A Lukewarm Pint

British Policy Toward European Monetary Cooperation 1978-1992

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Group identification contributes to intimate international cooperation; lack of group identification makes such cooperation less likely.¹ When a leader perceives their state to be part of a group of states, they are more likely to favor cooperation within this group. This paper develops hypotheses from this insight and explains British policy toward European monetary integration from 1978 to 1992. My argument explains why the United Kingdom did not support monetary cooperation in 1978, supported it in 1990 when the pound entered the Exchange Rate Mechanism (ERM) of the European Monetary System (EMS) in 1990, supported it again when British Prime Minister John Major signed the Maastricht Treaty in 1991, and then withdrew that support in 1992 during the Black Wednesday crisis.

Social psychologists have established that individuals who believe themselves to belong to a common group are more likely to engage in cooperative behavior with other group members than individuals who lack such beliefs.² The perception of common group membership enhances the possibility of cooperation. A group is "two or more individuals who share a common social identification of themselves or ... perceive themselves to be members of the same social category."³ Although there are limits to the use of social

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²Hornstein 1972; Hornstein 1976, especially chapter 7; Turner 1978; and Turner 1982.

³Turner 1982, 15.
psychological insights to understand international relations,⁴ there are enough similarities to merit cross-fertilization. State decision makers, like the subjects of psychological experiments, think of themselves and their states as belonging to groups.

Current approaches to the problem of international cooperation can not adequately explain intimate international cooperation. Neorealist explanations often contain unspecified theories of the domestic sources of cooperation,⁵ and approaches that focus on the role of domestic groups and coalition formation assume away questions of preference formation.⁶ Explanations that focus on the role of domestic institutions and ideas can not show why a state might cooperate at one time and not another, and approaches that emphasize the role of historical contingency can not be used to unearth generalizable lessons about cooperation.⁷ We need an explanation that can illuminate the process of preference formation, that can show how preferences can change over time, and that can be applied to more than one case.

Constructivists argue that the formation of group identities affects the likelihood of cooperation. They urge us to examine the strategies and positions of the players, as well as

⁴See Streufert and Streufert 1986.

⁵Milner 1992; and Wendt 1987. For an example of a realist explanation of European monetary integration see Grieco 1996. For a neorealist interpretation of alliance formation see Walt 1987.

⁶For example, see Gourevitch, 1986; Milner 1988; Rogowski 1989; and Freiden 1991.

⁷For an example of domestic institutionalism see Hall 1986. Hall does not argue that British institutions changed between 1978 and 1991, even though the British refrained from cooperation on European monetary integration in 1978 and agreed to cooperate from 1990-1992. For an historical approach to European monetary cooperation see Cameron 1993. For an explanation of NATO that focuses on identity see Risse-Kappen 1996.
the intersubjective understandings that influence players' calculation of their interests. While constructivists are right to point us in this direction, to my knowledge they have yet to present a concrete method to apply their insights to understand reality. It is not enough for political scientists to suggest that group identity formation and external pressure interact to affect cooperation. Using the concepts without grounding them in empirical reality will only increase abstraction without adding real value.

To make group identity formation a useful variable, we need to understand how group identities form, and this means that the messy work of measuring identity can no longer be avoided. By measuring group identity and external pressure and by examining their interaction, I expect to advance knowledge about when states are likely to cooperate, and when they are likely to judge that they are better off on their own.

**How Group Identities are Adopted**

To adapt the concept of group identity formation to international relations, I devise a method to measure the relationship between the perceived similarities within a potential group and within other potential groups. Since group formation is an inherently social process, the dissertation examines the context in which a potential group member finds herself. Group identities only become salient when the category is accessible to potential group members and

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8For studies of cooperation based on game theory, see Oye 1986. For constructivist modifications see Wendt 1994, 390-391; and Mercer 1995. Wendt uses the word "collective" the way I use the word "group." I prefer the latter because it emphasizes the contribution of the social psychologists and also because it avoids jargon.

9Turner 1987, 51-52.
when the stimulus from the category fits the potential group members.\textsuperscript{10}

Accessibility is a necessary condition for the creation of group identity. If an identity is not available in the perceiver's environment, the perceiver will be unable to adopt that identity. One can not be what one is not familiar with. It makes no sense to be a devotee of Beethoven if one has never heard his work; or to be a Muslim if one has never seen a Mosque. Proximity can make an identity accessible by decreasing the distance between the perceiver and the identity.\textsuperscript{11} Technological advances in travel and communications have affected how people perceive distance, so perceptions of proximity have changed over time.\textsuperscript{12} I measure proximity with travel and telecommunications data.\textsuperscript{13} High volumes of traffic and telecommunications traffic show a high level of interaction between states.

Accessibility alone is not enough for a group identity to develop, however. Familiarity often breeds contempt. In addition to being accessible, an identity must fit its owner to be adopted. There must be some match between the perceiver and the group. Three factors can contribute to the fit of a particular identity. First, perception of a common affinity can bind

\textsuperscript{10}Oakes 1987, 126-132.
\textsuperscript{12}Deutsch \textit{et al.} 1957, 51-54; Bell 1976, 100-101; Deutsch 1953, 16; and Russett 1974, 331.

\textsuperscript{13}Travel data comes from various editions of the \textit{UN Statistical Yearbook} (New York: United Nations Statistical Office). I use raw numbers, even when comparing British and French travel because the populations of both countries are almost equal over this period. For example, the populations of Britain and France, respectively, in 1949 were getfigures and in 1966, the respective populations were getfigures. If I were to make comparisons using travel data (and other data that is sensitive to the number of people in a state) between states with different populations, it would be necessary to present travel as a percentage of the total population.
people together.\textsuperscript{14} I measure this factor by using trade dependency and public opinion polls. High levels of trade dependency and favorable responses to poll questions about another state indicate a sense of common affinity. Second, the existence of a common threat can also bind people together. If two or more countries perceive a common threat, they are likely to perceive themselves as a group with a shared interest in fending off the danger.\textsuperscript{15} I measure common threat by surveying statements by state decision makers about perceived threats to their state. When state elites agree about the tangibility of a menacing state or group of states, a common threat exists. Third, idea convergence contributes to fit a group identity to a perceiver.\textsuperscript{16} People like people who share their opinions. I measure idea convergence by examining policy debates. Decision makers demonstrate idea convergence when they agree about the end goal of a particular policy and the proper means to achieve this end. International group identification is often a relatively long-term process that shapes basic perceptions of other states with respect to their suitability as partners in cooperative agreements.

Identity does not switch on and off. Instead, identity shifts are gradual processes that can orient people towards or away from allegiance with a group of states. Some identities can be held stable over decades. Nevertheless, it is important not to take too static a view of identity. Large numbers of people can and do experience identity shifts in short periods of

\textsuperscript{14}See Wendt 1994, 389-390; Wendt cites Buzan 1993 and Ruggie 1986. For a social-psychological perspective on common affinity and group formation see Rabbie and Horwitz 1969.

\textsuperscript{15}Wolfers 1962, 27-29.

Group identification affects behavior significantly enough to be considered an important variable, and it can change enough to explain policy changes. Such changes do not occur every day, but they do occur and have important effects on our behavior. Group identities are likely to change more often when current group loyalties are relatively weak. The faint-hearted are the most likely to change their minds. Those that are deeply devoted to a group identity are unlikely to be swayed by late-breaking events or newly discovered facts.

In addition to considering group identity, I examine another variable: external pressure. External pressure can contribute to cooperation by highlighting the contribution that other states may be able to provide to an embattled state. High levels of external pressure can make cooperation less likely if the threatened state adopts an isolationist stance, and eschews help from others. If state elites feel that there are no acceptable potential partners, they may choose isolation, even in dire times. When external threats are high, cooperation is still not a given. When external pressure is low, states are less constrained and have more leeway to pursue secondary interests. Cooperation decisions will not be constrained in one way or another.

To measure external pressure, I examine means that could potentially harm a state. High prices in important commodities, such as oil, fluctuations in important exchange rates, decreases in world demand, high foreign interest rates, and poor capital markets can place pressure on a state. The careful reader will note that external pressure is similar to the level of common threat, which affects the accessibility of a group identity. Common threat refers to how previous and current threats contribute to the group identity process, while external

17 Deutsch, p. 12.
pressure refers only to currently perceived threats. Previous and current levels of external pressure may contribute to group identity by enhancing perceptions of common threat, while current external pressure may or may not contribute to cooperation. A gradually increasing perception of threat can contribute to cooperation by both (1) increasing the accessibility of a particular group identity, which raises the salience of the identity, and by (2) raising the necessity for cooperation. The first instance refers to common threat, the second to level of external pressure.

**Hypotheses**

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We can draw several specific hypotheses to show how group identity and external pressure interact to determine whether or not a state will choose to cooperate with others. If group identity is high and external pressure is low, a state will engage in voice negotiation. A state engages in voice negotiation when it would like to cooperate, but insists that the cooperative agreement be shaped according to its preferences. The state will adjust its policies, which is consistent with our definition of cooperation, but will insist that the
cooperative agreement corresponds closely to its preferences. Since external pressure is low, the state is not compelled to cooperate to counter a threat. In addition, high group identity makes it likely that decision makers will take the view that state interests are best served by cooperating within the group. Although some tension between the desire to cooperate and the desire to maximize state interests may exist, it will probably be resolved by remaining in the group. The state will still have to adjust its policies as part of the cooperative agreement, which will lead some groups within the state to argue that the cooperative agreement constitutes an unacceptable loss of policy autonomy. Policy makers will defend their decision to cooperate by arguing that state interests are best served by staying within the group, and that the state will enjoy more autonomy by working with the group rather than leaving it and facing the international environment alone.

If both group identity and external pressure are high, states will be highly constrained to cooperate with others. Policy makers will be likely to see cooperation as imperative to state interests, and will agree to cooperate even when the terms of cooperation are less than ideal for the state. They will argue that the importance of countering the external pressure outweighs the need for an ideal agreement. This is an example of submissive cooperation.\(^{18}\) State leaders will go along with other group members even if the agreement is not the best possible one for their state, and will practice diffuse reciprocity in negotiations with their partners.\(^{19}\)

\(^{18}\)Stein 1982.

\(^{19}\)Keohane 1986.
cooperative agreement with others, but only if the agreement is highly compatible with the state's interest. State leaders will perceive state interests in a unilateral strategy just as much as they will seek to cooperate with other states. Policy makers will hold out for concessions during international negotiations and, if these concessions are not forthcoming, they will not cooperate. I call this type of behavior acquisitive negotiation. Instead of going along with the agreement if it is diffusely reciprocal, these state leaders will insist on specific reciprocity and will guard their interests closely. Because group identity is low, other states do not appear to be attractive partners. Due to low external pressure, acquisitive states will not be constrained to cooperate. Even if they cooperate, they will be more likely to use the agreement for their particular interests than for the good of the group as a whole.

Concessions to the other cooperators will be minimal.

If group identity is low and external pressure is high, a state will be unlikely to cooperate with others. Policy makers will likely see cooperative agreements as hindrances to coping with the pressure rather than an effective way of countering it. States in this sector will exit rather than cooperate. Policy makers will argue that the state is better off on its own than in a group. The high level of external pressure makes the state's interests clear, and the low level of group identity enhances the differences between the state's interests and those of the would-be group.

This paper tests my hypotheses on British policy towards European monetary cooperation from 1978 to 1992. It examines the interaction between group identification and external pressure and discerns trends in these variables over the entire period, focusing on the decision not to join the ERM in 1978, the decision not to join in 1985, the decision to join in
1990, the decision to sign the Maastricht treaty in 1991, and the decision to withdraw the pound from the ERM in 1992. The paper measures British group identification towards West Europe and the level of external threat for this period. The chapter also examines British policies and discusses the historical setting in which British policy makers made their decisions.

In general, the British have had a mixed record with regard to European cooperation. British reluctance to cooperate with their European neighbors has a long history dating back to their role as the keeper of the balance of power on the European continent. During periods of historical calm, the British preferred to stay out of continental politics, but when their presence could restore order, they were willing to apply their resources towards this goal. This mixture of activity and isolation with respect to Europe also is evident in British monetary policy.

The British case supports my hypotheses. The West European group identity was accessible enough to the British, but fit less than it did the French. At the same time, British identification with West Europe has not been static. As we will see, British West European group identification was low in 1978-9, but became more accessible and fit better over the 1980's. By 1990, British group identification, while still weak in comparison to the French, was strong enough to allow the British to place the pound within the ERM in 1990 when external pressure was relatively low. Nevertheless, a decrease in British group identification with Europe took place over much of 1992. In addition, an increase of external pressure culminated in the September 1992 Black Wednesday crisis and drove the pound from the ERM. The shifts in British behavior throughout this period are consistent with my
hypotheses. From 1978-1989 the British refrained from European monetary cooperation. When group identification and external pressure are both low we should expect acquisitive negotiation, which the British displayed. In 1990, the growth in group identity along with moderate to low external pressure allowed the British to engage in voice cooperation. As we will see, during the brief period in which they belonged to the ERM (which included the negotiations for the Maastricht Treaty) the British practiced voice cooperation by seeking to shape the terms of European monetary cooperation to British benefit. Over much of 1992 British group identification with West Europe decreased. When external pressure rose, the British followed a policy of exit noncooperation.

1978 Thanks, but no

1978 was a year of hesitation for the British government. The British were haunted by memories of the 1972 withdrawal of sterling from the snake and from the need to apply for a loan from the IMF in 1976 to bolster confidence in the pound. Prime Minister James Callaghan's hesitation was fueled by British ambivalence about whether or not it belonged to the group of West European states with which the French identified. In the end, Britain's memory of itself as a dominant global power and long-standing support of multilateral arrangements prevented Callaghan's Labour government from developing a group identity with respect to West Europe, dampening the prospects for British participation in European monetary cooperation.

During the EMS negotiations, the Callaghan government took an extremely cautious stance. Callaghan sent as his personal representative Kenneth (now Sir Kenneth) Couzens,
who some thought to be skeptical of European currency coordination. The Callaghan government also complicated the negotiations by linking the issue of monetary cooperation to reform of the EC's Common Agricultural Policy (CAP), a bargaining tactic that annoyed the other negotiators and produced few results. Callaghan and Chancellor of the Exchequer Denis Healey were equivocal about the project of European monetary integration, and both were constrained by a minority government and backbench opposition to the ERM. Healey insisted that any solution to currency instability include the US. The British had several concerns about the proposed currency cooperation. They feared that linking the pound to other currencies would introduce unwanted deflationary influences into the British economy. They also believed that due to North Sea oil, the UK's position as a net oil exporter meant that the British economy would respond differently to the international economy than other EC member states. Members of the British cabinet felt that despite the French support for a currency basket instead of a grid the resulting system would not change significantly from the snake. The Callaghan government chose not to enter the ERM, but hesitated from completely disassociating from it by allowing the pound to be used in calculations to determine the basket in which EMS member currencies lie. The UK did join the EMS, but

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21 Cite Tony Benn from harmoncite.

22 Statler 1979, 209.

23 Dell, 15; The Times, 10 July 1978, 1.

24 Gros and Thygesen 1988, 40.

25 Dell 1994, 30, 49.
without joining the ERM, the heart of the EMS, the British refrained from European monetary cooperation. If the British were adamantly opposed to European currency cooperation, we would expect them to remove themselves completely from the system, but they did not follow such a course. In retrospect, later British membership of the ERM shows an ambivalence within British policy toward European currency cooperation that begs for explanation.

**Group Identification**

*Accessibility*

Despite the existence of the English Channel, the British were proximate to West Europe in 1978. This closeness was somewhat obscured by British proximity to North America, however. In 1978, 1,156,574 UK residents traveled to North America, which is quite large compared to the 364,868 French citizens who traveled there the same year. Britain ranks second among countries that send citizens to the United States.\(^{26}\) 10,380,000 UK residents visited EC member countries in 1978, which is considerably higher than the number traveling to North America. This is even higher than the 9,791,657 French travelers who traveled to other EC countries in 1978. The high absolute level of British travelers to the EC shows that even though the British were separated from West Europe by water, they were in fact more proximate to West Europe than the French.

Since the British and French populations are roughly equal, it is possible to make direct comparisons between the two countries. The high number of British travelers to North

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\(^{26}\)Figures on UK resident travel obtained from "Visits Abroad by UK Residents," Library and Information Service, Central Statistical Office, Newport Gwent, UK.
America is underscored when compared to the number of French who traveled to North America in the same year (1,156,574 to 364,868 or 3.2:1). The ratio of British travelers to the EC in relation versus those who traveled to North America is 9.0:1. The relatively low ratio of British travelers to North America with respect to British travelers to the EC emphasizes higher UK relative proximity to North America than that registered by the French, who did not register a ratio of less than 12:1 throughout the period under study.

Telecommunications data further emphasize Britain's orientation towards North America. In 1983, the earliest year for which data is available, the British spent 202,600,000 minutes calling the United States, which is almost three and a half times as many minutes as the French spent calling all of North America (58,442,000 minutes). The British report 143,200,000 telecommunications minutes with fellow EC states, but this figure does not include major telecommunications destinations such as Germany and France, so no meaningful comparison can be made between British calls to the US and those to EC states. Nevertheless, the disparity between British and French calls to North America shows greater proximity to North America than the French. The common tie of the English language helps account for North American accessibility to the British. Overall, British proximity to both North America and West Europe was greater than that of the French in 1978. The group identities associated with both regions were more accessible to the British than they were to the French.

Even though the West European identity was more accessible to the British than to the
French, the West European identity fit the British less than it did the French in 1978. Unlike France, Britain did not see the US as a common threat to West Europe. The historic "special relationship" between the UK and the US, nurtured by close collaboration during and after WWII, prevented this perception from emerging fully. Recent British devaluation of the pound and a recovering economy sheltered them somewhat from the two dollar crises that upset the French.27 British officials ruminating upon the EMS repeatedly expressed fear of West Germany rather than the US. Callaghan himself noted that entering the ERM would leave the pound helpless before a strong Deutschmark, which would pull sterling upwards, deflating the British economy.28 Callaghan and others feared that entering into an exchange rate agreement with the West Germans would lead to British deindustrialization, outweighing any gains resulting from currency stability.29 Healey turned against British entry into the ERM after discussions with German Social Democrat Manfred Lahnstein, who supported the EMS because he saw it as a means to keep the Deutschmark low and Germany competitive.30 Instead of identifying the US as a threat to West Europe, the British sought assurances that the ERM was not meant to be used to the detriment of the dollar.31

In addition to perceiving different threats than the French, the British held different economic beliefs, which prevented idea convergence between the British and the West

27See Ludlow 1982, 72-73; for the general state of the British economy see OECD 1978.

28Callaghan 1987, 492.

29The Guardian, 8 July 1978, 1, 6, 22. For another account of Callaghan's fears, see Carr getdatttt, 142.


Europeans. In 1978 British macroeconomic ideas placed more of an emphasis on growth through state demand management than did either German or French ideas. British governments traditionally ran through "stop-go" cycles, attempting to increase demand in order to spur growth, and defending an over-valued exchange rate. Those in charge of economic policy making under Callaghan have been described as "cautious Keynesians." British ideas also lacked the regional flavor displayed by French ideas. Whether this was due primarily to memories of the world-straddling Empire, longstanding support for multilateral approaches to economic matters, or a close relationship with the US is uncertain, but all three factors played a role. The British Treasury looked to the IMF, not Europe, as the preferred forum to achieve monetary stability, and insisted that the EMS act consistently with the IMF. This preference for the IMF could also have been due to the British belief that they would have more influence in it than in the EC. British ideas differed from those of other West European states, especially France and Germany.

Furthermore, Britain experienced a low to moderate level of common affinity with West Europe. Analysis of the direction of UK exports for 1978 shows a substantial orientation towards West Europe, but much less of a dependence on it than the French, with a

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33Hall 1986, 250-251.


36Ludlow 1982, 110. This could serve as another example of what Grieco calls "voice opportunities."
greater percentage of exports going to North America. Out of a total of $71,702 (millions of US dollars), the UK exported $28,064, or 39.1% to major EC members, and $8,313, or 11.6% to North America. The percentage of exports to major EC countries is large, but over 5% smaller than French exports to the same countries for the same year. Moreover, the percentage of UK exports to North America of 11.6% are considerably higher than French exports, which were 6.8%. The British exported more to the US ($6,690) than to Germany ($5,959). While a greater percentage of UK exports went to West Europe than to North America, these figures clearly indicate that the UK was much less dependent on exports to West Europe than France, and more dependent on North American exports, particularly to the US.

British public opinion data confirms that the British did not think of themselves as sharing a common affinity with Europeans. During March-April 1982, 72% of British poll subjects responded that they "never" thought of themselves as Europeans in addition to being British. In comparison, almost half as many French respondents, 37% responded similarly. The British were less likely to think of themselves as sharing a common affinity with West Europe than were the French. Thus, this variable would indicate a lower likelihood that the West European identity would fit the British.

**External Pressure**

External pressure on the British was moderate to low when they decided not to enter

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37 Results listed in *Eurobarometer 36*. 1982 was the earliest year that the Eurobarometer asked this question.
the ERM. The 1970’s were not a good decade for the British economy, but 1978 served as a lull between storms. Recall that world imports rose 14.5% from 1976 to 1977 and 16.2% from 1977 to 1978.38 British exports increased 21.5% from 1977 to 1978 as the British were able to sell more products across the globe. World commodity prices jumped from an increase of 8.2% in 1977-1978 to increase of 17.9% for 1978-1979.39 UK consumer prices increased 8.2% from the previous year, which is rather high, but is quite a drop from the previous year's increase of 15.9%. World crude oil prices increased slightly from $14.53 to $14.57 per barrel.40 As a petroleum exporting nation, the UK benefitted from the earlier petroleum price rises that worried the French. In addition, the exchange rate instability that threatened the franc had less of an impact on that pound, which had been drastically devalued in 1976. The pound rose moderately during the dollar crisis of the winter of 1977-78. Low German and Japanese interest rates also offset high interest rates in the US.41 In general, there was moderate to low external pressure on the British economy in 1978.

Acquisitive Negotiation

While the French chose submissive cooperation by joining the ERM in 1978, the


40 This and all subsequent references to the price of crude oil refers to the refiner acquisition cost of imported crude oil in dollars per barrel, and are taken from Energy Information Administration 1996, 111.

41 IMF 1992, 95. Also see IMF 1991, 4 for the drops in both German and Japanese short- and long-term interest rates and the corresponding rise in US rates over the same period (1976-1979).
British engaged in acquisitive negotiation. The British entered the EMS negotiations with a decidedly zero-sum stance, demonstrating a lack of willingness to offer concessions in the form of policy coordination to reach agreement. For example, they attempted to link the talks to CAP reform. In addition, rather than a European solution to currency fluctuations, the British preferred an approach that would involve the IMF. The British feared that, since they were prone to high inflation, they would forfeit competitiveness by linking themselves to Germany, a low inflation country with a strong currency. The British believed that the proposed system was too similar to the prior snake system and would again put themselves at the mercy of the West Germans. The British also felt that they would have more autonomy over the direction of monetary coordination in the IMF than they would in the ERM because of the presence of their long-time ally, the US.\textsuperscript{42} Even after the British decided that they would not join the ERM, they nevertheless remained party to the negotiations in an attempt to shape the final outcome. British willingness to join the EMS but not the ERM shows that they did fear isolation from West Europe, but in the last analysis they were unwilling to tie the pound to other European currencies.

Consistent with these considerations, the group identity variables caused British identification with a European group of states in 1978 to be somewhat weak. Despite high accessibility, relatively high British export orientation towards North America, fear of the West German economy, different economic ideas, and distance from the European continent all contributed to the absence of British group identity towards Europe on the issue of monetary integration. Group identity was not completely absent from the British psyche,\textsuperscript{42}

\textsuperscript{42}Ludlow 1982, 110.
however, as the level of British exports to Europe and relative physical closeness indicate. Even though the British did not join the ERM in 1978, they did allow the pound to be included in the calculations that would determine the basket of European currencies. These hints of group identity intensified over the next thirteen years, as the remainder of this chapter will show.

1978-1985 Pondering ERM

When the Conservatives, led by Margaret Thatcher, claimed office in May 1979, there was little prospect of an immediate change in the British stance towards the EMS. Thatcher had supported British membership when the Conservatives were in opposition, but now that they had gained power, she revealed her earlier support for the EMS to be political posturing against the former Callaghan government. Geoffrey Howe, Thatcher’s first Chancellor of the Exchequer, had been part of a group of Conservatives in favor of the EMS, but he did not think that conditions at the time favored sterling’s entry into the ERM. Thatcher herself refused to consider entry until her government could bring down inflation and reduce public spending.\(^{43}\) The Conservatives noted that the pound would enter the ERM "when the time is ripe."\(^{44}\)

Once in power, the Conservatives presented their Medium Term Financial Strategy (MTFS), which sought to provide a stable climate for investment by reducing the state role in

\(^{43}\)Thatcher 1993, 692.

\(^{44}\)In the mid-1980’s this formulation alternated with the phrase "when the time is right." See Lawson 1993, 485.
the economy and by limiting spending and inflation. The proper way to do this, they argued, was to control the money supply rather than react to short-term fluctuations in the economy.\textsuperscript{45} The Thatcher Government targeted sterling M3, a measure of the money supply that includes money in circulation plus bank deposits, and sought a gradual deceleration of the growth of sterling M3 over the next four years.\textsuperscript{46} They also lifted exchange controls; the pound was quite strong and they wished to increase British overseas assets and investment income.\textsuperscript{47} When asked about their ideas of the proper rate of the pound, the Conservatives insisted that they would let the market set its own rate and would refrain from Government intervention to influence the exchange rate. In October 1979 a group including Howe and Bank of England Governor Gordon Richardson broached the idea of sterling entry into the ERM to the Prime Minister, but Thatcher, concerned about potential conflict between domestic monetary targeting and EMS-imposed intervention requirements, rejected the proposal.\textsuperscript{48} The British would not seriously consider joining the ERM again until 1985.

In January 1985, the British were forced to order a series of interest rate hikes that left British rates at 14\%, their highest level in three years. Within the British treasury it became widely acknowledged that Sterling M3 could not be used to target government monetary policy. Exasperated by the need for a guide for domestic monetary policy, buffeted by downward pressure on sterling, Chancellor of the Exchequer Nigel Lawson concluded that the

\textsuperscript{45}For further discussion of the MTFS see Lawson 1993, 66-73.

\textsuperscript{46}Britton 1991, 51.

\textsuperscript{47}Howe 1994, 140-142.

\textsuperscript{48}Howe 1994, 274. At that time Howe only supported the pound's entry into the ERM as a "medium term objective".
answer was to place the pound within the ERM. An avid monetarist, Lawson considered the
ERM as another way to impose domestic discipline. In a series of January 1985 meetings
Lawson procured the support of key civil servants in the Treasury, along with Howe, for
eventual entry once the pound was relieved of the pressure placed upon it. Bank of England
Governor Robin Leigh-Pemberton was already favorably disposed toward the ERM. In
addition, in 1985 the ERM had been in operation for seven years and was believed to be a
credible disinflationary instrument, adding to its allure.\(^49\)

In October 1985 Lawson argued that the ERM could be used as a guide for policy
now that sterling M3 had been discarded, that a decline in oil income had lessened the
differences between the British economy and those of ERM members, and that ERM entry
would help the government's anti-inflation campaign.\(^50\) In addition to Lawson, Foreign
Minister Howe, Governor of the Bank of England Leigh-Pemberton, Secretary of State for
Trade and Industry Leon Brittan, Party Chairman Norman Tebbit and Deputy Prime Minister
William "Willie" Whitewall all spoke in support of ERM entry. Only John Biffen, Leader of
the House of Commons, spoke against the ERM.\(^51\) In one of the defining moments of her
premiership, Thatcher insisted that the pound not enter the ERM. "If you join the EMS, you
will have to do so without me," she told the assembled group.\(^52\) The November 1985 meeting
was the closest that Britain came to joining the ERM since its inception in 1978, and the

\(^49\)I am grateful to Mark Harmon for discussion on this point.

\(^50\)Stephens 1996, 49. A paper Lawson prepared for the meeting is reprinted as an annex
to his autobiography; Lawson 1993, 1055-1058.

\(^51\)Howe 1994, 450.

\(^52\)Quoted in Lawson 1993, 499.
closest that Britain would come before finally joining in 1990. Why did the British remain outside the ERM despite the support of most of the relevant cabinet members?

**Group Identification**

The 1985 decision to refrain from entering the ERM was a "nonevent" as it did not result in a change in British policy. Nevertheless, it is an important moment that deserves scrutiny. In 1979 the Thatcher government was almost unanimously against bringing the pound into the ERM. Even then-Chancellor Geoffrey Howe, who would eventually resign from the government over its European policy, did not judge the time right for pound entry into the ERM. By 1985 Howe, Lawson and other high-level government officials favored sterling's entry, but were thwarted by the opposition of the Prime Minister. A schism formed within Thatcher's government that would lead to her downfall five years later. I will discuss these events below, but for now I will focus on developments in British group identification and external pressure between 1978 and 1985 that created this split in the Cabinet.

**Accessibility**

The high British proximity to West Europe evident in 1978 continued into 1985. In the latter year 18,094,075 British citizens traveled to other EC countries, considerably more than the 10,812,538 French citizens who traveled there that year. Interestingly, British travel to North America in 1985 (860,837) declined from 1984 (927,574), suggesting a slight drop in North American proximity. A relatively weak pound made travel to the US exceedingly expensive, and limited British travel across the Atlantic. At the same time, proximity to the
EC continued to rise, increasing 1.4% from the previous year. To the extent that it can, British telecommunications traffic shows a similar trend. British telecommunications traffic data for this period is problematic as there is no data reported on British traffic to major countries such as Canada, France, Germany, Ireland and Spain. Still, the data shows that British telecommunications traffic to Belgium, Italy and Portugal in 1985 increased 10.6% from 1984. Over the same period, British telecommunications traffic to the US increased 24.4%, which indicates that British proximity to the US probably rose as well. Here there is disparity between travel data, which shows a slight decline in British proximity to North America, and telecommunications data, which shows an increase in British proximity to the US. Despite this disparity, it is safe to say that British proximity to West Europe was increasing in 1985, which indicates a rise in the accessibility of the West European group identity.

*Fit*

Export figures show an increase in British common affinity with West Europe. In 1985 the British exported 48.7% of their total exports to other EC members. This is quite an increase from the 39.1% of total exports that the British sent to the EC in 1978. British export dependency toward the EC in 1985 was even higher than French export dependency toward the EC had been in 1978. Just as British export dependency toward the EC was increasing, however, so was British export dependency toward North America, which in 1985 comprised 17.4% of total exports, an increase from the 1978 figure (11.6%). British export dependency toward North America is rather high when we compare it to French export
dependency for the same year (9.6%). This relatively high export dependency toward North America shows that while the British were more likely to perceive themselves as having a common affinity with West Europe in 1985 than they were in 1978, British perception of common affinity with North America was enough to cloud the picture.

Public opinion data indicates the relatively low level of common affinity given by export data. In October and November of 1985 28% of British poll respondents answered that they "often" or "sometimes" felt themselves to be Europeans in addition to being British, while 70% answered that they "never" felt this way. These figures are almost identical to results of the 1982 poll where 27% answered "often" or "sometimes", while 72% answered "never". The main difference between the 1982 poll and the 1985 poll is that the "often" response increased from 7% in 1982 to 11% in 1985, which shows some increase in the intensity of British common affinity with West Europe. Nevertheless, if we compare these percentages to the French respondents to the same poll, where 67% answered "often" or "sometimes," while 32 answered "never", and to the EC 12 average, where 54% answered "often" or "sometimes" against 42% who answered "never". We see that on average, the British perceived a lower level of common affinity with West Europe than many citizens of neighboring countries.

The British were not immune to perceiving the US as an economic threat. A strong dollar and large US budget deficit put pressure on the pound. Thatcher personally complained to Reagan before the US took responsibility to reduce the value of the dollar.\textsuperscript{53}

The resulting drop in the dollar from January to March 1985 contributed to confidence in the

\textsuperscript{53}Stephens 1996, 44.
pound. Despite Thatcher's intervention, her government did not register the suspicion of the dollar that is evidenced by the French. In addition, the British expressed their displeasure over Japanese protectionism and Thatcher berated Japanese Prime Minister Yasuhiro Nakasone over unfair trade practices.\textsuperscript{54} The perception of sharing a common threat with West Europe was fairly low, but was higher than it was in 1978.

British macroeconomic values were closer to those of their fellow West Europeans in 1985 than they had been in 1978. Along with a new leading political party, the 1979 election brought a new economic philosophy to British government: Monetarism. Monetarists argue that inflation is determined by the supply of and demand for money, and that by keeping the money supply under control, governments can limit inflation.\textsuperscript{55} The emphasis on keeping inflation low was definitely shared by other West European states.

The primary area of difference between the British and other West Europeans was the British monetarist belief that the government should not attempt to influence the exchange rate. Upon taking office, Thatcher and other monetarism members of her government firmly held that the market would set the proper exchange rate of the pound. This tenet began to give way as the Conservative government experienced difficulty in using Sterling M3 as a target by which to guide monetary policy. Card-carrying monetarists such as Lawson began to argue that it would be better to steer the economy by maintaining a stable exchange rate instead of allowing the market to set the price of sterling. Lawson did not see any

\textsuperscript{54}FBIS 6 May 1985, Q1-2; FBIS 10 October 1985, Q1.

\textsuperscript{55}For a description and critique of Thatcherite monetarism see Krugman 1994, 172-181. For one of the canonical works of monetarist economics see Friedman 1968.
contradiction between monetarism and government action to promote exchange rate stability, arguing that "an exchange-rate objective is monetarism at one remove; and that is indeed its attraction."\textsuperscript{56} Entering the ERM would be the best way to obtain this objective, he argued.

Lawson's conversion to government currency management was not experienced by Thatcher, or by Alan Walters, the Prime Minister's personal advisor who shuttled between London and Washington (where he worked for the World Bank). Thatcher and Walters argued against entry on the grounds that linking the pound to the Deutschmark would lead to unwanted deflation of the British economy, that British open exchange markets and low currency reserves would hamper British efforts to maintain the pound in the ERM, and that entering the ERM would limit the freedom of the government to alter interest rates. She was unconvinced that 1985 was the right time for entry.\textsuperscript{57}

The split in economic logic between Thatcher and Lawson would evolve into a political battle within the Conservative cabinet. What is clear is that British macroeconomic values had changed a great deal from those of the 1978 Callaghan government; and had even changed somewhat from the early days of the Thatcher government. The schism within the Thatcher government prevented whole-hearted idea convergence, but there was considerable movement in this area from the past.

\textsuperscript{56}Lawson 1993, 419.

External Pressure

The international economy was fairly benign in 1985. The level of external pressure on Britain rose from 1979 until the early 1980's, then dropped as the economy recovered from recession. By 1985 the British economy had recovered from the recession, and was under little pressure. There was little discrepancy between US and German interest rates. US interest rates increased in the early 1980's, with central bank discount rates ranging between 13% in 1980 and 12% in 1981.\textsuperscript{58} US interest rates then declined somewhat and were 7.5% in 1985. German rates rose to 7.5% in 1981 and 1982, and then dropped to 4% in 1985. The drop in world demand in the early 1980's hurt the weak British export industry, increasing external pressure on Britain. World imports dropped from 1980-1983, although they grew from 1983-1985.\textsuperscript{59} The drop in world demand was partially compensated for by North Sea oil income, however. Commodity prices also eased over the early 1980's, with non-fuel commodities dropping 23.7% from 1979 to 1985.\textsuperscript{60} Crude oil prices were high at $26.99 per barrel, but as a net oil exporter, the British benefitted from the high oil prices. Taken as a whole, external pressure on the British was low in 1985.

Acquisitive Negotiation

British group identity with Europe increased between 1978 and 1985, although it was

\textsuperscript{58}Interest rate figures are period averages of Central Bank Discount Rates in percent per annum, from IMF 1993, 95.

\textsuperscript{59}World Import data from IMF 1992, 113.

\textsuperscript{60}These are index figures from IMF 1993, 69.
still relatively low. External pressure was also low. Under such conditions I expect states to engage in acquisitive negotiation. States engaging in acquisitive negotiation will be unwilling to cooperate unless their demands are met. There were no negotiations between the British and the other ERM members in 1985, as the British opposed adjusting their policies to those of other European states. Still, continued British non-cooperation on EC monetary cooperation does not imply that British group identity remained stagnant between 1978 to 1985. To the contrary, it increased to the point that several prominent Cabinet members were willing to support the entry of the pound into the ERM, and were willing to call a meeting with the prime minister to propose the idea to her. Thatcher faced a divided cabinet, but was able to reject their proposal in part due to a lack of public push for change in British ERM policy. As British group identity toward Europe increased over the latter half of the decade, Thatcher's position would become less tenable.

1985-1990: Ripening

Despite their failure to enter the pound into the ERM, the pro-ERM members of the Thatcher government continued to work toward this goal. In 1986, falling oil prices put downward pressure on the pound, and Lawson raised interest rates to support the pound. Lawson and Howe argued that the drop in oil prices reduced the pound's position as a petro-currency, and strengthened the case for its entry into the ERM.\(^{61}\) Lawson was so convinced of this that he would eventually follow an unusual policy. In March 1987, Lawson began to

"shadow the Deutschmark," by maintaining the pound near a par value of DM3 to the pound. Convinced of the need for a stable exchange rate, and lacking Thatcher's support for ERM entry, Lawson pursued his policy without agreeing to a specific ceiling with the Prime Minister. Thatcher maintains that she was unaware of Lawson's unilateral policy until mid-November 1987; Lawson claims that Thatcher was aware of the policy. Regardless, the divergence shows the schism between the prime minister and her chancellor. In November Thatcher publicly denied that there was a set range for the pound, and pronounced that it was free to float. The Prime Minister's relationship with her chancellor was deteriorating.

Sterling was quite strong during this period, and British intervention in exchange markets consisted of efforts to keep the pound below DM3. The inflow of money resulting from British intervention in exchange markets threatened to increase the money supply and spark inflation. In March 1988, after a particularly large intervention, Thatcher, with the support of the Bank of England, ordered Lawson to cease his efforts of shadowing the Deutschmark. Lawson complied and the pound rose above DM3, reaching DM 3.18 in May. Lawson pressed Thatcher for a further interest rate cut of half a point to 7.5%, and was successful.

In the spring of 1989, EC central bankers met with Jacques Delors to draft what would become known as the Delors Report. The report, due to be discussed at the Madrid Council in late June 1989, set out three stages of monetary cooperation that would lead to European

63Thatcher 1993, 701. For another account, see Lawson 1993, 789.
64Stephens 1996, 86.
65Thatcher 1993, 705.
Monetary Union (EMU). Thatcher, predictably, bristled at this proposal. Lawson favored the entry of the pound into the ERM, but opposed EMU. Lawson and Howe argued that the best way for Britain to influence the discussion at Madrid would be for Thatcher to commit to joining the ERM by 1992. Shortly before the prime minister left for Madrid, her Chancellor and Foreign Secretary confronted her, informing her that they would resign if she didn't agree to enter the ERM. The meeting ended without agreement on the course Thatcher would take. At the Madrid Council, Thatcher agreed that the pound would join the ERM, but refrained from setting a date for entry.\textsuperscript{66}

Less than a month after Madrid, Thatcher reshuffled her cabinet, moving Howe to the position of Leader of the House. Thatcher's differences with Lawson continued to be exploited by the Opposition and the media. In late October Lawson threatened to resign if Thatcher did not fire anti-ERM advisor Walters, who helped provide Thatcher with the economic justification for her anti-ERM stance and whose presence as an economic advisor to the Prime Minister led to speculation that Walters had more authority over British economic policy than the Chancellor. After Thatcher refused to fire Walters, Lawson stepped down as Chancellor. Thatcher appointed John Major, who had served in the Treasury as Chief Secretary, to replace Lawson.

Sterling dropped following Lawson's resignation, nearing DM 2.7 in December. Major refrained from raising interest rates, and the pound eventually stabilized. In early 1990 Major

\textsuperscript{66}Thatcher argues in her memoirs that by not setting a date, she called Howe and Lawson's bluff (Thatcher 1993, 713). Lawson argues that since Thatcher's statement at Madrid was her more clearly in favor of ERM entry than previous statements, they succeeded (Lawson 1993, 927-934). A neutral observer agrees with Lawson (Stephens 1996, 118-119).
decided that the ERM provided the best means upon which to base UK economic policy, and set out to convince Thatcher to join ERM. Significantly Major endeavored to enlist the Prime Minister to bring the pound into the ERM despite knowledge that Thatcher's differences with Howe and Lawson over ERM had led to Howe's demotion and Lawson's resignation. Thatcher, who attributed Major's pro-ERM stance of that period to a desire to unify the Conservative Party, committed to joining in June 1990. On October 5, 1990, the British announced that on October 8, the pound would enter the ERM at a rate of 2.95 DM and within a 6% band rather than the 2.25% band used by most members, and that they would reduce interest rates to 14%. Still defiant, when discussing the announcement, Thatcher emphasized the rate cut rather than the ERM entrance. Despite Thatcher's reluctance and years of cabinet intrigue, the British committed to European monetary cooperation. The switch in British policy toward membership in the ERM, along with the fact that the Thatcher government made this decision, makes this an interesting case for my approach.

**Group Identification**

*Accessibility*

British proximity to the EC remained high in 1990, and the West European group identity remained accessible. British travel to the EC actually decreased slightly from 1989

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67 Stephens 1996, 146.

68 Thatcher 1993, 719.

(23,471,990) to the 1990 figure (22,907,560), a drop of 2.4%. British travel to North America increased to 2,796,992, and the ratio of British travel to the EC in relation to British travel to North America is 8.2:1, a slight drop from the ratio in 1985. These travel figures indicate a high level of proximity to the EC and a relatively high level of proximity to North America. Telecommunications data confirms the picture somewhat, but shows additional British proximity to North America. British telecommunications traffic to the EC increased 13.9% from 1989 to 1990. At the same time, however, British telecommunications traffic to the US increased 18.1%. The ratio of British telecommunications traffic to the EC versus British traffic to the US and Canada for 1990 was 1.8:1, showing that North America rivalled West Europe in proximity to Britain in 1990. Both the West European and North American group identities were accessible to the British.

**Fit**

The year 1990 witnessed an increase in British perceptions of common affinity with West Europe. 53.2% of total British exports were sold to other EC member-states, an increase over the 48.7% share that exports to EC countries in 1985. To compare this level of export dependency with our other case, the share of British exports to the EC in 1990 surpassed the share of French exports to the EC in 1985 (51.6%). At the same time, the effect of this export share was mitigated by a relatively large share of exports to North America, 14.7%, more than double the French export share to North America (7.1%). In addition the 1990 British export share to West Europe lagged behind the French export share for that year (60.8%), suggesting that while British perceptions of common affinity with West
Europe were on the rise, they were not as intense as French perceptions of common affinity with West Europe. In 1990, 71% of British citizens questioned responded that they "never" felt themselves to be citizens of Europe in addition to being British.

Polling data suggests that British perceptions of common affinity with West Europe remained near the level that they were in 1985. In spring 1990, 28% of British respondents reported that they either "often" or "sometimes" perceived themselves to be European in addition to being British, while 71% stated that they "never" felt themselves to be European. These figures are virtually identical to the 28% who answered "often" or "sometimes" and the 70% who answered "never" in 1985. When compared to the average of the EC 12, where 46% responded "often" or "sometimes" and the 51% who answered "never" in 1990, one can claim that the British exhibit a relatively low level of common affinity with West Europe.

There is a slight divergence between these two indicators for common affinity. Export dependency indicates that British perceptions of common affinity with West Europe, while not overwhelming, increased, while polling data shows little movement. It would be less than honest to report this mixed result as a clear increase in common affinity. Instead, I present the mixed result as it appears and ask the reader to consider that the tools for measuring group identification are less than perfect. Even if one indicator shows a slight increase while the other shows little movement, it is possible to argue that British common affinity with West Europe existed, but was somewhat weak in 1990 when the Thatcher government decided to enter the ERM.

British idea convergence with the rest of Europe in the late 1980's and early 1990's was much greater than it was in 1978. Thatcher's monetarist revolution had swept away the
remains of Callaghan's Keynesian growth oriented approach to macroeconomic policy. This policy shift allowed for a relatively constructive stance for the UK throughout the EMU negotiations, which contrasts with British obstructionism during the original EMS negotiations. The British argued for a market-oriented approach to EMU because "the moment... you go from the rigid and valuable discipline of the German central bank and people... you lose the very thing that helps you get inflation down." When she agreed to join the ERM at the Madrid summit, Thatcher argued that the British economic convergence with other EC economies would have to occur. The single most glaring divergence between the British and other EC economies in October 1990 was the relatively high British inflation rate. Members of the Thatcher government argued that joining the ERM would send a signal to markets that the British were committed to a policy of discipline, which would help lower inflation. The priority of lowering inflation and the belief that entering the ERM would help achieve this goal contributed to British group identification with West Europe in 1990.

External Pressure

The period between 1986 to 1990 was a fairly good one for the British economy. A drop in world oil prices reduced North Sea oil income, but benefitted industry by cutting production costs, raising profits and increasing the real value of wages. Inflation reached new lows; wages and productivity increased. By the end of 1988 two signs boded ill for the British economy: inflation was at 6% and the current account deficit was a record 15 billion


\(^71\)\textit{Britton} 1991, 75-80.
pounds. In 1989 the "Lawson boom" became a bust. Inflation rose, reaching 9% in April, and the current account deficit remained high. British interest rates remained high in an effort to counter inflation. In addition to their economic woes, the British government was torn by internal strife.

External pressure on the British was moderate to low in October 1990. The British economy actually went into recession in the summer of 1990, but the effects of the recession had not yet been perceived when the British decided to enter the ERM in October. Later, when the recession became more noticeable, some viewed British entry into the ERM as the cause. At the time, though, Thatcher mentioned that the economy was moving in the direction that the government intended. She had some justification in saying this.

Commodity prices in 1990 dropped 8.4% from the previous year. World imports increased 12.5% from 1989, indicating a rise in world demand. British exports increased 17.7% over the same period, which shows that the British were able to take advantage of this increase in demand. Petroleum prices also increased from $18.08 to $21.76 per barrel. German and US interest rate were about even, at 6% and 6.5%, respectively. British inflation was rather high, however, with consumer prices increasing 9.5% over the previous year. Nevertheless, the British were subject to low to moderate levels of external pressure in October 1990.

**Voice Negotiation**

When the pound entered the ERM, it did so under terms dictated by the UK to the

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72 Stephens 1996, 98.

73 The Times, 6 October 1990, 1.
other ERM members. The British announced the rate of the pound's entry without consulting other members of the ERM.\textsuperscript{74} The other states welcomed the entry of the pound, but worried about British commitment and ability to remain in the system.\textsuperscript{75} Over the weekend of October 6-7, Bundesbank representatives argued that the pound was entering at too high a rate, while the French argued that the rate was too low. The British insisted that their rate, supported by the market at that time, was the proper rate, and the pound entered the ERM the next Monday at DM 2.95. The British also insisted that the pound be allowed to fluctuate at a rate of 6\% around the core of the ERM instead of the normal 2.25\%. These British demands are typical of a state exercising voice in an international negotiation. Even though representatives of other EC states expressed misgivings about the circumstances of British entry, especially the rate of the pound and the fact that the British had not consulted their EC partners in advance, the pound's entry into the ERM was approved. Despite her longstanding opposition to the ERM, Thatcher allowed Major to do what Lawson had been unable to do: coordinate British exchange rate policy with those of the other EC members.

British entry into the ERM in October 1990 is consistent with my hypotheses. While British group identification with West Europe was not overwhelming, it had grown substantially since the original negotiations for the EMS in 1978. External pressure on the British was also moderate to low. Under these conditions we should expect the British to engage in voice negotiation, and they did. When the other ERM member-states accepted their

\textsuperscript{74}Harmon 1996, 70. The question of whether or not the pound entered at too high a rate would later become an issue after the British withdrew the pound from the ERM in 1992. See Barrell, Britton and Pain 1993.

\textsuperscript{75}For example, see Le Monde, 8 October 1990, 17, 19.
terms, the British ended over a decade of noncooperation to join the ERM.

1990-1 Opting in and out at Maastricht

Entry into the ERM did not end the strife within the Conservative cabinet. In November 1990 Howe resigned from office. In his letter of resignation Howe argued that the problem with Thatcher's approach to European integration was that it would affect Britain's influence on the future of Europe. Both Labour leader Neil Kinnock and Conservative Thatcher critic Michael Heseltine seconded this critique. Howe's resignation damaged Thatcher politically and marked the beginning of the end of her tenure as prime minister. When Major replaced Thatcher, he made sure not to inherit her stance on Europe. Major argued for the importance of maximizing British influence over European economic developments.

In 1991 the Conservatives' political difficulties were exacerbated by economic recession. High German interest rates prevented the British from making significant reductions in their interest rates, hindering efforts to bring the economy out of recession. Major would have liked to bring the pound within the 2.25% band in the ERM, but was forced to remain within 6% of the other European currencies. In the meantime, negotiations over the Maastricht treaty were underway.

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78 For an account of how Howe's resignation contributed to the end of Thatcher's term as prime minister, see Thatcher 1993, 832-842.

British support for EMU portion of the Maastricht treaty was as lukewarm as a pint of ale in a British pub. After much arguing in public and private, Major agreed to EMU only after amending the treaty to allow Britain to opt out of monetary integration if it chose to do so later. Thatcher might have completely opposed Maastricht, but Major tried to find a way alter the agreement to suit British interests. Major defended his government's approach to Maastricht by arguing that there were three routes it could take with respect to the EC: leave it, stay in it but stay on the sidelines, or stay in it and attempt to influence it. He favored the third option.\textsuperscript{80} British orientation towards Europe should not be overstated, however. In 1991 it was tempered by a reluctance to alienate the US or Japan.\textsuperscript{81} Major's government was not stacked with Europhiles, but this actually helped Major obtain domestic ratification of Maastricht. Norman Lamont, a known Eurosceptic, served as Major's first Chancellor. Lamont's support for Major's stance on Maastricht helped convince Conservative backbenchers to ratify government support for the treaty. Given British ambivalence over European monetary cooperation, British government support for the Maastricht treaty, along with its insistence upon an opt-out clause, presents an interesting challenge for my approach.

\textbf{Group Identification}

British support for the Maastricht provisions for EMU was a careful balance of two desires: maintaining a place in the vanguard of European cooperation and placating domestic opposition to the loss of British sovereignty to a federal Europe. British identification with

\textsuperscript{80} FBIS, 20 June 1991, 11-15.

\textsuperscript{81} FBIS, 9 December 1991, 10-11.
West Europe illuminates the ambivalence at the heart of British policy towards EMU at Maastricht.

**Accessibility**

British was fairly proximate to Europe in 1991. In that year British visits to EC member countries, 23,534,427, indicate a 2.7% increase from 1990. British visits to North America in 1991, 3,025,754, increased 8.2% over the same period. British proximity to North America and West Europe both continued to rise. Telecommunications data also indicates closer British proximity to West Europe in 1991. British minutes to EC countries in 1991 (1,219,000,000) are actually more than French minutes to EC countries in 1991 (1,151,888,000). But the British spent more than three times as many minutes talking to the US and Canada than the French did (603,000,000 to 169,600,000). The ratio of British minutes to the EC with respect to British minutes to the US and Canada in 1991 is 2.0:1. Compared to the French ratio of 6.8:1, the British ratio shows more proximity to North America than the French. In sum, the telecommunications and travel data support the argument that British proximity to West Europe and North America increased in 1991, but that neither increase was not overwhelming.

**Fit**

Examination of trade dependency data for 1991 shows increased British fit with a European group identity, although the European identity fits the French better than the British. In 1991 British exports to the EC increased to 56.6% of total exports, a rise of 3.4% from
53.2% in 1990. Interestingly, British export dependency on North America dropped from
14.7% in 1990 to 12.8% in 1991. British export dependency on the EC increased as its
export dependency on North America decreased. In 1991 British export dependency on the
EC was quite close to French export dependency on the EC for the same year (59.7%).
Again, the most striking difference between British and French export dependency is the gap
between the percentage of British exports to North America in 1991 (12.8) and French exports
for the same year (7.8%).

Similar to 1990, public opinion data suggests somewhat less common affinity than
does trade dependence. In 1991, 69% of British citizens questioned responded that they
"never" felt themselves to be citizens of Europe in addition to being British. This percentage
is considerably higher than the EC 12 averages of 48% for 1991. The British "never"
percentages are also higher than French figures for the same year, 40%. The divergence
between public opinion and trade data result in an ambivalent measurement of common
affinity for the British in 1991, which is apt given the ambivalence of British policy towards
European monetary cooperation over the same period. One possible explanation for the
divergence is that there is a lag between increasing British export dependency on the EC and
the public perception of common affinity with West Europe. Policy makers, who actually
spend time perusing export dependency data, are more likely to take such trends into account
more expeditiously than the general public.

British perceptions of the US as an economic threat, while not as vehement as French
highlighted British vulnerability to dollar drops. A lower dollar meant that the relatively high
level of British exports to the US would be less profitable than if the dollar held steady. British exports to non-industrial countries, paid for in dollars, similarly would suffer.\textsuperscript{82} British policy makers did not welcome either of these developments. US-UK relations were also strained by a dispute over European subsidization of Airbus.\textsuperscript{83} In addition, US pressure for lower interest rates had the British worried that financial markets would doubt the US's commitment to low inflation.\textsuperscript{84} British fears of US economic policy helped foster British perceptions of themselves as belonging to Europe.

As Major served as chancellor in the previous government, he did not alter Thatcher's economic policies substantially. The idea convergence between Britain and other EC states that had begun under Lawson and continued under Major's chancellorship persisted under the Major government.\textsuperscript{85} The new Conservative government continued privatizing industries, a trend that began under Thatcher. Major also retained an emphasis on keeping inflation low, a goal that he argued would be assisted by a single currency.\textsuperscript{86} UK emulation of German discipline underscored the amiability of British economic ideas with their fellow Europeans. In talks with German Chancellor Kohl, Major agreed that economic convergence of EC countries must occur before the institution of a common European currency.\textsuperscript{87} Major himself


\textsuperscript{84}The Independent, 25 April 1991, getpagrr.

\textsuperscript{85}Jay 1994, esp. 173-186.

\textsuperscript{86}FBIS, 21 November 1991, 5.

\textsuperscript{87}FBIS, 12 March 1991, 3.
emphasized the convergence of economic values between Britain and other EC states, arguing that it was the other Europeans who were "following our proposals and moving closer to us."  

**External Pressure**

External pressure on the British in 1991 was moderately low, but was rising. The British economy was suffering through a recession, but pressure was relatively equal upon most industrialized economies, and the British did not suffer more than other states. My indicators for external pressure support this mixed view. Commodity prices decreased a slight 4.6% from 1990. World imports increased slightly as well, up 3.6% from the previous year. British exports decreased a very slight .1% from 1990, which indicates that the British were unable to benefit from the meager increase in world imports. British inflation was 5.9%, a welcome drop from the previous year's 9.5%. However, crude oil prices also dropped from $21.76 to $18.70 per barrel, which did not help the oil-exporting British.

**Voice Negotiation**

The British identified more with Europe in 1991 than previously. Increased export dependency on West Europe increased British perceptions of sharing a common affinity with Europe. A weak dollar and US pressure to lower interest rates increased perceptions of the US as a common threat. British macroeconomic policy preferences also converged with European policy ideas as Major's government continued their modified monetarist policies,  

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emphasizing low inflation yet retaining the option of intervening in currency markets. British
decision makers also sought to increase the autonomy of their state by considering EMU. If
British policy at the Maastricht summit was voice negotiation we would expect the British to
insist on some sort of condition, related to the issue at hand, that would make the agreement
more in alignment with a strict interpretation of British interests. British policy at Maastricht
can be seen to be voice negotiation due to Major's insistence that the British be given the
chance to opt-out of EMU in the future. The opt-out clause allowed Major to sell the
agreement to Eurosceptics in Parliament while keeping Britain at the center of European
discussions on monetary cooperation. Despite these hedges, the UK took a decisive step
towards monetary cooperation by signing the Maastricht Treaty in 1991. British identification
with the West European group was relatively high and external pressure was relatively low.
Under these conditions my hypotheses expect a state to engage in voice negotiation. The
British stance at the Maastricht talks is consistent with this hypothesis.

1992 Black Wednesday

Major's hopes that the economy would recover from recession in 1992 were dashed by
continued sluggishness. During the summer of 1992 the dollar dropped, putting upward
pressure on the Deutschmark and downward pressure on the pound. Earlier in the year the
Federal Reserve lowered US interest rates to 3% in the hope of spurring demand, which
weakened the dollar. At the same time, German policy makers who sought to prevent
inflation from their recent unification maintained high interest rates (8.75% in October 1992),
which strengthened the Deutschmark.\textsuperscript{89} The pound rose against the dollar—hurting British exports to the US—and dropped against the Deutschmark, reaching the lower end of the ERM band. In May 1992 the Major government reduced interest rates to 10% to promote economic recovery. In more amenable economic circumstances, the British could have raised interest rates to support the pound, but the weakness of their economy prevented such a move. The British government was trapped, unable to raise interest rates to help the pound, and unable to lower interest rates to bolster the economy.

At the September 1992 meeting of EC Finance Ministers held in Bath, Lamont sought to alleviate British economic woes by obtaining a drop in German interest rates, which would ease pressure on the pound and allow the British to lower their own rates to spur their economy. At the Bath meeting Lamont asked German Bundesbank President Helmut Schlesinger to lower German rates. Schlesinger had neither the inclination nor the ability to agree to a change in German interest rate policy at a meeting of Finance Ministers. After Schlesinger refused to lower German rates, Lamont repeatedly requested lower German rates.\textsuperscript{90} Schlesinger would have walked out of the meeting had he not been restrained by German Finance Minister Theo Waigel. The Germans might have been amenable to an interest rate cut if the British were willing to participate in a realignment of ERM currencies, but the British would not devalue, and the French were unwilling to devalue before their

\textsuperscript{89}Interest rate data are central bank discount rates reported in percent per year; IMF 1993, 49.

\textsuperscript{90}One report of the meeting likens it to a bear baiting. Ludlow 1993, 251. For other accounts see Harmon 1996, 73-75; Stephens 1996, 228-233.
national referendum on Maastricht.\textsuperscript{91}

Soon after the Bath drama the September 1992 currency crisis placed such pressure on European currencies that Britain and Italy were forced to withdraw their currencies from the ERM, and France was forced to go to great lengths to defend its franc. Britain and Italy, both inflation-prone countries with high government deficits, were caught between the falling dollar and the rising Deutschmark. At the same time, European monetary integration became less of a certainty due to the looming French referendum on the Maastricht agreement. After forcing the lira from the ERM, currency speculators put pressure on the pound, forcing the British to raise rates from 10\% to 15\% in one day in a futile effort to support their currency. Eventually the British were forced to devalue the pound and remove it from the ERM.\textsuperscript{92} The decision to withdraw from the ERM was a painful choice for the British government. As the chancellor who had presided over the pound’s entry into the ERM, Major had a personal stake in maintaining it within the system. Despite this understandable motivation, Major agreed that the pound should be withdrawn. My approach should be applied to such an important event in British economic history.

\textbf{Group Identification}

\textit{Accessibility}

The West European group identity increased it accessibility to the British in 1992.

\textsuperscript{91}Harmon 1996, 75; Stephens 1996, 228-9.

\textsuperscript{92}For more detailed accounts of the crisis see \textit{Reuters European Community Report}, 16 September 1992; \textit{The Economist}, 19 September 1992, 15.
Somewhat less than 25,090,847 British citizens traveled to West Europe, an increase over the previous year's 23,534,427. The figure for British travel to West Europe in 1992 is slightly inflated because it includes Irish travel to France for that year. At the same time, British travel to North America increased to 3,360,383, an increase of 11% from the previous year. The ratio of British travel to EC states in relation to British travel to North America in 1992 is 7.47:1, which is lower than the French ratio for the same year, 12.1:1. This shows that the British maintained relatively high proximity to North America, which could have made the North American identity somewhat accessible to the British and provided some competition for the West European group identity. Nevertheless, the sheer volume of British travel to the EC, almost double French travel to the EC for that 1992 (13,372,084) shows the high proximity of Britain to the EC, and the high level of accessibility of the West European group identity to the British. Telecommunications data confirms this view. British traffic to other EC member states increased 8.0% from the previous year, while British traffic to Canada and the US increased 11.1%. The ratio of British telecommunications traffic with the EC versus British traffic to the EC in 1992 was 2.1:1, slightly higher than the 1991 ratio, 2.0:1. These figures indicate British proximity to both North America and West Europe.

Fit

British common affinity with West Europe decreased slightly in 1992. British exports increased further to $106,331 in 1992, which comprised 56.0% of total exports ($190,003) for the year. Interestingly, this indicates a slight drop from the previous year's figure, 56.6%. While British exports to West Europe decreased, British export dependency on North America
increased slightly from 12.8% in 1991 to 13.2% in 1992. These are not trends of great magnitude, but they do suggest either a decrease or stagnation in British perceptions of common affinity with West Europe.

There was a more marked shift in British threat perception. Instead of seeing themselves as sharing a common threat with West Europe, in September 1992 the British perceived West Europe as a threat. Specifically, the Major government regarded German policy as detrimental to British interests. Government critics such as Lord Tebbit argued that high German interest rates prevented the UK from taking the necessary step of lowering its rates. In addition, Conservative Eurosceptics led by former Prime Minister Thatcher warned repeatedly of the danger of Britain being placed under the rule of an EC-wide government based in Brussels. While fear of Europe was on the rise, fear of the US, the UK's traditional partner, was low. Major argued that "it would be crazy to... choose between a friendship with the European partners or with the United States."\(^{93}\)

The British also demonstrated a lack of idea convergence with West Europe in 1992. Major and Lamont argued that it was important to keep the pound strong.\(^{94}\) Other Europeans argued that weak British economic fundamentals dictated a weaker pound, which had been brought into the ERM at an unsustainably high rate.\(^{95}\) A devaluation within the ERM might have been possible, but the Major government refused to take such a step. The low level of idea convergence led to the open clash between Lamont and Schlesinger at the September

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\(^{93}\)FBIS, 15 July 1992, 14.

\(^{94}\)FBIS, 14 July 1992, 16; FBIS, 3 August 1992, 4.

\(^{95}\)Interview, anonymous senior official, French Treasury.
During and after the subsequent Black Wednesday crisis, Major and Lamont blamed the Germans for starting the run on sterling. Writing in the aftermath of the Black Wednesday crisis, in a letter to the chairman of the Commons Treasury and Civil Service Committee, Lamont wrote that for the pound to re-enter the ERM, "the requirements of German monetary policy and those of the UK must come closer in line." The British demonstrate a clear divergence of economic values with West Europe prior to the decision to withdraw the pound from the ERM.

**External Pressure**

External pressure was extremely high in September 1992. German interest rates rose to prevent inflation, while US rates dropped to spur economic recovery. The divergence between low US rates and high German rates led to downward pressure on the pound. As we mentioned in the previous chapter, there were some ameliorating conditions. Commodity prices dropped 12.5% and world imports increased 5.8% from the previous year. The slight drop in crude oil prices from $18.70 to $18.20 did not bode well for the oil-exporting British, however. In addition to these indicators, international currency speculators mercilessly drove down the price of sterling on world markets, humbling the Bank of England, which to this day has yet to declare the amount of foreign reserves it spent in its fruitless effort to maintain the value of the pound.

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96FBIS, 18 September 1992, 7; FBIS 18 September 1992, 8; and Stephens 1996, 271.

97FBIS, 14 October 1992, 4.
Exit Noncooperation

The fledgling British identification with West Europe evident in 1990-1991 decreased slightly in 1992 and was not strong enough to withstand the increase in external pressure brought by international currency speculators. Caught between the Deutschmark and the dollar, faced with a sinking pound, and saddled with a sluggish economy, the British refused to raise interest rates or seek a general realignment of the ERM during the summer of 1992. When the currency crisis began, brought on in part by the looming French Maastricht referendum, the British no longer supported the pound within the ERM. A combination of British unwillingness to sacrifice domestic priorities and the crushing pressure of currency speculation drove the pound from the ERM.

Alternative Hypotheses

In addition to my approach, we can apply other approaches to the British experience with the ERM. According to Joseph Grieco's terminology, the British chose exit in 1978 when they refused to join the ERM of the EMS. After over a decade of exit, they chose voice in 1990, only to shift again to noncooperation in 1992. Grieco's voice opportunities approach provides a way to describe these shifts in British policy, but is silent about the causal forces which influenced policy. If we agreed that British policy from 1978 to 1990 was a policy of exit, and that British policy from 1990-October 1992 was voice, Grieco's approach needs assistance to explain why there was a shift from exit to voice and another shift back to exit. As early as 1978 the Callaghan government joined the EMS on the grounds that they could hope to have some influence over European currency cooperation.
Throughout the latter half of the 1980's British ministers such as Lawson and Howe argued that the Britain would have more influence over the direction and form of European monetary cooperation by joining the ERM and working from the inside rather than remaining outside the agreement. Despite these voice-inspired arguments, the Callaghan and Thatcher governments shared an unwillingness to commit to the ERM. In 1990, after years of cabinet intrigue, Thatcher heeded the wishes of then-Chancellor Major to join the ERM. Almost two years later, the Major government pulled the pound out of the ERM. Grieco's approach does not illuminate factors which influenced the twists and turns of British policy. It describes more than it explains.

Other realists might argue that Britain's power position explains its ERM policy, although it is unclear what sort of power shifts would be likely to influence British adherence to the ERM in 1990 that were not evident in 1978-1989. Power differentials have been used to explain the initiation of major wars and increases in the possibility of major wars. There is no reason why power differentials could not be applied to explain British monetary policy. Nevertheless, the absence of dramatic swings in Britain's power position in 1990 and 1992 means that such an approach is unlikely to be successful in explaining the British case. Other realist explanations of economic cooperation emphasize the role of external threats in promoting cooperation. The absence of an external threat in 1990, when the pound was strong, puts the value of such an explanation in question.

David Cameron's regime-as-polity approach can provide an excellent description of the

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98Copeland 1996.

state of British policy at a particular point in time, but it cannot unearth the underlying causal mechanisms that influenced shifts in British policy. History necessarily influences policymakers' preferences. Unfortunately, it offers no guide to understand shifts in policy. Cameron argues that the British joined the ERM in 1990 for selfish motives, to bring down inflation, for example. Self-regarding motives certainly played a role in British decisions, but other ERM members also cite low inflation as a reason for joining and remaining in the ERM, and Britain was joined only by Italy in dropping out of the ERM in 1992. Moreover, the French are often accused of participating in European monetary cooperation in a selfish attempt to control Germany. Even if the British were selfish, it is not clear why this selfishness dictated that they cooperate with other ERM members from 1990 to 1992, but not after September 1992. It is not difficult to view the British as selfish because any loyal policy maker should act for the good of his or her state. Sometimes selfish motives lead to cooperation; other times the same motives encourage policy-makers to act unilaterally. The issue is less one of selfishness than of why leaders of different states come to different conclusions of the best way to act in the interest of their respective states. Cameron's historically-contingent approach provides an excellent historical narrative, but is unable to explain British policy.

Conclusion

The movement in group identification and external pressure From 1978 to 1992 helps explain British policy. A constant increase in proximity meant that the West European group

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100 Connolly 1995, 7-8, 75-76.
identity was accessible to the British. The introduction of Thatcherite monetarism and subsequent modifications in Conservative economic thought brought British economic values closer to those of other West Europeans as the 1980's progressed and as key Conservatives such as Howe and Lawson increasingly favored policies similar to those favored other West European leaders. Growing perceptions of common affinity and even common threat further inclined the British toward cooperating with the West European group on monetary policy. During periods of relative calm, such as the period from the pound's entry in October 1990 until early 1992, growing British identification with Europe was sufficient for the British to engage in voice cooperation and to join the ERM in the hopes of influencing the future of European monetary cooperation. This burgeoning identification weakened as British perceptions of sharing a common affinity and common threat with West Europe decreased, and as British economic values diverged from those of other West Europeans, especially after German reunification. When external pressure increased, instead of following a policy of submissive cooperation, as the French did in 1983, the relatively weak British identification with West Europe was not sufficient to muster the political will to keep the pound within the ERM. Consistent with my hypotheses, low group identification and high external pressure led the British to choose a policy of exit noncooperation, a policy they have continued to this day. Despite the application of my approach that lies above, there are a few possible objections to my argument that I must address before closing this chapter on British monetary policy.

One might argue that Thatcher's near isolation among British government economic elites shows the influence of an individual upon history. I will not attempt to enter fully into
the debate over the relative weight of individuals versus broader social forces in history.

Thatcher played an important role in British monetary policy, and her growing scepticism of the European community certainly limited British involvement with the EC during her tenure. Nevertheless, Thatcher's influence upon British monetary policy was not the case of an idiosyncratic individual who happened to hold power at a certain moment and shaped policy to her wishes. Thatcher was (and is) an individual, but there were forces at play in addition to her own iron will. She could not and would not have opposed British entry into the ERM in 1985 had there been more support for it in the public at large and in the Conservative Party in particular. She could have resigned in 1990, or asked for Major's resignation, if opposition to entry was more important to her than remaining in power. Despite her reputation for being a nonconformist, Thatcher could never have obtained and maintained her position as Prime Minister had she been unable to represent important sectors of British opinion. These sectors, as well as individuals such as Thatcher, are influenced by the group identity variables that I discuss.

Another objection to my argument could arise over my contention that the British followed a policy of cooperation with West Europe from 1990-1992. One could argue that Britain's insistence upon an opt-out clause at Maastricht, their unilateral decision to bring the pound into the ERM at DM 2.95, and the eventual withdrawal of the pound from the ERM in 1992 indicate that the UK did not really cooperate with other EC members.\footnote{See Milward 1992, 442-447; and Harmon 1995/6, 51-104.} But opt-out agreement or not, the signature and public support of a British prime minister for an
agreement as momentous as the Maastricht treaty symbolized an increasing British willingness to cooperate with its fellow EC members. One can see this trend in Lawson's shadowing of the Deutschmark, Thatcher's willingness (albeit reluctant) to allow British entrance into the ERM in 1990, Thatcher's dethroning due to reluctance towards Europe, and in the tentatively agreeable stance of John Major's government towards further cooperation with Europe. One can observe the roots of this policy shift in the embryonic but nevertheless tangible British group identity with respect to Europe.

It is important not to attribute too much causal force to cabinet infighting to explain why the British decided to enter in 1990. Despite the dramatic nature of the infighting, Thatcher was surrounded by Cabinet members who were in favor of the pound's entry into the ERM for the second half of the 1980's. Her need to balance between her own Euro-scepticism and the more cooperative attitude of other members of her government reflects the ambivalence inherent in Great Britain as a whole. If there was no domestic support for Thatcher's Euro-scepticism, she would never have been able to veto entry of the pound from 1985 to 1990. If there were no domestic base for a more cooperative approach, the power struggle that eventually led to Thatcher's abdication would never have taken place.

The group identity approach cannot explain the rise of the currency crisis but it does help explain why the UK dropped out of the ERM, while the French remained in it. Since British group identification with Europe was lower than French group identification, we would expect the British to make less of an effort to remain in the ERM than the French. In 1990-1991, when there was less speculation against the pound, a relatively low level of British identification with Europe was enough to encourage them to engage in European
currency cooperation. But when the international economic climate was more turbulent, as it
was during the currency crisis, British identification with Europe was not enough to merit
continued participation in the ERM. The same currency crisis did not drive the French out of
the ERM due to their high level of identification with Europe. The future of monetary
unification in Europe is unclear at this time. EMU optimists can point to the decision to base
a European central bank in Frankfurt. EMU skeptics note that continued British absence
from the ERM bodes against European-wide currency cooperation. Although the British are
understandably reluctant to rejoin the ERM, their brief experience with it from 1990-92 and
their tentative support for Maastricht in 1991 show that British support for European monetary
cooperation is not impossible. Considering group identification and the level of external
pressure helps explain British ambivalence toward European monetary cooperation.

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102 Financial Times, 30 October 1993, 1.

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