, however, a new problem emerges. Studying global transformation as a whole presents enormous methodological challenges. To study Britain's development in terms of the global system would be a herculean task. In this thesis, then, the focus is upon the key transnational relationship between Britain and the U.S., which has been central to the constitution and reconstitution of global capitalism. I attempt to identify an Anglo-American developmental sphere, centred upon the interdependence of Anglo-American banking in the City and New York, that has been key to the broader transformation of the global political economy.

How do we begin to think about this relationship in a manner that breaks from statist and nationalist discourse? Firstly, we need to identify a methodological basis for our inquiry. Several influential studies of British development have identified the centrality of the City-Bank-Treasury nexus as the dominant institutional configuration of power within British capitalism. Internationalising this nexus, by examining it within the context of American power, provides a methodological basis for understanding Anglo-American development. By situating the City-Bank-Treasury relationship within the British state in relation to the Federal Reserve-Wall Street-Treasury nexus within the U.S., we are able to explore the dynamic and interactive relationship between the key centres of financial power on both sides of the Atlantic. In this way we can move beyond a broad focus upon the role of 'the state' as an aggregate and undifferentiated whole in the politics of financial globalisation and capitalist development, towards a more nuanced approach that unearths the central locus of financial power within the capitalist state by disaggregating the state and revealing the manner in which state power is articulated within the context of broader



international forces. This methodological approach enables us to understand the revitalisation of the City of London's dominance in the post-war era and the manner in which the key centres of financial power were able to subvert and eventually dismantle the post-war Keynesian state. It also enables us to reveal the contours of Anglo-American development, the way that the interaction between Britain and the U.S., despite being highly uneven in terms of the lines of causality, also impacted the development of American capitalism and shaped the transformation of the global political economy.

### **Internationalising the City-Bank-Treasury nexus**

The most authoritative and influential identification of the City-Bank-Treasury nexus comes from Geoffrey Ingham. In his masterly account of British development, Ingham examines the historical function of the City of London within global capitalism. Ingham (1984: 5) suggests that London has held a, 'near monopolisation' of commercial activities that are based on international economic exchanges, giving it a central role within the world economy. Crucially, London's role as an international commercial hub goes beyond merely facilitating British economic interests, to the performance of functions for the 'world system as a whole'. This global role is encapsulated by sterling's historical role as an international currency.

For Ingham (1984: 6) the key consequence of the City's status as the lynchpin of the world capitalist system has been the development of a 'dual character' within British capitalism. Britain's standing as the first industrial economy coexisted with its role as the

world's major commercial entrepot. Although coexistent, the two facets have not been equal. International commercial capitalism has been dominant, leading it to have a greater impact upon British society. Internally, the City's privilege over industrial interests has been bolstered by institutional support from both the Treasury and the Bank of England.<sup>6</sup> The commercial orientation of the City has left British industry without adequate support from banks, with the resultant low investment explaining the low productivity of post-war Britain's capitalism. The fundamental schism within British capitalism, between the City and industry, was already in place by the end of the nineteenth century. By this point the City stood in 'complete indifference' to domestic industry (Ingham, 1984: 149).

Ingham's account is primarily concerned with identifying the central structural weaknesses that explain British decline. But in doing so he provides a fertile methodological framework for understanding the central nexus of power within British capitalism. In order to explain the continued division between the City and industry, and the failure of the British state to develop sufficiently interventionist tendencies to successfully modernise industry, Ingham focuses upon the 'City-Bank-Treasury' nexus.

By the late nineteenth century, the relationship between these three poles of institutionalised power had evolved into an integrated and interdependent system (Ingham, 1984: 131). The contours of this relationship, however, predated the industrial era. The Bank of England's management of government debt through loans raised in the City established an early and intimate relationship between the Bank and the City, while the

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<sup>6</sup> This is not, for Ingham (1984: 36-37), a consequence of 'City hegemony' or the capture of the state by banking capital. Rather, this coincidence of interests has emerged from the desire of each of the players involved to maintain their power and standing within the broader institutional matrix of British capitalism.

Treasury's capacity to levy interest upon these loans gave it a stake in the debt financing process. During the nineteenth century, under the leadership of William Gladstone, the Treasury's role evolved substantially. Customs revenues were abolished and public expenditure was drastically reduced. This led to the rise of rational accountancy and the doctrine of the balanced budget, as part of the 'Treasury View' of minimal state spending and intervention that became increasingly dominant as the Treasury came to control the expenditure of the entire state apparatus (Ingham, 1984: 130). The major cornerstones of British economic policy during the nineteenth century, free trade and the gold standard, arose out of an emerging commonality of interest between modernising groups within the state and the commercial and wholesale banking capitalists of the City (Ingham, 1984: 126).

Within the associated regimes of free trade and the gold standard, the Bank and the Treasury arrived at a, 'complementary and mutually sustaining' set of policy commitments. The Treasury's parsimony and proclivity for balanced budgets was matched by the Bank's sensibility towards sound money (Ingham, 1984: 132). Tasked with managing the gold standard system, the Bank adopted an increasingly interventionist stance towards the money markets, lowering or increasing interest rates in accordance with the requirement to maintain the gold-sterling parity.

The linkages between the Bank and the Treasury are also underpinned by structural connections with the City and its major banking institutions in particular. The institutional structure of the money markets and the specific role of the clearing banks within British capitalism have been the, 'most important power resources by which commercial and wholesale banking capital's hegemony has been maintained' (Ingham, 1984: 153). These

institutional linkages were reinforced by cultural cross-fertilisations that centred upon associations between bankers and the landed aristocracy. While the government offices and City institutions tended to be staffed by members of the public school and Oxbridge elites.

The upheaval caused by two World Wars presented opportunities for the reform of the core institutions of British capitalism. What actually transpired, however, was a gradual return to the former orthodoxy centred upon the City-Bank-Treasury nexus. The disastrous return to the gold standard in 1925, with a severely overvalued pound, was eventually aborted in 1931. But despite the global economic turmoil set in train after the Wall Street crash, no fundamental restructuring of the state occurred, with the Treasury in particular continuing to function as an obstacle to greater state involvement in Britain's industrial development (Ingham, 1984: 191). After WW2, sterling was maintained as an international currency while the Conservative governments of the 1950s restored the City to its former pre-eminence. These missed opportunities for radical restructuring of British capitalism cast the die for Britain's post-war development. They also formed the backdrop for the failed attempts at industrial modernisation in the 1960s, while providing the natural basis of support for the monetarist principles and liberal international economic policies associated with Thatcherism from 1979.

Other accounts of British development have, less explicitly than Ingham, also been attentive to the powerful influence of the City-Bank-Treasury nexus.<sup>7</sup>In what came to be known as the 'Anderson/Nairn thesis' Perry Anderson and Tom Nairn produced a number

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<sup>7</sup> For other important identifications of the role of the City-Bank-Treasury nexus see: Sidney Pollard (1982) *The Wasting of the British Economy: British Economic Policy 1945 to the present*, New York: St Martin's Press; Gary Burn(1999) 'The State, the City and the Euromarkets', *Review of International Political Economy*, Vol. 6, No. 2, 225-261,

of influential articles critiquing Britain's idiosyncratic and archaic form of capitalist development. Anderson and Nairn argued that much of Britain's economic underperformance in the post-war period and the almost continual condition of economic crisis, were traceable to the deeper history of the British state.<sup>8</sup> Of the two authors, Anderson's writings are the more relevant here.

Anderson and Nairn identified a number of peculiarities specific to British development. These included the limited and early occurrence of bourgeois revolution, Britain's status as an industrial pioneer, the impact of imperial history and the absence of external invasion and radical state restructuring during the two World Wars (Anderson, 1964: 27-37). Taken altogether, these peculiarities amounted to a stunted form of capitalist development, characterised by a subservient working class bound within the confines of labourism, a traditionalist ruling elite that was resistant to industrial and administrative modernisation and a generally ossified social structure permeated by deep and durable capitalist hegemony. The crisis of the 1960s was, for both Anderson and Nairn, a consequence of more immediate conjunctural factors interacting with the longstanding deficiencies of British capitalism (Anderson, 1964: 53; Nairn, 1979: 44).

There is no doubt that Anderson and Nairn erred too far towards structural determination in their analyses, presenting a theoretical oeuvre that essentially reduced class actors to mere executors of strategies that are heavily over-determined by the deeper

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<sup>8</sup> The relevant articles here are; Perry Anderson (1964), 'Origins of the Present Crisis', *New Left Review*, 1/23, pp27-53; Anderson (1992), 'The Figures of Descent', in *English Questions*, pp121-193, London: Verso: 121-193; Tom Nairn (1964), 'The Nature of the Labour Party-1', *New Left Review*, 1/27, 38-65; Nairn (1964), 'The Nature of the Labour Party-2', *New Left Review*, 1/28, 33-62; Nairn (1979), 'The Future of Britain's Crisis', *New Left Review*, 1/23, 113-114: 43-69;

history of British development. This sort of approach left little room for historical contingency or genuine class agency. Within Anderson's original essay however, there is an illuminating awareness of the impact that Britain's imperialist internationalism exercised over capitalist development. This was particularly the case in regard to the role of the City. Anderson (1964: 51) attacked the continued existence of the Sterling Area as the final enduring form of empire, dominated by the, 'first historic nucleus of British Imperialism'-the City. The City had a singularly significant impact upon the contours of the 1960s crisis, being both the, 'most sociologically revealing and the most sectionally decisive single determinant of the shape of the economy'. For Anderson, the role of the City neatly encapsulated all the defects of British capitalism. Anderson also implicated the Treasury in Britain's crisis, suggesting that the failure to adopt an interventionist stance had cost Britain dearly. Writing on the eve of Margaret Thatcher's Conservative premiership, Tom Nairn (1979: 53) shared Anderson's conviction that the predominance of the City had directly contributed to Britain's industrial failings.

These themes are taken on more extensively in Anderson's later work. In *Figures of Descent* Anderson expanded upon his original analysis of the City's culpability for the failings of British capitalism. Drawing on Ingham's account, Anderson (1992: 139) points to the relative independence of the City and industry as distinctive factors in British development and draws out the implications for Britain's class and state structure. The City continued to support free trade despite its impact upon falling British manufacturing competitiveness as other countries turned to protectionism. Britain's belated embrace of protectionism, long after the horse of British industrial decline had bolted, is explained in

terms of the close ties between the City and the Conservatives. This influence was strengthened by the unusual financial dominance of the Treasury within the British state, which reigned supreme as the nerve-centre of government from the Gladstone era onwards (Anderson, 1992: 144).

Anderson (1992: 166) criticises the post-war Labour government for failing to break sufficiently with the existing orthodoxies of British capitalism, a failure that was evidenced by the ease with which the Conservatives restored the City during the 1950s. During this process the Bank recovered its role as 'conductor to the City' and the Treasury was able to reassert its primacy within the state. The 1960s and 70s witnessed several different attempts, first by Wilson and then by Heath, to revitalise British capitalism. Both were unable to arrest the acceleration of decline. Thatcher's efforts to reverse decline actually reinforced the process by further entrenching the primacy of the City and provoking an unprecedentedly rapid period of deindustrialisation (Anderson, 1992: 169-184).

Both Ingham and Anderson correctly identify the centrality of the City-Bank-Treasury nexus within the development of British capitalism and in doing so they produce powerful analyses of Britain's chronic economic underperformance and the crisis tendencies of the post-war period. By disaggregating the state into its constituent elements and identifying the privileged centres of power within the broader state complex, they generate a remarkable level of precision in their diagnoses of British decline and provide a rich understanding of the particularities of British development.

The great deficiency here is not to be found in an errant analysis, but rather in the way that within the work of both Ingham and Anderson, the guiding problematique of

decline circumscribes, a priori, the explanatory potential of the City-Bank-Treasury. By identifying the explanation of decline as the principal intellectual task of their analyses, they obscure a great deal of the explanatory potential that the focus upon the City-Bank-Treasury nexus offers. The interaction between the City, the Bank and the Treasury is not only a useful focus for understanding decline and economic performance, it is also able to tell us a great deal about a number of other questions: why the Keynesian state project that was launched in the wake of World War II failed so spectacularly, how the transition away from the Keynesian state was articulated within the broader context of the international monetary system and why the neoliberal transformation that undermined and supplanted the Keynesian state occurred, which social forces and institutions drove the process, and who were the major beneficiaries.

Unfortunately, this analytical potential is buried beneath the overriding concern with accounting for decline. But the latent explanatory potential of this methodological approach is not confined to understanding Britain's development in a predominantly national sense, in fact understanding that development requires us to introduce the transatlantic vector into our analysis of Britain by Atlanticising the City-Bank-Treasury nexus. In the process, we are able not only to get a firmer handle on the post-war transformation of British capitalism, but also to understand the role that Anglo-American development has played within the broader reconfiguration of the global political economy. By broadening and redefining the intellectual ambitions that motivate our investigation into the City-Bank-Treasury nexus, we are able to activate the latent explanatory potential within this framework. This is a rather simple step to take, it would seem, but the



dominance of the decline narrative has smothered this potential and left it buried beneath other concerns and intellectual preoccupations. By methodologically incorporating American power, we are able to shift the terrain of inquiry away from the well-trodden territory of British decline and towards new vistas of Anglo-American development.

### **The transatlantic vector**

Having examined the importance of the City-Bank-Treasury nexus, we now move on to a related limitation of the decline literature; the absence of a sustained treatment of the relationship between American power and British development. This is despite the widespread acknowledgement that the U.S. has played a privileged role in the reconstitution of the global political economy post-WW2 (Cox, 1987; Panitch & Gindin, 2012; Rupert, 1995; Keohane, 1984; Gilpin, 1987; Gowan, 1999; Arrighi, 1990). It is only by addressing this related deficiency that we are able to bring the problematique of Anglo-American development towards the surface.

While the decline literature often acknowledges the importance of American power to British development, it does so in a latent, implicit or empirically and conceptually underdeveloped manner. What we have is acknowledgement and partial explanation without the required methodological adjustment necessary to fully incorporate the role of American power into our analysis of British development. Overwhelmingly, studies of British decline remain enclosed within a statist/national development theoretical framework. In order to uncover the political economy of the Special Relationship, a much

fuller methodological adaptation is required. Returning to Geoffrey Ingham reveals the deficiencies of the existing literature in more detail.

American power was, according to Ingham, crucial to the post-war restoration of the City's prominence. But rather than the exercise of post-war hegemony that one might expect from the U.S., the City was in fact restored precisely because of the unwillingness and inability of the U.S. to take on the role that Britain had formerly played as the lynchpin of the international economy. For Ingham (1984: 201) then, British decline is rooted more in the deficiencies of American leadership, rather than the overbearing predominance of American power. In particular, the outcome of the Anglo-American discussions over the future of the international economy both during and after the war, are understood to be central to understanding sterling's international role and the revitalisation of the City.

Britain's successful recovery of a world role for sterling and the City would require that American policymakers agree to underwrite the British balance of payments deficit and defend sterling. The American's did just that and the consequences were severe. American sponsorship enabled the City to be restored as a commercial and wholesale banking centre. This had a major impact upon British economic strategy at large, with the policies required to support sterling placing, 'definite constraints' upon the management of the domestic economy. In the longer term, the effort to maintain the value of sterling through deflationary measures 'proved to be a barrier to the implementation of long term planned productive growth' (Ingham, 1984: 201-202).

The Anglo-American politics of the post-war period are clearly central to Ingham's analysis of Britain's development. Importantly, Ingham suggests that the unwillingness and

hesitancy of American global leadership in the early post-war years led American policy makers to articulate their power through the subordinate integration of Britain's traditional international role. What resulted, then, was effectively a co-articulation of global capitalist governance in which Britain would now clearly play second fiddle to American dominance. American sponsorship of sterling's international role and the revitalisation of the City that went alongside it were the key support struts for the reconstruction of the traditional institutional basis of British capitalism.

The problem here is that Ingham conceives of American power over Britain only in terms of a tightly delineated framing process that occurred in the early post-war years and involved the establishment of parameters for subsequent British development. After this moment passes, with Britain set upon a particular path, American agency disappears from the analysis altogether. The continually co-constitutive patterns of Anglo-American development remain invisible and where they are explored, the concern is to explore their impact upon Britain's economic failings.

In much the same vein as Ingham, Andrew Gamble argues that the contours of the Special Relationship after 1945 ensured the, 'prolongation, not the termination, of Britain's traditional world role'. This prolongation had disastrous effects. It led to a renewal of Britain's traditional liberal approach to the world economy and the continuation, at American behest, of high overseas spending on military commitments. These policies provoked tension between the requirements of the domestic economy and Britain's international priorities that were manifested most clearly in the terminal balance of payments crises of the 1950s and 60s (Gamble, 1991: 106-111). Unfortunately however,

Gamble acknowledges the centrality of the Anglo-American relationship in structuring post-war British development but does not offer any further elucidation on the matter. Here then, Gamble falls into the same trap as Ingham: identifying the role of America power in framing British development during the early post-war years, but abandoning any attempt to trace this co-constitutive relationship into the subsequent decades of Anglo-American development.

Susan Strange's study on the decline of sterling similarly offers a limited but revealing exploration of the transatlantic dimension. Strange examines the international role of sterling and its connection to British imperial power. Focusing on the overextension of British power after WW2, Strange (1971: 178-180) suggests that Britain's high level of overseas military spending, which was linked to the preservation of the Sterling Area, caused severe strains on the balance of payments. This was a primary cause of the repeated crises of sterling that derailed Britain's post-war economic revitalisation. Britain's desire to maintain the international role of sterling, according to Strange, necessitated extremely high levels of defence expenditure. Countries that held sterling balances tended to do so under the proviso of British military guarantees. As Britain's economic might waned the need to provide political protection for those holding sterling became more acute.

Within this context, American post-war power played a very important role. American financial aid through the Marshall Plan, and the broader American tolerance of sterling's international role and the protected monetary system of the Sterling Area, enabled the prolongation of a massively defective and outmoded British policy framework (Strange, 1971: 66). Strange's account shows a greater breadth of awareness of the Anglo-

American dimension than most studies. This is particularly the case in her treatment of the emergence of the Euromarkets from the late 1950s. Here, Strange provides important clues as to the role of American power and the dollar in enabling the restoration of the City within an increasingly integrated Anglo-American financial matrix (Strange, 1971: 207). But once again, there is no attempt to isolate or treat continuously the contours of Anglo-American development, or to identify a specific sphere of Anglo-American development within the global political economy. American power is brought in to explain important signposts on the road towards decline, but it recedes into the background once more thereafter.

Where the focus upon the Anglo-American aspect of British development has been more empirically substantive, it has tended to be chronologically confined to the immediate post-war years. Peter Burnham and Edward Brett provide contending accounts of the centrality of American hegemony to Britain's post-war development. While Brett argues (1985: 138-147) that it is Britain's capitulation to American hegemony that explains post-war decline, Burnham argues (1990: 177) the reverse positions, suggesting that the successful resistance of U.S. hegemony cast the die on British decline. These are provocative and revealing analyses but they provide an extremely limited basis, both historically and theoretically, from which to uncover the problematique of Anglo-American development. We return to the contending interpretations of Brett and Burnham at greater length in chapter three, as part of a wider discussion of the Bretton Woods framework and the emergence of the post-war Anglo-American relationship.

Perry Anderson's account of British decline exhibits a similar recognition of the American dimension. But although Anderson treats the impact of American power in a more chronologically extensive manner, the account remains theoretically and empirically limited. Anderson identifies the acceptance of the Special Relationship with the U.S. as a key component of the restoration of British imperial power in 1945. By accepting American imperial power, British elites preserved the traditional class structure and prolonged the existing developmental deficiencies. Decisions made in Washington were now effectively shaping the, 'cycles of reformism' in London. Reflecting upon the failed attempt at modernisation during the 1960s, Anderson notes the failure of the Labour government to reconsider the international position of Britain. While France, 'expelled US bases from its territory, withdrew from NATO's military command, and disavowed the American war in Indochina', Britain, by contrast, placidly accepted its traditional subordination within the American protectorate (Anderson, 1992: 171). After a cooling of the relationship during Heath's courtship of EEC membership in the early 1970s, the relationship between British and American imperialism was revived by the unusual ideological compatibility of Thatcher and Reagan. Anderson's work represents a more sustained consideration of the impacts of Anglo-American development, but there is no explicit or extensive delineation of the patterns and processes central to the constitution of Anglo-American development, and the feedback effects upon the U.S. are never explored. Causality here, as with much of the British decline literature, runs along a one-way street, with the U.S. shaping Britain but without any comparable impact of British development upon the U.S.

Much like Anderson's essay, Henk Overbeek's study places significant analytical weight upon the role of American power in shaping British development. Overbeek (1990: 1) reads the evolution of British capitalism in conjunction with the development of the capitalist world system, identifying different hegemonic 'concepts of control' employed by ruling groups in conjunction with distinct phases of capital accumulation. Britain's post-war reconstruction was strictly limited by the contours of U.S. hegemony and, crucially, American power provided the framework within which the City's internal dominance could be restored. American support for sterling's international role and acceptance of the continuation of the Sterling Area, contributed to persistent capital outflows and the repeated balance of payments crises associated with the stop-go cycle of the 1950s and 60s. American investment, first through the Marshall Plan and later through private inflows, underpinned the international financial position of Britain and led to a deeper economic integration between the two states (Overbeek, 1990: 91-105).<sup>9</sup>

Most importantly, Overbeek (1990: 33 & 108) describes the manner in which U.S. hegemony underpinned the City's restoration as an international financial centre and, in the process, enabled the continued pre-eminence of the City-Bank-Treasury nexus within British capitalism. Similarly to Strange, Overbeek is aware of the financial dimension of the transatlantic relationship, particularly in regard to the birth of the Euromarkets, but includes it only as a component of the broader concern with decline. Despite the limited scope of Overbeek's treatment of Anglo-American development, his study offers by far the

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<sup>9</sup> Overbeek (1990: 91) identifies the misuse of the Marshall Plan funds by British policy makers and capitalists as serious failing. By investing the funds overseas, British investors missed the opportunity for the sort of thoroughgoing modernisation that British industry required.

most promising methodological potential of all the decline literature. It is in Overbeek's work that we can first see genuine clues as to how a methodology that captures the political economy of the Special Relationship might be constructed.

All of the above studies have, in different ways, contributed towards revealing the importance of post-war Anglo-American dynamics to shaping Britain's role within the global economy and setting the contours for the subsequent development of British capitalism. What they collectively fail to excavate, however, is the re-emergence and intensification of an Anglo-American developmental field during the post-war period, which continued to shape capitalist development on both sides of the Atlantic as well as the wider international monetary system, during the decades that followed Bretton Woods. Anglo-American developmental interdependence had been prominent during the 19<sup>th</sup> century, and it became more important during the 1920s as Britain and the U.S. played central roles in attempting to reconstruct the gold standard. During this time, the political economy of the City and sterling became increasingly intertwined with the development of New York and the dollar. It was this nascent field of developmental interactivity between Britain and the U.S., hinging upon the interdependence of their respective currencies and financial centres and the state institutions within which they were imbricated, that would re-emerge during the post-war period and play a central role in shaping the construction and subsequent collapse of the Bretton Woods system.

This force field of Anglo-American development exerted a generative influence both on the development of Britain and the U.S., but also upon the wider institutional basis of the international monetary system. Because of the systemic importance of Anglo-American



banking, and the centrality of sterling and the dollar as the dominant international currencies, Anglo-American developmental dynamics were central to the composition and decomposition of the post-war international monetary system. Despite the decline of British economic power, it remained central to the politics of the international monetary system. American bankers and government agencies of the U.S. recognised the need to articulate American financial power through a subordinate and increasingly integrated British financial system that became part of a transatlantic financial axis hinging upon New York and London, which lay at the heart of a rapidly globalising political economy. For their part, bankers and government officials in Britain increasingly recognised the need to draw in American financial power and capacity in order to maintain their own national dominance and international standing. These actors and interests constituted the core of the political economy of the Special Relationship, exerting a major impact upon the development of the global political economy, not only during the formation of Bretton Woods, but also with the hugely important development of the Eurodollar market from the late 1950s and the attempt to instantiate an increasingly liberalised international financial system under floating exchange rates during the 1970s and 1980s. Why then, have these dynamics not been properly uncovered or explicated? The answer lies only partly in the deficiencies of the 'declinist' literature that we have reviewed above. It also stems from the ambiguity and contention surrounding America's post-war status within the global political economy.

## **U.S. power: redefinition or retreat?**

The preoccupation with decline and failure to consistently examine Anglo-American developmental dynamics has, as we have seen, limited our understanding of British development and obscured an important set of institutional mechanisms that have been central to the transformation of the global political economy. Apart from studies that focus upon the immediate post-war years, a sustained discussion and methodological incorporation of the impact of U.S. power has been neglected. This is partly due to the preoccupation with decline, which has largely confined the interest in Anglo-American developmental interaction to the first decade of the post-war period, where the shape of the emerging Special Relationship is suggested to have concretised British decline by restoring and prolonging the pre-existing deficiencies of British capitalism.

Oversight on the part of contributors to the decline debate is not, however, exclusively responsible for the absence of long-term analyses of Anglo-American development. Ambiguities within IPE have also played a very important part. Firstly, there has been no consensus established over the question of whether or not American power has been in retreat. A number of influential studies have suggested that the United States was a hegemonic power in the early post-war period (Keohane, 1984; Cox, 1987; Gilpin, 1987; Arrighi, 1990; Rupert, 1995). While realist studies saw this hegemony as being rooted in material power predominance and liberals understood it as an imbrication of state power within international regime building, critical theorists pointed to the class and ideological dimensions of American hegemony arising from the expansion of Fordist

accumulation regimes. Despite the consensus over American predominance post WW2, there is much more ambiguity over whether or when this hegemonic power began to decline.

Prompted by turbulence in international affairs, a debate over American hegemonic decline began in the late 1960's. While a number of scholars suggest that American power has experienced a pronounced decline, a contending group proposes that American power has been redefined rather than suffering terminal retreat. The debate over American decline has created ambiguity regarding the form and extent of American power and its projection and impact upon subordinate states.

Those theorists who have contested the notion of U.S. decline have done so by evoking the concept of American 'structural power'. Whilst this is a useful heuristic concept, it is extremely difficult to operationalise methodologically. A further problem relates to the absence of clear indicators of American power being exerted over Britain. In the earlier post-war period the Washington Loan negotiations are often examined as a key example of U.S. leverage being applied to Britain. Unfortunately, similarly clear criterions of U.S. power are harder to identify over the longer span of Anglo-American development.

Beginning with proponents of the decline thesis, Robert Keohane suggests that U.S. hegemonic leadership peaked during the long decade of the 1950s (Keohane, 1982: 49). Industrial and financial dominance, allied with overwhelming military-political power, enabled America to adopt a relatively benign posture towards Western capitalism. This form of US leadership was, however, short-lived. The U.S. contracted a 'disease of the

strong' by refusing to adapt to change and failing to reproduce the conditions of its earlier success, namely trade dominance and monetary control (Keohane, 1982: 66-68).

Following from Keohane, Krasner (1982) correspondingly proposes that U.S. power has been in decline since the late 1960's. The increasing discord experienced in the coordination of international economic relations during the 1970's testified to the diminishment of America's hegemonic control. The 'overwhelming power of the U.S.' had formed the 'central structural characteristic' of the immediate post-war period. In this era U.S. power dominated not only at the aggregate level, but also over a 'wide range of specific issue areas'. This period was characterised by America's commitment to internationalist goals that benefited the whole of Western capitalism and not just American national interests. But from the late 1960's, as American power began to decline sharply, nationalist policy goals began to re-emerge and hegemonic considerations fell by the wayside. Nixon's delinking of the dollar from gold in 1971 signalled a shift in the international stance of the U.S. After this point American leaders were no longer amenable to sacrificing national interests in order to promote global economic prosperity (Krasner, 1982: 33-42).

Approaching the question of US decline from a different angle, Robert Gilpin locates the retreat of American power within the growing disconnect between multinational corporate interests and American national interests (Gilpin, 1975: 6-8). Gilpin challenges the wisdom of pursuing corporate expansion through foreign direct investment, arguing that overinvestment abroad at the expense of the home economy would lead the U.S. to

experience a similar decline to former world powers.<sup>10</sup> After the mid-1960's U.S. investment abroad signified decline rather than ascendance (Gilpin, 1975: 46-47).

Whether or not American power has declined from a post-war peak is of course a crucial question. How we answer that question informs our understanding of the contemporary global political economy and the structures of state power and authority that shape it. Yet the focus upon delineating decline has served to push other questions and concerns into the background. IPE scholarship has become too concerned with the what, why and how of U.S. decline, to the neglect of the underlying developmental processes that have defined America's role within the post-war international political economy. In particular, the constitutive role of the U.S. in shaping the global political economy recedes from vision, with attention turning to the level of material capacities and the scope of American interests that are taken to guide American statecraft. By already accepting the legitimacy of the hegemonic cycles approach to understanding IPE, these accounts become fixated upon exploring the transition from hegemony to decline rather than tracing the manner in which the development of American capitalism has continued to shape the global political economy. Methodologically, the analyses remain fixed on U.S. power as a national question, but this neglects the extent to which the American state had already been internationalised in the process of reconstructing global capitalism after WW2, through the formation of Bretton Woods, the promotion of the international role of the dollar, the extension of New Deal institutional patterns into Western Europe with the Marshall Plan. The debate over U.S. hegemonic decline further obscured key process of American state

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<sup>10</sup> Here he points to the Netherlands and in particular Britain whose historical decline is used as a point of comparison for American development (Gilpin, 1975: 63).

internationalisation during the 1960s and 1970s, first in the attempt to maintain the Bretton Woods order and then with the instantiation of an international monetary system based on floating exchange rates (Panitch & Gindin, 2012: 7-13).

In response to the prevalence of decline arguments within American academic circles in the 1970's and 80s, contending theorisations of structural power were developed. The general thrust of these arguments is that the international system had been transformed by the growing interconnection of the global economy. This transformation meant that structural power was now more significant than relational power (understood as the power of A over B) traditionally examined by realists. These accounts of structural power were intended to draw attention to the continuing imbrication of American dominance within the systemic transformation of the global political economy, precisely the dynamics that the declinist arguments had neglected.

Susan Strange (1987: 565) provides the most concise definition of structural power as 'the power to choose and to shape the structures of the global political economy within which other states, their political institutions, their economic enterprises, and their professional people have to operate'.<sup>11</sup> Structural power is rooted in four distinct yet related spheres: security, knowledge, production and finance (Strange, 1988a: 26). As the nature of relationships between states changed, from the mid-1960's onwards, structural power became more important (Strange, 1987: 553). America benefited from this transformation, with its structural power increasing. Strange points to continued American financial and military dominance as evidence of this enduring power (Strange, 1988b: 7-8).

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<sup>11</sup> For a fuller discussion of the concept cf: Susan Strange (1988), *States and Markets: An Introduction to International Political Economy*, London: Pinter Publishers: 23-28.

In a comparable manner to Strange, Stephen Gill focuses upon the structural transformation of the post-war global political economy. Gill denies that U.S. power was in decline during the 1970's and 80's, arguing instead that, 'American centrality in the global political economy has changed and in some respects has been re-emphasised'. What was occurring during the supposed period of U.S. hegemonic decline was in fact a change in key social forces within global capitalism (Gill, 1990:3-7).

Critiquing the notion of US hegemonic decline, Gill's work challenges realism's state-centric understanding of American power. Gill argues that Realist's empiricist methodology and preoccupation with Weberian 'power over' leave them unable to understand the foundations of U.S. hegemony. Realists accordingly neglect the structural and cultural dimensions of American power. They also underestimate the degree of systemic transformation attendant to the global expansion of U.S. corporations and the emergence of a more interdependent world economy. Concluding his challenge, Gill proffers that, 'the basic structural continuities in the American neo-imperial system have remained intact' (Gill, 1990: 63-86).

The interpretations offered by Gill and Strange are important correctives to the preoccupation with decline that had come to shape studies of American power. By shifting our attention to structural dimensions of American power, they are able to elucidate the continuing influence of the U.S. in shaping the parameters of action within the global economy and promoting American interests in the process. In order to trace more concretely the intersection of American power with British development however, we need to achieve a greater disaggregation of the institutional power bases within the American

state than these accounts provide. By doing so, we can move beyond a broad concern with structural power, towards a framework that enables us to chart the co-articulation of developmental processes central to the political economy of the Special Relationship. Several studies that have attempted to disaggregate the concentrations of institutional power within the U.S. help bring us closer towards achieving this end.

Peter Gowan's study of American dominance illuminates the privileged position of the U.S. within the global financial and security structures. For Gowan the continued dominance of the U.S. into the current era rests upon two key elements. Firstly, Gowan identifies the global 'Protectorate System' that the U.S. employed during the Cold War and has since extended in the post-Cold War era. The Protectorate System pacified relations between core capitalist states by enabling a qualitatively new form of globally extensive U.S. sovereignty. The Protectorate System enabled the U.S. to set limits upon the actions of other states, to define the terms of the security climate and perhaps most importantly to behave exceptionally with regard to the rules that constrained others (Gowan, 2003: 1).

Accompanying the Protectorate System is the second axis of American structural power: the 'Dollar-Wall Street Regime', in which the interaction between The Federal Reserve, Treasury and Wall Street are central (Gowan, 1999: 19). It is this aspect of Gowan's study that is most relevant to our present purpose. Regarding the financial transformation of the Nixon era, Gowan identifies the enactment of a new global monetary regime based solely on the dollar as a means to restore the international dominance of American power (Gowan, 1999: 23). For Gowan, then, the collapse of the Bretton Woods



system did not signal the faltering steps of a stumbling hegemon. It signalled the reassertion of American financial muscle over the rest of the capitalist world.

Echoing Strange and Gowan, Panitch and Gindin (2009: 32-36) argue that a global financial system centred upon New York capital markets and American debt testifies to the continued supremacy of the U.S. Under this interpretation, Bretton Woods was intended as a cradle for American finance. American financial power would be liberated from restrictive measures once sufficient redevelopment of the global political economy had occurred. The crisis of the later 1960's and 1970's is understood not as evidence of declining American power, but rather, 'the difficulty of controlling and steering a financial system that was bursting at the seams' (Panitch & Konings, 2009: 3).

Panitch and Gindin go beyond Gowan by providing a much deeper historicisation of the Federal Reserve-Treasury-Wall Street nexus. Their analysis is intended as a counterpoint to the way in which Gowan downplays the links between Wall Street and Washington throughout the entire post-war period by stressing their centrality only from the 1970s onwards. This nexus of power within the American state was progressively internationalised as American capitalists and state officials sought to refashion global capitalism and steer globalisation, transforming the international orientation and characteristics of other capitalist states in the process (Panitch & Gindin, 2012: 1-15)

The particular emphasis placed upon the role of the U.S. Treasury, the Federal Reserve and Wall Street in shaping global capitalism is common to the interpretations of

Gowan, Panitch and Gindin<sup>12</sup>. By bringing attention to the role of the U.S. in 'making' global capitalism, Panitch and Gindin draw us towards an extremely important appreciation of the role of the transformation of American state capacities in driving the development of global capitalism. This focus takes us away from the preoccupation of structural power theories around the way that the U.S. defines the parameters of action, or the limits of the possible, and towards the role of American agency in actually constituting classes, states and their interests through interaction with other states within the global political economy.

Focus upon this nexus of financial power within the U.S., and its constitutive role in shaping the global political economy, draws us naturally towards the Anglo-American dimension, as there has been a profound and unusual symmetry between the core institutional complexes of capitalist power in both countries. The 'Federal Reserve-Treasury-Wall Street' complex at the heart of American financial power, has been articulated in and through the central nexus of power within the British state; the City-Bank-Treasury nexus. This process was central to the way in which the gradual diminishment of British power has interacted with American ascendance. By examining the dynamic interactions of these two institutional nexuses, through which the intersection of private and public financial power is produced and reproduced, we are able to position the problematique of Anglo-American development within the context of the international monetary system and the politics of financial globalisation.

Britain played a privileged role in the formation of global capitalism during the nineteenth century by sponsoring free trade and financing global capitalism through the

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<sup>12</sup> See Martijn Konings (2011) *The Development of American Finance*, Cambridge: Cambridge University Press, for a further study employing this framework.

commercial operations of the City of London. Under the classical gold standard, the pound sterling functioned as the key international currency, with the Bank of England and the British Treasury playing a crucial role in managing and underpinning the system. The precondition of American capitalism's modern ascendance then, with the post-war dominance of American banks, American corporations and the U.S. dollar, was the decomposition of the old international financial system centred around Britain. During the reconstruction of global capitalism under U.S. leadership, the Federal Reserve and the U.S. Treasury have played increasingly important managerial roles.

In both countries, the integration of private banking power with key financial institutions of the state has been central to their modern development. It is through this central nexus between private finance, Treasury control and central banking that capitalist power is principally instituted within the state. The Treasury and the Central Bank function as two related components of the government account (Wray, 2012). The Treasury is empowered with the capacity to spend, tax and issue public debt, while the Central Bank sets interest rates, regulates credit supply, governs the exchange rate and pursues price objectives while also serving as the lender-of-last-resort to private banks. Through these interrelated processes, the behaviour of Treasuries and Central Banks are crucial to regulating and shaping the overall flow of national economies and their situation within the broader world market.

There is, therefore, a fundamental interdependence between these public and private components of capitalism instituted at the heart of the state and enacted through

fiscal policy and monetary policy.<sup>13</sup> Contrary to the prevailing neoliberal discourse, which tends to view 'states' and 'markets' as opposing interests and clearly differentiated spheres of activity, the reality of economic activity within a modern capitalist system points to a much deeper functional co-articulation between 'market' and 'state' power. To examine how this co-articulation has unfolded within Anglo-American development, we need to move beyond structural power and towards a more dynamic conception

### **Beyond structural power: power as process**

This study shifts our focus towards elements of American power that are not adequately captured by the concept of structural power by exploring Anglo-American development through the interactions between the key centres of financial power within each state and the way that these interactions occurred through the institutional architecture of the international monetary system. Over the long run, we can see that the power interactions between Britain and the United States have been diverse. They have ranged from more direct and explicit forms of American leverage over the British state, to a more indirect and often unintentional impact upon the trajectory of British development. But even within the context of these more indirect and direct forms of power there are further nuances. The power exerted over Britain during the Washington Loan negotiations was much more explicit than with the IMF loan of 1976, where the American influence was refracted

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<sup>13</sup> See Randal Wray (2012) *Modern Money Theory: A Primer on Macroeconomics for Sovereign Monetary Systems*, 102-108, Basingstoke: Palgrave Macmillan, for a more detailed discussion of this process.

through the medium of the IMF's institutional power and the political imperatives of other contributing states. It was American imposition at one remove, through the mediation of an international financial institution and multilateral bargaining. There are, therefore, instances both of direct, and more discreet, impacts of American power upon Britain.

As a concept, structural power is unable to capture these nuances. This is particularly the case because, according to Strange, structural power did not become prevalent until the 1960s. Strange's dualism of relational and structural power also overlooks the fact that both forms of power always involve fluid power processes that occur over a diachronic horizon. In this sense structural power implies a misleading sense of stasis that obscures the micro-dynamism of capitalist state development within the international political economy. Studying Anglo-American development over the longer run, then, requires a more chronologically extensive conception of American power. It is better to think in terms of power as a set of dynamic *processes rather than exclusively as structural presence or ordering*. Power through processes certainly draws upon and mobilises the resources, both material and ideational, associated with structural power, but it implies a more dynamic and formative sense of co-development between interactive national capitalisms.<sup>14</sup>

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<sup>14</sup> Robert Cox's influential work (1992: 30) on the 'internationalisation of the state' captures some of this notion of power as process, identifying the transformation of the state within the context of broader developments within the global political economy that led social forces to reorient the state towards transnational capital. But Cox's 'outside-in' approach to understanding this process, relies upon too neat a delineation between the global and national economy (Panitch, 1994: 71) while his analysis also understates the continuing centrality of the U.S. in driving these dynamics. Cox's theorisation is taken up at greater length in chapter five.

Structural power too often posits a one-way monolithic impressing of American power onto the broader global political economy. Contrary to the notion of structural power, American policies and practices often ended up constraining and delimiting the possibilities for American development and not only subordinate states. The stress placed on the American state's capacity to 'choose and to shape the structures of the global political economy within which other states, their political institutions, their economic enterprises, and their professional people have to operate', fails to capture the unintended and unexpected outcomes of co-development between capitalist states (Strange, 1988a: 26). Although the lines of causality here are complex and uneven, with American power a much more decisive factor in British development than vice versa, there is an important developmental feedback loop that has also impacted the U.S. and the wider global political economy.

By shifting the focus to development as a set of dynamic processes driven by unstable combinations of private and public power, occurring over different temporal horizons and initiated by different class actors within different institutional settings, we arrive at a more fluid and diachronically extensive notion of American power that can inform the problematique of Anglo-American development. These power processes feed into the composition and decomposition of historically instituted frameworks of social power, which constitute the global political economy. Nationally, the most significant transformation has been the shift from the Keynesian form of post-war capitalism to the contemporary neoliberal state. Internationally, the transition from the Bretton Woods framework to the Post-Bretton Woods system is paramount.

Anglo-American development must, therefore, be contextualised within the creation, continuation and collapse of the Bretton Woods system of international monetary relations. At this point we can return to the discussion of Helleiner's work with which we began. Although Helleiner is aware (1994: 14) of the predominance of the City-Bank-Treasury nexus in shaping British development, his explanation of Britain's orientation towards the politics of the international monetary system as a consequence of a 'lagging' hegemonic policy, essentially a hangover from the nineteenth century, leads him to understate the dynamic role of this nexus and the way that it actively reconstituted its interests and strategies through interaction with the U.S. and the financial power of Wall Street.<sup>15</sup> In the process, Anglo-American development played a central role within the politics of financial globalisation. Although his work intelligently recognises the central importance of Britain and the U.S., Helleiner is unable to tease out the contours of Anglo-American development and the constitutive role of the political economy of the Special Relationship in shaping the transformation of global capitalism.

Helleiner's work never explicitly considers where the institutional nexus between private and public financial power lies within the capitalist state. The dynamics that drove towards the eventual collapse of the Bretton Woods regime did not emerge exclusively from the strategic actions of states. Instead, they frequently emerged from a haphazard construction of regulatory imbalances and developments that were authored through

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<sup>15</sup> In applying the concept of 'hegemonic lags', Helleiner draws upon Stephen Krasner's analysis of British international trade and monetary policy. According to Krasner, 'the British state was unable to free itself from the domestic structures that its earlier policy decisions had created, and continued to follow policies appropriate for a rising hegemony long after Britain's star had begun to fall' (Krasner, 1976: 342). Thus, institutions created during a period of hegemonic ascendancy came to exert static and 'lagging' policy orientations long after that ascendancy had passed.

private/public interactivity and which drew in international actors, provoking broader responses in international policy. Within these transformative processes, the interactions between Britain and the U.S. were, as this thesis demonstrates, very important.

In some instances, these Anglo-American developmental processes were driven by American leverage power 'pushing in' on Britain, as in 1945 and again in 1976. At these moments, some British state officials resisted the imposition of American power. But at other moments in the lineage of Anglo-American development, it was more a case of bankers and officials within Britain 'pulling in' American power in order to further their own ambitions. This was very much the case with regard to the emergence of the Eurodollar market during the 1950s and 1960s, when the City sought to restore its international standing by drawing in the dollar and embracing American financial power. The American's have also retained the disciplinary option of 'pulling out' their support for Britain, particularly during the crisis years of Bretton Woods, when Britain was heavily dependent upon recourse to financial support. Over time, these combinations of pushing in, pushing back, pulling in and pulling out have been part of a dynamic reconfiguration of sovereign power between Britain and the U.S. as a feature of the uneven co-articulation of Anglo-American development.

This dynamic has also impacted the articulation and extensity of spheres of *sovereign* and *private* power within Britain.<sup>16</sup> As the British state was transformed through the decomposition of Keynesian capitalism and the emergence of neoliberal capitalism, a

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<sup>16</sup> For a more focused and extended discussion of the evolving dynamics between private and public power within IPE, cf: Stephen Gill (1995) 'Globalisation, Market Civilisation, and Disciplinary Neoliberalism', *Millennium Journal of International Studies*, 24: 399-423; Claire Cutler (1999) 'Locating "Authority" in the Global Political Economy', *International Studies Quarterly*, 43(1): 59-81.



process shaped by and through American power, the balance and interaction between sovereign power and private capitalist power, has altered. With regard to the banking communities on each side of the Atlantic, a compatibility of interests and accumulation imperatives has frequently acted as a centrifugal force drawing British and American capitalism together.

Methodologically the constructive and destructive consequences of these interactive developmental processes, the way that they create certain potential state and capitalist strategies while negating others, can best be uncovered through a strategy of *tracing*. This requires us to explore developmental interaction by uncovering the origins, charting the processes and examining the outcomes of interactive international development. The focus on the articulation of the City-Bank-Treasury nexus through its relationship to the Federal Reserve-Treasury-Wall Street nexus provides an institutional basis for exploring the political economy dimension of these processes. The following chapters seek to flesh out these suppositions.

The following chapters mobilise this methodology to explain a number of key moments in the development of British capitalism, reading those moments through the lens of Anglo-American development and situating them within the broader transformation of the international monetary system. Rather than selectively drawing on Anglo-American development to explain decline, I explore key moments and processes that were important not just for British development, but also in terms of their impact and ramifications upon the wider global political economy.

## **2 The Great Reversal:**

### *Anglo-American Development from the Nineteenth Century to the 1930s*

In the middle of the nineteenth century, Britain was at the peak of its power, having achieved naval dominance and with it an unprecedented role at the centre of the burgeoning world economy. Sterling functioned as the dominant trading and reserve currency around the world and the City of London was the principal centre for international finance. The spoils of empire had conferred enormous wealth upon the members of Britain's ruling elite who invested their capital around the world to handsome reward. Britannia's predominance looked set to endure indefinitely.

Beneath the surface appearance of enduring power, however, British predominance had in actual fact already reached its zenith. It would rapidly diminish during the latter decades of the nineteenth century, and the rise of the U.S. would play a key role in this transformation as the development of the two countries became increasingly central, not only to their own futures but to the future of the international economy as a whole. From a colonial province of the British Empire in the 18<sup>th</sup> century, the United States had become, by the end of WW1, an industrial giant and growing financial power to rival Britain. The shift from British dominance to American primacy has been understood largely in terms of hegemonic transitions between great powers. For a series of scholars the two countries serve as exemplars of 'hegemonic leadership', and the tale of their respective rise and decline serves as a template for the history of modern international relations (Gilpin, 1987;

Cox, 1983; Keohane, 1984; Arrighi, 1990). Despite this emphasis, little heed has been paid to the mechanisms that account for the changing fortunes of the two powers in their mutual relations, or the attendant consequences for their national development and that of the international economy as a whole. This chapter attempts to correct that deficiency by exploring Anglo-American developmental dynamics, with a particular focus upon financial relations between the two states. The period is important not only because of the great reversal in Anglo-American power dynamics, but also because the developments of the 1920s and 1930s were instructive for the post-war planners who drew up the Bretton Woods system of international monetary organisation (Pauly, 1997: 45). As the processes driving this great reversal in the relative standing of Britain and the U.S. intensified, their increasing economic interdependence meant that the future of the international economy came to rest ever more upon the potential for a twin pivot of Anglo-American cooperation, with the national development of both countries increasingly expressed in and through the development of the international monetary system.

This chapter provides an overview of Anglo-American development from the nineteenth century up to the outbreak of WW2. The central argument is that American ascendancy and the deterioration of British power fostered an increasing level of economic interdependence, expressed most clearly in the intertwined fortunes of London and New York alongside the pound and the dollar. As Britain's capacity to singularly underpin the international monetary system weakened, a process greatly accelerated by the war, greater cooperation between the financial communities became a necessary cornerstone of the emerging Anglo-American axis of the international economy. The City of London was forced

to draw in American financial power in order to restore its domestic and international hegemony, in a manner that foreshadowed the way in which the City would draw upon the dollar's strength under the Bretton Woods system.

But although cooperation intensified after the war, there was still a great deal of rivalry as the U.S. sought to employ British war debts as a lever to weaken British power and clear the way for American expansion. Ultimately, the informal and ad hoc patterns of Anglo-American cooperation proved too weak to hold together the reconstructed gold standard, and the politics of sterling and the dollar were fundamental to its collapse and the emergence of rival financial blocs during the 1930s. This was not merely a failure of the U.S. to take on appropriate responsibilities under the new gold standard, but also a consequence of the enduring deficiencies of its financial system to play such an internationally calibrated role (Konings, 2011: 71). It was only in the post-WW2 period, with the institutionalisation of the Bretton Woods agreement, that Britain and the U.S. would play a formalised role within an increasingly multilateral international monetary system that rested no longer upon the supremacy of sterling, but on the unrivalled strength of the dollar and the U.S. economy.

In the first section, we review the economic interdependence of Britain and America during the nineteenth century and outline the role of the classical gold standard at the heart of industrial, trade and financial links between the two countries. American industrial development, fuelled by inflows of British capital, rapidly caught up with Britain's pioneering industrial system. As American ascendance gathered momentum, Britain's stuttering economic development undermined the foundations of the classical gold

standard. But despite the acceleration of American catch-up during the century, it took the outbreak of war in 1914 to really close the gap between the two states, by eroding Britain's financial status and dragging it into the disciplinary orbit of its new American creditor. The First World War also led to an increasing intermeshing between private transatlantic financial power and the financial capacity of the British state, with important consequences for the way in which both Britain and the U.S. would approach the issue of post-war economic reconstruction.

The second section of the chapter then examines the attempt to reconstruct the gold standard and resuscitate the international economy in the wake of the Great War. Britain and Europe suffered the loss of export markets during the war and emerged from it burdened by an enormous debt load and increasingly uncompetitive within the world market. For the U.S., by contrast, the war was a boon for economic development. Whereas the pound sterling lost value and broke from gold, the dollar remained firmly convertible throughout and enjoyed a rapid increase in its international standing as New York attracted more and more business. But although the American financial power was augmented by the war, it continued to lack a sufficient market infrastructure to spur the dollar on to greater heights and entrench New York at the centre of the international payments system. Instead, the narrowing gap between New York and London meant that the two financial centres, and their respective currencies, became increasingly interdependent. This foreshadowed the centrality of these two centres within the Bretton Woods financial system in the post-WW2 era. Increased interdependence necessitated closer cooperation between both private

bankers and central bankers on each side of the Atlantic. But after the American rejection of the Genoa proposals, cooperation emerged only on a limited, halting and ad hoc basis.

Finally, the chapter explores the breakdown of the restored gold standard and the emergence of separate currency and trading blocs within the increasingly rivalrous pattern of international relations that preceded the outbreak of WW2. The behaviour of the U.S. government in attempting to manage national economic development within the context of the gold standard, and continuing to insist on the repayment of war debts, was central to the collapse of the interwar gold standard. Ultimately, I argue, the informal structures of Anglo-American cooperation at the centre of the reconstructed gold standard proved too weak to prevent the international economy from breaking into rival spheres of influence during the 1930s, ending Britain's longstanding commitment to free trade in the process.

### **Interdependence, war, and the rise and fall of the gold standard**

Although American secession from the British Empire was both violent and rapid, a remarkable degree of cultural and economic affinity endured after the separation. The mutual trade dependence of the two nations was inescapable during the first half of the nineteenth century. Britain's early industrial development boosted the Atlantic slave trade and the Southern plantation system. British workers, who emigrated to the U.S. in large numbers during the nineteenth century, brought with them the know-how of industrial production. In the 1820s and 1830s it was Lancashire specialists who were largely responsible for introducing Calico printing to New England (Temperley, 2002: 35-36).

British methods were imported too, with techniques originating from Leeds and Sheffield employed in the wool and iron industries. Great Britain accounted for around half of American exports in 1850 with America deriving one third of its imports from Britain (Holmes, 1976: 11).

There was a strong reciprocal dimension to the balance of Anglo-American trade. So much so that Temperley (2002: 36) encourages us to think of Britain and America not as separate economies, but rather as, 'closely interrelated parts of a single fast-developing web of global credit and commercial enterprise, at the centre of which were the bankers, merchants and insurers of the City of London'. America relied on the import of British manufactured and semi-manufactured goods and its prodigious industrial expansion was nourished by a torrent of British capital, which poured into America in unparalleled volumes during the nineteenth century. In 1854 a quarter of British investment was in U.S. assets, by 1870 it had reached 27% of total foreign investment before declining prior to WW1. Britain was heavily dependent upon imports of American grain and other raw materials (Holmes, 1976: 10).

The international monetary system based on the gold standard was key to the development of Anglo-American economic interdependence. Britain was the originator of, and the main player within, the classical gold standard system of payments. The convertibility of sterling, the world's principal trading and reserve currency, into gold on demand was at the heart of the system. The City of London was home to the most sophisticated clearing mechanisms in the world and the predominance of Britain as a

foreign investor and trader meant that sterling was the dominant international currency with over 60% of world trade denominated in the currency (Eichengreen, 2011: 15).

Other countries followed the lead of the world's preeminent power, with the U.S. moving onto the gold standard by 1879. By the early twentieth century the system was widespread internationally. Under the system, countries promised to exchange currency for gold at a fixed price, with the national money supply underpinned by a correspondent level of gold reserves. The widely shared commitment of governments to maintain convertibility was the cornerstone of the system. Markets had confidence that the required policy measures would be taken in order to maintain the fixed value of currencies in gold terms. The commitment to convertibility generated the level of confidence required for an extensive system of international trade and capital flows (Eichengreen, 2008: 6-29). Britain's economic pre-eminence was central to the stability of the system. British international lending, which served as the major source of liquidity for international trade and investment, was supported by capital goods and merchandise exports that boosted Britain's balance of payments (Block, 1977: 13; Ahamed, 2009: 423). The Bank of England played a key coordinating role at the head of a 'follow-the-leader' convention within central banking, according to which changes in the Bank's discount rate would be followed by foreign Central Banks (Eichengreen, 2008: 41).

Given Britain's financial predominance, it was no surprise that American importers and exporters relied upon London as the principal source of trade credit. Although American financial dependence was a consequence of British financial power, it was also in part a result of the relatively underdeveloped nature of American financial markets. The



American financial system was born out of its British counterpart, but it began to diverge from the British model in significant ways during the course of the nineteenth century (Konings, 2011: 9). Compared to the British model, the American financial system remained fragmentary and lacked an overall network power of concentrated and integrated credit relations. This meant that American traders remained dependent upon the British financial system. Without a Central Bank until the creation of the Federal Reserve in 1913, the U.S. financial system was much more prone to crises, experiencing fourteen in the century before WW1.

The gold standard's reliance upon British pre-eminence was, paradoxically, both the source of its strength and its fundamental weakness. As Britain lost ground to competitors towards the end of the nineteenth century, its status at the centre of the system began to weaken. The United States led the pack of late industrialising countries that began to catch up with and overtake Britain. Railway mileage in America, a key indicator of industrial development, expanded rapidly between 1850 and 1860; increasing from 9000 to 30,000 miles and fostering a large internal market (Holmes, 1976: 13). Railway expansion also played a key role in the increasing concentration of ownership in America and the associated development of the holding company. A great wave of industrial mergers during the 1880s and 1890s gave birth to giant enterprises.

America was much less dependent upon foreign trade for its industrialisation, benefitting from the existence of an increasingly large internal market and a generous endowment of natural resources important for industrial development (Holmes, 1976: 74; Temperley, 2002: 66). In the second half of the nineteenth century America began to

diversify its exports, shifting towards higher value-added manufactured goods. Up until the 1860s America ran a deficit on both the balance of trade and the balance of payments, with interest charges on British capital accounting for the latter. But during the 1870s America began to achieve balance of payments surpluses in some years. Britain on the other hand, never experienced surpluses on the balance of trade but did consistently achieve balance of payments surpluses through earnings from 'invisibles' such as banking, insurance and merchant shipping (Holmes, 1976: 90).

By the eve of WW1, the economic gap between the two nations had narrowed considerably. American growth, from 1870-1914, outpaced that of Britain (Holmes, 1976: 25). Population growth, a larger country and an entrepreneurial class ready to invest capital were among the factors that combined to produce rapid American catch-up. Britain was still reliant on the older industrial activities of the first Industrial Revolution: coal, steel, iron and shipbuilding. Moreover, while Britain still depended heavily upon American imports, the U.S. had effectively undertaken to diversify away from reliance on British markets.

Overall, economic primacy had shifted towards America, which surpassed Britain as the world's biggest manufacturing nation (Allen, 1956: 29; Dimpleby & Reynolds, 1988: 34). In more general terms, Britain's relative power was diminishing by the turn of the twentieth century. Between 1870 and 1910, Britain's share of world manufacturing capacity decreased from 32% down to 15%. The British share of world trade decreased from 25% down to 14% in the same period (Temperley, 2002: 89). Now it was Britain who looked to the U.S. for the latest techniques in manufacturing and industrial know-how. In

chemicals, automobile manufactures, industrial management and electrical goods, America led the way. We begin to see in this period the first wave of American corporate expansion into Britain: Singer opened a factory outside Glasgow in the 1860's while Ford opened a large factory in Manchester in 1908 (Temperley, 2002: 90). The great reversal had begun to gather momentum. Crucially however, *Britain remained predominant in matters of international finance; still performing a role as the world's principal creditor*. Strength in shipping and other invisibles continued to serve as a substantial source of national income.

Although the American's had caught up in terms of industrial prowess and merchandise exports, the U.S. financial system remained insufficiently mature to service international markets. American banks were prohibited from establishing branches overseas and national banks were also forbidden from dealing in trade credit up until the Federal Reserve Act of 1913. The lack of foreign branches made it very difficult for American banks to support their clients abroad. Although private banks such as J.P. Morgan and Company were not burdened with these restrictions, they still did not move into the financing of U.S. foreign trade on a large scale. The major problem for American banks was the cost advantage enjoyed by London. Interest rates and risks were lower in London, as the existence of a broad population of investors to whom trade acceptances could be resold, gave the market a highly liquid character. The well-developed market meant that there was little uncertainty over the price that could be obtained when discounting a bill. London also had the benefit of a Central Bank that would step in to rediscount bank's securities when they needed to cash them, with the effect of stabilising the market (Eichengreen, 2011: 17-20).

It would take the outbreak of war in 1914 to dislodge Britain's financial predominance, and even then the U.S. would not be able to establish itself in a comparable manner. The war brought an end to the gold standard, with the increased rivalry and military tensions within Europe having undermined the financial solidarity that underpinned the gold standard. Countries then sought to cordon off their gold supplies and suspend convertibility in order to pay for essential materials (Block, 1977: 14; Eichengreen, 2008: 42).

At the outbreak of war the U.S. remained the junior partner in the Anglo-American relationship. By the time peace fell across Europe in 1919, a drastic turnaround had occurred. War sapped the strength from Britain while swelling American coffers and emboldening her leaders. Britain was now forced to go cap in hand to her American ally. The primary mechanism of this reversal was the *power of credit*. It was a lever of power that the U.S. would use to great effect in order to break European predominance in the post-war world.

Although the reversal of credit-debtor relations was enormously significant for inter-governmental relations between the two nations, private power played a major role. During the three years of American neutrality, from 1914 to 1917, the House of Morgan banking dynasty supplied liquidity to the Allied war effort. Not only did the House of Morgan raise funds through placement of British and Allied bonds in the New York money market, by 1915 it was also the exclusive purchasing agent for all Allied acquisition of goods from the United States (Burk, 1985: 19; Chernow, 1990: 187).

The House of Morgan grew out of the massive import of European capital into American during the nineteenth century. Financial relations between the U.S. and European countries gave rise to investment banking houses that dealt in foreign exchange and orchestrated the sale of American securities to European investors (Corey, 1969: 42). By the late 1860s, the House of Morgan organised the majority of British investments in the U.S. These investments were large. By 1869 Europeans owned around \$1 billion of American government bonds and around \$465 million of American corporate securities (Corey, 1969: 87). More than any other activity, it was railroad expansion that accounted for the largest amount of foreign investment.

The investment bank oversaw centralisation, enabling it to acquire overall discretion over the paramount issues of business management. J. P. Morgan's predominance heralded the more general historical shift towards investment bank's strategic control over industry at large within the U.S. Having achieved unprecedented consolidation in the control of assets within the U.S., the House of Morgan looked abroad for new opportunities. Nearly all of the industrial combinations controlled by Morgan's took a dynamic role in America's budding imperialism, investing large amounts of capital overseas (Corey, 1969: 333). This was part of a larger competition with European investors in China and Latin America. Morgan's overseas ambitions received active encouragement from the American government (Corey, 1969: 333; Chernow, 1990: 132).

The U.S. government had adopted a stance of formal neutrality towards the belligerents. This foreclosed the possibility of the U.S. Treasury raising funds for Britain through placements of British bonds in America. Private banking was the only remaining

alternative: the House of Morgan duly stepped forward. An avowed anglophile, John Pierpont Morgan spent half of every year in Britain (Dimpleby & Reynolds, 1988: 45; Owendale, 1998: 12). Crucially, the House of Morgan had no major linkages to German industrial firms, leaving the way clear for unrestricted engagement with the Allied cause (Burk, 1981: 27). This engagement came at huge risk: if Britain lost the war Morgan's would likely be bankrupted. But beyond the raw profit motive, genuine sentiments of Anglo-American patriotism conveyed in private communications between the American and British branches of the bank, appear to have played a key role in the decision (Burk, 1985: 27).

By 1915 Morgan's had become the sole purchasing agent for the Allies. Not only did Morgan's purchase goods, they also initiated an expansion of new productive capacity to meet surging Allied demand. Financiers and manufacturers were brought together to accept huge contracts from the British government (Burk, 1985: 24). The disordered competition and inflation that attended early Allied purchasing was brought under control by the Morgan monopoly. As Allied orders increased, Britain's financial dependence rose accordingly. Already by October 1915, the House of Morgan had arranged a loan of \$500 million to be spent by the Allies on American purchases, by the war's end, the House of Morgan had raised over \$1.5 billion in Allied credits (Corey, 1969: 423; Chernow, 1990: 200).

Private lending was virtually extinguished once the U.S. Treasury monopolised the creditor function after joining the war effort. The American government established enormous control over the U.S. economy, setting prices and directing industry (Corey,

1969: 426; Burk, 1985: 57). Morgan's power was greatly diminished as a consequence, with the American government placing loans and organising purchases. Wartime state of emergency enabled a massive reassertion of government sovereignty over economic activity.

Undoubtedly, America's participation in the war swung the conflict in the Allies' favour. America's vast resources were immediately brought to bear on the war effort. *But it also meant that the legacy of inter-Allied borrowing would be intensely politicised, creating a major bone of contention in the post-war political economy.* Although temporarily maligned, the House of Morgan continued to play a key role in Anglo-American relations in the post-war period of reconstruction and uncertainty. Indeed, its efforts were central to the disastrous attempt to restore the gold standard during the 1920s, as the cooperation between Anglo-American bankers became increasingly important in shaping the international economy.

### **Resuscitating the gold standard**

As the guns fell silent across Europe in November of 1919, the dust settled upon a radically altered landscape. Many of the old certainties of the international order had been shaken at their foundations, none more so than Britain's position at the apex of international power.<sup>17</sup> The war greatly destabilised the international economy. While American industrial power had increased, European economies had been gravely weakened and their currencies

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<sup>17</sup> In continental terms, Europe had clearly been weakened through its internal warring. America and Japan both experienced an increase in their relative power as a consequence.

experienced major instabilities (Eichengreen & Temin, 2000: 194). In the aftermath of the war, the international economy was blighted by overproduction, overcapacity and rising inflation (Holmes, 1976: 107).

For Britain, economic adjustment to the post-war world would be painful. Two of Britain's key industries, shipbuilding and steel, were hit hard by overproduction and overcapacity. International competitors had emerged and world demand had slackened. To add to this, British industrial dominance in coal and textiles was also under threat.<sup>18</sup> Wartime textiles industries in Japan and America posed a particularly sharp challenge (Holmes, 1976: 109). Britain would experience a worsening balance of trade during the 1920s as imports remained high but exports declined markedly.<sup>19</sup> Reliance upon traditional industries (coal, steel, textiles) hamstrung the possibility of export led growth in a more competitive world market (Moggridge, 1972: 29, Dimpleby & Reynolds, 1988: 97). Even Britain's longstanding predominance in 'invisibles' was under threat. Around seven hundred thousand tonnes of merchant shipping were lost during the war.

Nowhere was the transformation of British power more evident than in the reversal of its financial status. No longer creditor supreme to American industrialisation, Britain was now heavily indebted to the U.S. By March 1920, Britain's overall public debt stood at 7.8 billion pounds. During the 1920s debt servicing consumed a staggering 40% of Britain's budget (Temperley, 2001: 123). The majority of this was owed to the U.S. government and would have to be repaid in dollars. Britain's trade deficit with both America and Canada

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<sup>18</sup> The destruction of merchant vessels during the war hastened the introduction of oil-powered vessels, accelerating the obsolescence of coal (Holmes, 1976: 159).

<sup>19</sup> Britain's trade deficit with the dollar area increased by 156.4 million pounds during the war (Moggridge, 1972: 34)



made this difficult, as did the increasingly protectionist stance of the U.S. during the 1920s (Holmes, 1976: 106).

These changes drastically undermined Britain's capacity to stand at the centre of the international economy as it had before 1914 (Block, 1977: 14; Konings, 2011: 71). As British power waned, American ascendance accelerated. The interactive fortunes of sterling and the dollar were central to this process. From 1915, sterling's value relative to gold had fluctuated, reducing its reliability as an international trading and reserve currency. By contrast, the dollar remained pegged to gold during the period. Because of the dollar's greater stability, importers and exporters throughout Latin America, Asia and the U.S. decided that the dollar was a more appealing unit through which to conduct their business. Although Britain was able to peg sterling to the dollar from 1916, the fears of investors and traders were not allayed. Britain had run up massive wartime budget deficits and was experiencing substantial inflation. The markets rightly anticipated that the pound's value would fall once American support for the currency was withdrawn at the end of the war (Eichengreen, 2011: 27).

Britain's diminishing power contrasted starkly to American ascendance, a process encapsulated by the rise of the dollar. The war led to a massive expansion of American export business as the U.S. became the, 'factory and grainery to the world' (Eichengreen, 2011: 26) American businesses were the primary beneficiaries of the withdrawal of European producers from foreign markets during the war. The war had also severely disrupted the credit mechanisms in place before 1914. German and British banks were forced to turn to their counterparts in New York for the acceptance of bills in order to

purchase imports from the U.S., Latin America and Asia (Eichengreen, 2011: 26). This expansion of dollar denominated trade credit was part of a broader decentralisation of credit relations that damaged sterling and empowered the dollar. As a consequence, New York emerged as the key social space for the transmission of international credit. From 1921-1924, the value of new issues of foreign securities in New York stood at \$2,373 million, compared to a meagre \$917 million in London during the same period. The First World War had set in place a 'competitive duality' between New York and London as the key international financial centres, with power increasingly shifting away from London and towards New York (Langley, 2002: 61). This was the beginning of the substantial competitive interaction between London and New York that would prove to be so crucial to the politics of financial globalisation in the post- World War Two era.

The dollar's rise was not, however, exclusively a consequence of sterling's demise. It also reflected the growing capacity of American financial markets. The creation of the Federal Reserve in 1913 was a game changer in this respect. The American system now had a Central Bank that could act as a lender-of-last resort and play a market-making role to extend the liquidity of trade acceptances in the U.S. market (Konings, 2011: 73). The Federal Reserve Act also empowered national banks to deal in trade credit for the first time and enabled them to establish branches abroad. By the end of 1920, American banks were operating 181 branches abroad (Eichengreen, 2011: 18-28). But despite this enhanced financial infrastructure, the U.S. still lagged behind Britain in terms of the maturity of its financial system and its suitability to play an international entrepot role. While Britain's dominant position had been rooted in its unprecedented pre-eminence in world trade, its

massive overseas investments and a highly liquid discount market, the U.S. was not yet comparably endowed with these features (Konings, 2011: 72). *The demise of Britain's financial capacity, and the immaturity of the American alternative, were crucial factors in the disastrous attempt to resuscitate the gold standard during the 1920s as Anglo-American dynamics played a decisive role in the transformation of the international monetary system.*

Reactivation of the gold standard was made all the more difficult by the difficult negotiations over war debt repayments and trade relations that marked the early 1920s. The 1920s witnessed intensive financial rivalry between Britain and America. Britain had a number of goals that shaped the approach to international reconstruction. A financial bloc centred on London was identified as a means to maintain sterling's international role. Britain also sought favoured status in Russian development, the reduction of war debts and a regulated system of world capital flows as well as stability in world prices. In all these endeavours Britain was opposed by the United States (Costigliola, 1977: 914; Watt, 1984: 49).

Contrary to Britain, the U.S. intended to rebuild the world economy on the basis of a free market rather than regulation and special privileges. America turned to the 'Open Door' policy.<sup>20</sup> The American stance was motivated by a desire to ease industrial, agricultural and capital surpluses through outlets in the international market (Costigliola, 1977: 915). But the American position was beset by a major contradiction: although pushing for open markets internationally, America was insistent upon the maintenance of

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<sup>20</sup> This same 'open door' policy would be pursued vigorously after the Second World War.

her own high tariffs and full war debt repayment. This stance made it very difficult for European countries to earn the currency required to pay off their war debts to the U.S.

War debts proved the most rancorous bone of contention in the great power diplomacy of the period. The burden of the debts, imposed on top of the European loss of export markets and overseas investments, had a crippling impact upon the economic recovery of the major European powers. Michael Hudson interprets the American government's reluctance to soften its stance on the repayment of Allied war debts as part of an emerging imperialist strategy. Hudson views American conduct towards Britain after the war as 'political aggression': forcing Britain to pay crippling interest and capital charges on the debt despite implied promises to the contrary made to the Allies. Britain and her Allies were prevented from raising dollars through exports by the imposition of the Fordney McCumber Tariff in 1922 (Hudson, 1972:9, 18). America expected the Allies to repay debts not by boosting their export growth (as this would likely damage American industry), but rather through austerity at home.

Further signals of America's intention to disassemble British power were indicated in the lenient stance towards Germany, on the basis of which Hudson concludes (1972: 23) that the U.S. coveted Britain's empire. Debt had become a weapon to be wielded in the struggle between rival imperialisms. By re-establishing Germany as Britain's rival, the U.S. sought to check Britain's post-war power. Britain was trapped in a vicious cycle. Declining world prices in the later 1920s and the growing demand for dollars, weakened sterling and served to increase the real burden of Britain's war debts. For Hudson (1972: 33), no single mechanism had more of role in the genesis of World War II than the American insistence on

debt repayment by European powers. Rather problematically, however, Hudson's thesis ignores key cooperative tendencies driven by the trans-Atlantic banking community. Private banking power played a major role in solidifying Anglo-American relations and spurring the reconstruction of the international monetary system during this period, something that Hudson neglects in preference for a focus upon government driven financial imperialism. The great difficulty in delineating the boundary between 'private' and 'government' power during the 1920s, makes the clear conceptual distinction upheld by Hudson difficult to maintain.

Although the negotiations and contestation over war debts was intense, Britain and the U.S. were able to cooperate effectively in their attempt to re-establish the gold standard. The primary motivation for Britain's desire to return to gold was the need to restore London as the premier financial centre of the world (Clarke, 1967: 72; Dimpleby & Reynolds, 1988: 90).<sup>21</sup> But the need to maintain imperial unity around the dominant role of sterling in the face of the rising American challenge provided the wider political context (Costigliola, 1977: 923). With the increase in trade financed in dollars during the 1920s, Britain feared a gold standard based upon the dollar as a mortal threat to the international role of sterling.

For the City and the Bank, the restoration of the gold standard was seen as integral to maintaining the dominance of sterling, while it was also hoped that renewing the commitment to gold convertibility would prevent politicians from interfering in monetary politics. The government also stood to benefit from a return to gold, with increased

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<sup>21</sup> Prior to the war some two thirds of the world's trade credit had passed through London and half the world's long-term investments (Ahamed, 2009: 130).

confidence in the pound expected to reduce the cost of new government borrowing and help service the huge national debt. It was further hoped that the return to gold would increase the City's contributions to national revenue and provide a firm financial base for industry (Boyce, 2004:215). The attitude of British industry was much cooler towards the return to gold, but it was the City that 'exercised overwhelming influence over deliberations on the future of sterling' (Boyce, 2004: 220). Not for the last time, the privileged view of the City would lead Britain towards economic disaster.

Despite the coolness of industrial opinion, the decision to return to gold won the day. This was in large part a consequence of the predominance of gold standard thinking among British bankers and government officials. Britain had been on the gold standard from 1717 to 1914, interrupted only by a brief interval during the Napoleonic wars. By the 1830s the gold standard had become, 'an unquestioned article of faith to most economists and bankers', it remained so until 1914 and was still central to their thinking during the 1920s (Moggridge, 1972: 2; Eichengreen & Temin, 2000: 183). But the support of the Treasury, in favour of the interests of the Bank and the City, was also crucial. The Treasury's need to finance the national debt gave it a natural interest in the health of financial markets, which overlapped with that of the City and the Bank. In line with its traditional balanced-budgets orthodoxy, the Treasury believed that the gold standard could exert an important disciplinary effect upon British workers and government expenditure (Boyce, 2004: 222). There were nonetheless, concerns about the potential impact of returning to gold. Winston Churchill, the Chancellor of the Exchequer, expressed concern that the higher interest rates required to return to gold might severely retard the progress of trade, industry and

employment. While the increasingly influential John Maynard Keynes, was also an outspoken critic (Ahamed, 2009: 172). But the Governor of the Bank, Montagu Norman, assuaged Churchill's concerns by claiming, entirely disingenuously, that there was no relationship between the gold standard and domestic conditions (Eichengreen & Temin, 2000: 194). It was the City-Bank-Treasury nexus, then, which was central to Britain's desire to return to gold.

The return to gold was, however, impossible without broader international support. Anglo-American cooperation was crucial in this regard. The new gold standard system emerged on an ad hoc basis, owing to the non-participation of the U.S. in the 1922 Genoa Conference. Led by the British delegation, the subcommittee on financial questions produced a report, which recommended that countries should negotiate an international convention that would permit their Central Banks to hold an unlimited amount of foreign-exchange reserves. The intention was to overcome the gold supply problem that threatened to limit the scope for international economic growth, by moving on to a gold-exchange standard under which reserves could also underpin the monetary base. The conference also sought to promote international cooperation, with Central Banks expected to work together in order to maintain stable prices and fixed convertibility through an appropriate adjustment of interest rates. The Genoa proposals, 'reflected a British perspective on international monetary relations', with the holding of exchange reserves likely to benefit Britain, as they would most probably be held as sterling balances in London (Eichengreen, 2008: 60). Bringing foreign-exchange reserves to London would restore its international position and reconstruct the balance of payments mechanism that had operated prior to the

war. But the follow up meeting of Central Banks that the subcommittee proposed, in order to work out the details, never occurred. This was due to a lack of American support, with Fed officials resentful of the Bank's leadership of the meeting and political interests within the U.S. sceptical of both the gold-exchange standard and the need for formalised Central Bank cooperation.

The Americans were now in a very strong bargaining position. By the end of the war, the U.S. had the largest gold supply in the world, which would make it potentially the key player in a restored gold standard and produced scepticism over the need for a gold-exchange system (Ahamed, 2009: 95; Eichengreen, 2008: 61). Although the Genoa proposals were not adopted, the role of the League of Nations in attempting to organise multilateral solutions to international economic problems as part of an economic oversight role, throughout the 1920s and into the 1930s, formed a template for the eventual development of much more through multilateral regimes within the Bretton Woods framework (Pauly, 1997: 47-59).

The Genoa episode demonstrated that although key social forces in both Britain and the U.S. shared a commitment to rebuilding the world economy, 'their contrasting positions of ascending and descending power led to considerable disagreements as to the appropriate organisation of world finance' (Langley, 2002: 63-64). This prevented the establishment of a broadly agreed multilateral framework for restoring the gold standard and meant that ad hoc central bank cooperation between Britain and the U.S. would be key to the revival of the international monetary system when sterling was restored to gold convertibility in 1925.



Within the context of these broader Anglo-American disagreements, the banking communities on both sides of the Atlantic functioned as the primary engine in driving cooperation forward (Burk, 1991: 126). American international bankers supported the plan to restore sterling's convertibility to gold at the pre-war parity because they viewed it as central part of the stabilisation of the European monetary system as a whole, which was a necessary precondition for the realisation of American economic ambitions. As a whole, internationalist sections of American capital, exemplified by Wall Street bankers, tended to take a more lenient approach to the question of war debts and pushed for a more constructive engagement with European politics. Although divided over the best means through which to supplant the British, American bankers viewed the restoration of the international monetary system, alongside the British, as the best means to establish American banking predominance internationally. But within the context of an isolationist Republican administration, the capacity to pull American diplomatic power along with them was limited (Block, 1977: 15-18; Konings, 2011: 74; Chernow, 1990: 227).

Once again the House of Morgan was to the fore in leading cooperative efforts alongside central bankers from both countries. The central figures were Montagu Norman, Chairman of the Bank of England, and Benjamin Strong, head of the Federal Reserve Bank of New York. The importance of the relationship between the two men reflected the growing significance of Anglo-American central banking to the international economy as a whole, with the rise of the dollar and the demise of sterling bringing about a dualistic pattern of central bank leadership based upon the Bank and the Fed. Indeed, because of the heavy exposure of New York financial houses to European war debts, the New York Fed frequently

appeared to be more concerned with its relationship to the Bank of England than it was with the Federal Reserve Board in Washington (Konings, 2011: 66).

On a personal level, Norman and Strong were close friends who had developed enduring personal ties during the war and both aimed towards the restoration of the gold standard and increased autonomy for Central Banks (Chernow, 1990: 244; Ahamed, 2009: 92). Norman recognised that he would need to draw upon American financial power in order to restore the City's position. This realisation stemmed in part from the increased interdependence of New York and London money markets after the war. The Bank of England had reluctantly placed an embargo upon foreign loans to all but the Dominion countries after the war (Ahamed, 2009: 210). The restrictions were initially put in place because the Treasury wanted to make sure that there was a ready market for British government and corporate stock sales but they were subsequently extended in order to keep domestic savings and gold reserves from flowing out (Attard, 2004: 196). As part of this effort, Norman actively diverted business to New York in order to decrease the pressure on sterling and the London capital market. In fact, Norman had even suggested that Dominion countries should raise funds in the New York capital markets. For Norman, the restoration of sterling's standing as the foremost international currency was paramount above concerns with London's predominance as a capital market (Attard, 2004: 211).

Norman's recognition of the need to draw in American financial power in order to restore the City was also based on the realisation that the pound simply wasn't strong enough on its own. By building up Wall Street linkages, Norman hoped to recover pre-eminence for the City and the Bank. Just as it would do in the 1950s, with the birth of the

Euromarkets and the importation of dollar business into London, the City looked to American financial power to restore its own national and international predominance. Norman's relationship with the House of Morgan was a key component of the strategy to draw in the Americans. At a time when Anglo-American rivalry was on the rise in other areas, the House of Morgan's London branch, Morgan Grenfell, 'emerged as an important conduit between the City and Wall Street' (Chernow, 1990: 273). The American Morgan partners in New York shared the appetite of their London colleagues for getting Britain back onto gold. They saw the restoration of the gold standard as a means to protect exchange rates from manipulation by politicians. The U.S. Treasury gave its approval for the New York Fed and the House of Morgan to coordinate Britain's return to gold (Chernow 1990: 275).

The key question in the run up to restoration was at what dollar price should the pound be fixed to gold? It was decided that sterling should be restored at the pre-war parity of \$4.86, despite the dissenting voice of John Maynard Keynes, who believed that the pound was overvalued by 10-15% (Eichengreen, 2008: 57). British financial leaders feared that if the pound returned to gold at under \$4.86 foreign investors would lose confidence in sterling, taking even more of their business to New York (Costigliola, 1977: 923). Money markets on each side of the Atlantic had become more tightly intertwined than ever before with the rise of New York. Crucially, this meant that,

'Changes in the attractiveness of New York as a deposit centre for secondary money markets or changes in New York's volume of lending affected the sterling exchanges independently of the

position of the British pattern of settlements and balance of payments at the time' (Costigliola, 1977: 34-6).

This degree of interdependence made Central Bank cooperation imperative. Strong and Norman enabled sterling's return to gold through a cooperative strategy dealing with relative prices, interest rates and stabilisation credits (Clarke, 1972: 75). By making sure that interest rates were kept higher in London, the Federal Reserve and Bank of England created conditions that drew capital away from New York. The New York Fed and J.P. Morgan Co. provided \$200 million and \$100 million respectively in support of sterling's return to gold (Hogan, 1977: 73; Chernow, 1990: 276). *The centrality of London and New York to the resuscitation of the gold standard during the 1920s anticipated their crucially interdependent role within the Bretton Woods system of international monetary relations that was put in place after the Second World War. American financial ascendance was gradually de-privileging Britain's unique role within the international monetary system and driving a much more interdependent and equal Anglo-American axis upon which the system increasingly rested.*

Beyond the return to gold in 1925, the early to mid-1920s had marked the high-water mark of inter-war Anglo-American cooperation over international finance. During the war a grouping of Anglo-American bankers emerged who, 'shared common values and goals, and a sense of commitment to prevent future wars through cooperating in financial questions' (Dayer, 1991: 158). These bankers wanted governments to remove themselves from business, pushed Central Banks to regain control over national currencies and

stabilise exchange rates, and looked to the funding of war debts and the return to gold to prevent the political manipulation of currencies (Ibid).

Simultaneously however, American and British bankers were also rivals. Bankers from both nations strove to achieve dominance within international markets.<sup>22</sup> By the end of the war, America had established a foreign banking system (Abrahams, 1969: 572). Both Strong and Norman intended to establish their own national currencies as the major unit for international trade and attempted to convince foreign governments to hold their reserves in dollars or pounds (Dayer, 1991: 159-60). This tension had been in evidence during negotiations over how the reformed Reichsbank should hold international reserves earlier in the decade. The Americans wanted Germany's foreign exchanges to be held in New York, in order to be readily convertible into gold. Britain viewed the potential transfer of reserves to New York as a threat to sterling's credibility. Eventually, Britain triumphed in this negotiation, but the effect was to increase the pressure for a swift return of sterling to convertibility with gold.

Nevertheless financial relations between the two powers were part of an emerging 'informal entente' between the two states (Hogan, 1977:77). After the war British elites realised that they would have to open up areas of the world formerly under their domination. This meant rescinding some control over international finance, resource development and communications. The British saw that cooperation with the U.S. would avoid unprofitable competition and prompt the Americans to share some of the burden of managing world order. From the American perspective, the Republican government of the

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<sup>22</sup> The Federal Reserve Act of 1913 had enabled the internationalisation of American banking (Abrahams, 1969: 572).

1920s wanted cooperation based upon private programs organised and orchestrated by business and financial leaders. The upshot of this was that *both domestic and international arenas of public policy became largely a private concern* (Hogan, 1977: 1,7).

The Republicans promoted the role of private finance in the reconstruction of the European powers.<sup>23</sup> Groundwork for cooperation was laid when the Congressional War Foreign Debt Committee cancelled 50% of the combined Allied debt in 1922, after Britain had made a desperate last ditch attempt to soften terms with the Balfour note. The accord over debt was crucial to Anglo-American cooperation. It alleviated, at least temporarily, a major source of disquiet between the two powers and represented, 'the first block in an incipient structure of Anglo-American cooperation' (Hogan, 1977: 56).

The House of Morgan's involvement in Anglo-American attempts to restore sterling's convertibility and finance European reconstruction was symptomatic of a broader trend in international affairs: the involvement of private bankers in political as well as 'financial' discussions with governments. The 1920s were an age of unprecedented prestige for the international banking community, with central bankers in particular now a major focus of public attention (Ahamed, 2009: 9). Private bankers laid out political requirements for securing loans. The Anglo-American financial community was the most internationally influential of all. During a time of great economic and political uncertainty, cooperation between the Anglo-American financial communities provided a key impetus in integrating the economic strategies of Britain and the U.S., with the merging entente between the two

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<sup>23</sup> In fact the Treasury resisted attempts by the American banking community to promote a large influx of American government financial aid to the struggling European economies (Abrahams, 1969: 577-80).

countries during the 1920s 'reflected in central and private bank cooperation, and in a common British and American approach to the important issues of war debts and reparations' (Hogan, 1977: 77).

Anglo-American bankers had grown accustomed to working with one another, finding cooperation easier than their respective Treasuries did (Hogan, 1977: 149). Governments on both sides of the Atlantic recognised the importance of their respective financial communities, endeavouring to utilise them for political ends and national interests. Nevertheless they did respect 'boundaries beyond which it was not legitimate, or possible to control private banks and bankers as they went about their business' (Hogan, 1977: 149). In a deeply undemocratic manner, private bankers often made decisions of enormous political significance during the 1920s.

### **The Great Depression and the road to war**

Despite the centrality of Anglo-American financial cooperation to rebuilding the post-war international economy, the tail end of the 1920s was marked by a rapid disintegration of efforts at cooperation as the flimsily reconstructed gold standard rapidly began to unravel. During the latter half of the decade cooperative efforts, 'coexisted with new strains in Anglo-American relations' (Hogan, 1977: 220). Sterling proved to be grossly overvalued, as Keynes had suggested prior to the return to gold. European exports were cheaper and an overvalued currency hindered Britain's economic recovery during the second half of the 1920s. The fundamental conditions underpinning the classical gold standard were no

longer in place during the post-war gold standard. The old mechanisms of adjustment under the gold standard, which relied upon wage deflation to correct balance of payments deficits and boost competitiveness through a downward shift in prices, could no longer be applied without political resistance. The growth of trade unionism, working class parties and unemployment benefits all contributed to the slowing down of wage adjustment and meant that austerity couldn't be imposed upon workers as it once had been. Central bankers were not nearly as insulated from political pressures as they wished to be (Eichengreen & Temin, 2000: 192).

This reality was nowhere demonstrated clearer than in Britain. Ever since returning to gold the Bank of England had been battling gold losses, as gold was hoarded by France, Germany and the U.S. With gold holdings now so overwhelmingly concentrated in the U.S., European countries, particularly Britain and Germany, were left facing major supply shortages (Ahamed, 2009: 164). Although Britain had been keen for other countries to hold sterling reserves rather than underpinning their monetary base exclusively with gold, French officials viewed the proposals made by Britain at Genoa as a 'British ploy to fortify London's position as a financial centre at the expense of Paris'. They preferred to hold gold instead and built up huge reserves on the back of an undervalued franc. Capital inflows into Germany, with the U.S. as the major source, led to a tripling of the Reichsbank's gold reserves between 1924 and 1928. This absorption of gold by France and Germany put increased pressure on the Bank of England (Eichengreen, 2008: 65).

In response to these pressures the Bank would raise Bank Rate to pull in gold and limit domestic liquidity through the imposition of austerity. But this strategy could no



longer be undertaken with the ease of the pre-war period. Persistent high unemployment meant that Montagu Norman was constrained by the political implications of raising rates (Attard, 2004: 205). Churchill demanded that Norman reduce Bank Rate in 1925 and after initially resisting, Norman agreed to do so (Boyce, 2004: 226). The gold standard had not provided the desired degree of insulation from political pressure. When a coal strike morphed into the General Strike in 1926, the political opposition to the gold standard dictates grew even stronger (Block, 1977: 17; Eichengreen & Temin, 2000: 193). Britain's weakening balance of payments, with the overvalued pound pricing British goods out of foreign markets, further undermined the maintenance of convertibility and led to increasing tensions between the City and British industrial producers (Boyce, 2004: 216). Britain's preoccupation with her position vis-à-vis America and the dollar led policy elites to neglect the problem of undervaluation from her European competitors (Costigliola, 1977: 927-8). Once convertibility had been restored, the coordination required to prevent Britain experiencing shortages of gold did not arise.

But the decisive blow to the post-war gold standard came from the dynamics of the American economy and the way that the Federal Reserve behaved in its attempts to manage them. As the American economy prospered during the 1920s and war debt repayments were collected, gold flowed in to the country. By 1926, the U.S. held nearly 45% of the world's gold supply, with one quarter of this 'free gold'- meaning that it was above and beyond the 40% per cent backing for the money supply mandated by the American gold standard law. But rather than allowing the domestic money supply to increase in response to these inflows, as gold standard protocol dictated, the Americans sterilised the gold

inflows and refused to allow American prices to increase in order to allow other countries to adjust (Block, 1977: 21; Eichengreen, 2008: 65-67; Ahamed, 2009: 170). Rejecting the traditional gold standard relationship between the gold supply and the money supply, Benjamin Strong at the New York Fed devised a new and expanded mandate for central banking. No longer was the Fed exclusively concerned with stabilising domestic prices (although this remained its primary objective), it was also attentive to the need to respond to fluctuations in the level of domestic business activity by making appropriate adjustments to the credit supply. Strong's new monetary policy principles foreshadowed the expanded Central Bank mandates of the modern era. But the domestic concerns of the Fed were now jeopardising the entire international payments system. By hoarding gold and failing to allow a commensurate increase in the money supply (with an associated increase in demand for imports and higher U.S. prices that would dampen exports) Strong was undermining the gold standard system by forestalling the adjustments that would help correct international imbalances (Ahamed, 2009: 171). In addition to these American policy failures, the weaknesses of the newly inaugurated Federal Reserve System also caused problems and symbolised the inadequacy of America's institutional capacity for international financial leadership. The exact locus of power within the system was unclear and this resulted in internal struggles over who should wield power. The Federal Reserve Board in Washington was hamstrung by an unclear mandate and a lack of precisely defined purpose. Ambiguities and tensions within the Federal Reserve System left it ill-suited to play its emerging global role with genuine conviction (Ahamed, 2009: 176).

A bad situation then became much worse in the final years of the 1920s. A booming New York stock market had fuelled an increasingly speculative pattern of investment and reoriented the interests of American investors away from Europe and towards opportunities within the U.S. This effectively cut European countries off from the capital inflows upon which they were dependent in order to service war debts. The U.S. stood at the centre of a complex payments triangle in which American private financial inflows funded Germany, which then made debt repayments to Britain or France, who in turn made payments to the U.S. (Konings, 2011: 74). When the Fed raised interest rates in order to stem the boom, Europe was deprived of essential capital inflows and forced to pay higher interest rates on existing loans (Eichengreen, 2008: 69). Once the private loans to Germany began to dry up, the system came under increasing strain, but the U.S. steadfastly refused to annul the debts. The Wall Street Crash in October 1929 sent the U.S. stock market into free fall. Within a month, in October 1929, shares on Wall Street had lost 40% of their value. Around six thousand American banks closed between 1929 and 1932. By 1933 unemployment had reached 25% in America and economic output had fallen by one third (Dimpleby & Reynolds, 1988: 110). Overall, the U.S. contribution to international financial development during the interwar years was 'more destructive than constructive' (Konings, 2011: 75).

Developments in the U.S. had a huge impact on Britain's standing within the gold standard. The imposition of tariffs abroad and the collapse of world trade associated with the Depression undermined the invisible earnings that had supported Britain's balance of payments. Between 1929 and 1931, Britain experienced a major deterioration in its trade

balance and a massive collapse of its invisible's balance. British exports declined by 31% in the same period. In this context, it became increasingly difficult for Britain to maintain sterling's value against gold. Britain initially benefited as investors retreated from the dollar after 1929, but pressure soon turned to sterling in 1931. Despite increases to Bank Rate, Britain continued to suffer from major capital outflows until currency traders eventually provoked a major sterling crisis (Block, 1977: 28; Eichengreen, 2008: 78-82). A worsening budget deficit prompted a run on sterling. In a humiliating twist, the Labour Prime Minister Ramsey Macdonald appealed to J. P. Morgan for assistance but was told that he must cut social security spending and balance the books in order to receive funds (Temperley, 2002: 129; Allen, 1955: 760). Morgan's power had enabled the imposition of conditionality upon a British Prime Minister.

The Labour government acceded to the deficit cuts and received a \$200 million credit from J.P. Morgan (Chernow, 1990: 330; Ahamed, 2009: 427). But these actions were not enough and Britain was forced to go off gold on September 19<sup>th</sup>, 1931. This action symbolised the termination of the interwar gold standard (Eichengreen, 2008: 82). By 1932, the international monetary system had fragmented into three distinctive blocs and later in the year Roosevelt took the dollar off gold and devalued by 40% against gold. The end of the gold standard also seriously restricted the dollar's rise as an international currency in more general terms and revitalised sterling's relative standing during the 1930s (Konings, 2011: 74; Eichengreen, 2011: 36)

The collapse of the gold standard further aggravated tensions between the two countries; with the war debt issue having recurred from 1929-1931, while Britain and

America were at loggerheads once again over the issue of full cancellation. Tensions over the naval balance between the two nations also re-emerged in the later 1920's. Growing Japanese power raised American concerns over the potential of a combined Anglo-Japanese naval threat in the Far East. Britain went to great lengths to make clear to America that this was not a realistic possibility but to no avail. Wrangling over the Washington Naval Treaty continued to blight diplomatic relations between the two powers (Allen, 1955: 734-50).

Britain eventually defaulted on the remaining debt to America. Amidst a rapidly deteriorating international economic climate, Britain abandoned its longstanding commitment to free trade. At the Ottawa Conference in 1932, Britain moved to Imperial Preference and discrimination against American goods. As the storm of depression raged, Britain sought refuge within protected imperial markets. Sterling could no longer function as the international 'Top Currency' (Strange, 1971: 55). Instead, Montagu Norman established an exclusive 'Sterling Area' of dependent colonial territories that traded in sterling with Britain at its centre. The international monetary system had fragmented into rival currency and trading blocs and would not be restored on an effective multilateral basis until the 1950s. The structures of Anglo-American cooperation at the centre of the reconstructed gold standard had proved too weak and the international economy was thrown into lasting turmoil that fed directly into the inflammation of geopolitical tensions and the outbreak of WW2.

Although the informal cooperative efforts of Britain and the U.S. had failed, there were important changes in multilateral thinking which occurred during the depression era. After 1933, the Economic and Financial Organization of the League of Nations began to

develop a new model. This model would go on to become a direct forebear to the IMF. The final economic studies carried out by the League went on to shape the post-war settlement, by moulding a new consensus that was institutionalised through the 1944 Bretton Woods Agreement. Under the new consensus, obstacles to trade would gradually be removed and transparent, monitored agreements would facilitate an orderly approach to exchange-rate adjustments. The scope for countercyclical fiscal and monetary policies, as well as capital mobility, would be shaped by the need to liberalise trade and promote a stable system of exchange rates (Pauly, 1997: 73). Although the endurance of the old orthodoxies had nearly brought the world economy to ruin, the seeds of a new international monetary order were beginning to be sown.

### **The limits and affects of the great reversal**

From a colonial dependency late in the 18<sup>th</sup> century, the United States had become the foremost industrial power in the world by the eve of WW2. As this chapter has demonstrated, American ascendancy was closely linked to the gradual diminution of British power. In matters of finance, the de-privileging of Britain's singular role at the centre of the international monetary system occurred in no small part due to the growth of American power. American industrial catch-up eroded British trade dominance and the impact of the war greatly accelerated the rate at which America was able to emulate British pre-eminence.

It was the outbreak of the First World War that enabled the financial power of the Morgan dynasty to attain such a significant role at the heart of Anglo-American financial linkages. By eroding British power and stimulating American industry, the war accelerated America's rise in relative standing. But it also had the effect of drawing Britain into a critical borrowing relationship with the American government that soured relations in the 1920s and increased British dependency upon American finance.

Through the war transatlantic financial relationships became, paradoxically, both a source of contestation and a fulcrum of cooperation. The post-war transatlantic relationship was, as we have seen, marked by bitter political disagreements between governments over the repayment of war debts. Simultaneously, it was defined by Central Bank cooperation and the growing importance of an Anglo-American financial community that spanned the Atlantic. By the 1920s a form of private international governance, led by private and central bankers, had begun to play a key role in international politics.

As sterling's singular dominance ebbed away, and the dollar rose to prominence, the fates of monetary politics in Britain and the U.S. became increasingly intertwined during the 1920s. That pattern would continue to be crucial to the wider international political economy under the Bretton Woods system after WW2. But although Britain and America managed to resuscitate the gold standard through sporadic and ad hoc cooperation, the absence of a firmer multilateral commitment to economic cooperation and the policy blunders of American financial authorities, played a key role in the decomposition of the interwar gold standard and the disintegration of the liberal international political economy. This was not merely a case of a failure of American leadership, but also a product of the

inadequacy of American financial capacity to supplant Britain's ailing role as the lynchpin of the international economy.



### **3 British Development and Post-war American Power:**

#### *Beyond the Hegemony/Rivalry Binary*

After the devastation of World War II, Britain and the U.S. were once again at the heart of efforts to reconstruct the international monetary system. But with Britain now gravely weakened by its role in a second global conflagration in less than thirty years, the great reversal in power that had accelerated after WW1 reached terminal velocity. American power vastly outstripped that of Britain. By the end of WW2, American predominance was beyond doubt. Britain's junior role in the political economy of the Special Relationship was clearly evinced by the manner in which American representatives led the Anglo-American negotiations that eventually produced the Bretton Woods agreement in 1944.

In their attempts to understand the impact of American predominance upon British development in the early post-war years, scholars have arrived at a polarised stasis. The contending interpretations offered by Edward Brett, and Peter Burnham, represent the central cleavage in this debate. For Brett (1985: 139), Britain's capitulation to American hegemony was complete. Burnham (1990: 2) by contrast, chided Brett for overstating British capitulation and overlooking the degree of rivalry that persisted. Both scholars tied their analyses of early post-war Anglo-American relations into diagnoses of Britain's post-war economic malady. But the conclusions they arrived at were markedly different. For Brett (1985: 156) it was the degree of capitulation that spelled Britain's undoing, while for Burnham it was precisely the opposite. Britain's successful evasion of American hegemony

was ultimately self-defeating, prolonging the defunct Sterling Area and keeping Britain on the margins of robust intra-European trade growth (Burnham, 1990: 12).

This chapter contests the polarised interpretations offered by Edward Brett and Peter Burnham, arguing that both authors, despite drawing attention to important aspects of the emerging post-war relationship, overlook many of the key processes and tensions at play. In the first section of the chapter I explore the Anglo-American developmental processes at play during the interwar and wartime periods arguing that these processes are central to understanding the politics of the early post-war years and the reconstruction of the international political economy. The chapter then stresses the need to disaggregate the national interests of Britain and the U.S. in order to trace the manner in which currents of institutional development shaped the negotiations over Bretton Woods. In light of this analysis, I then review the contending ‘capitulation’ and ‘inter-imperial rivalry’ theses propounded by Edward Brett and Peter Burnham. I argue that Brett’s ‘capitulation’ interpretation overstates the degree of British subordination and obscures the underlying compatibility of interests between the banking communities in Britain and the U.S. The conditions of the immediate post-war political economy produced obstacles to the realisation of these mutual trans-Atlantic interests, but the nascent foundations for their subsequent confirmation were already firmly in place.

Moving on to Peter Burnham’s ‘inter-imperial rivalry’ thesis, I argue that Burnham exaggerates the notion of ‘inter-imperial rivalry’ by falling prey to the realist fetish of the ‘national interest’ and failing to disaggregate the different centres of institutional power within the state. Breaking from the capitulation/rivalry binary, I argue that post-war Anglo-

America dynamics should be characterised in terms of ‘contained rivalry’ and ‘uneven interdependence’. Although Britain and America remained rivals, the rivalry existed within a militarily pacified relationship that had emerged during the war. While Brett’s emphasis upon capitulation unduly erases all traces of Anglo-American rivalry, Burnham’s account, conversely, anachronistically overstates the fractiousness of the relationship by conceptualising it in terms of ‘inter-imperial rivalry’. The contained rivalry between Britain and the U.S. was part of a broader pattern of ‘uneven interdependence’ that would continue to characterise Anglo-American development in the decades after Bretton Woods. This was a two-way dynamic in which American power was predominant, but both countries recognised their mutual dependence upon the developmental trajectory of the other. Britain was financially dependent upon the U.S., but American state officials and the New York banking community in particular, recognised that in order to realise their post-war ambitions, they would need to encourage Britain to adopt a multilateral outlook upon the international economy and work towards the restoration of sterling convertibility.

In contrast to the picture of policy consensus and unified national interests that Brett and Burnham present, I argue that serious tensions over the best policy framework for post-war international monetary relations existed within the British state. While Keynes and the government grudgingly accepted the need to move towards multilateralism under the Bretton Woods framework, the Bank of England and orthodox elements within the Treasury preferred the maintenance of a bilateral framework grounded in the prolongation of the Sterling Area. Over time, the orthodox forces within the British state, which

prioritised the international status of sterling and the City above the need for reconstruction and full employment, gradually achieved dominance. Tensions within the British state were mirrored in the different degrees of emphasis that the U.S. Treasury and the State Department placed upon the need for Britain to return to convertibility. The U.S. Treasury's role as the primary representative of American state power during the negotiations at Bretton Woods produced a firm emphasis upon the right for countries to implement capital controls and enabled Keynes to secure breathing space before Britain had to restore convertibility. Yet the New York banking community, who rallied around the New York Fed's 'Key Currency Plan' and received support from the State Department, opposed the plan.

Although the Bretton Woods agreement primarily reflected the U.S. Treasury's post-war blueprint, the balance of power within the American state shifted after Roosevelt's death in 1945. Prominent New York bankers within the State Department and influential within the Truman administration were able to challenge the Bretton Woods agreement by pushing Britain towards a swifter restoration of convertibility. That attempt failed, but it brought about the eventual realisation by the Bank of England that only a multilateral approach could safeguard sterling's international role.

It is precisely these tensions and struggles then, within both Britain and the U.S., which account for the limited triumph of Keynesian thinking within the British state and the restoration of the orthodox City-Bank-Treasury nexus under the Conservative governments of the 1950s. These early struggles for influence over the post-war economic agenda, on both sides of the Atlantic, laid the groundwork for the subsequent undermining of the

Keynesian compromise in the decades that followed. The re-emergence of the influence of private and central bankers in the early 1950s laid the foundations for the post-war integration of Anglo-American finance that followed with the birth of the Eurodollar market later in the decade. In the post-war years, Anglo-American banking power would lay the foundations for the subsequent subversion of Keynesianism and the realisation of financial globalisation.

### **The continuity of process: integrating war and post-war**

Understanding the post-war Anglo-American context requires us to dismantle the traditional analytical division between 'war' and 'post-war' to unearth the continuity of developmental processes that span across the two periods. The tendency to attempt the neat delineation of phases of world order, common within IPE, obscures a focus on longer-term developmental processes (Lacher: 2006). Processes of institutional transformation were underway during and after the war but were manifested in different strategies and outcomes. During the war many of the conditions of the post-war world were moulded, particularly those between Britain and the U.S. (Kolko, 1968: 7; Hudson, 1972: 37; Dobson, 1995: 72). Negotiations over Lend-Lease were central here. The war rapidly exhausted Britain's financial reserves. Gold reserves that had stood at \$4 billion in 1938 were down to \$1 billion by September of 1940. The British government nationalised private overseas investment holdings of citizens to meet the mounting costs of war. As Britain's reserve position worsened they turned to the U.S., resulting in the Lend-Lease agreement of 1941.

Under Lend-Lease Britain would no longer need dollars to purchase U.S. goods, abating the pressure on reserves (Skidelsky, 2000: 100). The cost of transactions was deferred until after the war. But as Michael Hudson notes, the agreement was not only a strategy to bolster Britain's resistance to Nazi Germany, it was also a lever with which the U.S. could ensure Britain's post-war dependence, win commitment to the end of British trade discrimination and gain access to formerly exclusive areas of British interests (Hudson, 1972: 44; Dobson, 1986: 32). What Hudson misses is that Lend-Lease also pushed the two countries closer towards cooperative integration by intensifying the pooling of resources (Ovendale, 1998: 47). Financial integration was matched by integration in the technological and intelligence fields (Ovendale, 1998: 45; Dobson, 1995: 74). There was enormous transatlantic exchange of administrative capacities too, with Grosvenor Square in London becoming the home of a huge American presence while in Washington, during the height of the war, around nine thousand British officials were based around the British Embassy.

The alliance of World War II was much closer than that forged during WW1 and a departure from the mutual suspicion of the 1930s (Kolko, 1968: 13; Dimpleby & Reynolds, 1988: Saville, 1993: 64). Viewing the relationship through the lens of imperial rivalry obscures these important cooperative aspects. The Quid pro Quo for this integration however was a redefinition of British sovereignty, with the U.S. now permitted to audit British finances under the terms of the Lend-Lease agreement (Temperley, 2002: 162; Dobson, 1995: 72).

Although the overall context of allegiance was never in doubt once the U.S. had entered the war, there were still significant strategic differences (Saville, 1993: 64). Kolko (1968: 21) neatly describes Anglo-American wartime strategy as a, 'synthesis of grudging compromises'. American officials were, at times, concerned that Britain might attempt to form a post-war Western European bloc, based on an allegiance with France and independent of both the U.S. and the U.S.S.R. Post-war tensions over economic policy were briefly foreshadowed in Anglo-American positions on the future of Italy. Both powers were committed to keeping the Left out of Italian politics, but the U.S. was keen to secure a dominant position as principal economic donor to prevent Italian integration within an independent British political bloc (Kolko, 1968: 6, 49).

In many ways, then, the dependency of Britain upon the U.S. had already been entrenched during the war, rather than in a post-war capitulation. There was no dissolution of competing interests and priorities during the war either. The war acted as a crucible for the transformation of British sovereignty, permitting an unprecedented degree of cooperative subordination to the United States. But the U.S. was still dependent upon British power too, giving the British considerable bargaining power and making this a relation of *uneven interdependence*. As the Key-Currency proposals of the Federal Reserve Bank of New York and American international bankers after the war made clear, the New York financial community realised that they needed to restore sterling's international status alongside the City's entrepot role in order to realise their vision for the post-war world economy (Langley, 2002: 72). Just as Montagu Norman had looked to boost the City's status through drawing in American support, the New York bankers now looked to re-

establish the City and sterling as integrated components of their attempt to establish international financial dominance.

As American power expanded British sovereignty was transformed, but so too was the developmental interdependence between the two countries. Not only did the wartime relationship display continuity with the context of post-war relations of contained rivalry. It also gave rise to important processes of state formation, in both countries, key to understanding Britain's development within a transatlantic orbit. It is to these processes that our analysis now turns.

### **Anglo-American currents of institutional development**

The key wartime development within the British state was the temporary demotion of the Treasury. For most of its history the Treasury was at the centre of British governmental power, exerting a powerful and continuous influence upon the development of British society (Roseveare, 1969: 9). War acted as a catalyst for Treasury evolution, which had seen its powers extended after WW1. But the Treasury's fortunes during and after WWII were mixed. From 1939 until 1942, the Treasury was, 'under a political shadow which not only diminished its customary prestige and authority but disqualified it from access to the new centres of deliberation' (Roseveare, 1969: 325, 273).<sup>24</sup>

The inter-war years and the attempt to restore the gold standard had led to an unprecedented internationalisation of the Treasury's role as its Finance Department

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<sup>24</sup> Side-lining of Treasury authority enabled the development of a more expansive welfare state in the post-war period (Cronin, 1991: 151).



undertook multilateral efforts to rebuild the international monetary system, through the League of Nations, alongside the finance ministries of other countries. This new activism, a break from the informal evolution of the classical gold standard during the nineteenth century, was evidenced in the prominent role of Treasury officials during the 1922 Genoa Conference organised through the League of Nations (Roseveare, 1969: 261). John Maynard Keynes and Ralph Hawtrey, who was the Director of Financial Enquiries at the Treasury, played significant roles in drafting the Genoa proposals and made sure that Britain's perspective on monetary relations was paramount (Eichengreen, 2008: 60). During the 1930s Treasury representatives were frequently present in the foreign embassies of the major powers. This was part of the new, expanded function of the Treasury reflecting the, 'breadth and intensity of Britain's monetary problems' as it attempted to restore the gold standard on the basis of its gravely weakened interwar political economy (Roseveare, 1969: 261).

Simultaneous to this expansion of Treasury mandate was the emergence of a creeping Keynesian influence within the department, represented most explicitly by Keynes's direct involvement in drafting the Genoa proposals. The slump of the 1920s and the global failure of the 1930's spurred the progress of Keynesian thinking, while the implementation of Imperial Preference and protectionist measures during the 1930s represented a further rupture from traditional orthodoxy. The Treasury had assumed a greater influence over monetary affairs after Britain broke from gold in 1931, with the City and the Bank experiencing a diminished influence due to their implication in the disastrous return to gold. Using its increased influence, the Treasury began to push for a monetary

policy that was more germane to the fulfilment of domestic goals rather than maintaining external balance. An 'Exchange Equalization Account' was established, under the Treasury's mandate, in order to offset the impact of short-term gold movements upon domestic monetary dynamics while the Treasury also maintained surveillance over the foreign lending of City firms (Helleiner, 1994: 32). But, crucially, the advance of Keynesianism was never more than partial (Roseveare, 1969: 261-268). In the fiscal realm, the Treasury remained largely committed to the old orthodoxy of balanced budgets, while its support for low interest rates was more a reflection of the need to finance national debt at low cost than to stimulate domestic expansion. It was not until the outbreak of war that attitudes began to shift away from the old gold standard thinking (Helleiner, 1994: 32). The incompleteness of the Treasury's Keynesian transformation would prove absolutely critical to the development of Britain's post-war political economy.

With the arrival of Churchill as Prime Minister in 1940, the focus shifted towards organising the necessary raw materials for the war effort. Consequently, the Treasury was subordinated to other ministers and other departments.<sup>25</sup> But as the war effort matured the relevance of the Treasury was re-established. Securing finances for the war effort, and the related dollar diplomacy with the U.S., became increasingly prominent issues (Roseveare, 1969: 273- 274). As the Treasury's centrality was restored it underwent a transformation of purpose (Green, 1992: 203). After the budget of 1941 the Treasury's domestic role was extended to include responsibility for the balance of resources and demand in the economy

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<sup>25</sup> New departments emerged dealing with wartime planning and for a time the Chancellor of the Exchequer was excluded from the meetings of the war cabinet.

as a whole (Roseveare, 1969: 274; Hall, 1986: 72).<sup>26</sup> This represented a break from balanced budgets, Gladstonian orthodoxy. The Treasury was now partially responsible for price levels, savings incentives and the level of capital investment.<sup>27</sup> Acceptance of this expanded role by the wartime Treasury marked the, 'long-deferred triumph of the Keynesian philosophy over the nineteenth-century orthodoxies' (Roseveare, 1969: 276).<sup>28</sup>

Importantly, the transformation of the Treasury's responsibilities disrupted its traditional relationship to the Bank of England. Under pre-war orthodoxy, the Treasury's domestic role was limited to the management of government finances. This meant that the Bank was the Treasury's principal point of contact with the wider economy (Green, 1992: 203). Under its expanded remit the Treasury was now brought into regular contact with a wider range of actors, diluting the traditionally privileged role given to the Bank. Indeed, Cairncross (1995: 71) suggests that from 1941, 'the Bank was nearly always at odds with Keynes and the Treasury'. But, crucially, both the triumph of Keynesian ideas and the disruption of the Treasury-Bank nexus were temporary and partial. By the early 1950s the traditional orientation of institutional power was restored, opening the way for the integration of Anglo-American financial power that would follow with the development of the Eurodollar market later in that same decade.<sup>29</sup>

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<sup>26</sup> Britain's wartime budget was inspired by Keynes's work *'How to Pay for the War'*. Keynes had begun to exert a big impact upon the orthodoxy of Treasury thinking from 1937 onwards (Skidelsky, 2000: 20).

<sup>27</sup> Under inflationary conditions the Treasury would be expected to increase taxation to curb excessive demand, while a deliberate budget deficit could expect to be implemented during a recession.

<sup>28</sup> This triumph was not, however, complete.

<sup>29</sup> Restoration of the traditional orientation occurred within a new acceptance of American pre-eminence however, with the British Treasury now subordinated to that of the United States in its responsibilities for the management of the international economy.

Within the American state, comparable processes of transformation were underway. The U.S. entered the war still working through the resolution of New Deal-era politics. Blueprints for American post-war international reconstruction reflected the ambivalent way that domestic struggles over distribution were resolved before and during the New Deal (Maier, 1977: 607; Waddell, 1999: 232). During the 1930's the New Deal administration recognised that greater involvement from public institutions was required to remedy the maladies of American capitalism (Panitch & Gindin, 2012: 55). Central here was the rise to prominence of the U.S. Treasury relative to other key institutions within the American state (Helleiner, 1994: 30; Sarai, 2009: 76). The U.S. Treasury supplanted the State Department, Federal Reserve and private bankers such as the House of Morgan in taking responsibility for international financial negotiations (Panitch & Gindin, 2012: 71). Indeed, the Roosevelt administration blamed the New York financial community, and the House of Morgan in particular, for the catastrophic failure of the interwar monetary system (Helleiner, 1994: 30). Government borrowing during the New Deal expanded the market in Treasury Bills as private investors increased their holdings. The Treasury Bill market became important to the restoration of Wall Street. In response to the banking crisis, the Federal Reserve was granted extended authority by Congress. The 1935 Banking Act expanded the Federal Reserve's powers (Brinkley, 1996: 81), but the Fed's remit was subsequently subordinated to Treasury imperatives during the war as fiscal policy came to dominate monetary policy (Epstein & Schor, 1995: 7).

During the 1930s labour radicalism had pushed Roosevelt towards drastic social reforms. Under the Wagner Act, trade unionism was legalised. The Social Security Act

founded the American welfare state with nation-wide provision of unemployment and retirement benefits (Brinkley, 1996: 202; Panitch & Gindin, 2012: 59). These changes greatly enhanced the administrative capacities of the American state. In 1938 a 'Grand Truce' with capital was instantiated (Brinkley, 1996: 89). The truce was a product of meetings held by Roosevelt with moderate trade unionists, bankers and industrialists. Out of this truce emerged a transformation in economic thinking that mirrored the advancement of Keynesianism within the British Treasury. The American Treasury recognised the need for deficit spending to stimulate demand and investment (Panitch & Gindin, 2012: 62). Just as in Britain this represented a break from the traditional balanced budgets orthodoxy of the gold standard era. And just as in Britain, the break was only partial.

### **Disaggregating the national interest: Bretton Woods and beyond**

These currents of institutional development within both states fed into the negotiations that led to the eventual formulation of the Bretton Woods agreement. For both Britain and the U.S. the formulation of policy positions on the future of the international monetary system proved divisive, reflecting the new patterns of power that had evolved between different departments within the state. In Britain, it caused a major split between the Bank of England and the Treasury. Keynes, a contentious figure, represented the Treasury in its negotiations with the U.S. and divided opinion within the British state. Britain's commitments to maintaining sterling as an international currency, and the desire to remain

outside of an integrated European Payments Union caused major tensions with the U.S. Treasury. American policy makers, for their part, identified the Sterling Area and Imperial Preference as major obstacles to the reconstruction of an open international economy after the war (Kolko, 1968: 246).<sup>30</sup>

American post-war priorities eventually converged around a commitment to multilateralism and currency convertibility, international free trade, exchange rate stability and European integration (Hogan, 1984: 289; Hearden, 2002: 59). But as with Britain there were differences and tensions between institutional interests that emerged during the articulation of these objectives. During the war the contending interests of the U.S. Treasury and the State Department caused frictions over a number of issues, with disagreements over the future of Germany particularly prominent (Skidelsky, 2000: 133). Treasury Secretary Henry Morgenthau, mistrusted British motives and hoped to establish American financial hegemony after the war by exhausting British financial assets (Skidelsky, 2000: 98). In general, however, the Treasury was staffed by progressive New Deal figures such as Morgenthau and White, who favoured more heterodox blueprints for the post-war international economy that would allow greater scope for deficit spending and insulation from deflationary pressures. The State Department by contrast, headed by Cordell Hull, was principally concerned with dismantling Britain's Imperial Preference System and creating the kind of open world economic conditions that had underpinned the gold standard era

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<sup>30</sup> By 1938 the Sterling Bloc accounted for one-third of world trade and was increasingly independent of dollar imports (Kolko, 1968: 246).

(Skidelsky, 2000: 126)<sup>31</sup>. Both the Treasury and the State Department were, however, agreed upon the importance of gaining British acceptance of multilateralism and currency convertibility at the earliest date possible. They viewed Britain as a key cog to be turned in the effort to restore the international economic order (Block, 1977: 41).

While American officials harboured clear objectives for the post-war international economy, Britain's leaders lacked coherent political-economic war aims (Skidelsky, 2000: 137). The Foreign Office in particular, underestimated the coherence of the American's post-war ambitions and objectives and clung to the old priorities of the British Empire (Saville, 1993: 65). British and American officials expected to emerge from the war in different circumstances, with Britain, 'stripped of trade and assets and burdened with debts', with the U.S. in the, 'opposite position'. These differences, between debtor and creditor nation, were reflected in the divergent priorities for Bretton Woods, 'the British wanted a scheme which would enable them to borrow without strings; the Americans one which would lend with strings' (Skidelsky, 2000: 182).

Within the British state the Bank of England, which represented the interests of banking and financial services (Green, 1992: 203), disagreed with Keynes's general plans for the post-war international economy, although they did agree upon the need for capital controls (Cottrell, 1995: 110; Cairncross, 1995: 71). In contrast to Keynes's plan for an international clearing union based on the 'bancour', the Bank favoured continuity with the wartime system based on payments agreements and preservation of the Sterling Area. Counter to American Treasury and State Department demands for the liquidation of the

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<sup>31</sup> These agendas were contradictory, as the exhaustion of British financial assets would inevitably increase the desire to maintain an Imperial privileged trading zone after the war.

Sterling Area, the Bank believed that it would be better to build on the use of sterling and the dollar in existing international payments arrangements rather than attacking the Sterling Area payments system. The problem for the Bank was that its influence over monetary policy was limited under the post-war Labour government (Cairncross, 1995: 70-71).

Given the significance of this disagreement between key institutional components of the British state it is surprising that Brett and Burnham pay such little attention to them. Disaggregating the state enables comprehension of the developmental dynamics at play. Under the Conservative governments of the 1950's, with their traditional affiliation with the City of London, a revitalised Bank of England would begin to interpolate much more coherently with the interests of resurgent American banking. Through the channel of the Bank of England, the interests of British banking would be expressed at the heart of British capitalism, effectively rendering the Keynesian transformation stillborn.

The transformation of British and American state capacities, and the advancement of ideas that broke from the classical liberal economic orthodoxy within their respective Treasuries, were reflected both in the planning for Bretton Woods and the pattern of Anglo-American monetary relations in the early post-war years. The Anglo-American agreement instituted at Bretton Woods reflected both the lessons of the past and projections of the future. The two chief architects of the plan, John Maynard Keynes and Harry Dexter White, who represented the British and American Treasuries respectively, were determined not to replay the failings of the interwar years and to advance the interests of their respective states to the greatest degree possible.



Despite the different interests of Britain and America, which became increasingly apparent as the negotiations wore on, both men were able to converge upon a common commitment to the implementation of capital controls. In fact, the U.S. Treasury had already been in contact with its British counterpart after 1936 over the possibility of cooperative efforts to control flows of hot money (Helleiner, 1994: 31). These bilateral contacts foreshadowed the collaborative planning undertaken in preparation for the Bretton Woods agreement.

Both Keynes and White were critical of the orthodox economic thinking associated with the gold standard. They viewed the implementation of capital controls as an essential precondition for the kind of international monetary system that would protect the policy autonomy of the interventionist welfare state from disruptive international capital movements, while also providing conditions suitable for the continuation of economic planning processes that had been developed during the 1930s. Their convictions on capital controls were rooted in a shared belief that the maintenance of fixed exchange rates and a liberal international trading system was not compatible with a fully liberal financial order. Keynes and White were not, however, opposed to all forms of capital flows. Both men accepted the need for 'productive' (as opposed to speculative flows) capital flows and were in support of equilibrating flows that would help correct, rather than aggravate, balance of payments imbalances. Despite these caveats, Keynes and White identified the right of states to control capital flows as a cornerstone of the post-war international monetary system. Their thinking embodied a critical appraisal of the interwar monetary system and

reflected a marked departure from the liberal financial principles of the gold standard (Helleiner, 1994: 33-38).

The shared commitment to capital controls contained in the early drafts created by Keynes and White were not well received by all quarters. New York bankers were troubled by White's emphasis upon capital controls and feared that they would lose the highly profitable business of receiving European capital flight, which had benefited New York during the 1930s (Helleiner, 1994: 39). Too much emphasis upon capital controls might impede the bankers in their quest to establish the international predominance of American banking, a goal that they had held since the 1920s.

Around the issues of Bretton Woods we see the re-emergence of pre-war complementarity between bankers in New York and London. Anglo-American financial cooperation, between private and central bankers alike, had been key to the international reconstruction efforts of the 1920s. But as we have seen in the previous chapter, these informal efforts were not strong enough to hold the interwar gold standard together. The impetus for restoring the Anglo-American axis of international financial power now came from the Americans and was encapsulated by the 'Key Currency Plan' proposed by John Williams, the head of the FRBNY, as a critical riposte to White's planning for Bretton Woods.

The Key Currency Plan rested upon the belief that restoring the convertibility of the world's two foremost currencies, sterling and the dollar, would provide the surest route to a rapid international economic recovery (Helleiner, 1994: 41). The U.S. would provide Britain with a substantial loan in order to underwrite the restoration of sterling's international role. The loan would then enable Britain to swiftly return to convertibility and

pursue multilateral trade policies. It would also restore London as an international capital market and foster British cooperation with the U.S. in the shared management of the international monetary system (Block, 1977: 52). Crucially, the Plan would require the removal of all controls on sterling and the dollar, as such it stood in direct tension with White's endorsement of mandatory capital controls. Not only did the Plan challenge the direction of White's planning, it was also based upon a serious underestimation of sterling's post-war weakness. Britain's exposure to massive sterling balances accumulated by its Imperial territories during the war had rendered the pound incredibly vulnerable to a mass sell-off in favour of much needed dollars once convertibility were restored. These problems would become very clear just two years after the Bretton Woods agreement.

Despite the grave flaws of the plan, the New York financial community enthusiastically rallied around it and proceeded to publicly champion its cause. Lamont, Chairman of J. P. Morgan, suggested that a better plan for the establishment of post-war international monetary stability would be to have American and British bankers create a dollar-pound exchange ratio to which all other currencies were tied (Hearden, 2002: 61) Randolph Burgess of the National City Bank was keen for the American government to give Britain a direct credit of \$2billion in order to provide liquidity for the post-war system. Similarly, Winthrop Aldrich, Chairman of Chase National Bank, identified Britain's need for dollars to purchase American goods as the crux of the post-war financial conundrum, arguing that this problem 'should be faced squarely because it would be in the interest of the United States to have a strong British economy' (Hearden, 2002: 63). Aldrich's critiques of White's plan had a big impact and forced the alternative proposal onto the policy agenda

(Helleiner, 1994: 43). These plans reflected continuity with financial cooperation between the Anglo-American banking communities during the 1920s. Once again, American bankers preferred an international monetary system based upon a cooperative axis of private power in London and New York. The stance of the New York banking community was lenient compared to the hardball tactics of the Treasury under Morgenthau. American bankers recognised the significance of the City's role as a key nodal point within a restored international monetary system. Their long-term plan to establish dominance in international finance required them to work through the City of London, breaking down the sterling area by restoring the convertibility of sterling and then using Britain as a twin-engine, alongside American financial power, to boost world trade and foster a broad climate of multilateral trade and investment. *The strategic thinking of New York bankers attested to the continuing centrality of Anglo-American developmental dynamics, expressed through the interdependence of the dollar and sterling, alongside the City and New York. Although America's financial power had been greatly augmented by its participation in two World Wars, and the exhaustion of British power, bankers in New York still depended upon the City's international role in order to achieve their long-term ambitions.* This pattern of mutual dependence would continue to define Anglo-American development as the politics of globalisation began to unfold during the decades that followed Bretton Woods.

Criticisms raised by the bankers of New York proved too strong for White's original plan to survive intact. Bankers voiced their discontent within Roosevelt's administration and Republican Congressional success in 1942 further strengthened their hand. The bankers' opposition to White's plan symbolised the, 'still unresolved direction of New Deal

financial politics'. Although bankers had initially supported the New Deal, principally because they saw Roosevelt's agenda as a means to loosen the House of Morgan's firm grip over New York finance, their appetite for further initiatives that might shake up the American financial system was limited once this goal had been achieved. (Helleiner, 1994: 43-44). Their lobbying efforts ensured that White's revised plan placed a greater emphasis upon the need for productive capital flows.

Given the centrality of Anglo-American banking cooperation to the resuscitation of the gold standard, one might have expected the Key Currency Plan outlined by the New York Fed and Wall Street bankers to have received a welcoming reception over on Threadneedle street. But the opposite was in fact true. The Bank of England actually joined forces with the British Treasury in order to resist the amendments to White's plan that had been driven by the pressure of the New York bankers. The Bank insisted that an explicit guarantee of the right to use exchange controls in order to limit capital flows be included in the final agreement. Although the Bank's stance was undoubtedly disturbing to the New York bankers who sought to rekindle the Anglo-American axis of the interwar years, many of the City's bankers were also supportive of the thrust of Keynes's and White's plans (Helleiner, 1994: 45).

The Bank's surprising endorsement of capital controls was explicable in terms of its reorientation towards the protected sterling bloc during the 1930s and its continued concern over the perilous state of Britain's balance of payments. Bank officials believed that the best way to restore sterling's international role, at least in the short to medium term, was to maintain and extend the sterling bloc. Sterling was too weak and British reserves far

too low, to move towards convertibility in the immediate future. The Bank's preferred strategy, which received the support of some within the Treasury, was to continue the wartime sterling arrangements, to maintain a common dollar-saving import policy for all Sterling Area countries and to continue to control the movement of capital from the Sterling Area to the rest of the world (Helleiner, 1994: 45; Newton, 2004: 261). This might be possible, the Bank believed, if cohesion within the Sterling Area was maintained and threats were made to block the sterling balances of countries that threatened to liberalise their exchange controls or abandon dollar discrimination. But despite its seemingly heterodox endorsement of capital controls, the leopard had not changed its spots entirely. The Bank's plan for the continuation of a restrictive currency bloc would require domestic economic policies that put reconstruction plans on hold and prioritised the achievement of external balance (Newton, 2004: 261-262). Clearly, the Bank had not lost its preference for austerity.

Despite its appetite for capital controls, the Bank did find common cause with New York financiers over a different issue. Bank officials shared the New York bankers' antipathy towards the potential for multilateral oversight and international public financial institutions. The American bankers were worried that public financial institutions might reduce the control of private and central bankers and lead to inflationary dynamics by creating too much policy space for expansionary national economic programmes. Their preference was for the maintenance of the old gold standard system of financial discipline, whereby capital flows could work to ensure deflationary measures in the interest of maintaining convertibility (Block, 1977: 53). These concerns were echoed by the Bank of

England, which also felt that the international monetary system should be shaped by the action of bankers.

The agreement that was eventually set out at Bretton Woods reflected a compromise between the original interests of the planners, one in which American priorities were clearly dominant. It also contained amendments that reflected the lobbying efforts of the bankers. Keynes wanted an 'International Currency Union' in which international transactions that gave rise to surpluses and deficits on the balance of payments would be settled through 'clearing accounts' held by major central banks as part of an International Clearing Bank. Keynes's plan aimed to maintain balance of payments equilibrium between each member country and the rest of the world and allow space for domestic policies of full employment and expansion without suffering from the intense deflationary pressures of the gold standard system (Block, 1977: 47; Skidelsky, 2000: 206).<sup>32</sup> Under his proposed system there would be pressure on both surplus and deficit countries to clear their accounts. This would mean revaluing their currencies accordingly. The plan envisaged more punitive consequences for surplus countries however, and it was clear that Keynes's target here was the United States (Eichengreen, 2011: 46).

Harry Dexter White wanted the establishment of two institutions: an International Stabilization Fund and a Bank For Reconstruction (Skidelsky, 2000: 244).<sup>33</sup> In conjunction these two institutions would prevent the collapse of the monetary and credit system, enable the restoration of foreign trade and supply reconstruction capital and relief (Panitch &

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<sup>32</sup> Under Keynes's scheme the pre-war level of trade would determine a country's borrowing capacity. This would suit Britain's immediate post-war needs.

<sup>33</sup> These were the blueprints for the IMF and World Bank, which were created at Bretton Woods.

Gindin, 2012: 74). Under White's plan for an International Stabilization Fund there were limits to free capital movement internationally, and the Fund (which eventually became the IMF) would provide financing so that countries could avoid deflationary measures and restore external balance (Block, 1977: 41). Members could refuse inward investment and requisition foreign investments of nationals to counter the threat of capital flight (Skidelsky, 2000: 245). But, crucially, the New York banking lobby were successful in toning down the commitment to cooperative capital controls, to the extent that by the time the Joint Statement was announced in 1944, 'almost all mention of the obligation to cooperate in controlling undesirable flows had been removed' (Helleiner, 1994: 47). In the absence of cooperation, controls would inevitably prove much harder to enforce. Keynes's plans for the 'bancour' credit were rejected in preference for a system based upon the centrality of the dollar, which would be tied to gold (Hudson, 1972; Panitch & Gindin, 2012: 76-77). White's plan substituted Keynes's automatic taxes on surplus countries for a much more vague possibility of penalties for country's that ran perennial balance of payments surpluses (Eichengreen, 2011: 46). Once the serious discussion began, it was White's Plan that became the central focus, with America's superior power reflected in the bargaining pattern between Keynes and White (Block, 1977: 48).

American Treasury officials were required to launch a campaign of persuasion in order to convince Congress to vote for Bretton Woods in the face of opposition from the New York bankers. The final agreement departed from the previous gold standard regime of the interwar years in a number of ways. Although fixed, exchange rates were now made adjustable. Secondly, controls were now accepted as a legitimate means to regulate



international capital flows and provide a degree of insulation for domestic policies. Finally, the IMF was established with a mandate to conduct multilateral oversight of national economic developments and provide balance of payments financing to countries in need. But the final agreement over the IMF contained certain ambiguities that would later be seized upon to push the remit of the Fund far away from the original emphasis of either Keynes or White (Block, 1977: 50). The new regime instituted at Bretton Woods was a direct response to the challenges faced during the 1920s and 1930s (Eichengreen, 2008: 91). And just as Anglo-American dynamics had been central to the interwar period, they were now institutionalised and applied to the wider international political economy through the Bretton Woods agreement.

Having examined the continuity between Anglo-American developmental processes that spanned the interwar, wartime and post-war periods, feeding into the creation of Bretton Woods, we can now explore the deficiencies of the two predominant interpretations of post-war Anglo-American dynamics: Edward Brett's 'capitulation thesis' and Peter Burnham's 'inter-imperial rivalry thesis'.

### **The 'capitulation thesis'**

Edward Brett's interpretation (1985: 132) identifies three commitments of Britain's post-war economic strategy, established as part of a national consensus by the end of the first Labour government in 1951. Firstly, British policymakers concerned with avoiding the mass unemployment of the 1930s committed themselves to Keynesian social democracy

and full employment. This was combined with an export-led growth strategy to be achieved through the gradual liberalisation of trade and payments. Finally, Britain would accept a position as a junior partner to the U.S. in the effort to rebuild a stable global economy and combat the rising Communist threat. In these three objectives, according to Brett, the central deficiencies of Britain's post-war strategy are rooted. These objectives were in fact, 'neither mutually compatible or in line with the country's diminished economic resources' (Brett, 1985: 133). Britain's capitulation to American power was the undergirding factor in the adoption of this triad of deficient and contradictory policy objectives. The seeds of capitulation were sown during the war, with the progressive financial exhaustion of the Exchequer delivering Britain into American dependence through Lend-Lease, while the need for American finance to enable reconstruction solidified dependency after armistice (Brett, 1985: 135).

American assistance however, came at a high price. American leaders had set their sights on dismantling the Sterling Area, a free trade zone based around sterling under which, 'dealings between the whole Sterling Area and the USA were closely controlled and the supply of dollars to any user strictly rationed' (Brett, 1985: 136). To secure American assistance, Britain would have to move towards full convertibility of sterling and accept American opposition to protectionism. This would be disastrous for Britain's commitment to full employment, with British industry unfit to compete with its American counterpart on equal terms. Furthermore, the likely balance of payments deficit provoked by competition with American exporters would necessitate domestic deflation and politically unpalatable cuts to welfare spending.

This was the context within which Keynes headed to Washington in 1945 to negotiate a Loan Agreement with the U.S. According to Brett (1985: 139), British negotiators were cowed by an unexpectedly hostile American stance. Keynes and his compatriots accepted crushing concessions, agreeing to full convertibility of sterling within one year of the agreements ratification. The consequences of this were twofold. Firstly, Britain would have to enact deflationary measures to offset pressure placed on sterling as holders rushed to move into dollars for purchasing American goods. Secondly, the U.S. would become the effective guarantor of the Sterling Area, through liquidity supplied by the loan and subsequent Marshall Aid. Overall, this involved massive erosion of British sovereignty, leading Brett to conclude (1985: 139) that 'capitulation to American hegemony had been rapid and complete'.

Britain's capitulation at Washington had dire consequences. Brett (1985: 141) suggests these concessions 'turned Britain into a willing American client'. Moreover, Washington set the course for Britain's faltering development in the post-war era. Acquiescing to America's hegemonic ambitions, 'allowed many short-term problems to be resolved with less sacrifice and stress than would otherwise have been necessary, but at the cost of creating conditions that were to guarantee a gradual decline into economic and political mediocrity.'

Subordination to American sponsorship caused Britain's subsequent decline. It facilitated enormous British military spending on the Korean War. This put tremendous pressure on the British balance of payments and, under conditions where full employment had already been achieved, diverted resources away from much needed industrial

reconstruction. Returning to convertibility at American behest provoked the sterling crisis of 1947. Finally, the influx of American dollars stabilised the staggering Sterling Area and was therefore, 'undoubtedly a significant element in the long-term tendency to British decline' (Brett, 1985: 141). Crucially, Marshall Aid underwrote an economic system that British economic power alone could no longer support.

These factors exacerbated and intensified an underlying contradiction between domestic Keynesian commitments and external economic policy (Brett, 1985: 149). The Sterling Area encouraged a massive outflow of British investment into member countries, channelling funds away from domestic outlets and lowering internal investment. War in Korea halted the furtive growth that occurred between 1947 and 1950, prompting deflation and manufacturing decline. Sterling's role as an international currency required a healthy balance of payments position, leading British elites to pursue cautious domestic economic policy that tended to discourage investment and limit growth (Brett, 1985: 147). This was evidenced in the sterling crisis of 1947 and the stop-go cycle of the 1950s and 1960s. Ultimately Brett (1985: 156) identifies Britain's acceptance of junior partner status vis-à-vis the United States, as central to Britain's post-war decline. American sponsorship prolonged an outmoded Imperial system, aggravating terminal contradictions within Britain's post-war strategy. Brett's conclusions have not, however, gone unchallenged.

## **The 'inter-imperial rivalry' thesis**

For Peter Burnham (1990: 5) the post-war relationship was distinguished by the successful subversion of American demands by British policy-makers. Reconstruction occurred through the prism of inter-imperial rivalry rather than under the auspices of American hegemony. Burnham challenges (1990: 8) the 'hegemony approach', demonstrating its inability to explain interstate relations within the supposed hegemonic heartland. Post-war reconstruction was not about the global imposition of American dominance, or the emergent interests of a global capitalist class, but rather, 'The outcome of an uneven process whereby nation-states working within domestic political constraints pursued individual accumulation strategies in the context of re-establishing conditions for global accumulation'. This uneven process, of different national strategies, produced contradictory relations of collaboration and conflict. The major point of friction between Britain and the U.S. was over the fate of Western European integration. While American strategists sought to expand through trade and investment into an integrated Western Europe, British leaders identified their principal interests with Sterling Area nations (Burnham, 1990: 8).

Although the Americans clearly harboured ambitions to greatly expand their power through the subordination of Britain, they were continually frustrated in their attempts to pursue these objectives. British officials played a clever game of deception: subverting the Washington Loan Agreement obligations and using dollar aid to, 'restructure trade, stimulate production and reduce the dollar gap to gain some degree of independence from the United States' (Burnham, 1990: 10). The British Treasury in particular resisted the

more vociferous American ambitions. Sterling's role as an international currency and the status of London as the, 'world's premier financial centre', gave Britain bargaining strength with U.S. policymakers, who recognised that working through Britain was crucial to expanding American influence in Europe (Burnham, 1990: 9).

Rather than an effective tool for the establishment of American hegemony, then, the Marshall Plan and associated attempts to promote European integration had limited efficacy regarding Britain. Burnham suggests that the Marshall Plan, 'simply fed Britain more dollars without achieving the European integration which was its political rationale'. British resistance dampened integrationist efforts and led to a reduced form of 'non-committal coordination' (Burnham, 1990: 10). These were not therefore, as Brett had suggested, signposts on the journey towards Britain's capitulation to American hegemony.

For Burnham, contra Brett, Korean rearmament did not exemplify British pliability under American pressure. It was an autonomous decision taken by the British government in order to demonstrate Britain's independent status within Western Europe. Rearmament did not, as Brett suggested, have a serious negative impact on the British economic recovery. Impacts were limited and government spending actually stimulated development of some industries through subsidy (Burnham, 1990: 12).

All of these points of contention lead Burnham towards very different conclusions. Britain trenchantly resisted the hardball tactics of the U.S, and ultimately the attempted imposition of U.S. hegemonic ambitions was blocked by British and Western European resistance. The pattern of post-war reconstruction that evolved was far removed from that

envisioned by American planners. We are left with two radically different interpretations of the period.

### **Beyond the capitulation/rivalry binary**

The 'capitulation/rivalry' binary through which Brett and Burnham explore the post-war period is gravely misleading. Regarding Brett, the notion of 'capitulation' is far too unequivocal to capture the complexities of Anglo-American jockeying for power during and after the war. Brett overlooks the rivalry and contestation underway during the war, which continued into the post-war years. Focusing upon the 'post-war' era as an analytically distinctive moment is useful to a certain degree, but it masks the continuities at play during and after the war. As we have seen in the preceding section, many of Britain and America's 'post-war' priorities were actually determined either before or during the war (Maier, 1977: 607, Waddell, 1999: 244; Cronin, 1991: 137; Bartlett, 1977: 9). Terse bargaining underway during the war did not stop afterwards.

In this respect, Burnham's critiques of Brett's analysis are well placed. Burnham (1990: 10) correctly identifies Britain's centrality to realising American plans for European integration. This provided leverage for Britain, and British politicians were able to stifle American ambitions for an integrated Europe (Cronin, 1991: 166; Hogan, 1987: 21). There is also support for Burnham's claims regarding Britain's ability to evade responsibilities agreed to in negotiations with the U.S. (Maier, 1977: 621; Cronin, 1991: 166). Clearly then, Brett's (1985: 139) suggestion that Britain's capitulation to American hegemony had been

'rapid and complete' is misguided. Britain fought to maintain sterling's international status and entry into the Korean War was consistent with the desire of British leaders to demonstrate their commitment to a continuing world power role.

Nonetheless, Burnham's alternative account pushes us towards a comparably deficient extreme. Characterising the post-war relationship as 'inter-imperial rivalry' obscures more than it reveals. Applying this concept to the post-war period is deeply anachronistic.<sup>34</sup> Anglo-American relations had moved beyond the possibility of armed conflict, after the unprecedentedly intimate wartime alliance between the two (Ovendale, 1998: 47; Temperley, 2002: 46). Negotiations occurred within the boundaries of a militarily pacified relationship, suggesting that something beyond 'inter-imperial rivalry' was at play. There was rivalry, but the background commitment to partnership was solid. This was contained rivalry; the parameters of military and strategic cooperation were secure but struggles over 'softer' political issues of trade and monetary policy continued. The contained rivalry between Britain and the U.S. was symptomatic of a broader redefinition of West European sovereignty under the global 'Protectorate System' that American power facilitated after World War II, with the Americans now the lead and exceptional players in defining the overall security context of Western Europe against the threat of the Soviet Union (Gowan, 2003: 1).

There were also areas of commonality with regard to the Anglo-American vision for the post-war world order. Neither Britain nor the U.S. wanted the return of the corrosive

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<sup>34</sup> It is better suited to the pre- WW1 period in which, as we have seen in chapter two, the unifying impact of German bellicosity stymied strategic tensions between Britain and America that had threatened to boil over.



trade rivalry and currency instability that characterised the inter-war years (Maier, 1977: 619). And neither did either welcome unchecked expansion of Soviet power in Europe and beyond. In the longer term, powerful interests within Britain and America wanted to see a return to an international free trade order, but the timing and character of this order was the subject of considerable contention.

In a much more nuanced account than Burnham's, Michael Hogan (1987: 21) identifies continuity between the post-war period and the interwar years. At stake were the terms and conditions of British sovereignty as the transformation from independent Imperialist power to subordinate partner within an American-led world order accelerated. But intrusions into British sovereignty were tolerated because of the desperation of Britain, the intensity of wartime collaboration and because both states had a commitment to creating a more liberal post-war economy (Dobson, 1995: 90). Wartime exhaustion of British power catalysed this process as it had during WW1. Although Brett correctly identifies the central process of British subordination, he overstates the readiness and comprehensiveness with which Britain gave up independence. Ultimately, both Britain and the U.S. wanted to push the post-war international economy in the same direction but the routes that they envisaged, mapped out by distinctive interests, were markedly different. Only by examining processes stretching across the wartime and post-war periods are we able to escape the capitulation/rivalry binary and explore the co-constitutive currents of Anglo-American development.

How did currents of institutional transformation bear on post-war dynamics between Britain and America? Understanding the different institutional priorities at play

during the Anglo-American negotiations at Bretton Woods and beyond requires that we disaggregate the national interest and problematise its formation across space and time. Processes of institutional transformation within both countries, underway before and during the war, were key to the tone and scope of post-war developments. Indeed, many of the questions that would motivate the post-war planners who drew up the Bretton Woods agreement, were born directly from the troubled international economic developments of the interwar years and the way that state institutions developed in response to these challenges. What emerged after the war, then, bore the indelible imprint of the legacies and lessons of the interwar political economy. The shadow of the gold standard loomed large over the Bretton Woods blueprints for international economic order (Pauly, 1997: 45).

Due to the deficiencies within their analytical approaches, both Brett and Burnham overlook the significance of these diachronic developmental processes. Consequently, they fail to identify the tensions within the British state and the bearing this had on post-war relations with the U.S. Brett's (1985: 133) assertion that a national consensus had been established around three major policy objectives by 1951 obscures the degree of internal contention over these goals and exaggerates the extent to which they were universally accepted.<sup>35</sup> Similarly, Burnham (1990: 185) rules out the possibility of divisions within governmental institutions, proclaiming that, 'the role of the capitalist state is to express the 'general interest' of capital'. Rather than exploring formation of the 'national interest', both Brett and Burnham deduce it from mechanistic conceptions of uneven development. For

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<sup>35</sup> For an excellent analysis of the exaggeration of consensus politics in the post-war period see: Peter Kerr (2001) *Post-war British Politics: From Conflict to Consensus*, London: Routledge.

Burnham this results in a crude economic determinism that obscures the evolution of institutional perspectives on post-war economic policy. In Burnham's mechanistic framework, increased 'economic' cooperation gives rise to 'political' consolidation. Attempts to investigate tensions and processes at work within the state are dismissed as, 'Weberian empiricism' (1990: 186). This dismissal is unwarranted, leading Burnham to exaggerate rivalry and underplay the development of complementarity between institutional and class actors within Britain and America.

### **The restoration of orthodoxy**

Preoccupied with questions of decline, hegemony and inter-imperial rivalry, Brett and Burnham overlook crucial facets of institutional development within the British state and the interpolation of these processes with currents of development in the U.S. In particular, they disregard the manner in which these transformations and tensions played out in the formulation of Bretton Woods and the impact that this had upon subsequent developments. Their polarised interpretations, expressed in terms of 'capitulation' and 'inter-imperial rivalry', leave little space for excavating the nuanced patterns of institutional transformation that characterised the post-war state. These patterns are integral to understanding Britain's development within the context of the common interests of banking communities in London and New York.

Both Brett and Burnham chronically underestimate the centrality of the Bank of England and the influence of the City on British policy. Burnham (1990: 180) dismisses the

possibility of a divergence of interests within British capitalism out of hand.<sup>36</sup> But as we have seen, these differences were already at play during the formulation of Bretton Woods. Burnham's theoretical dismissal simply sidesteps the large body of literature that makes the case for a distinctive nexus of institutional power within the British state: that between the City, Treasury and Bank of England (Ingham, 1984; Green, 1992; Hall, 1986). Inquiry into the historical processes of institutional development underway immediately before, during and after the war reveals the importance of this dynamic nexus. The shifting balance of power between these institutional centres of power within the British state, and the manner in which they intersected with the evolving balance within the U.S., were key to the unfolding of post-war Anglo-American development.

Despite the Bank's animosity towards Keynes, the predominance of the City within official British thinking was already inscribed, to a certain degree, within Keynes's post-war objectives. Keynes was committed to a liberal, multilateral international economic order very much in keeping with the longstanding interests of the City (Cottrell, 1995: 210; Green, 1992: 198). Although there were frictions with the Bank over the timing of a return to sterling convertibility, Keynes's ultimate ambition was to, 'recover for London its ancient prestige and its hegemony' (Hall, 1986: 211). Notwithstanding the failure to properly institutionalise Keynesian thinking within the key centres of the post-war British state, then, the strategic failures that led to the revitalisation of the City and undermined the

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<sup>36</sup> For Burnham the capitalist state is a monolithic form that expresses the interests of capital in general in an essentially negative way, by removing barriers to capital accumulation and ensuring the sanctity of private property and the stability of money. This perspective disables our capacity to disaggregate the state by rejecting any such attempts, apriori, as Weberian pluralism or 'overt empiricism' (Burnham, 1990: 180).

Keynesian compromise within Britain were also very much a product of the inconsistencies and contradictions within Keynes's own thinking. There was substantial overlap between Keynes's post-war planning and Gladstonian orthodoxy, with the maintenance of London's role as the cornerstone of the international economy remaining central.

These overlapping interests began to emerge more clearly after 1947, in the aftermath of Britain's disastrous attempt to restore sterling to convertibility under American duress. The American attempt to corral Britain into convertibility was in itself an expression of the shifting balance of power within the American state following the death of Roosevelt in 1945. Roosevelt's death brought about a reconfiguration of the power balance within the American state. New Deal figures such as Morgenthau and White were now sidelined and American bankers took up important roles within the new Truman administration (Helleiner, 1994: 52). The State Department now began to exert a greater influence upon American foreign policy, with policy-makers now beginning to look much more favourably upon the Key Currency Plan. State Department planners had been unhappy with the extent to which Bretton Woods had departed from gold standard principles and believed that five-year breathing space granted to Britain before it had to restore convertibility had been too generous. Their opportunity to impose this new vision, which sought to restore sterling to convertibility well before the five-year period had elapsed, arose during the Washington Loan negotiations in 1945.

The Americans had abruptly terminated the Lend-Lease arrangement at the end of the war, leaving Britain desperate for additional dollars (Helleiner, 1994: 52-53). Keynes was sent over to the U.S. to negotiate for additional funding, but with the U.S. position

having hardened under the increased influence of the State Department, he was only able to secure funding at the expense of a commitment to restore convertibility by July 1947 (Saville, 1993: 150; Newton, 2004: 260). While Keynes was able to win support for the loan agreement within government, the Bank and sections of the Treasury were opposed to the restoration of convertibility. Keynes had proposed that Britain's military expenditure should be cut and that all sterling balances should be blocked for five years in preparation for a smooth transition to convertibility that would insulate the reconstruction programme from currency shocks. But the attempt to block the sterling balances was a failure, particularly after Keynes's death in 1946. The Bank was only willing to negotiate a scaling down of the balances with creditors rather than unilaterally blocking them, as Keynes had wanted. The Bank feared bringing about the demise of the sterling area and with it sterling's status as an international currency. The Bank's refusal to compromise on the issue of sterling balances greatly heightened the risk of convertibility and resulted in the disastrous flight from the pound that occurred as soon as convertibility was restored. Crucially, the calamitous attempt to restore convertibility, 'meant the collapse of Keynes's efforts to establish an international context which would support British reconstruction', while the Bank's role in the failure was a reflection of its, 'continuing dissent from the reconstruction consensus and preoccupation with the external status of sterling' (Newton, 2004: 265).

After the failure to restore convertibility, a consensus briefly emerged around the need to maintain sterling as an inconvertible currency. The maintenance of inconvertibility received support both from Keynesians and officials within the Bank and the Treasury who

were principally concerned with sterling. The Bank viewed the continuation of bilateral arrangements as an improvement from possible bankruptcy, while Keynesians supported controls that would insulate the domestic economy from dollar shortages. But this consensus was extremely fragile, and it began to break down when sterling came under renewed pressure in 1949.

The fragility of Keynesian thinking in planning the future of sterling was reflected in the Treasury's domestic strategy too. Although the Keynesian revolution did make headway within the Treasury's domestic strategy, it was met with resistance from other key strategic sites within the state.<sup>37</sup> Brett's (1985: 133) suggestion that an overarching national consensus on British policy had been reached by 1951 overly simplifies complex and contradictory processes. As Peter Kerr (2001: 52) notes, it is important to remain cautious over the extent to which Keynesian thinking overcame the longstanding liberal orthodoxy within key institutions of the British state as 'Throughout the post-war period, pre-Keynesian beliefs continued to dominate the Treasury, thereby serving as a major obstacle to the introduction of an effective demand-management strategy for achieving full employment' (Kerr, 2001: 52). The variant of Keynesianism that became tenuously consolidated displayed a substantial continuity with previous practice. An 'oral tradition' of sound money persisted within the Treasury, colouring the economic policies of all post-war governments (Cronin, 1991: 160).

After 1947 there was a retreat from the wartime physical controls on prices and production. These were substituted for monetary and fiscal management techniques

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<sup>37</sup> And, of course, from within the Treasury itself.

(Green, 1992: 204). Abandoning physical controls meant that the Treasury re-emerged as the principal institutional hub for formation of economic policy. This restoration of Treasury control was enormously beneficial to the City, because it implicitly entailed the reassertion of the City's privileged relationship with the main hub of economic decision-making. Exclusive reliance on monetary and fiscal methods of economic management augmented the role of the financial sector and money markets in shaping policy. In the light of these considerations, 'Britain's much-vaunted 'Keynesian Revolution' begins to look far less of a radical break from pre-war practice than has generally been assumed' (Green, 1992: 204). Although the Treasury was made solely responsible for planning from 1947, its concern with industrial issues extended only to the point at which they affected the balance of payments and the status of sterling (Saville, 1993: 170).

Substantial changes did nonetheless occur. Public spending increased massively during and after the war, rising from 14% of GNP in 1900 to 38% by 1961. Increased state involvement in economic development had qualitative impacts on the nature of Treasury control, with an expanded institutional apparatus arising in order to meet these challenges. Crucially, the internationalisation of the Treasury underway during the 1920s and 30s intensified after the war. Under Cripps' chancellorship the Treasury's international section expanded greatly. Expansion was prompted by the enduring balance of payments problems and the sterling crisis of 1947. After this point, 'the centre of gravity, in terms of capacity as well as achievement, now lay in the large Overseas Finance Division of the Treasury'. This section of the Treasury dealt with the external crises of 1946-51 and was responsible for planning around the formation of the O.E.E.C and the European Payments Union. By the



early 1950s the Overseas Finance Division of the Treasury was better staffed and better equipped than its domestic counterpart (Roseveare, 1969: 284-286, 317).

The post-war internationalisation of the Treasury reflected continuity with interwar dynamics, but with a crucial difference; now British Treasury power was subordinated within a transatlantic network linked to a comparably internationalising American Treasury. The difficult negotiations between the two Treasuries at Bretton Woods demonstrated the remarkably close ties between them and foreshadowed the coordinating role that the American Treasury would play with former Great Powers in the post-war world (Panitch & Gindin, 2012: 77).<sup>38</sup>

Labour's inability to orchestrate a lasting institutional transformation of the British state enabled a Conservative reaction in 1951 (Cronin, 1991: 189). Even after nationalisation in 1946, the Bank of England retained a high degree of operational autonomy (Roseveare, 1969: 321; Cronin, 1991: 168; Green, 1992: 204). Under the Tory government the Bank of England regained the initiative in monetary policy.<sup>39</sup> The Bank had begun to question its commitment to bilateralism from 1949, as it grew increasingly concerned that sterling's international role could not be maintained without embracing convertibility.<sup>40</sup> The Bank and the Treasury requested an American loan in order to make the pound rapidly convertible. They were supported by American bankers in the U.S.

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<sup>38</sup> American officials believed that close cooperation with the British Treasury would legitimise the transition in international currency status from sterling to the dollar and ingratiate American aims with the Old World (Panitch & Gindin, 2012: 77).

<sup>39</sup> In the earliest post-war years, much decision making power had continued to be vested in the wartime planning committees (Cronin, 1991: 157; Helleiner, 1994: 69).

<sup>40</sup> The Bank was worried that the sale of 'cheap sterling' in the New York black market was undermining the status of sterling and diverting business away from the international markets in London (Newton, 2004: 266).

Treasury, who recognised an opportunity to restore the Anglo-American financial alliance of the 1920s. But the bankers' plan was rejected by the ECA (the body responsible for administering Marshall Plan aid), which believed that a return to sterling convertibility would undermine attempts to promote European cooperation through the European Payments Union (Helleiner, 1994: 69). Although this attempt to restore the Anglo-American financial axis failed, it foreshadowed the developments that would occur during the following decade and signalled that within Britain, both the Bank and the Treasury were now interested in restoring convertibility.

With the Conservatives keen to restore the City's international position and sterling's international role from 1951, the proponents of a new external policy were presented with an opportunity. George Bolton at the Bank advised the Chancellor to promote 'progressive convertibility', by incrementally moving towards full convertibility (Newton, 2004: 270). But American financial support for such a move was not forthcoming, with the Truman administration now prioritising European integration through the EPU. In December 1951, the Conservatives reopened the City as a centre for foreign exchange dealing (Strange, 1971: 64).<sup>41</sup> By early 1952, the Bank and the Overseas Finance Section in the Treasury launched 'Operation Robot': attempting a unilateral restoration of convertibility at a floating rate, without American financial support. The plan caused a battle within the government and, crucially, revealed a deep schism 'between those who supported the aims of post-war reconstruction and those who did not'. Robot was not compatible with the post 1944 policy consensus, as its implementation would have implied

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<sup>41</sup> Butler, the new Tory Chancellor, enacted all of the Banks proposals in November 1951, when it called for a rise in the Bank Rate and deflationary cuts in public spending (Cairncross, 1995: 75).

the need for severe deflationary measures. Tighter monetary policy and spending cuts, proposed by senior Treasury officials, would have been required to stabilise the pound. Keynesian economists within the civil service rejected the plan on the grounds that it would return macro-economic policy to the pre-war orthodoxies (Newton, 2004: 271-272). The plan was eventually rejected, but it demonstrated clearly the growing influence of the Bank and the continuity of pre-war policy orthodoxy both within the Bank and sections of the Treasury. The plan made a mockery of Britain's supposed Keynesian consensus. The Bank had been waiting for its opportunity to restore the international orientation of the City and the pound, whatever the cost for reconstruction efforts and full employment.

Developments within Britain intersected with comparable processes in the U.S. During the war, the independence of the Federal Reserve was restricted by the imperatives of war financing.<sup>42</sup> For the first time in the history of the Fed, elected officials rather than unelected Federal Reserve members controlled monetary policy (Epstein & Schor, 1995: 7). This ushered in an unprecedented phase of public control over the Federal Reserve. The project was short lived however; by 1951 the Federal Reserve- Treasury Accord had restored the independence of the American central banking system and freed the Fed from the obligation to support the U.S. government bond market by ensuring that it could be financed at low interest rates. The wartime arrangement had facilitated massive fiscal expansion, but it had also undermined the Fed's capacity to control inflation as it was forced to buy U.S. government bonds every time long-term interest rates threatened to rise above the agreed level (Axilrod, 2011: 25-26). Just as in Britain, this outcome represented the

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<sup>42</sup> The central issue during the war was the level of interest rates for U.S. Treasury bonds. The Federal Reserve was forced to accept lower rates than it had wanted (Epstein & Schor, 1995: 15).

limitations of post-war Keynesian transformation. The Fed had been worried by the inflationary effect of wartime financing and wanted to raise interest rates in order to end the easy money policies of the wartime years (Konings, 2011: 111). It successfully lobbied prominent members of the banking community and associated business interests to push for independence in the face of Truman's administration and figures within the Treasury, who had sought to hand control of monetary policy over to the President (Epstein & Schor, 1995: 28).<sup>43</sup> By winning this battle, the Federal Reserve and its allies ushered in a "Conservative Keynesian" policy framework.<sup>44</sup> In restoring the independence of monetary policy from governmental control, the Accord between the Fed and the U.S. Treasury laid the foundations for the tight monetary policies of the 1980s and 1990s, which would be used to restore the power of capital and break working class aspirations and shatter the Keynesian promise of full employment (Epstein & Schor, 1995: 28). The Accord was seen as a way to prevent radical forces within any government administration from pursuing inflationary policies, in this sense then, the roots of monetarism were actually implanted during the 1950s, with macroeconomic policy priority given to the need to manipulate short-term interest rates in order to control inflation and shape aggregate demand (Panitch & Gindin, 2012: 86-87).

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<sup>43</sup> It was Russell Leffingwell, the Chairman of J.P. Morgan and Co., known by the head of the Federal Reserve as the, 'dean of the financial community', who was the most important individual player in pushing for Federal Reserve independence (Epstein & Schor, 1995: 16).

<sup>44</sup> From now on, an independent Central Bank would use adjustments in interest rates as the primary mechanism for control over the economy. Conservative Keynesian planning is defined by a lower degree of, 'intervention to control prices, wage rates and resource allocation in the private sector' (Burkhead, 1971: 335).

In both Britain and the U.S., then, the old deflationary orthodoxies entailed by Central Bank control over monetary policy had begun to reassert themselves convincingly by the early 1950s. The restoration of the Bank of England's power over monetary policy in the United Kingdom was mirrored by the re-establishment of Federal Reserve independence in the United States. This represented the restoration of banking power in both countries in the early post-war period.<sup>45</sup> As the 1950s progressed, the restoration of Central Bank power in both countries would be central to the continuation of Anglo-American development and the politics of financial globalisation.

Within Britain, the re-emergence of the orthodox City-Bank-Treasury nexus, after a period of internal contestation between different power centres within the state, was a defining feature of the post-war period. From 1947, the Treasury was largely concerned with the international standing of the pound, with the domestic economy viewed largely in response to international developments and confidence in the pound (Blank, 1978: 104). The restoration of the traditional City-Bank-Treasury nexus, and the gathering momentum towards the restoration of convertibility within both the Bank and the Treasury by the early 1950s, were key to the restoration of the international economy around the Anglo-American financial axis that American bankers had wanted since before Bretton Woods. During the 1950s and 1960s, the City-Bank-Treasury nexus would increasingly come to be articulated through the Federal Reserve-Wall Street- Treasury nexus in the U.S. as the two countries played central and interdependent roles in the politics of financial globalisation.

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<sup>45</sup> Epstein and Schor (1995: 8) suggest that the Accord laid the foundations for major victories for capital against labour, through the tight monetary policy of the 1980s and 1990s.

The reorientation of state institutions towards the Anglo-American financial axis was assisted by enduring ties between private bankers on both sides of the Atlantic. Just as it had done during the First World War, the House of Morgan played a significant role once more. Lamont championed the British cause during the war, pushing for Roosevelt to lift the arms embargo on Britain and assisting the British Ambassador Lord Lothian. Morgan Grenfell, the British wing of the House of Morgan, was depopulated during the war as many of its senior staff took up public positions within government. This was a logical extension of the bank's pre-war role as, 'something of a branch office for the Bank of England, the Treasury, and the Foreign Office'. Tom Catto, a senior Morgan Grenfell partner, was appointed to the role of 'special advisor' to the wartime chancellor, Kingsley Wood.<sup>46</sup> Lamont maintained a distinctive diplomatic channel with Catto at the Treasury. Anglo-American financial power was in this way implanted within, and channelled through, the dominant institutions of governance (Chernow, 1990: 460).

Undoubtedly these informal channels were weakened by the growth of multilateral institutions and the new climate of public accountability that followed the end of the war. An informal partnership of the Federal Reserve, Bank of England and the House of Morgan, which had virtually run the international monetary system in the interwar years, was supplanted by the World Bank and IMF (Chernow, 1990: 486). While within the U.S., rival investment banks used the New Deal era hostility towards the 'Money Trust' in order to promote reforms that would weaken the House of Morgan's control over American finance (Konings, 2011: 80). These ambitions were realised with the passing of the Glass-Steagall

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<sup>46</sup> Catto and John Maynard Keynes were given rooms on opposite sides of the Chancellor's office (Chernow, 1990: 460).

Act, which undermined the unity of investment and commercial banking functions that had been key to Morgan's dominance within the U.S. (Ferguson, 1995: 149).

Nevertheless, the old ties still mattered. Catto served as head of the Bank of England from 1944 to 1949, an appointment that was interpreted as, 'underscoring the need for close post-war cooperation with the United States' (Chernow, 1990: 476). Although Britain's relative power had decreased, American bankers continued to recognise the importance of sterling and the City for the realisation of their ambitions. New York was undoubtedly the world's premier financial centre and the City experienced only stuttering recovery in the early post-war years. The continuation of wartime controls confined London merchant banks to Sterling Area loans. Members of the banking community in London viewed these controls as onerous impediments to growth (Roberts, 1992: 313).

The sentiments of London's merchant banking community towards the post-war international monetary order are exemplified by the thoughts of one of its most prominent figures- Siegmund Warburg, the head of the famous Warburg merchant bank that would later play a key role in the emergence of the Eurobond market during the 1960s. In a demonstration of the continuing importance of trans-Atlantic linkages between London and New York, Warburg made several business trips to New York from February 1946 in order to scope out the potential for business ties with the prominent New York investment bank 'Kuhn Loeb'. By the end of 1948, Warburg and his colleagues had made fourteen trips to the U.S. But Warburg was disappointed with the meagre business outcomes of these trips and began to grow increasingly frustrated with the post-war order (Ferguson, 2010: 159-160). Warburg was critical of the post-war Anglo-American financial order drawn up at Bretton

Woods on two grounds. Firstly, he opposed the manner in which gold standard thinking had infused the agreement in the form of the American dollar's fixed convertibility to gold. And secondly, Warburg opposed the restraints on capital mobility that were accepted at Bretton Woods as a necessary counterpart to fixed exchange rates and independent monetary policies. Warburg was critical of the early termination of Lend-Lease and, importantly, thought that Anglo-American bankers should do all that they could to create a closer link up between finance and industry within the two countries (Ferguson, 2010: 167-169). Indeed, by 1950 Warburg was calling for a currency union between North America and Western Europe (Ferguson, 2010: 164). These attempts to restore Anglo-American financial links would become much more important as the decade wore on.

### **The stillbirth of the 'Keynesian' state**

In the face of enduring policy orthodoxy, centred on the Bank of England, the City and the Treasury, Britain's post-war Keynesian compromise never stood much of a chance. By the early 1950s, the old forces of orthodoxy were in the ascendancy, with the Conservative government and its traditional orientation towards the City of London providing fertile conditions for the reassertion of the Bank of England's control over monetary policy and a broader privileging of the pound within the core financial nexus of the British state. The limited headway that Keynesian thinking had made within the Treasury before and during the war left the path open for the reassertion of the old gold standard concerns. Policy became increasingly focused upon a strong pound and the appropriate deflationary



medicine required to achieve external balance. The post-war Labour government, despite nationalising the Bank of England in 1946, was unable to thoroughly institutionalise an alternative set of economic priorities within the key institutions of the British state.

The restoration of orthodoxy within Britain also owed much, as this chapter has demonstrated, to the enduring influence of the New York banking community within the U.S. Domestically, their attempts to bring Britain and sterling into a multilateral international economic order were at first thwarted by the more gradualist approach to achieving British convertibility endorsed by the U.S. Treasury under Roosevelt. Internationally, the Bank's commitment to bilateralism in the early post-war years presented a major obstacle. But despite the failure of the New York bankers and the U.S. State Department to restore sterling's convertibility on a lasting basis in 1947, it was not long before the City-Bank-Treasury nexus began to embrace the multilateral vision that the New York financial community and the American state had sought to promote all along.

Dynamics between Britain and the U.S., and between different institutions and power centres within each state, were central to the manner in which the post-war international economic order unfolded. By framing these interactions in terms of 'capitulation' and 'inter-imperial rivalry', the existing debate has understated the crucial way in which the working out of competing interests within Britain and the U.S. impacted the relationship between the two countries and moulded the manner in which the post-war international economic order was instituted. Only by disaggregating the national interest and revealing the dynamics tensions both *within* and *between* states, are we able to apprehend these processes. The erosion of Keynesian commitments within both states and

the re-emergence of Central Bank autonomy, already underway by the early 1950s, would be central to the latter decomposition of the Bretton Woods order and the emergence of financial globalisation.

From the late 1950s, the uneven interdependence of Anglo-American development expressed itself in the emergence of the Euromarkets and the continued interactivity of sterling and the dollar, alongside London and New York, as both countries struggled to manage their balance of payments deficits under the Bretton Woods order. In the process, Anglo-American developmental dynamics played a critical role in the decomposition of the Bretton Woods order and the gradual rise of the alternative monetary system that began to emerge from the early 1970s.

#### **4 Anglo-American Development, the Euromarkets, and the Decomposition of Bretton Woods**

No event contributed more to Anglo-American financial integration than the emergence of the Euromarkets. As the Cold War order crystallised Soviet officials, fearing seizure of dollar assets by American authorities, deposited their holdings with European banks (Burn, 1999: 229). In 1955, the Midland Bank used these holdings to finance domestic activity during a period of tight money in the UK (Schenk, 1998: 224). So began the most important development in the post-war history of international finance. The Eurodollar market, and later the Eurobond market, became the crux of a new wave of globalisation. At the heart of this process lay the deepening integration of New York and London, and of the United States and Britain as key players in a resurgent global political economy.

The birth and rapid growth of the Euromarkets exemplifies the complex interactivity of Anglo-American development. It ushered in the final passing of sterling's aspirations to top currency status, cementing in its place the hegemony of the dollar within rapidly expanding global capital markets. It was the locomotive that drove the City's revival as an international financial centre of the first rank, but it did so at a price. No longer British banks but American would lead the way in international banking. And no longer sterling but the dollar, would function as a truly international currency. Not least, *the power of private banks would be further entrenched within the British state*, presenting a major obstacle to democratic control of global finance.

While the emergence of the Euromarkets has tended to be understood either as a consequence of the changing relationship between states and markets, or more recently, as a product of the outward expansion of American finance, this chapter deploys original archival and statistical evidence to suggest that the emergence of the Euromarkets must be understood as a result of the *interdependence of Anglo-American development*. Rather than emerging principally as a consequence of coherent state strategies, or through the spontaneity of market innovators, the Euromarkets developed through the manner in which bankers and state officials on both sides of the Atlantic attempted to negotiate the crises and constraints of the post-war international financial order. In combination, these Anglo-American strategies produced outcomes that were often unintended, but which nonetheless helped lay the basis for the collapse of Bretton Woods. For Britain, the Euromarkets revitalised the City and enabled the merchant banking community to maintain influence within the corridors of power. In the process, the City became an archipelago of American finance and the British state was drawn more tightly into the embrace of globalising capital markets.

The emergence of the Eurodollar market and its acceptance by the Bank of England represented an attempt to restore the City's international pre-eminence. But unlike the attempts to restore the City's role in the 1920s, with the failed resuscitation of the gold standard, this endeavour occurred within *recognition of the preeminent power of American banks and the American dollar*. The dollar became a surrogate currency for British banks that could no longer rely upon sterling. British merchant bankers drew American power into the City to maintain their domestic dominance and re-launch its international role.

Through the transatlantic interactivity of Anglo-American development the City was transformed. This was a return to the pre-WW1 internationalism of the City, and part of the emerging *splintered sovereignty* of international finance.

The chapter begins by reviewing the dominant IPE interpretations of the origins and emergence of the Euromarkets, arguing that they have not captured the centrality of the interaction between private bankers and state officials, on both sides of the Atlantic, in driving the emergence of the Euromarkets. I then go on to explore the emergence of the Euromarkets within the context of the Bank of England's attempt to restore the City's international role. The subsequent sections then explore the way that American financial development under the constraints of the Bretton Woods system and domestic financial regulations, drew the American banks into the Euromarkets. I then explore the Americanisation of the Eurodollar market and argue that transatlantic monetary policy became increasingly interdependent as a result. Finally, I examine the impact of the Euromarkets upon the fiscal basis of the British state before concluding that the development of the Euromarkets represented a key moment in the transition towards financial globalisation, undermining the basis of the Keynesian state and placing Anglo-American developmental dynamics at the centre of transformations within the global political economy.

## States, markets and the Euromarkets

Much of the debate over the Euromarkets has focused upon identifying their origins (Martenson, 1964; Bell, 1973; Schenk, 1998). These scholars have unearthed many of the processes that spawned the Euromarkets. Alternatively, the Euromarkets have been explored in the context of either, Britain's national development (Strange, 1971; Ingham, 1984; Overbeek, 1991; Burn, 2006), or, the international transformations associated with the collapse of the Bretton Woods System (Block, 1973; Helleiner, 1994; Langley, 2002; Eichengreen: 2008). Within the IPE literature, another grouping of scholars has argued that the emergence of the Euromarkets was functional to the deepening of American structural and financial power (Strange, 1987; Gowan, 1999; Panitch & Gindin, 2010 & 2012; Konings, 2012).

The IPE literature on the Euromarkets has been criticised for reducing the debate to a simple dichotomy between state and market. Responsibility for the development of the Euromarkets is then accorded *either* to state agencies *or* market operators (Burn, 1999: 227). In reality, as Gary Burn has shown, the responsibility for the emergence of the Euromarkets is hard to pin down in these bifurcated terms. In Britain the most relevant state institution, the Bank of England, acted as an interface between the state and the market and played the roles of 'poacher and gamekeeper' simultaneously (Burn, 1999: 241). Blurring the boundary between state and market renders some of the conventional IPE accounts of the Euromarkets highly problematic.

But there is a further deficiency within the IPE literature. The notion of discreet national states transformed by globalising markets that are somehow exterior is also deficient. A number of scholars have challenged this orthodoxy within IPE, pointing towards the special role that the United States has played in the constitution of global capitalism (Gowan, 1999; Panitch & Gindin: 2010 & 2012; Konings, 2012). Panitch and Gindin (2012: 119) view the collapse of Bretton Woods and the emergence of financial globalisation not as a consequence of globalising markets escaping the control of national states, but rather as a result of the international expansion of American finance. Similarly, Konings (2012: 88) critiques adherents of the 'states versus markets' approach for missing the extent to which the globalisation of finance in the 1960s, which undermined the Bretton Woods system of capital controls and fixed exchange rates, was an outgrowth of American finance.

These accounts provide an indispensable tonic to the naïveté of the literature that viewed globalisation in terms of the 'retreat of the state'. But they have not fully grasped the extent to which the articulation of American financial power in and through Britain was not merely *incidental* but rather absolutely *integral* to the reconstitution of global capitalism. An emergent *Anglo-American field of developmental interactivity*, which became increasingly important during the late 1950s and the 1960s, played a fundamental role in financial globalisation and the collapse of Bretton Woods.

What's required, then, is a synthetic approach that explores these processes of Anglo-American development within the broader context of the constraints and contradictions of the Bretton Woods system. This chapter focuses upon the development of

the Euromarkets as a prism through which to trace both the *patterns* and the *effects* of Anglo-American developmental interdependence. The analysis builds upon the work of scholars such as Susan Strange (1971) and Henk Overbeek (1990), who have recognised the significance of the Euromarkets for Britain's modern development and postulated some of its effects, without substantiating these claims. Gary Burn's (1998; 2006) excellent work on the Euromarkets also provides an important reference point. But whereas Burn's account is principally concerned with demonstrating how little the Americans knew about the Euromarkets during their inception, ours is concerned with demonstrating the Anglo-American developmental dynamics that brought American banks into London and accelerated the decomposition of Bretton Woods.

The exact origins of the Euromarkets are murky.<sup>47</sup> It is certainly the case that the Eurodollar market preceded its Eurobond counterpart. A very discreet Eurocurrency market began during the early stages of the Cold War, in the late 40s and early 50s. Dollar deposits were placed with banks in London and Paris by the Soviet and Chinese governments, who feared that American authorities would seize their assets (Higgonet, 1985: 27). Controls on sterling's use for trade between third parties and as refinance credits, prompted by British concerns over a deteriorating balance of payments, as well as the return to convertibility of Western European currencies from 1958, were also

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<sup>47</sup> The term 'Euromarkets' applies to transactions in two distinct but related markets: the 'Eurocurrency/Eurodollar' and 'Eurobond' markets.<sup>47</sup> But the prefix 'Euro' is rather misleading. The term is used as an umbrella to describe transactions of offshore currency traded outside of nationally prescribed banking authority (Burn, 1999: 226). Essentially, it describes an offshore market in foreign currency. The market is wholesale, predominantly comprising of large-scale operators such as commercial banks, governments and large companies (Higgonet, 1985: 30).



contributory factors to the rapid growth of the Eurodollar market from the late 1950s (Martenson, 1964: 14; Bell, 1973: 8; Schenk, 1998: 223; Burn, 1999: 229). To understand the origins of the Euromarkets, we need to situate them within the context of the post-war British state.

### **The Bank, sterling, and the City's international role**

During the post-war era Britain's place in the world was rapidly and radically reconfigured. As we have seen in chapter three, Britain was levered into acceptance of a junior role in the relationship with the United States. Bretton Woods heralded the dollar's emergence as the key international currency, and its gradual displacement of sterling continued throughout the 1950s and 1960s. Militarily, Britain had also to adjust to new realities. The humbling abortion of the Suez intervention in 1956, at American behest, encapsulated the impotence of Britain's attempts to pursue independent imperial objectives.

But Britain was not alone in riding a rising tide of change. By the 1960s the Bretton Woods framework was unravelling. The uneven development of national economies came to place mounting strains upon the international monetary system.<sup>48</sup> By 1971 the system had collapsed entirely, with Nixon unilaterally delinking the dollar from convertibility with gold. It was within this context of international tumult that policy-makers within key

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<sup>48</sup> Among the key facets of this period were: the continued decline of sterling as an international reserve and trading currency, the reversal of the United States' post-war surplus on trade and invisible earnings along with growing American expenditure abroad, and the increasing strength of the Japanese, German and other major economies (Jessop, 1980: 25).

institutions of the British state designed and implemented their strategies in the decades after the Second World War.

After surviving a temporary diminishment of its powers in the early post-war years, the Bank of England had regained its former pomp by the time the first post-war Conservative government came to power in 1951. The Conservatives made clear their intention to revitalise the City's international role. Despite the nationalisation of the Bank in 1946, its institutional autonomy had been left virtually undisturbed (Roseveare, 1969: 321; Green, 1992: 205). There was also continuity in the Bank's principal ambitions, which continued to focus upon recovering sterling's international status by removing exchange controls and promoting full convertibility (Cairncross, 1995: 76).

These ambitions manifested themselves in the ill-fated 'Operation Robot'. Robot was an attempt by the Bank to create a currency union between Britain and the U.S. by making sterling fully convertible (for non-residents) with the dollar at a floating exchange rate. Beyond attempting to restore sterling's international standing, Robot was intended to reassert the traditional discipline of sound money over the British economy (Burn, 2006: 80). The creeping Keynesianism of the early post-war years provided a bone of contention between the Bank and elements within the Treasury, with the Bank's Governor, Cameron Cobbold, highly suspicious of Keynesian economics (Capie, 2010: 44). Convertibility through Robot would have brought about a deflationary discipline upon the home economy, with interest rate hikes and public spending cuts required to strengthen confidence in sterling. Despite having momentary support from within the Cabinet and the Treasury, the plan was eventually rejected.

Robot signalled the Bank's intention to reassert control over monetary policy, which had been threatened by wartime price controls. Just as it had done with the re-establishment of the gold standard in the 1920s, the Bank was reverting to orthodoxy, despite the interruption of war and the new realities of international financial power.

After Robot's failure, senior officials at the Bank continued to map the route to convertibility. As advisor to the Governor of the Bank, George Bolton had worked on various proposals for the re-establishment of convertibility. Bolton went on to play a key role in the emergence of the Eurodollar market later in the decade. By March of 1954 the London Gold Market had been reopened, further strengthening the City's international role. All restrictions upon the movement of non-resident sterling outside of the dollar area were removed as sterling edged closer to full convertibility. The Bank of England was keen to go further but the Government opposed its intentions (Burn, 2006: 82).

The Bank Policy Rate was kept high from 1954 to 1957 as sterling came under repeated speculative attack. This was part of the much-maligned 'stop-go' cycle that bedevilled British policy during the 1950s and 60s. Periods of domestic expansion resulted in balance of payments deficits that prompted speculative movements against the pound. Fearing devaluation, policy-makers enacted deflationary measures to curb domestic consumption and expansion in the hope of restoring a healthier payments position.<sup>49</sup> Underlying the stuttering stop-go rhythm of Britain's post-war recovery was a level of overseas spending drastically out of kilter with Britain's post-war capacities. Overseas

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<sup>49</sup> The Bank feared that devaluation would damage sterling's international credibility by reducing the value of foreign holdings of sterling and weakening its role as an international reserve currency (Brittan, 1964: 64).

military commitments placed a heavy drain on the Exchequer and pulled the balance of payments towards persistent deficits (Strange, 1971: 180).<sup>50</sup> Throughout the 1950s and 1960s, Britain experienced major sterling crises. The decline of sterling's stability and appeal were inextricably linked to the general waning of British power in the post-war era.

The continued sterling crises of the mid-1950s produced enormous tensions between the Bank and the Treasury. When the Governor suggested that Bank Rate be increased to 7% in 1957, Harold Macmillan and his Chancellor, Peter Thorneycroft, disagreed and suggested that the clearing banks reduce their lending instead. The banks refused to comply and Governor Cobbold refused to induce them towards accepting the Government's request. Thorneycroft was outraged and began to look for ways to give direct instructions to the banks and enforce Treasury control over lending. In response, Cobbold effectively threatened to make the Government bankrupt by refusing to meet its cheques. After this fearsome restatement of the Bank's independence, Thorneycroft eventually backed down and averted a major crisis for the British state.

This was a key moment in the post-war history of the British state. In winning the contest with the Treasury the Bank had secured control over monetary policy and as a consequence, of the banking sector and the City more broadly (Burn, 2006: 86). This control was a vital precondition for the Bank's capacity to control the environment within which the Euromarkets would take root.

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<sup>50</sup> There is no doubting that American pressures for Britain to maintain a global presence had an impact here. But Britain's leaders were themselves desperate to hold on to their former status within the international system.

Bank Rate did eventually rise to 7%, but Macmillan won a ban on refinance credits and sterling credits for financing international trade as a quid pro quo for the increase. These dynamics fostered the immediate conditions within which the Eurodollar market really began to flourish. Raising Bank Rate increased the cost of credit for the British economy while the ban on refinancing credits and the use of sterling credits for financing third party trade left British merchant banks in need of an alternative medium for financing international business (Burn, 2006: 86). The measures raised questions about how financing needs would be met with restrictive monetary policy and exchange controls in place. The answer was the Eurodollar.

Although the first instance of Eurodollar deposits may have occurred in mid-1955, involving the Midland Bank (Schenk, 1998: 224), the market really gathered momentum from 1957 (Martenson, 1964: 14; Bell, 1973: 8). George Bolton, a merchant banker and former advisor to the Governor of the Bank, played a key role in this regard. Bolton had left the Bank after becoming dissatisfied with the pace of movement towards convertibility. Bolton became Chairman of BOLSA (Bank of London and South America) in 1957 and once there he imbued the bank with the belief that sterling's use as an international reserve and vehicle currency would 'virtually cease' in the near future. Bolton's convictions led him to shift BOLSA out of sterling business and into dollar-denominated activity (Burn, 2006: 104).

Somewhat paradoxically, although encouraging the shift into dollar business, Bolton was still advocating the relaxation of controls on sterling. Despite his convictions Bolton, like many other bankers in the City, could not let go of the prestige and principle associated with sterling's role as an international currency (Burn, 2006: 104). Indeed, it was not until

the landmark devaluation of 1967 that it really became clear just how far the fate of the City had become disentangled from that of sterling.

By the late 1950s then, sterling's perennial problems had lessened its appeal as a stable medium for international exchange. In this context, it was not surprising that the dollar, now the lynchpin of the international monetary system, became a much more attractive vehicle for financing trade. It is in this light that the domestic roots of the Eurodollar market need to be understood. With sterling weakening and subject to restrictive controls on its employment for trade, British banks were only able to maintain their international standing by switching into the dollar. Decolonisation had already precipitated a rapid loss of market share for British merchant banks in some countries, notably India, where whole markets were lost due to nationalisation. These problems were rooted in the broader decline of British power. Banks that had grown up financing British overseas trade now found themselves with less business and a declining customer base. Their status as sterling institutions, once a tremendous source of strength, was now becoming a weakness (Jones, 1993: 248-287). Not surprisingly then, it was the merchant banks that led the Euromarkets charge with most gusto, setting the stage for the City's rebirth.

The 'offshore' status of the Eurodollar market made it unique. An informal approach to regulation in the City allowed the Euromarkets to flourish and effectively split the British banking system, 'into a highly regulated domestic market and a totally unregulated

international market' (Burn, 1999: 226).<sup>51</sup> Ex-patriate dollars were deposited on a short-term basis, within a market that paralleled the more restrictive official market. This fertile regulatory climate was traceable to the classical gold standard era. The laissez-faire regulatory context established during the nineteenth century, defined by the intimate relationship between the Bank and the City's merchant banking community, was left intact after World War Two despite Bank nationalisation (Burn, 1999:225-228; Burn, 2006: 16). But to explain the Eurodollar market in terms of the unique regulatory context of the City and the demise of sterling is insufficient. Interactivity between the dollar supply, U.S. monetary policy and the status of the City as an entrepot centre gave the development of the Eurodollar market a peculiarly Anglo-American dimension. To apprehend this dimension we need to turn our attention towards American financial development and the Bretton Woods context.

### **American development and the Bretton Woods dimension**

In the United States, the post-war regulatory climate was markedly different from the City's permissive conditions. In the aftermath of the Great Depression, American monetary authorities introduced 'Regulation Q' and the Glass-Steagall Act (Bell, 1973: 9). Regulation Q capped the interest rate that American banks could offer for depositors, while Glass-Steagall maintained a strict division between commercial and investment banking. Despite this restrictive regulatory context, and partly because of it, American finance experienced a

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<sup>51</sup> Catherine Schenk (1998: 233) describes this regulatory context as one that, 'encouraged innovation as a means of evading controls while tolerating such innovations ex post'.

prolonged period of growth after the war. New Deal policy makers promoted the expansion of mortgage and consumer lending in order to pull American citizens into an intricate web of financial relations (Konings, 2012: 100).

The Federal Reserve was central to this growth dynamic. After the Great Depression and during the War, the Fed played second fiddle to the Treasury. It forwent its status as the 'banker's bank', to directly serve the government's requirements (Konings, 2012: 101). It did this by assisting the Treasury's debt funding efforts. The Fed agreed to maintain fixed interest rates on long-term government bonds while limiting fluctuations in short-term rates in order to finance the war at affordable rates (Epstein & Schor, 1995:7; Axilrod, 2011: 25)). In doing so, it relinquished some influence over liquidity creation. Because banks could sell practically any amount of government debt that they wanted to at desirable rates, these government securities became highly liquid assets. These assets were put to use in the expansion of American commercial banking after the war.

By the later 1950s however, American banks were pushing against the limits of New Deal regulations. Their ability to expand their base of profitable loans was increasingly constrained by limited funding supply. Regulations limiting expansion of branches and capping interest rates, made these obstacles hard to overcome. Additionally, banks faced a disintermediation problem: non-bank financial institutions, offering higher rates, were drawing away deposits, while the Federal Reserve-Treasury Accord of 1951 freed the Fed from its obligation to stabilise the market for government securities. As interest rates rose, investors shifted into commercial paper and Treasury bonds, which now offered higher yields (Konings, 2012: 107).



American banks responded to these constraints through an unprecedented domestic merger wave between 1955 and 1961. The Chase National Bank merged with the Bank of Manhattan Co. and Bronx County Trust Co. to form the Chase Manhattan Bank, while the National City Bank of New York took over the first National Bank of New York. In 1959, the Guaranty Trust Co. merged with JP Morgan Co. Inc to form the Morgan Guaranty Trust Co (de Cecco, 1976: 386). By 1961, at the end of the wave, a massive increase in the concentration of bank deposits had occurred. The ending of the merger wave coincided with the appointment of James Saxon as Comptroller of the Currency. Saxon enthusiastically promoted bank expansion and the relaxation of New Deal era restrictions (White, 1992: 7). By the end of the merger wave, the five largest banks in New York accounted for 75% of deposits, while the same banks responsible for 77% of total commercial bank loans (de Cecco, 1976: 386).

Internationally, the desire to support the rapid expansion of U.S. corporations overseas during the 1950s and 1960s also brought banks into tension with regulations (Cohen, 1986: 24; Sylla, 2002: 54). The Treaty of Rome and formation of the European Economic Community, along with the restoration of full currency convertibility in Western Europe in 1958, signalled to U.S. Multinationals that Europe was now ripe for investment. U.S. MNC's could evade the EEC tariff barrier by investing inside member countries, and the restoration of convertibility removed obstacles to repatriating profits. Between 1955 and 1965 American manufacturing FDI in Europe tripled (Panitch & Gindin, 2012: 113-114).

By the late 1950s and early 1960s then, American banks were pushing at the limits of New Deal regulations. Although this framework had nurtured the development of

American banking, it had become an obstacle to further growth. Regulation Q acted as a disincentive for American banks to compete with their European counterparts, enabling the Europeans to attract dollar holdings through offering higher yields.<sup>52</sup>

While the expansion of American banking encountered these limitations, policy makers within the United States were also increasingly discontented. The contradictions of the Bretton Woods system within which American power was internationally intertwined, were posing a mounting problem and threatening to limit U.S. freedom of action in the international arena.

The problem centred on the role of the dollar and the status of the United States within the Bretton Woods system. During the 1950s the U.S. made the supply of international liquidity a cornerstone of its foreign economic policy (Block, 1977: 110). European countries suffered from a 'dollar gap', which limited their capacity to purchase the much-needed American imports required for post-war recovery. But American liquidity supply was not an act of benevolence, the Marshall Plan Aid and war spending on Korean re-armament that boosted the European dollar supply was also intended to raise demand for American exports and stimulate expansion of international trade.

Boosting international dollar liquidity enabled European countries to return to convertibility without making painful deflationary commitments. But America's role as the world's central banker was deeply contradictory. In the long run it threatened to undermine the keystone of the Bretton Woods system: the dollar's fixed convertibility to gold at \$35. By the late 1950s the 'dollar gap' had been transformed into a 'dollar glut' as

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<sup>52</sup> Not only did it damage American banks international competitiveness, it also made it difficult to attract deposits and corporate customers (White, 1992: 8).

European recovery enabled central banks to build up stockpiles of dollar reserves. In 1958, the U.S. balance of payments deficit led to a run on the American gold stock for the first time.

This was a landmark moment, after which U.S. policy began to shift from one of liquidity pumping, into attempts to strengthen their payments position. The U.S. balance of payments deficit became the dominant issue of international monetary politics for the next fifteen years (Block, 1977: 140). The problem was known as the 'Triffin Dilemma'. Robert Triffin had identified a crucial weakness of the Bretton Woods system. Triffin realised that the United States' deficit had become the key source of international liquidity and that running a continuous deficit would be critical to supplying the dollars required for financing international trade, exchange and the build-up of reserves (Gowa, 1983: 42). But here was the bind: if the U.S. kept running a deficit then confidence in the dollar's convertibility to gold at \$35 per ounce would be imperilled. This could lead to a run on the gold stocks, forcing the U.S. to float the dollar and terminate Bretton Woods in the process. This was, of course, the eventual outcome when Nixon delinked the dollar from gold unilaterally in 1971. But the stage was set for the 1960s as a decade in which the crisis of Bretton Woods gathered momentum.

These international dynamics stimulated the growth of the Eurodollar market. Flows of ex-patriot dollars were swollen by the vast liquidity expansion undertaken by the U.S. This fed directly into the capacity of London banks to absorb these deposits by offering interest rates higher than those permissible under Regulation Q. But the existence of the Eurodollar market provided a further problem. It limited the efficacy of deficit reduction

measures that the U.S. introduced during the 1960s. These measures would, in avertedly, provide a massive stimulus to the market.

### **The birth of the Eurobond and the paradox of the Eurodollar**

As American officials grappled with mounting balance of payments problems in the early 1960s, they started to lay the grounds, quite unintentionally, for the development of the second component of the Euromarkets; the Eurobond market. The first ever Eurobond issue was signed in July of 1963. It was made to the Italian company Autostrade and guaranteed by the IRI, a financial and industrial holding company owned by the Italian state. George Bolton, so influential to the development of the Eurodollar market, was involved once again, smoothing the progress of this landmark bond issue by employing his influence with the Bank (Kerr, 1984: 14).

The issue was signed by S G Warburg & Co., the British merchant banking house. Siegmund Warburg, the paternalistic head of the bank, was a longstanding advocate of European integration. For Warburg and other Eurobond pioneers, the revival of London's role as an international capital market dealing in foreign currency was a mechanism for promoting British entry into the EEC. They hoped that this would enhance Britain's membership prospects by turning the City of London, 'from a liability into an asset' (Ferguson, 2010: 204). Unbound from sterling, the City would be beneficial, not burdensome, to the future of the EEC.

Despite Warburg's European ambitions, the roots of the Eurobond market lay, at least in part, in the signals given out by U.S. Treasury Secretary Douglas Dillon and American reluctance to capitalise on the international bond market's shift to New York, which occurred during the interwar years. As the U.S. payments problem deepened, Dillon began, from 1962, to encourage the Europeans to establish their own international capital market.<sup>53</sup> His remarks did not fall on deaf ears, with European banks discussing his suggestions at length (Kerr, 1984: 17). Dillon did not realise was that he was unwittingly encouraging the development of an offshore bond market comprised principally of dollar-denominated issues. By promoting a European capital market, Dillon thought, the U.S. Treasury would be able to relieve pressure from the capital outflows associated with the New York bond market (Burn, 2006: 147). Rather than tightening controls at home, Dillon wanted to push the Europeans into liberalising their capital markets, taking pressure off the U.S.

Dillon's signals encouraged both Warburg and Bolton to travel to the U.S. in 1962, in order to gauge the American mood. On returning to Britain, Bolton encouraged the Bank to clear the way for Eurobond issues and by early 1963 the approval of the Chancellor and the Inland Revenue were secured. For their part the European financial community had been keen to see the practice of international bond issuing returning to London. Syndication practices in the U.S. had reduced the potential for commissions and fees that the Europeans could charge, as the U.S. authorities had insisted that American investment houses must play the lead role in the syndication, charging accordingly (Kerr, 1984: 17). The restoration

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<sup>53</sup> Dillon's May 1962 speech in Rome was particularly important (Burn, 2006: 111).

of a European long-term capital market would prove crucially important in the decades to come.

By the early 1960s, the Americans were becoming aware of the Eurodollar market. The Federal Reserve most likely didn't hear about it until 1960. But upon discovery they became concerned about its impact on the U.S. payments position and the international financial system. The Federal Reserve Bank of New York sent two staff members to London in 1962 on a Eurodollar fact-finding mission. When American bankers read their report, they lamented the presence of Regulation Q and the evidence that the locus of international lending had begun to shift across the Atlantic (Burn, 2006: 142-143). This was the first sign that the Euromarkets would begin to have a feedback loop with the regulatory context in the U.S.

The Fed's peers in the U.S. Treasury knew even less about the Eurodollar market during the early 1960s. According to archival evidence, the term wasn't used until 1961. And President Kennedy wasn't briefed on the existence of this new market in London until 1963. This was a major problem, as the Eurodollar market was beginning to have an impact on the U.S. payments position by this point. Not only were U.S. dollar outflows drawn in by the Eurodollar markets higher interest rates, but by acting as a transmission belt between the U.S. and European money markets, the Eurodollar market was undermining American attempts to wrestle with the balance of payments. By generating a growing pool of dollars that could quickly move from the dollar into gold or other currencies, the market increased the dollar's vulnerability to speculative attacks. But although there was only a partial awareness of the problems the Eurodollar market was causing, there was an increasing

realisation of the opposite effect. By encouraging private creditors to hold onto their dollars the Eurodollar market was keeping dollar holdings out of official central bank reserves and preventing a continuing decline in U.S. gold reserves, thus strengthening the dollar and keeping Bretton Woods intact (Burn, 2006: 147).

This, then, was the paradox of the Eurodollar. The Euromarkets were simultaneously intensifying the vulnerability of the dollar to speculative attacks, while also contributing to the deepening of dollar hegemony by massively expanding the scope for dollar-denominated business. This paradox would serve as a major contributory factor to the demise of Bretton Woods. By cementing the dominance of the dollar as the world's premier international currency, the Euromarkets paved the way for Nixon's unilateral break from Bretton Woods and the establishment of a dollar standard.

### **The parallel of deficits**

During the 1960s, monetary policy on both sides of the Atlantic became increasingly concerned with fighting a rear-guard action against the pressures and contradictions threatening to undermine Bretton Woods. There was a peculiar symmetry between the position of the U.S. and that of Britain, as the two major deficit countries within Bretton Woods. Both countries suffered chronic payments deficits, and both were issuers of major reserve currencies, with high exposure to external liabilities. Not surprisingly then, the 1960s witnessed a series of measures, on both sides of the Atlantic, to prop up the ailing Bretton Woods framework. Through this process, a high degree of central bank cooperation

emerged, particularly between the Fed and the Bank, as it became increasingly clear that collaborative action was required to reinforce the system. Through this interaction too, the Euromarkets received a major impetus.

As the Americans arrived at a fuller recognition of the gravity of the problems facing Bretton Woods they began to embark upon concerted international action to stabilise the system. Robert Roosa, the U.S. Undersecretary of the Treasury, organised a series of swap arrangements between central banks and made efforts to expand the IMF's resources. Swap arrangements provided standby credit lines that could be used in order to defend existing exchange rate parities. Roosa also introduced, 'Roosa Bonds': non-negotiable U.S. government bonds denominated in foreign currencies and sold to foreign central banks. These were intended to transform excess dollar holdings of foreign central banks into longer-term debt, reducing the level of liquid funds that could be mobilised in speculation against the dollar (Block, 1977: 179-180).

The establishment of the 'London Gold Pool' in late 1961 was another crucial development. The pool was formed in response to the 1960 "dollar crisis", during which speculation in the private gold market in London had pushed the price of gold to \$40 per ounce, jeopardising confidence in the dollar's convertibility to gold at \$35 per ounce (Panitch & Gindin, 2012: 123). Under the gold pool, a number of countries agreed to intervene to stabilise gold prices around the \$35 per ounce commitment enshrined at Bretton Woods. This multilateral action reduced pressure on the U.S. gold stock and stabilised gold prices (Block, 1977: 178).



In Britain, the worsening fate of sterling and the balance of payments was increasingly apparent by the early 1960s. In March of 1961, European central banks intervened heavily in foreign exchange markets on behalf of sterling, while Britain drew \$1.5 billion from the IMF, with a further \$500 million made available under a standby arrangement (Eichengreen, 2008: 123). By the summer of that year, the Chancellor had announced plans to restrict private investment outside the Sterling Area. This was a highly significant step, as it broke from the recent trajectory of exchange control liberalisation. The Bank's monetary policy during the early 1960s was focused principally upon defending the pound, with the central goal of maintaining parity with the dollar at \$2.80 (Capie, 2010: 193).

By the mid-1960s, on both sides of the Atlantic, the problems were intensifying. Successive U.S. administrations attempted stopgap measures to rectify the balance of payments deficit and stabilise confidence in the dollar. The outgoing Eisenhower Administration had already issued an executive order that prohibited U.S. citizens from collecting gold coins along with measures to boost exports and increase tourist receipts (Eichengreen, 2008: 126). President Kennedy then further intensified restrictive measures.<sup>54</sup> The 'Interest Equalization Tax', introduced in 1964, imposed a one per cent tax on foreign security issues in the United States. The tax was strongly opposed by investment bankers, stockbrokers and Republican Congressmen, but was passed into law nonetheless (Gowa, 1983: 55).

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<sup>54</sup> This was a departure from the pattern of United States' macroeconomic policy that had emerged after World War Two. Generally, macroeconomic policy was conducted with indifference towards balance of payments considerations and the wellbeing of the international monetary system (Gowa, 1983: 50).

Efforts at restraining capital outflows under Kennedy were extended by the Johnson Administration. By 1965 inflation was on the rise as Johnson attempted to fund his Great Society project in conjunction with increased spending on the Vietnam War, without introducing corresponding tax increases. The war was having a sustained inflationary impact upon the global economy and shaking confidence in the dollar. Vietnam forged a clear link between the fate of American foreign policy and the sustainability of the international monetary system. As the payments problem intensified in synchronicity with the war effort, Johnson's Administration introduced the 'Voluntary Credit Restraint Program' in 1965. The Fed's Board of Governors oversaw its management, with the mandate to ensure that corporations and banks did not substantially increase their export of funds (Gowa, 1983: 56). Johnson further requested that the Department of Commerce steer the repatriation of overseas American investment.

Meanwhile in Britain, the election of Harold Wilson's 1964 Labour government, within the context of a deteriorating balance of payments, had spooked the markets, bringing speculation against the pound to a new level of intensity. The previous year had been marked by an extremely harsh winter, de Gaulle's veto of British EEC membership and a high degree of pre-election uncertainty (Eichengreen, 2008: 125). These factors combined to produce an extremely challenging context for Wilson's new government. In August 1964, an additional \$1 billion standby credit was arranged with the IMF and a further \$500 million of funds were secured from various foreign central banks.

This was not, however, a challenge that the new government faced alone. The Americans were increasingly drawn in to the management of Britain's monetary policy. The

U.S. had long recognised the significance of sterling to the stability of the post-war system (Eichengreen, 2008: 123). Although the dollar was the world's dominant currency by 1945, sterling was still its major rival and, as such, a pillar of the international currency markets whose price fluctuation would inevitably have systemic ramifications. But it was clearly an increasingly fragile pillar at its \$2.80 parity with the dollar, and from 1964 supporting the existing rate became a fundamental component of U.S. international monetary policy. Sterling was the first line of defence in maintaining the integrity of Bretton Woods and the stability of the dollar. While the pound was weak it was certain to draw some of the speculative pressure away from the dollar, but if the pound were devalued then the dollar would undoubtedly be subjected to firmer scrutiny (Block, 1977: 185).

For his part, Wilson was an advocate of the Anglo-American relationship. He feared that any devaluation of the pound would be viewed as an abdication of Britain's international obligations (Block, 1977: 188). The rise in Bank Rate undertaken in 1964 was a landmark event; it was the first time that there had been open consultation with American monetary authorities in the run up to a rate adjustment (Capie, 2010: 193). Already in 1963, the Governor of the Bank had consulted Bill Martin, the head of the Fed, on the need to coordinate future Anglo-American rate changes so as to minimise the impact of interest rate differentials (which would inevitably lead to destabilising capital flows).

These interactions were a symptom of a *deepening Anglo-American monetary cooperation*. But they were also a symptom of the broader intensification of the role of the Fed and the U.S. Treasury in managing international monetary affairs during the 1960s (Panitch & Gindin, 2012: 123). Private central bank power was dramatically restored

during the 1960s, in what was in many ways the post-war heyday of Central Bank cooperation. The Fed set about activating and energising the international network of central bankers.

From December 1960, the Fed's staff participated in monthly meetings of the Bank for International Settlements (BIS) in Basle. While the Treasury had formerly opposed this, it was now supportive, thanks in no small part to the fact that it had undergone its own aggrandisement of international influence. The Treasury was becoming the 'pivot' in a new institutional apparatus to accommodate the internationalisation of advanced capitalist states. It did so through taking a much more active role in international dealings of dollars and gold. Both the Fed and the Treasury were active in weaving a web of currency swap arrangements between Central Banks in order to provide the ammunition required to defend against speculative attacks (Panitch & Gindin, 2012: 124).

American institutions were not alone in leading the intensification of international financial cooperation. The Bank of England also played an active role. Indeed, it was the *Anglo-American coordination of monetary policy* during the 1960s that lay at the heart of the broader network of cooperation between Central Banks and finance ministries. The connectivity between British and American monetary policy prompted Humphrey Minors, the Deputy Governor of the Bank, to remark in a letter to Bill Martin that, 'what when I was a boy was a purely domestic concern of this institution, now looks like being a matter of argument not merely between the City and its West end Branch, but even between our two governments' (Capie, 2010: 194). The Bank's international significance was further amplified by the staggering growth of the Euromarkets from the mid-1960s.

It was within this transatlantic context of balance of payments crises, policy transformations and growing Anglo-American coordination of monetary policy that the next stage in the development of Euromarkets got underway. It did so as part of a broader transformation in the international monetary system that saw intensifying cooperation and attempts at coordination as the crisis of Bretton Woods deepened.

### **The Americans arrive in the City**

A perfect storm of domestic accumulation dynamics and regulatory arbitrage pushed and pulled American banks into the Eurodollar market during the 1960s. After rubbing up against New Deal legislation and undergoing an unprecedented merger wave, they began to arrive in the City en masse in order to benefit from the accommodating regulatory climate of the Euromarkets. By 1975, no less than 58 U.S. bank branches had been established in the City (Sylla, 2002: 66). The same massive banks that dominated the New York money market after the merger wave of the 1950s and 1960s now arrived in the City.

The American takeover offered both a challenge and an opportunity for policymakers and bankers alike in both the U.S. and Britain. For the Bank of England, their arrival raised crucial questions about responsibility and sovereign authority for foreign banks. While for British bankers, their arrival presented a potential competitive challenge. But for both the Bank and the bankers, their arrival was also a major opportunity. By invigorating and expanding the scope and depth of the Euromarkets, the American invasion offered

British bankers the chance to take a bigger slice of a rapidly growing pie, even if their relative share was declining.

For the Bank, the arrival of the Americans was a boon for the status of the Euromarkets. This would inevitably be reflected in the status and standing of the Bank itself, as the epistemological authority on, and gatekeeper to, the Euromarkets. The arrival of the Americans, then, brought a momentum that the Bank rode in order to reassert its centrality and significance within the British state and the wider international financial community. But their arrival also raised troubling questions about the status of British merchant banks and rendered Britain more sensitive to the shifting sands of American economic policy.

So too for the Americans the expansion of U.S. banks beyond their parochial fetters represented both a challenge and an opportunity. American banks established a foothold within the offshore enclave of the Euromarkets, circumventing Regulation Q and tapping in to the vast pool of offshore dollars. But the quid pro quo of this regulatory liberation was dependence upon the sovereign authority of a foreign Central Bank. One that would naturally be expected to hold closer ties to the old order of the City's banking elite than to the American interlopers.

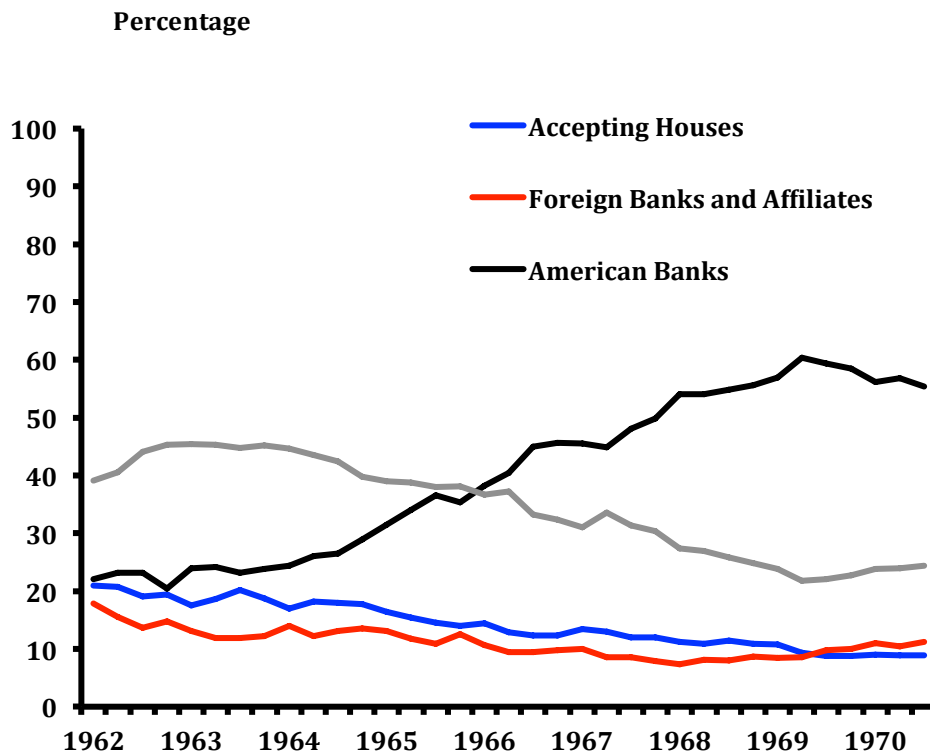
For the U.S. Treasury and the Fed, the American takeover of the Euromarkets was similarly Janus-faced. By escaping the New Deal regulatory parameters and dependence upon the domestic dollar supply, the American banks had gravely undermined the capacity of American fiscal and monetary policy to control banking. This would become all too clear from the mid-1960s. But they had also alleviated some of the pressure on the U.S. balance of

payments, by tapping in to offshore dollar flows, and intensifying the global standing of the dollar as a vehicle currency. All of this during a period in which the Bretton Woods order looked increasingly primed to implode.

The scale and pace of the American capture of the Eurodollar market in particular was breath-taking. Figure 1.1 below depicts this. Current account deposits of overseas residents represent Eurodollar market deposit-taking and increased dollar deposits account for the increase overwhelmingly.

**Figure 1.1**

***London Banks, 1962-1970***  
Market Share Current Account Deposits of Overseas Residents (All Currencies)



Source: Bank of England Quarterly Bulletin Statistical Annex 1962-1970. Yearly values from 1965-1967, quarterly values thereafter.

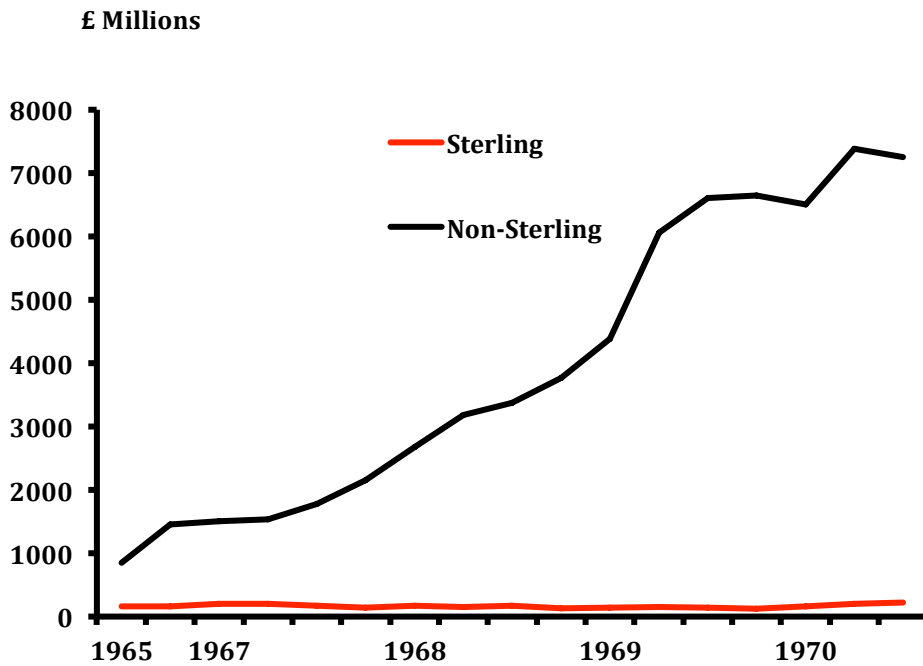
We can see in figure 1.1 that British Overseas and Commonwealth Banks experienced a major loss of relative market share, with their share of Eurodollar deposits dropping from c.40% in 1962, to c.25% in 1970. Accepting houses also experienced a severe contraction of their market share, from 20% down to 8% between 1962-1970. For American banks the story was very different. Their share of Eurodollar deposits rose precipitously, from just over 20% in 1962, to around 55% in 1970.

By disaggregating deposits into sterling and non-sterling we get a clearer picture of the vast take-off in Eurodollar deposits from figure 1.2.



Figure 1.2

**American Banks, 1965-1970**  
Total Current Account Deposits of Overseas Residents



Source: Bank of England Quarterly Bulletin Statistical Annex 1962-1970. Yearly values from 1965-1967, quarterly values thereafter.

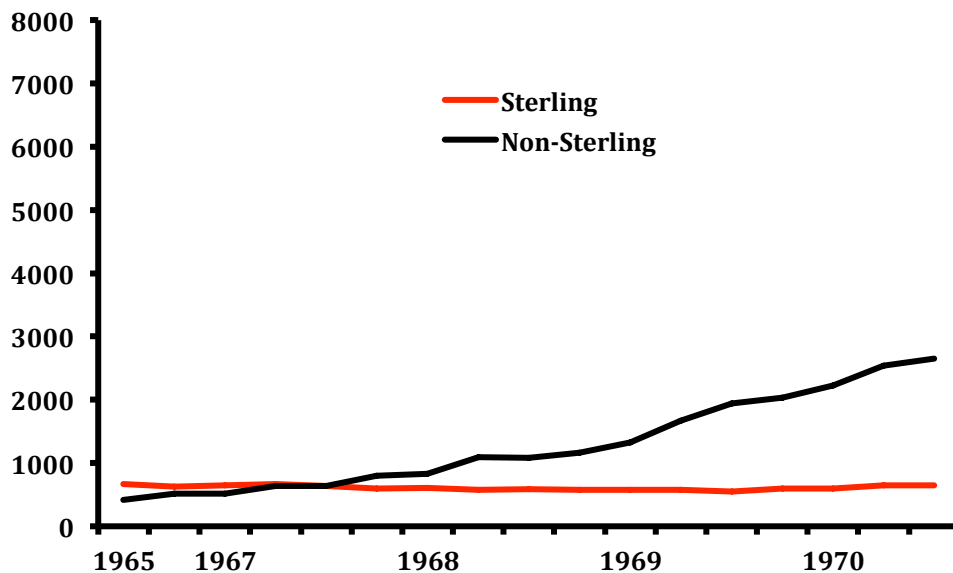
For American banks, the growth in deposits of overseas residents was overwhelmingly accounted for by a sharp increase in non-sterling (i.e. dollar) deposits. The low level of sterling deposits remained remarkably stable over the period.

Contrastingly, British Overseas and Commonwealth banks (figure 1.3) experienced much more gradual increases in the volume of non-sterling deposits from overseas residents. Whereas American banks experienced a sevenfold increase in the volume of

overseas non-sterling deposits between 1965-1970, British Overseas and Commonwealth banks experienced a threefold increase. But despite the paucity of their gains in relative terms, overall British banks participated in a level of market expansion unimaginable without the influx of American banks and the enormous U.S. corporate client base that they brought with them.

**Figure 1.3** *British Overseas and Commonwealth Banks, 1965-1970*  
Total Current Account Deposits of Overseas Residents

£ Millions



Source: Bank of England Quarterly Bulletin Statistical Annex 1962-1970. Yearly values from 1965-1967, quarterly values thereafter.

How did the Bank of England respond to the Americanisation of the Eurodollar market? As the archival evidence shows, it certainly did not go unnoticed within the cloistered

corridors of the City. The Bank really took notice of the American banks from 1963. The regular meeting of Euro-currency experts at the BIS provided a forum where the Euromarkets were discussed. Reporting on the 1963 BIS meeting, Bank officials acknowledged that London branches of American banks were more active than before in the Eurodollar market, with U.S. businesses borrowing there rather than New York (BofE, 1963: 6A123/1).<sup>55</sup>

Correspondence between the Treasury and the Bank provided the primary channel of policy formulation around the Euromarkets. Bank officials outlined the parameters of their responsibility for Eurodollar activity in these exchanges. The archival record makes clear that the Bank was the primary source of official epistemic authority on the subject of the Eurodollar market. The Treasury and the Cabinet Office would turn to the Bank for information and advice about the burgeoning offshore trade.<sup>5657</sup>

In correspondence between the Bank and the Treasury, Bank officials made clear that what applied for British banks, regarding the Bank stepping in as a lender of last resort, 'cannot be held to apply in the same measure at all to the London branches or subsidiaries of foreign banks' (BofE, 1964: 6A123/1).<sup>58</sup> It was concluded by officials that their

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<sup>55</sup> Bank of England Archives 6A123/1 'Economic Intelligence Department Files: Euro Currencies-Including Euro Dollars and Euro Bonds 1/1/65-31/7/64', Report on Meeting of Experts on the Euro-currency Markets at the BIS, November 9<sup>th</sup> -11<sup>th</sup> 1963.

<sup>56</sup> In 1968 the Treasury requested information from the Bank in order to prepare the Prime Minister's annual speech at the Lord Mayor's banquet, specifically asking for guidance over what the Prime Minister's stance should be with regard to the role of the City in the development of the Eurodollar market (BofE, 1968: 6A123/5).

<sup>57</sup> Bank of England Archives 6A123/5 'Economic Intelligence Department Files: Euro Currencies-Including Euro Dollars and Euro Bonds 1/1/68-31/5/69', Memo from Treasury to the Bank of England requesting Prime Ministerial brief on the Eurodollar market, October 22<sup>nd</sup> 1968.

<sup>58</sup> Letter regarding document to be prepared by the Bank of England in response to a Treasury request for information of the standing of the Eurodollar market, March 6<sup>th</sup> 1964.

responsibilities in times of crisis should not extend beyond supporting British banks. London branches of foreign banks were not viewed as the responsibility of British authorities but rather those of their head offices. Beyond the head offices, national Central Banks from the originating country would take ultimate responsibility. This discussion occurred within a context whereby London branches of American banks now accounted for 30% of deposits in the Eurodollar market. Crucially then, the City's hosting of foreign banks and Eurodollar business did not entail a corresponding globalisation of the Bank's function as lender of last resort. As the transformation of the international financial system accelerated, the Bank was right at the heart of the process, carefully navigating its way through these uncharted territories through processes of institutional learning.

As monetary conditions tightened in the U.S., the significance of the Eurodollar market increased rapidly. Between 1965 and 1966 a credit squeeze in the U.S. and the introduction of the 'Voluntary Foreign Credit Restraint' programme lead New York banks to turn to their London branches for a supply of funds. The Bank was fully aware of this and noted that this dynamic was practically 'inevitable' given that the traditional sources of liquidity within the U.S. had dried up. In fact, monetary conditions in the U.S. were so difficult that when a Bank official met with a senior member of the Chase Manhattan bank on a visit to the U.S. in early 1966, the Chase employee suggested that the Eurodollar market had been so important for improving reserve positions that, 'without it, we'd have been dead' (BofE, 1966: 6A123/3).<sup>59</sup> The Bank's own statistics on lending from London

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<sup>59</sup> Bank of England Archives 6A123/3 'Economic Intelligence Department Files: Euro Currencies-Including Euro Dollars and Euro Bonds 1/8/65-31/10/66', Memo from Bank of England Overseas Office charting U.S. banks drawing dollars through London branches, August 22<sup>nd</sup> 1966.

branches of American banks to their New York counterparts suggest that in the first seven months of 1966, the figure stood at £500 million, with a staggering £230 million of that lending occurring in July alone. Bank officials also noted that American banks had been prepared to pay, 'somewhat over the market rate' for money in order to attain funding (BofE, 1966: 6A123/3).<sup>60</sup>

Johnson's restrictive measures and the credit crunch implemented by the Fed in 1966 marked a watershed in the orientation of American banks towards the Eurodollar market. Prior to this American banks had only borrowed passively, with overseas branches placing excess deposits with their head office. Now U.S. banks borrowed actively, with their foreign branches soliciting deposits to finance domestic operations (Kane, 1981: 13). No longer taking only a passing interest in the market, they now identified Eurodollar expansion as integral to their business strategy.<sup>61</sup>

The Bank's position at the centre of the City enabled it to effectively gauge the intensity with which the Eurodollar market was being shaped by changes in U.S. monetary policy. As more American banks set up shop in London, their role in funnelling funds back to their American head offices led to an *increasing interactivity of interest rates* on each side of the Atlantic. As we can see in figure 2.1 below, a *triadic interaction of interest rates* evolved during the 1960s: that between Bank Rate, the Eurodollar Rate and the Federal Funds Rate.

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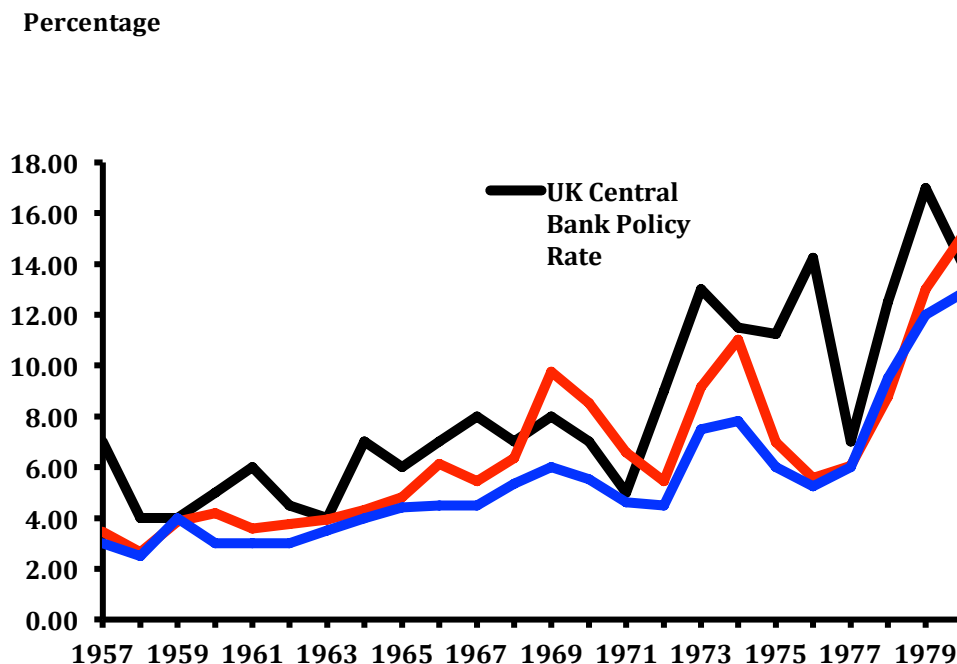
<sup>60</sup> Internal memo, Bank of England- 'Eurodollar Lending to the U.S.', August 9<sup>th</sup>, 1966.

<sup>61</sup> Richard Sylla (2002: 62) describes this transformation aptly, suggesting that while American banks gave little consideration to operations in Europe before 1963 they, 'thought about little else in the decade thereafter'.

The principal relationship here was between the Eurodollar Rate and the Federal Funds Rate, with the absence of interest rate ceilings enabling the Eurodollar Rate to be set consistently above that of the U.S. money market rate with the effect of drawing money out of the U.S. capital markets and into London. Figure 2.1 shows that the U.K. Bank Rate was consistently the highest rate of the three. This was partly a function of the need to maintain the attractiveness of sterling holdings in the light of the emergence of the Euromarkets but also a measure of sterling's general weakness. But given the increasingly limited role for sterling as a trade and investment currency, and the dominant role of the dollar, the impact of the sterling rate upon the price of dollar borrowing was not without limits. The differential between the Eurodollar Rate and the Federal Funds Rate was more important with respect to the price of dollar borrowing.

**Comparative Interest Rates, 1957-1980**

**Figure 2.1** UK Bank Rate. US Federal Funds Rate and London Eurodollar Rate



Source: Global Insight Database, IMF International Financial Statistics UK Interest Rates Central Bank Policy Rate Per cent Per Annum (1948-2011) IMF code: 11260ZFHS52; IMF International Financial Statistics UK Interest Rates Euro Dollar London Rate Per cent Per Annum (1957-2011) IMF code: 11260DZFHA52; IMF International Financial Statistics United States Central Bank Policy Interest Rate Per cent Per Annum (1948-2011) IMF code: 11160ZFHS52

Authorities on both sides of the Atlantic were aware of this dynamic early on. Already in April 1963 during a U.S. Treasury meeting, Robert Roosa expressed discontent with the British monetary authorities, which he suggested had pushed up Bank Rate in order to keep ahead of the Eurodollar Rate. While in the past a rising rate for sterling would only have been considered in terms of its effect in drawing money out of dollars and into sterling, it was now understood that the British action might also push up the Eurodollar Rate, aggravating U.S. balance of payments difficulties through the resultant capital outflow (Burn, 2006: 158). This dynamic is clearly evidenced in figure 2.1, which shows that Bank Rate was the highest rate, with the Eurodollar Rate beneath it and the U.S. Federal Funds Rate consistently the lowest of the three. Apart from a three-year period, between 1968 and 1971, the British Bank Rate was continuously the highest rate.

During the mid-1960s this relationship intensified. As figure 2.2 below shows, there was a strong correlation between the Eurodollar Rate and the US Federal Funds Rate. This graph shows clearly that whilst during the early 1960s the Eurodollar Rate was kept marginally above the Federal Funds Rate in order to draw money away from the U.S. capital market, from the mid 1960s as the U.S. tightened its monetary policy, the Eurodollar Rate spiked in response to a massive surge in demand. This was a result of precisely the factors that the Bank had recognised; by drawing funds from their London branches the New York banks were pushing up the price of Eurodollar borrowing (BoFE: 6A 123/3). We can see this clearly in figure 2.2, with the two spikes in the Eurodollar Rate that pushed it well over the Federal Funds Rate from 1965 to 1967 and then again from 1968 to 1971.

By this point the interaction between the Eurodollar market and American economic policy was complex and reciprocal. Eurodollar movements were beginning to exert sustained pressure upon the international monetary system. Large-scale American borrowing introduced a, 'permanent element of demand' shaped by economic conditions within the U.S. (Kane, 1983: 13). This had the effect of integrating the U.S., Eurodollar and European markets much more tightly. As a result European capital markets became more exposed to fluctuations in U.S. monetary policy, creating a form of hub and spokes relationship (Bell, 1973: 62; Kane, 1983: 13). These developments contributed to the increasing international monetary disorder of the later 1960s and early 1970s, the twilight years of Bretton Woods.<sup>62</sup>

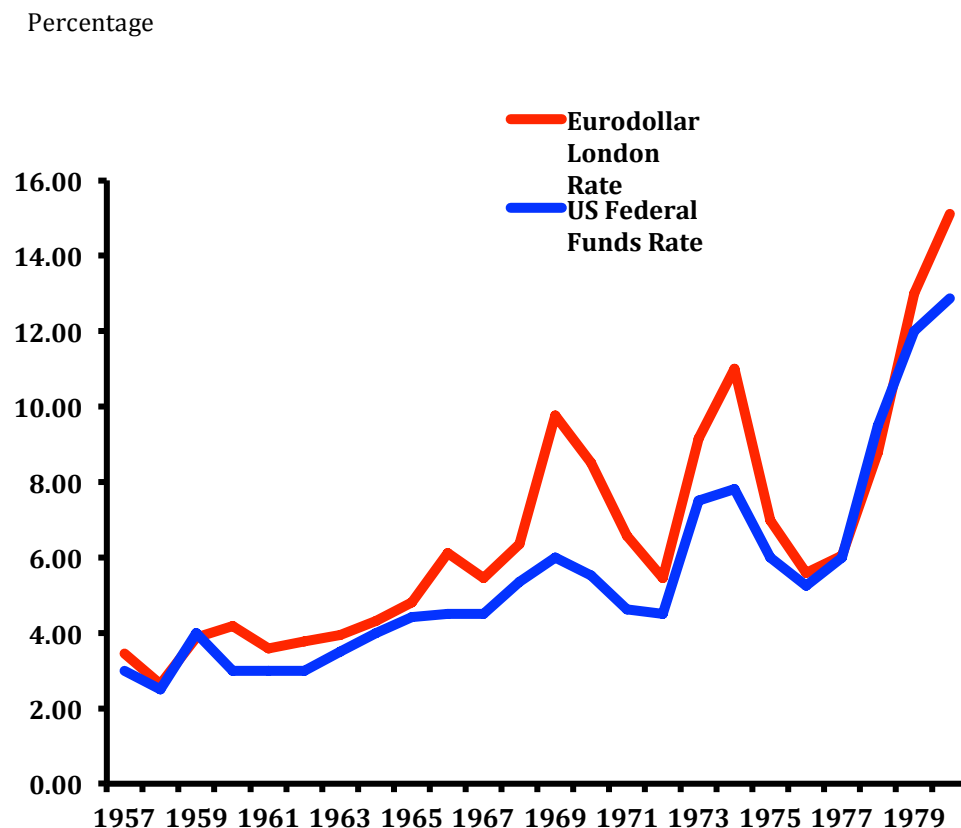
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<sup>62</sup> The 'Eurodollar slop', an expanding pool of ex-patriate dollars that tended to move predominantly back and forth across the Atlantic, was the underlying root of the dollar crisis of 1970/71 that preceded Nixon's delinking from gold and the de facto termination of Bretton Woods (Strange, 1972: 198).



**Figure 2.2**

***Comparative Interest Rates***  
London Eurodollar Rate and US Federal Funds Rate, 1957-1980



Sources: Global Insight Database, IMF International Financial Statistics United Kingdom Interest Rates Euro Dollar London Rate Per cent Per Annum (1957-2011) IMF code: 11260DZFHA52; IMF International Financial Statistics United States Central Bank Policy Interest Rate Per cent Per Annum (1948-2011) IMF code: 11160ZFHS52

Funnelling of Eurodollars into the U.S. money markets was discussed at the BIS meeting in 1966. A Federal representative highlighted the granting of loans by American bank branches to the head offices of U.S. corporations, who lent the money on to their overseas subsidiaries. This method was devised explicitly to circumvent the Interest Equalization

Tax (BoFE, 1966: 6A123/3).<sup>63</sup> When asked about the attitude of the U.S. authorities towards this borrowing, given that it weakened the impact of U.S. monetary restraint, Samuel Katz of the Fed replied that the borrowing was not a serious problem given its small size. Significantly, Katz added that these borrowings were in fact ‘welcome’ given that they had the effect of strengthening the dollars position and easing the U.S. balance of payments. But as the Eurodollar market’s integration with the U.S. money market intensified during the latter 1960s, the American attitude hardened.

The American position was detailed by Andrew Brimmer, a member of Fed’s Board of Governors, in a presentation at the LSE in November 1969. Brimmer’s talk came after a period of chaos in the international gold market in 1968 had drawn even more restrictive responses from Johnson in order to prevent capital outflows: further investments in Western Europe were banned, tighter constraints imposed upon bank lending, suggestions to limit American travel abroad and reduce foreign exchange costs incurred as a result of overseas military expenditures. Although these measures did nothing to curb the longer-term weakness of the U.S. balance of payments, American banks keenly felt their effects.

In response to the surge of American bank borrowing from their London branches in 1968, Brimmer suggested that while the Eurodollar market was based in London, ‘its basic driving force during the last year has centred in about a dozen large banks in the United States’ (BoFE, 1969: 6A123/6).<sup>64</sup> These banks had turned to the Eurodollar market in order

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<sup>63</sup> Bank of England Archives 6A123/6 ‘Economic Intelligence Department Files: Euro Currencies-Including Euro Dollars and Euro Bonds 1/6/69-31/3/70’, Report on the ‘Meeting of Experts on the Euro-Currency Market’, July 12<sup>th</sup>, 1966.

<sup>64</sup> Transcript of presentation given by Andrew Brimmer, ‘The Eurodollar Market and the US Balance of Payments’, November 17<sup>th</sup> 1969.

to compensate for the loss of domestic deposits. Brimmer acknowledged that bidding for Eurodollar funds by American banks had pushed up the Eurodollar Rate and made monetary management in the U.S. more difficult.

These dynamics were also beginning to have an effect upon the regulatory stance of the Federal Reserve. In August of 1969, the Fed introduced a 10 per cent marginal reserve requirement for U.S. bank liabilities to overseas branches and on funds acquired by overseas branches from their U.S. head offices while also adjusting the required reserve level for other channels of offshore funding.

The Eurodollar market was *driving regulatory transformations* on both sides of the Atlantic as authorities in Britain and the U.S. attempted to come to terms with the shifting architecture of international finance. For their part American officials allowed Eurodollar expansion, but they certainly did not devise it as a strategy for augmenting American financial power. Any benefit they eventually derived was unintended at the outset.

Battilosi (2002: 16) suggests that the Federal Reserve adopted a 'permissive' approach, with foreign expansion, 'accommodated, if not actively encouraged', while Schenk (2002: 89) concludes that there was a 'passive acceptance' of the multinationalisation of American banks. Kennedy's administration had certainly understood that borrowing through the Eurodollar market would be beneficial to the balance of payments (de Cecco, 1976: 390). But Helleiner (1994: 89) is an isolated voice when he asserts that Eurodollar market expansion was 'actively encouraged' by the Federal Reserve and the Treasury.

Nevertheless, there were certain regulatory changes undertaken in the United States in order to facilitate internationalisation (Brimmer & Dahl, 1975: 343). But on balance the

regulatory and policy context within the U.S. was more disabling than encouraging, with tight money in the U.S. and attempts to restrict lending from domestic offices the principal policy catalysts for international expansion (Battilosi, 2002: 62; Misrachi & Davis, 2004: 118). But once the market emerged, American policy makers certainly did seek to make use of it in order to promote their perceived national interests. In this respect then, both Panitch and Gindin, and Strange, are right to highlight its functionality to American power. American monetary authorities were coming to terms, *in a complex and contradictory fashion*, with an enormously fluid period in the history of the international monetary system as the crisis of Bretton Woods intensified.

For the Bank, the regulatory pressure emanated from the arrival of American banks with large deposit bases and a desire to push against the dealing limits put in place for British banks. Bank officials were keen to, 'forestall any Treasury worrying', regarding dealing limits (BofE, 1969: EID4/113).<sup>65</sup> As American banks entered the market they had the effect of pushing up the level of dealing limits. It was thought that an attack on the policy of limits would be an embarrassment to British banks, which needed them to effectively conduct their operations. The Bank's adoption of a new policy, allowing larger dealing limits, was seen as, 'a purely defensive one forced on us by the very large number of American banks now coming to London' (BofE, 1969: EID4/113). But in insisting upon the maintenance of dealing limits Bank officials also believed that they were acting in the interests of the Americans, by preventing them from being associated with any decline in

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<sup>65</sup> Bank of England Archives EID4/113 'Home Finance: Banking- General Papers 7/12/64-17/11/66', Internal memo, Bank of England- 'New American Banks in London- Dealing Limits', March 5<sup>th</sup> 1969.

sterling's position (BofE, 1969: EID4/113). By this point then, the Bank had already begun to *act on behalf of the interests of American banks*.

There was general concern about the American arrivals too. Bank officials reflected that people were, 'constantly wondering aloud whether the large and seemingly never-ending influx of American banks into London is an unalloyed benefit' (BofE, 1969: EID4/113). Regarding competition with British banks, it was inferred that British banks' willingness to help their American counterparts suggested that the newcomers were not viewed as an existential threat. Where competition for clients did appear likely, it was anticipated that the greater impact would be upon the UK- based American subsidiary clients of other American banks (BofE, 1969: EID4/113). In fact, the inflationary impact upon City rents generated by the Americans was viewed as potentially beneficial. It might push more peripheral players to relocate away from the City, freeing up space for more substantial businesses to move in (BofE, 1969: EID4/113).

On balance then, the Americanisation of the Eurodollar market appears not to have been viewed as a major concern for the Bank in terms of any perceived threat to the profitability of British banking interests. Where concern did arise, it was more a question of how the Bank ought to adapt its regulatory stance and continue to safeguard sterling. Both on the question of lender of last resort responsibility and the issue of dealing limits, it was clear that the Bank was rapidly recalibrating its policy.

In doing so, the Bank was adapting to the Euromarkets and creating a new form of international financial sovereignty. A form of *splintered sovereignty* constituted through Anglo-American development. Although hosting a growing number of foreign banks, a key

component of the Bank's institutional functions, its role as a lender of last resort, remained exclusively national. Simultaneously, the presence of American banks brought the lender of last resort responsibility of the Fed into London. The Euromarkets produced a *fracturing of jurisdictional authority* that spawned ambiguity over regulatory responsibility and spurred the evolution of regulatory regimes to clarify the situation in the following decades. Clarification required Central Bank cooperation and appreciation of the increased interdependence of transatlantic monetary policy. But it also had much broader ramifications for the development of international financial supervision.

The Bank's experience with the Eurodollar market and its discussion as early as 1964 of the limits to jurisdictional authority over foreign bank branches during times of crisis, were the progenitors of the 'home country rule' (BofE, 1964: 6A123/1). Home country rule attributed the responsibility for defining and regulating financial institutions to the state. States would look to one another, rather than to supranational organisations, in order to legislate and enforce collective agreements on supervision (Kapstein, 1996: 9). Not only did the Bank stumble across this innovatory principle in responding to the problems raised by the Euromarkets, it also led the development of this principle internationally.

The regulatory challenge provided by the Euromarkets and a series of major banking crises during the 1970s led to an acceleration in the development of international banking supervision (Capie, 2010: 588; Goodhart, 2011: 4).<sup>66</sup> As the banking crises of the early 1970s unfolded the Governors of the G10 Central Banks met to hammer out proposals for

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<sup>66</sup> The most prominent crises in this respect were the major losses of Lloyds' Lugano branch, the collapse of the Israel British Bank in Tel Aviv, the Franklin National Bank in New York and most notably of all the failure of the West German, Bankhaus Herstatt (Capie, 2010: 625).

international supervision. These meetings produced the 'Basle Concordat', which was circulated widely amongst Central Banks and supervisory authorities (Capie, 2010: 627). The Bank played the lead role in these discussions, providing the first two chairmen of the committee. The Basle Committee on Banking Supervision, as it came to be known, had a strong British makeup from the start (Goodhart, 2011: 44). This reflected the Bank's unparalleled epistemic authority in these matters.

In addition to the increasingly active stance taken by American authorities in managing the international monetary system therefore, we must also acknowledge that the Bank of England was fundamentally important to developing the supervisory framework required to keep pace with financial globalisation. Key developments like the Basle Committee of Bank Supervisors stemmed from the initiative of the Bank of England and drew upon the institutional learning that it underwent during the 1960s. New York and London were functioning as the twin pivots of financial globalisation and their attendant monetary authorities played an integral role in laying the institutional groundwork for this process. *The Fed-Wall Street-Treasury nexus was increasingly articulated through and with the Bank-City-Treasury nexus as part of an Anglo-American twin-engine room of financial globalisation.*

Geographically, the City of London became central to the interaction of Anglo-American developmental dynamics. This was part of a transatlantic paradox: sterling's decline was accompanied the City's rebirth, while the dollar's ascent led, counter-intuitively, to the diminishment of New York's status. Offshore was a distorting mirror through which transatlantic development was reflected.

This was a major departure from the sheltered politics of the interwar years, where the restrictive Sterling Area had been assembled as a bulwark for British trade predominance within the Commonwealth. Now sterling was no longer the centrepiece of a rival currency block and foundation of British banking dominance, but an increasingly marginal component of a rapidly expanding international financial system hinging upon the dollar. In a matter of several decades, the financial markets of Britain and America had been integrated more completely than ever before.

Eurodollar business restored the City's centrality within the international financial system. But it was now a nodal point in the global extension of American capital markets, American banking and the hegemony of the dollar. The City had become the 'banker to the dollar', and was now increasingly defined by its 'enclave function' within the British economy (Coakley & Harris, 1983: 23). It was once again a mediator between the borrowers and lenders of the world, but unlike the nineteenth century the business was denominated in dollars not sterling and the major players were American banks, not British. And crucially, the City could continue to play this role regardless of the health of British factories, British merchants and sterling (Coakley & Harris, 1983: 23).<sup>67 68</sup>

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<sup>67</sup> In his 1968 speech at the Lord Mayor's banquet, after the devaluation of 1967, Harold Wilson proudly spoke of the 'Europeanization of the City' (BofE, 1968: 6A123/5). Wilson's speech was informed by the experts at the Bank of England, who had earlier been asked to provide a summary of London's role in the development of the Eurodollar market (BofE, 1968: 6A123/5). In an implicit recognition of the City's growing entrepot status, Wilson commented that despite the decreased role of sterling as an international reserve currency and continuing balance of payments problems, London was maintaining and in fact increasing its role as an international financial centre (BofE, 1968: 6A123/5).

<sup>68</sup> Harold Wilson's speech to the Lord Mayor's banquet, November 11<sup>th</sup> 1968.



The evolution of the City's role was not without consequence for British banking. American banks brought new management techniques and financial innovation into the London market. Most notably, the introduction of Certificates of Deposit in May 1966, a move that was mirrored by the issuing of sterling CD's by British banks from 1968.<sup>69</sup> The negotiability of CD's, pioneered in the U.S. money markets earlier in the decade, enabled them to function as liquid assets (BoFE, 1966: 398; Oxford, 2008: 75). American banks also introduced the 'going-concern' approach to lending, with future expected earnings rather than the resale value of their assets now the principal criteria for evaluating a borrower's creditworthiness. Covenants imposed by American banks, through which they monitored the profitability of borrowing businesses, led to an intensified role for banks in restructuring business operations in periods of crisis (Coakley & Harris, 1983: 138-140). The growth of offshore banking increased competition for deposits denominated in major currencies, with the American banks competing for sterling deposits after establishing a foothold in London. This had the effect of increasing the competitiveness of the sterling deposit market (Aliber, 1985: 83; Jones, 1991: 125).

British banks were forced to respond to the competitive challenge posed by the Americans. While the merchant banks were prominent players in the first decade of the Euromarkets, their limited deposit bases restricted their capacity to compete as the markets grew in size (Jones, 1993: 326). The British clearing banks, which didn't make a sustained entry into the Euromarkets until the 1970s, had been sheltered from competition

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<sup>69</sup> Certificates of Deposit are negotiable certificates received by the depositor in return for a time-deposit placed with a bank. A large secondary inter-bank market for CD's developed during the 1960s.

through their cosy relationship with the Bank of England and the interest rate cartel that they had long maintained (Jones, 1991: 135). The entry of the Americans provided a competitive jolt to the British banks, shaking them out of their torpor (Moran, 1986: 22).

With international banking rapidly reconfigured, the national regulatory frameworks within which it was embedded were placed under mounting strain. A *transatlantic regulatory feedback loop* emerged during the 1960s and stimulated the processes of financial deregulation that gathered pace in the following decades. By increasing the competitive pressure on British banks, the American influx destabilised the prevailing regulatory order within the City. In the post-war period, the Bank had relied upon its relationship with a concentrated and cartelised banking sector to manage monetary policy and control credit levels. As the number of foreign banks operating in London grew it became increasingly difficult for the Bank to rely on its traditional relationship with a closed network of dominant British banks (Moran, 1986: 2; Michie, 2004: 44). Economic planning and government management of financial markets became much harder. Credit markets were increasingly responsive to global demand fluctuations rather than the requirements of the British government.

To compete with their well capitalised American counterparts, British banks moved towards universal banking and away from traditional divisions between merchant and commercial banking (Battilossi, 2002:114-116). These transformations required a corresponding regulatory recalibration and the Conservative government's 'Competition Credit and Control' policy offered exactly that. It broke from the moves towards credit rationing by administrative decree, which had proliferated during the tight money policy of

the 1960s, freeing up credit markets by substituting price levels for government controls as the decisive determinant of credit levels (Moran, 1986: 30). As we shall see in chapter 5, this had serious implications for the stagflationary crisis of the 1970s.

In fact then, the origins of the deregulatory dynamics of the 1970s and 1980s can be located within the transformation of financial markets during the 1950s and 1960s. Mirroring the imperatives of Competition Credit and Control and increasingly conscious of the competitive challenge that the City posed to New York, deregulation began to gather pace in the U.S. Nixon called for the gradual phasing out of interest rate ceilings in 1973 while the SEC brought about New York's 'Big Bang' in 1975, breaking from its longstanding support for the cartel-like organisations that had dominated American capital markets since the 1930s (Panitch & Gindin, 2012: 149). Regulatory transformations in the U.S. then fed back into Britain, with the further liberalisation during the 1980s and Thatcher's own 'Big Bang' carried out after British officials had visited the U.S. in order to learn from the American regulatory apparatus (Moran, 1994: 168).

### **The fiscal basis of the British state**

Not only did the Euromarkets recalibrate regulatory frameworks and integrate Anglo-American monetary policy, they also fed back into the domestic foundations of Britain's political economy by reconfiguring the fiscal basis of the British state. British merchant bankers were able to use the momentum generated by the Euromarkets to leverage their

own power and influence within government. In the process they helped steer Britain down a developmental path corresponding to their interests.

As Britain's balance of payments problems intensified during the 1960s the coalition of forces behind stop-go unravelled and support for alternatives gathered momentum. Opponents of stop-go called for domestic expansion, modernisation and a move towards indicative planning (Jessop, 1980: 32). Crucially, the Conservative Party began to rethink their stance on state intervention. In the early 1960s the Conservatives began to enact their plans. They established the National Economic Development Council (NEDC), which served as a tripartite medium for national planning. The Conservatives encouraged rationalisation and modernisation, introducing an incomes policy and applying for British membership of the European Economic Community (Jessop, 1980: 33).

Labour began to give planning increased priority under Wilson's administration (Roseveare, 1969: 326; Jessop, 1980: 39; Overbeek, 1990: 7). This was part of the Labour government's broader economic strategy for raising investment levels, increasing exports and replacing imports deemed inessential (Roseveare, 1969: 343). Labour's newfound commitment to planning was embodied in the establishment of the Department of Economic Affairs (DEA) in 1964, along with the establishment of the 'Industrial Reorganization Corporation', which was formed in 1966 in order to intervene directly in the rationalisation of industry and accelerate the process of merging and regrouping among British companies (Brittan, 1971: 319). The DEA took responsibility for prices, incomes and industrial policies, and was primarily responsible for the preparation of the National Plan and regional policy (Brittan, 1971: 315).

But the development of the new planning apparatus was doomed from the beginning. The new agencies were separate from the 'central axis', of state power (the Bank and the Treasury), and the division of responsibility between the DEA and the Treasury was ambiguous (Jessop, 1980: 40; Brittan, 1971: 312). Economic planning in Britain had traditionally been constrained by the domineering power of the Treasury-Bank relationship and the creation of the DEA was unable to overcome this. The DEA was involved in a losing struggle for supremacy with the Treasury, which retained primary control over public expenditure and public investment (Roseveare, 1969: 344). The Bank and the Treasury were able to maintain the traditional priority of the balance of payments and the reserves over and against the commitment to growth and full employment entailed by support for planning (Jessop, 1980: 40).

The indicative nature of the new planning was a serious limitation. When the NEDC and the DEA drew up their proposals there were no specific policy tools for securing either direct or indirect compliance with the specified growth targets (Jessop, 1980: 41). When Wilson's government was faced with the choice between devaluation, as a precondition of planned growth, and deflation to safeguard the reserves, they opted for the latter (Jessop, 1980: 40).<sup>70</sup> The modernisation efforts of the 1960s failed to restore competitiveness to British business (Gamble, 1990: 119). Even after the devaluation of 1967, which effectively ended sterling's international role, the government continued to prioritise deflationary measures (Jessop, 1980: 40; Cassis, 2010: 202). This failure was in no small part down to

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<sup>70</sup> Gamble (1990: 120) identifies this failure to challenge the internationalist orientation of British economic policy and break out of the stop-go cycle as the key reason for the failure of modernisation attempts during the 1960s.

the Labour government's fear of alienating the Americans through devaluation (Brittan, 1971: 292). With the dollar under increased pressure during the 1960s, the Americans feared that a British devaluation would dent the market's confidence in the dollar (Gowa, 1983: 39).

As the relentless stop-go cycle deepened Britain's industrial crisis, the Euromarkets increasingly shaped the fiscal strategy of the British state. The Eurobond market in particular became highly significant. With an intensifying fiscal crisis, Eurobonds were touted as a potential source of funds. Already in 1961, the White Paper on the 'Financial Objectives of the Nationalised Industries' suggested that nationalised industries needed to make a reasonable rate of return on the capital invested. Nationalised industries would have to contribute to their own capital needs, charging prices that were in realistic relation to the underlying costs. These were more demanding objectives than the prior goal of simply breaking even (Brittan, 1964: 96). It was within this context of transforming the *raison d'être* of the nationalised industries that the question of Eurobond borrowing took centre stage.

Within the Treasury, the possibility of easing access to Euromarket funds was discussed at length. This followed hot on the heels of the renewed sense of crisis that swamped Britain after devaluation in 1967. The Treasury and the Inland Revenue discussed the possibility of easing access to the Eurodollar market for UK traders. The motivation here was the perceived benefit to the British balance of payments with reserves to be strengthened if U.K. traders borrowed outside of the Sterling Area in order to finance

domestic investment (Treasury, 1968: IR40/16006).<sup>71</sup> In order to encourage Eurodollar borrowing, the Bill proposed to make more interest on foreign borrowing tax deductible.

These proposals were not well received by the Inland Revenue, who expressed concerns about the potential impact of a relaxation of borrowing controls upon offshore tax havens.<sup>727374</sup> But the Treasury and the Bank overrode the Inland Revenue's concerns. In a meeting between Treasury and Bank officials the increased balance of benefits payments post-devaluation were stressed. With confidence in sterling low, it was felt that any measures that could help bolster the U.K.'s reserve position were to be encouraged (Treasury, 1968: IR40/16006).<sup>75</sup> The move towards greater Eurodollar borrowing would have an additional benefit. It was in fact partially devised as a means to reduce Britain's exposure to destabilising short-term capital movements.

By expanding the financing options available to firms, the proposal would lead to, 'the average lengthening of our borrowing abroad', a step which was seen as a, 'modest but significant step in line with the Government's policy of reducing the country's sensitivity to short-term flights of funds'. Increases in reserves derived from this practice would, it was understood, be a, 'very real gain', and, 'would be recognised as such in every financial centre in the world' (Treasury, 1968: IR40/16006).<sup>76</sup> The Bank firmly supported the proposal and

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<sup>71</sup> Treasury File National Archives IR40/16006 'Discussions with Financial Secretary, Treasury and Revenue on whether companies should be encouraged to borrow on Eurodollar market 1966-1978', Memo from Treasury to Inland Revenue, Undated.

<sup>72</sup> This was hugely ironic given that London was already the offshore haven par excellence.

<sup>73</sup> The Revenue argued that dismantling the regulations around Eurodollar borrowing could have a knock on effect upon tax avoidance (Treasury, 1968: IR40/16006).

<sup>74</sup> Memo from Inland Revenue to Treasury Officials, 29<sup>th</sup> May 1968.

<sup>75</sup> Meeting between Financial Secretary, Treasury and Bank of England Officials, 17<sup>th</sup> May 1968.

<sup>76</sup> Note by the Financial Secretary on Eurodollar Borrowing, May 1968.

the Treasury agreed that the Inland Revenue's tax objections were, 'insubstantial' (Treasury, 1968: IR40/16006). By the end of May 1968, the Chancellor of the Exchequer had concluded that the balance of payments benefits outweighed the tax difficulties (Treasury, 1968: IR40/16006).<sup>77</sup>

Quite perversely then, the growing offshore market that had enabled vast movements of hot money previously unseen during the post-war period was now viewed as the most viable means to insulate Britain from speculative movements.<sup>78</sup> Capital controls were ruled out and the solution appeared to be an even tighter integration with the vicissitudes of the Euromarkets. The Euromarkets were both the malady and cure. And in a peculiar Anglo-American parallel, the Euromarkets had begun to serve as a key strategic arena for the management of the balance of payments in both countries.

The increased appeal of the Euromarkets as a source of funds was not purely circumstantial. From the mid-1960s, merchant bankers began to actively press the government to promote Eurodollar borrowing. Treasury officials reported to the Inland Revenue that, 'merchant bankers at home and abroad have been urging for some time that if certain tax impediments were removed U.K. firms and public bodies would be able to raise large sums in medium and long term issues of Eurodollar bearer bonds' (National Archives, 1967: IR 40/16006).<sup>79</sup> Foremost among these merchant banker advocates was, unsurprisingly, Siegmund Warburg himself.

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<sup>77</sup> Memo from Inland Revenue to Treasury Officials, 29<sup>th</sup> May 1968.

<sup>78</sup> This is hugely ironic, given that the ease of switching out of sterling and into dollars through the Eurodollar market played a major role in destabilising capital flows in 1966 and 1967 (Brittan, 1971: 329).

<sup>79</sup> Treasury letter to the Inland Revenue- 'Draft paper on Eurodollar borrowing', October 4<sup>th</sup> 1967.



In 1965 Warburg's had joined with Hambros and Rothschild's in order to push the Bank of England to exempt foreign bonds issued in London from paying stamp duty. They also pressed the Treasury to lift the requirement that income tax be deducted from interest on bonds issued by companies based in the U.K. (Ferguson, 2010: 225). Warburg was keen to accelerate the liberalisation of London's services for international investors, viewing this as essential to achieving European integration. Harold Wilson had come to lean heavily upon Warburg for financial advice during the 1960s.<sup>80</sup> And although Warburg had vociferously lobbied Wilson to avoid devaluation, the firm nonetheless 'stood ready to advise the government not only on currency questions but also on the finances of nationalised entities like the National Coal Board' (Ferguson, 2010: 285).

Long term borrowing requirements of the nationalised industries had, since 1956, been financed wholly through the Exchequer (National Archives, 1967: IR 40/16006).<sup>81</sup> This meant that their borrowing requirements were aggregated with other government borrowing. Between 1962 and 1967 the funds required for borrowing had grown from £432 million to £1.1 billion. The problem then became one of financing investment without further weakening Britain's balance of payments. Within this context, the intervention of two different interests was crucial.

Firstly, the IMF recommended in the summer of 1967 after agreeing to loan to Britain, that the nationalised industries, 'be required to make a greater contribution to their

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<sup>80</sup> Niall Ferguson (2010: 276) suggests that, 'In the early 1960s it was S.G. Warburg & Co. more than any other City firm that appeared capable of helping British governments to address their recurrent financial problems'.

<sup>81</sup> Memo from the Chancellor of the Exchequer to the Treasury- 'Financing National Investment', September 13<sup>th</sup> 1967.

own requirements so as to reduce the burden of the Exchequer' (National Archives, 1967: IR 40/16006). The IMF was beginning to have the sort of transformative impact upon British development that it would exert more strenuously during the 1970s. Concurrently, the merchant bankers and Warburg in particular were continuing to advocate greater Euromarket borrowing for the government, local authorities and the nationalised industries. Warburg declared to the Exchequer, rather ambiguously, that borrowing from the Euromarkets would be "good for the credit" (National Archives, 1967: IR 40/16006).<sup>82</sup> He subsequently raised the issue with the Minister of Power and commented that Britain was making less use of the Euromarkets than Germany and France.

An unholy and unwritten alliance between the IMF and the City's merchant bankers was pushing Britain deeper into the embrace of private capital markets and transforming the fiscal basis of the British state. Whereas past studies had concluded that the overall benefits of increased Eurodollar borrowing would be negligible, the deteriorating fiscal climate and the intensive lobbying campaign of the merchant banks, aided by IMF prescriptions, proved game changing. The lobbying efforts of Warburg and others bore fruit: in 1969 the Gas Council raised £31 million through deutschmark denominated Eurobond issues, and by October of 1971 British public sector agencies had raised £51 million through this channel (Ferguson, 2010: 285).

The Euromarkets had intensified banking power in Britain, not only by pulling American banks into Britain en masse, but also by energising City merchant banker's efforts to use their privileged access to the Treasury-Bank nexus to render government fiscal

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<sup>82</sup> Treasury paper on the possibility of borrowing abroad to finance the nationalised industries and local authorities, May 25<sup>th</sup> 1967.

policy compatible with their interests. Borrowing costs were higher for individual Eurobond issues offered by public sector agencies than for the Exchequer borrowing through its own aggregate account. No wonder Warburg and his kin were so keen to advocate this course of action. Their presence helped ensure that financing public sector utilities was achieved not through progressive taxation or government management of the banks, but through the embrace of private capital markets. Within a Bank of England that had long stood for the traditional Gladstonian orthodoxy of balanced budgets and a Treasury that had been converted to Keynes only in technique, not thought, they found fertile soils for their arguments to be implanted (Roseveare, 1969: 325).

By the late 1960s a creeping monetarist influence was exerting itself within the Treasury. Whereas the initiative on monetary policy had traditionally been left up to the Bank until the 1960s, the Treasury now became more involved with the measurement of the money supply (Brittan, 1971: 80). Geoffrey Bell, a leading advocate of the new quantity theory of money, took a position within the Treasury's Finance division. Bell and other officials began to take an interest in the flow of money throughout the economy and had begun to calculate figures for Domestic Credit Expansion by the beginning of 1969 (Brittan, 1971: 81). From the mid-1960s, the Finance side of the Treasury began to recover some initiative on overseas matters from the Bank. Sterling's problems could no longer be remedied with short-term credits from other Central Banks but needed regular recourse to the IMF instead. Increasing contact with the IMF, which dealt directly with the Treasury, augmented Treasury influence (Brittan, 1971: 80). With Roy Jenkins as Chancellor after the devaluation of 1967, IMF prescriptions were enacted through attempts to control the

money supply in order to limit consumption and restrain imports (Panitch & Leys, 1997: 109). These foretastes of monetarism inspired by the IMF would, as we shall see in chapters five and six, develop a much fuller flavour in the following decades.

### **Anglo-American finance and the crisis of Keynesianism**

The birth of the Euromarkets represented a defining moment in the post-war history of the British state. By hosting a financial market that transformed the landscape of international finance, critically undermining the Bretton Woods order, the City-Bank-Treasury nexus placed British chips firmly in the hat of a rapidly globalising world economy. But Britain did not move in this direction independently. The power of American finance was crucial in giving the required weight and depth to the Euromarkets. It was a truly *Anglo-American process* that would have been impossible without the interaction between their differential developmental processes. Static typologies of hegemony miss the significance of this expression of American power within the institutional fabric of Britain. By focusing predominantly upon America's post-war power, scholars have neglected the extent to which Britain's role as a key nodal point in the articulation of financial globalisation was fundamental to the collapse of Bretton Woods and the birth of a new order of globalised finance. American ascendancy was articulated in and through British decline, as their developmental paths occasioned a constitutive interaction within the City. It was Britain's peculiar imperial history and long-standing commitment to an open international financial order, in contrast to the controls put in place by other European states, which enabled

American banking to break through its national boundaries, reconfiguring the international monetary system in the process.

We can only understand the Euromarkets through this Anglo-American lens. By neglecting this kind of analysis, scholars of British development have often understated its significance. Arrival of American banks en masse into the Euromarkets meant that decisions taken about the City were inevitably also decisions taken about American banking. Hosting the Euromarkets became a serious constraint upon the policy autonomy of the British state.<sup>83</sup> Crucially, discussions about the nationalisation of key City institutions, which gathered momentum during the 1970s, would unavoidably become discussions that threatened the position of internationalised American banks in London. The United States had a more obvious and active stake in Britain's political economy than ever before.

The Eurodollar embrace was a constraint that fatally undermined the Keynesian experiment of the post-war British state. Britain willingly subjected itself to market discipline that weakened the pound and intensified the disastrous stop-go cycle of post-war recovery. As the City became ever more multinationalised and banks began to push against the existing regulatory framework, it became increasingly difficult for the Bank and the government to control credit to the extent required for a Keynesian growth strategy and economic planning. The growth of financial power brought about through the Euromarkets would be foundational to the development of neoliberal policies that gathered momentum during the crisis years of the later 1970s. But to state, as does Burn, that the importance of the Eurodollar market lies ultimately in, 'the resurrection of an institutional state structure

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<sup>83</sup> Andrew Gamble (1990: 121) in particular, is culpable of neglecting this crucial factor in his analysis of British decline.

reminiscent of that which defined the pre-1931 City-Bank-Treasury nexus', is to overlook the centrality of the Anglo-American dimension (Burn, 1999: 227). Power did remain concentrated within the City-Bank-Treasury nexus, yet it was articulated through and embedded within a new order of Anglo-American financial integration.

Through the Euromarkets and the entrenchment of dollar hegemony, the Fed's global role was augmented. This was evidenced by effect the Fed's policies had in pushing up interest rates in the Eurodollar market and shaping the geographical flow of Eurodollar funds from the mid-1960s. The City had recovered its role only through the acceptance of a particular place *within an American-led and American dominated world order*. It had become an archipelago into Europe and the wider world for American capital markets, a key nodal point in the articulation of financial globalisation. We need not explain Britain's acceptance of this role as a result of 'hegemonic lag' as Helleiner (1994: 99) erroneously proposes. It was in fact the outcome of the active lobbying and business practice of the City's merchant bankers who successfully innovated to create the Euromarkets. They then waged an effective campaign to pull Britain deeper into the clutches of the Euromarkets, transforming the fiscal basis of the state. In doing so they excluded potential alternatives for the post-war state and guaranteed that Britain would recover its traditional orientation to international finance, albeit in a qualitatively different form.

But the story of the Euromarkets' origins is also one of the decomposition of the Bretton Woods order. As both countries wrestled with the crises of the Bretton Woods system during the 1960s, they responded to these challenges in a way that, often unintentionally, spurred the further growth of the Euromarkets. In pursuing their own

distinctive strategies of national development, and through the constitutive interaction of these strategies, Britain and the United States sowed the seeds for a new order of liberalised international finance. The flows of hot money unleashed by the Eurodollar market were destabilising both to sterling and the dollar during the 1960s and 1970s (Strange, 1972: 198; Bell, 1973: 67; Higonnet, 1985: 36; Overbeek, 1990: 109). By increasing the exposure of these two key currencies to speculative attacks, the Eurodollar market played a central role in the collapse of fixed exchange rates and the Bretton Woods system.

During the 1970s, as the international monetary system continued to unravel, a new era of financial discipline was born. Floating exchange rates began to exert the kind of disciplinary pressure towards balanced budgets that had not been effectively enforced under Bretton Woods.<sup>84</sup> The Oil crisis of 1973 combined with a crisis of profitability and increased working class militancy to spark a world crisis and years of stagflation in the West (Glyn & Harrison, 1980: 21; Brenner, 2002: 18). Britain felt these pressures more acutely than any other developed nation. When the Labour government was forced to go cap in hand to the IMF once more in 1976, the Americans seized the opportunity to impose discipline upon what they viewed as a spendthrift Britain living beyond her means. As Britain's Keynesian compromise entered its death throes, Anglo-American dynamics would be central once again.

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<sup>84</sup> Under Bretton Woods, the proposed system of adjustable pegs had in effect become a system of rigidly fixed exchange rates. Within this system, both devaluations and revaluations became, 'politically untouchable' (Gowa, 1983: 37-38).

## **5 Britain and America in the Eye of the Storm**

*From the Breakdown of Bretton Woods to the IMF Crisis of 1976*

The international monetary system designed at Bretton Woods finally burst apart during the early 1970s. The terminal balance of payments deficits of Britain and the United States, which had dominated the international monetary politics of the 1960s, reached their day of reckoning. America's eventual answer to the Triffin dilemma was the closing of the gold window, which jolted the world onto an impromptu dollar-standard and restored American policy autonomy. Without the power to enact similar unilateral measures, Britain's status as a tottering key currency component of Bretton Woods produced much graver consequences. Facing a sterling crisis of unprecedented proportions, Britain became the first major casualty of the post-Bretton Woods financial order of which America was the chief architect.

As it had done throughout the 1960s, Britain drew on IMF financing once again in 1976. But the rules of the game had now been rewritten. Britain could no longer draw on the Fund with the leniency and privilege it had been accustomed to. The costs of British borrowing, through the severe conditionality imposed in chief by the American moneymen at the Fed and the Treasury, would be sufficiently severe as to provoke a humbling curtailment of national sovereignty and rapidly accelerate the decomposition of Britain's Keynesian compromise.

Britain's 1976 bailout was a crucial moment in the politics of globalisation (Helleiner, 1994: 128). Had the restrictive measures that some within the Labour Party and



Cabinet advocated actually been adopted, the trend of further financial liberalisation of the global economy would have been drastically arrested by a state that had formerly been central to its progression. That this did not occur was in part due to the resistance that these proposals met from opponents within the Cabinet, the Treasury, Bank and City. But it was also due to the persistent pressure exercised by key officials within the American state. As American power pushed in on Britain through the disciplinary stance of the U.S. Treasury and the Fed, refracted through the power of the IMF, British officials, the Tories and the bankers of the City also drew American discipline in onto what they understood as an outmoded and fiscally reckless Labour Government.

This chapter challenges the dominant political economy interpretation of the 1976 crisis. I argue that analyses of the crisis have fallen into an either/or approach to understanding the relationship between national and international development. Within this framework, the predominant concern is to clearly establish a privileged level of causality that explains the events in order to explain the abandonment of Keynesianism by the Labour government. Setting the 1976 crisis within the context of longer-term Anglo-American developmental processes reveals a more complex picture of the events. The crisis was the culmination of over a decade of negotiations between Britain, the IMF and the U.S. during which Britain's deepening financial dependence drew it ever closer to the disciplinary power of the U.S. and the IMF. Once again the interaction between the Fed-Treasury-Wall Street nexus and the City-Bank-Treasury nexus was crucial.

The American stance taken in 1976 needs to be viewed as part of a continuum that stretches back at least as far as the 1967 sterling devaluation and IMF drawing (Burk &

Cairncross, 1992: 12). That stance, and the impact that it had upon British sovereignty, is explicable only as the result of nearly a decade of growing American impatience with Britain's balance of payments crises and the chronic weakness of sterling. By 1976, the Americans had run out of patience with Britain and were considering direct supervision of the British Treasury by its American counterpart, had Britain failed to meet IMF conditionality.

Fearing that the British might jeopardise the future of the liberal international economic order that had been reconstructed after the war, the Americans used their power to steer the development of the British state away from strategies that might have challenged that order. For Britain, this represented a key moment in the 'internationalisation' of the state, with the Fed and the U.S. Treasury channelling pressure onto the Bank of England and, with even greater intensity, the Treasury, in order to alter the priorities of the British state. That pressure was resisted by some elements within the British state and society, but others, who were hostile to British social democracy, willingly drew it in.

The first section of this chapter critically reviews Robert Cox and Eric Helleiner's analyses of the global political economy during the 1970s. I argue that both scholars provide interpretations that are unable to capture the specificity of the transformation of Britain's political economy during the period and underplay the impact of American state power in reconstituting the British state through Anglo-American development. I then show how similar conceptual failings influence studies of Britain's 1976 IMF crisis. The chapter then develops an alternative account of the 1976 crisis by tracing Anglo-American

development within the context of the growing crisis of the Bretton Woods system during the 1960s and early 1970s. In the third section, I demonstrate how continuing Anglo-American development and the collapse of Bretton Woods fed into the reconstitution of British capitalism and the erosion of the post-war consensus. In the process, forces hostile to the Keynesian state were able to exert a growing influence and the transatlantic ideological ascendancy of monetarism was deployed to further their interests. In the fourth section, I explore the immediate political economic context of the crisis, tracing the key events and demonstrating the way in which American disciplinary power was exerted upon, and drawn into, the internationalisation of the British state during a key moment in the politics of globalisation.

### **The internationalisation of the state**

The global political economy underwent a period of profound transformation during the 1970s. The Bretton Woods order unravelled with astonishing rapidity. The era of cheap energy, which had facilitated the post-war boom, appeared to have run its course. The OPEC oil price hike of 1973 spectacularly highlighted this. Transnational corporations grew in power and rapidly globalised their production networks, while newly industrialising countries contributed to the disruption of the existing international division of labour. Within capitalist states, the Keynesian compromise between capital and labour eroded under the conditions of shrinking profits, rising inflation and increasing union militancy. The massive growth in the scale and power of international finance undercut the potential

for nationally autonomous growth strategies and exposed governments to increasing speculative pressure (Gill, 1992: 160).

Within this shifting international context the purposes, practices and priorities of the state were transformed through the 'internationalisation of the state'. Under the Bretton Woods system states were accountable to external agencies associated with the international economic order. Agencies such as the IMF, the World Bank and GATT, supervised the management of trade liberalisation, exchange-rate stability and convertibility. But although they were subject to the need to achieve harmony with the dictates of the Bretton Woods regime, nation states were also allowed facilities and space to adjust their national economies without having to sacrifice domestic welfare objectives. From the late 1960s however, the breathing space for adjustment and the importance of preserving the welfare of domestic groups within a framework of national policy autonomy came under sustained pressure (Cox, 1992: 27-28).

A series of structural transformations within the global political economy, pertaining to the shift from Fordist to Post-Fordist production, the increased reliance of governments and corporations upon debt and the intensified structural power of capital, collectively undermined the former conditions of national development. Alongside these structural transformations, Cox suggested that opinion formation had become increasingly centralised within an elite coterie of institutions such as the BIS, G7, IMF, OECD, Bilderberg and Mont Pelerin society. Through these agencies, a consensual plan for the management of the global economy was established. The emergent policy consensus resulted in a structural

'internationalisation' of the state that occurred as part of a general reconfiguration of sovereignty within the global economy:

'The state becomes a transmission belt from the global to the national economy, where heretofore it had acted as the bulwark defending domestic welfare from external disturbances' (Cox, 1992: 30).

As the state is internationalised the hierarchy of power within it is also reconfigured, with those agencies most closely interconnected to the global economy, such as Treasuries, Central Banks and Prime Ministerial offices, accorded greater primacy while more domestically oriented institutions experience a related demotion.

Although the Coxian conception captures important facets of state development under conditions of globalisation, the notion of the state as a 'transmission belt', relies upon an excessively formal delineation between the global and national economy (Panitch, 1994: 71). By focusing too much upon the decline of U.S. hegemony, it also underestimates the continuing role of the U.S. in driving processes of state internationalisation through cooperation with foreign Central Banks and Treasuries, and the particular ways in which American power was drawn into national development. Despite conditions of global economic crisis, American networked state power, drawing upon the internationalisation of the Fed and the Treasury during the attempts to maintain Bretton Woods in the 1960s, continued to play a vital role during the 1970s. This was not a case of the return to inter-imperial rivalry, or American free-market ideals against the interventionist preferences of

Europe and Japan, but rather the continued and deepening integration of major capitalist states. The U.S. played the central role in maintaining the international dominance of the dollar during the 1970s, by promoting a common purpose and direction among major capitalist states through forums such as the G7 (Panitch & Gindin, 2012: 134).

Eric Helleiner's portrayal (1994: 101-102) of the period in terms of American free-market initiatives in opposition to West European and Japanese demands for capital controls overstates the degree of opposition and understates the high level of integration between states that had already occurred. In reality, the Americans recognised the deep interconnections of state and market power. Even the most avowed proponents of neoliberal ideology within the American administration, such as Treasury Secretary Bill Simon, understood the need for state intervention to underpin the globalisation of financial markets. Simon announced at the annual IMF meeting in Washington in 1974 that, 'we do not believe in an attitude of laissez-faire, come what may. If there is a clear need for additional lending mechanisms, the United States will support their establishment' (Panitch & Gindin, 2012: 146). Furthermore, Helleiner's failure to examine the links between capitalist interests within different states, in preference for a focus on the role of states, leads him to underplay the level of capitalist integration and the degree of business opposition to capital controls within Europe and Japan (Panitch & Gindin, 2012: 146).

To read the international monetary politics of the 1970s as a case of an increasingly neoliberal American administration foisting its ideas upon Western Europe and Japan, as Helleiner does, exaggerates the degree of 'laissez-faire' conviction within the U.S. administration and underplays the support for further liberalisation within Western

European states. Indeed, Britain's position was much more complex and contradictory. The City now hosted the Euromarkets and depended upon an open international financial system. Britain therefore had to balance between European initiatives for controls, within a context where Britain was keen to secure membership of the EEC under Ted Heath's government, and the need to maintain freedom of financial flows as a precondition for the further growth of the Euromarkets and the City. Within West Germany, those who wanted temporary capital controls were actually some of the most conservative and monetarist figures and were very much opposed to the principles of Bretton Woods (Panitch & Gindin, 2012: 146).

Cox's notion of the shift in the state's role from a 'bulwark' against the exigencies of the global economy, towards a 'transmission belt' for them, is particularly inappropriate for understanding British development, while Helleiner's inattentiveness to a specifically Anglo-American field of capitalist development, grounded in the interdependence of the City and New York, leads to a failure to correctly identify Britain's orientation towards the international monetary politics of the 1970s. As we have seen in the previous chapter, Britain's hosting of the Euromarkets had drawn American power into the constitution of British capitalism and the accumulation strategy of banks in the City. In seeking to regain international pre-eminence, the City opened itself up to transatlantic integration. Cox's 'outside-in' approach to causality obscures the extent to which the 'inside' had already been constituted through its external orientation to American power as part of an emergent Anglo-American developmental sphere centred upon the interactive relationship between the financial communities in London and New York. Instead, I argue in this chapter, we

need to think in terms of the co-constitutive and uneven interaction of national and international developmental force fields, emphasising the Anglo-American vector of capitalist development. American power exerted pressure upon Britain, but it was also very much a case of powerful class interests within Britain, particularly in the City, pulling in American discipline by voraciously attacking the foundations of the post-war consensus through the frequent pro-monetarist salvos launched in the financial press. The 1976 IMF crisis exemplifies the problem of national development within the context of a global political economy dominated by American power.

The outside-in pattern of causality advanced by Cox and the prevailing either/or analytical binary associated with the debate over the internationalisation of the state, have influenced interpretations of Britain's 1976 IMF crisis. Andrew Baker critiques (1999: 83) Cox's, 'vague, ambiguous and empirically deficient' understanding of the internationalisation of the state and argues that the demise of Keynesianism and within Britain should be understood not in terms of the climate of international opinion but rather in regard to 'changes in the social basis of the state, national economic problems and a domestic climate of ideas and opinion that reflected this'. According to Baker (1999: 83), the negotiations with the IMF had only a, 'very limited role' in this transformation, merely accentuating the size of public spending cuts that were already underway without, 'any lasting or profound effect on British policy'.

Chris Rogers' analysis (2009: 972) follows Baker's privileging of the national level of determination, suggesting that the IMF's intervention did not act as a catalyst for 'social learning or disciplinary constraint', but rather merely, 'provided the government with the



room for manoeuvre to implement its established preferences by altering perceptions about the range of policies effectively within its scope for discretionary action'. In this explanation the intervention of the IMF is understood to have had no significant consequences for the outcomes of Britain's break with Keynesianism other than enabling a shrewd government to pass off their own political priorities of austerity as the dictates of an external agency. Rogers's analysis is based on a crude severance of the conjuncture of 1976 from the broader historical context. By isolating the synchronic conditions of 1976 from the preceding diachronic developmental processes, Rogers unduly privileges the national level of determination and overstates British autonomy within the international system, while grossly understating the centrality of American power to the outcomes of the IMF negotiations.

We see a similar concern to state the primacy of national determination in shaping the transition away from Keynesianism exhibited in Steve Ludlam's account, which seeks to debunk myths about the IMF deal. Running through a list of policy outcomes that were supposedly resultant from the engagement with the IMF, such as enacting public spending cuts and introducing monetary targets, Ludlam argues (1992: 715) that in each case, 'the policy shift identified with the intervention of the IMF preceded the settlement of December 1976'. By focusing on the degree to which the intervention of the IMF and the Americans was responsible for the break from Keynesian policy priorities, accounts have overlooked the importance of disciplinary and supervisory processes and their centrality to the internationalisation of the British state.

Mark Harmon (2008: 1-2) provides a more nuanced account of the crisis, which delineates different phases during which the level of determination shifted from one determined primarily by national priorities (1974 to early 1975), to being shaped by international pressures and priorities (late 1975 to 1976). Harmon's analysis focuses upon the role of American 'structural power', but neglects the manner in which social forces within Britain, which were hostile to the Labour government and the Keynesian state, drew in American power.

Overall, accounts of the crisis succumb to a politics of chronology that counterpoises an apparently pristine trajectory of 'national' development and 'national' priorities against the incursion of 'international' pressures, represented by the IMF. In doing so they neglect the manner in which Britain's national priorities had been shaped within the context of the Bretton Woods system and the conditioning force field of Anglo-American development in particular. The role of American disciplinary power as an active process central to reconstituting the British state has been understated. The Bank and the Treasury were already deeply embedded within the network connections that had been constructed by the American state during the attempts to forestall the collapse of Bretton Woods during the 1960s, and promote collective adjustment to financial globalisation during the 1970s. Indeed, the Bank itself played a prominent role here in its role within the BIS and the Basle Committee.

Through incursion into British sovereignty, the U.S. and the IMF were able to internationalise Britain's policy objectives and render them amenable to the priorities of global capital. American state power was deployed in conjunction with private market

power in order to steer Britain away from a radicalisation of social democracy and towards a neoliberal abandonment of the post-war consensus. Beginning from Britain's mounting balance of payments problems during the latter 1960s, we can clearly see the events of 1976 as the outcome of long term interaction between Britain, the IMF and the U.S. in which the disciplinary pressure on Britain gradually rose until reaching a crescendo in 1976.

### **The death throes of Bretton Woods**

The roots of the 1976 crisis lay in the persistent British balance of payments problems of the 1960s, during which the Americans grew increasingly frustrated with British profligacy. Lyndon Johnson's administration was exasperated by the failure of the Wilson government to arrest the decline of sterling and forestall market fears of devaluation. The acceleration of Britain's balance of payments crisis during Wilson's government was the beginning of the process that gradually drew Britain closer into the disciplinary orbit of American power. The head of the Federal Reserve, Bill Martin, took an increasingly firm stance towards Britain from 1965, urging much sharper cuts to public spending in order to calm the markets (Schenk, 2010: 161).

With Britain in dire need of funding to support sterling, Martin and Johnson appeared to have reached the end of their tether. Martin proposed that massive pressure be put on the British to introduce a much more comprehensive package of spending restraint, if that failed, sterling should be abandoned altogether, with the U.S. instead turning to the

IMF to construct a package to protect the dollar.<sup>85</sup> Johnson, for his part, described Wilson as a 'drunk and reckless boy', writing checks on his father, but unable to honour them (Schenk, 2010: 162). The impression of a fiscally incontinent Labour government was becoming deeply entrenched. Treasury Secretary Fowler did, however, temper Martin and Johnson's plans. Fowler knew that the actual costs of abandoning sterling would be very high, with the resultant termination of Bretton Woods. Instead, it made more sense for the U.S. to continue to contribute to multilateral support for Britain.

The negotiations from 1965 exhibited important precursors to the austerity measures imposed in 1976, with conditions stipulated on action over wage restraint, prices and government expenditure (Capie, 2010: 207).<sup>86</sup> During this period, sterling's weakness exposed Britain to the American plan for rebalancing the international economy. The American vision emphasised restrictive monetary policy and credit control rather than the industrial policy favoured by the Labour government (Schenk, 2010: 190).

During the 1960s Britain held the bargaining power of a key currency country central to maintaining the Bretton Woods order. That power enabled Britain to resist the implementation of American austerity measures during negotiations (Schenk, 2010: 204). But this power was diminished under the system of floating rates that followed the collapse of Bretton Woods. The consequences of this were significant for 1976.

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<sup>85</sup> Writing to the Bank of England Governor, Lord Cromer, in 1965, Martin stressed the need for dramatic measures to restore market confidence in sterling and suggested that "a wages and prices freeze would probably do this" (Capie, 2012: 214).

<sup>86</sup> The Martin-Cromer plan is an important example of these creeping austerity demands. The plan was created by Bill Martin and involved the employment of a syndicate of countries who would support the sterling exchange rate through concerted market intervention. But in order to access the support, the British government would have to agree to the announcement of a wage, price and dividend freeze in order to boost market confidence (Schenk, 2010: 165).

Already during the 1960s, then, many of the patterns of the 1970s negotiations were discernible. As they would be in 1976, the Bank of England and the Treasury were notably more receptive to IMF calls for austerity than the British government. As Britain drew upon the IMF again and again during the 1960s, the surveillance and conditionality attached grew incrementally, with a particular focus upon the imposition of monetary and fiscal restraint through the use of quantitative targets. These conditions, despite their limited efficacy in practice, represented an important departure from Britain's traditional dealings with the Fund.

Britain was the heaviest drawer on the Fund's resources during the first 25 years of the IMF's life. As a powerful key currency country, Britain was able to make drawings with scant oversight or conditionality. Britain's heavy and regular use of IMF funding began before the conditionality principles of the Fund's lending were firmly established. Discussions over the conditionality of IMF lending had been an important aspect of the post-war Anglo-American discussions on international monetary politics. Whereas Britain had wanted IMF funding to be delivered without insistence upon deflationary measures, the Americans were keen on deflationary stipulations. American proposals for amending the IMF Articles of Agreement, to include a statement that balance of payments financing was not an unqualified right, were initially resisted by the other members. But by 1950, the Americans had successfully campaigned for the acceptance of a conditionality principle linked to IMF funding. By the end of that decade, the major elements of conditionality were in place, but the conditions tended to be used only in negotiations with developing countries (Harmon, 1997: 21-27).

Conditionality emerged, then, as a consequence of American power and the desire to use the Fund as a source of disciplinary control over countries facing balance of payments difficulties. The IMF existed only in a relationship of limited independence from American power. The U.S. was the largest single contributor of funds to the IMF and it also wielded an exclusive veto vote over Fund policies. Added to this, the Fund's basis in Washington ensured a spatial and symbolic proximity to the power and priorities of the U.S. (Burk, 1994: 354). From the mid-1960s, Britain was drawn progressively deeper into this disciplinary trap, having to accept an ever-higher degree of conditionality and surveillance as a quid pro quo for the support of sterling.

Tense Anglo-American negotiations and the increasing British dependence upon IMF funding were precursors the collapse of Bretton Woods during the early 1970s. Once the pound had been devalued in November 1967, speculative pressure turned almost immediately towards the dollar (Block, 1977: 193). Britain and America were now, for very different reasons, centre stage during a defining period in the politics of globalisation. The dollar came under renewed strain between 1970 and 1971. On coming into office Nixon had sought to curb inflation, which had risen steadily during the 1960s, by raising interest rates, with the federal funds rate hitting 9%. However, the effect of the rate rise created instability within the U.S. financial system, provoking a crisis within the commercial paper market and leading to the insolvency of Penn Central, one of the largest corporations in the U.S. In response, the Nixon Administration began to reduce interest rates and suspended regulation Q ceilings in order to boost liquidity for the banking system (Kane, 1983: 51; Panitch & Gindin, 2012: 138-139).

Nixon's administration were forced to pull back from their efforts to choke off inflation, but the Fed's behaviour here foreshadowed the more sustained effort to reduce inflation under the stewardship of Paul Volcker. The Fed's U-turn in 1970 demonstrated the impact of financial market developments, which had been sponsored by Central Banks, on restricting the scope for Central Bank action. With more and more businesses now entangled in expanding financial markets, tight money threatened to spark off a financial crisis. The Fed was forced to negate its efforts to control inflation, by prioritising its lender-of-last-resort and pumping liquidity into the markets. As financial globalisation accelerated, the Fed's crisis management role would become increasingly important (Panitch & Gindin, 2012: 138-139). More immediately, the Fed's measures had a major effect on Eurodollar flows as American banks became less dependent upon Eurodollar borrowing and began to unwind their Eurodollar positions. The availability of low cost funds led to large European capital inflows, which contributed to crises of the deutsche mark and the dollar (Strange, 1972: 198; Block, 1977: 197). The failure to arrest the dollar's travails through the imposition of tight money at home also ensured that other solutions would have to be found in response to the problems of Bretton Woods.

This period of instability in the money markets had major consequences for the international monetary system. In response, West European and Japanese monetary authorities began to push for cooperative capital controls and the regulation of the Euromarkets. The trend towards financial liberalisation was now under scrutiny from countries increasingly dissatisfied with monetary instability (Helleiner, 1994: 101-105). But this was not, as Helleiner erroneously suggests (1994: 116-117), a case of a fervently

neoliberal U.S. administration bent on pushing the international monetary system towards further liberalisation. Nixon's approach to Bretton Woods was much more pragmatic and was guided, above all, not by ideological commitments to monetarism but by the desire to preserve American national policy autonomy precisely in order to avoid the domestic imposition of monetarist precepts favouring domestic deflation and increased unemployment. This was a long way from the genuinely neoliberal principles that were later enacted by Paul Volcker and Ronald Reagan. Indeed, for much of the 1970s, American monetarists did not enjoy a great deal of power or influence (Johnson, 1998: 145). When the American's did finally delink from gold unilaterally, it was only after they felt that they had exhausted all multilateral options (Gowa, 1983: 79).

In his attempt to clearly delineate an, 'us and them' schism between the U.S. on the one side, and Western Europe and Japan, on the other, Helleiner overlooks Britain's contradictory position on the issue of capital controls. British authorities shared the broader West European commitment to the maintaining the system of fixed exchange rates, but they were very hesitant to countenance any restrictive measures that might imperil the future of the Euromarkets. In defending the Euromarkets, British authorities were protecting the major channel through which disruptive capital flows could occur, imperilling the system of fixed exchange rates in the process. Throughout 1971, British Treasury officials closely monitored the emerging position of the international community with regard to the Euromarkets, paying particular attention to the increasingly important bilateral discussions between the U.S. and West Germany (National Archives, 1971:



T312/3106).<sup>87</sup> The pressure over the Euromarkets' apparent culpability for international financial instability grew to such a degree that the Governor of the Bank of England felt it necessary to dedicate his speech to the Bankers' Club of Chicago to a defence of the role of the Euromarkets and a cautioning against measure to regulate Euromarket activity (National Archives, 1971: T312/3106).<sup>88</sup>

In a testament to just how important the Euromarkets had become for Britain's international economic policy, the concern for their defence from regulatory encroachment was articulated at the highest level of British government. Briefing Prime Minister Edward Heath for his meeting with the French President Pompidou, Treasury officials stressed that although the British preference was for the maintenance of the Bretton Woods system, Heath should be, 'defensive if Pompidou complains of the Euro-dollar market as an amplifier of the US deficit'. Although Britain should express support for international discussions over ways and means to curb excessive Eurodollar flows, which were underway through the BIS, OECD and EEC, Heath was instructed to make clear that the Eurodollar market was not the source of the trouble (National Archives, 1971: T312/3106).<sup>89</sup>

The Americans, for their part, attempted to muddle through the international monetary discussions of the early 1970s. The Nixon administration prioritised national autonomy above the maintenance of the Bretton Woods regime. They were unwilling to

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<sup>87</sup> Treasury File National Archives T312/3106 'U.S.A Balance of Payments Deficit and Eurodollar Outflow 5/4/71- 3/72', Address by Leslie O'Brien, Governor of the Bank of England, to the Bankers' Club of Chicago, April 27<sup>th</sup> 1971.

<sup>88</sup> Address by Leslie O'Brien, Governor of the Bank of England, to the Bankers' Club of Chicago, April 27<sup>th</sup> 1971.

<sup>89</sup> Passage to be inserted for Treasury brief for Prime Minister's meeting with President Pompidou of France, May 14<sup>th</sup> 1971.

countenance the sort of subordination of domestic economic priorities to international imperatives that had led Britain into the disastrous stop-go cycle in an effort to maintain the value of the pound. Ultimately, the rules of Bretton Woods were viewed as a potential limitation to the management of the U.S. economy. Within the calculations of the U.S. policy elite, Bretton Woods would only be maintained as long as it did not impinge upon America's capacity to set domestic economic policy and foreign policy autonomously (Gowa, 1983: 13-22).

Nixon's administration was unwilling to endorse international monetary reform and held a principled opposition to the extension of capital controls.<sup>90</sup> But despite these convictions, they adopted a pragmatic approach to policy, maintaining the existing capital controls into the early 1970s and implementing wage and price controls as part of the package that delinked the dollar from gold in August 1971. These policies were far from neoliberal, instead they reflected the acknowledgement, in the wake of the Fed's disastrous attempt at hiking interest rates, that monetary policy couldn't yet work to stem inflation in the way that monetarists hoped (Panitch & Gindin, 2012: 141).

During the Nixon administration, the power to shape international monetary politics rested overwhelmingly with the Treasury and in the committee known as the 'Volcker Group' after its chairman Paul Volcker, the Undersecretary of Treasury for monetary affairs who, 'for all practical purposes was Treasury'.<sup>91</sup> The Volcker Group was united in a

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<sup>90</sup> The opposition was partly a response to those who complained that capital controls disproportionately affected small banks and corporations that could not operate in the Euromarkets with the ease of their larger competitors (Gowa, 1983: 84).

<sup>91</sup> The Federal Reserve Board were not heavily involved in the planning of the Volcker Group. The New York branch of the Fed, known as a staunch defender of Bretton Woods that was more likely to

commitment to prioritise national interests over the wider interests of the international system. In policy terms, their consensus ensured that devaluation, deflation and constraints upon American foreign policy (all measures that might have prolonged Bretton Woods) were foreclosed as potential options (Gowa, 1983: 62-99).

Mirroring its centrality in the construction of Bretton Woods, the U.S. Treasury was now central to its dismantling. But this was not part of a conscious design of grand strategy. It was, in fact, a 'tentative and uncertain', decision to break the dollar's link with gold (Panitch & Gindin, 2012: 130). The Nixon Administration closed the gold window over the weekend of August 13<sup>th</sup> 1971, imposing a 10% import surcharge onto other countries in order to push them towards a revaluation of their currencies and saving the U.S. the humiliation of having to devalue the dollar (Eichengreen, 2008: 131). As a quid pro quo for the currency realignments, the Western Europeans did manage to secure a commitment from the U.S. to retain its controls on capital exports (Helleiner, 1994: 104).

But that commitment was to be short lived. The U.S. wanted to make sure that despite the ending of Bretton Woods, American deficits could still be covered by foreign capital inflows while the private outflows of American investors would continue to have access to foreign capital markets. The retreat from Bretton Woods could not mean a retreat from the openness of international financial markets upon which American economic strategy so depended (Panitch & Gindin, 2012: 130-131). By 1974, the U.S. would announce

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gear domestic policy towards balance of payments concerns, was excluded from the negotiations and was more generally maligned within the Nixon Administration due to its support for Bretton Woods (Gowa, 1983: 112-113).

that the program of capital controls in place since the 1960s would be abolished, reversing the commitments made at the Smithsonian agreement (Helleiner, 1994: 110)

In effect, the U.S. had, reluctantly and after what it felt was the exhaustion of multilateral solutions, pushed other states onto a dollar standard by breaking the link to gold. They had then encouraged the major capitalist states to accept new exchange rates with the Smithsonian Agreement of December 1971. Although the West Europeans and Japanese were reluctant to move towards a system of floating exchange rates, there was a widespread recognition that maintaining fixed rates was simply too difficult within a context of liberalised financial markets and speculative capital flows. Furthermore, the adoption of permanent and rigid exchange controls was never given serious consideration, and by 1973, controls were only countenanced on a temporary basis and for balance of payments purposes (Panitch & Gindin, 2012: 145-146).

Instead of actively addressing the U.S. payments deficit, as had been unsuccessfully attempted during the previous decade, the Americans now adopted a more passive strategy in the wake of the collapse of Bretton Woods; pushing for a realignment of exchange rates from other countries that was intended to boost U.S. competitiveness in foreign trade (Block, 1977: 198). This new strategy was born out of a growing awareness of the spectacular structural power of the U.S. The construction of a dollar standard, untethered from the obligation to honour convertibility to gold, gave the Americans unprecedented power to shape the flow of world credit by controlling the supply and availability of dollars (Strange, 1987: 586-589). Within a liberal international system, U.S. policy autonomy could be maintained despite growing internal and external deficits.

## **The breakdown of the post-war consensus**

Britain suffered under the new international financial order that gradually emerged from the ruins of Bretton Woods. This was in part due to the world recession experienced from 1970-71 as governments sought to contain rising inflation by implementing austerity measures and tight monetary policy. That recession was the precursor to nearly a decade of international economic instability and rising class conflict as workers took to the streets in order to defend their living standards in the face of rapidly rising inflation and low growth (Glyn & Harrison, 1980: 1). By the beginning of the decade, Britain lagged behind other advanced industrialised capitalist states, with industrial productivity only one-third of the U.S. level and roughly two-thirds of the French and West German levels (Glyn & Harrison, 1980: 36). The long-term post-war decline of British capitalism, particularly with regard to industrial production, was coming to a head by the 1970s as the golden age of capitalism underpinned by Bretton Woods gradually expired.

Britain's plight during the early 1970s was not, however, purely a consequence of an increasingly challenging capitalist world market. It was also a direct result of the policies enacted by the Conservative government of Edward Heath. Heath's government enacted a radical market-centred policy of revitalisation for British capitalism in anticipation of the full-blooded monetarist programme that Thatcher would implement at the end of the decade. Heath's government gave a new priority to the fight against inflation and viewed

the disciplining impact of market forces, rather than an interventionist industrial strategy, as the best route to more competitive capitalism (Clarke, 1987: 406).

A cornerstone of the Heath government's strategy to combat inflation was the implementation of restrictive trade union legislation through the Industrial Relations Act. Heath's policies set the tone for the way in which the distributional struggles of the 1970s, between capital and labour in the context of low growth and high inflation, would repeatedly be conducted through state policies that sought to impose the costs of the economic difficulties upon the living standards of British workers. Alongside the restrictive policy on the unions, the Heath government attempted to rationalise British capitalism by allowing bankruptcies for uncompetitive industries, cherry picking efficient sectors of the nationalised industries to be handed over to private control and pushing membership of the EEC as a means to subject British firms to the panacea of European competition.

The impact of these policies was an unqualified disaster. The restrictive strategies that comprised the first phase of the Heath government 'ran into severe difficulties on all fronts'. The rationalisation measures did not restore competitiveness but did provoke a period of economic stagnation. Heath's anti-union measures were even less effective. Rather than demoralising and debilitating the labour movement, Heath's new Industrial Relations Act galvanised union solidarity and sparked a wave of political strikes. Sour relations with the union movement eventually led to the downfall of the Heath government (Glyn & Harrison, 1980: 57-68).

Perhaps the most disastrous innovation of all under the Heath government however, came in the sphere of monetary policy. In a continuation of the Tories longstanding role as

champions of financial power in Britain, which had begun its post-war incarnation with the City's re-launch as an international financial centre under the Conservative governments of the 1950s, the Heath government sought to unshackle British banks from restrictive constraints on lending through the introduction of 'Competition, Credit and Control' (CCC). The introduction of this policy framework came as a direct response to the changing landscape of international banking and finance of which the development of the Euromarkets in the City had been by far the greatest catalyst. *Anglo-American developmental dynamics that had been at the heart of the Euromarkets' emergence were now feeding back into the disintegration of traditional monetary policy and the construction of new regimes of monetary control, inspired by the intellectual ascendancy of monetarism, that began its first phase in 1971 but reached full maturity under Margaret Thatcher.*

In response to the intensification of international competition in banking brought about by the rise of the Euromarkets, British Clearing banks pushed for the unravelling of quantitative restrictions over their lending in order to compete with their better-capitalised international rivals. During the 1960s, the London clearing banks had been specifically targeted for the adoption of interest rate limits and portfolio controls. They were also subject to a 'Special Deposits' scheme whereby the Bank of England could call in special deposits to be frozen as part of efforts to control the flow of credit through administrative decree. These restrictions hampered the ability of the clearers to compete with international banks and the new building societies.<sup>92</sup> As the market share of the clearers contracted, the efficacy of a monetary policy framework based upon regulating their

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<sup>92</sup> Accepting houses, international banks and non-clearing institutions such as secondary banks benefited differentially from this policy framework.

intermediation decreased accordingly (Artis & Lewis, 1981: 1-6). Lending ceilings had been removed in April 1967 but were reinstated around the time of devaluation, in a move that was met by a furious response from the clearers. Ceilings had, in any case, become increasingly difficult to enforce given the manner in which the development of offshore had punctured the national regulatory system. CCC arose out of a growing dissatisfaction with controls over lending and a concern within the Bank and the Treasury that British banking needed to be made more competitive (Capie, 2010: 427-437). The transformations associated with the globalisation of banking, hosted in the City, were rapidly corroding the foundations of British monetary policy.

CCC sought to transform monetary policy by removing quantitative restrictions upon bank advances and abolishing the cartel arrangements that controlled clearing bank interest rates. Where controls did remain, they were either reduced or extended universally to level the playing field. Crucially, the new policy hinged upon a commitment to the primacy of competition and market forces as the means to achieve credit control objectives. Under the new policy, monetary aggregates were attributed greater significance than before, with their rate of growth now controlled through the market mechanism of interest rates, influenced by the Bank's open market operations (Artis & Lewis, 1981: 7-8; Moran, 1986: 30; Capie, 2010: 500-507).

The focus that CCC attributed to monetary aggregates was evidence of the creeping advancement of monetarist ideas within the British state. The rise of monetarism was the key policy strut of the fight against inflation that gathered momentum during the 1970s. Intellectually, it was rooted in a conviction in the quantity theory of money, while in policy



terms it was centred upon a preoccupation with control of the money supply as the surest means to contain inflation and promote orderly growth. But the more general significance of monetarism lay in its vehement opposition to state intervention, in favour of the need to subordinate political choice to the dictates of the market (Clarke, 1987: 393).

Monetarist ideas in Britain had hitherto largely been confined to an ostracised and marginal group of academic economists. But the rise of monetarism within Britain from the late 1960s had much to do both with rising inflation and a growing transatlantic intellectual synthesis. The interrelated decomposition of Bretton Woods and the Keynesian nation state underpinning it opened spaces for an epistemic shift in economic thought, with monetarist thinkers waging war against Keynesian orthodoxy. Milton Friedman and the Chicago School of economists led the attacks against Keynesianism.<sup>93</sup> Friedman's 1963 book, *'A Monetary History of the United States'* was the definitive text of the monetarist counterrevolution. The book criticised the role of the Fed during the Great Depression in the first salvo of a sustained campaign against the policies of the Fed that gathered momentum during the 1970s (Smith, 1987: 17-21).

Britain proved a fertile ground for Friedman's theory. The devaluation of 1967 and general awareness of economic decline produced a climate of dissatisfaction with the Keynesian consensus that had prevailed in the post-war era. Indeed, the advancement of monetarism moved almost in step with the disintegration of Bretton Woods and the steady rise of inflation and stagnant growth known as 'stagflation'. At the *Financial Times*, Samuel Brittan became an influential champion of monetarism, helping to achieve a major shift in

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<sup>93</sup> Cf: Smith (1987: 3-16) For a detailed analysis of the major theoretical differences between monetarism and Keynesianism.

thinking within the financial community of the City from 1968. Peter Jay of *The Times* also began to champion the monetarist cause around this time, with a leading article in *The Times* entitled, 'Understanding the Role of the Money Supply'. The influential City mouthpiece, *The Banker*, then took up the monetarist cause in December 1968 with a contribution from Friedman himself. The Institute of Economic Affairs, a think-tank established to counter state control of the economy, also began to trumpet the monetarist cause (Smith, 1987: 35-36; Burk & Cairncross, 1992: 139-144).

Despite the increasing interest in monetarism from the City and the financial press, its roots within the thinking of British state officials in the Bank and the Treasury were not primarily or exclusively endogenous. The initial impetus for the emergence of monetarist thinking and techniques within the Treasury and the Bank actually came through contact with the IMF in 1965 (Capie, 2010: 450; Schenk, 2010: 189). During the 1960s, British monetary policy was principally concerned with maintaining the fixed exchange rate and up until 1965, voices within the Bank in support of control of the money supply were, 'few and, when heard, quietly ignored or put down' (Capie, 2010: 450).

Within the Treasury, a 1965 draft document on credit control had explicitly rejected consideration of the quantity of money and the role of interest rates. In that same year however, the Letter of Intent to the IMF required Britain to commit to quantitative targets relating to credit policy including estimates for increases in bank lending to the private sector (Schenk, 2010: 189). This was the first instance in which external pressure was exerted upon the Bank and the Treasury to make commitments on monetary growth.

Despite the exertions of the IMF, the attitudes of the Treasury and the Bank towards monetary control were ambivalent

When Britain was forced to turn to the IMF again between 1967-68, the pressure on monetary targets was much greater and the Bank and the Treasury were pushed to accept that there must be a clear and successful attempt to contain monetary growth. In response to the IMF's conditions, the Bank and the Treasury began conducting joint exercises on the issue of the money supply. These discussions were reinforced by an IMF seminar on the subject of domestic credit supply held in Washington in 1970, at which Bank and Treasury officials were in attendance. The discussions, began in 1968, were to carry on over the next decade before reaching their fullest expression under the Thatcher government (Capie, 2010: 451-463).

The impacts of Heath's policies and of CCC in particular, were shambolic, leading to a recession that brought about the infamous 'U-turn' in government policy. Taking its cue from a similar change in tack from Nixon's administration in the U.S., the Heath government shifted from an emphasis upon market discipline to Keynesian reflation through the 'Barber Boom' from 1972-73 (Glyn & Harrison, 1980: 72; Gamble, 1991: 125; Overbeek, 1990: 159). The Barber boom relied upon massive tax cuts, a continued expansion of the money supply and increased public spending to provide a temporary boost to productivity. But the investment was largely channelled into a speculative property and stock market boom, which fuelled inflation and further aggravated the balance of payments deficit by

stimulating imports (Anderson, 1992: 175).<sup>94</sup> These dynamics were further intensified by the inflationary impact of CCC, with the removal of quantitative lending restrictions rapidly leading towards an unprecedented expansion in the money supply, followed by a massive financial collapse during the secondary banking crisis of 1972, which required concerted action between the major Clearing banks and the Bank of England to launch the 'Lifeboat' rescue operation (Capie, 2010: 525). The Bank's Minimum Lending Rate rose from 7.5% in July 1973, to 13% by the end of the year, as the government attempted to wrestle with rising inflation and a deteriorating balance of payments (Capie, 2010: 531). But just as in the U.S., the Bank was forced to pull back from tight money due to the massive banking crisis that the interest rate hikes helped provoke. The conditions, both in the U.S. and the U.K. were not yet in place for the high interest rate regimes that would be enacted during the 1980s. Just as it had done for the Fed during the commercial paper crisis, the Bank's lender-of-last-resort function trumped its capacity to tighten the monetary supply and forced it to inject liquidity into the system or face a widespread collapse.

As the British economy spiralled out of control, the pound came under sustained attack in the international financial markets, with domestic and international financial instability increasingly interactive. Britain was forced to float the pound out of the parity agreed at the Smithsonian meeting, causing exit from the European currency snake of which it had briefly been a part (Eichengreen, 2008: 131; Schenk, 20120: 356). With sterling under attack again, the dollar followed shortly after with a renewed wave of

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<sup>94</sup> The money supply was growing at an annual rate of 31 per cent by the second quarter of 1972 while bank lending to individuals rose by 175 per cent between July 1971 and July 1973 (Glyn & Harrison, 1980: 77).

speculative activity against the greenback in 1973, as contagious currency instability spread under conditions of mounting international monetary disorder. By 1974, a four-week miner's strike has brought the Heath government to an ignominious end (Overbeek, 1990: 161).

The policies of the Heath government were indicative of the way in which Britain's fragile Keynesian compromise was creaking under the pressure of growing class conflict and a deteriorating international economic climate. In response, new policy strategies emerged, from both left and right, which began to move beyond the confines of the post-war consensus. The early free market radicalism of the Heath government was paralleled by the emergence of the Alternative Economic Strategy within the Labour Party and the rise of the Party's left wing.<sup>95</sup> The failed modernisation programmes of the 1960s opened spaces for more radical responses to the malaise of British capitalism, with socialist industrial programmes increasingly popular within the Labour Party membership and the trade union movement. Key figures on the Labour Left believed that social democracy had failed to deliver, with a strategy to transform the economy in a socialist direction the only remaining option for the left (Gamble, 1991: 172-177).

Labour won the 1974 election on the promise of a more conciliatory relationship with the unions than the Conservatives had been able to deliver (Harmon, 2008: 5). The central policy platform for this promise was the 'Social Contract'; a policy framework in which the TUC agreed to wage restraint in exchange for welfare concessions, with pension increases central. Given the upsurge of trade union power that had toppled the Heath

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<sup>95</sup> The key positions held by the left were Tony Benn's role as Secretary of State for Industry and Michael Foot's appointment as Employment Secretary in the Department of Employment.

government, the demands of the TUC were actually incredibly modest. They reflected the long-standing timidity of the British working classes, as they continued to embrace the consensus politics of labourism (Anderson, 1992: 177).

Alongside the pact with the unions, Labour's election manifesto promised to deliver the most radical upheaval in British industrial policy since 1945. The Alternative Economic Strategy hinged upon the proposal, made by Benn and Stuart Holland, to form a major state holding company and undertake a compulsory nationalisation of twenty to twenty-five of the largest manufacturing companies. Compulsory planning agreements would facilitate an expansion of state control over private capital and a major programme of redistribution was to be undertaken with income, wealth and social service provision adjusted in favour of the working class. Trade union power would be augmented, through the repeal of the Industrial Relations Act and the extension of worker control over industrial activity (Glyn & Harrison, 1980: 91-96).

The actual policy delivered by the Labour government in power broke sharply with the promises of the manifesto. That it did so was down to the effective marginalisation of the Labour left, and Benn in particular, by the right wing of the Party, with Wilson, Callaghan and Healey the chief architects. It was also a consequence of the overall weakness of a minority government in Westminster. Resistance to the radicalism of the Alternative Economic Strategy also came from officials within the Treasury and the Bank and the hostility of the City to plans for radical reorganisation of British capitalism. But the Labour strategy was further limited by the broader international context and the hardening stance of an American administration increasingly comprised by right wing Wall Street affiliates

who were hostile to social democratic welfare states and staunchly anti-communist (Panitch & Leys, 1997: 107).

Labour entered office faced with rapidly rising inflation, the aftermath of the secondary banking crisis, a liquidity crisis in industry, and a slump in the stock market alongside a rapidly deteriorating balance of payments. These difficulties were partly a legacy of the Tory's catastrophic policy experimentations, but they were also in large part the product of a growing crisis of global capitalism. On top of the international monetary disorder resulting from the Americans' termination of Bretton Woods and the onset of a world recession sparked by stagflation, oil prices rose by four hundred per cent between 1973 and 1974 as major oil producing countries formed the OPEC cartel (Glyn & Harrison, 1980: 20; Burk & Cairncross, 1992: xiii). By 1974, Britain was paying £2.5 billion more for five per cent less oil than had been imported during 1973 (Dell, 1991: 9).

For Britain, the consequences of the oil crisis were particularly acute. The crisis transformed the status of sterling as a reserve currency by leading to the build-up of large sterling reserve positions by oil-producing countries whilst traditional holders of sterling unwound their reserve positions (Schenk, 2010: 357). After the devaluation of 1967, the BIS had led multilateral action to rebuild Britain's reserves and stabilise sterling through encouraging countries to hold sterling balances. The problem was that the addition of OPEC balances on top of the multilateral rebuilding effort now meant that the sterling balances were much larger than before, rather than gradually being wound down in an orderly fashion as had been planned. The build up of large, liquid sterling reserves renewed the pound's vulnerability to sudden movements in currency markets. By 1976, the official

sterling balances were over twice as large as they had been in 1968 (Burk & Cairncross, 1992: 12).

It was this dynamic around sterling after the crisis that would draw Britain into the disciplinary orbit of American power. Although the 1976 crisis was the product of a specific historic conjuncture, then, it was also a product of the longstanding weakness of sterling that had been such a pronounced trait of Britain's post-war development. *Just as the weakness of sterling had led British bankers to draw in the dollar and American financial power through the Euromarkets, it would now draw together a much less welcome intersection between British development and American power. What followed was a reconfiguration of British sovereignty that involved a much more direct relationship between the state agencies of the U.S. and Britain than had been the case with the Euromarkets, where the Federal Reserve and the Treasury would intervene to reorder the priorities of the Bank-Treasury nexus in Britain.* If the Euromarkets had contributed to the internationalisation of the City and the Bank, it was the IMF negotiations of 1976 that would be the key moment in the internationalisation of the British Treasury. The disciplinary power of the U.S. was deployed to steer British development in a direction amenable to the American vision for a liberal international economic order. This intervention came at a key moment, when the interactive decomposition of the social basis of the Keynesian state and the Bretton Woods order were opening spaces for alternative forms of social order.



## **Internationalising the British state**

The 1976 crisis was a key moment in the prolonged post-war demise of sterling. Britain's eventual appeal to the IMF for financing was both preceded and succeeded by broader multilateral negotiations over the future of sterling (Schenk, 2010: 369). The crisis was differentiated from prior episodes by the views of the foreign interests involved, principally the Americans, that this should be the last sterling crisis and that all pressure necessary to guarantee this should, and could, be exerted (Burk & Cairncross, 1992: 3). In 1974, Chancellor Barber had warned Heath that massive sums would be required to defend sterling at its existing exchange rate. With the oil crisis feeding into the existing inflationary dynamics within Britain and a worsening balance of payments position, sterling began to depreciate in a sustained fashion from April 1975 (Schenk, 2010: 369).

Wages were now rising at over thirty per cent per year and Dennis Healey's April 1975 budget provided a record £9 billion public sector borrowing requirement that was met with a 'chorus of dismay' from the financial press, prompting international markets to rapidly lose confidence in the government's wages and spending policy. Financial commentators denounced profligate and inflationary borrowing, while *The Economist* went so far as to suggest that the official estimates of public spending were now viewed as 'works of fiction'. These sentiments were shared by the *Wall Street Journal* in an article entitled, '*Goodbye, Great Britain*', which argued that the British government was so clearly headed towards a policy of, 'total confiscation', that anybody with assets in Britain was left,

'discounting furiously at any chance to get it out of the country' (Burk & Cairncross, 1992: xiii).

Hysterical responses by the financial media fed into the behaviour of capitalist investors and market operators who began to speculate heavily against the pound. In the City, the climate of opinion was increasingly hostile to the Labour government. The banks and financial institutions in the City had become increasingly concerned with the state of the public finances during the 1970s. As the crisis worsened from 1974, the continued budget deficits produced a situation whereby, for the first time, potential lenders were no longer confident of the capacity of the British government to service its debts. The government was now forced to pay higher interest rates than before and to orient its borrowing more towards the requirements of investors and creditors. This was a watershed in the post-war relationship between the City and the government, which had largely been characterised by mutually beneficial cooperation up to this point. For the financiers of the City, the 1974 Labour government was viewed in very unfavourable and oppositional terms (Michie, 2004: 47).

Within this climate of distrust, long simmering dissatisfactions with government policy reached boiling point, particularly from those interests within the City that depended upon the well-being of the faltering domestic economy. For the offshore sector of the City however, which had grown rapidly through the Euromarkets, the instability of the 1970s represented a boom, as financial innovations such as derivatives created profitable opportunities for benefiting from currency instability (Michie, 2004: 47-49). But despite their booming trade in hedging against currency movements and recycling petrodollars

emerging from the OPEC country surpluses, the offshore interests of the City had reasons to be fearful of the Labour government too. The Alternative Economic Strategy, with its emphasis upon exchange controls, import restrictions and selective insulation from the world economy, constituted a direct threat to the climate of international financial openness upon which the Euromarkets were so dependent. These threats increased as Benn and other members of the Labour left began to formulate alternatives to the acceptance of IMF conditionality that would challenge the sanctity of private financial power in the City.

As the Bretton Woods order collapsed and the crisis of Keynesianism accelerated, the lines between public power and private capitalist power were rendered uncertain. Concerns over the intentions of the government combined with the rising tide of monetarist critique of Keynesian policy and the vociferous attacks of the financial press to create an increasingly oppositional climate. One in which the government appeared increasingly to be a threat to private finance. This climate of distrust was a major contributor to the immediate crisis of 1976, forcing the government to go to the IMF, both for financing and to restore credibility in the eyes of the financial markets which now held so much power.

With sterling's plight worsening, Britain turned towards the IMF for funding under the special oil facility that had been established in response to the OPEC price hikes. Throughout 1975, British Treasury officials worked out strategic responses to the growing economic crisis faced by Britain and began to work on drafting applications to the Fund for drawings from the oil facility and the first credit tranche.

From late October 1975, the Treasury began to formulate a position on the impact of drawing from the Fund. The principal consideration related to whether Britain should draw from the IMF oil facility, from the first credit tranche or from both simultaneously. Countries that drew from the facility would have to commit to the maintenance of an open trade policy and would not be allowed to undertake import restrictions. At this point, the Treasury was giving serious consideration to the imposition of import controls as a temporary corrective to the balance of payments problems. This was the strategy formulated by Tony Benn and the Labour left, which would have meant a reduction in Britain's openness to the international economy. Treasury officials anticipated that the proposal would, however, be opposed by the Fund staff, even if it were made on a temporary basis. In a revealing acknowledgement of the predominance of American power within the IMF, Treasury officials suggested that in practice, 'the decision of the Fund Board must ultimately depend on the views of the major countries and, in particular, the USA' (National Archives, 1975: T385/30).<sup>96</sup>

It was hugely improbable that the Americans would look kindly upon a potential British turn to import controls. Americans officials were now in favour of a system of floating exchange rates that would rely upon the disciplinary affect of market forces upon national currency values. These principles were endorsed in an agreement reached by the U.S. Treasury and French finance ministry officials at the Rambouillet summit in November 1975. The Rambouillet meeting was a product of the linkages between finance ministries

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<sup>96</sup> Treasury File National Archives T385/30 'International Monetary Fund: applications for drawings by the UK 1/1/75-31/12/75', Undated Treasury document, 'Implications of a Fund Drawing in Relation to Policy Options', from October 20<sup>th</sup> to November 4<sup>th</sup> 1975.

that the U.S. Treasury had developed during the 1960s. This multilateral infrastructure of linkages between major capitalist states formed the basis for the development of the Group of Six, which convened for the first time at Rambouillet, as the focus was now turned towards creating the institutional and legal basis for floating exchange rates.<sup>97</sup> The Rambouillet agreement suggested that stable currency values would be derived from the operation of market forces in response to evidence of domestic price stability. As part of this transformation of the governing principles of the international monetary system, away from the politically negotiated values of Bretton Woods, the IMF's role would be extended in order to enhance its capacity for surveillance over the policies of individual states, who were expected to demonstrate commitment to facilitating market discipline (Panitch & Gindin, 2012: 145-155).

The new policy stance of the U.S. towards the IMF reflected of the growing momentum of financial liberalism within the U.S. and the commitment to an international monetary system that would maximise U.S. policy autonomy. In the aftermath of the 1973 oil crisis, the Americans opposed plans that would have seen the OPEC petrodollars recycled through IMF channels. The Americans made clear that private financial markets should be the beneficiaries of these flows. They then abolished their programme of capital controls in December 1974, breaking the commitment made at the Smithsonian agreement (Helleiner, 1994: 110-112). In doing so, the American administration was moving towards a firmer advocacy of liberal international finance. That position had been advocated by the Republican government of the early 1920s, who were intent on restoring the gold standard

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<sup>97</sup> The 'Group of Six' was comprised of France, West Germany, Britain, the U.S., Italy, and Japan. It later became the G7, with the addition of Canada in 1976.

in the wake of the First World War. It was a stance that had also been favoured by the bankers of Wall Street after WW2, keen for a market based international monetary system in which private capital flows would exert discipline over government policy.

In the wake of Bretton Woods' collapse, a market-oriented approach to reforming the international monetary system could preserve American policy autonomy and the primacy of the dollar. The capacity to attract foreign investment was enhanced by the deregulation of Wall Street brought about by the transformation of the Securities and Exchange Commission's (SEC) oversight of Wall Street in 1975. Under these changes, the SEC broke from its traditional support for the cartelised relationships between brokers, investment bankers and corporate managers. The SEC dismantled obstacles to price competition and market entry but also gained new powers. It was now able to impose debt-capital ratios on investment banks, make sure that competitive market practices were upheld and intervene in patterns of self-regulation. Deregulation occurred alongside market innovation, with the rapid growth of the derivatives business within American financial markets and an increasing internationalisation of the American bond market that facilitated greater inward investment into the U.S. (Panitch & Gindin, 2012: 149-151).

As had been the case with CCC in Britain, the American regulatory order was unravelling and being reconstituted in step with the broader transformation of the international monetary system after the collapse of Bretton Woods. *In both countries, the changes were also a reflection of the competitive dynamics between London and New York and the attempts of policy makers to gain advantage by creating the conditions required for market growth as the transatlantic regulatory feedback loop set in motion by the*

*Euromarkets gathered momentum during the 1970s. The reconfigurations of the American money market facilitated the international financial liberalism advocated by the U.S. Treasury.*

For Britain, the U.S. stance imposed serious limitations upon the space available for policy manoeuvre. But it appears that some within the Treasury were unaware of the degree to which American thinking had shifted, with officials rather optimistically suggesting that recent U.S. legislation in favour of domestic protection and Congressional pressure in this direction meant that Britain, 'might reasonably expect support from the USA for the right of member countries to take genuinely selective protective action' (National Archives, 1975: T385/30). Treasury officials did recognise that support from the IMF for import restrictions would only be forthcoming if it was made explicit that these restrictions would be temporary and that associated measures would be taken to deal with the public sector borrowing requirement (PSBR) and questions of monetary policy.

Crucially, action on cutting the PSBR and imposing monetary restraint in order to satisfy the IMF was not viewed as a, 'major new constraint on policy' by Treasury officials, as it was assumed that the Chancellor had already rejected a reflationary strategy and was aiming at reducing the PSBR (National Archives, 1975: T385/30). This evidence supports the arguments made by Ludlam, Rogers and Baker that deflationary policies had already been decided upon prior to the first appeal to borrow from the IMF. However, it was recognised that appeal to the oil facility would lead to a great intensification of international

pressure on Britain if a policy of import restriction was subsequently introduced (National Archives, 1975: T385/30).<sup>98</sup>

Import controls were further considered in a draft Treasury document dealing with the international repercussions of their implementation. If Britain were to unilaterally impose import restrictions for one to two years, this would likely run the risk of, 'retaliation, emulation, denial of international financial assistance and invalidation'. It was now considered that the reactions of the U.S. Congress and American industry might generate pressures for emulation that the administration, 'would find it difficult to resist'. The full gravity of the implications of import controls were then laid out in stark terms, 'if our action were copied by any other important country, the whole world could rush into protectionism, with great damage to economic activity everywhere, including the UK' (National Archives, 1975: T385/30).<sup>99</sup>

These comments demonstrate the Treasury's awareness of the massive consequences that introduction of import controls might have, not just for Britain but also for the international economy. In terms of winning over international opinion, the views of the U.S., Germany and France were understood to be crucial to successfully implementing this strategy. Significantly however, the strategy of import controls was not considered in terms of a broader strategy of reflationary expansion. This is where the manner in which Rogers and Baker prioritise national determination becomes highly problematic. Import controls would, it was felt, have to be implemented alongside curbing of public expenditure

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<sup>98</sup> Letter from Principal Private secretary of the Treasury to other Treasury Officials, 'Outstanding Questions Concerning a Fund Drawing', October 21<sup>st</sup> 1975.

<sup>99</sup> Undated Draft Treasury Document, 'International "Negotiation" of Import Controls', from October 20<sup>th</sup> to November 4<sup>th</sup> 1975.



and action to control the money supply. Officials noted that some of the countries whose agreement would be key were in a, 'critical mood', and that other countries would likely press for greater domestic control over the money supply and public expenditure. This demonstrates that the climate of opinion among the major capitalist states was hardening against Britain's economic strategy by 1975 and that these considerations, and not simply predetermined 'national' priorities, were factored into Treasury strategy,

'Whereas a combination of some temporary import control with a significant attack on the public sector deficit or money supply in the short-term would strike chords of sympathy and provide useful debating-points, the argument over the combination of exchange rate depreciation and import controls must be an uphill battle' (National Archives, 1975: T385/30).

The implications of borrowing from the IMF and implementing import controls were not considered simply in terms of 'depoliticising' existing priorities, then, but were actually being factored into the formulation of national economic strategy. Treasury officials were clear that out of the two available strategies for responding to the balance of payments crisis, austerity and monetary restraint on the one hand, and import controls and exchange rate depreciation on the other; the former would be much easier to sell to the wider international community and to the French, Germans and Americans in particular. As the crisis of the 1970s intensified and British dependency upon external financial support deepened, national economic strategies were increasingly interactive with the broader climate of international opinion and preference over economic strategy. British policy makers were actively internalising the international context. Indeed, the argument for

seeing the role of the IMF as a mere stooge for the depoliticisation of British policy is further undermined by Chancellor Dennis Healey's acknowledgment that it might well be, 'politically counter-productive', if too close a link were made between the IMF borrowing and cuts in public spending (National Archives, 1975: T385/30).<sup>100</sup>

Talk of a British turn towards import controls was extremely concerning to Johannes Witteveen, the Managing Director of the IMF. In a letter to Chancellor Dennis Healey on October 26th, Witteveen warned that import controls should be avoided and that the government should adopt other policies to achieve a viable balance of payments (National Archives, 1975: T385/30).<sup>101</sup> The Fund's tough stance over British import controls filtered through to the Treasury, where officials concluded by the end of October that British controls would face severe opposition because of Britain's size and importance to world trade and the serious concerns of the IMF (National Archives, 1975: T385/30).<sup>102</sup> Talk of import controls also met a hostile reception from the Americans who viewed their implementation as contravening the agreements devised at Rambouillet (National Archives, 1975: T385/33).<sup>103</sup>

By late November Dennis Healey informally approached Witteveen to borrow 1 billion Special Drawing Rights (\$1.2 billion) from the oil facility and a stand-by credit for 700 million SDR (Burk & Cairncross, 1992: 16). Healey had suggested that a simultaneous

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<sup>100</sup> Undated Treasury Memorandum circulated to the Bank of England, 'IMF Drawing: Chancellor's Dinner with Dr. Witteveen',

<sup>101</sup> Memorandum from Johannes Witteveen, Managing Director of the IMF to Dennis Healey of the Treasury (Chancellor of Exchequer) October 26th 1975.

<sup>102</sup> Internal Treasury Memo, 'IMF Oil Facility and Import Restrictions', October 27<sup>th</sup> 1975.

<sup>103</sup> Treasury File National Archives T385/33 'International Monetary Fund Applications for Drawings by the United Kingdom 9/11/75-12/12/75', Treasury Memorandum, 'IMF Drawing: American Reaction to Import Controls', November 27<sup>th</sup> 1975.

drawing from both the oil facility and the first credit tranche would be a good way of demonstrating that Britain was, 'firmly embedded within the international monetary system' (National Archives, 1975: T385/30).<sup>104</sup> Healey's thinking here attests to a growing international climate of doubt over whether Britain's actions would contravene the principles of the international monetary system through the use of import controls or devaluation. In the end, import controls were not seen as a viable corrective for the balance of payments in 1975. The decision was made both on the basis of the likely inflammatory consequences that such a measure would bring about internationally and because it was felt that import controls were a form of protectionism that would insulate business from exposure to the modernising catalyst of international competition (Wass, 2008: 92). Within the Labour Party, the outmanoeuvre of the left over the referendum on membership of the EEC greatly diminished the power of leading left figures to turn Britain away from the IMF and austerity (Burk & Cairncross, 1992: 15).

A formal approach to the IMF was made in December, and by the end of January 1976 Britain had borrowed all of the money available under the oil facility, the gold tranche and the stand-by credit. In doing so it had now exhausted the borrowing potential under the more lenient first tranche credit conditions (Wass, 2008: 161). Firmer conditionality now lay just around the corner.

In March 1976, the Bank of England was detected selling pounds even though sterling's exchange rate against the dollar was already falling. This led to a sustained period of speculation against the pound. During the following three months the rate fell from \$2.02

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<sup>104</sup> Note of a working dinner at No. 11 Downing Street with: Chancellor of the Exchequer, Mr. C. W. France, Dr H. J. Witteveen- Managing Director IMF, Mr. D. Green. Monday November 3<sup>rd</sup> 1975.

to the pound to around \$1.70, despite the fact that the Bank had expended \$1.5 billion in reserves to support the rate over the first night and a full thirty per cent of the reserves between February and April (Burk, 1994: 358). By June, Britain had been forced to turn to the U.S. for support, beginning a process of negotiations that would seriously compromise British financial sovereignty and rapidly accelerate the internationalisation of the British state under the auspices of American disciplinary power.

The Republican Administration in Washington was increasingly frustrated with British policy. This was not helped by the conservative disposition of key figures involved in negotiations with Britain. William Simon, the Secretary of the Treasury, was a New York bond dealer with a fervent conviction in market forces. Simon's Undersecretary of the Treasury, Edwin Yeo, was a banker hailing from Pittsburgh who believed in balanced budget orthodoxy. The staffing of these key positions within the Treasury by private financiers was a testament to the intimate relationship between the U.S. Treasury and Wall Street. The influential head of the Federal Reserve, Arthur Burns, referred to himself as a 'Neanderthal conservative', who thought that the Labour Government was 'profligate' (Dell, 1991: 220; Burk & Cairncross, 1992: 37; Panitch & Leys, 1997: 116).

Both Simon and Yeo, in a sign of the hardening of the American position on the management of the international monetary system, now advocated a policy whereby access to deficit financing was to be curtailed for chronic deficit countries. This was intended as a strategy to push them towards adjustment. For their part, the West Germans adopted a similar stance to the Americans between 1975-76, but with less severity (Harmon, 2008: 7). The hardening position of the U.S. and West Germany represented a broader shift in

international opinion between 1975-1976. Whereas in the immediate aftermath of the oil shock the emphasis had been placed on accommodating the financing needs of deficit countries, the tide had now turned in the opposite direction, with the market-centred approach of the Americans steering the international community towards accepting the need for adjustment by deficit countries. By 1976, then, the Americans were intent on depriving countries of financing by any other means than through the IMF. If the necessary steps towards domestic retrenchment were not undertaken, countries would be drawn into the conditionality and austerity ordained by the IMF.

In general, the American moneymen adopted a very firm stance towards Britain. Edwin Yeo believed that the role of the U.S. was to convince the British that the, 'game was over' and they had, 'run out of string'. Other members of the U.S. central banking system believed that they had given over far too much time in shoring up the pound. After over a decade of propping up the ailing pound, the Americans were finally running out of patience with Britain's chronic balance of payments deficits. But the firm stance taken by key staff within the Fed and the U.S. Treasury was not mirrored throughout all core components of the American state. The State Department and to a certain degree the President and his staff, were opposed to the hard-line taken by the Fed and the Treasury. Throughout the crisis of 1976, Kissinger, attempted to mediate the pressure applied to Britain and Callaghan and viewed President Ford as an ally. Brent Scowcroft, the National Security Advisor to Ford, was also more sympathetic towards Britain (Burk & Cairncross, 1992: 38).

Divisions between different components of the American state, delineated in terms of differences between the Treasury and Fed on one side, and the executive and the State

Department on the other, were reflective of a broader pattern of institutional relations between finance ministries, Central Banks and executive power during the crisis. In the cases of all of the major players involved, the U.S., West Germany and Britain, there were tensions between the treasuries and Central Banks vis-a-vis their affiliated political authorities (Burk, 1994: 352). In each case, the Treasuries and Central Banks showed a stronger commitment to the implementation of austerity and market discipline.

The leaders of major American corporations, creating a formidable alignment of public and private power, mirrored the stance of the American administration. In September 1975 the leaders of large American transnational corporations were invited to Britain in order to make an assessment over the investment climate. Twenty-one chief executives, responsible for annual sales of \$26 billion, arrived in the country. This was an enormously influential group of visitors, with many serving on Government Committees or holding other Directorships. In general, the visitors had reported upon arrival that Britain was perceived within the American business community to have slipped from its former 'unquestioned' standing as an attractive location for investment to a situation in which 'other locations now appeared more attractive'. The more extreme views within the party suggested that Britain was now a 'high-risk, low reward location' (National Archives, 1975: T385/29).<sup>105</sup>

Sentiments of this kind would have frightened the government, with American foreign investment a major ingredient within British capitalism that they could ill-afford to

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<sup>105</sup> Treasury File National Archives T385/29 'Visits of United States Ministers and Officials to the United Kingdom 21/10/75-5/11/76', Letter from G Booth, Director General Trade Development, to Sir Peter Ramsbotham, Ambassador British Embassy Washington, 'The US Investment Mission to Britain 18-27 September 1975' September 1975.

lose. The changing conditions of Britain's political economy were now repelling potential American investment. Britain's social democratic compromise with the unions, and the agenda laid out in the Alternative Economic Strategy, were anathema to U.S. investors who were all 'believers in a vigorous free enterprise system' and were described as 'quick to react when they consider that the free enterprise system is under challenge'. Although reassured by their visit to Britain, the investors still expressed discontent with British capitalism in a wide range of neoliberal critiques. The public sector was seen to be too large as a percentage of GDP, while the idea of government-run businesses was criticised alongside planning agreements. Britain's level of personal taxation was attacked for being too high while it was suggested that a higher income gap between managers and workers would help release the talents of Britain's managers (National Archives, 1975: T385/29). These sentiments, from the captains of American industry, added weight to the pressures emanating from the American administration.

An appeal by the Governor of the Bank of England for financing from the U.S. Federal Reserve presented the key moment for the Americans to begin the enactment of their strategy to enforce adjustment. Arthur Burns's response to the request was initially cool. Burns believed that the right course was for Britain to focus upon cutting the fiscal deficit rather than arranging bilateral financing with the U.S. Burns eventually agreed to provide the requested financing, but only under the condition that the UK make an associated commitment to go to the IMF for a drawing if it were required to repay the swap arrangement. To make this much more likely, the swap arrangement was limited to an usually short three month period. Indeed, Burns acknowledged in his notes to the members

of the Federal Reserve's Open Market Committee that the U.S. had set out with the intention of using the swap arrangement to force Britain to change its policies (Burk & Cairncross, 1992: 40). The Americans were aligning their sovereign power directly behind the IMF in order to push Britain into conditionality.

The agreement was signed on the sixth of June and was made between the U.S. Treasury Exchange Stabilization Fund and the Bank of England for \$ 1billion, with the NYFRB acting as agent (National Archives, 1976: T381/76).<sup>106</sup> Crucially, the Treasury provided part of the funding rather than the Fed supplying all of it as was customary in bilateral swap arrangements. It seems likely here that the Treasury was ensuring that the question of renewal of the funding should be in its hands rather than under the remit of the Federal Reserve (Wass, 2008: 198). Although there was no explicit connection made between this swap arrangement and a borrowing from the second credit tranche of the IMF, the connection was implicitly acknowledged as a central part of the agreement. The key factor here was the six-month (after a three month extension) time limit on the repayment of the swap. When Yeo had arrived in London to finalise the details of the swap arrangement, Callaghan fiercely opposed the suggestion of a six-month time limit. In the end however, Britain's desperation led Callaghan to accept the six-month limit. Over the weekend following the negotiation of the swap arrangement Chancellor Dennis Healey wrote to Treasury Secretary Simon acknowledging the six-month limit and confirming that Britain would turn to the IMF if they were unable to pay back the funds within that period.

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<sup>106</sup> Treasury File National Archives T381/76 'Swap Facility with the Federal Reserve and the United States Treasury December 1976, 6/6/76-5/1/78', 'Swap Agreement between US Treasury and Bank of England', June 6<sup>th</sup> 1976.



Alongside the formal swap agreement, other informal agreements were made with the Americans according to which the government promised to reduce public expenditure and reign in excess liquidity in the economy (Burk & Cairncross, 1992: 42). As a quid pro quo for the financing from the Americans, which was part of a larger \$5.3 billion Central Bank package from the G10, Callaghan was forced to publicly announce in parliament that Britain would accept IMF conditionality if the six month repayment could not be met. Edwin Yeo later characterised the June 1976 swap arrangement as 'bait' that was designed to 'hook the UK economy into IMF control when the loan had to be repaid' (Harmon, 2007: 10).

In response to the cuts agenda pushed by the Americans and increasingly accepted by the government, Tony Benn and Francis Cripps began work on an alternative anti-cuts strategy. Benn recognised that the government would have to maintain a relationship both with the TUC and the IMF. It was very unlikely that Britain could repay the Americans by December without recourse to the IMF, as the markets were likely to take further speculative action against the pound in the interim. Benn believed that Britain was actually in a much stronger bargaining position vis-à-vis the IMF than Callaghan and the Cabinet suggested. Britain's importance within the global economy and the possibility that the fall of the Labour government may weaken control over the union movement, thus imperilling Britain's role within the international monetary system, were sources of considerable leverage over the Americans and the IMF (Burk & Cairncross, 1992: 48). Benn's hunches about American fears over the British political situation were well placed.

Those fears existed at the highest levels of the American administration and were understood by senior British officials. During a meeting with an American Embassy official in May 1976, Derek Mitchell of the Treasury told the official that although he did not foresee the possibility of a political collapse in Britain that might lead to a Communist Government but that he suspected that Yeo certainly did entertain that worry as part of a potential “domino” chain involving the collapse of governments in Italy and France too (National Archives, 1976: T385/29). The document shows the degree of American fears over the future of the international economy at this time, and the concerns about the stability of liberal capitalist governance within the West. Yeo later recalled that, ‘we feared that if a country like Britain blew up, defaulted on its loans, introduced foreign exchange controls and froze convertibility, we could have a real world depression’ (Burk & Cairncross, 1992: 4).

Other U.S. officials, such as the National Security Advisor, Brent Scowcroft, also feared that a left-wing government that would push for withdrawal from NATO and Europe might run Britain. While the Germans considered these fears to be groundless, the Americans were not so easily assuaged (Burk, 1994: 353). *The existence of the Euromarkets and American banking within the City, sterling’s role as a major international currency, and the importance of Britain’s role as a historical supporter of an open liberal international capitalist economy all made what happened in Britain very significant for America’s management of the global political economy.*

Given the degree of integration between Britain and America, the Americans could legitimately fear the feedback effects of the collapse of capitalist governance in Britain and

the ways in which it might translate into the political economy of the U.S. Had Britain chosen to impose import controls and exchange controls, then the trajectory towards globalisation would have been halted by the reversal of what had formerly been one of its foremost proponents. American fears must have been greatly heightened when the National Executive Council of the Labour Party endorsed the statement on 'Banking and Finance' in August 1976. The statement called for the nationalisation of the big four clearing banks alongside the seven largest insurance companies, in order to create a platform for financial planning. The statement was then subsequently endorsed at the Labour Party Conference later in the summer (Panitch & Leys, 1997: 124). Widespread support for such radical measures to challenge major elements of private control over the British financial system would have seriously threatened the City's international role and imperilled American financial interests in London.

Had Britain adopted policies that substantially veered from the path of further liberalisation, the risk of emulation by other countries would have been substantial. In fact, these fears were explicitly voiced during the major investment mission in 1975, when the CEO's of major American TNC's recognised how important the revitalisation of liberal democratic capitalism in Britain was for their interests, both abroad and at home,

'We want Britain to succeed; more- we need you to succeed; if Britain, as one of the few remaining democracies fails, then the challenge to us in the USA will not be long delayed' (National Archives, 1975: T385/29).

These sentiments, prevalent within both the private and public power bases of the U.S., go a long way to explaining why the Americans took such a firm stance with Britain during the negotiations.

For the Americans, then, the international and domestic contexts had become highly interactive during the crisis years of the 1970s. For the Fed in particular, the need to be firm with Britain was also a product of the growing politicisation of monetary policy within the U.S. as the monetarist counterrevolution gathered momentum. The rise of monetarism within the U.S. preceded its development in Britain. By the early 1970s, the monetarist offensive was slowly gathering momentum in the U.S. although it had yet to achieve considerable institutional influence (Johnson, 1998: 145). Its advancement moved in step with the recognition that the U.S. was witnessing a period of sustained inflationary pressure. By 1969, the annual rate of price increases was over %6, but by 1974, the consumer price index was rising at a staggering %12.2 per year. For Milton Friedman, the source of this inflation was easily identifiable: it was the result of the Fed's wayward monetary policy (Greider, 1987: 88).

Mounting inflationary pressures fed into the transformation of institutional power within the U.S. Inside the Federal Reserve system, the St Louis Fed had become a government funded bastion of monetarist thinking and research, with its monthly publication at the centre of the debate between monetarists and their detractors. Within the American business and banking community too, monetarism had started to take hold. Within this climate, the operations of the Fed were placed under a degree of public scrutiny and debate never before witnessed in the post-war era. It was debate in which monetarist

economists like Milton Friedman were setting the agenda (Woolley, 1984: 99; Greider, 1987: 97). In 1973, Friedman and other leading monetarist economists began meeting as a 'Shadow Open Market Committee', which shadowed the activities of the Fed's Open Market Committee (responsible for monetary policy), and poured scorn upon what they viewed as the Fed's archaic and misguided practices (Woolley, 1984: 99).

Under these conditions, the actions of the Fed were brought into the scrutiny of the public eye like never before. And as inflation mounted, the credibility of the Fed's sound money credentials steadily eroded. In response to the pressure from the monetarists, the Fed was forced to make piecemeal concessions on the techniques of monetary control, agreeing to focus more upon the monetary aggregates as a guideline for policy. This was in contrast to the Fed's traditional approach to monetary policy, which arrived at target interest rates based upon the consideration of multiple factors. For the Fed's Chairman, Arthur Burns, the challenging domestic context was reinforced by downward pressure on the dollar from the international markets, which further intensified the United States' inflationary dynamics (Axilrod, 2011: 55-71). Given these conditions it's hardly surprising that Burns and the Fed adopted a firm stance towards Britain throughout the crisis, insisting upon the need to control monetary expansion before any more support could be secured from the U.S. (Schenk, 2010: 375). The Fed had to be seen to be taking a firm line with Britain and not handing over promises of American financial support without something in return. Burns made his commitment to fighting inflation clear on a visit to Britain in shortly before the June swap agreement (National Archives, 1976: T385/29).<sup>107</sup>

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<sup>107</sup> Internal Treasury Memo, 'Visit of Dr. Burns', May 17<sup>th</sup> 1976.

Developments in Britain paralleled the rise of monetarism and the growing discontent with the unravelling of the Keynesian order in the U.S. *This was not just a case of American power pushing in on Britain, but also a case of interests within Britain, who had lost faith with the post-war Keynesian class compromise, drawing in the disciplinary dictates of the U.S. and the IMF. Drawing upon American power and attacking the Keynesian welfare state enabled these forces to steer British development away from radical social democracy and towards neoliberalism.* Cox's understanding of the 1970s in terms of a transnational 'nebuleuse' driving the internationalisation of the state is clearly inadequate to understanding Britain's transformation, while Helleiner's notion of American neoliberalism imposed from without is equally inappropriate. Social forces within Britain, embedded within Anglo-American development and Atlantic integration, were actively drawing in American discipline. This was a case of push and pull, not purely the transmission of external interests upon the British state. The high degree to which British capitalism had already been Atlanticised, meant that distinctions between external and internal pressures driving the transition away from Keynesianism were difficult to maintain. From 1975, when Margaret Thatcher became leader, the Conservative Party began to give increasing attention and support to monetarist ideas. The Tories were very keen to reduce borrowing and slash public spending. In October 1976, as the crisis gathered momentum, Thatcher announced that the budget deficit could be halved without causing much harm (Burk & Cairncross, 1992: 158).

Within the Treasury and the Bank, there were similar pro-austerity interests supportive of Britain's need to accept discipline. When the Governor of the Bank of England,

Gordon Richardson, approached the Fed to arrange the June swap, Callaghan was highly suspicious. Callaghan believed that the swap, negotiated between the two Central Banks and the U.S. Treasury, 'seemed simply designed to embroil the Government with the IMF for the specific purpose of enabling them to impose cuts in public expenditure' (Schenk, 2010: 372). Callaghan's suspicions over the Bank's intentions were well founded. In a memo to Kit McMahon, the Deputy Governor of the Bank, a Bank official lamented the disappearance of the 'disciplinary virtues' of the fixed parities system and suggested that stable rates could only be recovered once price stability was restored. Price stability was the objective that 'has always been sacrificed' in Britain's post-war economic strategy and the official opined that, 'all but the French now seem to realise that stable exchange rates will not guarantee price stability, it must be the other way round' (BofE, 1975: OV38/117).<sup>108</sup>

Clearly then, the need to achieve domestic price stability had begun to attract more concern within the Bank in the context of increased international monetary disorder. Implementing austerity was the most obvious way to achieve this. Inside the Treasury, the view was split between those who favoured Keynesian proposals for escaping the crisis and those in favour of deflationary measures (Dell, 1991: 248). Chancellor Healey himself had been a keen supporter of austerity prior to the crisis and many officials within both the Treasury and the Bank were supportive of the position taken by the IMF and the U.S. Treasury (Helleiner, 1994:129). During the height of the crisis, officials from the Bank and the Treasury met clandestinely with Simon and Yeo at a London tailor. It was likely that Simon was seeking an inside scoop on the proceedings here, and the meeting gave the

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<sup>108</sup> Bank of England Archives OV38/117 'International Monetary Fund 1/9/75-30/11/75', Internal Bank Memo, 'The Exchange Rate Regime', October 20<sup>th</sup> 1975.

Americans a clear picture of the different positions taken by the IMF and Chancellor Healey (Harmon, 1997: 194).

The Americans also had direct linkages to the banks and financial institutions within the City. Indeed, American banks were now a major force within the City of London, and during 1976 the Chancellor and the Prime Minister both held meetings with the heads of major American banks. The Chancellor met with the President of Chase Manhattan Bank, while the Prime Minister met with the Chairmen of Citibank and Morgan Guaranty Trust (National Archives, 1976: T385/29).<sup>109</sup> Although the minutes of these meetings were largely unrecorded, one can easily anticipate the pro-austerity message that would have been put across to the government. Throughout 1976, the stockbrokers W. Greenwell & Co., provided the American Embassy in London with daily reports on the gilt-edged market, which could be digested by Simon, given his expertise as a bond dealer. It's likely that other City institutions were also involved in supplying information about the markets to the Americans (Dell, 1991: 221). These connections were a testament to the linkages brought about through Anglo-American developmental interdependence.

The final decision to go to the IMF was prompted by the concerted action of bankers and investors in London and New York, who anticipated that the UK would have to turn to the IMF and pay higher interest rates on gilts. Bankers on both sides of the Atlantic refused to buy government gilts in the run up to the IMF appeal because they knew that they would receive higher returns afterwards (Burk & Cairncross, 1992: 52). When asked by the

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<sup>109</sup> Internal Treasury Memo, 'Visit of Mr Butcher' (President of Chase Manhattan Bank), August 13<sup>th</sup> 1976; Internal Treasury Memo, 'Prime Minister's Meeting with Mr. Walter Wriston (Chairman of Citibank)', May 26<sup>th</sup> 1976; Internal Treasury Memo, 'Invitation to the Prime Minister from Morgan Guaranty', November 2<sup>nd</sup> 1976.



Chancellor whether he believed that the markets had already discounted a Fund drawing into their assessments, Yeo replied that he was 'partly responsible for the idea that a drawing from the Fund would be a good housekeeping seal for the UK' (National Archives, 1976: T385/29).<sup>110</sup> Indeed, when Britain looked to American banks to finance its deficits in early autumn, the leading players fell into line with the American administration and the Fund by stating that they would not participate in further financing for Britain until negotiations with the IMF had been completed (Wass, 2008: 219). *The actions of private and public actors during the crisis were highly interactive, with the U.S. Treasury central to orchestrating operations in order to bring maximum pressure to bear and shoehorn Britain into IMF conditionality.*

When Callaghan made his famous speech signalling Britain's break with Keynesian policy on September 28<sup>th</sup>, the Americans were cock-a-hoop. Much to the chagrin of the Labour left, Callaghan denounced Keynesian demand management and publicly signalled a shift in the government's policy orientation. The speech came shortly before Britain's formal approach to the IMF and was intended to signal the government's austerity credentials in the run up to an approach to the IMF. Despite Callaghan's speech however, the government were still confident that they could apply on the basis of third tranche conditionality without having to substantially amend their existing policies. They were hoping that the IMF would merely rubber stamp the UK's economic credibility with the effect of restoring gilt sales, stabilising the exchange rate and allowing interest rates to fall (Burk & Cairncross, 1992: 59). But they were in for a much rougher ride than expected.

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<sup>110</sup> Note of a meeting held at NO.11 Downing Street, with Chancellor of the Exchequer, Sir Douglas Wass and Mr Edwin Yeo- Undersecretary of the US Treasury, August 5<sup>th</sup> 1976.

October proved to be a very significant month in the unfolding of the crisis. Callaghan grew increasingly concerned by what he saw as a conspiracy by the U.S. and U.K. treasuries to use the Fund in order to foist more severe retrenchments upon Britain. In order to circumvent the finance ministries and the IMF, Callaghan began to make direct approaches to President Ford and German Chancellor Schmidt. Although Ford was sympathetic to Callaghan's plight, he was not in a position to override the wishes of the U.S. Treasury and the Fed. With Burns, Simon and Yeo all convinced of the need to change Britain's ways through the pressure of the Fund, 'they were unlikely to transmit requests from the President or his advisers to the IMF to lessen this pressure' (Burk & Cairncross, 1992: 62-64).

The inefficacy of Callaghan's efforts to go over the head of the Fund to the executive power centres in the U.S. and Germany demonstrate just how limited executive power was during the crisis. It was the Treasuries and Central Banks that were endowed with the institutional power and expertise to push through the internationalisation of the British state and undermine the foundations of Keynesian welfarism. In both the U.S. and Germany, Central Banks enjoyed a high degree of constitutional independence from the executive branch, while Ford's power was further limited by his status as an unelected President. Although Schmidt took a more sympathetic stance towards Callaghan, by offering to use Germany's dollar reserves to help solve British problems with the sterling balances, his power to do so was extremely limited. As Schmidt's State Secretary in the Finance Ministry, Karl-Otto Pohl, pointed out, Schmidt was not constitutionally empowered to dispose of the Bundesbank's reserves in this fashion (Burk & Cairncross, 1992: 66).

British officials from the Bank and the Treasury were left with no doubts about the resolution of the IMF and the Americans to enforced conditionality when they attended the IMF conference in Manilla. Bank officials reported that Arthur Burns's stringency was widely shared within the international community and that the Labour government had frequently been arraigned for placating its left wing rather than taking the necessary measures to restore economic balance. In summary, Bank officials suggested that the 'general climate of opinion towards the UK is not propitious'. When the prospect of an agreement to stabilise the pound by alleviating the problem of the sterling balances was discussed, it was concluded that 'among the people who count', the Americans and Germans, there was no appetite for discussing the sterling balances until the UK had enacted austerity and drawn from the Fund (BofE, 1976: G1/210).<sup>111</sup> Financial officials from the U.S. and Germany were determined not to let the U.K. off the hook.

By late 1976 the, the international climate of opinion towards Britain had clearly hardened. But although the growing consensus around the need for British restructuring was crucially important, it was not principally from the policy 'nebuleuse' that the agency involved in the internationalisation of the British state stemmed. The U.S. Treasury played the definitive role. The disciplinary approach of the U.S. Treasury and the Federal Reserve proved to be unwavering. Crucially, it was the process of disciplinary supervision enacted by the U.S. Treasury and the Fed that steered Britain into the clutches of the IMF and away from the post-war class compromise. This was not simply a case of American structural

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<sup>111</sup> Bank of England Archives G1/210 'Governor's File: The IMF and International Bank of Reconstruction and Development- Christopher William McMahon's Impressions of the Annual General Meetings 10/76-10/79', Internal Bank Memo to the Governors, 'Manila Impressions', October 11<sup>th</sup> 1976.

power, then, but an *active process of discipline* through which the Americans steered British development during a definitive moment of crisis.

The full degree of disciplinary supervision over Britain is revealed in a Treasury document that outlines a proposed bilateral swap between Britain and the U.S. at the height of the crisis in December 1976. The swap was valued at \$500 million, with \$250 million each from the U.S. Treasury and the Fed. Crucially, the swap was explicitly tied to approval of IMF standby credit,

‘Drawings and renewals for additional three-month periods shall only be agreed if the U.S. Treasury-Secretary, having consulted with the Managing Director of the Fund, is satisfied that the Government of the United Kingdom is following appropriate economic and financial policies, including policies that permit the sterling exchange rate to reflect underlying economic and financial conditions, and that all conditions and performance criteria specified in the IMF stand-by arrangement are being fulfilled by the United Kingdom’ (National Archives, 1976: T381/76).<sup>112</sup>

By explicitly linking their funding package with the IMF negotiations, the Americans were aligning themselves with the IMF and pooling their sovereign power with the authority of the Fund. The text referring to the requirement for the sterling exchange rate to reflect ‘underlying economic and financial conditions’ embodied the American commitment to an international monetary system based upon the primacy of market forces and internal price stability. The negotiations over the December swap demonstrate how tightly American strategic priorities were imbricated with those of the IMF. Discussing the details

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<sup>112</sup> Internal Treasury Memo, ‘U.S. Swaps: Draft Agreement’, December 21<sup>st</sup> 1976.

of the swap, a Treasury official commented that ‘no process of examination of the British economy by the U.S. Treasury is contemplated so long as the programme agreed with the Fund is proceeding satisfactorily’ (National Archives, 1976: T381/76).<sup>113</sup> Had Britain accepted this swap agreement along these terms, violation of the IMF conditions would have led to direct supervision of the British Treasury by its American counterpart. This would have amounted to a humiliating curtailment of British sovereignty and it showed the degree to which the U.S. was intent on using IMF conditionality, and failing that direct American supervision, to shape British economic policy. The draft agreement shows the centrality of the relationship between the two Treasuries to the politics of the crisis and the internationalisation of the British state.

In the end, Chancellor Healey decided that the second swap agreement with the U.S. was not required. It was felt that the IMF funds were sufficient, and there would likely also have been concerns about entering into an agreement with the Americans that contained the potential for direct supervision. After much debate within the Cabinet, Dennis Healey announced to the Commons on December 15<sup>th</sup> that large cuts would be made in public expenditure as a condition of Britain’s drawing from the IMF. The package involved a £1 billion reduction of public spending from 1977-78 and the sale of £500 million of the Government’s shares in BP. There would be a further £1.5 billion reduction of spending from 1978-79 and then £500 million for 1978-79.

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<sup>113</sup> Foreign Office and Commonwealth Office Telegram No.4025 for Mrs Hedley-Miller of the Treasury from Bridges, ‘Swap Agreement’, December 17<sup>th</sup> 1976.

## **A prelude to Thatcherism**

The events of 1976 were a key moment in the modern development of the British state. American disciplinary power played a crucial role in steering Britain away from a radicalisation of social democracy and towards a form of neoliberal development compatible with American priorities. The central role of the U.S. during the negotiations exemplified the importance of the U.S. in coordinating the international response to the collapse of Bretton Woods. The networked power of the American state, which had internationalised key functions in an attempt to forestall the collapse of Bretton Woods during the 1960s, continued to play a key coordinating role during the transition to floating exchange rates. While the crisis did not represent the beginning of the drive for austerity and the abandonment of Keynesianism, which had already developed momentum from within Britain (albeit through processes of international development), it certainly did do a great deal to encourage and accentuate these processes as a key moment in the internationalisation of the British state. The interaction between the Fed-Treasury-Wall Street nexus on the one hand, and the City-Bank-Treasury nexus on the other, mediated by and through the IMF, was central to this process. The crisis of 1976 reflected the outcome of more than a decade of developmental interaction between Britain and America that centred upon the dynamics of sterling and the dollar under the Bretton Woods system. This was not a case of internationalisation according to the interests of a transnational policy 'nebuleuse', or as a consequence of American neoliberalism imposed upon Britain from outside. Anglo-American development produced a situation whereby social forces that

benefited from Atlantic integration drew in American disciplinary power to further their domestic ambitions.

By focusing upon the extent to which the intervention of the IMF and foreign states determined the break from Keynesianism, analyses of the crisis have obscured the importance of the disciplinary processes involved and their role in rearticulating British sovereignty. This was not simply a case of American structural power, but rather the initiation of *active processes of disciplinary power* by the U.S., in conjunction with the IMF and the international community, that were exercised in order to promote a redefinition of British policy priorities, and those of the Treasury and the Bank of England in particular. The intention was to make those priorities more compatible with the interests of global financial markets. Far from witnessing a retreat of American power over the conduct of major capitalist states during the 1970s then, the British case demonstrates the continued centrality of the U.S. to managing the crises of the global political economy.

Without the crisis of 1976 and the failure of the Labour government to deliver its manifesto commitments, the Thatcherite transformation that followed may never have occurred. By steering Britain away from policy options that would have severely challenged the liberal international economic order and threatened to halt the forward march of financial liberalisation, the U.S., the IMF and Britain's domestic opponents of the Keynesian welfare state established the preconditions for Thatcher's radical break from the post-war consensus. As American power pushed in upon Britain, social forces that were amenable to American priorities pulled in American discipline and endorsed the dictates of the IMF. The network linkages that the U.S. Treasury and the Fed had developed with other finance

ministries and Central Banks during the 1960s meant that the Bank and the Treasury were already entangled with American power and complicit with the agenda of promoting further liberalisation and undermining Keynesianism.

Britain's post-war consensus fractured in synchronicity with the decomposition of the Bretton Woods order, as the frameworks of instituted power unravelled nationally and internationally in a highly interactive fashion. Within that unravelling and the reconstitution that began to emerge in place of Bretton Woods and the Keynesian state, the Anglo-American channel of development played a crucial role. Not only in shaping the future of British development but also in enabling globalisation to continue apace, during the crisis decade of the 1970s.

The Labour government's implementation of incomes policy and the acceptance of IMF austerity weakened Labour's relationship with the unions and culminated in the 'winter of discontent', which was sparked by public sector unions in August 1978 (Glyn & Harrison, 1980: 118). Labour missed the opportunity to implement the AES and break from the dictates of the financial markets. By pushing the costs of the stagflationary crisis onto workers, the Labour government destroyed the political basis for a socialist strategy in Britain and 'prepared the political conditions for the right' (Clarke, 1987: 418).

But Labour did not arrive at that endpoint independently. The power of the U.S., exerted through IMF conditionality, played a key steering role. That role was made much easier by the endorsement of monetarism and the rejection of Keynesian economic strategy by the City, the Tory Party and those within the government and the state who wanted to restructure Britain's social democratic state. During the defining rule of Margaret Thatcher



that ushered in the end of the 1970s, those forces saw their wishes for a radical restructuring of the British state realised to an unprecedented degree.

## **6 Internalising Discipline**

### *The Bank, the Fed and the Political Economy of Price Stability*

Margaret Thatcher's election victory in May 1979 represented a definitive moment in the evolution of British politics. During her eleven years in office, Thatcher presided over a radical break from Britain's post-war consensus. Continuing what Callaghan had begun under the duress of the IMF, Thatcher signalled her intent to abolish the foundations of post-war Keynesianism and usher in a new world of freer markets and monetarist theory.

Thatcher's political project, alongside the comparable policy programme of Ronald Reagan in the U.S., was central to the 'neoliberal' transformation of capitalism that got underway in earnest from the late 1970s. Broadly defined, neoliberalism rests upon a commitment to the maximisation of human well-being through enlarging the scope for individual, entrepreneurial freedoms and skills inside an institutional framework defined by, 'strong private property rights, free markets, and free trade' (Harvey, 2005: 2). In Britain, neoliberalism was underpinned by a set of closely interrelated policy commitments, which were designed to roll back the social democratic welfare state and extend the scope of market power through selective pro-market state interventions and the restoration of a virile sense of law and order. The key policy measures included the re-imposition of employers 'right to manage' their employees, the strategic engagement and defeat of the labour movement, high interest-rates to defeat inflation and restructure domestic manufacturing, the abolition of corporatist institutions, cuts to personal taxation rates, the privatisation of nationalised industries and the deregulation of other economic sectors

(Peck & Tickell, 2007: 28). In the United States, Ronald Reagan's Republican policies followed a remarkably similar pattern. Neoliberal ideology would go on to become the dominant framework through which capitalist globalisation was intensified during the 1990s, under the rubric of the 'Washington Consensus' (Gamble, 2001: 130).

Trans-Atlantic dynamics were essential to the reconstitution of British capitalism in the neoliberal era. Thatcher's project, resting on the twin ideological pillars of the 'free economy' and the 'strong state' (Gamble, 1994: 6), occurred in a highly interactive synchronicity with the transformation of the American political economy under the stewardship of Paul Volcker at the Fed, and Ronald Reagan in the White House. The reconfiguration of Anglo-American capitalism along neoliberal lines sent shockwaves through the entire global political economy and laid the foundations for the dominance of neoliberal ideology and financial deregulation that defined the trajectory of global capitalism in the decades after. The increased financialisation of the Anglo-American economies, and the decrease in wages associated with staunch anti-inflationary politics, laid the foundations for the dependence on consumer borrowing and housing price inflation that would, in the longer term, sow the seeds for the global financial crisis of 2008 (Montogmerie, 2006: 122; Gamble, 2009: 453; Hay, 2011: 1).<sup>114</sup> Furthermore, the financialisation of the U.S. economy led to the massive capital inflows that underpinned U.S. fiscal policy during the Reagan era and beyond, as foreign investors reacted to the high interest rates and liberalised markets in the U.S. (Krippner, 2012: 104). The interest rate

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<sup>114</sup> By financialisation I here refer to the processes by which more and more aspects of social life and economic activity are drawn into the orbit of credit-debtor relations centred upon liberalised financial markets which promote the deepening and extension of these relations.

shocks imposed by the Fed and the Bank also had an important North-South dimension, producing a disastrous increase in borrowing costs for debtor countries from the Global South (Kiely, 2007: 202). An Anglo-American heartland of debt-driven consumption and financialisation would underpin the neoliberal model that imploded spectacularly during the 2000s.

Despite the interactivity of neoliberal political economy in both countries, the interconnections between monetary dynamics in Britain and America during the early years of the Thatcher-Reagan era have scarcely been analysed.<sup>115</sup> The links between developments in the two countries have tended to be treated as a consequence of ideological synchronicity rather than institutional symbiosis. Consequently, although many accounts of the development of neoliberalism point to the significance of the ideological similarities between Thatcherism and Reaganism (Krieger, 1986: 17; Gamble, 2001: 129; Harvey, 2005: 22; Peck & Tickell, 2007: 28), there has been much less attention given to the fundamental interdependence and interconnectivity of the monetary policy regimes adopted in the early neoliberal period. What we are left with, then, is a notion of neoliberal synchronicity without an understanding of the underpinning processes of institutional symbiosis.

It is these neglected symbiotic aspects of the neoliberal revolution in Britain and the U.S. that this chapter highlights, by focusing upon the principal dynamics and consequences

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<sup>115</sup> The notable exception here is a brief but revealing discussion of the impact of the adoption of monetary targeting within the Fed and the IMF upon the Bank of England and the City's attitudes towards monetarism and the eventual adoption of 'technical monetarism' during the Callaghan-Healey administration in: Bob Jessop, Kevin Bonnett, Simon Bromley, Tom Ling (1984) 'Authoritarian Populism, Two Nations, and Thatcherism', 44, *New Left Review* 1/147: 32-60.

of financial liberalisation, monetarism and monetary policy between 1979-1982: the first phase of the Thatcher government's economic strategy and the key period in which the 'Volcker shock' was implemented in the U.S. I argue that by situating these processes within the broader lineage of Anglo-American development and the effects of the transatlantic regulatory feedback loop identified in chapter four, we are able to identify key institutional complementarities which help account for the synchronicity of the simultaneous adoption of extreme tight money policies and financial liberalisation in both Britain and America. The first section of the chapter briefly examines the developing post Bretton-Woods monetary system and its impact upon the strategic calculations of central bankers. I then examine the 1979 abolition of exchange controls in Britain, situating the process within the broader context of Anglo-American financial competition and integration, arguing that the liberalisation of exchange controls was a key component of an emerging form of 'coordinated competition' between British, American and European monetary authorities. The third section of the chapter explores the political predominance of monetarism and its selective adoption by central bankers. In particular, I suggest that where monetarist methods of central banking were adopted, they were utilised in a pragmatic sense, with both the Fed and the Bank having to resist attempts by doctrinal monetarists within their respective governments who felt that more radical measures needed to be taken. The successful defence of Central Bank autonomy in the period was a key precondition for the increased significance and independence of Central Banks, which has defined the monetary politics of the neoliberal era. Finally, the chapter explores the enabling preconditions of the early neoliberal Anglo-American tight money regimes in terms of the development of

financial markets and the transformation of financial regulations that was supported by the banks. The differential impacts of neoliberal central banking, upon banks, manufacturers and workers, are then briefly mapped out.

The first phase of Thatcher's premiership was defined by the commitment to implement monetarist policy techniques in order to squeeze inflation out of the economy, with the intention of restoring price stability by reducing inflationary expectations (Gamble, 1994: 101). Early Thatcherite policies corresponded with a related attempt by Paul Volcker, the newly appointed Chairman of the Federal Reserve, to stamp out inflation in the U.S. by adopting a monetarist approach to central banking and allowing interest rates to reach record levels. In both countries, monetarist ideas and techniques were embraced in order to provide an epistemic justification for the break from post-war orthodoxy. And in both countries, tensions arose between the Central Bank and the executive, as monetary policy was accorded an unprecedented priority in the management of the economy. Both the Bank and the Fed adopted new approaches to the exercise of monetary policy and prioritised anti-inflationary objectives above the pursuit of economic growth. In the process, they sparked off deep recessions that strengthened the power of their respective financial sectors, accelerated regressive wealth redistribution and damaged their manufacturing and export-led sectors. Under the tight money regimes of the early neoliberal period, the Keynesian compromise, with its commitment to full employment and rising living standards, was torn apart in favour of anti-inflationary politics and induced recession.

As hosts to major international financial centres, Britain and America were particularly sensitive to the need to restore price stability and reverse the inflationary

trend of the 1970s, which had posed a major challenge to the profitability of bankers and investors, with inflation tending to damage creditor institutions (who saw the value of their savings eroded) and benefit debtors (who saw the real value of their debts depreciate). The adaptation of the financial sectors in both countries during the 1970s, and the recalibration of monetary regimes during the early 1980s, facilitated the radicalisation of monetary policy by cushioning the financial sector from the impact of interest rate shocks. In both Britain and the U.S., monetary policy was being reconfigured to serve the needs of private financial power and hasten the development of globalising financial markets. This represented another key stage in the emerging developmental interdependence of Anglo-American capitalism and a continuation of the deregulatory dynamics set in motion by the emergence of the Euromarkets.

Overall, this chapter argues that the radicalisation of monetary policy and the primacy accorded to central banking marked a watershed in post-war Anglo-American capitalism, with enormous ramifications for the wider global political economy. It set the tone for the renewed importance of central banking in a neoliberal era defined by the massive growth in the power of financial markets and the heightened dependency of economic activity upon credit-debt relations. It also highlighted one of the central deficiencies of neoliberal capitalism: the crucial role and enormous power of unelected central bankers in steering the economy and shaping society. The adoption of the 'technical dictates' of monetarism, with their pseudo-scientific notions of necessity, represented a return to the classical gold standard insulation of central banking from public accountability and democratic openness. In the field of monetary policy, the technical

determinacy implied by monetarist ideology was a key step towards the enshrinement of neoliberal political economy.

At the heart of the monetarist attempt to crush inflation and depoliticise monetary policy, however, lay a contradiction. Britain and the U.S. attempted to tighten monetary control, on the one hand, while they accelerated financial liberalisation, on the other. These two goals were incompatible, rendering the pursuit of monetary targets ultimately unsuccessful. This was a result not only of this central contradiction in ambitions, but also because of the bogus theoretical foundations of monetarist ideology. Where radical trans-Atlantic monetary strategies did succeed however, was in inflicting austerity, provoking recession, and dampening inflationary expectations in combination with strong anti-union policies from the government. In reality, the restoration of capitalist class power was a central aim of the neoliberal austerity project and the downward push on wages, union rights and working conditions was a key component of this. These effects were foundational to the emergence of neoliberal capitalism and, through their demonstration effect, the broader reconfiguration of global capitalism (Streeck, 2011: 11-14).

### **Floating rates and the inflationary challenge**

The collapse of Bretton Woods gradually led to the reconfiguration of national monetary regimes as states adjusted to the new system of floating rates. With the pound floating from 1972 onwards, monetary policy was no longer shaped by the requirement to maintain a fixed exchange rate. Relative to fiscal policy, monetary policy now became more important



than before. In Britain, the emergence of new patterns of international monetary relations also presented an opportunity for monetarists to further advance their strategic priorities.

After the fall of Ted Heath in 1974, monetarists within the Conservative Party had risen to the top under the leadership of Thatcher. Geoffrey Howe and Nigel Lawson had begun to emerge as key monetarist figures within the Conservative Party. The Conservative Party's new economic strategy was outlined in their 1977 document, *'The Right Approach to the Economy'*. The paper set out their commitment to lower government spending, cuts in direct taxation and the containment of inflation. Combatting inflation was to be achieved by controlling the money supply and allowing the exchange rate to rise in order to lessen the impact of imported inflation (Keegan, 1984: 70). Thatcher's new government were convinced that Heath's 'U-turn' in 1972 had been a major mistake, and that a more resolute commitment to achieving price stability was required. Inflation was now viewed as the principal threat to social and political stability, and it was recognised that tough measures were needed in order to counter inflationary forces.

By adopting a monetarist approach to inflation, the new Conservative government set themselves apart from the broader European strategy of anti-inflationary politics. In March 1979, the countries of the European Monetary System (including France, West Germany and Italy), established an Exchange Rate Mechanism by fixing their exchange rates to that of the Deutschmark (Johnson, 1991: 36; Stephens, 1996: 5). This was a key difference from the approach taken by Britain and, crucially, the United States. While the Europeans would attempt to achieve price stability and arrest inflation by tying themselves into a regional fixed exchange rate system, Britain and the U.S. went about internalising

monetary discipline through the turn towards monetarism and the pursuit of unorthodox monetary policies. But this was never simply a question of technical adjustments to the intricacies of international monetary politics. Monetarism, and the austerity that it advocated as a cure to inflationary dynamics, was always about the restoration of class power too. Workers expectations of rising wages and improving living standards, a key component of the post-war capitalist compromise, would be driven down during the neoliberal era. Not just by the monetary tightening, but also by the imposition of anti-union laws and the provocation of set piece engagements between unions and the state.

Even before taking up the reins as Chairman of the Federal Reserve in August 1979, Paul Volcker was clearly aware of the need for the U.S. to internalise discipline. Volcker felt that more than a decade of mounting inflation had undermined the validity of interest rates as a guide for monetary policy (due to the difference between nominal and real rates), weakening the credibility of the Fed and leading to uncertain expectations over price fluctuations. Under the pressure of monetary instability and inflationary forces, the 'fabric of discipline', was 'fraying at the edges' (Volcker, 1978a: 9) Whereas expectations were formerly stabilised through the gold standard, the doctrine of the balanced budget and fixed exchange rates, those disciplines had either dissolved altogether or were, 'so attenuated as to be meaningless' (Volcker, 1978b: 332). As a consequence, the United States would now have to discipline itself (Panitch & Gindin, 2012: 163).

Within this context, targeting monetary aggregates could provide a useful tool for communicating expectations to the public and restoring the credibility of the Fed. Targeting aggregates could also serve as a discipline on the monetary authorities themselves. Volcker

was not, however, a card carrying monetarist. He recognised that inflation was not exclusively a consequence of movements in the money supply, but stemmed from a complex combination of social, economic and political factors (Volcker, 1978b: 338). As Volcker's stewardship of the Fed would subsequently demonstrate, his was a much more pragmatic and politically motivated approach.

The strategy outlined by Volcker could only be undertaken within the context of the floating rates that followed on from the collapse of Bretton Woods. Within the Bank of England, it was this very same international monetary context that helped justify the use of monetary targets, which were now viewed by some officials as key to 'filling the vacuum' left by the abolition of fixed exchange rates (BofE, C40/1440: 1978).<sup>116</sup> Mirroring the view taken by Volcker at the Fed, Bank officials were increasingly willing to employ monetary targeting in a pragmatic rather than principled manner. With demand management policies now delegitimised by their supposedly inflationary impacts, and the absence of fixed rates as a reference point for the judgement of economic policy, monetary targets became the new yardstick for judging macroeconomic performance in an inflationary age. No longer restrained by the requirement to maintain fixed parities, monetary authorities on both sides of the Atlantic allowed interest rates to be pushed much higher with much more severe fluctuations in the exchange rate. Internationally, it was this context that enabled the interest rate shocks that characterised the early years of the neoliberal period in Britain and America. National and international monetary orders were continuing to develop in a highly interactive fashion. Neoliberal central banking has to be understood within the

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<sup>116</sup> Bank of England Archives, C40/1440, 'Monetary Policy: Miscellaneous 18/9/78-31/10/79', Internal Memo, 'Monetary Targets and Economic Policy', September 28<sup>th</sup> 1978.

broader context of the constraints, contingencies, and capacities of the international monetary system.

For both Britain and America, the desire was not only to dampen inflation as a means to achieve price stability domestically, but also to restore the international value of their respective currencies. Given the international key currency role of the dollar, this was clearly a central strategic priority for the United States. The world was now effectively on a dollar standard, which required stable expectations about the dollar's future value in order to effectively underpin the international monetary system and maintain the attractiveness of American financial assets and U.S. Treasury bonds (Panitch & Gindin, 2012: 163). For Britain, the immediate appeal of a strong pound is at first less clear. But examining the Bank of England's archival record illuminates the motivations.

Within the Bank, the exchange rate of the pound was now identified as a key factor in the battle to counter inflation. A further OPEC oil price hike in spring of 1979 meant that prices had nearly redoubled over the last year. Speaking at the Bank of England's Court meeting, Gordon Richardson, the Governor of the Bank recognised that a fall in the strength of the pound during the 1976 crisis had led to an increase in inflation, with companies raising prices to meet the increased cost of imports. Richardson made clear the need to, 'avoid the inflationary impact of a lower rate' and also mentioned that some sectors of the economy, 'sought to benefit from a high rate' (BofE, 1979: G37/3).<sup>117</sup> The anti-inflationary priority was now firmly entrenched within the Bank's thinking and the maintenance of a high exchange rate was seen as central to achieving this objective.

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<sup>117</sup> Bank of England Archives G37/3, 'Court of Directors: Informal Records 16/1/75-31/12/80', 'Notes From the Bank of England Court Meeting', 24<sup>th</sup> May 1979.

The Bank's anti-inflationary stance reflected not only the priorities of the new Conservative government, whose monetarist economic advisers were strongly in favour of a floating pound, but also a broader shift in international opinion. This emerging consensus on the need for anti-inflationary policies to be prioritised over and above the expansion of economic growth was clearly expressed in a Bank report on the October 1979 IMF meeting in Belgrade. Government officials from around the world had become much less confident about their capacity to curb inflation, with many now concluding that, 'gradualism will simply not work in slowing down inflation'. In this context, it was felt that a sharp recession, at least as sharp as that of 1974, was now required in order to adjust inflationary expectations (BofE, 1979: G1/210).<sup>118</sup> Despite all of the focus on monetary aggregates and targets, then, the real strategy for combating inflation was an induced recession to slacken demand, provoke unemployment and produce spare capacity. This would hopefully lead to falling prices. Creative destruction would pave the way for stable accumulation in the future.

For monetary policy to be effective, interest rates would have to be pushed much higher than before. This was a consequence of the effect of inflation upon real interest rates (making them negative unless they were sufficiently high), but also a result of the Euromarkets. The supply of liquidity available within the Euromarkets had eroded the efficacy of monetary policy as a means to curb inflationary pressures, meaning that it would now have to be much tighter than it had been in the past to effect a comparable slowing

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<sup>118</sup> Bank of England Archives, G1/210, 'Governor's File: The International Monetary Fund and International Bank of Reconstruction and Development- Christopher William McMahon's Impressions of the Annual General Meetings 10/76-10/79-: 'Thoughts after the IMF/Belgrade Meeting', October 1979.

down of economic activity (BofE, 1979: G1/210). The problem of Euromarket leakage frustrated attempts to regulate the money supply on both sides of the Atlantic. Opting for higher interest rates was not, therefore, simply an act of ideological voluntarism, but was partly a pragmatic adaptation to the evolving monetary conditions associated with financial globalisation and high inflation. Offshore financial markets had punctured holes in national money markets and the decomposition of Bretton Woods had eroded the foundations of national monetary regimes. These developments combined with inflation to produce a requirement for the radicalisation of monetary policy if inflation was to be successfully combated by Central Banks.

In the face of these challenges, a strong exchange rate was identified as the surest means to quell inflation by reducing import prices. But the exchange rate question was also important in terms of another policy development that defined the early years of the Thatcher government: the abolition of exchange controls and the acceleration of financial liberalisation. These processes would come to undermine the tight interest rate policy employed in Britain, creating a central contradiction within the early neoliberal policy programme, but liberalisation was nonetheless undertaken as government officials transformed the regulatory order to further facilitate the expansion of global financial markets.

## Opening the floodgates

Abolition of exchange controls was one of the first and most important actions of the new Conservative government. Exchange liberalisation accorded with the philosophical commitment to extend the scope of markets forces to the widest possible degree (Keegan, 1984: 149). The Bank had long called for an end to controls and set to work providing technical justifications for the process. In June and July of 1979, the Chancellor removed all restrictions on the financing of outward investment, enabled British merchants to use sterling in order to finance third country trade, substantially reduced controls on individuals and began to liberalise portfolio controls by allowing securities denominated in European Community currencies or issued by international organisations of which Britain was a member to be purchased with official exchange (BofE, 1979: EC5/649).<sup>119</sup>

Bank officials were tasked with strategic planning for the further removal of the remaining portfolio controls and began to evaluate the actual and anticipated effects. In general, officials felt that once most controls had been removed it became logically necessary to dismantle what was left and expressed concerns that failure to do so would provoke a, 'very critical reaction', from media commentators and the City- the same interests that had championed the monetarist cause throughout the 1970s (BofE, 1979:EC5/649). It was expected that abolition of controls would lead to greater purchases of overseas assets by British residents, producing net capital outflows. But the extent to

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<sup>119</sup> Bank of England Archives, EC5/649, 'Exchange Control Act File: Relaxations- Papers Covering the Relaxation and Dismantling of Exchange Controls 6/9/79-17/9/79': 'The next stage in dismantling exchange controls', September 7<sup>th</sup> 1979.

which this occurred was likely to depend upon the strength of confidence in the British economy. More specifically, the Bank's thinking on the issue can broadly be split into three distinct components: the impact upon fiscal and monetary policy, the impact upon international regulatory dynamics and, finally, the impact upon the future of sterling.

Regarding fiscal and monetary policy, officials recognised that the abolition of controls was likely to have profound effects. One key impact would be upon the potential growth of offshore banking. If UK residents were allowed to borrow sterling deposits from overseas then a growth in offshore banking could occur, which might lead to, 'possible adverse consequences for the control of the UK money supply' (BofE, 1979: EC5/649). British authorities were now facing a very similar dilemma to that faced by the U.S. after the rapid growth of American banks' involvement in the Euromarkets. The offshore dollar pool had reduced the Fed's capacity to manage the credit supply by providing an escape valve through which U.S. banks could borrow abroad in order to lend on to their domestic branches and circumvent tight money policy at home. With sterling liberalised, the same erosion of national monetary control would now begin to affect the British authorities. Financial liberalisation was continuing to unsettle monetary regimes on both sides of the Atlantic.

It was understood by the Bank that the abolition of exchange controls ensured that Britain's banking system, 'loses a degree of insulation from the world monetary system' (BofE, 1979: EC5/649).<sup>120</sup> This inevitably exposed Britain to new problems arising from the interaction between domestic and external pressures. The Bank clearly understood how

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<sup>120</sup> 'Monetary Policy and the Banking System', September 13<sup>th</sup> 1979.



this might undermine the government's policy goals, commenting that, 'it could pose problems for both the techniques and efficacy of monetary controls in the situation where effective controls of the money supply and declining monetary targets were the centre piece of the Government's economic strategy' (BofE, 1979: EC5/649). In the past, British authorities had relied upon direct controls over lending (apart from the disastrous and abortive attempt to do away with them during CCC) in order to control the money supply. These controls operated by restricting the growth of either part or all of the banks' balance sheets or by taxing the banking system by forcing them to hold assets at the Central Bank that they would not ordinarily hold. The problem now was that full liberalisation of sterling would produce a situation whereby banks could easily circumvent such controls by persuading their customers to switch their deposits and borrowing to an overseas branch. It would also enable overseas banks, which weren't subject to the same controls, to extend their sterling operations in the domestic money market (BofE, 1979: EC5/649).

At the very moment when the new Conservative government had come to power espousing the virtues of monetary control and price stability, then, the abolition of controls was totally undermining the existing framework of monetary control. This was the great contradiction at the heart of the monetarist attempt to quell inflation. The government's incompetence here was unsurprising, given that monetary policy had actually received very little attention from the Tories while they were in opposition, leaving them unprepared for the technical details of monetary reform and confused over monetary policy matters upon their arrival in office (Keegan, 1984: 124). The aspiration towards price stability through reining in the money supply was entirely at odds with financial liberalisation. Offshore

banking was undermining British monetary control in a remarkably parallel fashion to the erosion of American monetary control during the 1960s as the existence of offshore markets corroded the institutional conditions of onshore finance. Indeed, officials noted that similar processes had already caused serious problems for monetary authorities in both the U.S. and Germany (BofE, 1979: EC5/649).

The decision over the liberalisation of exchange controls was not, however, taken solely in accordance with considerations about the efficacy of British monetary control. Abolition of exchange controls occurred against a backdrop of wider international regulatory competition in which competition between Britain and the U.S. was centre stage. In the run up to the decision to liberalise, the Bank produced detailed reports on the abolition of exchange controls in both the U.S. and Japan (BofE, 1979: EC5/649).<sup>121</sup> Anglo-American competition to attract Eurodollar business into their respective financial centres provided the definitive context within which the decision over liberalisation occurred. We should, therefore, view the decision to further liberalise exchange controls and further open up the City's financial markets within the broader lineage of Anglo-American development and the competition between New York and London, which lay at the heart of this process. Liberalisation was not simply a consequence of philosophical preferences towards free markets, but rather a response to the competitive challenge posed by New York.

In the year before Thatcher came to power, the New York Clearing House Association made a crucial proposal. It stipulated that New York should be granted a specialised status as a "monetary free trade zone". The plan was essentially an attempt to

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<sup>121</sup> Exchange Controls in the USA, July 26<sup>th</sup> 1979; Japan Exchange Control, July 26<sup>th</sup> 1979.

draw offshore banking back into the U.S. by encouraging both American and foreign banks to establish “International Banking Branches” (IBBs) in New York (BofE, 1978: 4A115/3).<sup>122</sup> This proposal posed a major competitive challenge to London’s status as a centre for offshore banking and was undertaken by the New York authorities with exactly this intention in mind. By drawing the rapidly expanding offshore banking business back into New York, it was hoped that major benefits would accrue to the city, the U.S. Treasury and the banks themselves. American regulators were now on the front foot in their attempts to restore New York’s pre-eminence as a centre for global banking and it was the City of London, given its status as the principal location for Euromarket business and for overseas American banks, that could potentially stand to lose out. It was no surprise, then, that Bank officials paid careful attention to developments on the other side of the Atlantic.

Under the new scheme IBBs would be able to make loans to, and take deposits from, overseas borrowers, without being encumbered by the reserve requirements and interest rate controls that were applied within the U.S. This constituted an attempt by American regulators and bankers to consciously and strategically reproduce the kind of conditions that had drawn American banks into the City of London’s Euromarkets en masse during the 1960s. The plan would require the amendment of the Fed’s Regulation D, which as part of the New Deal regulatory framework governed the reserve requirements for banks in the U.S. And crucially, the plan would also require the amendment of Regulation Q, which prohibited payment of interest on deposits that fell short of 30 days (BofE, 1978: 4A115/3).

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<sup>122</sup> Bank of England Archives, 4A115/3, ‘Monetary Analysis: External Development and Policy Meetings 4/1/78-28/12/79’, Memo from the Bank of England Overseas Department, ‘New York as a Free Trade Banking Zone’, May 31st 1978.

*The competitive dynamics between rival financial centres, New York and London, were now driving the further erosion of the New Deal regulatory architecture in the U.S. and the homogenisation of Anglo-American regulatory regimes, as American authorities attempted to bring offshore business back under American territorial auspices by aping the regulatory climate of the City of London.* The transatlantic regulatory feedback loop was continuing to have an enormous impact on regulatory frameworks on both sides of the Atlantic. Existing accounts of American financial deregulation during the Volcker era have understated the centrality of these Anglo-American competitive dynamics (Greider, 1987: 155; Panitch & Gindin, 2012: 169; Krippner, 2012: 73).

For the Americans, it was thought that bringing the business back into New York would bring substantial benefits. Repatriating offshore banking business would recover tax revenue that the federal government had previously lost out on, while the plan might boost the local New York economy (at a time when the city had been through a major fiscal crisis only a few years previously) by restoring the city's prestige as an international banking centre and drawing in some portion of the Eurobond underwriting activities that were currently undertaken in London. It was anticipated that these developments might create between four to six thousand jobs (BoFE, 1978: 4A115/3). Unlike Britain, the regulatory transformations in the U.S. were also motivated in part by internal competition at the federal level, reflecting the differential geographical and constitutional composition of the U.S. Regulators in New York were keen to take action before rival cities in other states *within* the U.S., such as Florida, Delaware, Chicago and Houston, acted on similar schemes.

In the U.S. then, the decomposition of regulatory regimes was motivated not only by trans-Atlantic competition, but also by inter-federal competition.

Although attentive to the potential competitive challenge from New York, officials within the Bank remained fairly sanguine over the effects of the proposed changes. They recognised that the Fed may well filibuster the proposal from New York, in an attempt to maintain monetary control in the face of potential leakage of funds between IBB and domestic markets, and noted that the Fed had rejected a similar proposal in 1975 on precisely these grounds. The new proposal was emerging at a time when the Fed was sensitive to its weakening control over the U.S. monetary system, with declining membership of the Federal Reserve System by American banks already a major concern (BoFE, 1978: 4A115/3).

Beyond their circumspect appraisal of the Fed's likely attitude to the New York proposal, Bank officials also continued to extol the virtues of the London markets. Officials noted that London would still have a number of attractions compared to New York, even if the plan went ahead. It was felt that London had two major advantages over New York. Firstly, its geographic location gave it a temporal overlap with continental Europe that increased its attractiveness as an entry point into European markets. And secondly, the expertise built up in London over decades at the centre of the Euromarkets was also an enduring strength. In general, Bank officials accepted the view expressed by New York bankers; that the scheme wouldn't pose any more of a threat to London than other offshore centres already did (BoFE, 1978: 4A115/3).

The proposals of the New York Clearing House Association were clearly intended as a competitive challenge to existing offshore centres and were subsequently approved by the Fed's Board of Governors in June 1981 in the form of 'International Banking Facilities'. The Fed eventually accepted the proposals: partly because earlier attempts to regulate the Euromarkets had failed. Between 1978 and 1981, the Euromarkets and offshore banking were central to the interactions between British and American monetary authorities. Volcker and other officials at the Fed were wary of the Euromarkets impact on the conduct of American monetary policy and believed that the absorption of Eurodollar funds into the U.S. money market, during a period of tight monetary policy, would undermine attempts to squeeze the credit supply. This had been the case in the late 1960s, as we have seen in chapter four. But by the late 1970s, the Eurodollar market had grown even larger and by 1981 the Eurodollar market was estimated to have grown to the size of approximately 10% of the U.S. M3 money supply. As such, it constituted a major source of additional money that was not directly subject to the policy operations of the Fed (Helleiner, 1994: 135).

Faced with the challenge of Eurodollar leakage, the Fed attempted to build international support for an attempt to encourage Central Banks to impose reserve requirements upon the international operations of their national banks and thus introduce reserve requirements for all Eurodollar activity. This was intended to arrest the market's growth and limit its negative impact upon national monetary policy autonomy. But when the Fed took the plan to the BIS, it met stiff resistance from the Bank of England and the Swiss National Bank, which hosted major Euromarkets centres. By April 1980, after the

Bundesbank had also rejected the plan, the proposal had been entirely scuppered (Helleiner, 1994: 137).

Through its failed attempt to regulate the Euromarkets, the Fed demonstrated the difficulty of trying to lead cooperative action to regulate international financial markets. If the plan had gone ahead, it might well have substantially arrested the trend towards deregulation and financial liberalisation. But the failure of the Fed's regulatory efforts meant that the growth of international financial markets continued apace. As a consequence, the international trend towards deregulation and openness continued as foreign governments made every effort to, 'create markets that would match conditions in London and the United States in order to attract footloose global financial operators' (Helleiner, 1994: 139).

The failure of the Fed's attempt to regulate the Euromarkets was not simply a consequence of opposition from foreign Central Banks. American banks themselves were now actively lobbying for further deregulation and the recreation of offshore conditions within the American financial system as the feedback effect of the liberalised offshore conditions within the City of London continued to erode the New Deal regulatory framework within the U.S. American banks had begun to lobby for the replication of Euromarket conditions within the U.S. from the late 1970s, in an attempt to escape restrictive New Deal regulations and compete more effectively with non-bank financial institutions who were creating disintermediation by offering higher interest rates (as they were not encumbered by New Deal rate ceilings) at a time of high inflation. Although Helleiner (1994: 138) rightly suggests that American banks were using the competitive

pressures of the Euromarkets to push for domestic deregulation, he misses the extent to which this dynamic was part of a transatlantic regulatory feedback loop emerging from the specific dynamics of Anglo-American financial development that had their origins in the birth of the Euromarkets during the 1950s. As banks on each side of the Atlantic pushed their governments to create regulatory conditions favourable to competing internationally, the existing regulatory orders gradually broke down. These effects continued to erode American financial regulation during the 1980s.

Questions of where offshore banking would be hosted were only one aspect of the broader regulatory interaction between London and New York. Britain was keeping a close eye on American deregulation through officials at both the Treasury and the Bank of England. In a letter to the Bank, the British Treasury delegation at the Embassy in Washington noted that the American financial system was marked by a, 'discernible trend towards deregulation and greater competition in the financial environment' (National Archives, 1979: T388/98).<sup>123</sup> Most importantly, Treasury officials noted that the momentum behind the dismantling of Regulation Q was continuing to build and noted that a majority of regulatory agencies would, 'accept the eventual elimination of Regulation Q'. As the existence of Regulation Q had been crucial to the original establishment of the Euromarkets, its abolition would have been expected to have significant implications for the City. The Euromarkets would no longer be able to rely on their interest rate differential

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<sup>123</sup> Treasury File National Archives T388/98, 'International Monetary System and the U.S. Dollar 15/12/78-23/5/79', Letter from United Kingdom Treasury and Supply Delegation, British Embassy Washington to R Gilchrist, Bank of England, 'Developments in US Financial Environment', March 7<sup>th</sup> 1979.



with American banks as a means to draw funds away from the more tightly regulated American money markets.

Keen observations of international regulatory dynamics were not, however, confined to the British. The Americans were also scrutinising developments within Britain's financial system. In mid-1979, Harold Williams, the Chairman of the U.S. Securities and Exchange Commission paid a visit to London. Williams was on a fact-finding mission that would take him to a number of key international financial centres, with London of foremost importance in this regard. Williams intended to, 'examine the regulatory system operated in the UK, as compared with the comprehensive U.S. system' and was supposedly himself inclined to, 'prefer self-regulation to imposed controls' (National Archives, 1979: T388/98).<sup>124</sup>

Although deregulation in both Britain and the U.S. occurred within a competitive context, it also did so in a manner marked by remarkably high levels of cooperation and openness, with officials on both sides seemingly well aware of, and often in direct communication about, developments on the other. This was a relationship characterised by 'coordinated competition'; the methods employed were neither underhand nor antagonistic, but employed in a manner that was recognised and reciprocated by authorities in the other country as part of an overall goal of maximising the competitiveness of international financial markets. The degree of integration between financial markets in London and New York, as well as the major presence of American banks within the City, meant that deregulation, although competitive, occurred in a highly symbiotic fashion and tended towards a homogenisation of regulatory conditions on either side of the Atlantic, as

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<sup>124</sup> Visit by Mr Harold Williams, Chairman of the SEC, April 30th 1979.

offshore banking practices and financial liberalisation were increasingly embedded within both countries. This dynamic of coordinated competition between Britain and the U.S. was mirrored in the way that British financial markets were gradually being integrated into the competitiveness predicates of the European Common Market.

Williams's reception by British officials is instructive with regard to coordinated competition. Heading to London with the explicit intention of understanding how the SEC's rules impacted overseas borrowers, Williams sought to gauge foreign perceptions of the usability of the New York markets. Such perceptions were a key component in their overall competitiveness. To this end, discussions between Williams and his British counterparts were open and frank. Senior Treasury officials openly discussed their perceptions of the Yankee-Bond market with Williams, raising the complaint that the New York market required borrowers to divulge too much information. The relative attractions of the New York and Eurodollar markets were also openly discussed and Williams was keen to discover whether the introduction of the Banking Act would impact U.S. banks in the U.K. (National Archives, 1979: T388/98).

Frank and open discussions between senior officials on both sides of the Atlantic were a symbol of just how extraordinarily integrated Anglo-American financial markets had become as financial globalisation gathered momentum from the late 1950s. The situation contrasted markedly to the earlier ignorance and suspicion of the U.S. Treasury and regulatory bodies, during the early years of the Eurodollar market, as to what exactly the Eurodollar market was, how it functioned and what impact it might have on the U.S. Increased financial interdependence required a greater degree of cooperation, openness

and mutual knowledge, but it did not eradicate competitive dynamics between rival banking centres. Instead, the acceptance of international financial competition and openness was inscribed in the new regulatory regimes that were gradually constructed in both countries.

Although cooperation was remarkably close, there was still considerable room for friction as the above manoeuvres around Euromarket regulation demonstrate. But the potential for tensions within the broader context of coordinated competition were not confined to the transatlantic horizon. Britain's gradual integration within the European Economic Community (EEC) was also a source of potential disagreement. Exchange control liberalisation ignited American concerns by demonstrating the potentially different tempos and biases of coordinated competition. The Americans felt that the July liberalisation measures had unduly privileged the EEC by liberalising the securities market preferentially towards European markets, while maintaining regulations on the U.S. Chancellor Howe was prompted to explain to the Americans that this was just the first step towards the eventual goal of world-wide portfolio liberalisation (BofE, 1979: EC5/649)<sup>125</sup>. Indeed, the Americans were so put out by the European-bias of exchange controls liberalisation that Howe felt compelled to write a letter to the U.S. Ambassador explaining the measures on technical grounds and assuaging American fears (BofE, 1979: EC5/649).<sup>126</sup> In their efforts to liberalise financial markets, then, British monetary authorities increasingly had to negotiate a course that respected the broader context of coordinated competition within both the

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<sup>125</sup> The next stage in dismantling exchange control, September 7<sup>th</sup> 1979.

<sup>126</sup> Brief note to the Governor concerning U.S. sensitivity about U.K. exchange control discrimination, September 11<sup>th</sup> 1979.

E.E.C and the Anglo-American sphere of monetary interdependence. If the Americans felt that Britain was leaning more towards European markets at the expense of the U.S., frictions were likely to ensue.

The third major factor bearing upon the liberalisation of exchange controls was the future role of sterling. Officials at the Bank and the Treasury were aware that exchange controls could only be liberalised if sterling was in a strong position. Otherwise the pound might be subjected to intense speculative pressure and major outflows. But officials within the Bank did express concerns over the potential for sterling to re-emerge as a major international reserve currency after liberalisation. It was felt that too great an expansion of sterling's international role would violate the Basel facility and agreements made in 1976, which involved the phasing out of sterling's status as a major international reserve currency (BofE, 1979: EC5/649).<sup>127</sup>

Concerns about the impact of a major resuscitation of sterling's international role did not, however, prevent the Bank from speculating about the pound's future trajectory. The thoughts expressed here are extremely revealing, both in terms of the Bank's perception of the changing nature of the international monetary system and the anticipated impact of exchange control abolition upon British capitalism. Looking ahead, Bank officials speculated that a number of factors were likely to make sterling an attractive asset to private investors and managers of official reserves over the following decade. The key factor was the relative decline of the dollar, which was expected to continue unchecked

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<sup>127</sup> Note to the Chancellor of the Exchequer and Bank and Treasury officials, Dismantling Exchange Control and the International Role of sterling', September 19<sup>th</sup> 1979.

(BofE, 1979: EC5/649).<sup>128</sup> The value of the dollar had fallen precipitously throughout 1979, in the wake of sustained U.S. inflation and the OPEC price hikes (Greider, 1987: 18). Clearly then, the Bank's calculations about the impact of liberalisation upon the pound were highly dependent upon expectations about the future value of the dollar. The global significance of American monetary policy, and the interdependence of financial markets, ensured that British policy decisions would have to be carefully calibrated with regard to American policy dynamics. By liberalising exchange controls and expanding the scope for sterling business, as well as making it easier for businesses to conduct dollar transactions and hold offshore accounts, British authorities were heightening the interactivity between interest rates on sterling and other currencies, particularly the dollar (Johnson, 1991: 37).

Domestically, the production of North Sea Oil was expected to exert sustained upward pressure on the value of the pound. While the continued predominance of the City as 'the most important international banking centre in the world', and the wider accessibility of sterling compared to other major currencies, were also key factors in the Bank's assessment. But the broader international context was paramount to their considerations. Bank officials were convinced that a multi-currency system was on the horizon as the dollar's hegemony faltered (BofE, 1979: EC5/649).<sup>129</sup> As the multi-currency system developed, sterling's international role would be revived as investors diversified away from the dollar.

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<sup>128</sup> Sterling as an international currency, September 19<sup>th</sup> 1979.

<sup>129</sup> Memo by the Bank of England External Finance Group, Official sterling balances, September 14<sup>th</sup> 1979.

Regarding the future of the British economy, the Bank's assessment revealed the differential impact of a strong pound on British capitalism. A potential to boost invisible earnings was identified as the main advantage of an enhanced international role for sterling. Banks and brokerage firms dealing in sterling would experience growth in their business. But the Bank recognised that the attendant sterling inflows and the high value of the pound could prove damaging to the traded goods sector; exposed to a greater volume of international capital movements, the economy 'might run at a lower level of activity than otherwise' (BofE, 1979: EC5/649). The Bank appeared under no illusion about the differential impact of a strong pound upon British businesses. It would most likely be good for the financial sector, and potentially highly damaging for the manufacturing sector and export industries. Their assessment turned out to be incredibly accurate. The Tory's commitment to a strong pound and exchange liberalisation would wreak havoc on British manufacturing while bringing about a boom for banking in Britain.

Where the Bank proved less accurate, however, was in its assessment of the dollar's future standing as the lynchpin of the international monetary system. With the appointment of Paul Volcker in October 1979, they were in for a hell of a shock. The dollar's decline would be arrested in a drastic manner and with important bearings upon Britain's own monetary policy framework. In order to arrest the dollar's decline and push interest rates up to level that were highly damaging to sectors within the American economy, Volcker would initiate an epistemological shift in central banking that was instructive for the development of monetary policy in Britain.

## **The epistemological break: monetarism triumphant?**

Paul Volcker took charge of the Federal Reserve in August 1979 in one of the most important political appointments in the post-war history of American capitalism. Jimmy Carter's presidency had been wracked by high inflation and faltering economic performance. The problem of inflation, which had been simmering since the 1960s, was now at boiling point. It had become the paramount issue within the American political economy, threatening to severely upset the existing distribution of wealth and power.<sup>130</sup> With inflation seemingly out of control, investors bet against the dollar, driving its value down in international markets. As inflation eroded the value of U.S. government bonds, which were essentially offering a negative rate of return in real terms, bondholders and asset owners began to exert sustained pressure upon American monetary authorities to take action in order to combat inflation (Greider, 1987: 40-45).

The power brokers on Wall Street identified Volcker as the right man to lead the war on inflation. After years of indecisive action from the Fed, which had severely eroded its credibility in the eyes of investors and monetarist economists, Volcker was tasked with restoring its credibility and stamping out inflation in order to restore stable accumulation conditions for investors. The way that Volcker went about achieving these goals in the following years signalled both the resolute commitment of the U.S. to quelling inflation and

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<sup>130</sup> It was upper income households that suffered the biggest losses during high inflation as the real rate of return on financial assets was steadily eroded. For the home owning middle classes, house price inflation and wage inflation were beneficial. In broad terms, debtors were rewarded by inflation (which eroded the real value of the borrowed money and interest rates), while savers were penalised as their asset values depreciated (Greider, 1987: 17). Banks, as net creditor institutions, tended to be highly averse to unexpected and excessive inflation (Woolley, 1984: 71).

restoring the international standing of the dollar (Panitch & Gindin, 2009: 31), and the power of the Federal Reserve as an unelected body that could exert enormous influence over American and global monetary dynamics.

Volcker immediately recognised that an extremely tight monetary policy was required to exert pressure upon the credit supply and dis-incentivise borrowing. Under his stewardship, interest rates reached record levels.<sup>131</sup> Volcker pushed the discount rate up to 10.5% in his first month in charge, its highest level in the history of the Federal Reserve System. By October of 1979, the Federal Funds rate had hit 16% and by January 1980 it reached 20% (Greider, 1987: 76, 146).

As a veteran of the American political scene, Volcker understood that provoking a recession through extraordinarily high interest rates would be politically contentious, not least because it would provoke unemployment and business closures. The proposal for a sustained policy of tight money and austerity amounted to a conscious termination of the Keynesian commitment to growth and full employment, in favour of a deflationary recession. Volcker's answer to this political problem was to bring about a paradigm shift in central banking techniques that would help insulate the Fed's decisions from political scrutiny by implying that interest rate decisions were taken on grounds of technical necessity rather than political choice (Greider, 1987: 106; Konings, 2011: 134; Krippner, 2012: 108). This move to depoliticise interest rate policy was a key precondition of the

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<sup>131</sup> The Fed's key mechanisms for affecting the money supply were open markets operations and discount window transactions. The Federal Funds rate (the price of borrowing between banks on the overnight market to cover shortages in their reserves relative to their portfolio), set through the Fed's open market operations, was the key rate for the American monetary system and was the most closely monitored rate in the market (Greider, 1987: 62-64).



Central Bank activism that ushered in the neoliberal era in the U.S. As we have seen, Volcker had been championing the merits of practical monetarism prior to his appointment as Chairman of the Fed (Volcker, 1978: 332). He put these views into practice by instituting a new Central Bank policy regime that involved a different approach to the traditional lever of open market operations. The new regime was designed to exercise tighter control over the money supply by enacting operating decisions on the basis of the aggregate level of reserves in the banking system, rather than targeting interest rate levels, as had traditionally been the case. The Fed's new operating system would be in place for the next three years, during the crucial conjuncture of Volcker's attempt to quell inflation (Axilrod, 2011: 89-93). The Federal Open Market Committee (FOMC) would meet to decide a short-term path for money growth and would then task the market manager in New York with providing the system with a level of reserves that was thought to be consistent with the monetary targets. Under the new approach, interest rates would be allowed to fluctuate freely during the six-week period between FOMC meetings.

The stated aim of these measures was to restore the credibility of the Fed and provide a reliable basis (the monetary targets) according to which the markets could make judgements about interest rate directions. Yet it also came with the unstated benefit of passing off highly political decisions about interest rates as a consequence of pseudo-scientific necessity rooted in monetarist convictions about the privileged causal relationship between the money supply and inflation. It allowed the Fed to depoliticise its controversial measures. The epistemological shift in favour of monetarism was, then, a facilitating factor in the political enactment of higher interest rates and regressive wealth

redistribution. Monetarist theory was pragmatically employed in order to introduce radical interest rate policies that effectively ended the Keynesian commitment to maintaining growth and full employment, regardless of any associated inflationary consequences. Now the fight against inflation was sovereign, unemployment and recession were accepted as inevitable consequences, and monetarism reigned supreme. Internationally, the fact that the Volcker shock followed so closely on the heels of Carter's failed attempt to promote a Keynesian 'locomotive strategy' through the G7, in which Japan and Germany would stimulate global demand and drive growth, sounded the death knell of Keynesianism internationally and paved the way for the ascent of neoliberal policy.

Over in Britain, there was a similar degree of upheaval regarding monetary policy. Pressure from the IMF during the Callaghan government had already helped bring about a more intensive focus upon monetary targets in Britain. But under the new Conservative government the intellectual commitment to monetarism became a central pillar of economic policy. This was reflected in a whole raft of changes affecting the conduct of monetary policy, beyond the aforementioned impacts of exchange liberalisation. These changes reflected a continuation of the failed attempt to reform monetary policy through the abortive CCC policy in the 1970s and were similarly geared towards expanding the scope for 'market forces' within monetary policy. With the failure of CCC, monetary authorities had introduced the Supplementary Special Deposits Scheme to restrain credit creation and check competition for deposits within the banking sector. Under the scheme, banks were required to hold noninterest-bearing deposits at the Bank of England if their portfolio of interest-bearing deposits grew beyond a certain level mandated by the Bank.

This scheme, colloquially known as the 'Corset', was abandoned in June 1980, as it was thought that the abolition of exchange controls rendered it ineffective (Artis & Lewis, 1981: 1; Buitter et. al., 1981: 332-333). A new Banking Act had been introduced in 1979, to make clear which institutions could operate as banks within the evolving, institutionally diverse and increasingly competitive monetary system. Reserve asset ratios were phased out from 1980 and new operational techniques for open market operations began in November 1980. From 1981, there were adjustments to the cash reserve requirement and experimentation with systems of monetary base control (Artis & Lewis, 1981: 1).

This amounted to a revolution in British monetary policy and it didn't pass without producing serious tensions between the Governor of the Bank and the Prime Minister, in a pattern of Central Bank-Executive tensions that was neatly mirrored across the Atlantic. In 1980 the Treasury and the Bank published a paper on '*Monetary Control*', which outlined that, in the absence of the Corset and other quantitative limits on bank lending, control of the monetary supply would now be achieved through adjustments in the level of interest rates and restraint of the Public Sector Borrowing Requirement (PSBR). Control over interest rates would be achieved through open market operations and variations in the Minimum Lending Rate.<sup>132</sup> The PSBR would be controlled through adjusting levels of taxation and spending (Buitter et. al., 1981: 332-337). These related components of monetary and fiscal control were encapsulated in the Government's 'Medium Term Financial Strategy' (MTFS), which mapped out medium term targets for growth of the money supply as part of a broad deflationary strategy that intended to lower the

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<sup>132</sup> The Minimum Lending Rate was the term used to describe discount window operations carried out by the Bank.

inflationary expectations of managers and trade union negotiators by tying the government into longer-term targets for monetary expansion (Stephens, 1996: 13).

Gordon Richardson, the Governor of the Bank, opposed the government's plans for the MTFS and argued that it would undermine the government's credibility by committing them to targets that were far too specific. But Thatcher's monetarist Chief Advisor, Terry Burns, stood fast and received the support of the influential Nigel Lawson.<sup>133</sup> The MTFS was rolled out in the March 1980 Budget, with the only concession to the Bank and other critics being that the monetary targets were now given in ranges of percentiles rather than the firm figures originally proposed (Keegan, 1984:142). The adoption of the MTFS signalled to the Bank the severity of the government's commitment to deflationary policies. But the conflict did not end at this point. Chancellor Howe's announcement during the March Budget that the Corset would be gone by June, proved to be, 'the harbinger of what turned out to be the worst period of diplomatic relations between a Prime Minister and a Governor of the Bank of England since the days of Harold Wilson and Lord Cromer during the mid-1960s' (Keegan, 1984: 150).

The government's high interest rate policy and the rising value of the pound were beginning to exert a heavy toll upon British industry. By July 1980 officials at the Bank had decided that the situation facing British industry, with increasing costs of borrowing and rapidly decreasing international competitiveness, was too grave to be allowed continue. Distress borrowing by struggling British industrial firms was pushing up the money supply figures. The Bank determined to 'de-rate M3': to push the government off its fixation with

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<sup>133</sup> Lawson was perhaps the foremost enthusiast for monetarism within Thatcher's government.

the measure for broad money in the economy. In practice, the Bank was already undermining the government's commitment to reducing the growth of M3 by using its contacts with the clearing banks to ensure a supply of credit to stuttering industrial firms. In the Bank's eyes, monetary policy was needlessly tight and in danger of creating very high unemployment, with GDP falling by 2.2% in 1980 (Smith, 1987: 90). The pragmatism of the Bank was increasingly running up against the ideological fervour of Thatcher's administration.

Events came to a head when Richardson visited Downing Street in early July. He implored Thatcher to lower interest rates, on pain of strangling corporate sector of the economy. Thatcher grudgingly acceded to Richardson's request, but from that point onwards wrath towards Richardson and the Bank was, 'one of the recurring themes of Mrs Thatcher's economic administration'. With the M3 figures worsening and undermining the government's credibility, Thatcher's discontent with the Bank continued to grow. Tensions between the Prime Minister and the Bank were not, however, confined to disputes over the appropriate level of interest rates. The Bank increasingly came under pressure from Tory politicians and their monetarist advisers to adopt a form of monetary base control derived from the quantity theory of money. This would have implied an attempt to achieve much tighter control of the monetary base by the Bank, but as a consequence, interest rates would fluctuate unpredictably as they were doing in the U.S. (Johnson, 1991: 32).

At this key moment in the first phase of Thatcher's government, with monetary policy increasingly politicised within elite circles (ironically as a consequence of the government's attempt to depoliticise monetary policy through the adoption of monetarist

techniques) of the British state and with high interest rates beginning to seriously undermine British industry and intensify the recession, the Fed was increasingly drawn in as an important player in the debate, demonstrating the transatlantic interactivity of the neoliberal transformation in Central Bank practices. Officials at the Bank looked to the Fed in order to fulfil their own domestic political objectives in thwarting some of the more radical Thatcherite proposals. By drawing in the Fed's expertise, the Bank sought to navigate through the institutional upheaval of the Thatcher government without sacrificing its institutional autonomy. With the Bank experiencing less independence than the Fed, the risk of being steamrollered by a fervently monetarist administration was graver than that faced by its American counterpart.

Thatcher and her advisers were clearly inspired by the adoption of the Fed's new monetary policy techniques under Volcker and wanted to apply these same methods to the Bank. British officials had been casting around for novel methods from a whole range of foreign Central Banks, but given its status and significance the Fed was a particularly important source of technical inspiration. This was the context within which Stephen Axilrod, a senior official at the Fed, met with a series of British Bank officials in order to discuss monetary policy. Axilrod went through the Fed's new operating procedures in detail with his British colleagues and was also invited to attend a Parliamentary Committee setup to scrutinise British monetary policy. While in London, Axilrod met with Gordon Richardson, where they discussed how and to what extent the Bank of England should bring monetary and reserve aggregates into the policy process. Crucially, the discussion was focused upon, 'how to go halfway toward meeting the Prime Minister's wishes without

actually going quite that far' (Axilrod, 2011:103-106). At a time of profound political struggles over the conduct of monetary policy, institutional cooperation between the Bank and the Fed was employed to maintain Central Bank autonomy and navigate a pragmatic and conciliatory path through the prescriptions of monetarist politicians and their advisers. In the end the Bank, with the support of officials from the Treasury, was able to resist the government's attempts to move wholeheartedly towards a system of monetary base control (Keegan, 1994: 156; Stephens, 1996: 20).

*The defence of Central Bank autonomy under the duress of fervently monetarist political pressure was a defining feature of the neoliberal central banking revolution on both sides of the Atlantic. These early struggles represented a key moment in the growth of Central Bank power and autonomy that would come to characterise the neoliberal period in Britain and the U.S.* Reagan's electoral victory in 1980 brought a monetarist President and a highly ideological government to power in the U.S. During Volcker's tenure, the Fed came under pressure from Reagan's Undersecretary of the Treasury for Monetary Affairs, Beryl Sprinkel. Sprinkel was a monetarist economist and former banker (Greider, 1987: 363). He was uncomfortable with the idea of the money supply being under the Fed's independent control and repeatedly made public announcements intended to undermine the Fed's credibility (Axilrod, 2011: 100). Jerry Jordan, a former economics professor who had participated in the Shadow Open Market Committee, served on Reagan's Council of Economic Advisors and was also highly critical of the Fed's anti-inflationary credentials.

Tensions between Reagan's administration and the Fed came to a head in the spring of 1981, with Reagan's senior officials and advisers, men like Sprinkel and Jordan,

vociferously criticising the Fed for allowing the monetary aggregates to rise at an unacceptable rate (Woolley, 1984: 125). They were convinced that Volcker's actions were undermining the President. Indeed, Treasury Secretary Regan later confided that he and the President had even considered 'abolishing the Fed' (Greider, 1987: 378).<sup>134</sup> Volcker was called into the Oval Office to defend his actions in front of the President and his advisers. But Volcker drew on his wealth of political experience in order to defend the Fed's autonomy and evade answering questions transparently. He cloaked his analysis in the armour of complex technical details relating to monetary operations (Greider, 1987: 376-381). Volcker was able to maintain the Fed's independence despite pressure from the Reagan administration. Indeed, the constitutional basis of the Fed's independence gave the American Central Bank a more secure footing than the Bank of England enjoyed, but the scope for policy actions was nevertheless highly dependent upon the broader political context.

Despite different operating procedures and different degrees of institutional autonomy, both Central Banks consistently pursued a deflationary course of high interest rates between 1979-1982. That they were able to do so had much to do with the evolution of financial markets since the 1970s. But it was also very a much a consequence of the lobbying efforts and political pressure applied by the banking sector. Regulatory and market developments enabled the banks to prosper from the high interest rate regimes, while industry and workers suffered. At the heart of the neoliberal central banking regime,

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<sup>134</sup> Of course, the political fallout from such a drastic move would have been immense and it is no surprise that this option was never attempted in practice.



then, lay a partisan representation of the interests of the financial sector that paved the way for the massive expansion of financial sector power during the neoliberal era.

### **The differential impacts of neoliberal central banking**

In both Britain and America, the high interest rate regimes and deflationary policies that ushered in the neoliberal period involved a dangerous game of brinkmanship with banks and the wider economy. In the past, the Fed had been forced to pull back from sustained attempts at tight money policy due to the possibility of major financial collapses resulting from the strain caused by increased borrowing costs. This had been the case in 1969-1970, when the American financial system had proved unable to deal with the high-interest-rate policy that had produced the commercial paper crisis and led to the collapse of Penn Central. In response to the crisis, the Fed had been required to rapidly inject liquidity into the banking system, undermining the original aim of tight money in the process. American policy makers had been particularly sensitive to this possibility ever after (Konings, 2011: 134; Panitch & Gindin, 2012: 169). In Britain, the experience of the Secondary Banking Crisis in 1974 had produced similar concerns, with interest rate hikes provoking a series of collapses within the secondary banking sector that forced the Bank to organise a support operation in concert with the major clearing banks (BofE, 1979: G1/210; Capie, 2010: 525).<sup>135</sup>

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<sup>135</sup> Thoughts after the IMF/Belgrade Meeting, October 1979.

That the Fed and the Bank were now able to implement policies of high interest rates and stick to them fairly consistently was a consequence not only of a generally supportive political climate, but also because of the development of financial markets during the 1970s. Sustained inflation during the 1970s affected nominal interest rates and changed the impact of interest rate ceilings and other financial regulations. Banks in both the U.S. and the U.K. also became more dependent upon wholesale markets and were increasingly able to circumvent domestic tight money policies through the importation of offshore funds. Banks also moved increasingly into loans and advances and away from traditionally safer assets such as government securities. As a result, they became more vulnerable to a sudden loss of earnings if market rates rose above loan rates. This led banks to switch towards variable rate lending contracts or 'flexi-rate' loans (Lewis & Davis, 1987: 9). Flexi-rate loans increased banks' capacity to weather the interest rate shocks of the early neo-liberal period by passing on the fluctuations in rates onto their customers, thus insulating themselves from risk. Rapid innovation and technological development within financial markets continued apace during the 1980s (Llewellyn, 1985: 10).

The growth of wholesale banking and the Euromarkets meant that banking practices became increasingly standardised on both sides of the Atlantic. Techniques of American banks were merged with practices in Britain and then exported back to America, driving homogenisation. As new Eurocurrency markets emerged in other countries, the banking practices pioneered by British and American banks in London began to be transmitted worldwide (Lewis & Davis, 1987: 9, 83). Another notable innovation was the introduction of rollover credits. These new loans 'combined the interest-rate flexibility of British

overdrafts with the legal formality of US medium-length term loans'. Instead of a fixed interest rate for the entire span of the loan, the rate would be fixed for certain intervals of time (3-6 months) and then adjusted in line with the changing market rates on bank deposits. The LIBOR rate was used as the basis for these calculations, reflecting the international predominance of the London market. These innovations were part of a process whereby wholesale bankers pioneered techniques for passing on interest rate risks to borrowers at rollover dates that were directly linked to funding costs (Banking Information Service, 1985: 11; Lewis & Davis, 1987: 87, 111). Floating rate issues, adjustable to interest rate movements, also became much more widespread within the Eurobond market. High inflation and interest rate volatility also led corporate borrowers to change their practices by shifting from fixed interest capital market sources of funds to floating rate bank sources (Llewellyn, 1985: 18).

Nevertheless, high interest rate policies still ran the risk of triggering major financial collapses. Both the Fed and the Bank realised that selective interventions in the market were required to provide support to systemically significant firms in both the financial and industrial sectors. The Fed was able to undertake selective bailouts for systemically significant banks. It did so with the bailout of the First Philadelphia Bank- the largest bailout in U.S. history at the time (Panitch & Gindin, 2012: 170). In Britain, the Bank felt compelled to organise the clearing banks to provide support for significant firms that were struggling to manage within the context of higher interest rates and recession (Coakley & Harris, 1983: 194; Keegan, 1984: 146).

In both Britain and the U.S., high interest rate regimes were also conditioned by, and contingent upon, the regulatory transformations that affected the financial sector. Towards the end of the 1970s, financial institutions had begun an intense lobbying campaign in the City in order to push for the abolition of exchange controls, which had limited the scope for overseas investment during the post-war period. This was essentially a lobbying campaign for the City to be free to export capital to wherever in the world it chose to do so, without politically instituted limitations (Coakley & Harris, 1983: 35-36). When controls were abolished, the impact was hugely significant. Pension funds substantially increased their overseas investment portfolio between 1979-1980, transforming the geographical spread of their investment by moving into the stock markets in Tokyo, Hong Kong, Singapore and Australia (Coakley & Harris, 1983: 37). Holdings of foreign currency deposits also increased dramatically after liberalisation, while the proportion of international business that British banks conducted in sterling doubled between 1979 and 1983 (Banking Information Service, 1985: 15; Artis & Taylor, 1989: 14).

British banks quintupled their overseas earnings between 1980 and 1984, with a large proportion of their increased earnings derived from areas which had been influenced by the abolition of exchange controls, for example portfolio investment income and interest earned on lending abroad in sterling (Banking Information Service, 1985: 33). The abolition of the corset enabled banks to expand and evolve their lending without the funding constraints that previously existed. As a consequence, they moved into the mortgage markets on a massive scale. The mortgage market had previously been a virtual monopoly of the building societies, but between 1980-1982, bank lending to the mortgage market

rose from £50 million per month to over £3500 million per month. During this same period, banks' share of new mortgage lending increased from 6% to 40%, while the share of the building societies from 80% down to 54% (Llewellyn, 1985: 27). It's not hard to detect here the beginning of the intensified mortgage market competition that would eventually filter through to the subprime crisis several decades later.

After the abolition of exchange controls, the transformation of monetary policy became, to a large extent, a *fait accompli*. By removing the protection for domestic banking activity the abolition of controls, 'forced the reform of monetary regulation to take place on a very liberal basis' (Artis & Taylor, 1989: 1). This was particularly the case given the accelerated internationalisation of financial markets during the 1970s, which meant that, 'monetarism's promotion of *laissez-faire* in financial markets became a necessity rather than a policy choice, given the City's growing international role' (Coakley & Harris, 1983: 207). So although a move in this direction might have occurred regardless, 'the abolition of exchange controls provided a ruthless logic for it' (Artis & Taylor, 1989: 1-2). By pressing for liberalisation, then, the City set in motion a process that culminated in a wholesale reorganisation of monetary policy. Monetary policy had to be formulated within the constraints imposed by ever-higher financial integration within the global economy. In this context, the move from quantitative and administered controls on lending, towards a market-based system centred exclusively upon the role of interest rates in shaping the price and demand for money, was enabled.

The tighter integration of national money markets also stimulated a convergence of interest rates, as financial operators were able to easily switch between markets in pursuit

of interest rate arbitrage, thus lower rates would lead to potentially destabilising capital outflows as investors sought higher returns elsewhere (Llewellyn, 1980: 1). With the Bank of England intent on maintaining a strong pound in order to dampen imported inflation, the need to follow suit with the movements of the dollar became even more important (BoFE, 1980: G37/3).<sup>136</sup> So when Volcker pushed up U.S. interest rates, the Bank felt obliged to follow suit. Pursuing an independent interest rate policy became increasingly difficult as the processes of interest rate interactivity that began with the birth of the Euromarkets continued to develop into the neoliberal era. Despite the apparent promise of the floating rates system in allowing a more independent and discretionary monetary policy than had previously been possible under Bretton Woods, the reality was that intensifying financial integration increasingly undermined this possibility.

In the United States, the financial deregulation that had been, 'gestating for more than a decade' came to fruition with the Depository Institutions Deregulation and Monetary Control Act in 1980 (Greider, 1987: 156). The Act was a major political coup for the Fed, with all depository institutions now legally obliged to maintain reserves with the Central Bank (Woolley, 1984: 70). Membership of the Federal Reserve System had been declining and the Fed passed off the legislation as a technical prerequisite for effective control of the money supply. In reality, the Act was really intended to strengthen the Fed's political support base by tying it in with the power of the private banks (Greider, 1987: 155). The unspoken quid pro quo of the Act was that the banks would accommodate the political requirements of their chief regulator, in return for favourable responses to their request for

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<sup>136</sup> Economic Developments Abroad: March 1980', March 4<sup>th</sup> 1980.

mergers, branches and the extension of their powers. The Act also included direct benefits for the banks, by eliminating interest rate ceilings for banks and other financial institutions (Meltzer, 2009: 1013, 1066-1067). This was a key moment in the financialisation of the U.S. economy. With the old Regulation Q checks on lending now gone, credit could flow freely around the economy even if market rates rose. Whereas the old ceilings had served as 'stop-valves' within the financial system, choking off credit when market rates rose above the administered ceilings, now credit simply became more expensive. Higher and more volatile rates associated with the abolition of ceilings fed into the development of a macro-economic climate that increasingly favoured financial activities over investment in industry and manufacturing (Krippner, 2012: 58).

A series of associated legislative measures were passed through Congress in order to deregulate finance and win the support of the sector for the Fed's tight money regime. These measures repealed the New Deal regulatory rules put in place during the 1930s and put the American financial system firmly on the path towards neoliberal deregulation, with the implication that, 'borrowers, businesses and consumers would pay higher interest rates and creditors would enjoy higher returns on their wealth' (Greider, 1987: 156). The Act embodied something symptomatic of broader trends within neoliberal financial regulation: a combination of expanded supervisory authority and control for the Fed *alongside* increased liberalisation for banks and other financial institutions. The Act widened the state's regulatory purchase over the entire banking sector. It was this combination of increased liberalisation alongside and through increased supervision, which allowed the

Fed and the financial sector to effectively steer a course through the Volcker shock (Panitch & Gindin, 2012: 170).

It was this exact same combination, of increased supervisory authority alongside financial liberalisation that occurred in Britain, as Anglo-American developmental interactivity drove a synchronised homogenisation of regulatory conditions.<sup>137</sup> The Banking Act, which was introduced in April 1979, shortly before the liberalisation of exchange controls and other measures, required that all institutions accepting deposits had to receive authorisation from the Bank as either recognised banks or licensed operators. The Bank would then supervise deposit-taking institutions, with their advertisements for deposits, use of banking names and descriptions all regulated. All institutions were also required to pay in to a deposit protection scheme for their clients (Capie, 2010: 635). Liberalisation of finance in the neoliberal era was conducted *alongside* and *through* the increased formalisation of supervisory authority held by Central Banks and other regulatory bodies. In reality, deregulation meant reregulation.

What was the impact of all these changes in trans-Atlantic regulatory regimes and the neoliberal interest rate shocks? The benefits were enormously differential, both in terms of business sectors and in terms of the relationship between capitalists and labour, but they followed a remarkably similar pattern in both Britain and the U.S. The start of the Volcker shock marked the beginning of the most profitable period for American commercial banking since WWII. Despite the wider recession in the American economy, banking

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<sup>137</sup> This is not to make the argument that the regulatory systems in Britain and the U.S. became identical, as they clearly did not and retained a high degree of institutional difference. Yet the tendencies towards simultaneous supervisory extension and centralisation alongside financial liberalisation were remarkably similar.



experienced an increase of 10.3% in its net operating income in 1980, which was followed by another increase of 9% in 1981. Within this context of overall banking profitability, the largest gains went to the biggest banks. While returns on many other business activities fell, bank profits increased by more than 25%. The banks were able to take advantage of wide interest rates spreads when rates began to fall, borrowing cheaply but continuing to lend to customers at very high rates. Volcker's measures were first and foremost good for the largest banks, which happened to be the Fed's key constituency (Greider, 1987: 411-413). But even within the financial sector, there were casualties of the measures. Savings and Loans companies experienced severe difficulties both during and after the Volcker shock with the number of insolvencies in the hundreds (Greider, 1987: 413; Panitch & Gindin, 2012: 173).

Other interests also suffered during the Volcker shock. The strengthening dollar reduced demand for American exports, with grain farmers and the steel industry hit particularly hard, while manufacturers experienced falling export volumes and a reduced share of the domestic markets as foreign imports became cheaper (Greider, 1987: 415-416; Konings, 2011: 138). But the real losers during the Volcker shock were American workers. Given the contradiction at the heart of the Fed's tight money regime, between increasing financial liberalisation on the one hand, and the aspiration towards fuller monetary control on the other, it was not surprising that the most effective anti-inflationary strategy would be to use an induced recession and the threat of unemployment to reduce worker's wage share. Indeed, it is arguable that inflation was not squeezed out of the American economy,

but merely redirected away from wages and consumer prices and into the financial sector and asset prices (Konings, 2011: 137).

Volcker's achievements in reducing inflation owed much to the accompanying stance of Ronald Reagan towards American labour disputes (Axilrod, 2011: 99). Reagan's tough stance against the Air Traffic Controller's trike, where he resisted their wage demands and effectively broke their union, set in place a demonstration affect that contributed to the rapid fall in wage-push inflation (Axilrod, 2011: 99). Volcker's struggle to contain inflation was always about more than technical issues of monetary policy. It was part of a broader neoliberal attempt to shift the balance of class power in the U.S. back towards capital. Breaking the political capacity of the American working class in order to dampen their expectations of increasing wages and rising living standards was a key component of that project (Greider, 1987: 430; Panitch & Gindin, 2012: 171). This was a point that was not lost on Volcker, who always accepted that in reality, inflation depended upon a broader socio-political context, rather than the level of the money supply (Volcker, 1978: 330-331). Between 1979 and 1983 personal incomes from interest earnings grew by over 70%, whereas wage incomes grew by only 33% during the same period (Greider, 1987: 578). The differential benefits of the Volcker shock were clear. Volcker's high interest rate regime accelerated the trend towards financialisation that was already underway during the 1970s as funds were drawn into the U.S. banking system from corporations, savers and foreign investors. With wages falling, workers became more entwined in the relations of consumer-credit dependence that came to define the neoliberal era. Internationally, the strong dollar pulled in capital inflows that helped cover the U.S.'s ballooning public debt during the

Reagan era of massive defence expenditure. In the process it replenished the dollar's role as the dominant international currency and strengthened the international appeal of U.S. financial markets (Konings, 2011: 139-140). The reorganisation of America's domestic class relations was intimately bound up with the maintenance of America's position at the heart of the global political economy.

In Britain the story of the early neoliberal austerity regime runs remarkably parallel. The strong pound exerted a crushing toll on British manufacturing and export-led industries as British goods were priced out of international markets and borrowing costs soared under higher interest rates (Stephens, 1996: 17). The consequences were, in fact, much more severe than in the U.S. and rapidly accelerated the decline of U.K. manufacturing. In a period when measures of French and West German real exchange rates were roughly stable, Britain's rose from 106.3 in 1978 to 137.9 in 1980 and was still at the level of 135.2 by the end of 1981. Britain's effective exchange rate increased by 21.6% between 1979 and 1980 (Buiter et. al., 1981: 330). Britain's economy experienced a fall in output on a scale not witnessed since the 1920s with a decline of more than 5% of GDP between 1980 and 1981, and a doubling of unemployment. Manufacturing output fell by a staggering 20% between 1979 and 1980 (Keegan, 1984: 127, 171, 196-203; Stephens, 1996: 18).

Beset by the same contradiction between increased financial liberalisation and the aspiration towards tighter monetary control, Thatcher's government failed spectacularly in its attempt to hit the prescribed monetary targets. Monetarism was always defined more by its political implications than any semblance of intellectual coherence, a case of the

'uncontrollable in pursuit of the indefinable' as a member of one of Thatcher's early cabinets stated (Buiter et. al., 1981: 367). But the policies were much more effective in weakening labour through the inducement of large scale unemployment and the weakening of traditionally well unionised sectors. The real showdown with the unions would come later on than in the U.S. with the landmark defeat of the bitter miner's strike in 1984.

For the City, the benefits of neoliberal austerity were widespread and Thatcher's free market oriented credit policy was warmly received (Johnson, 1994: 39). The high interest rate regime was beneficial to British banks. The profitability crisis of the 1970s had led to a decreased reliance upon internal funds for corporate financing; this led to a shift away from fixed rate bond issues and towards bank financing. Between 1972-1980, bank borrowing financed over 50% of the corporate sector's gross borrowing requirement. Banks also became more competitive and aggressive during the period, partly in response to the increased entry of foreign banks into the market, while high inflation increased corporations requirements for working capital of which banks were an important source. As the recession continued to bite under Thatcher, businesses were forced into "distress borrowing" in order to stay afloat (Llewellyn, 1985: 22). These factors combined to insure that the demand for credit was actually highly inelastic, with the implication that businesses would continue to borrow despite the increase in interest rates.

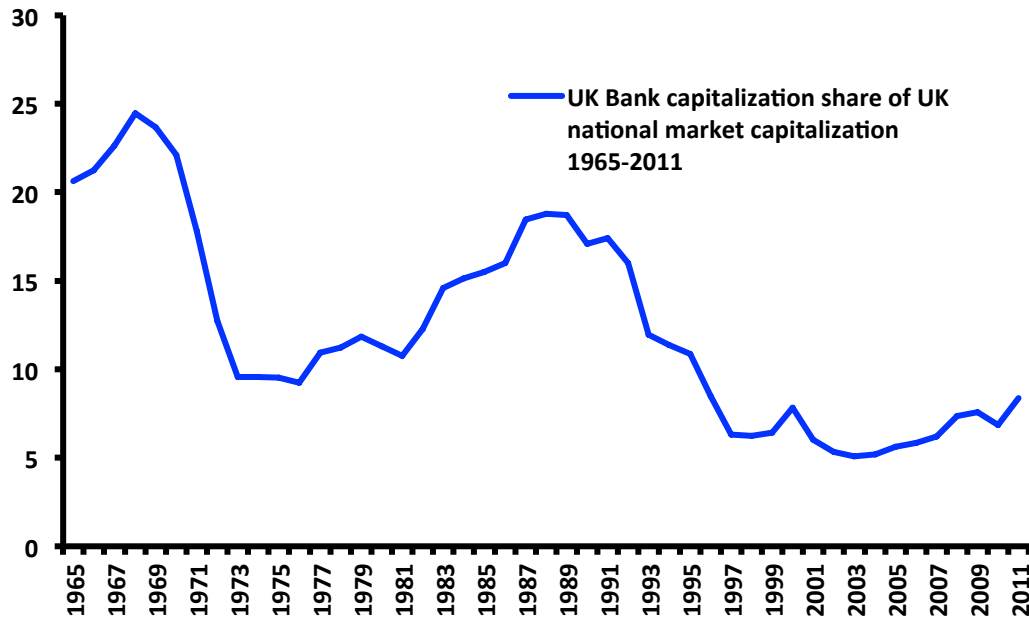
Under the monetarist regime, the British economy at large suffered while the City prospered (Coakley & Harris, 1983: 192). The banks in the City accepted monetarism's avowed attempts to control the money supply, as long as it did not entail direct restrictions their freedom, 'it had to be achieved without direct controls on the banks and with the

government operating as indirectly and unobtrusively as possible in the markets that affect them' (Coakley & Harris, 1983: 200). Viewed from the perspective of the banks, then, the contradiction between monetary control and financial liberalisation makes much more sense. But the policy was not without its dangers to the banks, which might begin to suffer if the recession wiped out too many large-scale industrial customers. All in all however, the City supported monetarism as long as control of the money supply was mainly achieved through fiscal retrenchment and that the government supported a laissez-faire approach to the markets for foreign exchange and credit (Coakley & Harris, 1983: 204). The benefits to banks in Britain are neatly demonstrated below, in figure 3.1:

Figure 3.1

**UK Banks 1965-2011**  
Capitalization as a share of National Market Capitalization

Percentage



Source: Thomson Datastream, Series Codes: Banks UK market value BANKSUK(MV) and Total UK market value TOTMKUK(MV).

As the graph demonstrates, U.K. banks (all banks operating in Britain and not just British-owned banks) witnessed a very large increase in their share of total market capitalization between 1979 and 1989. The first ten years of the Thatcher government were therefore enormously beneficial to banks based in Britain, who saw their share values rapidly appreciating.

Despite the differential impacts of neoliberal austerity within business sectors, this was not a case of banking versus industry. By the end of the 1970s, American industry had by and large come to support the anti-inflationary stance of the Fed and recognised the benefits of a strategy to defeat labour (Panitch & Gindin, 2012: 163). And as we have already seen, S&Ls were major casualties of the Volcker shock. In Britain, Thatcherism was based upon an unstable alliance of interests, with the CBI, the chief representative of British industry, welcoming the promise of lower inflation and reduced taxes for businesses. The possibility that a recession might allow the 'reimposition of managerial authority', was also widely welcomed in the business community and the 'sound money' common sense of monetarism had appealed broadly to British society (Jessop et. al., 1984: 43-45). The real victims of the monetarist austerity regime, then, were the millions of unemployed workers that felt the squeeze on both sides of the Atlantic.

The development of Anglo-American high interest rate regimes and accelerating financial liberalisation also had significant international ramifications. In the U.S., high interest rates drew in foreign capital on a massive scale during the 1980s. These inflows allowed the Reagan administration to finance its deficit while also further contributing to the expansion of credit within the U.S., further fuelling financialisation and driving up financial sector profits. Inadvertently, the Reagan administration had stumbled upon a solution to the fiscal crisis of the late 1960s and 1970s, with foreign inflows into U.S. Treasury bonds and dollar assets enabling the U.S. to avoid the kind of fiscal deflation or increased taxation that would have been required without the vast inflows to cover the deficit (Krippner, 2012: 87-92).

Not only did the interest rate shocks and financial liberalisation transform the U.S. capacity to finance its deficit, it also exerted a crushing impact on developing countries in the Global South. By responding to the difficult economic conditions of the late 1970s by inducing further recessionary conditions, the Thatcher and Reagan administrations dampened global demand and devastated the primary commodity economies of developing countries in Africa and Latin America, as demand for their exports dried up (Greider, 1987: 415; Kiely, 2007: 202). The interest rate shocks and austerity also aggravated the debt crisis in the Global South. These countries had borrowed heavily from the banks in the City and the New York during the 1970s, with the vast OPEC surpluses generated from the oil price shock recycled through the Anglo-American financial systems and lent on to developing countries. Interest payments on this foreign debt rose from \$24.3 billion in 1979 to \$41.8 billion in 1981, with massive increase in the percentage of GDP attributed to servicing the debt (Kiely, 2007: 2002).

### **Anglo-American symbiosis and the termination of the Keynesian compromise**

The tight money regimes imposed in Britain and American brought a stunning end to the post-war Keynesian compromise and signalled the birth of the neoliberal era in the West. The trans-Atlantic synchronicity of these regimes was not, as the story has so often been told, coincidental or merely a consequence of shared ideology. It was rather a consequence of the symbiotic development of Anglo-American financial markets and central banking practices. The shared desire to rein in inflation and achieve price stability was a



consequence of the manner in which Anglo-American government officials sought to provide an anchor to macro-economic objectives in an era of floating exchange rates. Unlike the European members of the ERM, they did this through the adoption of monetarist ideology and technical practices, rather than through the construction of a multilateral fixed rate system. The re-composition of national monetary regimes in Britain and the U.S. emerged from the way in which they sought to organise their monetary politics within the post-Bretton Woods context of floating exchange rates and high inflation.

Restoring price stability was also very much about arresting the destabilising impact of inflation upon investors and financial markets and restoring class discipline over labour by means of austerity. It was no coincidence, then, that the most avowed attempts at monetarist policies were made in the two countries that played host to the foremost financial centres of the global economy. Bankers on both sides of the Atlantic wanted to see a return to stable accumulation conditions and increased returns. Convergence of monetary regimes in Britain and the U.S. was underpinned by the increasing integration of global financial markets, which centred upon the interactivity between London and New York and the transatlantic regulatory feedback loop set in motion with the birth of the Euromarkets. Dynamics of 'coordinated competition' between regulators in London and New York were central to the way in which the offshore conditions of banking, brought about through the original Anglo-American developmental interactivity of the 1950s and 60s, were embedded within national monetary regimes through processes of financial liberalisation and supervisory centralisation. The central contradiction at the heart of the Anglo-American experiments with monetarism, was that between financial liberalisation,

on the one hand, and control of the money supply, on the other. The attempt to control the money supply more tightly were made at the precise point when the further liberalisation of transatlantic financial markets and the continued expansion of the Euromarkets, made monetary control ever harder to achieve without recourse to the kind of quantitative and administered restrictions that were now rejected. Attempts to ration credit by adjusting interest rates to effect demand proved to have a limited effect, given the apparent inelasticity of demand for credit (Krippner, 2012: 83).

By tying themselves into neoliberal austerity policies, Britain and the U.S. demonstrated their commitment to countering inflation and restoring credibility. In the process, they showed that the 1980s would not be characterised by the rising wages and growing militancy of trade unions, or the sustained inflation that had characterised the decade before. They also brought about a new era of increasingly financialised capitalism under which more and more aspects of social life and economic activity would be drawn into the orbit of credit-debtor relations centred upon liberalised financial markets. It was during this period that the epochal conditions were laid for the spectacular crisis that engulfed the global economy in 2008. As the Anglo-American austerity regimes pushed down on workers' wages and weakened the sectors in which the unions had formerly been strong, wages fell and growth became increasingly dependent upon debt-driven consumption fuelled by financial innovation. Thus, the growing Anglo-American household indebtedness that became an increasingly central feature of their economic development can be understood as the, 'inadvertent outcome of the concomitant process of wage stagnation and financial services liberalisation', that were central to the abandonment of

full employment in favour of price stability. The pursuit of non-inflationary growth policies entailed the transformation of labour markets and the development of financial services markets that laid the preconditions for neoliberal development and promoted increased dependence upon personal indebtedness to drive growth (Montgomerie, 2006: 122; Crouch, 2009: 382, 390). Under this new neoliberal model of capitalism, Central Banks and monetary policy were accorded a more prominent role than during the post-war era. The political struggles between the Fed, the Bank and their respective executives during the early neoliberal period were key to the pattern of increased Central Bank independence that came to define the neoliberal era in Britain and the U.S.

One of the major consequences of the elevated role of Central Banks, and the increased independence that went alongside it, was that Anglo-American financial development was central to the restoration of a global economy that was driven by politically unaccountable and insulated central bankers. Neoliberalism was, therefore, very much a case of 'back to the future': the shadowy patterns of Central Bank interaction and cooperation that had defined the global economy during the 1920s were restored after the Keynesian hiatus, demonstrating the cyclical nature of capitalist governance. Processes of Anglo-American development, driven by the interactivity of financiers in London and New York, and the actions of government officials who sought to accommodate their needs, were central to the restoration of global financial power and the increased role of central banking. The puncturing of national systems of financial regulation and control that had begun with the Euromarkets, and had gradually eroded the basis of the Keynesian state in Britain and the U.S., had now come home to roost. Greater financial integration and

coordinated competition spurred a homogenisation of monetary regimes and accelerated the drive towards greater liberalisation.

In both countries the consequences of these developments were severe. As the power of finance increased and wages fell or stagnated, workers became more indebted and dependent upon financial markets. The 'politics of productivity' that had offered so much promise to workers in the post-war period was now shattered by the restoration of capitalist power under neoliberalism. It was not until several decades later that the model instated during the 1980s would fully implode in a spectacular manner during the global financial crisis of 2008.

## **8 Conclusion: The persistence of orthodoxy**

Unearthing the problematique of Anglo-American development has enabled us, in the preceding chapters, to shed light upon aspects of the development of British capitalism that were previously shrouded within the question of decline. By breaking out of the decline paradigm and opening up the question of British development within the wider transatlantic context of Anglo-American development, this thesis has provided a deeper understanding of the breakdown of the post-war Keynesian compromise and the synchronised collapse of the international monetary regime within which that compromise was framed.

The dynamics of Anglo-American development, centred upon the interdependence and integration of finance in the City and New York, the interactivity of sterling and the dollar, and the close linkages between the City-Bank-Treasury nexus and the Federal Reserve-Treasury-Wall Street nexus, have been crucial to these transformations. The analysis provided in this thesis has revealed the role of Anglo-American bankers, both private and central, in destabilising the post-war Keynesian compromise and unleashing the forces of liberalised finance by driving processes of deregulation that undermined the limitations put in place on the freedom of capital movement at Bretton Woods and rendered the maintenance of fixed exchange rates much more difficult.

During the crisis years of the 1970s, when high inflation threatened the accumulation strategies of Anglo-American bankers, they successfully pressed for the

implementation of austerity within the context of Central Banks that prioritised interests of the banking sector above the wider needs of their national political economies.

States did make globalisation, as Helleiner correctly identifies (1994: 3) and the role of Britain and the U.S. was central here. But the centrality of their roles was a consequence precisely of the limits of state autonomy in the context of powerful international financial centres and banking communities that sought to advance their interests through harnessing the power of the state to provide suitable conditions for business to flourish. That meant looking beyond the confines of national sovereignty and developing business strategies that would depend upon transatlantic interaction, the transformation of international regulatory conditions and the further internationalisation of key state institutions.

In the process of these attempts, Anglo-American bankers and state officials set in motion a transatlantic regulatory feedback loop within the broader dynamics of Anglo-American development that corroded the foundations of their national financial systems and weakened the international monetary order instituted at Bretton Woods. That process was highly interactive with the international monetary system and we can only understand the Anglo-American embrace of monetarism and the early neoliberal interest rate shocks as components of the new national monetary regimes that were rendered possible by the transition to floating exchange rates during the 1970s. In the absence of the old disciplines of the Bretton Woods system, however ineffective they proved in practice, Anglo-American banking communities searched for new forms of discipline. The right wing administrations of Thatcher and Reagan were happy to enforce those disciplines and reorder the hierarchies of social forces within their societies.

Only by disaggregating the state and isolating the interactive centres of public and private financial power, can we understand the unfolding politics of globalisation and the pivotal role of Anglo-American development within them. Holding on to the traditional framework of hegemonic cycles of rise and decline, as Helleiner and so much of IPE does, simply doesn't afford us the possibility of examining the dynamic reconstitution of these institutional bases of capitalist power through processes of international development and integration.

Without identifying the importance of this Anglo-American developmental sphere, we risk overstating the degree of national state autonomy in the politics of financial globalisation or stressing too much the singularity of the U.S. in implementing the Bretton Woods agreement and then shaping the politics of financial globalisation and the rise of neoliberalism. The U.S. clearly did play a privileged and unparalleled role in shaping the development of global capitalism, but it did so in conjunction with other major capitalist states. The relationship of uneven interdependence with Britain was crucial in this regard. American ascendancy and its achievement of global financial dominance, expressed in the primacy of American banking and the unrivalled international role of the dollar and U.S. Treasury bonds, was expressed through and conditioned by the subordinate integration of Britain. This integration was brought about by processes of Anglo-American development, which exerted a hugely formative impact upon the post-war development of British capitalism, producing important feedback effects upon the U.S., none more so than the gradual decomposition of the New Deal regulatory framework, which had shaped the development of American finance since the 1930s.

The enormous power and influence of bankers in the City and New York was central to the way that Anglo-American development undermined the Bretton Woods order and drove the dynamics that led towards financial globalisation. As we have seen, the interdependence of bankers on both sides of the Atlantic was at the core of Anglo-American development and was critical to the restoration of the City's role as the world's premier financial centre. As the competitive challenge from London intensified and the integration of transatlantic money markets accelerated, the New Deal regulatory framework in the U.S. came under increasing pressure.

The City's restoration occurred within a context of transatlantic financial integration that meant that the dollar and American banks became the dominant players in the City of London. The social forces that benefited from the City's restoration then drew in American disciplinary power in order to reorient the British state away from the potential radicalisation of social democracy during a key crisis moment in 1976. The success of the U.S. in disciplining Britain, through the dictates of the IMF and supported by the actions of financial markets, was a key moment in the furtherance of international financial liberalisation and the politics of globalisation. The Labour government's public renunciation of Keynesian objectives remains one of the defining moments of both Britain's post-war political history and the politics of globalisation.

At the heart of all of these developments, lay the continued concentration of power within the institutional complex of the City-Bank-Treasury nexus in Britain, and the Fed-Wall Street-Treasury nexus in the U.S. The interactions between these transatlantic concentrations of instituted capitalist power, where public and private finance were co-



articulated, were key to the collapse of Bretton Woods and the unfolding of financial globalisation. These institutional centres also provided a crucial basis for the emergence of monetarism and the launching of the broader neoliberal project during the 1970s and 1980s. As banking power increased after the development of global capital markets and decades of increasing financial liberalisation, Central Banks within both countries became increasingly vital to the management of economic development during the neoliberal era.

By the early 1980s, after the Conservatives had actively championed the creeping monetarism that had gathered momentum during the crisis years of the 1970s, the power of finance and the priority of price stability over full employment were dramatically reinstated. Over in the U.S., the Volcker shock represented a key moment in U.S. political history, ushering in the neoliberal era and recalibrating the balance of social forces within the American political economy. The neoliberal austerity regimes imposed by Thatcher and Reagan, in which such a large emphasis was placed upon the role of monetary policy, have had truly global ramifications in the decades since.

The financial liberalisation that intensified during the 1980s, represented a continuation of the dynamics set in motion with the emergence of the transatlantic regulatory feedback loop after the birth of the Euromarkets. Those processes of competitive deregulation fed directly into the subprime mortgage crisis that engulfed the global political economy in 2008. After being pioneered in the U.S. (Thompson, 2009: 17), mortgage-backed securities were brought into London after the passing of the Services and Building Societies Act in 1986, which enabled U.S. investment banks to establish mortgage-lending

subsidiaries in London. This practice then spread throughout British retail banking and building societies (Wainwright, 2009: 377).

The contours of the contemporary global financial crisis, then, have deep-lying connections to the patterns of Anglo-American development that have been mapped out in this thesis. Those patterns continue to be of substantial relevance to the contemporary global political economy and will likely continued to do so while the predominance of London and New York within the world's capital markets endures.

One of the major lessons to be derived from this thesis is that the enduring priority of austerity within Anglo-American capitalism should come as no surprise. It is the Keynesian heyday of the post-war period, and not the rise of neoliberalism, that is the real anomaly to be explained within the lineage of Anglo-American development and the historical transformation of global capitalism. The major conclusion to be drawn from the experience of the Bretton Woods monetary order and the troubled history of the post-war compromise between capital and labour is that it is incredibly difficult to overcome the forces of economic and political orthodoxy within Anglo-American capitalism.

It took the unfolding of two cataclysmic World Wars within twenty years, the experience of the Great Depression and decades of working class struggle before the old gold standard orthodoxy of balanced budgets and deflationary adjustments imposed on the working classes, was properly challenged. Post-war planners attempted to create the space required, at Bretton Woods, for countries to run deficits and implement expansionary economic policies that would enable full employment and high growth rates. But the Anglo-American banking elite never lost their appetite for the old austerity politics of the gold

standard era. The Keynesian transformation of the British state did not go far enough in reorienting the City towards Britain's national development goals or the politics of full employment. In their desire to maintain the international role of the pound and restore the City's prestige, the City-Bank-Treasury nexus undermined the foundations of a lasting Keynesian transformation and successfully attempted to restore the old orthodoxy of fiscal discipline and price stability. In Britain and the U.S., both of the major political parties came to accept and advocate this policy programme wholeheartedly.

Within thirty years of the implementation of Bretton Woods, the vision of Keynes and White had largely receded from view. The birth of the Euromarkets had punctured wholes within national money markets. The domestic commitment to full employment was cracking under the pressure of increasing worker militancy and stagflation. The IMF had been transformed into an agent that would impose market discipline and austerity upon debtors rather than affording them space to grow their way out of trouble and pursue Keynesian objectives.

In Britain, the country that had produced the founder of the most successful intellectual challenge to the old orthodoxy, John Maynard Keynes, it was the IMF that helped drive the adoption of monetarism and the enactment of austerity. The system of fixed exchange rates and capital controls, designed to provide the domestic breathing space for expansionary fiscal policy and full employment, and to insulate states from the disruptive influence of speculative capital flows, had collapsed under the pressure of liberalising global financial markets that were hosted within the Anglo-American twin engine rooms of financial globalisation: London and New York.

Despite the positive experiences with planning and enlarged Treasury control over national economic management during the wartime years, it did not take long before the Bank and the Fed were able to recover their former institutional privileges in the early post-war period. Once those privileges had been regained, even in the wake of the Bank's nationalisation in Britain, they were able to promote financial expansion and eventual liberalisation in a manner that imperilled their own post-war models of national capitalism and the broader international monetary system. These processes did not always unfold in accordance with a grand strategic plan. It was at many points a product more of the haphazard interaction of private finance and state agencies, as Anglo-American bankers sought to negotiate the crises, constraints and opportunities of the international monetary system.

What is clear from this study is that the Keynesian transformations of Anglo-American capitalism did not go far enough in restraining the freedom of finance and failed to enact adequate institutional transformations to put finance in the service of more egalitarian goals. In this respect the post-war Labour government in Britain was a failure. It left far too much of the existing structure of British capitalism untouched (Anderson, 1992: 164). In the U.S., the more radical elements of New Deal politics ran out of steam too early to effect the kind of changes that were required to put American capitalism upon a progressive trajectory over the longer term (Brinkley, 1996: 4). The incomplete transformation of the post-war state and the unwillingness to confront the power of finance more directly left the way open for the gradual reassertion of the old economic orthodoxies.

By the 1980s the predominance of Central Banks and bankers in shaping the global political economy had been restored. By the 1997, with the Bank of England granted formal independence by the New Labour government, independent Anglo-American Central Banks were once again fundamental to the politics of the international monetary system. With a distribution of national wealth and levels of income inequality reminiscent of the interwar years, one could be mistaken for thinking that the politics of the 1920s had returned under the neoliberal political economy of the 1990s and 2000s.

In the wake of the financial crisis of 2008, the age-old bankers remedy of austerity is once again at the top of the policy agenda. The response to the crisis in Britain and the U.S. has relied upon the adoption of coordinated policies of quantitative easing and loose monetary policy. These policies have boosted asset prices, continued the regressive redistribution of wealth associated with the neoliberal era and shored up the balance sheets of banks. But they have done little to solve the problem of unemployment and low wages.

Just as the neoliberal era was ushered in by the adoption of unorthodox Anglo-American central banking practices, its most severe crisis has been met with a parallel response. Now, unlike the 1980s, the concern is with forestalling deflation and the collapse of asset prices, but the focus upon activist monetary policy in combination with fiscal austerity remains the same. If the failure of the post-war monetary order and the Keynesian state tells us anything, it is that the way to escape the recurrent politics of austerity in the longer term is through firmly challenging the power of private finance and reconstituting the key centres of the state in line with different goals and priorities. That will inevitably involve circumscribing the freedom of finance and democratising the key financial

institutions of the state: the Central Bank and the Treasury. For that to happen, progressive social forces will have to agitate for change in a much more convincing and consistent manner.

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