

# THE DISADVANTAGE OF TYING ONE'S HANDS: THE RISE AND FALL OF THE EUROPEANISATION OF BRITISH MONETARY POLICY.<sup>1</sup>

*Jim Buller*

*Department of Politics,*

*University of York,*

*Heslington,*

*York. YO10 5DD*

[jrb6@york.ac.uk](mailto:jrb6@york.ac.uk)

Paper presented to the ESRC Seminar Series on the Europeanisation of British Politics, University of Sheffield, 19<sup>th</sup> September, 2003.

## **Introduction.**

What is it about the Europeanisation of British monetary policy that merits attention? From a superficial glance at the subject, one might conclude: 'not a lot'. In policy terms, this Europeanisation process as represented by sterling's membership of the European Exchange Rate Mechanism (ERM) appears to have lasted a mere two years. As is often the case, Britain joined late (October 1990), found the experiment an uncomfortable experience before crashing out spectacularly in September 1992. Since then, while paying lip-service to future membership if the euro, the Treasury, first under Lamont, then Clarke and Brown, has gone about carefully constructing a domestic institutional framework for confronting issues and problems in this particular policy area. Those commentators who predicted that New Labour would join the Single Currency in its first term, have been forced to revise these arguments.

However, a slightly closer look at this topic reveals a different dimension to this story. Since the 1970s, a number of British policy-makers have been continually attracted to the idea of Europe providing a solution to continual difficulties experienced in the

area of monetary policy. In this context, a gradual enthusiasm for ERM membership developed in the first half of the 1980s, to the point where a majority of Conservative Cabinet ministers became supportive by 1985. Frustrated by Thatcher's veto of the policy at this time, Lawson went on to covertly shadow the Deutschmark (DM) in the late 1980s before Thatcher finally relented in 1990 (Thompson, 1996). Since 1992, while politicians and officials in Whitehall have been sceptical of the case for sterling's membership of the Single Currency, it is possible to find a similar constituency of opinion in favour, including the present Prime Minister. Britain may have only formally taken part in European monetary institutions for two years, but this picture does not accurately reflect the strength of feeling concerning the Europeanisation of monetary policy in some quarters of the British Establishment.

These opening comments raise issues that have only been touched on briefly in the workshop discussions so far. First this case study of monetary policy suggests that Europeanisation may not necessarily be a gradual, incremental or linear process that increasingly affects domestic politics as the scope of European integration grows wider. Rather, its trajectory may be much more uneven: it might be halted or even reversed in some instances. Second, the case study of monetary policy highlights the obvious (but not much commented on) fact that the impact of Europeanisation can be controversial and divisive one in British politics. These two issues are not mutually exclusive. Indeed, in many ways they are related, as we shall see.

This paper attempts to do three things. It begins by charting the rise and fall of the Europeanisation of British monetary policy over the last two decades or so. It goes on to ask why the Europeanisation of British monetary policy (in the form of ERM membership) became so controversial in the 1990s. Finally, it concludes by asking whether there is a connection between the events of Black Wednesday and present Treasury reluctance to join the euro. The main argument developed below is that Europeanisation took place initially as a method of depoliticising British economic management (taking the politics out of policy-making). However, it became controversial because it was criticised for locking policy-makers into a course of action which appeared to set them at odds with the demands of many of the electorate. Put another way, objections to Europeanisation in this case were as much to do with democracy (or a particular understanding of democracy) rather than sovereignty. The

Blair Government has continued to resist membership of the euro because it too perceived the institutions of the eurozone to be too rigid and remote from political interference. To join is to once again risk being tied to a policy which may threaten the legitimacy of the party in office.

### **Conceptualising Europeanisation.**

It is not the intention of this paper to re-rehearse the arguments already presented by Buller and Gamble concerning the conceptualisation of Europeanisation. Suffice it to say that it remains the author's position that any definition should be sensitive to the following issues. First, it should be internally consistent, in the sense that the properties of Europeanisation (its intension) should be logically related to the phenomena it is trying to explain (its extension). Second, the conceptual boundaries of Europeanisation should be as sharp as possible, showing how it is differentiated from other related concepts. Finally, the concept should be a genuine addition to the semantic field surrounding the subject area, not merely an alternative label for the same thing (something which may cause confusion).

This paper sticks closely to earlier definitions of Europeanisation (albeit with some differences) used in earlier workshop discussions by conceptualising it as:

‘a process whereby the domestic politics of a country is significantly affected by distinct EU structures of governance and policy-making’.

The phrases ‘domestic politics’ and ‘EU structures of governance and policy-making’ are deliberately designed to be broad, referring both to observable behaviour as well as non-observable factors such as ideas, beliefs and culture. Inclusion of the word ‘distinct’ reminds us of the problem of external differentiation. The EU is of course a relatively autonomous organisation, but it is still influenced significantly by the behaviour of external entities such as member states and broader global trends. We need to be clear that when we refer to Europeanisation, we are not just talking about domestic and international forces ‘passing through’ Brussels without being affected by the institutions and processes of the EU. Finally, the word ‘significantly’ is

intended to discriminate between important and minor change that takes place at the domestic level as the result of Europeanisation. Of course, the question of how we distinguish significant and non-significant effects is a difficult one. However, without such differentiation, there is a danger that the concept and causal properties of Europeanisation will become trivialised as it is used to explain every little domestic alternation which results from the EU, no matter how small.

Of course, the process of Europeanisation will still reflect both top-down pressure from EU institutions and the 'bottom-up' strategies of member states (or more likely, a combination of the two). Ontologically, then, Europeanisation is a multi-levelled phenomenon and, as such, differs little from the process of European integration. What appears to make Europeanisation distinct as a field of enquiry is its *analytical* focus. Here, the primary concern is to chart the impact of the European on the domestic (something that European integration theories have largely, but not totally neglected). Interestingly, as first glance, this case study appears to defy the top-down, bottom-up debate concerning how Europeanisation takes place. Rather ERM (and euro membership if and when Britain joins) appears to reflect a process whereby British politicians 'reached up' to the EU level and selected a policy for implementation at the domestic level. Britain had little decisive influence on the design of the ERM in the late 1970s (see Ludlow, 1982), so in no sense does membership represent the exporting of a domestic initiative from the bottom-up. At the same time, it cannot be said that Brussels in any sense imposed this policy from the top-down.

### **The Europeanisation of British Monetary Policy: the Rise and Fall of a Depoliticisation Governing Strategy.**

How might we explain the Europeanisation of British monetary policy? One approach might be to highlight the influence of certain economic ideas that become influential in the relevant policy community at the right time. In this sense, ERM membership became attractive to an increasing number of policy-makers in Whitehall in the 1980s because it was perceived to provide the 'best' solution to a set of policy problems that had emerged at this time. It would be crass to deny the general validity of such an

argument. It seems inconceivable that a group of policy-makers would select a policy solution that they did not think would at least be a marginal improvement on the existing situation. In short, new policies when formulated and implemented, reflect the relative influence of the prevailing set of economic ideas at the time – usually with some sort of time lag (Hall, 1989).

The problem with this sort of argument is that most economic ideas and policies are ‘essentially contested’ by the epistemic communities which propound them.

Membership of the ERM was no different in this sense. It follows that the nature of economic advice facing ministers would have been divided and a choice would have had to have been made between ERM membership and the competing alternatives.

The problem then becomes: on what grounds do politicians make such choices? The argument below is that ‘governance’ considerations played an important role in this case study. More particularly, Europeanisation was encouraged as a ‘policy support’ for a broader strategy of depoliticisation that already existed in this area.

Depoliticisation has been defined as: ‘...the process of placing at one remove the political character of decision-making...’ (Burnham, 2001). It reflects the motivations and actions of a governing elite: in this case, party leaders, their advisers and top civil servants (see also Bulpitt, 1986; Buller, 2000. For an alternative Marxist approach, see Bonefeld, Brown and Burnham, 1995; Burnham, 2000).

In the context of monetary policy, depoliticisation serves two broad functions. As Burnham (2001) has argued, depoliticisation seeks: ‘...to change market expectations regarding the effectiveness and credibility of policy-making’. Such a strategy may become attractive against a backdrop of opinion which displays a loss of faith in the ability of politicians to ‘steer’ the economy. This may be because they lack the knowledge or technical expertise to implement many of the tasks expected of them. Even worse, the public may suspect that politicians will abuse what little knowledge they have for their own gain rather than the pursuit of the national interest. In such a climate, the best way for a government to promote an image of credibility and competence is to take (or appear to take) the politics out of policy-making.

Second, depoliticisation, ‘...helps to shield the party in office from the consequences of unpopular policies’ (Burnham, 2001). Policy-makers may not only be concerned

with power. They may not always attempt to control or resolve problems in the face of opposition. They may confront some issues that are intractable, even with perfect information. Others may be so controversial that new policy initiatives may make things worse rather than improve matters. In this sense, a more 'rational' strategy might be to devolve responsibility for policy onto other groups or organisations and let them take the political heat. However, depoliticisation is a more subtle and complicated process than this. Attempting to place at one remove 'the political character' of decision-making is not quite the same as a fully-blown act of devolution. More often than not, politicians will want to retain an ultimate stake in policy, just in case things go wrong and the strategy has to be reversed. It follows that while depoliticisation is ultimately a deliberate political ploy, we as researchers need to make a distinction between the reality of this act and the rhetoric that surrounds it.

In short, the Depoliticisation interpretation implies that policy is not always important in its own right. At times, policy initiatives may need to be considered in the context of broader governance strategies, which themselves take place within particular institutional environments. Put in different terms, Europeanisation as a process may be *instrumental* to those that encourage it in the sense that it will be used partly to put a more positive gloss on cruder governing beliefs and techniques. In one sense, this observation is a statement of the obvious. British politicians (like their counterparts on the Continent) will try to manipulate the EU policy process in a way that compliments their domestic position. However, this discussion raises an additional and arguably more important point. It may not only be necessary to disaggregate the effect of Europeanisation at the domestic level, but to consider how these various domestic factors are *related*. If these factors are related, are some more important than others? If so, how might such a conclusion affect academic judgements concerning the importance of the domestic impact of Europeanisation?

If Europeanisation in this area should be partly understood as a policy support for a more general strategy of depoliticisation, it was not the only, or indeed the first instrument employed to achieve this governing objective. Indeed, initial attempts to secure the depoliticisation of economic management rested on a 'domestic' framework represented by the twin ideas of sound money and free markets. Of course, the official rhetoric usually stressed a different message. In particular, the Thatcher

Government after 1979 was adamant that policies based on this neo-liberal ideology would increase the efficiency and productivity of the British economy, thereby reducing decades of relative decline. No longer would governments attempt to create growth and jobs through the manipulation of demand (as Keynesian doctrines had prescribed). In future, these tasks would be devolved onto groups operating within the British economy. This was not to say that the government had no role at all. Ministers accepted that they had a duty to provide a nominal framework capable of generating low and stable inflationary conditions for British business. Moreover, they acknowledged that specific measures might have to be undertaken to remove any 'restrictive practices' hindering the freedom of individual firms. In this context, the rolling programme of industrial relations reforms unveiled in the 1980s and 1990s was probably the most controversial.

As already suggested, behind this message lay additional political, or governance considerations. Faced with the long-standing nature of many of Britain's economic problems, this neo-liberal economic philosophy was also attractive as a way of depoliticising the conduct of economic management. Perhaps the key feature of this strategy was the adoption of a rule-based regime for monetary policy. Monetarism stipulated that there was a direct relationship between inflation and the level of the money supply circulating around the economy, not the wage rises achieved by the unions. This policy was operationalised by the Medium Term Financial Strategy (MTFS), which contained pre-publicised and centrally defined targets or rules for the growth of  $\text{£M3}$ , as well as interest rates and public expenditure. Gone was the need for an incomes policy and the continuous wrangling between politicians and unions over various pay norms, 'going rates', differentials and 'special cases'. Instead, monetary policy could be reduced to the 'technical' task of monitoring and controlling the money supply in the institutional confines of the Treasury. In short, this rule-based framework reduced the need for political choice or discretion on the part of politicians. The less the need for discretion, the less the danger of policy mistakes being made (or of politicians being blamed if they did). That was the theory at least (see Kydland, Edward & Prescott, 1977; Barrow & Gordon, 1983; Browning, 1986: 261).

One of the earliest indications that political leaders were aware of the advantages of this rule-based strategy could be found in the Conservative Party's policy paper, *The Right Approach to the Economy* (1977):

Monetary targets, openly proclaimed and explained, can have a crucial effect in reducing inflationary expectations. The extent of that influence will depend on increasing public awareness. The monetary authorities will often be subject, directly and indirectly, to political and industrial pressures to modify and relax their policies, frequently for reasons of short-term expediency. The dangers of yielding to such pressures will be reduced if monetary policy is the subject of regular and open public discussion, and if the authorities are expected as a matter of course to give account of their conduct of policy and of their objectives for the future (Howe, et. al., 1977: 9).

Writing fifteen years later, Lawson spoke in similar terms:

governments that believe in unfettered discretion are likely to be led astray by short-term pressures and the politically expedient. A government that simply reacts to the pressure of events is likely to make more mistakes than one constrained by rules embodying experience accumulated over a long period (Lawson, 1992, pp.66-67; 1021; and 1040).

Indeed, Lawson (1992: p.1025) went further: 'A government of rules...is less intrusive and – in the long run – more acceptable to the public at large than a government of men'.

While there is evidence to suggest that, by the mid-1980s the public had grudgingly acquiesced in their acceptance of these policies (Butler and Kavanagh, 1984; Crewe, 1988), the Conservative leadership was experiencing significant problems operating monetarism. Both Howe and Lawson had real difficulties in establishing a reliable relationship between the level of money supply and the rate of inflation. Targets for £M3 were consistently missed, yet inflation was brought down to three per cent. One of the Treasury's responses was to gradually take into account the importance of the exchange rate when trying to achieve price stability. By the March 1981 budget,



monetary policy was gradually being relaxed in an attempt to bring down the high value of the pound which was squeezing inflation, but also pricing British exporters out of international markets. However, exchange rate management also faced implementation problems as sterling oscillated wildly on the currency markets. In June 1984, the pound was dragged upwards in the wake of a rising dollar, boosted by figures showing a significant rise in economic growth. By July 1985, sterling was falling to \$1.10 after Ingham had let it slip that Thatcher would let the pound slip to \$1 if that was what the markets decreed.

What was it about EMS membership that was so attractive in these circumstances? At its most basic, the collapse of monetarism meant the Conservative leadership needed an alternative policy to try and control inflation. As noted above, exchange rate management had become an increasingly prominent instrument in implementing this objective. However, it was felt that EMS membership and the adoption of a public target would lend this policy more credibility, while at the same time helping to counter the threat of currency speculation as markets attempted to discover the ceiling and floor of an implicit rate. Just as important were the support arrangements that existed as part of the constitution of the EMS (strengthened as a result of the Basle-Nybourg Agreement). In the past, central banks had intervened in the markets and credit had been provided to a country whose currency was in danger of breaching its margins of fluctuation in the parity grid. Lawson was aware that this help was not automatic. Indeed, Whitehall experienced problems first hand in December 1987 when the Bundesbank made it difficult for the British authorities to buy DM's in support of sterling (Lawson, 1992, pp. 786-91). That said, there remained a general optimism that once Britain was actually in the system, the pound would receive institutional support in the event of a sterling crisis.

If monetarism had been introduced partly as a rule-based policy designed to discipline public expectations and de-politicise the conduct of economic management, ERM membership also offered an alternative framework at 'one remove'. As far back as 1981, Lawson was writing about the governing benefits of such a policy in these terms. In a memorandum to Howe, Lawson distinguished between two types of financial discipline needed to contain the demands of societal groups and control inflation. The Conservative leadership could operate a self-imposed explicit monetary

target, as it was doing at the time, or an externally imposed exchange rate discipline. Although Lawson at this time preferred the former, he ruminated out loud whether the latter might not be more effective, especially on those Conservative backbenchers who had made it known that they were less than enamoured by the initial results of the monetarist experiment:

...those of our colleagues who are most likely to be pressing for the relaxation of monetary discipline, are those that are keenest on the UK joining the EMS (European Monetary System). In other words, we turn their swords against them (Lawson, 1992, pp.111-12; 1058; see also Scott, 1986, p.198; Howe, 1994, p.639).

Or as Samuel Brittan put it in an article for the Financial Times:

We are back with the need for some kind of constitutional break on the politics of excessive expectations and over-promising...The only way of injecting some credibility into counter-inflationary policy is an exchange rate objective; and the only one available is the exchange rate mechanism of the European Monetary System (quoted in Scott, 1986; p.98).

Similar governing calculations were being made by the Labour leadership at this time, particularly a small group consisting of Kinnock, Smith, Eatwell and Brown. This elite accepted the argument that increased processes of economic and financial liberalisation now placed significant constraints on the operations of a future Labour Government. More particularly it was feared that any attempts to stimulate the economy through demand management would be penalised by adverse movements in global financial markets. In this context, what the leadership required was a new policy framework that would constrain the expectations of supporters and convince opinion that there would be no return to the short-term discretionary policies associated with the party in office in the 1960s and the 1970s. ERM appeared to offer an ideal solution to this problem: this external institution would 'tie the hands' of Labour politicians and keep them on the financial 'straight and narrow'. It is also noticeable that at this time, many of the interventionist industrial policies that had been developed by the party during the policy reviews of the mid-1980s were now

gradually abandoned (McSmith, 1993, ch. 13; Wickham-Jones, 1995; Eatwell, 1992; Radice, 1989).

If Europeanisation in this area was an alternative policy support for a broader depoliticisation strategy designed to shore up the Conservative Party's reputation for governing competence, ejection from the ERM in September 1992 heralded its failure. The issue of why this policy failed is not the primary concern of this paper. Instead, the discussion below is structured around two different but related questions. First, why was the failure of this policy so controversial? After all, Europeanisation in this case was supposed to take the politics out of policy-making? Yet as some senior figures were to admit later, the Conservatives never enjoyed the same public confidence as they did before 'Black Wednesday', (Major, 1999; p.334-35; Seldon, 1997). Second, is there any link between the controversy surrounding this episode and the Blair Government's non-decision on euro membership? If so, what is the precise nature of this connection? Why has the Europeanisation of British monetary policy been halted (reversed?) in this particular policy area?

Approaching the question of why some policies become controversial is not an easy task. There appears to be little in the way of a literature which explicitly addresses this topic and as a result, the following conclusions are very tentative. Perhaps the first point to make is that policy failure is not synonymous with controversy. As we have already seen, monetarism was quietly dropped after a period of unsatisfactory implementation, but this U-turn did not inflict lasting damage on the political reputation of the Thatcher Government. This observation implies that for policy failure to become controversial or politicised, it must also impinge on some broader feature of the political system deemed to be significant or important. The argument below suggests that Europeanisation in this case was controversial because it became tied up with questions of democratic legitimacy.

There can be no doubt that part of the reason why Europeanisation had such a controversial impact in this area was because ERM membership generated perverse consequences for the conduct of domestic economic policy. At a time when the UK was heading into a recession, Lamont was forced to raise interest rates to preserve sterling's parity with the DM: a decision that placed real strain on the financial

positions of many companies and individual households. That said, many policies produce perverse consequences that adversely affect the welfare of the public. What was just as controversial was the image of a government boxed into a policy stance over which it had little or no control. Lamont himself describes the sense of impotence that he felt at the time: 'I was playing a part in some drama that had been written for me. That was how it had to be and that was my pre-determined role' (Lamont, 1999, p.255). How can we explain this situation?

The Major Government could have sought a general revaluation of all currencies within the ERM to take the pressure off sterling. Indeed Lamont lobbied for such a re-alignment but these efforts got nowhere. The Bundesbank was resistant to change because of worries about the inflationary consequences of any easing of policy. The French Government was just as opposed to a general revaluation because it would undermine the Franc-fort strategy which had become the centrepiece of economic policy after 1983. Just as important, however, was the fact that broader international and European developments had helped to solidify the structure of the ERM at this time. The destabilising effect of the fluctuating dollar in the second half of the 1980s, as well as worries about resurgent German power after re-unification and the ending of the Cold War, led member states to negotiate a three stage process towards Economic and Monetary Union (EMU). ERM membership represented Stage One of this progression towards the fixing of rates and the eventual abolition of European currencies. Whereas revaluations in the ERM had been possible in the past, it was likely that they would be much more difficult to achieve in this institutional climate.

At the same time, some commentators bemoaned the failure of the Conservative Government to seek a devaluation of the pound (Stephens, 1996, pp.212-14; 219). Indeed, the way that Major and other senior party leaders seemed to treat ERM membership as a 'badge of honour' was noted with an increasing sense of incredulity. Looked at in simple policy terms, this behaviour does appear difficult to explain. However, once ERM membership is understood as part of a broader depoliticisation governing strategy, the logic underpinning Europeanisation in this instance demanded this type of response. The whole rationale of ERM membership was to guard against such short-term fine-tuning that societal pressure could encourage (especially after the

failure of monetarism). Devaluation in this context was almost unthinkable; the image of a remote and unresponsive elite was almost inevitable.

At the same time, hope that this depoliticisation strategy would shield the Major leadership from the unpopular consequences of ERM membership did not materialise. What was notable about the House of Commons debate that followed Black Wednesday was the ill-disguised distaste at Major's attempt to off-load responsibility for failure onto the so-called 'fault-lines' of the system. For example, Budgen wanted to know why, bearing in mind ERM membership had been discussed exhaustively in the 1980s, it had taken Major until September 1992 to discover these fault-lines (*Hansard (Commons)* Vol. 212, 24 September, 1992: col. 6). A number of other Conservative backbenchers refused to condemn Germany for Britain's plight. Policy-makers in Bonn were only following their own legitimate national interest (see the contributions by Biffen, col. 34; Watts, col.40; Baker, col. 57; Townend, col.73). Lamont makes a similar observation concerning the reaction of the media: 'For the British press, this was a British crisis caused by stupid British politicians, particularly myself' (Lamont, 1999, p.270).

It is one thing to create an impression that the policy-making community is isolated and unreceptive to the demands of the public. For policy to become controversial, this impression also becomes the subject of critical comment, at least within the Westminster village. That this was the case is most obviously manifest in the discourse of the Conservative Euro-sceptics as it developed in the 1990s. Of most interest here was the argument that Europeanisation could undermine the democratic legitimacy of the British political class. This case ran crudely as follows. For democracy to exist, the people must feel that they are properly represented in the institutions that govern their lives. For this to happen, they must feel that their representatives are genuinely in authority, even if they are not totally in control of policy. At the same time, the public must have effective sanctions to impose their will if they are unsatisfied with the performance of a particular government. The problem with ERM membership was that it had exposed the unrepresentative and unaccountable nature of elite rule in graphic terms. Euro-sceptics feared that Europeanisation would produce a real public backlash against British politicians who would become little more than 'lightening conductors' for popular frustration and

discontent (Buller, 2000, pp.157-63). Whether this argument had any validity or not is of less importance. What mattered was that it was articulated and gained a certain currency at this time. Chris Gill, speaking in a House of Commons debate on the Maastricht Treaty probably best sums up the message:

stripped of power to influence or decide matters of state, we shall have created the classic recipe for failure: responsibility resting with a body of people who do not have the authority to discharge that responsibility in full measure. This will result in public disillusionment with politicians and with people's capacity to obtain satisfaction through their elected representatives. In the fullness of time that disillusionment will turn to frustration and anger, which will lead ultimately to the rejection of established political leadership, traditional party loyalties and the whole body politic (*Hansard* (Commons), vol. 201, 18 December, 1991, col. 415).

### **The Blair Government's and the Re-nationalisation of Monetary Policy: the 'Democratic' Limitations of Depoliticisation through Europeanisation.**

What, if any, is the connection between this past experience of Europeanisation and the present monetary policy of the Blair Government? Perhaps the first point to note is that depoliticisation remains an important governance objective for the Labour leadership (see for example, Brown, 1997; Balls, 1998; Robinson, 2000; Balls 2002). However, the policy chosen to support this objective is once again 'domesticist' in its orientation. Put in different terms, the process of placing at one remove the political character of decision-making in monetary policy has been achieved through the granting of independence to the Bank of England. Several features of this institutional reform are worth noting in the context of the argument developed below. First, this independence is operational. The Chancellor remains responsible for formulating the objectives of monetary policy (in this case an inflation target of 2.5%), whereas a new Monetary Policy Committee (MPC) of independent experts is charged with implementing this goal. Second, this inflation target is symmetrical. Deviation either side of 2.5% is looked on unfavourable by the Treasury. Finally, the minutes as well as the individual voting records of the MPC are published shortly after each meeting.

At the same time, this depoliticisation of monetary policy has been buttressed by the development of two rules designed to remove suspicion of political interference in fiscal policy. The 'Golden Rule' states that on average, over the economic cycle, the government will only borrow to invest and not to fund current spending. The Sustainable Debt rule stipulates that debt will be held over the economic cycle at a 'stable and prudent' level. Some critics have highlighted problems with this framework. It is acknowledged that there are real methodological difficulties in measuring the beginning and end of an economic cycle. In this context, it is feared that the Treasury will end up defining the economic cycle in a way that suits its own policy purposes. The question then becomes: how much of a discipline do these rules really represent (Portillo, 2000; Howard, 2002)? The Treasury has responded by arguing that these rules maintain a sensible balance between economic stability on the one hand and flexibility to vary policy between years. In other words, rules are important, but they can be too tight. It is not for nothing that this framework has been labelled 'constrained discretion' (HM Treasury, 2002; Glyn & Wood, 2001).

That said, the adoption of this domestic monetary framework was in no sense pre-determined or inevitable. An alternative policy support which appears to be just as suitable for this depoliticisation strategy is sterling's membership of the euro. Responsibility for monetary policy would still be devolved onto an independent central bank. Indeed, the independence of the ECB is enshrined in EU law. Under Article 107 of the Maastricht Treaty, it is explicitly forbidden from taking any instructions from any other organisation or body. At the same time, the Growth and Stability Pact has rules designed to prevent national politicians from manipulating fiscal policy in a way which affects the maintenance of price stability in the eurozone. In particular, a government's budget deficit should be close to balance or surplus and certainly not exceed 3% of GDP (although recent revisions to this policy in November 2002 specify that this position will be judged over the economic cycle). At the same time, a country's ratio of government debt to GDP should not exceed 60% (Radice, 2003).

So why has the Blair Government (or more accurately the Treasury under Brown's stewardship) presided over what might be termed the re-nationalisation of British

monetary policy? After all, the government has explicitly stated on a number of occasions that there is no constitutional or political bar to membership of the euro. We might add that such a policy would certainly fit in with Blair's more general desire for Britain to be playing a leading role in Europe. Of course, there are the five economic tests (allegedly drawn up by Brown and Balls in the back of a taxi). However, a consensus has developed behind the view that they are too broad (and indeed, too partial) to provide anything other than a smokescreen behind which a decision will be taken for other reasons. Instead, the argument below asserts (in rather speculative fashion) that further Europeanisation of monetary policy has been halted because of concerns about a 'democratic deficit' in the institutions governing the eurozone. Put more accurately perhaps, it is felt that the Treasury's domestic monetary framework is better at disguising the undemocratic and elitist nature of the depoliticisation strategy that it is supporting.

More particularly, there are three institutional properties of the eurozone which, at present, threaten to undermine the democratic legitimacy of any future depoliticisation (through Europeanisation) strategy. The first is the legal mandate of the ECB. As already noted, depoliticisation represents the act of placing at one remove the political character of decision-making. However, if 'Black Wednesday' conferred one lesson on policy-makers in the Treasury, it was ensuring that the mechanisms of depoliticisation are conditional and reversible if politicians become unhappy with the results. The problem with the current structure of the ECB is that it is *too* independent. Not only is this status entrenched in EU law, changing it is likely to prove difficult, as such an act would require a unanimous vote at an Intergovernmental Conference. Moreover, as we have already seen, it is not guaranteed that British politicians will be able to off-load blame onto EU institutions if things go wrong. If legitimacy is to work in this context, other actors that are affected by the policies of the ECB will require a general stake in these arrangements (De Grawe, 1998; see also Currie, 1997; *Financial Times*, 19 December, 2001; 10 June, 2003).

A second institutional property which is perceived to affect the legitimacy of Europeanisation in this area is the goal independence of the ECB. As already noted, the ECB is responsible for implementing monetary policy in the eurozone. Where the



Bank is different is that it has a policy formulation role as well. Whereas Article 105 of the Maastricht Treaty states that the prime objective of the ECB is the maintenance of price stability, no numerical target for the level of inflation is specified. Initially, the Bank committed itself to an asymmetrical figure of 2% or less, although this has recently been revised to 'close to, but below 2%' (*Financial Times*, 9 May 2003). One problem with such a goal is that, unlike the Treasury's symmetrical target, it runs the risk of producing policy with a deflationary bias. More fundamentally, as long as the ECB retains this goal independence, it will be judged not only on its inflation record, but also on its success in balancing the requirements of price stability with the need to maintain and expand industrial output and employment. Failure to manage this trade-off successfully may provoke criticism from member states and the legitimacy of the ECB will suffer. Indeed, evidence of such discontent already exists as France and Germany have publicly exhorted the ECB to cut eurozone interest rates further in response to sluggish economic growth (Islam, 2003).

Finally (and perhaps most obviously) the ECB's lack of openness and transparency is also perceived by the Treasury to undermine its legitimacy. The ECB does not publish the minutes of its meetings until 16 years after the event. Instead, it provides a monthly report at a press conference which highlights the reasons for (what is presented as) a majority decision and the consensus surrounding it. Of more significance perhaps is the fact that national oriented representation on the Bank's decision-making machinery almost compels this secrecy. Members of the Executive Board are appointed through the common accord of member states after consultation with the European Parliament. Similarly, remaining members of the Governing Board (which includes the Executive Board) are national bank governors of all countries in the Single Currency. While the legal nature of the ECB is supposed to guarantee its freedom from political interference, this national orientated representation highlights the possibility that policy outcomes may be susceptible to national political lobbying (the Duisenberg/Trichet episode being an obvious case in point). To publish the minutes and voting records of Governing Council meetings runs the risk of exposing national divisions and fuelling speculation about the relative influence of particular member governments. In recent evidence to the Treasury Select Committee, Melanie Johnson (Economic Secretary) appears to have accepted the argument that openness

in this context may lead to the politicisation of eurozone monetary policy (HM Treasury, 2000; see also Favero, 2000).

If the institutional features of the eurozone are perceived to pose a threat to the legitimacy of any future Europeanisation of policy, the fiscal rules of the Growth and Stability Pact (GSP) are thought to be too rigid by the Blair Government. Treasury ministers and their advisers have continually argued that trying to balance the budget year on year could actually be damaging to the economy. Politicians could find themselves having to cut spending or raise taxes (or both) at the time of a recession. Moreover, that such measures are likely to generate domestic opprobrium and discontent. Indeed, it is clear that complaints about the inflexibility of the GSP from France, Germany and Italy stem in part from concerns about the domestic effect of Europeanisation in this area. Looking at these events from the outside, it is easy to see why Whitehall might make some sort of a connection with Black Wednesday. Moreover, while it is possible to cast doubt on the constraining nature of the Treasury's own fiscal rules, it is clear that their great merit is that they will help guard against the loss of autonomy that British politicians experienced on 16<sup>th</sup> September, 1992.

## **Conclusions**

This paper has generated three broad conclusions. First, the temporal path of Europeanisation in the area of monetary policy has been uneven, to the point where it may even be said that it has been halted at present. Second, explanations of this trajectory need to consider the relationship between Europeanisation as a process and its 'democratic properties. It should be stressed this paper is not putting forward a particular definition of democracy. Nor it is arguing that the EU or Europeanisation is necessarily undemocratic. What it is suggesting is that British politicians understand that the Europeanisation process may bring with it difficult issues of accountability and legitimacy. This observation indicates that future research should be concerned not just with the 'reality' of Europeanisation, but also the way it is perceived.

## **References.**

- Balls, E. (1998) 'Open Macroeconomics in an Open Economy', *Scottish Journal of Political Economy*, 45 (2) 113-132.
- Balls, E. (2002) *Why the Five Economic Tests? The 2002 Cairncross Lecture*, 4<sup>th</sup> December.
- Barrow, R. J. & Gordon, D. B. (1983) 'Rules, Discretion and reputation in a Model of Monetary Policy', *Journal of Monetary Economics*, 12, pp.101-21.
- Bonefeld, W., Brown, A., Burnham, P. (1995) *A Major Crisis? The Politics of Economic Policy in Britain in the 1990s* (Aldershot: Dartmouth).
- Brown, G. (1997) *Speech to Mansion House*, 12 June ([www..treasury.gov.uk/speech](http://www.treasury.gov.uk/speech)).
- Browning, P. (1986) *The Treasury and Economic Policy, 1964-85* (London: Longman).
- Bulpitt, J. (1986) "The Discipline of the New Democracy: Mrs Thatcher's Domestic Statecraft", *Political Studies*, 34, pp.19-39.
- Buller, J. (2000) *National Statecraft and European Integration: the Conservatives and the European Union, 1979-97* (London: Pinter)
- Burnham, P. (2000) 'Globalisation, Depoliticisation and "Modern" Economic Management', in W. Bonefeld & K. Psychopedis (eds.) *The Politics of Change: Globalisation, Ideology and Critique* (London: Palgrave).
- Burnham, P. (2001) 'New Labour and the Politics of Depoliticisation', *British Journal of Politics and International Relations*, 3 (2).
- Butler, D. & Kavanagh, D. (1984) *The British General Election of 1983* (Basingstoke: Macmillan).

- Crewe, I. (1988) "Has the Electorate Become Thatcherite?", in R. Skidelsky (ed.) *Thatcherism*, (Basingstoke: Macmillan)
- Currie, D. (1997) *The Pros and Cons of EMU* (London: HM Treasury).
- Eatwell, J. (1992) 'The Development of Labour Policy, 1979-92', in J. Michie (ed.) *The Economic Legacy 1979-92* (London: Academic Press).
- Favero, C. et. al.. (2000) *One Money, Many Countries: Monitoring the European Central Bank 2* (London: Centre for Economic Policy Research).
- Glyn, A. & Wood, S. (2001) 'Economic Policy Under New Labour: How Social Democratic is the Blair Government?', *Political Quarterly*.
- Hall, P. A. (1989) "Introduction", in P. A. Hall (ed.) *The Political Power of Economic Ideas: Keynesianism Across Nations* (Princeton: Princeton University Press).
- HM Treasury (2000) *Treasury's Eight Report on Britain's Participation in the Single Currency* (London: HM Treasury).
- HM Treasury (2002) *Reforming Britain's Economic and Financial Policy: Towards Greater Economic Stability* (London: Palgrave).
- Howard, M. (2002) 'Brown's Golden Rule Starts to Lose its Lustre', *Financial Times*, 31 October.
- Howe, G., Howell, D., Joseph, K., Prior, J., Maude, A., (1977) *The Right Approach to the Economy* (London: Conservative Central Office).
- Howe, G. (1994) *Conflict of Loyalty*, (Basingstoke: Macmillan)
- Islam, F (2003) 'Its Not All Over for the UK and the Euro', *The Observer*, 13, April.

Kydland, F. Edward, C. & Prescott, E. C. (1977) 'Rules Rather Than Discretion: the Inconsistency of Optimal Plans', *Journal of Political Economy*, 85 (3) pp.473-89.

Lamont, N. (1999) *In Office* (London: Little Brown).

Lawson, N. (1992) *The View From Number Eleven*, (Bantam).

Ludlow, P. (1982) *The Making of the European Monetary System* (London: Butterworth Scientific).

McSmith, A. (1993) *John Smith: Playing the Long Game* (London: Verso).

Portillo, M. (2000) 'Rigorous Disciplines For Hard Times', *Financial Times*, 11 December.

Radice, G. (1989) *Labour's Path to Power: The New Revisionism* (New York: St Martin's Press).

Radice, G. (2003) *How to Join the Euro* (London: Foreign Policy Centre).

Robinson, G. (2000) *The Unconventional Minister* (London: Michael Joseph).

Seldon, A. (1997) *Major: A Political Life*, (Weidenfield & Nicolson)

Scott, A. (1986) 'Britain and the EMS: An Appraisal of the Report of the Treasury and Civil Service Committee', *Journal Of Common Market Studies*, 24, (3) pp.187-201.

Stephens, P. (1996) *Politics and the Pound*, (Basingstoke: Macmillan).

Thompson, H. (1996) *The British Conservative Government and the European Exchange Rate Mechanism*, (London: Pinter).

Wickham-Jones, M. (1995) 'Anticipating Social Democracy, Pre-empting Anticipations: Economic Policy-Making in the British Labour Party, 1987-1992', *Politics and Society*, 23 (4) 465-94.

---

<sup>i</sup> The title represents a rephrasing of F. Giavazzi & M. Pagano's (1988) 'The Advantage of Tying One's Hands: ERM Discipline and Central Bank Credibility', *European Economic Review*, 32, 1055-82.