The Day the HK Dollar 'Came of Age'[1]

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> 'Of all the motley crew of heavyweights in the sterling association, Hong Kong is surely the most bizarre.'
> S. Strange, Sterling and British Policy (1971), p. 112.

> 'I think I can make one claim – that the Hong Kong dollar came of age last week'. JJ Cowperthwaite, Speech in the Legislative Council of Hong Kong, 29 November 1967.

The devaluation of 1967 marked a watershed for Britain's place in the international economy and the global role of sterling. After having struggled through recurring balance of payments crises for almost two decades without devaluing, the Labour government finally gave up the fight and betrayed any lingering trust of sterling balance holders. This opened the opportunity finally to curtail sterling's reserve role, which had been aspired to by Treasury and Bank of England officials since the early 1960s.[2] From September 1968 Britain signed agreements with the governments of all major sterling balance holders to guarantee the exchange value of a proportion of sterling reserves as a quid pro quo for these holders not selling off any more of their sterling assets. The negotiations from July to September 1968 were difficult and frequently embarrassing, but were considered worth the price to divest sterling of its reserve role under the umbrella of support from members of the Bank for International Settlements.

The aftermath of the devaluation is usually portrayed only in terms of the performance of the British economy, but it had more far-reaching implications.[3] The debacle of 1967 exposed the changed financial relationship between Britain and its overseas dependencies and prompted the end of the sterling reserve system. It also threw a stark light on the distinction between dependent and newly independent status in the Commonwealth, or between Commonwealth and Empire. Many colonies felt betrayed over the devaluation, became openly critical of the British government's policies and pushed for new financial relations with Britain; the governor of Bermuda advised London that 'quite frankly, I fear the time has come when Bermuda will no longer accept a position which leaves it completely at the mercy of the UK economy'.[4] These were strong words from the governor of a small colony. The betrayal of colonies led to new arrangements that blurred the economic distinction between Empire and Commonwealth.

By 1965 Britain had divested itself of most of its empire and all that remained were small territories such as islands in the Caribbean and Pacific Ocean.[5] What then did it mean economically to be a colony in the mid-1960s and did colonies still matter? Financial links were still among the most important. Unlike independent countries, colonies did not have autonomy over their exchange rate or over the proportion of their reserves held in sterling. While decolonisation did not usually bring an immediate change in the financial or economic relationship with Britain,[6] many independent members of the Commonwealth diversified their foreign exchange reserves to varying degrees, mostly through new accruals rather than through exchanging existing balances. By the 1960s many 'older' independent members of the sterling area had already diversified their reserves.[7] London resisted this process, urging members to keep at least 50% of their reserves in sterling, but the government had no legal or constitutional powers of enforcement. Instead they relied on moral-suasion and the threat that if all sterling area members acted 'irresponsibly' then the sterling area as a whole would collapse. The colonies, however, could be more tightly controlled. They were required to keep their currency backing in sterling and were expected to do the same with other government reserves.

After the devaluation, these rules were changed. Bermuda was reluctantly allowed to diversify up to 25% of their reserves and Bahamas was allowed to diversify a further £4.25 beyond the £2m agreed in October 1965.[8] While these compromises were reached relatively quickly, the case of Hong Kong raised even more serious and profound questions about the definition of colonial status in the new post-colonial world, and it exposed the vulnerability of Britain to the legacy of colonial monetary relations.

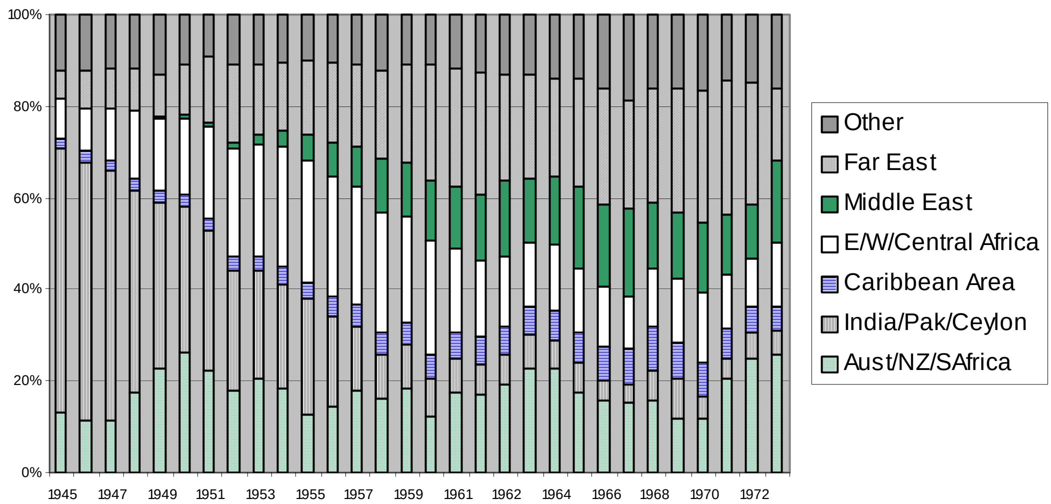
The conflict with Hong Kong after the devaluation is barely mentioned in existing accounts. Some earlier scholars such as Strange and Cohen in the 1970s mentioned the deal struck with Hong Kong in the context of the Basle Agreements,[9] but it has fallen out of more recent accounts that have mainly focused either on the reasons for the devaluation decision or on the impact of the new exchange rate on the British economy.[10] The post-war economics of empire has recently attracted interest from Krosewski and Hinds, but these studies have assumed a declining importance of the financial link after convertibility in 1958.[11] Krosewski, for example, states that from 1960 'the remaining empire as a whole had become largely irrelevant to Britain's external economic relations'. He notes that policy with respect to Hong Kong 'followed a peculiar rationale' partly because of its 'special economic status' but does not elaborate.[12] This paper will argue that the vestiges of empire by the late 1960s still mattered. Prolonging the colonial monetary system devised in the 1930s through to the late 1960s created problems for Britain that shifted the balance of power to the point where Hong Kong and other colonies were able to force British government against its will to re-negotiate their link to sterling. The colonial monetary system had been designed to lend colonial currencies the stability of sterling and to reduce exchange risk in the imperial trade with Britain. By the late 1960s, the colonies instead were supporting the stability of sterling by accumulating sterling assets and then suffered when sterling's exchange risk affected their own economies adversely. The British deal with Hong Kong was an important departure from previous commitments not to offer exchange guarantees for sterling both because they would be expensive and because they might undermine confidence in the exchange rate for un-guaranteed balances. Just after the guarantee was offered to Hong Kong, the British government offered guarantees to all other sterling area governments as part of the Basle Agreements. An examination of this episode therefore offers a fresh perspective on the determinants of British sterling policy in the 1960s and the erosion of imperial financial relations.

Unlike other colonies, Hong Kong was a major sterling balance holder and it remained tangled up in the more traditional ties of colonial status. The UK had a considerable military presence in Hong Kong, and economically the colony remained a market for British goods and source of cheap imports. Because Hong Kong held large sterling balances, the UK could not afford to allow even a small percentage of reserve diversification because of the impact on Britain's reserves and on the reputation of sterling for other holders. The contrast between Hong Kong and the newly independent Singapore was particularly galling for the government of Hong

Kong. With a more highly developed international banking centre than Singapore, Hong Kong had considerable financial clout, but as a formal dependency protected by British troops it was subject to decision-making in London while the independent Singapore government blithely diversified their reserves in 1966-67 without informing London.

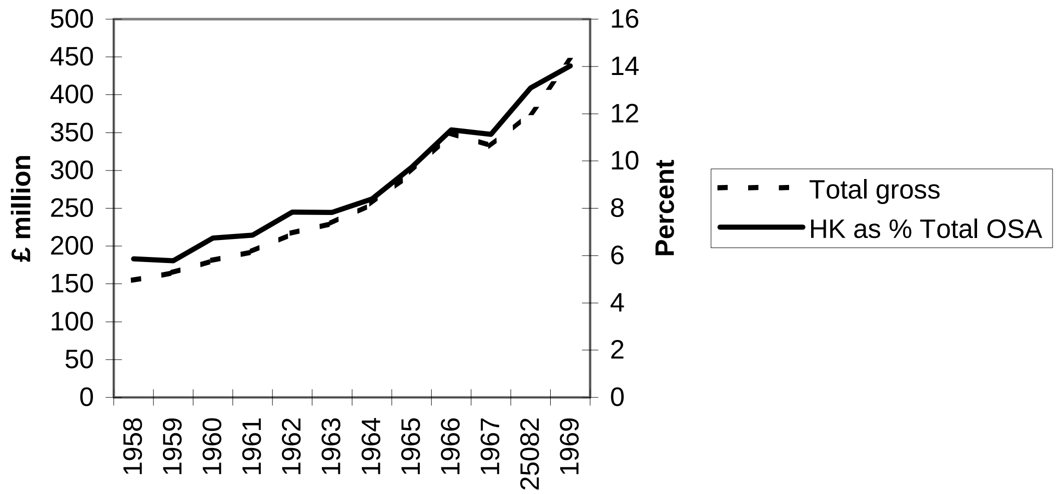
For Hong Kong, the aftermath of devaluation must be viewed as part of the development of imperial policy in these years. The defence review of 1966/67, the Communist riots in the summer and autumn of 1967, and the devaluation of sterling in November have never before been considered together but they help to explain why Britain was driven to concede an exchange guarantee for Hong Kong's sterling reserves well in advance of making this concession to any other holders of sterling. Underlying all the political, military and economic relations between Hong Kong and Britain in the 1960s was the potential impact on Hong Kong's sterling balances, and by extension on the UK foreign exchange reserves at this precarious time for confidence in sterling. Hong Kong built up its sterling assets during the 1960s as a result of balance of payments surpluses and an expanded money supply from about £140-160m in the last few years of the 1950s to £363m by October 1967.[13] This amounted to over 10% of the UK's total sterling liabilities to the overseas sterling area (OSA), making Hong Kong the second largest single holder of sterling balances after Kuwait one month before the devaluation.[14] At this time sterling comprised 72% of OSA reserves; if Hong Kong is excluded this figure is reduced to 64%. Figure 1 shows the published regional figures and how the share for East Asia and the Middle East increased dramatically from the 1950s. Figure 2 shows the growth in Hong Kong's sterling balances pieced together from published and archival records and their rising share of total OSA sterling balances.[15] This growth was the result of successful industrialisation combined with the colonial monetary system that required 100% sterling reserves.

Figure 1: Distribution of OSA Sterling Balances 1945-73



The conflict with Hong Kong over defence and the devaluation in 1967 led to a re-assessment of the value of the colony and even consideration of abandoning it either voluntarily or after being forced out. However, Britain's vulnerability to Hong Kong's sterling balances in the end made a compromise necessary. As the Bank of England/Treasury Sterling Area Working Party Report for 1968 noted 'In the case of colonial territories it was regarded as inconceivable that the metropolitan power would permit the local currency to maintain its old dollar parity when sterling was devalued…Only when devaluation came did the implications of the changed political and economic relationships which had been occurring progressively become starkly apparent.'[16] The next section describes the importance of the defence review of 1966 for these relationships.

Figure 2: Hong Kong Sterling Balances 1958-1969



I

The 1960s marked an era of change in Britain's overseas military strategy and this was influenced by the process of de-colonisation as well as by balance of payments considerations. Britain was able to withdraw forces from Singapore because it was an independent state and no longer under imminent threat after the end of the Indonesian Confrontation in August 1966. Forces were retained in Hong Kong, where Britain had an obligation to its colony and the shadow of Mao's China loomed. Nevertheless, Hong Kong was required to contribute to the cost of its own defence. Withdrawing troops was contemplated briefly, and the potential economic cost considered, although ultimately rejected. This section argues that while imperial obligation meant that Hong Kong's forces were in the end retained despite the withdrawal of troops from East of Suez, the renegotiation of Hong Kong's contribution in 1966/67 poisoned relations with the colony by exposing Britain's reluctance to continue the economic burden of empire.

The British government began to discuss reducing UK defence expenditure abroad from the early 1960s.[17] In the end, however, the withdrawal from Singapore/Malaysia and Australia (ie the withdrawal from 'East of Suez' or of forces from the Far East) could not take place until after the successful conclusion of the Confrontation with Indonesia. This was finally considered imminent during the sterling crisis of July 1966 when planning for withdrawal accelerated. The agreement ending the Confrontation was signed in August, paving the way for serious defence cuts in Southeast Asia in the 1967 Defence White Paper.[18]

No cuts in expenditure were planned for Hong Kong.[19] Partly this was because withdrawing from Hong Kong would not generate much savings. Annual expenditure in 1966/67 in Hong Kong was only about £11m p.a. (3.8% of total defence expenditure abroad in 1967) compared with £86m (30%) in Southeast Asia. The most brutal cuts were to come from reductions in Singapore. It was generally agreed that the UK had to station RAF and army units in Hong Kong, but expenditure was to be tapered off to the absolute minimum. To this end the Ministry of Defence tried to identify the proportion of military expenditure used for internal Hong Kong security and to make the colony pay for this itself. In fact, of course, no British force was likely to be able to protect Hong Kong against a genuine campaign by China to take over the island, so internal security was closely identified with external security. As the Commonwealth Secretary noted, Hong Kong ‘lives on a knife edge for just so long as China is willing to accept the status quo’. On the political system:

> ‘The Administration is frankly colonial, but that is the way the people want it; if an elected element were introduced into the Legislative Council this would bring into the open and precipitate a clash between the supporters of the rival ideologies of Taiwan and Peking. It would then be harder for Peking to stand aside.[20]

Thus, the status quo was only possible through the suppression of opinion considered provocative to China, and it was the internal security of Hong Kong that delivered China’s tolerance on which the colony’s independence depended.

Hong Kong had agreed in 1950 to contribute £1m p.a. to its own defence and this was increased to £1.5m p.a. in 1958.[21] In 1964 the commitment was lengthened to £6m over six years for capital works plus various payments for the return of navy and military property to civilian use. In July 1966 the Cabinet was told ‘Hong Kong provides a special problem. The present defence contribution falls short of meeting the cost of those of the units which are stationed in Hong Kong for purposes of internal security. The total cost of these amounts to £5.5m [p.a.] and it is proposed to seek an additional contribution form the Hong Kong government which would meet the gap.’[22] In August 1966 the Prime Minister instructed the Secretary of State for the Colonies to approach the Governor of Hong Kong about increasing the local contribution to the local cost of the garrison.

Hong Kong strongly resisted contributing more to its own defence. The Governor, Sir David Trench, objected on the basis that his government’s spending was focussed on social services for refugees and development for which the UK gave no aid.[23] Trench’s initial refusal led the Chancellor of the Exchequer to consider the extreme position of withdrawing all troops from the colony. He asked to be briefed on the implications for Hong Kong’s presence in the sterling area, strategic consequences and the impact on Hong Kong as a market for British goods.[24] In the end, however, the Commonwealth Secretary was able to negotiate support from Hong Kong for the foreign exchange cost to the UK of four major units in the garrison. After vigorous negotiations Hong Kong agreed from April 1967 to commit £4.245m p.a. plus local works for the maintenance of the garrison taking the total to about £5m p.a., nearly half of UK defence expenditure in the colony and five times the commitment to date.[25] This was not an easy negotiation and it generated considerable heat in the Executive and Legislative councils.[26] Like the Governor, they resented not getting aid for their social programmes while having to contribute to defence costs that were rightly a burden of empire for the metropole.

The importance of a continued British military presence in Hong Kong for the internal security that was crucial to external security was highlighted by disturbances and civil unrest that erupted in May 1967.

II

At the beginning of 1967, China reportedly encouraged Communist insurrection in Hong Kong and this led to a series of work stoppages.[27] In May, a factory strike turned violent, drawing in a sharp police response and escalating the movement. There followed a series of high profile demonstrations by Communists that were met with large-scale arrests. At the beginning of July, renewed activity culminated in a firefight near the Chinese border in which five police were killed, and this provoked the Hong Kong authorities to begin to use military forces as well as police from mid-July. On 17 July the police closed down the offices of three pro-Communist newspapers and arrested their leaders, provoking an ultimatum from Beijing calling for their release or 'serious consequences'. The British did not heed the ultimatum, and on 22 August the Red Guard sacked the British Embassy in Beijing. The worst of the rioting in Hong Kong was then ended relatively quickly, although there were sporadic terrorist attacks through the rest of the year.[28]

There is considerable doubt about the level of support China gave to the agitators, and whether the disturbances really threatened the integrity of Hong Kong.[29] Both the Americans and the British believed that China could be aiming at a sustained campaign to weaken Hong Kong's authority to the extent that the Communists would rule there without direct confrontation through war. The risks to Hong Kong were mitigated by the economic and financial advantages that Hong Kong provided China. From 1960-67 Hong Kong was the source of about £875m in sterling for China, amounting to one third of China's foreign exchange earnings.[30] The greatest danger was to business confidence, on which Hong Kong's future prosperity and continued usefulness to China depended. By May 1967, however, the Cultural Revolution was under way in China and this movement put political and social revolution above all other considerations. A disaster for a generation of Chinese, there was the possibility that the fervour of the movement might spill over into Hong Kong and/or generate an irrational decision by the Chinese government to invade.

At first, the British Cabinet was sanguine about the disturbances in Hong Kong. At the end of May and again in early June, the Commonwealth Secretary reported on the violence but praised the handling of the Governor and the police in suppressing the protestors.[31] The Chancellor again asked his advisers in May 1967 for an assessment of putting Hong Kong out of the sterling area and of implications for the UK trade balance of cutting off trade with Hong Kong, but was reassured that no action was required or desirable.[32] The sacking of the embassy in July, however, prompted contingency planning in case Britain was forced to withdraw from Hong Kong.[33] This prospect was studied in a poorly titled secret project called Operation Junkheap.[34] A special ministerial committee was established by order of the Cabinet to keep tabs on the situation in Hong Kong.[35] Interestingly, the CIA reported at this time that 'We do not believe the loss of Hong Kong would be a serious psychological blow to Britain or to the Labor government', indeed 'most Britons would accept it philosophically as an inevitable part of the winding up of Empire'. Finally, 'Britain's retreat from Asia will be effectively signalled by the announcement – expected this month [July 1967] – of its intention to give up the Singapore/Malaysia bases by the mid 1970s. The loss of Hong Kong would probably add only marginally to the impact of that announcement'.[36] The pragmatic British approach to evacuation supports this assessment.

The Treasury, Bank of England and Board of Trade prepared a report on the economic and financial implications of evacuation, which was the most urgent aspect under study. The report concluded that no fixed assets would be removable, but the official sterling balances and the sterling assets of Hong Kong residents could be blocked within 24 hours to prevent the Chinese Communists converting them to other currencies. This was the extent of forward planning that was possible for a full evacuation. The report recommended, however, that the Hong Kong government should be drawn into consultations about possible reactions to capital flight if there were renewed disturbances in Hong Kong.[37]

Operation Junkheap promoted a pessimistic tone for Britain's assessment of Hong Kong's future. The Rogers Working Party studying evacuation noted that before the riots the view was that 'although the recent phenomenal growth in HK was unlikely to continue, there could be a long way to go before real economic decline set in', probably only from about 1989. However, after the riots confidence had been shaken and they concluded that 'the greater likelihood may now be a gradual decline from now on'.[38] The Commonwealth Office concluded that very few individuals other than SOE operatives could be evacuated from Hong Kong if China invaded, and that no further precautions could be taken without involving the Hong Kong government. This was dismissed as impossible: 'if any hint emerged that evacuation was being contemplated this would have the most grave effects on the confidence of the Hong Kong population and on the continued viability of the colony in face of Chinese pressure. These effects could well include damage to Hong Kong's economy and financial stability, which in turn could lead to a run down of her sterling balances.'[39] Again, the sterling balances were a major constraint on Britain's position. In any case, the political situation eased considerably by the autumn of 1967 and the contingency planning was abandoned by the end of the year, although the special ministerial committee on Hong Kong's prospects continued to meet sporadically.

Hong Kong's Financial Secretary, J.J. Cowperthwaite was rather taken aback by the resulting consultation exercise that took place in London in September 1967 to discuss how to deal with capital flight from future political disturbances. He asserted that there was 'no tension in the Colony now' and that the Hong Kong government did not engage in long term contingency planning because there were 'too many imponderables'. Foreshadowing problems to come, Cowperthwaite 'was more interested in contingency planning in the event of a devaluation of sterling.... the independent Commonwealth countries had been able to diversify out of sterling to some extent but the dependent Commonwealth had not been able to diversify. His point was not that Hong Kong would necessarily wish to diversify, but that Hong Kong had not the freedom to do so even if they did so wish.'[40]

III

This section assesses the implications of the May crisis for sterling. In Hong Kong, three major banks issued currency by depositing sterling in the Exchange Fund in return for Certificates of Indebtedness.[41] The Exchange Fund invested the sterling in various official sterling assets and interest earned was added to the fund so that the currency was backed 110% by sterling assets. The loss of political confidence in the colony generated a flight of capital through the free exchange market as well as a rise in the demand for currency. During May 1967 alone deposits at the largest bank in the colony, the Hongkong and Shanghai Banking Corporation [hereafter Hongkong Bank] fell by HK$277m or 9%.[42] Over the crisis as a whole from April to August total deposits of the banking system fell by HK$1.2b or 13% (time deposits by 22%). Currency in circulation increased by 35% over the same four months, equal to 65% of the value of the fall in deposits. In May/June 1967 capital flight took place particularly through the free market in US dollars, the market peaking at US$1=HK$6. Perversely, this led to a shortage of sterling. The security sterling market in London was closed in April 1967 so the Hongkong Bank had been using the free market to buy US$, then converting them to the sterling the bank needed to feed

China's demand, to increase their reserves in London, and to cover the issue of extra currency notes. With free US$ leaving the colony or being hoarded locally, the Hongkong Bank was short of ways to buy sterling. This prompted them to appeal to the Government for support since their problems arose from their duties as the main note-issuers for the colony.

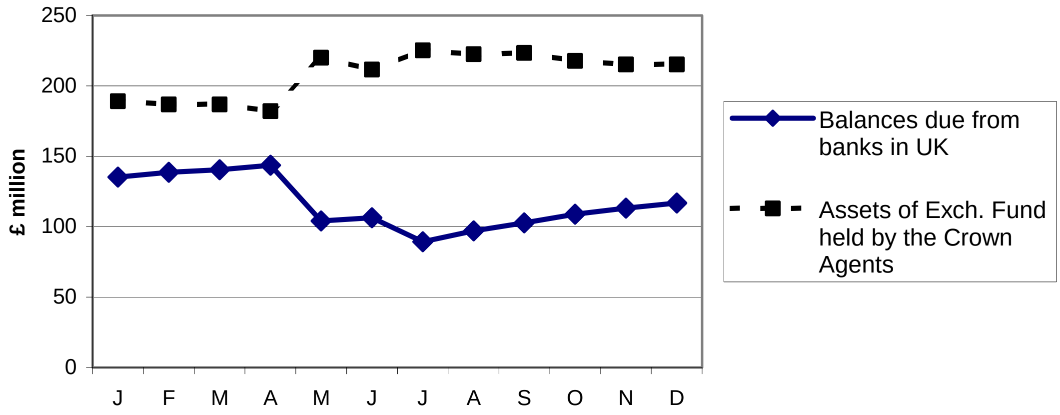
The emergency note issue sparked a large demand for sterling, particularly by the Hongkong Bank. The 'disturbances' of May 1967 required the Hongkong Bank to increase the note issue by HK$671m (£42m) from May to July (of which HK$80m [£5m] was issued in the first week of June).[43] In the first half of 1966 the Bank had purchased £34m of sterling through the free market but in the first half of 1967 were only able to buy £15.3m.[44] On 18 May 1967 Freddie Knightly of the Head Office in Hong Kong noted that 'the open market for US$ has dried up'.[45] On 5 June Knightly met with the government to warn them of the impending shortage of sterling needed to expand the note issue and to 'feed the Bank of China'.[46] NHT Bennett of the Hongkong Bank identified this as 'the most pressing problem that faced us and the Government at the moment' since if Hong Kong could not supply China with its required sterling, Hong Kong would be of 'no economic benefit to them.'[47] As noted above, sterling receipts from Hong Kong amounted to one third of China's foreign exchange earnings.[48]

At the start of the 1967 crisis, the Hongkong Bank had £72m in available sterling cash but this had fallen to £28.5m by 5 June (net of £16m committed to be delivered to the Bank of China and other banks by September). The Hongkong Bank hoped that the UK would provide the sterling to expand the note issue and meet the Bank of China's demands. Failing this, they suggested closing the free market or reducing the sterling backing of the currency.[49] In February 1965 the Bank of England had pledged £20m as emergency note issue in response to the banking crisis of that year so it was not unreasonable to expect a similar arrangement two years later, however, the request was refused. Instead, the Hong Kong government suggested that the Hongkong Bank could pledge their own British government securities as backing for the note issue, to which Knightly replied 'our securities were part of the bank's reserves as a whole and were not available to meet a crisis inflation of the Note Issue. I have always thought there was a trap attached to this Note Issue role of ours'.[50] This is particularly interesting in view of the claim by banks in 1968 that their sterling assets should be considered equivalent to official sterling balances and so subject to guarantee under the Basle agreements. Cowperthwaite (with the support of the Bank of England) suggested that HK$ deposits by banks could be used as cover for the note issue since this was legal under existing legislation.[51] At the end of June, the Hong Kong Government deposited £10m for 'liquidity reasons' on seven-day deposit, thus increasing the Hongkong Bank's London balance of sterling from £42m to £52m.[52] In the end, the demand for notes eased off and the note issue did not need to be expanded much after the first week of June. The Hongkong Bank was thus able to ride out the storm at the expense of their reserves in London, which remained below £60 to the end of the year.[53] Unlike during the banking crisis of 1965, no support had been forthcoming from the UK.

As Figure 3 shows, the net effect of the expanded note issue was to transfer sterling from the account of the note-issuing banks to the official reserves of the exchange fund. At the end of 1966, official and private balances each comprised about half of total sterling balances but by the end of June the official share had risen to 60% with only 40% held privately and this proportion continued through to October. However, during the autumn high interest rates in London did attract some

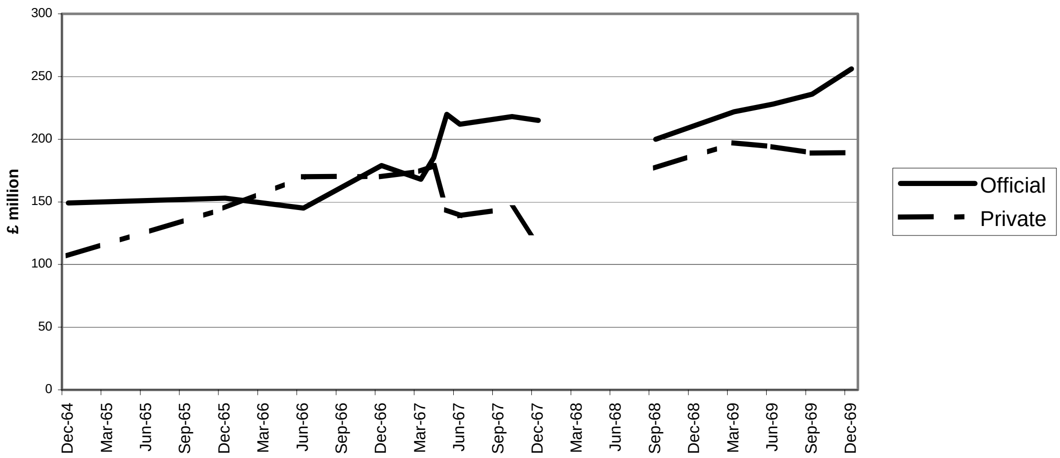
Hong Kong banks, particularly Hang Seng, which had £10m in London on the eve of devaluation.[54] Figure 4 shows the change in the distribution of official and private balances.

Figure 3: Hong Kong Banks' Deposits in UK Banks; Assets of Exchange Fund (monthly 1967)



While Hong Kong's sterling balances stayed relatively stable overall, those of another major group were run down in the months leading up to the devaluation. Between May and August 1967, Arab states' official holdings of sterling fell from £812m to £592m due to war in the Middle East. Most of these balances were held by Kuwait, whose gross sterling reserves fell from £440m to £346m, although by the end of November they had recovered somewhat to £399m.[55] Meanwhile, with sterling under pressure, Australia ran down its official balances by 17% in the first ten months of 1967 to £266m.[56] This put Hong Kong in a relatively more prominent position as a sterling balance holder on the eve of devaluation.

Figure 4: Official and Private Sterling Balances 1964-69



In summary, the defence review, closely followed by the Communist disturbances, led to a reassessment of Britain's commitment to Hong Kong. It was decided that military protection could not be withdrawn in the way that it could from Singapore, although these troops would not be very useful strategically once cut off from chains of supply. Hong Kong's sterling balances were a primary concern when discussing whether it was possible to abandon the colony. Passing to Hong Kong half of the financial burden of the troops raised hostility between Hong Kong and London in the months before devaluation. The disturbances of 1967 emphasised the fragility of Britain's tenure in Hong Kong and the possible loss of the colony was considered with equanimity, although it was not in the end necessary. The financial consequences were more long-lasting; business confidence weakened, sterling assets were transferred from banks to the government, ways for the UK to ease Hong Kong's monetary difficulties were proposed, rejected and in the end abandoned. Into this rather uneasy truce between London and Hong Kong came the devaluation debacle.

IV

Hong Kong had considerable autonomy by the 1960s, born in part from Governor Grantham's vigorous defence of the colony's aberrant foreign exchange procedures such as the free exchange market and gold market in the 1940s and 1950s.[57] From 1948 the colonial government set its own budgets and expenditure and was not the recipient of British aid. Unlike other colonies, Hong Kong was in the process of rapid and successful industrialisation and hosted an increasingly important international financial centre. However, this success left a flavour of resentment between London and Hong Kong. In his tour of the Far East at the beginning of 1967, the Commonwealth Secretary noted that 'the Government of Hong Kong have done so much for themselves that they tend to feel forgotten by us. For that reason any gesture demonstrating continued interest and concern would be very welcome'.[58]

As pressure against sterling mounted, Hong Kong tried to ascertain what independent powers it had over its relationship with sterling. In October 1966 the Commonwealth Office enquired on Hong Kong's behalf whether the British or the Hong Kong government legally set the parity rate for sterling. The response from the Bank was ambivalent, with Mynors noting that 'there is an even chance that the lawyers would say there is no power of direction'.[59] A year later, on the eve of the devaluation, the British official position was that it was up to the Hong Kong authorities whether they changed their parity with sterling.[60] We shall see that after the fact, they changed their minds.

As noted above, Cowperthwaite was on a visit to London in the autumn of 1967 and asked whether Hong Kong was free also to diversify their reserves. D.F. Hubback (Under-Secretary of the Treasury) replied that formally the Secretary of State for the Colonies would have to give direction on this issue but that the UK hoped that Hong Kong would not diversify. Cowperthwaite followed up with the observation that if Hong Kong did not have the freedom to diversify as other sterling area countries did, then Hong Kong should be entitled to compensation in case of devaluation. Hubback's refused to consider this citing the traditional colonial monetary system; a large part of Hong Kong's sterling reserves were backing for currency and so could not be diversified anyway, although as was seen above they might have been protected from devaluation if HK$ were used. He also argued that most trade was with sterling countries (and so would not be damaged by devaluation if they all followed the pound) and in effect Hong Kong already had dollar reserves through the holdings of US$ by commercial banks arising from the free market. Nevertheless Cowperthwaite warned that Hong Kong 'had to look to us [UK] to safeguard their interests. As a dependent territory, for instance, they could not turn to the Fund or any other international body for help'.[61] Britain did not heed the warning that Hong Kong expected support from the metropole and this set the stage for confrontation.

At the time of the devaluation Hong Kong's total sterling assets were about £400m including outstanding sterling export contracts, so the devaluation of sterling by 14% created an immediate loss of £56m.[62] The Hong Kong government reported that the sixty authorised banks in Hong Kong held £80m in sterling but very few US$ because their 'authorised' status precluded keeping large overnight positions. The 20 largest unauthorised banks held £14m in sterling (of which £10m was held by one bank – likely Hang Seng) and they also held about $20-30m in US$.[63] The total cost to Hong Kong of sterling's devaluation was estimated to be £30m for the government and a further £20-25m for banks (about half of which was for commercial contracts). The government's share of the losses was to be paid from surpluses and official reserve funds that had been set aside for development projects.

One of the most important symbolic issues for Hong Kong was that they did not receive adequate notice about the decision to devalue. Australia, New Zealand, Singapore and Malaysia (as independent sterling balance holders in a distant time zone) were informed at around 09:30 GMT on Saturday 18 November, some six hours before Hong Kong, which was informed along with the rest of the independent sterling area, although ahead of other colonies.[64] The Commonwealth Office urged the Treasury to inform Hong Kong at the earlier time, but the Treasury refused. Ryrie recalled that 'we were reluctant to give Hong Kong more privileged treatment than other independent countries'.[65] Hong Kong was the only colony to receive any advance warning, but this did not soothe their indignation since members of the executive and legislative councils heard the news from banking contacts in Singapore and Malaysia rather than from their own government.[66]

After the decision to devalue sterling was made, Holmer of the Bank of England was sent immediately to Hong Kong and reported back on the decisions taken by the government there on the 19th November. At first, Cowperthwaite stuck to his earlier position and asked for compensation if Hong Kong agreed to maintain parity with sterling but Holmer refused even to consider this option. Official opinion in Hong Kong was split. Among members of the Executive Council, bankers wanted to maintain the parity to avoid losses on uncovered positions in HK$, while Chinese and some official members wanted to change the parity in order to minimise the inflationary impact of higher imported food costs (45% of Hong Kong's food was imported from China which did not devalue).[67] Saunders of the Hongkong Bank was particularly angry and challenged Holmer about the UK reaction to Hong Kong liquidating all of its official sterling assets at once. Holmer replied that this would 'invoke the bald constitutional relationship', i.e. that Hong Kong would be denied the right to take such action against the UK interest. The Hong Kong government quickly announced that the HK$ would follow sterling in its 14% devaluation against the US$.

Meanwhile, opinion critical of the decision to devalue the HK$ mounted. On the morning of the 20th November, Cowperthwaite met Holmer at breakfast and asked about the possible IMF reaction to a revaluation of the HK$ and whether the Bank of England would help organise (but not pay for) the compensation to traders for the change in decision. This threw London into a panic since if the IMF did not agree to this change in parity, the UK might not be able to draw on the Fund to support the devaluation. In the end, however, the Executive Board in Washington approved the new rate 'with only a little pulling of our [UK's] leg'.[68]

The Executive Board of the IMF met twice on 22 November. At its first meeting the Board accepted the full devaluation of the HK$ on the basis that 'the monetary systems of the non-metropolitan territories, although nominally different, were for all practical purposes, a part of that of the UK.'[69] Given the penetration of Hong Kong textile imports into Europe, there was some dissent from this position in the case of Hong Kong, which was described by Plescoff as 'known to be internationally competitive, required separate study, if [whether], in fact, a fundamental disequilibrium did exist in that territory'. The Board was then recalled later the same day to agree to the revaluation of the HK$. Saad remarked that 'the Board look ridiculous to pretend that both that decision [of previous meeting] and the one now proposed were correct.' but the new rate was agreed.[70] On 23rd November the Hong Kong government announced a revaluation of 10% against the pound (from HK$16 to HK$14.5), amounting to a devaluation of 5.7% against the US$. This marked a victory of public and official opinion over financial interests but was an embarrassment for the Governor and Financial Secretary. The lobbying now began in earnest for compensation for past events and guarantees for the future.

V

On 28 November 1967, Sir David Trench wrote a bitter letter to the Commonwealth Office that marked a watershed in Hong Kong's imperial relations with Britain. In an impassioned tone, he wrote

> I find it difficult to find words to express my feelings and those of my advisors, official and unofficial, on the manner in which Britain has now defaulted on its very large net financial obligations to Hong Kong.

He deplored the lack of notice given to Hong Kong compared to other independent countries and the failure of the UK as 'the Metropolitan Power' to protect Hong Kong's interests, and asked the UK government to make an 'expression of regret' at how the debacle was handled. With respect to the unusual position of the HK$ he noted 'it is no easy task to operate what has in fact, in spite of its traditionally very close links with sterling, become a quite important international currency without the right to enter into international relations such as representation on the IMF or elsewhere might give, and without even the right of direct access to departments in London.' Thus, Hong Kong's regional financial importance was incongruous with its colonial status. He asked for compensation either in the form of 'waiving the current defence contribution for the remainder of the present quadrennium or a £10 million grant towards the airport extension'. Also he asked to consult on measures 'to safeguard so far as that is possible our future financial interests in such a way as to minimize the effect on them of adverse developments in the British economy-at least to the extent that has been permitted the independent members of the Commonwealth', i.e. diversification of reserves.[71] A day later in the Legislative Council, Cowperthwaite announced 'I think I can make one claim – that the Hong Kong dollar came of age last week'.[72]

The Treasury's response was a firm rejection of any prospect of allowing Hong Kong to diversify their reserves. Hubback believed that the Governor's indignation was misplaced, arguing that

> It is wrong to argue that Hong Kong should be allowed to diversify just like any Overseas Sterling Area country, e.g. Australia. Hong Kong is sui generis in being an entirely artificial economy. If for some reason or another we cease to show an interest in Hong Kong, the Chinese would walk in tomorrow and then Hong Kong might well find all its sterling blocked. It is wrong to

> describe our request to Hong Kong not to diversify as 'colonial exploitation'. Hong Kong is in a very special position – though Mr Cowperthwaite quite understandably likes the Nelson touch.'[73]

Ryrie in the Treasury was one of the most vocal exponents of the Treasury view, describing Trench's telegram as 'unreasonable'[74] and remarking that 'the fact that the Governor and the Financial Secretary are indignant is neither here nor there and I am not sure that a certain amount of indignation in the Executive Council matters very much either'.[75] The Commonwealth Office, however, believed that Hong Kong ought to be allowed to diversify, mainly because of the political unrest that might follow a flat refusal, given the recent Communist disturbances.

Under pressure at home, in January 1968 Cowperthwaite compensated local banks for the re-adjustment in the exchange rate, excluding unauthorised banks (who were not required to keep external balances in sterling or HK$) and those that could have covered their positions but did not do so. Contrary to Strange's assertion, the British government itself never compensated private banks in Hong Kong.[76] The Hongkong Bank received the most compensation, HK$82.8m (£5.7m) after claiming HK$86.6m.[77] Hang Seng Bank was particularly bitter that it received no compensation because it had built up its sterling balances in London just prior to the devaluation for commercial purposes and to take advantage of high interest rates there.[78] The Governor expected that in future Hong Kong banks would seek to cover all sterling transactions through the forward market in London at some cost to the Bank of England. To avoid this, Cowperthwaite asked the British government for an exchange guarantee for the official reserves that would allow the Hong Kong government to compensate banks for any future devaluation.[79] This was flatly refused on the basis that 'to allow such a radical departure from sterling area practice at this point of time would be an invitation to other governments to ask for similar treatment; and the implications of this could be very serious.'[80]

Meanwhile, the Under Secretary of State for the Colonies, Arthur Galsworthy, was sent to Hong Kong to 'take some of the heat out' of the devaluation issue and 'to gauge the strength of feeling outside Government circles on the question of diversification, particularly amongst Chinese opinion' to better inform British decisions about how to deal with the impasse.[81] Galsworthy found that the unofficial members of both Executive and Legislative Councils (who met as UMELCO) were much more upset by this issue than they had been by either voluntary export restrictions on cotton textiles or the demands for contribution to defence expenditure. Galsworthy returned to London convinced that some element of diversification was necessary, noting that 'the Governor himself is quite categorical in his view that we cannot any longer simply treat Hong Kong as a conscript into sterling, and ignore the strong feeling that they should be given the same freedom to diversify as is enjoyed by, say, Malaysia or Singapore'. Moreover, many unofficial members of the councils were threatening to quietly resign their posts, which would make 'immense difficulties for us [UK] in Hong Kong'.[82]

By this time the Bank of England agreed with the Commonwealth Office that some gesture toward diversification would be necessary, and suggested a total equal to about 25% of existing balances over 18 months, costing about £40-50m in reserves.[83] This was the deal that had been secretly agreed with Bermuda and Bahamas because of the damage devaluation had caused to international banks there. However, the case of these other colonies was much less controversial because their official reserves were only £5m and £8m compared to £371m for Hong Kong. As well as political dangers, the Bank was worried that if no diversification of official reserves were allowed, large banks in Hong Kong would lose confidence in their government's ability to compensate them for a future devaluation. These banks might then diversify their own holdings of sterling (that amounted to almost half of Hong Kong's sterling balances) through the free market. This would result in a less orderly drain on British reserves than official diversification. This was also the rationale behind the compromise in the case of Bermuda and Bahamas, where private balances amounted to £56m and £90m respectively.[84] The pressure for changing the sterling reserve system therefore arose from fears of uncontrolled diversification of private sterling balances rather than official balances. In Bermuda and Bahamas the ratio of private to official balances was more than 10:1 compared to an almost equal balance in Hong Kong. This helps to explain the early compromise on diversification in these territories, in addition to the relatively small amounts involved.

The Treasury was not convinced that diversification needed to be offered to Hong Kong and chose to play the game long. When Cowperthwaite returned to Hong Kong in January, they hoped that no agreement might be necessary in the end since Cowperthwaite was not returning to London until April and it was hoped the whole issue would blow over in the meantime.[85] At this time Hubback reported that Cowperthwaite had told him that in his view there were 'no political difficulties in Hong Kong to their leaving the sterling area. Indeed such a move would be welcome in so far as it gave the Hong Kong government more freedom to run its own affairs and in particular its own reserve policy.'[86] However, this would entail diversification of Hong Kong's reserves unless the sterling balances were blocked, which would itself damage sterling's reputation and generate a flight from sterling by other holders. Removing Hong Kong from the sterling area had been considered ever since the late 1940s but was repeatedly rejected. In the 1950s and early 1960s the reasoning was that the free exchange market could not effectively be suppressed, it provided a safety valve for otherwise tight exchange controls, and it tightened the security sterling market. There was also a possible threat to political stability if ejection from the sterling area were interpreted as a lessening of British interest in the colony.[87] By the late 1960s, when sterling balances were so much greater, the practical obstacles to blocking them became paramount.[88]

On his return to Hong Kong, Cowperthwaite was greeted with intransigence on the part of UMELCO, where feelings were still bitter. This prompted him to return to the offensive in his correspondence with London, arguing that 'It is clear that it is no longer possible to require even a politically dependent territory to hold its reserves in such form that its wealth, livelihood and standard of living are at the complete mercy of adverse economic and financial developments in the metropolitan country for which it is no way responsible.' He also began a campaign to include private bank assets in any deal on guarantees or diversification. In particular, the banks that issued currency had to keep precautionary sterling reserves and also were the recipient of considerable government deposits, so Cowperthwaite argued that 'no distinction can be made in the present context between official and bank assets'.[89] He demanded 50% diversification of reserves including banking assets and official funds, arising from 10% p.a. of existing reserves and all of newly accruing reserves. In the meantime he asked for a gold guarantee for the exchange value of 50% of existing reserves. This would have cost the British reserves about £56m p.a. for 1968-70 and £45m in 1971.[90]

In February 1968 the Treasury position remained firm; 'Hong Kong is a Colony and that, whatever the other sterling area countries do, we cannot allow Colonies to rock the boat'.[91] But Hong Kong was rocking the boat anyway. Cowperthwaite raised the ante by hinting at a deal for diversification in his budget speech at the end of February, which was taken up by the newspapers in London, put pressure on the sterling exchange rate, and prompted other sterling area countries to enquire about the details of negotiations. The Governor also sent a petition from local bankers demanding a gold value guarantee for their sterling assets.[92] The First National City Bank in Hong Kong began to refuse forward cover for sterling exports and other banks insisted on fixing rates for contracts for sterling imports.[93] Exporters in Hong Kong began to sell their sterling forward to the note issuing banks, increasing the banks' overbought position substantially. These banks threatened to refuse to continue to accept sterling and Cowperthwaite was forced to guarantee these positions using the Exchange Fund. Thus the Hong Kong government was essentially providing forward cover for sterling themselves out of their own resources. Cowperthwaite complained that London 'can instruct this Colonial Government to refrain from taking any step in Hong Kong's interest which it deems be against its own, and thereby force us into providing banks with protection at our own expense if our banking and foreign exchange facilities are not to break down. Surely it would not be unreasonable to describe this as a clear misuse of Colonial power?'[94] It was clear that the Treasury's hope that the issue would merely fade away was not going to be realised. In the meantime the collapse of the Gold Pool in mid-March 1968 sparked new concerns about the future of sterling in the international monetary system.[95]

Hong Kong's demands hardened the Bank of England's view. At the end of March, Haslam of the Bank wrote:

> 'As Hong Kong receives no development aid she feels that the UK is neglectful of the wellbeing of citizens of a Colony where per capita incomes remain low. What is continually overlooked, of course, is that the UK's defence commitment to Hong Kong is onerous indeed… Against this Hong Kong's arguments for complete financial independence are quite unrealistic, not to say somewhat impudent'.[96]

At the end of February, in a separate discussion about the dangers of diversification by the Overseas Sterling Area (OSA) and how to avoid it, Snelling at the Commonwealth Office suggested copying the Roosa Bond, i.e. issuing bonds denominated in an OSA's own currency in return for sterling assets.[97] Although dismissed by the Treasury at first, Ryrie eventually conceded at the end of March that it might be an attractive option for Hong Kong whose currency was 'stronger' than sterling. The UK would issue HK$ denominated bonds that Hong Kong would acquire in exchange for a proportion of their sterling assets. The bonds would be medium term (7 years) and would protect this portion of the reserves from a sterling devaluation (if the HK$ did not follow).[98] This plan had the advantage that it would not appeal to many other sterling area countries, whose own currencies were not likely to be stronger than sterling in the medium term, although it did provide Hong Kong with a 'thinly disguised version of a sterling value guarantee'.[99] At this time there were no plans to offer guarantees to any other sterling balance holders.

When recommending the scheme to the Chancellor of the Exchequer, Samuel Goldman, Third Secretary to the Treasury, advised that 'We sink or swim together, and it can be argued that in these circumstances there is no call for us to grant concessions to Hong Kong. Moreover we can ill afford any concessions particularly at present'.[100] However, there were four arguments in favour of a compromise. First, he remarked that 'one can no longer wield the big stick in one's relations with a colony, not even one so uniquely placed as Hong Kong.' Secondly, Hong Kong had 'a sophisticated economy and financial structure which functions quite independently of the UK and one can argue that now it has been shown that the link with sterling can be broken, some cover for their exchange risks should be allowed against a further divergence of the currencies'. Thirdly, there was a considerable danger that private banks would diversify their substantial assets and stop cooperating with exchange control if they did not feel confident that a compromise had been reached that would reinforce their government's ability to compensate them in the future. Finally, he noted the threat to political stability if UMELCO members resigned. The Chancellor agreed to recommend a bond of £100m or about 50% of official reserves. This would not provide enough cover to fully compensate banks in the event of a future devaluation of sterling, so the Hong Kong government was advised to bring some of these assets into official reserves through the issue of Treasury Bills to the banks. This preserved the principal of distinguishing between support for official over private holdings while still de facto extending the guarantee to bank reserves.

It proved difficult to sell this plan to Cowperthwaite and Trench when they met at the beginning of May in London.[101] After three meetings, Trench had approved in principle but asked for a total of £200m, finally settling for £150m or 50% of reserves (variously defined), whichever was the less. By this time the UK calculated that Hong Kong's official and private sterling balances had increased to £371m of which £200m (54%) were official reserves. Trench clung to the view that private bank assets must also be protected from sterling's future rate changes.

The Commonwealth Office took the opportunity to advise on the constitutional position on changing the parity between the HK$ and sterling. Letters patent and Royal Instructions of 1917 gave the right to decide on this matter to the Secretary of State. This power had been delegated to the discretion of the Governor in November 1967, but only for this specific instance so the right to decide in any future case still lay with Secretary of State. The Treasury explained that this power was reserved mainly to prevent parity change of HK$ without prior approval of IMF that could only be sought by the British government since Hong Kong was not itself a member. Trench was disappointed and expressed his view that the bond scheme would be tacit recognition that in practice the exchange rate now lay within the discretion of the Governor of Hong Kong. For him, this was another advantage of the scheme.

Cowperthwaite left for Hong Kong immediately after the meetings and returned ten days later without the agreement of the Executive Council, which still insisted on a guarantee in terms of US$. Moreover, the banks resisted giving over their assets in return for Treasury Bills and wanted separate cover for their sterling holdings.[102] The government itself did not want to issue Treasury Bills since it had never issued them before and there was no fiscal need to issue debt. Hong Kong also felt that the interest rate payable on the bonds was disadvantageous. The wrangling continued until the Secretary of State sent a strongly worded personal telegram to the Governor in Hong Kong

> we cannot continue the bazaar haggling... It is, I am convinced, no exaggeration to say that the reception by world financial opinion of what is decided between you and us could have a profound effect on the future of sterling and indeed on the whole world monetary mechanism. In these circumstances I not only earnestly hope that you will carry your Executive Council to endorse the agreement as at present drafted.[103]

This had the desired effect and the next day the Executive Council reluctantly agreed to the bond scheme. Trench advised the Secretary of State that at the Executive Council meeting

> some fairly outspoken language was used by both Chinese and Europeans, and I fear confidence in HMGs good intentions towards Hong Kong may have suffered further erosion. It has been difficult for them to understand, much less accept, why no better arrangement could be allowed us, and the feeling is strong in them that a device which the course of events may render of no benefit, but for which we must pay a by no means inconsiderable price, has been forced on them by reason of Hong Kong's dependent status.[104]

Press reaction to the agreement generally marked this as a watershed for the end of the sterling area and the starting point for negotiations with other sterling area countries. In June 1968, Singapore expressed interest in negotiating a similar scheme for its sterling assets and was told that in principal an approach from Singapore would be welcomed.[105] A mere two weeks after the deal was concluded, however, the Commonwealth Office advised Hong Kong that negotiations for a medium term facility related to fluctuations in sterling balances were underway in Basle.[106] Hong Kong was then treated on a par with independent sterling area countries and was among the first to conclude negotiations for a Basle Agreement, along with Bahamas and Fiji at the end of July 1968.[107] The Hong Kong government chose to scrap the existing deal, although they had already taken up £62m in HK$ bonds, and quickly negotiated an exchange guarantee for their sterling holdings in return for agreeing to keep a minimum sterling proportion of 99%.

How did the Hong Kong Bond scheme relate to the Basle Agreements of 1968? Ghose has assumed that press reports of the time were true and that the concession to Hong Kong sparked the search for similar protection from other sterling area countries that then negotiated the Basle Agreements.[108] Unfortunately, the archive trail is not so clear. The Hong Kong local currency guarantee was devised at the end of March, put to the Chancellor at the end of April, then to the Hong Kong government at the beginning of May, and finally concluded at the end of May 1968. The possibility of arranging multilateral support in the case of a wide-scale diversification of sterling reserves began to be discussed in the Treasury and Bank of England in February and March 1968 but was interrupted by the gold crisis of mid-March.[109] The Governor of the Bank of England put a plan to BIS central bankers in April for a medium term facility to 'fund' sterling area sterling balances, by which time the Treasury and Bank of England had designed the Hong Kong bond scheme. However, there was no guarantee of sterling balances as yet in the Basle Agreement discussions and it was ruled out by the Sterling Area Working Party in January 1968 and again by the Bank of England in April 1968.[110] The guarantee part of the Basle Agreements arose from pressure from European participants that some arrangement be made with the OSA to ensure that they would not diversify any further other than for balance of payments reasons before they would agree to offer support through the BIS.[111] Guarantees did not enter the Bank of England's deliberations until 7 May (a few days after the Hong Kong Bond plan was put to Trench and Cowperthwaite). An exchange guarantee became a firm possibility at the end of May (the same time the Bond scheme was finally announced) and was suggested to a few BIS partners in the first week of June 1968. The Bank of England and the Treasury finally agreed in mid-June 1968 to offer guarantees to the OSA only weeks before the negotiations began with OSA countries.[112] Although there is no smoking gun linking the Hong

Kong settlement to the Basle Agreements there can be little doubt that holding the line against guarantees was less vigorously pursued after the Hong Kong deal was public, and in this way the Hong Kong deal paved the way for the conclusion of the Basle Agreements of 1968.

VI

This paper has emphasized the importance of events leading up to the devaluation for the eventual outcome. The re-negotiation of the strategic burden of empire in 1966/67, the threats to Hong Kong's integrity and the monetary consequences of this disturbance all influenced the outcome of the devaluation debacle for Hong Kong. By November 1967, Hong Kong felt in a stronger moral and financial position because they received no aid from the UK and had agreed to take over almost half of the defence burden of the colony. In London, the May riots led to a questioning of Hong Kong's value and contemplation of withdrawal that stiffened British resistance to compromise. Britain's refusal to ameliorate the monetary consequences of the crisis marked a departure from the attitude taken two years earlier, and the shift of sterling balances to the government meant that the negotiation for official guarantee covered a larger share of the balances.

This episode shows that colonial status did matter in the late 1960s. Up to the time of the devaluation the Bank of England and the Treasury believed they could still control colonies through constitutional powers and that the colonial monetary system would survive the devaluation. Empire mattered also to the colonies themselves who had built up considerable sterling assets as a result of the colonial monetary system but lacked the ability to protect themselves from the weakness of the British economy and sterling. The growth of banking activity in Bermuda, Bahamas and Hong Kong increased Britain's vulnerability to diversification by colonial banks and prompted compromises on official sterling balances. Colonies where official balances were small were allowed to diversify, but in Hong Kong London's first sterling exchange guarantee had to be offered instead.

The devaluation of 1967 therefore had far-reaching consequences not only for the British economy and its relative performance but also for the evolution of imperial relations. The devaluation debacle clearly demonstrated the difference between the newly independent territories of the Commonwealth that had emerged in the 1950s and 1960s and those that remained colonies. Hong Kong found itself in the invidious position of being a major sterling balance holder, a major regional international financial centre, but still low down on the list of countries given warning of the devaluation and among the few territories refused the right to diversify reserves after the devaluation. However, it was Hong Kong that managed to negotiate the first guarantee for the value of official reserves, albeit a guarantee in terms of HK$ rather than directly in another currency or gold. The threat to Hong Kong's political stability was a factor, but this became less pressing as the negotiations progressed. The moral issue of not forcing a dependency against its will to hold sterling was also not the deciding factor. Hong Kong's pleas to diversify earned no response before devaluation. After devaluation, officials in the Treasury took a particularly hard line on the moral case, balancing this claim against Britain's defence commitment in Hong Kong, ignoring the increased local contribution. Instead, Britain's vulnerability to the diversification by private banks in Hong Kong was the driving threat.

The increase in Hong Kong's sterling balances through the 1960s as a result of the colonial monetary system gave the colony considerable power in their relations with the UK. The threat these liabilities posed to London's reserves was raised repeatedly as a constraint on British policy actions; Britain couldn’t withdraw from or undermine political stability in Hong Kong or put Hong Kong out of the sterling area unless those balances were blocked. If a major sterling balance holder had their assets blocked in circumstances short of invasion, this in turn would prompt a flight from sterling by other holders. Nevertheless, at the time of the devaluation, the Treasury and Bank of England certainly thought that ‘Empire’ still meant that the metropole could call the shots, despite having shifted much of the imperial burden of defence to Hong Kong in 1967. The Commonwealth Office was more sensitive to the local political dangers of issuing ultimatums, particularly in the case of Hong Kong because of the Communist insurrection of that year. In the end, however, the financial reality required that the UK back down from its initial complete refusal to compromise. British negotiators eventually had to concede their first sterling exchange guarantee to ensure that private sterling balances were not cashed in. This marked the acceptance of the shifted balance of power between Hong Kong and London. The financial distinction between colonies and independent states was subsequently eroded by the application of the Basle Agreements to all holders of sterling, dependent and independent.

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[2] At the end of 1962, R. Maudling, Chancellor of the Exchequer, asserted that 'I regard it as a major aim of policy to free the UK economy from the inhibitions of reserve currency status'. Quoted by Mynors, 3 January 1963. BE OV47/63. The Bank’s agreement was noted in JS Fforde to Thomson-McCausland, 2 December 1964. BE OV53/30.
[3] The classic account is A. Cairncross and B. Eichengreen, *Sterling in Decline*, (1983).
[4] Letter from the Governor of Bermuda, Lord Martonmere, 18 December 1967. National Archives, Kew, London, [hereafter PRO] T312/1979. See also correspondence with Bahamas, PRO T312/1981.
[5] For a list see D.K. Fieldhouse, *The Colonial Empires*, (1965). p. 408.
[6] C.R. Schenk, 'Monetary Institutions in Newly Independent Countries', *Financial History Review*, (4) 1997, pp. 181-198.
[7] By 1958 Australia held only 55% of its reserves in sterling and the sterling proportion for India, Pakistan and Ceylon was already below 50%. CR Schenk, *Britain and the Sterling Area*, (1994), p. 30.
[8] For Bahamas see PRO T312/1981. Bahamas had been allowed 25% diversification into US$ (equivalent of £2m over 2 years) in October 1965 due to its close economic links with the USA. For Bermuda see PRO T312/1979.
[9] B.J. Cohen, *The Future of Sterling as an International Currency*, (1971), p. 183 fn. S. Strange, *Sterling and British Policy*, (Oxford, 1971), p. 113.
[10] D. Aldcroft and M. Oliver, *Exchange Rate Regimes in the Twentieth Century*, (Cheltenham, 1998). B. Alford, *Britain in the International Economy since 1880*, (1996). H. James, *International Monetary Cooperation since Bretton Woods*, (Oxford, 1996), pp. 188-90. A Cairncross, *The British Economy since 1945*, 2nd ed. (Oxford, 1995), pp. 162-170.
[11] G. Krosewski, *Money and the End of Empire* (2001) A. Hinds, *Britain’s Sterling Colonial Policy and Decolonization* (Westport CT, 2001).
[12] Krosewski, *Money*, p. 205.
[13] Of the 1950s total about £50-60m was held by commercial banks, £30m in government reserves and the rest as currency backing held by the Exchange Fund. ‘Hong Kong Dossier’, prepared for Mr Haslam, 1 October 1959. Bank of England Archives [hereafter BE] OV14/13.
[14] Kuwait’s balances were £515m in October 1967. This data is from BE OV44/116, which differs slightly from published series.
[15] 1958-63 from Digest of Colonial Statistics, 1964-66 from BE OV44/116, 1967 from OV44/259.
[16] Sterling Area Working Party Report draft, 25 January 1968. BE OV44/116.
[17] M. Jones, ‘A Decision Delayed’, *English Historical Review*, June 2002.
[18] Note by Secretary of the Cabinet (Burke Trend) on The Economic Situation, 18 July 1966. Cabinet Memoranda CAB129/126.
[19] Report by the Defence Review Working Party, 4 July 1967. CAB129/131.

[20] Confidential Memo by Secretary of State for Commonwealth Affairs, 28 March 1967. CAB129/128.

[21] This was part of a wider re-assessment of the defence of Hong Kong. CK Mark, 'A reward for good behaviour in the Cold War', *International History Review*, 22 (4), 2000, pp. 837-61.

[22] Note by Secretary of the Cabinet (Burke Trend) on 'The Economic Situation', 18 July 1966. Cabinet memoranda CAB129/126.

[23] Letter from 10 Downing Street to PR Baldwin, 3 August 1966. PRO T317/1067.

[24] PR Baldwin to F. Figgures, 25 October 1966. PRO T317/1067.

[25] Ministry of Defence paper Defence Estimates 1967; draft white paper, 2 February 1967. CAB129/128.

[26] Telegram from Secretary of State for the Colonies in Hong Kong to Stonehouse in London. 6 December 1966. PRO T317/1067. See, for example, speech by YK Kan in the Legislative Council 15 March 1967. Hong Kong Hansard, Reports of the Meetings of the Legislative Council of Hong Kong.

[27] CIA Intelligence memorandum, Office of Current Intelligence, 'The Situation in Hong Kong', 11 July 1967. Lyndon B Johnson Library.

[28] I Scott, *Political Change and the Crisis of Legitimacy in Hong Kong*, (1989). Scott argues the riots prompted political and social reforms from 1968-71.

[29] R Buckley, *Hong Kong: the road to 1997*, (Cambridge, 1997), pp. 80-83. See also CIA Intelligence memorandum, Office of Current Intelligence, 'The Outlook for Hong Kong', 25 August 1967. Lyndon B Johnson Library.

[30] 18/5/67 Ministry of Defence (DEI) memo on 'The Economic Value of HK to China', 18 May 1967. PRO T317/902.

[31] Cabinet Conclusions, 30 May 1967. CAB128/42. There had been less serious riots ten years before at the end of 1956 just when Britain was considering reducing forces in Hong Kong. Mark, 'A Reward for Good Behaviour'.

[32] Note for the Record of a meeting between D. Rickett and the Chancellor, by PR Baldwin, 16 May 1967. PRO T317/902.

[33] Cabinet Conclusions, 11 July 1967. CAB128/42.

[34] An undated card at the start of this file notes that 'this is not a codeword provided by the Ministry of Defence'. PRO T295/240.

[35] The Committee was not very active. CAB165/624.

[36] CIA Intelligence memorandum, Office of Current Intelligence, 'The Situation in Hong Kong', 11 July 1967. Lyndon B Johnson Library.

[37] Bank of England, Treasury, Board of Trade paper, 'Hong Kong: Contingency Planning for an Evacuation (financial and economic)', 10 August 1967. PRO T295/240.

[38] A Mackay (HMT) to Hubback (BE), account of Rogers Working Party meeting 24 August 1967. PRO T295/240.

[39] SH Wright to Mr Lavelle, passing on Commonwealth Secretary's views to Chancellor of the Exchequer calling for an end to the contingency planning. 7 December 1967. PRO T295/240.

[40] Meeting of Cowperthwaite with Bank of England, Treasury officials, 15 September 1967. PRO T295/240.

[41] The Hongkong Bank issued 90% of the Hong Kong currency. The Mercantile Bank and the Chartered Bank issued the remainder.

[42] F.J. Knightly to G.O.W. Stewart, 5 July 1967. Chairman's Papers Carton 4, Hong Kong Disturbances 1967, HSBC Group Archives [hereafter HSBC].

[43] Reports of the Hong Kong office, End 1967. GHO201, HSBC.
[44] Reports of the Hong Kong office, First Half 1967. GHO201, HSBC.
[45] F.J. Knightly to JAH (Jake) Saunders, London, 18 May 1967. Chairman's papers Carton 4, Hong Kong Disturbances 1967, HSBC.
[46] F.J. Knightly to George O.W. Stewart, London 6/6/67. Chairman's papers Carton 4, Hong Kong Disturbances 1967, HSBC.
[47] N.H.T Bennett memo. 7/6/67. Chairman's papers Carton 4, Hong Kong Disturbances 1967, HSBC.
[48] A Mackay to Hubback, 24 August 1967. PRO T295/240.
[49] 'The Sterling Supply' by J.M. Scott. Given to Government and to Cowperthwaite (then in the UK), 6 June 1967. The Chartered Bank were also worried about the drain of sterling from the note issue. Haslam (Bank of England) to G.O.W. Stewart, 15 June 1967. Chairman's papers Carton 4, Hong Kong Disturbances 1967, HSBC.
[50] F.J. Knightly to G.O.W. Stewart in London, 7 June 1967. Chairman's papers Carton 4, Hong Kong Disturbances 1967, HSBC.
[51] Haslam (Bank of England) to G.O.W. Stewart, 15 June 1967. Chairman's papers Carton 4, Hong Kong Disturbances 1967, HSBC.
[52] F.J. Knightly to J.A.H. Saunders, 20 June 1967. Chairman's Papers Carton 4, Hong Kong Disturbances 1967, HSBC.
[53] Reports of the Hong Kong Office, 1967. GHO201. HSBC.
[54] At the end of 1967 the HSBC's funds in London amounted to £59.8m compared with £52m in June 1967. GHO201 HSBC.
[55]Fenton (BE) to Rickett with figures for the Prime Minister, 30 August 1967. PRO PREM13/1628. November figures from Draft brief for use by Chancellor of Exchequer in Cabinet 10 January 1968. PRO T317/1087.
[56] Draft Sterling Area Working Party Report, 4 January 1968. BE OV44/116.
[57] CR Schenk, 'Closing the Hong Kong Gap', *Economic History Review*, XLVII(2), 1994, 335-53. CR Schenk, 'The Hong Kong Gold Market and the Southeast Asian Gold Trade in the 1950s', *Modern Asian Studies*, 29, 2, 1995, pp. 387-402.
[58] Confidential Memo by Secretary of State for Commonwealth Affairs 'CW Secretary's visit to the Far East', 28 March 1967. CAB129/128. The Secretary suggested support for an extra runway at the Hong Kong airport. This possibility was raised again by the Hong Kong government as possible compensation after the sterling devaluation in 1967.
[59] Letter from the Bank to Galsworthy of Commonwealth Office, 12 October 1966. BE OV44/258.
[60] Note on Cowperthwaite's visit to Hubback in London, 27 October 1967. BE OV44/258.
[61]Ibid.
[62] Letter from Cowperthwaite to Galsworthy, 8 February 1968. PRO T312/1934.
[63] Note of a meeting between Hubback and Cowperthwaite, 10 January 1968. PRO T295/455.
[64] Note by JWL Lonie to Norton, Goldman and Ryrie, 4 January 1968. PRO T312/1934.
[65] WS Ryrie to Hubback, 8 January 1968. PRO T312/1934.
[66] Note by Galsworthy of his trip to Hong Kong, 2 January 1968. PRO T312/1934.
[67] The account of the Exco meeting is from Telegram from Holmer to Treasury and Bank of England 22 November 1967. BE OV44/258.
[68] Note from W.S. Ryrie (HMT), 23 November 1967. BE OV44/258.

[69] These remarks are ascribed to the US representative, Dale. EBM67/94, 22 November 1967 in file S121 Devaluations – 1967 Countries Announcing Changes in par Values, IMF Archives, Washington [hereafter IMF].
[70] Saad abstained from the vote. EBM67/95, 22 November 1967 in file S121 Devaluations – 1967 Countries Announcing Changes in par Values, IMF.
[71] Telegram from the Governor of Hong Kong to the Commonwealth Office, 28 November 1967. BE OV44/258.
[72] Speech by the Financial Secretary in Legislative Council of Hong Kong 29 November 1967. BE OV44/258.
[73] D.F. Hubback to Goldman, 6 December 1967. PRO T312/1934.
[74] W.S. Ryrie to D.F. Hubback, 21 December 1967. PRO T312/1934.
[75] Memo by W.S. Ryrie for Goldman and Wright, 6 December 1967. PRO T312/1934.
[76] Strange, Sterling, p. 114-5.
[77] The Hongkong Bank only expected to get HK$79.4m. Half-Yearly Report, Hongkong Bank, December 1967. HSBC GHO201. FHH King, *The Hongkong Bank*, (Cambridge, 1991). p. 738.
[78] See correspondence between QW Lee Chairman of Hang Seng Bank and Cowperthwaite in January and February 1968 in HSBC GHO322/4.
[79] W.S. Ryrie to D.F. Hubback, 21 December 1967. PRO T312/1934.
[80] Norton to Rickett and Baldwin, 29 December 1967. PRO T312/1934.
[81] Note by Galsworthy of his trip to Hong Kong, 2 January 1968. PRO T312/1934.
[82] Ibid.
[83] Minute of a meeting of Commonwealth Office, Bank of England and Treasury representatives in the Treasury, 4 January 1968. PRO T312/1934.
[84] For Bermuda, WJE Norton to Ryrie, 9 January 1968, PRO T312/1979. For Bahamas, WJE Norton to Ryrie 13 December 1967, PRO T312/1981.
[85] Minute by Hubback, 11 January 1968. PRO T312/1934.
[86] Letter from Hubback to C.W. Fogarty, British High Commission in Kuala Lumpur, 12 January 1968. PRO T312/1934.
[87] CR Schenk, 'Closing the Hong Kong Gap'.
[88] CR Schenk, *Hong Kong as an International Financial Centre*, (2001), pp. 78-93.
[89] Telegram from Cowperthwaite to Galsworthy, 8 February 1968. PRO T312/1934.
[90] R.H. Turner (Bank of England) to J.W.L Lonie (Treasury), 20 February 1968. PRO T312/1935.
[91] Hubback to W.S. Ryrie for instructing Fogarty in Hong Kong, 14 February 1968. PRO T312/1934.
[92] Details noted in memos from Ryrie to Hubback 29 February and 13 March 1968. PRO T312/1935. Letter from Kadoorie, Gordon, Graham, Herries, Kan, Kwan, Saunders, Tang and Rodrigues to Sir David Trench. 23 February 1968. BE OV44/259. The letter stated: 'It is no exaggeration to state that a serious collapse of the pound would have such repercussions on our currency as to ruin our economy.'
[93] S. Goldman to Chancellor of the Exchequer's Principal Private Secretary, 26 April 1968. PRO T312/1935.
[94] Cowperthwaite reported that the Hongkong Bank had reluctantly taken on £20m in this way. Cowperthwaite to Sir Arthur Snelling, 7 March 1968. BE OV44/259.
[95] OSA sterling reserves fell by £180m in the second quarter of 1968, reducing the sterling proportion of OSA reserves from 68% to 56%. Kuwait accounted for half of the decrease. Sterling Area Working Party, 12 February 1969. OV44/119.

[96] Paper by Haslam of Bank of England, 27 March 1968. PRO T312/1935.
[97] Snelling paper 26 February 1968. PRO T295/438.
[98] Paper by Haslam of Bank of England, 27 March 1968. PRO T312/1935.
[99] Ibid.
[100] Samuel Goldman to Principal Private Secretary of the Chancellor, 26 April 1968. PRO T312/1935.
[101] Minutes of meetings on 1, 2 and 3 May 1968. Trench, Cowperthwaite and members of Commonwealth Office, Bank of England and Treasury. PRO T312/1936.
[102] Meeting of Bank of England, Treasury and Commonwealth Office with Cowperthwaite, 14 May 1968. PRO T312/1936.
[103] Personal Telegram from Secretary of State for the Colonies to Governor of Hong Kong, 27 May 1968. PRO T312/1936.
[104] Telegram from Trench to Secretary of State for the Colonies, 28 May 1968. PRO T312/1936.
[105] 'Diversification Policy', July 1968. BE OV44/247.
[106] Telegram from Commonwealth Office to Hong Kong, 13 June 1968. PRO T312/1937.
[107] The agreement was formally signed in September 1968.
[108] TK Ghose, *The Banking System of Hong Kong*, (Singapore, 1987). p. 29.
[109] This was communicated to the Chancellor of the Exchequer at the beginning of March, Goldman to Ryrie, 7 March 1968. PRO T318/191. The Gold Pool collapsed in March 1968.
[110] Draft conclusions of the Sterling Area Working Party, 9 January 1968. BE OV44/116. 'Self-help for the OSA', CJ Morse, 25 April 1968. BE OV44/160.
[111] Note of a meeting in Bologna by CWM, 8 May 1968. BE OV44/161.
[112] Final Report of the Sterling Party Working Party on Sterling Balances, 14 June 1968. This was agreed by officials and put to the Chancellor on 19 June 1968. BE OV44/117.