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'Unwept, unhonoured and unsung': Britain's import surcharge, 1964–1966, and currency crisis management

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This article examines Britain's temporary import surcharge introduced in October 1964, a largely overlooked but significant dimension of the 1964 sterling crisis. Import surcharges (temporary supplementary tariff) were illegal under GATT rules and aroused fury among trading partners. Britain's surcharge is placed in context by consideration of the use of import surcharges by other countries under Bretton Woods as currency crisis management and balance of payments measures, notably Canada's import surcharge of 1962–3 that inspired Britain's. Developed by the Conservative administration from 1963, a 15 per cent surcharge was introduced by the newly elected Wilson government as a radical alternative to deflation or devaluation to help correct the record balance of payments deficit and meet the gathering sterling crisis. As a currency crisis management measure the surcharge worked in Canada but in Britain it made matters worse and was soon supplanted by conventional measures. Deemed a failure and discredited, the surcharge was eventually lifted in November 1966 'unwept, unhonoured and unsung' (*Financial Times*). Nevertheless, while in place the surcharge provided significant temporary assistance to the improvement of Britain's balance of payments.

Keywords: currency crisis, import surcharge, sterling, Wilson administration

JEL classification: N2, N7, F1, F3

I

On the evening of Monday 26 October 1964, Harold Wilson, Britain's new Prime Minister, made a 'TV appeal to bosses and workers', reported the pro-administration *Daily Mirr*or, to explain 'Labour's bold new prescription for treating Britain's ailing economy'.[1] In a ten-minute broadcast on 'the eleventh day of Mr Wilson's 100 days of dynamic activity to get Britain moving again', he warned that the 'profoundly unsatisfactory economic situation', inherited from the Conservatives, meant that the year's balance of payments deficit might hit a record £800 million. Overseas confidence in sterling had been waning since May and in mid September, as the election

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[1] 'Wilson's prescription', *Daily Mirror*, 27 Oct. 1964.

campaign got underway with the balance of payments an issue, the three-month sterling forward rate fell below its Bretton Woods lower band of $2.78 and a sterling crisis began to simmer (Oliver 2012, p. 315). The response of previous British post-war administrations to runs on sterling had been deflationary measures and overseas borrowings, but Wilson 'decisively rejected "any policy based on a return to stop-go economics"'. Although he made no mention of it in the broadcast, the administration's leaders had also rejected devaluation of the pound to address the balance of payments problem. Instead, Wilson's 'crash plan to beat the trade crisis' was a 15 per cent temporary import surcharge.

Much attention has been paid by contemporaries and historians to the reasons for Labour's October 1964 'non-decision' on devaluation and the consequences (Bale 1999; Brandon 1966; Hirsch 1965; Middleton 2002; Newton 2009; Oliver 2011; Tomlinson 2004). By contrast, the novel import surcharge mostly receives only passing references, though there are colourful passages in the memoirs of James Callaghan, Chancellor of the Exchequer, and Douglas Jay, President of the Board of Trade (Callaghan 1987; Jay 1980). Wilson devotes some sentences to the surcharge, but it is absent from the recollections of George Brown, First Secretary of State and head of the new Department of Economic Affairs (DEA), and the diary of Patrick Gordon Walker, Foreign Secretary (Brown 1971; Pearce 1991; Wilson 1971). Treasury mandarins Donald MacDougall and Leo Pliatzky simply note its introduction, likewise Treasury Press Officer Peter Browning (Browning 1986; MacDougall 1987; Pliatsky 1982). The notable exception is Alec Cairncross, Treasury economist 1961–9, who provides illuminating, though fragmented, mentions in his books *Sterling in Decline* (1983) and *Managing the British Economy in the 1960s* (1996). The surcharge also features several times in his diary, published as *The Wilson Years* (1997). Treasury interest in the surcharge as a policy measure led to an uncompleted departmental account, a 'first draft (an assembly might be a better description)', in early 1965; an addition to the internal Treasury Historical Memorandum series was intended but never happened.[2]

It is less than surprising that Labour's import surcharge has been largely overlooked since within weeks it was overtaken by conventional crisis management measures and it was deemed a failure. In fact, it was in place for 25 months and not without balance of payments effect. Two years earlier Canada had introduced an import surcharge to counter devaluation pressure on the Canadian dollar with notable success, which did not pass unnoticed in Whitehall or by Conservative ministers. The measures are of interest as a strand of Britain's struggle with sterling and as episodes in currency crisis management.

Currency crises are principally features of fixed exchange rate systems and countries with pegged currencies. There is an extensive economic literature on currency crises, which have been defined as: 'a speculative attack on the foreign exchange value of a currency that either results in a sharp depreciation or forces the authorities to defend

[2] The National Archives [henceforth TNA]. T312/1816. Miss Baggs to Hypher, 5 Apr. 1965.

the currency by selling foreign exchange reserves or raising domestic interest rates' (Glick and Hutchinson 2011). Currency crises are commonly associated with a balance of payments problem that leads to the depletion of the foreign reserves that can be used to defend the exchange rate. A balance of payments problem can turn into a currency crisis when it comes to be believed that a government is no longer able or willing to defend its fixed parity. Governments can implement a variety of defensive financial measures to forestall or confront a currency crisis, usually comprising some combination of international borrowing, spending cuts, tax rises, credit squeeze and interest rate rise. They can also impose 'physical measures' – import controls and export subsidies – that affect the trade balance.

Bordo *et al.* identified 40 currency crises among their 21-country financial crisis data set in the Bretton Woods era 1946–71 (Bordo *et al.* 2001, web appendix). After an initial bout of exchange rate changes in the late 1940s, politicians in developed countries with external payments deficits eschewed devaluation fearing punishment by voters (Solomon 1977, p. 70). Deflation also had a political price since it led to higher unemployment. But import restrictions had the attraction of offloading adjustment onto foreigners (Bergsten 1972). In fact, the Bretton Woods system's effective discouragement of exchange rate adjustment inadvertently encouraged governments to adopt import restrictions in response to balance of payments deficits (Irwin 2011, p. 32). Between 1954 and 1971, seven advanced economies imposed a temporary import surcharge. The most prominent and provocative was Nixon's import surcharge that formed a key component of his New Economic Policy unveiled on 15 August 1971, along with the suspension of the convertibility of the dollar into gold and a wages and prices freeze (Gowa 1983; Irwin 2012a; Matusow 1998; Roberts 2011)). The other major episodes affecting significant international currencies were the Canadian and British surcharges imposed, respectively, in 1962 and 1964, which are the focus of this article. It examines why and how Britain introduced an import surcharge and its contribution to the management of the 1964 currency crisis. What impact did it have? Why did Canada's import surcharge succeed while Britain's was regarded as a failure?

II

After the war policymakers sought to promote international trade and prosperity through the re-establishment of stable exchange rates and the liberalisation of international trade arrangements. The Bretton Woods system of fixed (but supposedly adjustable) exchange rates aimed to provide international monetary stability. The International Monetary Fund was established in 1946 to monitor the functioning of the system and assist countries with balance of payments deficits while they undertook domestic economic adjustments, or made an orderly shift to a new exchange rate. The General Agreement on Trade and Tariffs, drafted in 1947, was the trade counterpart to the IMF. 'For the first time in history', declared the GATT Secretariat, 'countries have accepted a code of practical rules for fair trading in international commerce and have co-operated in lowering trade barriers. This co-operation has been on a global, not a regional basis' (GATT Secretariat 1962, p. 1). GATT membership doubled from the founding 23 signatories to 44 members in the early 1960s, while a series of rounds of negotiations effected multilateral reductions to tariffs and barriers to trade; by 1962 GATT signatories accounted for four-fifths of world trade (Davis and Wilf 2011, p. 20).

Import controls can take the form of either quantitative restrictions (quotas) or a tariff. Article XII of the GATT code allowed countries with extreme balance of payments difficulties to impose import quotas for a limited period (Jackson 1969, pp. 673–87). The trade restriction was allowed as a temporary measure with a '"time-buying" function' similar operationally to, and perhaps accompanied by, an IMF loan to allow domestic fiscal or monetary measures to take effect. Consultation with other GATT signatories was required prior to the introduction of quotas, of which there were many instances. A tariff is a tax on imports that raises their price and is paid to the government of the importing country. An import surcharge is a *temporary additional* tax on imports supplementary to current tariffs. An import surcharge has an economic effect equivalent to an immediate devaluation – making imports more costly – constituting a powerful balance of payments instrument (Rickards 2011, p. 87). GATT rules banned increases in existing tariffs, and thus the import surcharge.

Aggressive trade measures, both quotas and tariffs, abounded in the 1930s. The temporary import surcharge appears to have made its debut in Hungary in 1934 where a 20–40 per cent surcharge was adopted to help manage the pengo.[3] Post-war, France maintained a 'special temporary compensation tax on imports' from 1954 to 1958.[4] The French measure was condemned in the GATT and OEEC.[5] Britain was 'dismayed at French disregard for the GATT rules…there was a clear breach…and we said so'; the criticism was not forgotten in Paris.[6] Import surcharges were also imposed by Denmark (1955–6 and 1971–2), Spain (1958–9 and 1967–71), Sweden (1959–60), Canada (1962–3), Britain (1964–6) and the United States (1971) (Bergsten 1977, p. 2). Germany placed a surcharge on *exports* and cut import tax in 1968 (Solomon 1977, p. 158). An application for a waiver of GATT rules to legitimate a surcharge imposed by a developed country was not favourably received and none was given, delinquents being 'formally urged' to remove the surcharge as early as possible.[7] Eight developing countries introduced an import surcharge up to 1971, mostly from Latin America. They were more kindly regarded by GATT, their applications for waivers being mostly granted.

3 'Hungary's exchange problem,' *Economist*, 22 Dec. 1934.

4 GATT documents, www.wto.org/english/docs_e/gattdocs_htm. [henceforth GATT] L/302. French compensation tax, 6 Jan. 1955; L/671. French special tax, 9 Sep.1957.

5 TNA. T312/1059. French import restrictions, 18 Nov. 1964.

6 TNA. T312/1059. Use of surcharges by other countries, 2 Dec. 1964.

7 GATT. COM.TD/F/W/3. Note by Secretariat, 25 May 1965.

III

'An unsavoury whiff from the nineteen-thirties drifted across the Atlantic on Sunday', observed the *Economist* on 30 June 1962 reporting Canada's introduction of an import surcharge. 'Could this, one is bound to ask, be the first play in an awful new round of beggar-my-neighbour?'[8] The Canadian dollar crisis of summer 1962 began with Canada's re-adoption of a fixed parity, having floated since 1950, on 2 May 1962 (Helleiner 2006; Johnson 1970; Plumptre 1977; Saywell 1963). The move was immediately followed by an election campaign with the poll on 18 June. Uncertainty about the post-election government's resolve to defend the new parity led to large-scale selling of the Canadian dollar during the campaign and after. 'The rate of loss became severe in mid-June', noted a GATT report. 'If no measures had been taken in late June it was clear that the reserves would have been completely exhausted in a couple of weeks.'[9] The outcome of the election was that John Diefenbaker continued as Prime Minister, but as head of a minority administration and the currency crisis intensified.

During the election campaign Louis Rasminsky, Governor of the Bank of Canada, put together a package of 'special measures' to support the exchange rate and avoid devaluation to be available to the post-election administration. 'Policy must be to err at first on being over-tough and then relax', he told Diefenbaker. 'Opposite approach fatal' (Muirhead 1999, p. 230). Each point of the package had to be a targeted precise commitment, otherwise it 'may be received with scepticism and fail to create the confidence which all have agreed is necessary if this program is to succeed'. The resulting package featured 'strong internal measures' to correct the adverse balance of payments complemented by large-scale short-term international support for the Canadian currency: (1) government spending cuts that halved the budget deficit, reducing aggregate demand and boosting market confidence; (2) a big interest rate rise from 4 per cent to 6 per cent, increasing the reward for holding the Canadian dollar; (3) 'sharp' reductions in duty-free allowances for Canadian tourists, in effect curbing imports; and (4) international credits from the IMF, the US and Bank of England totalling $1bn, doubling Canada's reserves.[10] These were familiar currency crisis measures, though their stringency and the articulation of the package were noteworthy. The novel element of Rasminsky's package was its fifth dimension – a temporary import surcharge that affected half of Canada's imports. The measure was designed to improve both the balance of payments deficit and the budget deficit. Diefenbaker announced the emergency measures to the nation on television on the evening of Sunday 24 June, ahead of the opening of the markets the following day when the run on the Canadian dollar was expected to accelerate.

[8] 'Canada's warning', *Economist*, 30 Jun. 1962.

[9] GATT. L/1916. Canadian import surcharges, 15 Nov. 1962.

[10] 'Emergency measures', *Economist*, 30 Jun. 1962; 'Dollar's defense – study in cooperation', *American Banker*, Nov. 1963.

Currency traders were awed by the administration's resolve and selling pressure vanished.[11] 'The emergency measures succeeded in restoring confidence and put an end to speculation', reported GATT's Group on Canadian Import Surcharges.[12] Canada's foreign exchange reserves reached Can$2bn in October and the rediscount rate was back at 4 per cent in November. With the crisis over, the international credits were promptly repaid or cancelled. The import surcharge lasted nine months, with relaxations from August and removal in March 1963.[13] The parity was maintained for the rest of the decade. The Canadian authorities were well aware that the import surcharge contravened GATT rules as well as the requirement for prior consultation. Nevertheless, trading partners were kept in the dark because of fears of a leak and the GATT Secretariat was informed the day *after* Diefenbaker's broadcast. Canadian spokesmen proclaimed the government's willingness for dialogue with trading partners and explained its preference for surcharges over quotas because: they could be quickly imposed; surcharges had 'less restrictive effects' on international trade; and Canada lacked the 'necessary machinery' for quotas.[14]

The Canadian surcharge aroused 'strong resentment' in the US and many other countries, reported a British Treasury official.[15] There was a chorus of complaint at the GATT Council meeting in Geneva on 12 July 1962.[16] Canada's finance minister stressed the 'very serious nature of the balance-of-payments crisis Canada had gone through' and stated that his government was 'somewhat disappointed at the lack of understanding that it had met in the Council'.[17] There was more criticism at Working Party 3, the OECD's Paris-based technical committee, and from the EEC.[18] George Ball, US Under Secretary of State, told Treasury Secretary Douglas Dillon that the Canadian surcharge was 'unworthy of an economically advanced country'.[19] But by the time GATT held hearings in the autumn, relaxation of the surcharge had begun and the government, commented Canadian political scientist Peyton Lyon, 'got off lightly' (Lyon 1968, p. 345).

IV

Britain experienced some dozen sterling crises of varying magnitude between 1947 and 1972 when the pound floated, with devaluations in 1949 and 1967 (Hirsch 1965, pp. 47–9; Kunz 1995, pp. 123–34). Canada's import surcharge was followed

11 'Dangerous period for Canada's economy', *Financial Times* [henceforth *FT*], 25 Jul. 1962.
12 GATT. L/1916. Canadian import surcharges, 15 Nov. 1962.
13 GATT. L/1977. Statement by Minister of Finance, 19 Feb. 1963; 'Canada cuts surcharges on imports', *FT*, 21 Feb. 1963.
14 GATT. L/1805. Canadian temporary import surcharge, 28 Jun. 1962.
15 TNA. T312/650. Canadian surcharges, 22 Feb. 1963.
16 TNA. T312/1059. Canadian import surcharges, 2 Dec. 1964.
17 GATT. L/1916. Canadian import surcharges, 15 Nov. 1962.
18 TNA. T312/1048. Canadian import surcharges, 4 May 1964.
19 Ball to Dillon, 17 Jul. 1962. *Foreign Relations of the United States* [henceforth *FRUS*] 1961-3, vol. XIII.

with interest by British Treasury officials. In February 1963 Douglas Allen, Third Secretary, requested a note on how

> in any future balance of payments crisis, we might consider using the same sort of surcharges as were imposed by the Canadians last June. They would obviously avoid a lot of the administrative and other difficulties that would confront us if we went for quantitative restrictions and they would be quick acting…it would be useful if we could have a note setting out precisely what the Canadian surcharges were, what the resulting GATT troubles amounted to (presumably the IMF did not object), and any lessons that might be of benefit to us in future.[20]

The resulting note observed guardedly that:

> Despite much sympathy for Canada's plight the surcharges were strongly criticised, especially in the US, and condemned in the GATT. This experience suggests that an attempt by us to follow the Canadian example…would cause a major disturbance in the GATT and elsewhere…The administrative problems are less, and they act with greater speed than import controls. But these are small advantages to set against the mainly international repercussions, including the effects on confidence.[21]

But the Prime Minister was captivated. 'I prefer this method', Macmillan told Chancellor Reginald Maudling, 'to an elaborate system of import controls and licensing.'[22] 'Import surcharges, on the Canadian model, was the least harmful of the available devices', concluded the Treasury. 'The Canadian experience showed that even GATT disapproval was not inconsistent with the willingness of other countries to furnish aid [short-term credits].'[23] The Board of Trade was asked to produce an import surcharge scheme and update its existing scheme for import quotas. While the paper was being prepared, Maudling delivered his expansionary April 1963 budget, setting a course that might possibly put sterling under pressure in future (Brittan 1969, pp. 177–9). In June he informed officials that he 'wanted the Government to be in a position to deal swiftly with balance of payments difficulties without having at the same time to cut back on economic expansion'.[24] Hence he was keen for the two outline schemes to be completed, himself believing that the surcharge method 'seemed more promising'. But the Board of Trade took 'strongly against' a surcharge because of its flagrant illegality.[25]

By early 1964 it was plain that the Maudling 'dash for growth' was well underway (Baston 2004, p. 227; Cairncross 1996, pp. 80–7). The boom was sucking in imports and in mid March the Treasury secretly estimated that an 'alarmingly large' balance of payments deficit of £400 million was in prospect for 1964.[26] This gave urgency and relevance to import controls as a currency crisis management instrument and a balance

[20] TNA. T312/650. Canadian surcharges, 20 Feb. 1963.
[21] TNA. T312/650. Balance of payments measures, 22 Feb. 1963.
[22] TNA. T312/650. Import control, 4 Mar. 1963.
[23] TNA. T312/650. Emergency measures, 13 and 14 Mar. 1963.
[24] TNA. T312/651. Tariff surcharges and import controls, 24 Jun. 1963.
[25] TNA. T312/651. Import surcharges and import controls, 21 Jun. 1963.
[26] TNA. T312/1047. Balance of payments prospects, 11 Mar. 1964.

of payments improvement measure, given that overt deflation was politically impossible with an election pending. Treasury officials favoured following Canada, partly because of quantitative restrictions' operational time lag, but also because a surcharge was more appropriate to a fully employed economy being 'more deflationary and less inflationary than quantitative restrictions'.[27] In April the Permanent Secretary, Sir William Armstrong, instructed the preparation of a Treasury plan for import surcharges in addition to an updated Board of Trade quota scheme, with both schemes aiming to save £200–250 million a year of imports.

Maudling told Armstrong to have both schemes ready by mid October, ahead of the forthcoming general election. The position was reviewed by a group of permanent secretaries assembled by Armstrong on Wednesday 7 October.[28] By then the campaign was in full swing, with polling on Thursday 15 October and a sterling crisis on the cards. As regards policy responses, deflation was ruled out by 'the current commitment of almost all opinion to a higher rate of growth and the elimination of the necessity for stop-go policies'. So was devaluation, which would be 'more a confession of failure than an instrument of policy'. Thus the focus was on import restrictions. 'The more the Board had studied the problem', stated the Board of Trade mandarin, 'the more they had been forced, reluctantly, back on the quantitative restrictions as the least objectionable scheme.' However, the weight of opinion in the discussion was that a surcharge was 'generally preferable, if the difficulty of our international obligations could be circumvented'. But the danger of a leak during consultations was deemed 'unacceptable'. 'It thus appeared', Armstrong summed-up inconclusively, 'that, in view of our international obligations, levies [surcharges] could not be preferred to quantitative restrictions without some international bargain; and the practical difficulties of the latter were obviously very great.' Following the meeting a three-page 'General briefing – import controls' was written for the new Chancellor – Conservative or Labour.[29]

V

Within hours of taking office, Wilson, Brown and Callaghan, Labour's economic triumvirate, decided against devaluation (Callaghan 1987, p. 187; Oliver 2011, p. 586). Then they met with officials to discuss Britain's daunting now £800 million prospective balance of payments deficit, the scale of which was as yet unknown by the markets. Armstrong explained that so far the deficit had been financed by borrowing, but officials had also been working on ways of reducing the trade imbalance by physical restrictions on imports. They had gone as far as they could without ministerial decisions. Should there be import controls at all? If so, which scheme? Wilson responded that ministers needed to think matters over adding that 'the

[27] TNA. T312/1047. Quantitative restrictions and import surcharges, 6 Apr. 1964.
[28] TNA. T312/1053. Import restrictions, 7 Oct. 1964.
[29] TNA. T312/1053. General briefing – import controls, 13 Oct. 1964.

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Government would need to make one or two dramatic gestures which would emphasise their determination to tackle the balance of payments situation'.[30]

Wilson, Brown and Callaghan were determined not only not to devalue but also to use alternatives to deflation to manage the currency and reform the economy, being desperate to break out of stop-go (as was Maudling). They intended economic regeneration through a 'third way' – the DEA, a National Plan, tax changes and an incomes policy – but the programme would take time. Immediately there was the gaping balance of payments deficit and an incipient currency crisis to be addressed; temporary import controls offered the answer, allowing them to avoid expenditure cuts or a hike in Bank Rate. The alternative short-term expedient was further international borrowing to tide the country over, but they were also against this since it would doubtless have deflationary conditions attached. A surcharge was preferred by both ministers and officials for the same reasons as in Canada: it would involve less bureaucracy; it would be quicker acting, less arbitrary and discriminatory; and it would generate revenue. Callaghan in his November 1964 budget estimated tax revenues from the surcharge of £200m a year (Tew 1979, p. 344).[31] But Douglas Jay, President of the Board of Trade, pressed strongly for quotas because 'the surcharge was illegal under both GATT and EFTA; whereas quota limitation was explicitly legal…They all made light of the illegality of the surcharge, to an extent which I found astonishing' (Jay 1980, pp. 298–9). The decision was made by Brown and confirmed by the Cabinet (MacDougall 1987, pp. 153–4).

The surcharge had a single 15 per cent rate. It was entirely non-discriminatory, applying fully to European Free Trade Area (EFTA) countries, the Common wealth and Ireland irrespective of preferential arrangements.[32] It covered manufactured goods and most semi-manufactures, but foodstuffs, tobacco and raw materials were exempted. The exemptions significantly mitigated the impact on the Commonwealth and EFTA because of differing compositions of British imports, being levied on 57 per cent of imports from the European Economic Community (EEC) and 48 per cent from the US, but only 36 per cent from EFTA and 9 per cent from the Commonwealth (Ray 1967, p. 65). Prior consultation with other countries was deemed 'impossible', but as a matter of courtesy ministers sent messages to opposite numbers in the US, the Commonwealth and EFTA. The EEC was notified on Sunday 25 October and GATT on Tuesday 27th' when Article XII was invoked (even though it applied to quotas not surcharges).[33]

'The Economic Situation. A Statement by Her Majesty's Government' was launched by Brown and Callaghan at a morning press conference on Monday 26 October. 'The immediate short term problem which we discovered', Brown began, 'is that we are faced here and now with a deficit…of the order of £700

[30] TNA. CAB130/202. Cabinet economic affairs. First meeting, 17 Oct. 1964.
[31] Parliamentary debates (Commons) 701, 11 Nov. 1964, 1028.
[32] TNA. T312/1054. Temporary import charges, 23 Oct. 1964.
[33] TNA. T312/1059. GATT: Charges on imports into the UK. Telegram, 27 Oct. 1964.

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million or £800 million.'[34] The statement's centrepiece – Wilson's 'dramatic gesture' – was the 15 per cent import surcharge. Commentators were unimpressed by the lack of detail and sceptical as to whether the measures were adequate to meet the underlying balance of payments problem. 'Yesterday's White Paper contains no detailed plan or comprehensive programme', observed a not unsympathetic leader in the *FT*. 'Deflation is ruled out for Labour, as it was for the Conservatives... Devaluation, though not mentioned, has plainly been ruled out equally firmly. The alternative is to operate directly on the trade balance with import restrictions and export incentives...Mr Maudling, if he were still in office, might well be taking precisely the same steps as his successors.'[35] Cairncross thought likewise, writing in his diary 'I don't doubt that Reggie would have done much the same, but a little later, and with more preparation of key foreigners' (7 November; 1997, p. 14).

As a currency crisis management package, the measures fell a long way short of Rasminsky's programme, to say the least. That had comprised a set of stringent and credible conventional corrective measures capped by an import surcharge. Labour's 'bold new prescription' relied entirely on the surcharge to restore confidence in sterling. The three-month sterling forward rate leapt immediately after the statement, but then fell day after day with sterling weakness becoming a sterling crisis.

VI

Confidence in sterling was battered by the storm of protest the surcharge provoked abroad. Ministers' bruising encounters began with Jay's briefing of 'stiff and frosty' EFTA ambassadors. 'Naturally, they concentrated in protest against the illegality, to which we had no real answer', he recalled, 'so that we were forced back on emphasising the £800 million deficit left us by the previous Government, which (as was foreseen) was not helpful to the exchange value of the pound' (Jay 1980, p. 301). 'There has been no meeting so unpleasant or so openly beastly in tone', reported the *Economist* of the EFTA Council meeting in Strasbourg on 29 October, recounting 'face to face encounters of the sort of towering rage that starts as a slow flush at the base of the neck and climbs flaming to the scalp, the kind of anger that reduced [the meeting] quite literally to uproar'.[36] Simultaneously, the European Commission called for the surcharge to be 'rapidly withdrawn'.[37] GATT members gave Britain a 'furious hammering' and Britain found itself 'in the dock' before the OECD's Economic Policy Committee in Paris on 5 November.[38] At a Western

34 TNA. T312/1054. Notes of a press conference, 26 Oct. 1964.
35 'Justifiable – but only for a short time', *FT*, 27 Oct. 1964.
36 'Foreign backlash', *Economist*, 7 Nov. 1964.
37 'Britain under fire by EFTA and the six', *The Times*, 30 Oct. 1964.
38 'Envoys called in', *Daily Express*, 31 Oct. 1964; 'Britain in the dock over import surcharge', *The Times*, 5 Nov. 1964.

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European Union meeting in Bonn, Jay was the recipient of 'an onslaught' against the surcharge.[39] For good measure there was even a protest from UNESCO. 'The big squabble is on the import surcharge', Cairncross wrote on 7 November:

> It looks to me as if the Government had no real idea of the consequences of this and regarded it as a heaven-sent way out of an awkward dilemma. In fact as we've always said, it is an alternative to borrowing and the Party are so much set *against* borrowing that they don't even stop to argue the matter. But they ought to have known what a furore it would cause abroad. (1997, p. 14)

The anger called into question the willingness of some countries, notably France, to support British emergency drawings from the IMF or central bank credits.

VII

Callaghan was scheduled to present an emergency budget on Wednesday 11 November. This presented the prospect of the introduction of additional measures to address the balance of payments deficit and buttress sterling. The weekend before Lord Cromer, Governor of the Bank of England, attended the monthly meeting of G10 central bank governors at the Bank for International Settlements in Basle. He reported to Armstrong by telegram that there were 'high expectations' of 'immediate and extensive contribution to solution of Balance of Payments problem to be expected from Wednesday's measures…I fear otherwise that disillusionment could have serious impact on exchanges.'[40] Charles Coombs, head of foreign exchange at the Federal Reserve Bank of New York (FRBNY) and a key figure in the international financial markets, who was also at the Basle meeting, reported that the central bank governors 'concurred in the view that the programme so far announced had left an impression of weakness and reluctance to come to grips with the problem and that this would inevitably lead to the emergence of speculation …[with] a potentially explosive situation in the gold and foreign exchange markets'.[41] Colleagues urged Cromer to raise Bank Rate; he needed no persuading, but the government called the shots.

In the event, the budget featured both tax rises and higher welfare spending in fulfilment of election pledges, being on balance mildly deflationary. Nevertheless: 'Abroad', stated the *FT,* the budget 'was thought irrelevant to the balance of payments, to give evidence of thoroughgoing socialism and to be directed "against" the City.'[42] Although disappointed, the market's verdict was suspended ahead of Thursday 19 November, which was the normal day for an alteration in Bank Rate. On 13 November, Cromer wrote to Callaghan advocating a 'modest' 1 per cent

[39] 'Mr Gordon Walker convinces Bonn of British sincerity', *The Times*, 18 Nov. 1964.
[40] Bank of England Archive [henceforth BoEA]. OV44/123. Sterling crisis, 8 Nov. 1964.
[41] Coombs, Notes on November 1964 BIS meeting. Quoted in Toniolo 2005, pp. 390-1.
[42] 'Seventeen days of sterling crisis', *FT*, 28 Nov. 1964.

increase in Bank Rate to abate the 'profound anxiety' overseas about the British government's commitment to an effective defence of sterling's parity.[43] The Governor and Chancellor met on Tuesday 17 November. Callaghan told Cromer that 'deliberate steps to make money dearer would be contrary to the policies on which the Government had fought the Election' – there would be no increase in Bank Rate.[44]

Thursday 19 November, the day of the non-Bank Rate increase, also saw a climactic showdown over the import surcharge at a meeting of EFTA ministers in Geneva. Jay and Gordon Walker encountered 'severe criticism', noted the Treasury, 'the breakdown of the Association was only narrowly avoided'.[45] EFTA ministers threatened legal action as well as country-by-country retaliation against British trade. With the acrimonious session spinning into the night, Gordon Walker, telephoned Wilson and reported 'heavy pressure…feeling was terrific and unless some satisfaction could be given there would be a serious situation. There was a demand for a precise date on which the surcharges would be abolished, but he and the President [Jay] could probably get off the hook if they could say in the Communiqué that "a reduction was to be expected in a matter of months rather than years".'[46] Wilson recounted the 'emergency, almost panic', call from the Foreign Secretary. 'He needed my clearance for a firm assurance that the 15 per cent import surcharge would be reduced in a matter of months…I gave him the assurance and at 4 am the conference reached an uneasy agreement' (Wilson 1971, p. 35).

The confrontation and climb-down was immediately leaked to the press. 'The Government's handling of its import surcharge has almost passed belief', lamented *The Times*:

From the outset the foreign reaction to its imposition was seriously underestimated. What happened at the EFTA meeting in Geneva during the early hours of yesterday morning may at last have brought home to Ministers what the protests, which have rumbled round Europe for three weeks and have grown rather than diminished, were all about. In order to impose the surcharge Britain had to break faith with international obligations. Yet, incredible as it still seems, Whitehall made no serious attempt to smooth the path beforehand. Only now is it possible to see the true cost of this neglect.[47]

Friday 20 November, with reports circulating of the EFTA disarray, saw a headlong flight from sterling with huge reserve losses. Cromer told Callaghan that 'the situation of sterling is deteriorating disturbingly quickly…the facts speak for themselves that the Budget has not created the degree of confidence necessary to sustain sterling…the unilateral devaluation of sterling, even by force majeure, could easily precipitate a world financial crisis for which this country would be held responsible.'[48] To avert

[43] BoEA. OV44/123. Sterling crisis, 13 Nov. 1964.
[44] BoEA. OV44/123. Sterling crisis, 17 Nov. 1964.
[45] TNA. T312/1816, p. 29.
[46] TNA. PREM 13/1240. EFTA. Note for record, 20 Nov. 1964.
[47] 'Mishandled', *The Times*, 21 Nov 1964.
[48] BoEA. OV44/123. Sterling crisis, 20 Nov. 1964.

this he urged an immediate 2 per cent increase in Bank Rate. On Monday 23rd Callaghan informed parliament that Bank Rate was being raised from 5 per cent to 7 per cent 'to place beyond any doubt the Government's determination to maintain sterling at its present parity'.[49] 'Perversely enough', recounted Coombs:

> the market reaction to such a forceful use of monetary policy by the Labour Government quickly degenerated into fears that the threat to sterling must have reached a truly crisis stage. The market seized on rumors that the $1 billion of short-term central bank credits at the disposal of the Bank of England had now been exhausted…this situation assumed increasingly grave significance on the London afternoon – and the New York morning – of November 24 when a virtual avalanche of selling developed. (Coombs 1965, p. 44)

Asked that evening by the Chancellor why the heavy losses, the Governor said that they were 'in a state of extreme crisis…it stemmed from a basic lack of confidence overseas in the policies of the Government…a feeling that the measures which had been taken were not in themselves enough…that the longer term measures the Government had proposed seemed blurred and insufficiently concretised.'[50] Armstrong said that 'the Government had rejected both devaluation and deflation. Looking back, he still believed that a middle course between the two could have been found. But great finesse would have been needed; in particular the need not to lose confidence at any point. In retrospect, the fact that the import surcharge had involved breaking treaties had been unfortunate.' Callaghan asked Cromer for his views on devaluation. The Governor replied that it was 'so desperately serious a measure that no Government could contemplate it as a calculated act. If it were resorted to now in preference to restraint at home it would be regarded as an act of extreme irresponsibility.' He warned apocalyptically of the possible results: the devaluation of the dollar, American isolationism, a global recession and rampant protectionism – 'he had memories of the 1930s and did not wish those conditions to be repeated'.

At 10.30 that night the Prime Minister met with the Chancellor and the Governor at 10 Downing Street. Cromer reported that the selling of sterling had started in France, but there were no signs of deliberate sabotage anywhere.[51] The US had offered to buy sterling the next day, as had Canada as part of a coordinated central bank operation with European countries to provide funds to 'put in the shop window'. Commenting on the possibility that there might be difficulty in getting some European central banks to participate, Wilson warned that:

> if central banks and governments were going to impose a situation in which a democratically elected government was unable to carry out its election programme then he would have no alternative but to go to the country. He would expect to win overwhelmingly on that xenophobic issue and would then be free to do anything he liked – devaluation included…if his party came back into office with a mandate to do all that was necessary, something on the

[49] BoEA. OV44/123. Sterling crisis, 23 Nov. 1964.
[50] BoEA. OV44/123. Sterling crisis. Meeting at Treasury, 24 Nov. 1964.
[51] BoEA. OV44/123. Sterling crisis. Meeting at 10 Downing Street, 24 Nov. 1964.

lines of a siege economy might have to be adopted. For example, all imports of French wine might be stopped…

Cromer replied that France could retaliate by restricting imports of British cars. The real issue was that 'the rest of the world did not believe that the policies so far put into effect were sufficient to put the economy straight'. (A personal note from Wilson's private secretary next day reported that he had changed his mind about threatening an election.)[52] To meet the crisis it was agreed that the Bank should immediately approach the US, Canada, Germany and other European countries for short-term assistance. 'Beginning early on the morning of November 25, the Bank of England, the Federal Reserve Bank of New York, and the central banks of other major countries were in almost continuous telephone communication', stated Coombs. 'At 2 p.m., New York time, it was announced that a $3 billion credit package provided by eleven countries and the BIS was at the disposal of the Bank of England' (Coombs 1965, p. 45). 'The pressure on sterling has evaporated completely', declared a Citibank foreign exchange trader following the 'biggest overdraft in history'.[53] 'It was the old firm that did its stuff today', Cairncross recorded in his diary on 25 November. 'The Governor delivered the goods, and but for him the Government would have been in a sad way with devaluation inevitable' (1997, p. 18). Sterling soared following the announcement of the record $3 billion credits, but it soon slipped back below $2.78 and despite continuous intervention stayed below the rate until April 1965, reflecting continuing anxiety about a possible devaluation.

VIII

Wilson visited President Johnson at the White House in early December. After thanking the President for US financial assistance, Wilson recounted the 'critical economic situation' he had inherited from the previous Conservative administration that had:

both failed to take necessary actions and concealed facts about the seriousness of the situation. The Prime Minister indicated his view that tighter money is no long-term solution to British economic problems, and that the import surcharges were basically wrong, though necessary in the short run.

The basic solution has to lie in improving Britain's competitive position both with respect to exports and to manufactured imports…He discussed at some length the unfortunate developments which led to a loss of confidence in the new British government.

He indicated particularly the unfortunate effects of having to explain and defend British policies before a whole series of international meetings, each generating leaks which agitated those in other countries who were already antagonistic toward a Labor government.[54]

52 BoEA. OV44/123. Sterling crisis, 25 Nov. 1964.
53 'Giant boost for £', *Daily Mirror*, 26 Nov. 1964.
54 Off-the-record meeting of the President with Prime Minister Wilson, 7 Dec. 1964. *FRUS* 1964–8, vol. XII, p. 480.

Treasury Secretary Dillon commented that 'the difficulties which the UK government had encountered could be in part traced to unfortunate statements which British officials had themselves made'. Federal Reserve Chairman William McChesney Martin concurred: 'the most serious element contributing to the British crisis had been the unfortunate statements made, or reported to have been made, by members of the British government'. Ministers' stress on the balance of payments crisis in defence of the surcharge had undermined sterling. Callaghan agreed: 'We emphasised this heavily as our justification for the import surcharge scheme – too heavily, as events were to show, for the health of the foreign exchange market' (Callaghan 1987, p. 170). The *FT* also linked the surcharge and the sterling crisis, commenting that the 'outburst of general fury was a major factor in undermining the confidence of foreigners in the Government and sterling'.[55] Having initially greeted the measure 'with sympathy', the paper had come to the view that 'in deciding to employ the tariff surcharge method of putting the brake on imports, the Government chose about the worst of the various methods available'.[56]

The GATT Council meeting on 30 November resounded with more complaints about the surcharge, particularly from EEC delegates.[57] 'Six are mad at US interventions at GATT especially as we and US had forced through condemnations of France in 1958 and now sought escape for more flagrant offence', Frank Figgures, EFTA Secretary-General, told Cairncross. 'We would "get nothing out of the surcharge". He argued that we *must* reduce by 5% in February and should abolish in the Budget. The high rate was interpreted as a sign of weakness and probable devaluation' (Cairncross 1997, p. 25). Under pressure from the EEC, especially a vengeful France, and LDCs, which protested on hardship grounds, on 18 December 1964 the Council formally declared the UK in violation of the GATT treaty.[58] The ruling explicitly endorsed the right of reprisal by members, with February set for further consultation. EFTA too was demanding action 'with increasing vehemence'.[59]

Brown headed off EFTA reprisals by announcing that the surcharge was being reduced to 10 per cent at a meeting of ministers in Geneva on 22 February 1965. The decision received 'a very warm reception', the Austrian Minister of Trade declaring that the crisis of confidence among the Seven was 'at an end'.[60] The EFTA partners reciprocated by dropping their demand for a removal timetable and the issue was defused. 'This can be interpreted as something of a victory for Mr Brown', commented the *FT*. 'The fact that this has been the shortest EFTA meeting so far owed much to the impression that was created that EFTA feelings had played a major part in the

55 'Unwept, unhonoured and unsung', *FT*, 1 Dec. 1966.
56 'Justifiable – but only for a short time', *FT*, 27 Oct. 1964; 'Issues raised by the rumpus over the UK use of surcharge', *FT*, 8 Dec. 1964.
57 TNA T312/1059. Geneva to Foreign Office, 30 Nov. 1964.
58 GATT C/W/86. UK Temporary import surcharges, 18 Dec. 1964; 'Developing states plead hardship', *The Times*, 18 Dec. 1964; 'UK surcharge violates treaty – GATT Council', *FT*, 19 Dec. 1964.
59 'Implications of the surcharge cut', *FT*, 23 Feb. 1964.
60 'Warm EFTA welcome for UK cut', *FT*, 23 Feb. 1964.

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British decision.' The cut, which came into effect from 27 April 1965, was followed by a British restocking surge, though the trade balance deterioration proved temporary.[61]

Thereafter the surcharge continued to operate but disappeared from pubic attention. A DEA Working Party on the Temporary Import Charge, on which the Bank, Treasury, Board of Trade, Foreign Office, Department of Agriculture, and H. M. Customs and Excise were represented, quietly oversaw the technical operation of the levy.[62] Much consideration was given to the possible substitution of an import deposit scheme to get round the illegality of the surcharge, but it was concluded that it was 'likely to be held contrary to the spirit of international agreements even if it was not contrary to their letter'.[63] The end of the surcharge was announced by Callaghan in his 3 May 1966 budget and took effect on 30 November after 25 months. 'On one point at least everyone should be absolutely clear. It failed in its essential purpose', stated a valedictory editorial in the *FT*.

> In the White Paper which announced its introduction … the Government said: 'We must no longer be in the position that every time we seek to increase our national production we are forced almost immediately into deficit.' These words have an ironic ring to-day … Undoubtedly it put off the evil day. Without it the Government would have been forced to face reality sooner than it did … And if it had deflated earlier, the dose need not have been so savage … The surcharge can thus disappear – unwept, unhonoured and unsung.[64]

IX

The tribulations of sterling in the 1960s have received considerable attention from contemporaries and historians. A recent contribution by Scott Newton identifies two sterling crises in autumn 1964, one that coincided with the result of the 16 October election and another that began several weeks later in mid November (Newton 2009, p. 75). As regards crisis management, there were indeed two phases: a first phase that began on 26 October with the import surcharge as the foremost feature; and a second phase from 23 November with 7 per cent Bank Rate and the $3 billion international credits as the principal measures. Newton characterises the first phase of the crisis that was met by the 'October package' as 'handled efficiently', deeming the measures adopted to be appropriate alternatives to deflation since there was no evidence of overheating in the economy. However, as a crisis management measure the October package was not only inadequate but aggravated matters, as Wilson and Armstrong acknowledged. The competence of the government's response to the onset of the 1964 crisis has been questioned by Michael Oliver, who observed that it was the first of many occasions over the period 1964–7 'when

61 'Trade deficit biggest since crisis peak', *The Times*, 16 Jun. 1965.
62 BoEA. 5A 140/10–5A 140/13.
63 BoEA. 5A 140/10. DEA Working Party on the Temporary Import Charge. 12 Jan. 1965.
64 'Unwept, unhonoured and unsung', *FT*, 1 Dec. 1966.

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the Treasury misread or even appeared not to understand the strength of feeling against sterling' (Oliver 2012, p. 318). He does not mention the import surcharge, but quotes the FRBNY, which noted with relief after the Bank Rate rise that the British had now adopted 'an air of urgency that had been lacking before'.

Oliver has also challenged the notion of there being two crises in 1964. Based on the three-month forward rate for sterling, he argues convincingly that there was a single crisis that began in September (or before) and lasted until April 1965 (Oliver 2012, p. 314). That is not incompatible with different stages in crisis management, beginning with the import surcharge. It was certainly the way that Cromer and fellow central bank governors perceived it, as his notes and memos show.[65] Indeed, from his perspective the 1964 crisis turned almost seamlessly into the next sterling crisis that began in July 1965, and there was a further crisis that started in June 1966. Indeed, Bordo, MacDonald and Oliver have argued that sterling was a non-credible currency over the whole period from 1964 until after devaluation in November 1967, being propped up by international rescue loans (Bordo *et al.* 2009, p. 456). The several sterling crises were instances of so-called 'first-generation' currency crisis models reflecting increases in inconsistency between the external peg and domestic fundamentals (Eichengreen 2003; Glick and Hutchinson 2011; Krugman 2000).

Britain's surcharge had two roles: (1) as a currency crisis management instrument; and (2) to improve the balance of payments. As regards the first, as a stand-alone protection shield for sterling it was plainly inadequate. Cairncross, who worked on the import control schemes during Maudling's chancellorship, observed that 'it had never been assumed that there would be no accompanying measures of a different kind' (Cairncross and Eichengreen 1983, p. 168). In Canada, by contrast, the surcharge was part of a coherent plausible package. Moreover, because of the acrimonious rows it engendered in international forums the British surcharge undermined confidence in sterling rather than bolstering it. Would a Conservative administration have done differently? Probably not; Maudling was plainly intent on introducing an import surcharge if he returned as Chancellor. Better? Who knows, though possibly the Bank might have been involved in the designing the October package and the government might have taken some heed of the Governor's anxieties and recommendations.

Regarding the surcharge's impact on the balance of payments, the government's estimate at the time of the surcharge's introduction was that it would cut imports by £200m a year, raised by Callaghan in his November 1964 budget speech to £300m. Adjustment for the subsequent reduction in the rate from 15 per cent to 10 per cent after six months suggests an official expectation of around £440m of import reductions over the two years. Between 1967 and 1973 at least eight econometric studies of the impact of the surcharge on the UK balance of payments were undertaken (Tew 1979, pp. 344–7). 'Import Surcharge – an idea that failed' was

[65] BoEA. OV44/123. Sterling crisis.

the headline above an article in *The Times* reporting the findings of the first of the studies by Johnston and Henderson of Manchester University.[66] They estimated the reduction in imports over the life of the surcharge at just £150–200m (Johnston and Henderson 1967, p. 107). Barker, on the other hand, using a different approach, estimated a surcharge effect of £462m; Boatwright, at the University of Reading, came up with £350–£450m (Barker 1970; Boatright 1969). Reviewing the various estimates, Tew commented that 'the government figure seems to have been on the optimistic side', himself favouring a study by Fane and Whitley that calculated the reduction at around £250m over the whole period (Tew 1979, p. 347). Whichever the number, the surcharge had, observed Cairncross, 'a large and immediate effect' on Britain's balance of payments (Cairncross and Eichengreen 1983, p. 175).

The import surcharges adopted by various countries in the 1950s and 1960s had significant balance of payments effects that temporarily substantially surpassed the multilateral tariff reductions resulting from GATT round negotiations (Irwin 2012b, p. 155). In Britain's case, the trade deficit fell during the surcharge years from £540m in 1964, to £260m in 1965 and £110m in 1966, though the surcharge was only one factor (Thirlwall and Gibson 1991, p. 232). Import growth declined while export volume grew at 7 per cent a year and the current account balance moved into surplus in 1966. The removal of the surcharge from December 1966 was followed by a rush of imports, and in June 1967 the *Economist* observed that 'it looks as if the import surcharge…may have had a bigger deterrent effect during 1964–66 than had been supposed', though the forthcoming sterling crisis was the result of other developments.[67] Soon the trade deficit ballooned to £600m and the balance of payments shifted heavily into the red, culminating in devaluation in November 1967. Despite the short-term relief provided by import controls, Bergsten argued that they did not provide a long-term solution to underlying problems and merely delayed par value adjustment. 'In every case where trade measures were adopted by a major country, they failed to prevent a subsequent exchange-rate change', citing France in 1958, Britain in 1967, and German revaluation in 1969 (Bergsten 1977, p. 3). Canada was evidently an exception to the general pattern.

X

The Canadian, British and other import surcharges were introduced to *avert* currency devaluation. Nixon's surcharge, paradoxically, was imposed to *achieve* devaluation (Irwin 2011, p. 32). Mounting balance of payments deficits led the administration to want a devaluation of the dollar to improve America's international competitiveness. But with the dollar as the anchor of the Bretton Woods system, the US could not devalue against itself. To do so it had to get other countries to revalue their undervalued currencies, which they were reluctant to do, generating growing resentment

[66] 'Import surcharge – an idea that failed', *The Times*, 5 Jun. 1967.
[67] 'Economic growth: who's fooling whom?' *Economist*, 3 Jun. 1967.

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in the US of perceived currency manipulation. To cajole them to revalue the US created an international monetary crisis through the measures introduced in August 1971 that included a 10 per cent import surcharge as an 'attention getter and bargaining chip' (Shultz and Dam 1978, p. 115). When they did so the surcharge was lifted in December 1971.

The move to floating exchange rates with the end of Bretton Woods in 1973 meant the end of the need to defend fixed exchange rates and hence the discontinuation among advanced countries of balance of payments trade measures. However, in the 1970s, 1980s and 1990s import surcharges were imposed by some emerging and transitional economies that pegged their currency to the dollar or developed an overvalued exchange rate (Drabek and Brada 1998). Accusations of currency manipulation and calls for a new Nixon-style import surcharge revived in the US in 1985 and again in the early 2000s (Bergsten 1990; Bergsten and Williamson 2003; Bergsten and Williamson 2004; Destler 2003; Kaempher and Willet 1987). Currency manipulation was back in the headlines in 2010–12 in relation to China, with Congressional moves to reimpose a Nixon-inspired import surcharge (Scott 2011).[68] It is not only financial historians for whom import surcharges in their various guises and usages may be of interest.

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[68] 'Tricky Dick and the dollar', *Economist*, 25 Mar. 2010; 'America and China both lose in a trade war', *FT*, 6 Oct. 2011; 'US currency bill passes Senate vote', *FT*, 12 Oct. 2011.

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