1965 June 16

Discussion of Devaluation Strategy at the UK Treasury, 1965. Meeting notes, labeled 'top secret', including considerations about the effects of the planned devaluation of the pound sterling on the London Gold Market. This excerpt is a note on a meeting held between ten Treasury and Bank of England officials regarding the potential consequences of a devaluation of sterling [in a document referenced as F.U.(65)]. The main topics of the discussion were the effects of devaluation on the operations of the London Gold Market and the group's unanimous rejection of a system of flexible exchange rates. Two years later, in November 1967, the pound was devalued to $2.40, the rate that this excerpt uses for "for illustrative purposes".

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F.U.(65)7th Meeting

Note of a Meeting held in Sir William Armstrong's room, Treasury Chambers, Great George Street, S.W.1. at 11.15 a.m. on WEDNESDAY, 16th JUNE, 1965

[...]

1. LONDON GOLD MARKET

The group had before them F.U.(65)23(Revise), a paper by the Bank of England. In discussion the following main points were made:

(a) Mr. Parsons said that in his view the initial shock of a sterling devaluation would have the effect of securing the maintenance of close co-operation as an insurance against the risk of immediate collapse of the world monetary system. But it was difficult to assess the likely attitudes of the members of the consortium over a longer period, and though they might be willing to co-operate initially to keep the London Gold Market open, they might be unwilling to do this indefinitely.

(b) The main question was whether the Americans would be willing to meet at $35 per ounce the heavy demand for gold which was almost certain to follow a sterling devaluation. For them not to do so would be a major retreat from their formal obligation to buy and sell gold freely, and would cast doubt on the stability of the dollar: the price of gold would rise immediately in the disorderly markets that would develop. Although the United States would probably wish to explore the possibility it was unlikely to be practicable in the circumstances envisaged to restrict gold sales through the London market to central monetary institutions. The Bank of Prance was known to operate in the domestic French gold market and would probably not be willing to participate in a restrictive scheme; there would be other serious difficulties in attempting to enforce segregation of sales.

(c) There was general agreement with the main conclusion of the paper that the London market should be kept open unless the devaluation had so struck at the foundations of the monetary system that everything was immediately in a state of flux. The paper did not however deal with the U.K. attitude in a situation in which our own reserves would be seriously depleted and where the Americans were themselves unwilling to help in keeping the market open. It was agreed that if,in spite of our advice bo the contrary the Americans were unwilling to continue to support the market we would have no option but to close it. Mr. Fforde undertook to prepare a revise of the concluding paragraphs of the paper to include this contingency.

(d) The paper had been written on the basis that sterling devaluation would take place when the dollar was relatively strong. If in fact the dollar was very weak we might find ourselves in fact unable to devalue, and it was obviously important to consider the impact of our own actions on the position of the dollar. The provisional view of the group was that if the American authorities showed themselves determined to maintain the gold price at $35 an ounce, although this might be expensive initially, they would probably be able to hold the parity of the dollar. Mr. Parsons undertook to set in hand the preparation of a paper on the consequences of a sterling devaluation for the world monetary system.

2. FIXED OR FLEXIBLE RATES

The group had before them F.U.(65)2l(2nd Revise). Sir William Armstrong said that although the present paper had been described as a revise of the earlier paper on the same subject, the latter should be regarded as a separate statement of the personal position of Mr. Neild and would be included as such in the dossier of papers for Ministers. The present paper by the Bank (F.U.(65)2l(2nd Revise) was intended as an objective assessment of the position expressing the views of the group as a whole. In discussion the following main points were made:

(a) It was agreed that although section 2 stated very fairly the case for a flexible rate the argument in section 3 needed strengthening to clarify that the considerations against flexible rates were felt to override those in their favour.

(b) The first sentence of section 4 suggested that there were still advocates of flexible rates who denied the need for some sort of stabilisation mechanism. This was clearly not the case and it was agreed that the sentence would be better omitted.

(c) It would be useful to include a reference at the beginning of section 5 to Canadian experience of flexible rates, though emphasising in particular the difference between the Canadian situation and that envisaged for the U.K.

(d) The main argument given in section 3 against flexible rates was of course that it was impossible both to have a flexible rate and to retain sterling's capacity as a reserve currency. The risk that others would adopt discriminatory import licencing was an obvious possibility together with other forms of retaliation: but these ought to be distinguished as longer term phenomena unlikely to follow immediately after the adoption of flexible rates. It was agreed that greater emphasis should be put on the main difficulties enunciated at the foot of page 2 and that the paragraph on page 3 should be re-drafted to put the references to retaliation into a rather longer term perspective.

(e) Section 6 of the paper discussed the possibility of adopting a [floor] of $2.40 to the £ and a ceiling of $2.60 to the £ for a United interim period. These rates were used only for illustrative purposes and the paper would be revised to clarify this where necessary.

(f) It was stated at the beginning of section 4 that the improvement in our external position in 1931 was probably in no way due to our not adopting a new fixed parity forthwith. This was felt to be controvertible: one of the main arguments for adopting flexible rates was that speculative flows would turn in our favour at an early stage. On the other hand it was arguable that the assumption of flexible rates would lead to official withdrawals of funds from London which might more than offset the speculative inflow; the rate, might, in any event, have to fall a considerable distance before any significant speculative inflow was achieved.

(g) A variation on the course of temporary adoption of flexible rates as discussed in the Bank's paper would be to refrain from announcing either a floor or ceiling for the rate, though declaring (as in the Bank's formula) the intention to revert to a new fixed parity within a specified period. Assigning a floor to the movement of the rate in fact compromised our ability to achieve the objective since we would be sacrificing the possibility of letting the rate fall below the floor level - reversing speculators' expectations if the initial speculative reaction was to force the rate heavily down. A further advantage of not specifying floor and ceiling rates was that this avoided the difficult problem of selecting the right rates: clearly the adoption of very wide margins would be interpreted as showing little confidence in sterling and yet with narrow margins few of the advantages of flexibility would be reaped.

Sir William Armstrong said that there would have to be further discussion of the present paper in particular on the point covered at (g) above. A meeting would be arranged to take place in the course of the following week after which the paper could be revised and re-circulated.

It had become clear in the course of discussion that there would have to be close consultations with the United States and with the International Monetary Fund in respect of the London Gold Market and if we *were* to adopt flexible rates, respectively: Mr. Jenkyns was asked to take these into account in the preparation of a further note on the various possible operations that had been discussed.

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***Source*:** *Bank of England Archives*, OV44/133, 2278/1, unnumbered [48BIS].