“What if there is a run on the pound?” asks Labour in the unlikely event of a Corbyn led government?

It was a moment of honesty from John Mc Donnell reminding us of Labour’s struggle to get elected to government in the 1980s and 1990s. Post war Labour governments in 1945, 1964 and 1974 all suffered badly from market dislike of their high spending high borrowing policies, which led to sterling crises in each case. It is etched on the memory of older Labour figures that market disciplines have previously prevented socialist policies being followed, and have created political tensions within Labour governments to be followed by loss of office as electors lose confidence in their ability to manage the economy.

The first two Labour governments inherited and kept a system of managed exchange rates. They were forced to devalue the rate. In 1949 Labour devalued the pound by 30% against the dollar, taking it down from $4.03 to $2.80. In 1967 Labour devalued the pound again, from $2.80 to $2.40, a fall of 14%. In 1974 they inherited a floating pound. Over their five years in office they allowed it to float down from $2.30 to $2.08, a fall of 10%. In 1976 there was a sterling and payments crisis leading to a visit to borrow money from the IMF to stabilise the pound and the financial position. This crisis sealed the fate of the Labour government which lost power for a generation. Only the John Major decision to join the damaging European Exchange Rate Mechanism and its economic impact changed the electoral position back in their favour.

The Blair government came to office in 1997 determined to avoid a fourth devaluation and sterling crisis for post war Labour governments. They adopted Conservative spending and borrowing plans, and spent the first few years moving the accounts into surplus. The economy continued to perform well. Labour then decided to make substantial increases in public spending, to increase public borrowing and to follow a very accommodating money policy which allowed large debt build ups. The end result was a bad recession and banking crash. Over their time in office with a floating pound there was a modest devaluation of 11%. This crisis is likely to keep Labour out of office for a considerable time period.

In total Labour spent around 30 years in office and presided over the bulk of the fall of 64% that occurred in the sterling/dollar rate between 1945 and 2015.

In government the Conservatives kept the fixed rate of $2.80 throughout their period in office from 1951 to 1964. In 1970 to 1974 with a floating pound the Conservatives presided over a 4% fall against the dollar. Between 1979 and 1997 with a floating pound there was a 22% decline. This included the Exchange Rate Mechanism fiasco which damaged the currency value and much else in the economy and led directly to the loss of office by the Conservatives. It kept them out of office until Labour presided over a worse economic crisis. Over the Coalition years 2010-2015 there was no change in the pound. If you average the rate of fall to an annual figure under Conservative governments the devaluation has been at a rate of 0.6% and under Labour at 2.2%. The Conservative devaluation was largely the result of the ERM disaster. a single policy error not to be repeated.

Floating rate policies are better than fixed rate policies. They give countries a bit more financial leeway. They do not, however, exempt a country from all the disciplines of the market. Mr Mc Donnell is right to worry about the market constraints on policies. The sorry history of Labour devaluations are a reason why I think a Labour win at the next election is unlikely. The constant resort to devaluation to deal with the consequences of the spending and borrowing policies shows the inherent tensions in their policy mix.

I have charted the pound in relation to the dollar as this has been the crucial rate throughout the period, with the devaluations formally expressed in terms of the sterling/dollar rate. The pound has also fallen against the DM and Swiss franc. Since its creation the Euro has had periods of both strength and weakness against the pound.