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The immediate crisis was averted but sterling reserves were so low that Operation Brutus remained the contingency plan for the rest of the year in its most drastic form - Brutus 3:

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Economic Policy  
(Gold) Pt 2

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DEPARTMENT OF ECONOMIC AFFAIRS

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Permanent Under Secretary of State

MR. HALLS

Contingency Planning: Operation Brutus

We have had two meetings of the Official Group which was set up after Sunday evening's talks. Two papers are being circulated to Ministers for their discussion tonight. The first deals with the contingency planning as such. The second with the possible effects on trade.

Contingency Planning (MISC.205(68)1)

Brutus 1 is so unsatisfactory as a means of stopping the drain on our reserves that it could be contemplated only in the situation of last weekend and has therefore served its turn. We recommend that contingency planning should concentrate on getting Brutus 3 into a more advanced state of readiness. What resources we should put into this operation depends on developments in the markets and on other demands; e.g. we must begin to prepare contingency plans against the possibility that the U.S. goes off gold.

In extreme emergency Brutus 3 could be applied very quickly. We could impose a block and in effect freeze all transactions while we got an administrative staff together. This would produce chaos but we should not be moving in this way other than in a chaotic situation. However we can without undue security risk improve on this situation by further work. The paper explains that there are two main things which need to be done to make possible the more orderly introduction of Brutus 3 at 48 hours' notice:-

- (a) Further work on the policy questions raised in paragraph 18. I recommend that my Group be asked to continue this work and to report.
- (b) Earmarking of the 150 staff and their accommodation required at the Bank of England and of the comparatively small additional number of staff required at the Treasury.

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T O P   S E C R E T

The Bank are already taking discreet steps which should serve to reduce substantially the three week period mentioned in the paper. I recommend that no formal instruction should be given to the Bank to go further than this until Ministers have considered the suggested answers to the policy questions and have received a further report on the trade aspects.

The paper brings out that the size of the participation of U.K. banks in the Euro-dollar market could produce serious problems if the shock to confidence resulting from blocking led to a withdrawal of funds from this market. I recommend that my Group should be asked to consider a paper by the Bank of England on this subject discussing whether it is desirable to seek to reduce the scope of the Euro-dollar market operations.

Trade Effects (MISC.205(68)2)

Discussion in the Group this morning indicated that the majority expected that our blocking of non-residents' use of sterling would fairly rapidly lead to a situation in which the U.K. would find itself short of foreign exchange to pay for current imports and that the introduction of a comprehensive control over the whole range of U.K. imports would become necessary within a comparatively short time. There was however a considerable amount of disagreement about the speed with which this situation would be likely to develop and about the ways in which we could deal with it. There was also considerable argument about some of the paragraphs in the trade paper which has been circulated to Ministers, but since there was insufficient time to amend it to the satisfaction of all concerned it was decided that it would be better to let the paper go forward to Ministers in the form in which it had been drafted. I recommend further that the Group should be asked to re-examine this question as a matter of urgency since the possible need to introduce comprehensive import control at an early stage after Brutus 3 would be a very major consideration.

Conclusion: Action Proposed

I recommend that Ministers should:

- (a) request the necessary work on the policy aspects of Brutus 3 to be put in hand forthwith;

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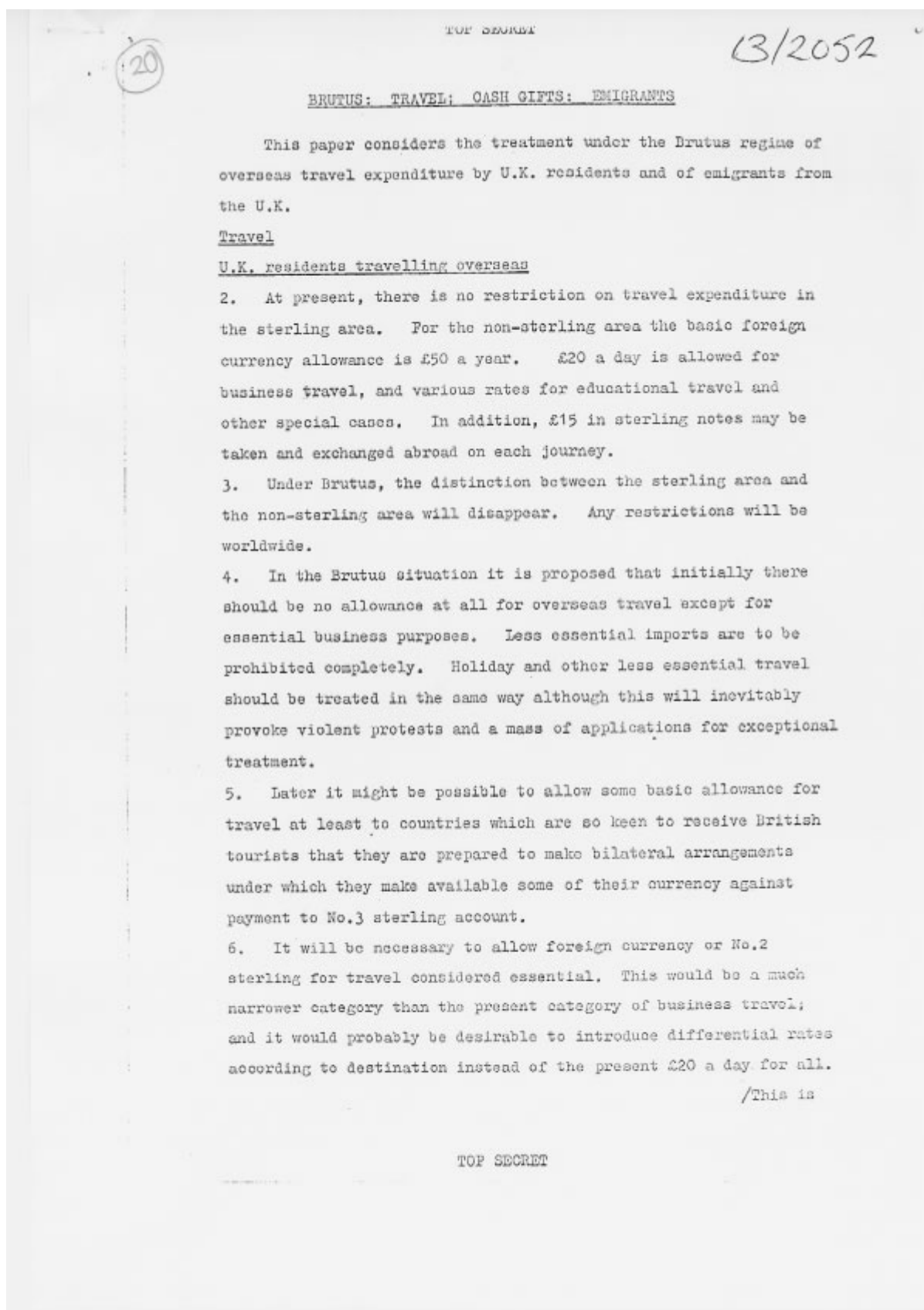
- (b) note that the Bank of England are making discreet preparations on the administrative aspects of the problem defer the issue of instructions to bring these preparations to a specific state of readiness (which must increase somewhat the security risk);
- (c) request a study of the Euro-dollar aspects of the problem mentioned above;
- (d) request a further paper on the trade effects, with particular reference to the possible need to introduce import control.

*DA*

(Douglas Allen)  
20th March, 1968

T O P   S E C R E T

Brutus 3 would have prevented all non-essential foreign travel:



This is not excessive for export sales business in New York. But it is more than enough in some other cases.

7. Similarly it may later be necessary to allow special treatment for some educational and perhaps health travel; and compassionate cases.

8. The strongest injunctions should be given to curtail travel abroad by Ministers and Government officials. Insofar as such journeys are really necessary, credit to No.2 account or foreign currency will usually have to be allowed so that the journeys can take place.

9. Further thought will be given to appropriate rules regarding the import and export of sterling and foreign currency notes.

10. Transitional arrangements will be necessary for U.K. residents who happen to be travelling abroad on the zero date. These are mentioned in another paper.

Non-residents travelling in the U.K.

11. Should non-resident visitors to the U.K. be allowed to draw on No.1 or No.3 sterling accounts to meet living expenses in the U.K.? Tourism is an invisible export. Like other exports, it should be financed from No.2 account sterling or with foreign currency. But it is harsh to stop non-residents using their own blocked sterling for living expenses in the U.K. The present rules for Rhodesia allow Rhodesian sterling accounts (though not suspense accounts) to be debited for this purpose.

12. It is recommended that a private holder of No.1 or No.3 account sterling may use it up to £250 a week for his own or his family's living expenses in the U.K.

13. Some exceptions will be necessary on hardship grounds, especially for residents of the former sterling area, and for educational expenditure in the U.K., and where a visitor has no other funds as an alternative to claim for national assistance.

Cash gifts

14. At present cash gifts are unrestricted to the O.S.A., and to  
the N.S.A.

the N.S.A. (except Rhodesia) allowed up to £50 a year in official exchange. It is suggested that under Brutus the allowance remain £50 a year, but payment be only to No.3 account. It will be up to the foreign banks concerned to determine whether and when they allow such gifts to be effective by releasing foreign currency to the recipient.

15. For cash gifts by non-residents to residents of the U.K., no restriction on debits from No.2 account sterling, but a restriction is necessary on gifts from No.1 or No.3 account sterling in order to prevent evasion in the form of commercial payments disguised as gifts. On the other hand it is reasonable to allow genuine gifts. A limit is suggested of £250 for any one gift (as for Rhodesia).

16. Some exceptions on hardship grounds will be necessary allowing larger gifts from No.1 or No.3 accounts in special cases.

#### Emigrants

17. Under present rules, there are no restrictions on emigrants' remittances to the sterling area; for the non-sterling area (except Rhodesia) the rule is no restriction on transfers of foreign currency securities or of sterling income, but on sterling capital there is a restriction of £5,000 (in official exchange) for the first four years, during which capital over £5,000 may only be transferred through the investment currency market (as a result of a recent case the rules are under review).

18. Under Brutus, restrictions on emigrants' remittances become worldwide and the following rules are suggested.

19. Emigrants who have already left the country but still have assets here restricted under the four-year rule: these restricted assets transferred to No.1 account and then subject to the normal No.1 account rules. No further transfers through the investment currency market, even if this still exists.

20. Post-zero emigrants may transfer up to £5,000 to No.3 account; any other sterling assets to No.1 account. Income arising from U.K. sources after emigration to No.3 account like other income due from the U.K. to non-residents. If the credits to No.3 account are not immediately effective in producing foreign currency abroad,

the emigrant will have to wait until they are.

21. The treatment of foreign currency securities belonging to post-zero emigrants depends on what is decided about mobilising foreign currency holdings of private individuals. If no such operation is yet in hand, it is scarcely feasible to prevent emigrants taking with them as at present any foreign currency securities already in their possession. If however a compulsory acquisition of foreign securities is already in train, then it is for consideration whether this could apply to such securities held by emigrants with the sterling proceeds credited to No.1 account. (This needs further consideration in the light of the drafting of any new legislation on this subject.)

22. The tight control on emigrants' remittances may be evaded by the purchase before emigration of jewellery or other articles of value, which can then be taken as part of an emigrant's personal effects. To check this by tighter controls over the export of personal effects would be extremely difficult administratively.

10th June 1968

Non-resident sterling accounts (both individual and corporate) would have been substantially blocked:

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ANNEX I

13/2052

BRUTUS: FRAMEWORK FOR DECISIONS

This note is intended as an aide memoire as a reminder of certain features of the Brutus scheme, and considerations arising out of them, which constitute the framework for various questions being put forward for detailed decision.

2. The Brutus scheme extends exchange control to transactions between the United Kingdom and all other countries. The existing distinction between the sterling area and non-sterling area disappears.
3. There are three categories of non-resident sterling accounts:
  - No. 1: These are blocked, with only narrow uses. They are not convertible into foreign currency. They may be transferred from one holder to another within the same country but not from one country to another. They are the depository of pre-zero sterling assets.
  - No. 2: These are fully convertible on demand into foreign currency and fully transferable from one holder to another. They are equivalent to foreign currency.
  - No. 3: These are transferable from one holder to another (and therefore probably convertible at a discount in unofficial markets abroad), but are convertible officially only in tranches as determined by the U.K. authorities. Most post-zero payments by the U.K. are to be made to these accounts.
4. In the situation postulated U.K. foreign currency reserves will be extremely small. Subsequent supplies of foreign currency will be limited to what is earned from post-zero exports, and some from pre-zero exports supplied on credit.
5. It must be a prime objective of policy to restrict further expenditure of foreign currency from the remaining reserves and payments to No. 2 account which is likely to be converted. If the amount credited to No. 2 accounts exceeds the available remaining

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reserves this will at once compel floating. If the rate is already floating, credits to No. 2 account will depress it.

6. It should also be an objective to minimise payments to No. 3 accounts. We need to keep down the length of the queue for official convertibility, and hence reduce the discount at which this sterling is unofficially convertible abroad. The more we can do this, the greater the chance of this form of payment being acceptable abroad.

7. There is less strong objection to payments to No. 1 accounts, but because of the stringent restrictions on the uses of No. 1 accounts such payments are not likely to be acceptable abroad; and any additions to No. 1 account add marginally to the problem of ultimately discharging these liabilities.

8. Payment to No. 3 account is primarily intended as the normal means of settlement for U.K. imports post-zero. If it does not prove acceptable abroad, and foreign suppliers insist on payment in foreign currency, the disruption of trade will be acute. The hope that settlement in No. 3 account sterling will in general be acceptable rests on the belief that the U.K. market is important to foreign suppliers, who will often be prepared to accept a certain delay in payment in order to maintain sales to the U.K. Where they are not so willing, this will reduce imports into the U.K, which, so long as they are not essential, is in itself in line with U.K. policy. (For essential imports special arrangements are envisaged if necessary.)

9. No. 3 account sterling is unlikely to be an acceptable means of settlement for transactions where the foreign supplier does not have an interest in the transaction taking place. In such cases there will be no alternative to allowing foreign currency or No. 2 sterling or accepting that the transaction cannot take place.

6th June, 1968

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The international monetary situation looked particularly perilous in November when the French threatened to devalue. The Prime Minister summoned the German Ambassador to a midnight meeting and threatened that the British might have to withdraw their troops from Germany unless the Germans revalued the Deutschmark:

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RECORD OF A CONVERSATION BETWEEN THE PRIME MINISTER, THE FOREIGN AND COMMONWEALTH SECRETARY, THE CHANCELLOR OF THE EXCHEQUER AND THE GERMAN AMBASSADOR AT NO. 10 DOWNING STREET AT 12.30 a.m. ON WEDNESDAY, NOVEMBER 20, 1968

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Present:

The Prime Minister	Herr Blankenhorn
The Foreign and Commonwealth Secretary	
The Chancellor of the Exchequer	
Sir Burke Trend	
Mr. Halls	
Mr. Palliser	

The Prime Minister apologised for summoning the Ambassador at such a late hour. But he wished him to be aware of the very grave concern caused to the British Government by the decisions announced that evening in Bonn in regard to the international monetary situation. The British Government regarded these as totally inadequate in the circumstances and as presenting Britain and the free world with an intolerable situation. They believed that the right answer would have been for the German Government to undertake a substantial revaluation of the DM. Instead of this they understood that various fiscal measures were to be taken. On their present information, they could not reliably estimate the extent of the effect of these, but they believed that it would be totally inadequate and would not reduce the fundamental imbalance existing at present. But a failure to do this would produce an intolerable situation. The British Government understood that there was to be a meeting the following day in Bonn of the Group of Ten,

on the invitation of Dr. Schiller. The Chancellor of the Exchequer would of course attend this meeting but he would be bound to represent the British Government's view that the measures announced that day by the German Government were not only inadequate but were irresponsible in terms of the free world as a whole. The British Government could not accept that they represented the final decision of the German Government: nor could they accept that the monetary markets of the world could be left in uncertainty for days or possibly weeks on end. If continuing doubt about the German position persisted, there would be a serious aggravation of the present situation and an intolerable escalation of speculation.

The Prime Minister said that, so far as they could judge at present, the decisions announced by the German Government were equivalent to barely a third of what was required: but this was simply an initial estimate. The exact figure might be different; but in any event the measures were clearly inadequate.

The Prime Minister recalled that, during the recent NATO meeting in Brussels, the Foreign and Commonwealth Secretary and the Defence Secretary had re-affirmed the British Government's determination that the defences of the West should be strengthened and our offer to contribute further to that end. But military defences were meaningless without an adequate economic foundation. If the deterioration in the present international monetary situation continued, the British Government - and perhaps

other Governments as well - would find themselves obliged seriously to re-appraise their present attitude. This would be totally contrary to their desires and to everything they believed in. They could only hope that the German Government would play their part in ensuring that such a re-appraisal did not become inevitable.

The Chancellor of the Exchequer explained that the British Government had initially favoured a meeting of the Group of Ten. But this was before the German Government's statement that evening, which had made it appear that the German Government had already taken their decisions; which meant that the decisions had now preceded the meeting. He would still attend the meeting, but he was now doubtful of its desirability and feared that it might simply increase international tension and speculation. Although the major money markets would be closed the following day while the conference was taking place, there was a danger that, if it failed to reach conclusions commensurate with the expectations which it would arouse, an even more dangerous situation would be created. This had been the purport of the message he had sent that afternoon to Dr. Schiller. The German Ambassador interjected that he was not aware of this message: he had no instructions: he was only aware from radio reports of what his Government had announced.

The Chancellor of the Exchequer explained that, in the light of the speculative pressure arising from the Deutschmark-French franc position, it might not be possible for the British Government to sustain the exchange rate of sterling. In such circumstances, they would have to allow the sterling rate to float, though they recognised that the consequences

of this would be grave both for Britain and for the other major currencies, including the dollar. Not only would it clearly be impossible in such circumstances for the British Government to contemplate any increase in the sterling cost of their expenditure in Germany; but they might have to make a major re-appraisal of their contribution to the alliance; and it could become difficult for them to continue to maintain a military presence in Germany. It was therefore essential that, by the end of the Group of Ten meeting, there should have been a redefinition of the German position. By far the most satisfactory solution would be a revaluation of the DM, accompanied by a devaluation of the French franc, while the exchange rates of the other currencies concerned remained unchanged. But at the very least - though this would not necessarily have the same effect as revaluation - there should be a substantial increase in the extent of the German measures announced that evening: such an increase should be at least threefold: the present measures were totally inadequate.

The Chancellor of the Exchequer said that the position of Dr. Schiller at the meeting the following day would be crucial. The meeting was being held in Bonn: Dr. Schiller was Chairman of the Group of Ten: and the position of the DM was the central issue. Judgement on the outcome of the meeting would be pronounced by the monetary markets of the world and the consequences could be exceptionally grave for both Britain and Germany.

The Foreign and Commonwealth Secretary said that the British Government, as he believed the German Government,

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Brutus 3 looked on the cards again:

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MR. HALLS

Cuba  
22/4/68

Exchange Rates

If the French move down and the Germans don't, we must float temporarily and be ready to introduce Brutus shortly afterwards.

So far we have only had the backwash of this crisis, yet in New York alone we were yesterday losing money at a rate approaching £300 million per week. Moreover it is accelerating - the loss yesterday (Thursday) was near 6 ~~three times~~ <sup>three times</sup> the loss on Wednesday. In my view Thursday's loss will be chicken feed once the French are off because:-

- (a) Our long-term competitive prospects will be worse - and this afternoon's announcement does nothing about that - thus sterling will be directly suspect.
- (b) Everyone will still expect the Deutsche Mark to go up and sterling will be obvious currency to get out of.

These effects are bound to be cumulative, and the gain from import deposits will be a flea bite compared with the outflow of sterling. Even at ~~its~~ <sup>its</sup> maximum deposits give us only about £6 million a week compared to £500 million in a day (!) which went out on the Friday before devaluation.

On the other hand if we float completely:-

- (i) We won't lose any money directly (the problem of the dollar guaranteed sterling balances will exist whether we make a fixed move or float).
- (ii) The strain will then pass to the dollar.
- (iii) This strain in its turn will be cumulative. Originally the strain was shared as money was moving out of francs, sterling and dollars, but with us floating all the strain would fall on one currency - the dollar - and there would be three obvious currencies to move into. Moreover, with us floating, sterling would offer the prospect of a direct and immediate speculative gain.

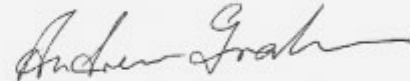
I realise this situation would cause temporary chaos in the financial markets but do we have very much to lose? The other alternatives seem no better:-

- (a) I think we will certainly be forced off if we don't move.
- (b) It is very unlikely we could hold a fixed drop without supporting this with both import quotas and Brutus and we should try to avoid this latter as long as we can.

The main argument against floating is that it could cause a wage/price spiral in this country, but surely not if it was really temporary (i.e. a matter of days rather than weeks) while it retains the major advantage of showing the Americans we mean business. It is the only option which actually makes them grapple with the outflows of money as opposed to mere verbal threats.

Conclusion

The Treasury are arguing that this afternoon's announcement will strengthen confidence. I very much doubt this. We must watch New York hour by hour. If the Treasury are wrong, a policy decision on whether or not to devalue and if so whether it should be fixed or floating, may be required in a matter of hours rather than days. This is the one occasion on which I pray to God that my advice is totally wrong.



(ANDREW GRAHAM)

22nd November 1968