



**THE SINKING POUND**

Over the last six years or so, the pound has displayed an extraordinary degree of volatility. From a low point of \$1.56 in 1976, it appreciated to around \$2.40 in 1980. Since easter 81 it has slumped sharply, the fall accelerating in recent weeks, so that at the time of writing a new low, beneath the 1976 level, is being witnessed. The Thatcher government continues to claim that the state of the UK economy has nothing to do with their policies, but rather is the result of our productivity performance, wage costs and world market forces. However, in blaming the 'Shore factor' (the 30% devaluation announced in *Labour's programme for*

*Recovery*) for the pound's slide, they are at least admitting that government policy — albeit the proposed policy of the Opposition — does matter.

In fact, the slide of the pound is easily explained as a market response to the extreme lack of competitiveness of UK industry and to the low interest rate, relative to other countries, in comparison with the early years of the Thatcher government. Now normally a depreciating currency is associated with a balance of payments deficit, whereas there is at the moment a large surplus. But the recent flight from sterling is quite consistent with the drop in world oil prices, and with the capital market anticipating modest growth in a pre-election year, stimulated by a generous budget. The latter will quickly push the balance of payments into deficit. The former will have the opposite effect for important oil-importing countries such as W Germany and Japan. Thus the value of the pound relative to their currencies is expected to (and therefore does) fall further.

This is not to argue there are no political factors at work in the pound's performance. But it is not so much devaluation (the pound is expected to depreciate any way) but rather the possible introduction of exchange controls which is motivating financial institutions. Capital was being transferred abroad at a rate of £5b a year in 1982 compared with £1b in 1978, the last full year before exchange controls were abolished. Even if the possibility of a Labour government coming to power is seen as remote, financial institutions will still plan for that contingency and will export more of their assets abroad than would otherwise be the case.

In the run up to the election, the pound may well fall further, achieving Shore's 30% devaluation without a change of government. And this highlights a major problem for an incoming Labour government, namely the stabilisation of the pound. The *volatile* pound — not the overvalued or undervalued pound — is the real issue facing a government embarking on an alternative economic strategy.

How can a Labour government control the exchange rate as it attempts to reflate out of the recession? Movements in the exchange rate are simply a price mechanism for regulating flows of financial capital and trade. In the past we have thought of governments intervening directly to affect the price of sterling by buying or selling, drawing on reserves of foreign currency as necessary. The Labour Party's 'devaluation' plan is written as though direct intervention is sufficient to achieve whatever exchange rate is deemed desirable. But this is no longer



true because of the huge volume of financial flows that cross over international boundaries every day. However there are a number of indirect ways of controlling the exchange rate.

The most obvious indirect way is through controlling flows of financial capital in or out of the country. The main problem here is that exchange controls to prevent an exodus from sterling can only apply to 'residents', leaving untouched a large proportion of transactions. Moreover, controls on 'residents' ie, the City) are not entirely unproblematic and may require quite extensive intervention, including nationalisation.

The regulation of the growth of imports as the economy expands (or 'planned trade' to use Michael Foot's recent phrase) would be an important additional instrument to help stabilise the pound. But in a capitalist world deep in recession, the dangers now of retaliation are greater should the import growth controls hit any one country or bloc severely.

A Labour government would seek to control movements of capital and trade (and thereby control the exchange rate) to achieve freedom of action to pursue an independent economic strategy of expansion in a capitalist world deep in recession. The problems discussed here suggest that the constraints imposed by Britain's position in the world economy constitute a formidable hurdle which may well jeopardise Labour's aim of reducing unemployment to one million over five years.

The conclusions we draw (borne out by the recent French experience) are that first, the longer term aspects of the alternative economic strategy in the areas of industrial strategy, democratisation and social policies need to be elevated above the shorter term

reflationary programme; second, successful reflation in Britain will need a more co-ordinated approach, possibly involving close co-operation with the Leftish governments which have recently emerged in France, Greece and Spain.

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