

**‘THE DISADVANTAGE OF TYING ONE’S HANDS’: TOWARDS AN
UNDERSTANDING OF THE CONTROVERSIAL NATURE OF
EUROPEANISATION IN THE AREA OF BRITISH MONETARY POLICY**

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Introduction.

What is it about the Europeanisation of British monetary policy that merits attention?¹ From a superficial glance at the subject, one might conclude: ‘not a lot’. In policy terms, this Europeanisation process as represented by sterling’s membership of the European Exchange Rate Mechanism (ERM) appears to have lasted a mere two years. As is often the case, Britain joined late (October 1990), found the experiment an uncomfortable experience before crashing out spectacularly in September 1992. Since then, while paying lip-service to future membership of the euro, the Treasury, first under Lamont, then Clarke and now Brown, has gone about carefully constructing a domestic institutional framework for confronting issues and problems in this particular policy area. Most notable in this context has been the decision to grant operation independence to the Bank of England to control inflation, as well as the

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introduction of two fiscal rules designed to place explicit limits on government borrowing and public debt. Commentators who predicted that New Labour would join the Single Currency in its first term, have been forced to revise these arguments.

However, a slightly closer look at events reveals a different dimension to this story. Since the 1970s, a number of British policy-makers have been continually attracted to the idea of Europe providing a solution to continual difficulties experienced in the area of monetary policy. In this context, a gradual enthusiasm for ERM membership developed in the first half of the 1980s, to the point where a majority of Conservative Cabinet ministers became supportive by 1985. Frustrated by Thatcher's veto of the policy at this time, Lawson went on to covertly shadow the Deutschmark (DM) in the late 1980s before Thatcher finally relented in 1990 (Thompson, 1996). Since 'Black Wednesday', while politicians and officials in Whitehall have been sceptical of the case for sterling's membership of the Single Currency, it is possible to find a similar constituency of opinion in favour, including the present Prime Minister. Britain may have only formally taken part in European monetary institutions for two years, but this picture does not accurately reflect the strength of feeling concerning the Europeanisation of monetary policy in some quarters of the British Establishment.

These opening comments raise two issues that often get less attention in the literature on Europeanisation. First this case study of monetary policy suggests that Europeanisation may not necessarily be a gradual, incremental or linear process that increasingly affects domestic politics as the scope of European integration grows wider. It is true that one of the common findings of existing work is that the European Union (EU) impacts at the national level in a highly differentiated way. However, the analytical focus of these studies is often spatial or functional, rather than temporal. Researchers on Europeanisation note the contrasts between countries; variation between distinctive policy areas within the same country; and occasionally differences between different sectors within the same policy area (see for example Goetz and Hix, 2001; Cowles, Caporaso and Risse, 2001; Knill, 2001). The hypothesis to be investigated here is that the trajectory of Europeanisation may also be uneven *across time*: indeed, it might be halted or even reversed in some instances.

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A second issue raised by the above comments, which is often passed over in the literature, is that the impact of Europeanisation can often be controversial and divisive in domestic politics. It is tempting to add that this is especially so in the UK and as such, the Europeanisation of British monetary policy is a particularly apposite case study for exploring these kinds of questions. However, in reality, divisions exist concerning the impact of Europe on national politics in all EU countries and it is not difficult to understand why. There is a long tradition of theoretical work in this area which has shown how domestic political groups have attempted to use Europe to strengthen their national position. Intergovernmentalists have described how decision-making elites appropriate EU structures and policies to by-pass resistance at the societal level and force through change (Moravcsik, 1998; Milward, 2000). Conversely, a range of other writers have charted how pressure groups have relocated their lobbying activity to Brussels, as a way of trying to reclaim or entrench their influence on the domestic stage (see for example, Greenwood, Grote and Ronit, 1992; Mazey and Richardson, 1993; Schmitter and Streeck, 1994). Put in different terms, Europeanisation will always have implications for existing patterns of interest, power, autonomy and democracy within countries. It would be surprising if this process *did not* generate contention. The more interesting question perhaps, is how such controversy, situated in particular spatial and temporal contexts, can be explained?

This paper attempts to do the following things. It begins by discussing and clarifying the concept of Europeanisation as it is employed in this paper. We cannot make assertions about the Europeanisation of British monetary policy (or the lack of it) without first being explicit concerning what we think the term means. Second, it outlines Cowles, Caporaso and Risse's three-step framework, which asserts that Europeanisation is a product partly of the degree of fit or misfit between EU level processes and domestic institutions. Having asserted that this approach might be a useful starting point for analysis, the paper goes on to chart the rise and fall of the Europeanisation of British monetary policy over the last twenty-five years or so. In particular, it addresses the question of why the failure of ERM membership became so controversial and explores whether there is a connection between this episode and the

Blair Government's continual refusal to join the euro. The main argument promoted here is that Europeanisation in the area of monetary policy became controversial and unpopular, not because it conflicted with the institutional realities of domestic British politics. Rather, this contention was more the product of a *discourse*, actively promoted by a group of Euro-sceptics, which asserted that there was a 'misfit' between *their particular interpretation of Britain's institutional tradition and membership of the ERM*. The paper concludes by suggesting that this discourse has also had an (often neglected) impact on the Treasury's present sceptical attitude towards the Single Currency.

Conceptualising Europeanisation.

A burgeoning (and contested) literature already exists on the definition of Europeanisation. While this work contains many insights, it often lacks an explicit recognition of the issues and problems involved in the task of concept formation (Sartori, 1970; 1984; Gerring, 1996). Put in different terms, any statement delineating the meaning of Europeanisation needs to be sensitive to certain rules and criteria which arise as part of this activity.² The first and most obvious task is to define what a concept means. What are its distinguishing properties (its intension) and what are the phenomena it is trying to explain (its extension)? However, we need to go further and insist that the properties and phenomenon of a concept be *internally coherent* in the sense that they are logically related to each other. Concepts that are internally inconsistent are likely to cause confusion when operationalised, thus providing a poor foundation for empirical work.

Second, the boundaries of a concept should be as 'sharp' and distinct as possible, showing how it is *externally differentiated* from related terms. Making it clear what a concept isn't is just as important as defining what it is. Indeed, an awareness of this issue is crucial if we are to avoid the problem of 'concept-stretching' which is sometimes said to afflict the terminology of the social sciences. Concept-stretching refers to the practice whereby academics take the line of least resistance and adapt

² For an extended version of this discussion, see (Buller and Gamble, 2002).

existing words to new contexts or situations for which they are not designed. Extending our concepts in this way runs the risk of generating confusion and ambiguity within the language we employ to explain social and political events. A similar problem can occur if we are insensitive to the *field utility* of new terms that are introduced into the lexicon of a particular academic discipline. Put a different way, new concepts should be a genuine addition to the semantic terrain surrounding a subject, not merely an alternative label for the same thing.

Keeping in mind these various canons, this paper proceeds to define Europeanisation as:

‘a process whereby distinct EU modes of governance and policy-making are incorporated into the domestic politics of the country or countries under study’.

The phrases *domestic politics* and *EU structures of governance and policy-making* are deliberately designed to be broad. They refer to both observable and non-observable variables, including institutions and administrative practices, ideas, beliefs and culture. In so doing, the definition is intended to be as inclusive as possible in terms of embracing theoretical traditions that might help to explain Europeanisation.

At the same time, inclusion of the word *distinct* reminds us of the issue of ‘external differentiation’. While the EU is a relatively autonomous organisation, it will still be significantly affected by events that exist outside its boundaries. In other words, we need to be clear that when we refer to Europeanisation, we are not just talking about domestic and international forces ‘passing through’ Brussels without being shaped by the institutions and processes of the EU. This is not to say that the definition of Europeanisation offered up here requires the total separation of the European from national or international levels. The key point here is that the EU must have its own governing beliefs, instruments and policies and that these should make a difference: if its activities in a particular area at a specific moment are reduced to some other factor or effect, we are talking about something other than Europeanisation.

If Europeanisation can be conceptualised as the incorporation of distinct modes of governance into domestic politics, something also needs to be said about the effects of

this process. While Europeanisation may lead to change at the national, regional or local level, such a conclusion does not necessarily flow from the above definition. EU modes of governance may serve to entrench and legitimise existing domestic institutions and policies, making it even more difficult to effect resistance and reform. What does matter in this case of consolidation and retrenchment is that these European and domestic processes are in some sense distinct. Put in different terms, a case where national governments or other domestic actors are just using the EU to 'feed through' their preferred policies, which will then be re-imposed at the domestic level, would not count as Europeanisation. It might be added in passing that examples like the one just quoted, are likely to be rare in EU studies.

Finally, as already suggested, the analytical focus of this definition is 'top down', looking from the European to the domestic. This feature is in line with many other understandings of the word Europeanisation and results from conscious thinking concerning how the concept can be distinguished from that of European integration. Historically, the term European integration referred to the process of institution-building at the European level (leading to the eventual establishment of some unspecified supranational polity). Europeanisation studies on the other hand, have shifted analytical focus to the relatively uncharted territory of how these European level processes impact on national politics and policy-making. Interestingly, this change of perspective has brought with it a shift in theoretical direction from the old International Relations theories which dominated the literature on European integration, to new approaches that have borrowed from work in Comparative Politics and Policy Analysis (Hix and Goetz, 2001).

What, then are these theoretical frameworks that might be employed to describe and explain this Europeanisation process? It is probably not an exaggeration to say that the vast majority of work in this emerging subject area has adopted a New Institutional perspective. Perhaps the defining feature of New Institutionalism is its attempt to move away from the narrow formal definition of institutions embodied in what some have called 'Old Institutionalism'. In this sense, institutions do not just refer to formal rules, regulations or statutes, which early students of politics spent so much time researching and describing. Institutions now cover: '...informal procedures, routines, norms, and conventions embedded in the organisational

structure of the polity or political economy' (Hall and Taylor, 1996, p.938; March and Olson, 1984; 1989). It should be noted in passing that, in many ways, this is where the agreement ends between advocates of this particular approach. New Institutionalism now contains anywhere between three and seven separate intellectual traditions, depending on which commentators you consult (Hall & Taylor, 1996; Peters, 1999). In short, this work does not provide a unified body of thought on the relationship between institutions and political behaviour.

This issue aside, Cowles, Caporaso and Risse's edited collection (2001) has provided a useful and influential framework for understanding the Europeanisation process, which employs this New Institutional perspective. When it comes to charting the relationship between the European and national levels, these authors suggest a three-step heuristic device to guide research (Risse, Green Cowles and Caporaso, 2001, pp.6-9). The first step is to outline the relevant European institutions and processes: that is, the formal and informal rules, regulations, norms and conventions that have the potential to affect national politics. Step two involves identifying the 'goodness of fit' between European and domestic structures. For Cowles, Caporaso and Risse, the greater the divergence between European and national levels, the larger the adaptation pressure and the more likely that Europeanisation will take place. It should be noted in passing that this specific assertion has been questioned by some writers. Knill and Lehmkuhl, (1999) for example suggest that domestic institutional change is more likely in cases where Europe requires incremental rather than substantial departures from existing arrangements.

Finally, while the degree of adaptational pressure generated by institutional 'fit' or 'misfit' will be important in accounting for the likelihood of Europeanisation, it will not be the determining factor. For Cowles, Caporaso and Risse, there is a third step: domestic mediating factors operating within institutions, which can shape pressure for change in line with local and contingent circumstances. In this context, some writers point to the importance of 'veto points' – any stage in the national decision-making process where agreement is legally required for political reform (Haverland, 2000; Sbragia, 2001). A second mediating factor sometimes mentioned in the literature is organisational culture. Collective understandings or beliefs held by decision-makers can have a relatively autonomous effect on the development of policy, including its

interaction and reaction to external forces. Others highlight the importance of learning (across time and space) as a variable which can influence the way policy-makers manage the relationship between domestic and European processes/events (Green Cowles and Risse, 2001).

In summary, Europeanisation has been defined here as a process whereby domestic politics is significantly affected by distinct EU structures of governance and policy-making. Moreover, Cowles, Caporaso and Risse's three step analytical framework has been put forward as a useful point of departure for understanding the development of Europeanisation. The challenge here is to analyse the 'goodness of fit' between EU and domestic institutions as they come into contact via the process of European integration. The rest of the paper is now concerned with explaining the Europeanisation of British monetary policy, and particularly how this process has ebbed and flowed over time. It argues that any understanding of the occurrence or absence of Europeanisation is not just about charting the institutional goodness of fit and adaptational pressure that results. Notions of goodness of fit/misfit can also be discursively constructed. Moreover, if actively promoted by agents, these narratives can also influence the material reality of the domestic policy process as it responds to Europe. In short, future theoretical work on Europeanisation needs to better explore the way that institutions interact with agency and discourse.

The Advantage of Tying One's Hands: Rules, Credibility and the Europeanisation of British Monetary Policy.

The governance consideration which constrained the behaviour of decision-makers in the area of monetary policy in the 1980s was the need to develop and protect an image of *credibility*, especially in the eyes of the financial markets. The significance of this objective is best understood against the backdrop of events that afflicted British political economy in the 1970s. This was the decade when the UK was known as the 'overloaded' or 'ungovernable' polity (King, 1975; Rose, 1979). On the financial front, the collapse of the Bretton Woods system of semi-fixed exchange rates, and the eventual decision to let sterling float, posed an unfamiliar set of choices for decision-makers in Whitehall. Not surprisingly, mistakes were made, most notably the botched

attempt to covertly manage a devaluation of the pound in 1976. This episode eventually led to a sterling crisis and an application by the treasury for an IMF loan to stabilise the British economy (Browning, 1986, pp.71-86; Healey, 1990, pp.426-36). More generally, the Keynesian economic strategy favoured by all post-war governments no longer seemed to offer a solution to many of the problems besetting British industry at this time. Demand management only induced ever higher rates of inflation and unemployment. Moreover, attempts to redress these problems through the construction of a prices and incomes policy proved to be unsustainable in anything but the short-term. These problems culminated in the so-called 'Winter of Discontent' (1978/9), where the trade union movement in Britain is commonly perceived to have brought down the then Callaghan Government. By the end of the decade, any notion of active government or political discretion came to be viewed with increasing scepticism and disdain (see also Donoghue, 1987).

If the need to promote an image of credibility or competence in the area of monetary policy was the challenge facing Whitehall in the late 1970s, how did successive British Governments respond? At a time when state intervention had become increasingly discredited, the Conservatives attempted to achieve governing competence through the technique of depoliticisation. Burnham (2001, p.127) has defined depoliticisation as, '...the process of placing at one remove the political character of decision-making', and in the early 1980s, this politico-administrative strategy was achieved in two ways. First, the Thatcher Government adopted a *general neo-liberal philosophical* stance which stressed the benefits of a radical reduction of state responsibility for economic affairs. Ministers now argued that governments could not manipulate output, growth, and employment (as Keynesians had proclaimed). Instead, politicians should restrict themselves to the pursuit of low and stable inflation and let businesses working within free markets, take care of the rest (Lawson, 1992, p. 413-14; Thatcher, 1993, p.14; Gamble, 1994). This strategy was operationalised via various policy initiatives including privatisation, industrial relations reform and the introduction of New Public Management techniques within Whitehall.

Second, but just as important was the introduction of *rules* into the areas of policy responsibility that the Conservatives claimed they could still control. Rules minimise

the need for discretion and political choice. They can help to insulate political elites from interest groups, lobbyists, even individual politicians looking for special favours over specific issues. As a result, economic policy can be reduced to the 'technical' task of monitoring and adjusting various targets within the institutional confines of Whitehall. The policy initially brought in by the Thatcher Government to support this strategy was monetarism. The governing advantages of monetarism was its general assertion that there was a direct relationship between inflation and the level of the money supply circulating around the economy, not wage rises achieved by the unions. This policy was operationalised by the Medium Term Financial Strategy (MTFS), which contained pre-publicised and centrally defined targets or rules for the growth of £M3, as well as interest rates and public expenditure. Gone was the need for any prices and incomes policy and with it, the requirement that ministers get involved in the endless negotiations with trade unions that had proved to be so damaging in the 1970s. Notably, there was no target for the exchange rate when this framework was first introduced (Howe, et. al., 1977, p.9; Lawson, 1992, pp.66-67, 1021, 1025, 1040; see also Kydland, Edward & Prescott, 1977; Ham, 1981; Barrow & Gordon, 1983; Browning, 1986, p.261).

While there is evidence to suggest that, by the mid-1980s the public had grudgingly acquiesced in their acceptance of these policies (Butler and Kavanagh, 1984; Crewe, 1988), the Conservative leadership was experiencing significant problems operating monetarism. Both Howe (Chancellor of the Exchequer, 1979-83) and Lawson had real difficulties in establishing a reliable relationship between the level of money supply and the rate of inflation. Targets for £M3 were consistently missed, yet inflation was brought down to three per cent. Ironically, the party's free market ethos was partly responsible for undermining this rule-based depoliticisation strategy. In the first half of the 1980s, reforms leading to the liberalisation of the financial services sector made monetary targets increasingly unreliable as a gauge for inflation. For example, legislation reducing controls in the banking sector encouraged these institutions to expand into the personal mortgage market, thereby unleashing a fierce wave of competition with existing building societies. The growth in lending that followed had unforeseen effects: it led to month-on-month increases in the money supply when Bank of England officials had only expected a one-off boost (Lawson, 1992, p.448; D. Smith, 1992, p.40). Moreover, £M3 did not even include building society deposits.

One of the Treasury's responses to this problem was to gradually take into account the importance of the exchange rate when trying to achieve price stability (HC 21, 1983, p.399). By the March 1981 budget, monetary policy was gradually being relaxed in an attempt to bring down the high value of the pound which was squeezing inflation, but also hampering the performance of British exporters. However, exchange rate management as a policy tool also faced implementation difficulties as sterling oscillated unpredictably on the currency markets. It is at this stage that a number of figures in Whitehall began to stress the difficulties of operating national policy instruments in an increasingly interdependent world. More particularly, the growth of the Euro-dollar market, and its emergence (in the absence of the US dominated Bretton Woods system) as the main institution regulating the flow of global credit, meant that domestic economic policy became increasingly vulnerable to shifts in 'opinion' or 'sentiment' on the currency exchanges (Bonefeld, et. al., 1995). The sensitive nature of the relationship between global capital and national policy could be observed in a direct way by the mid-1980s. In June 1984, the pound was dragged upwards in the wake of a rising dollar, boosted by figures showing a significant rise in economic growth. By July 1985, sterling was falling to \$1.10 and threatened to slip below \$1 after Ingham, Thatcher's press secretary foolishly let it be known that the Prime Minister would accept such a parity if that was what the markets decreed (Lawson, 1992, pp.467-71; see also, Heseltine, 1991, p.72).

In this context, the Europeanisation of British monetary policy through membership of the ERM became an attractive way of 'rescuing' Conservative leaders from these destabilising global developments.³ As noted above, exchange rate management had become increasingly prominent as an instrument for controlling inflation. However, it was felt that ERM membership and the adoption of an explicit exchange rate target would lend this policy more credibility, while at the same time helping to counter the threat of currency speculation as markets attempted to discover the ceiling and floor of an implicit rate. Just as important were the support arrangements that existed as part of the constitution of the European Monetary System and which had been strengthened as a result of the Basle-Nybourg Agreement. These required central

³ This theme is clearly a variation on an argument first put forward by Alan Milward (2000).

banks to intervene in the markets and provide credit to a country whose currency was in danger of breaching its margins of fluctuation in the parity grid. Lawson was aware that this help was not automatic. Indeed, Whitehall experienced problems first hand in December 1987 when the Bundesbank made it difficult for the British authorities to buy DM's in support of sterling (Lawson, 1992, pp. 786-91). That said, there remained a general optimism that once Britain was actually in the system, the pound would receive institutional support in the event of a sterling crisis.

At the same time, if monetarism had been introduced partly as a rule-based policy designed to discipline public expectations and de-politicise the conduct of economic management, ERM membership offered an alternative framework, but at 'one remove'. In other words, the Europeanisation of monetary policy was not accepted as being important in its own right, but as an instrument for supporting these broader politico-administrative aims. As far back as 1981, Lawson was writing about the governing benefits of such a policy in these terms. In a memorandum to Howe, Lawson distinguished between two types of financial discipline needed to contain the demands of societal groups and control inflation. The Conservative leadership could operate a self-imposed explicit monetary target, or an externally imposed exchange rate discipline. Although Lawson preferred the former at this time, he ruminated out loud whether the latter might not be more effective, especially when it came to those Conservative backbenchers who had made it known that they were less than enamoured by the initial results of the monetarist experiment:

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

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

We are back with the need for some kind of constitutional break on the politics of excessive expectations and over-promising...The only way of injecting some credibility into counter-inflationary policy is an exchange rate objective; and the

only one available is the exchange rate mechanism of the European Monetary System (quoted in Scott, 1986; p.98).

Similar governing calculations were being made by the Labour leadership at this time, particularly a small group consisting of Kinnock, Smith, Eatwell and Brown. This elite accepted the argument that increased processes of economic and financial liberalisation now placed significant constraints on the operations of a future Labour Government. More particularly it was feared that any attempts to stimulate the economy through demand management would be penalised by adverse movements in global financial markets. In this context, what the leadership required was a new policy framework that would constrain the expectations of supporters and convince opinion that there would be no return to the short-term discretionary policies associated with the party in office in the 1960s and the 1970s. ERM appeared to offer an ideal solution to this problem: this external institution would ‘tie the hands’ of Labour politicians and keep them on the financial ‘straight and narrow’. It is also noticeable that at this time, many of the interventionist industrial policies that had been developed by the party during the policy reviews of the mid-1980s were now gradually abandoned (McSmith, 1993, ch. 13; Wickham-Jones, 1995; Eatwell, 1992; Radice, 1989; Keegan, 2004).

It is worth pausing for a moment to consider whether the process being described can really be termed Europeanisation. That is to say, can we observe the existence of distinct EU institutions and policies that have been incorporated into domestic politics. At first glance, it might be argued that ERM membership (and the European Monetary System of which it is a part) reflects and entrenches broader neo-liberal principles of sound money and flexible markets which have come to dominate the conduct of economic affairs in the 1980s and 1990s. However, ERM membership (with its own institutions and practices) can also be characterised as a distinctly European response to the problems of currency management in an increasingly liberalised financial system. Indeed, part of the rationale of the ERM was to (in Thatcher’s terminology) ‘buck the market’ by insulating European economies from the destabilising movements of the dollar. It was this function which, in part, caused so much friction between Lawson (who sympathised with this objective) and Thatcher (who did not).

Moreover, although Lawson resigned first, he won this particular debate and as we have seen, ERM membership was incorporated in to Conservative economic strategy, if only for a short period of time. That said, we need to be cautious concerning claims that this process of Europeanisation resulted in a significant change in domestic priorities. Rather, by ‘reaching up’ to the European level and appropriating certain distinct European structures, ministers hoped to have discovered an alternative rule-based strategy for delivering the broader governing objectives of credibility through depoliticisation. At the same time, Europeanisation was encouraged in order to consolidate the position of the Conservative leadership, especially after the failure of monetarism. In this sense, this period should be viewed as the ‘Europeanisation’ of British monetary policy, although as we shall see, this ‘statecraft’ did not produce the intended effects.

Discursively Constructing Notions of Institutional Misfit: Euro-sceptics, ‘Black Wednesday’ and the Narrative of Representative and Responsible Government.

Why did Britain’s ejection from the ERM in 1992 become such a controversial issue in British politics? How if at all, has this controversy and debate influenced New Labour’s decision not to join the Single Currency? Put another way, how can we explain the halting (reversal) of Europeanisation in the area of monetary policy? How useful is the three-step Neo-Institutional approach outlined earlier in this paper in helping us address these particular questions? The argument to be pursued in the final section of this paper is three-fold. First, when it comes to understanding the causal influence of institutions on policy outcomes, we must not only consider the specific rules, regulations and norms which can inform the behaviour of decision-makers. Broader narratives or interpretations concerning the institutional configuration of the state can also shape the possibilities for action at any moment in time and space. Second, one of the reasons why Europeanisation became so contentious in this area was because a group of Euro-sceptics were successful in arguing that a misfit had taken place between ERM membership and their particular understanding of Britain’s institutional tradition. Finally, Labour’s non-decision on the euro can partly be

explained by the fact that these Euro-sceptic themes continue to exert an influence on Treasury thinking about this subject.

There is now an influential academic tradition which highlights the important effect that domestic political institutions can have on British diplomacy towards the EU. Indeed, Britain is often labelled the 'awkward' or 'semi-detached' partner in Europe, and this reputation is said to derive from particular features of its polity (see for example, George, 1992; H. Wallace, 1996; 1997; Denman, 1996). Britain's unbroken constitutional development and its tradition of parliamentary sovereignty is often mentioned as a variable in this regard (see for example, W. Wallace, 1986). The fact that parliament is the supreme legislative authority in Britain, with the sole right to make or unmake laws, sits uneasily with the requirement to share power which is a continual feature of EU business. We might add that the constraining nature of Britain's adversarial political culture does not help. As Ashford (1992) has argued, any attempt by a governing party at Westminster to more fully embrace the Europeanisation process would be attacked by the opposition as a sign of its willingness to accept a diminution of the UK's great power status. If we also remember that British political parties are internally divided over the European question (H. Wallace, 1996), with the electorate broadly sceptical, it is difficult not to concur with Bulmer's judgement that there is a powerful institutional logic which frustrates a more communautaire approach to the EU (Bulmer, 1992, p.28).

This paper also argues that domestic institutions are important when it comes to understanding the development of Europeanisation in the area of monetary policy, but the argument is slightly different. Not only do the particular rules, regulations, norms and procedures *within* the British Polity structure the possibilities for action. Both the narratives that are constructed *about* these institutions, as well as the way these interpretations are articulated and mobilised, can also serve as a powerful constraint on behaviour. As Birch (1964) has argued, a country's understanding of its own institutional tradition can vary historically and may be essentially contested at any one time. Moreover, the words we use to inform the discussion of our political structures will themselves be subject to different meanings and appropriated by different groups in different temporal periods. In short, we not only need to consider the 'real' effect of institutions, but the influence of particular 'stories' that we formulate around them.

Perhaps the most influential story of Britain's institutional tradition is the one that characterises it as *Representative and Responsible Government*. Two aspects of this narrative merit further attention in the context of the argument to follow. The first is the continued emphasis placed on the skilful and clever attributes of British political leadership. As already noted, Britain's unbroken constitutional development and more particularly, its ability to avoid external invasion and stave off internal revolution was compared favourably to the experience of other European countries in the eighteenth, nineteenth and twentieth centuries. For many, this superior track record was primarily the result of the pragmatic and flexible nature of elite rule. Shorn of any long-standing attachment to ideology or 'theory' and armed with good old-fashioned English empiricism and self-restraint, the ruling classes were able to incorporate opposition groups or factions in a way that did not disturb the fundamentals of their position (Beer, 1982, 110-14). Ironically, the importance of leadership is also stressed by much of the literature on Britain's relations with the EU, but in this case, the verdict is damning. The innate conservatism and short-sightedness of the British ruling classes rendered it blind to the opportunities of European integration in the 1950s and 1960s. The results have been a continued aloofness and ambiguity as London has struggled to adjust to an organisation whose design it had little or not influence over (see for example, Charlton, 1983; Denman, 1996).

Aligned with this established practice of strong, yet responsible leadership was the convention of representative government. Again, we have already noted the centrality of parliament within the British political tradition. What is important here is the dominant normative view that Westminster should provide the sole arena for the expression of interests within British society. Of course, in practice, the need for executive leadership has often conflicted with the demand for popular sovereignty. In such circumstances, it is understood and accepted that the former will take precedence over the latter. In other words, representative government in Britain has primarily meant elite rule *through* parliament not *by* parliament. Particularly, with the advent of party discipline in the House of Commons, leaders were able to control the political agenda, aggregate opinion and manufacture public consent. Although, in Bagehot's famous dictum, this development regulated parliament to a 'dignified' part of the constitution, the importance of this function should not be under-estimated. Those

who subscribed to this narrative of Representative and Responsible Government understood this façade of democracy was vital for the legitimation of elite rule. Parliament was important, so the argument went, because the masses still *thought* that it was important (Crossman, 1963; Crick, 1988; Judge, 1993; 1999, chapter 1).

The next question to consider how these observations relate to the question of why the Europeanisation of monetary policy in Britain became controversial in the 1990s. One obvious response is to point to the degree of misfit between European institutions and processes and British domestic politics at this time. The Thatcher Government's decision to join the ERM in 1990 had locked Britain into a Deutschmark zone when the economies of both countries were diverging significantly. The Bundesbank, attempting to cope with the inflationary consequences of re-unification, sought to raise interest rates in the early 1990s. Faced with an economy slipping into recession after a credit-fuelled boom in the late 1980s, the Treasury in Britain sought every opportunity to cut them. Realising the unsustainable nature of Britain's position currency speculators increasingly sold sterling. Lamont raised interest rates to 12% (he was going to raise them to 15%) and the authorities spent approximately £3 billion of taxpayers money trying to shore up the pound (Keegan, 2004, p. 102). Eventually the policy collapsed and ERM membership came to be held responsible for a balance of payments deficit topping £1 billion; an unemployment rate standing at 2.8 million; and increasing levels of negative equity reported to have reached 6 billion. No wonder Black Wednesday was such a controversial episode in the history of the Conservative Party from which its reputation for governing competence did not recover (for a good discussion, see Stephens, 1996). It seems that the process of Europeanisation had not been able to insulate the British economy from the unsettling shocks of the global financial system after all.

It did not help that the structure of the ERM had become a lot less flexible as a result of certain geo-political developments. The ending of the Cold War in 1989, as well as the re-unification of Germany in 1990 had led a number of member states to accelerate their plans for Economic and Monetary Union (EMU) (Grahl, 1997, pp.59-76; Baun, 1995/6, pp.610-12). Further integration in this area, like integration in the 1950s, was designed in part to guard against the renewed threat of German adventurism in central and eastern Europe. All of a sudden, ERM membership had

shifted from a free-standing policy of its own to becoming stage one of a broader and more ambitious *political* project to create a Single Currency. Where revaluations in the ERM had been possible in the past, they were now going to be much more difficult to achieve. Unsurprisingly, British attempts to negotiate such a change in order to aid sterling's plight, was firmly refused (Stephens, 1996, pp.236-37; Seldon, 1997, p.311).

However, a more prolonged period of reflection suggests that incidents of fit/misfit are not necessarily synonymous with controversy. We have already mentioned in passing research in the area of Europeanisation which demonstrates that misfit may increase adaptational pressure in a way that leads to the acceptance of EU policies at the national level. It follows then that the question of how institutional fit/misfit is defined and understood may not necessarily be a simple or 'objective' one. The subjective judgement of groups (with their own narratives concerning their own national political traditions) may also be important when it comes to judging the commensurability of European processes with domestic structures. In short, understanding why misfit leads to controversy (and indeed, the rejection of Europeanisation) requires the researcher to move beyond a focus on institutions to a consideration of how they interact with agency and are narrated through discourse.

It follows then that part of the reason why the Europeanisation of British monetary policy became so controversial was not because of the 'objective' material consequences of the misfit noted above. Attention also needs to be paid to the way that particular groups in Britain were able to take advantage these problems and articulate notions of misfit that were broader and more resonant than the economic difficulties associated with ERM membership. The most prominent group in this context was the Conservative Euro-sceptics (assisted initially by the Labour Party in opposition). In other words, the Europeanisation of British monetary policy (as well as its difficulties) was an issue that not only penetrated the House of Commons, but divided the political classes at Westminster (on this, see Buller, 2000, chapters 6-7). If there is a grain of truth to the view that the function of parliament in Britain is to manufacture consent and legitimate executive rule, then the implications of this development are self-evident. At this time, the Conservative leadership lost control of the issue and the dormant views of the Euro-sceptics rose up the agenda in a way that

had not been permitted throughout the 1980s. It should of course be added that these arguments achieved additional publicity from the Conservative press, which also turned against John Major at this time (Seldon, 1997, pp.288-89, 707-13).

What was it about ERM membership in particular that the Euro-sceptics understood to be so damaging for British domestic politics? Put simply, Europeanisation (in the area of monetary policy) not only produced the perverse consequences noted earlier. It undermined any sense of representative and responsible government which this group perceived to be the substance of the British political tradition – a tradition that the Tories should have been upholding in office. If we recall the precise nature of this narrative, it will be remembered that it contained two elements. The first was an emphasis on the skilful and flexible nature of British elite rule down through the centuries. The second was an understanding that, while representative government largely meant executive rule through Parliament, Westminster had a vital role to play in legitimising this centralised form of governance and the policy outputs it produced. Let's take each of these themes in turn.

What is interesting about surveying the discourse of the Conservative Euro-sceptics in and around the ERM episode, is their continual pre-occupation with the possibility that implementation of this policy might lead the party to box itself into an unsustainable position. During the House of Commons debate (*Hansard (Commons)* Vol. 177, 15 October, 1990) on Britain's decision to join, Major (who has succeeded Lawson as Chancellor) was continually asked whether he had left himself enough room for manoeuvre if sterling's parity proved to be impossible to maintain (see, for example, Shore, col. 933; T. Taylor, col. 934). Major's response was to assert that DM 2.95 represented the average inflation-adjusted real rate for the last decade and, even if sterling came under pressure, the authorities would do everything to keep it within its bands. He added for good measure that these concerns had been raised in other ERM countries, but had proved to be unfounded. Not happy with this response, Harry Ewing sought reassurance, asking Major once again:

‘...to spell out to the House and the country what powers are available to correct his own mistake if he had got it wrong? If he refuses to explain, we can only assume that he has left himself without any power (col. 938).

Major's response: '...I do not accept the right hon. Gentleman's premise that we have gone in at either the wrong time or the wrong rate, and events will bear this out' (col. 938).

Indeed, one feature of the Euro-sceptic contribution to the Cabinet debates on this issue in the 1980s was Thatcher and Ridley's concern that ERM membership would place too many constraints on their freedom of manoeuvre. It was all very well to seek credibility by 'tying your hands' to explicit rules, but rules could become too tight and an element of discretion was always desirable in the complex business of economic management. In this sense, the problem with Lawson was his desire for a policy instrument that would allow him to run the economy on 'automatic pilot'. It was a mistake to 'hanker after some lodestar, some fixed point against which to measure progress and assess the need for policy changes' (Ridley, 1992, p.189). This method of statecraft also smacked of defeatism. It effectively conveyed the message that Britain, or at least the Conservative Party, could not discipline itself and 'wanted to pass the responsibility...to something or someone else' (Thatcher, 1993, p.700, 707; Ridley, 1992, p.188-9, 193; see also Lawson, 1992, p.871).

Viewed from this perspective, the failure of the Conservative Government to seek a devaluation of the pound when sterling came under real pressure in September 1992 was understandable. It was true that this stance was heavily criticised (Stephens, 1996, pp.212-14; 219). The way that Major and other senior party leaders seemed to treat ERM membership as a 'badge of honour' was noted with an increasing sense of incredulity. However, once ERM membership is understood as part of a broader depoliticisation governing strategy, the logic underpinning Europeanisation in this instance demanded this type of response. The whole rationale of ERM membership was to guard against such short-term fine-tuning that societal pressure could encourage (especially after the failure of monetarism). Devaluation in this context was almost unthinkable.

Moreover, it is only in this context that we can at least partly explain the Euro-sceptics refusal to go along with Major's attempt to blame 'Black Wednesday' on the 'fault-lines' of the ERM (i.e. Germany). For example, Budgen wanted to know why,

bearing in mind this policy had been discussed exhaustively in the 1980s, it had taken Major until September 1992 to discover these fault-lines (*Hansard (Commons)* Vol. 212, 24 September, 1992: col. 6). A number of other Conservative backbenchers refused to condemn Germany for Britain's plight. Policy-makers in Bonn were only following their own legitimate national interest when they declined to intervene more in the currency markets to assist the pound (see the contributions by Biffen, col. 34; Watts, col.40; Baker, col. 57; Townend, col.73; see also Lamont, 1999, p.270). In short, the concern was not that Britain was losing sovereignty to some kind of European federal superstate. Instead, the charge was that, by self-emasculating their own power to effect outcomes in monetary matters, the Major leadership had presided over a period of 'irresponsible' government. The term irresponsible is used in both a factual and normative sense in this context. Not only did policy-makers deliberately 'tie their own hands' so as to insulate themselves from public opinion, but according to Euro-sceptics, this was a stupid strategy to undertake.

At the same time, Euro-sceptic discourse made a connection between this interpretation of irresponsible leadership and what they understood to be the deleterious knock on effects for representative government in Britain. In line with the discussion above, Euro-sceptics were clear that the role of parliament was to represent the views of the electorate, not to make policy. However, for this conception of representative government to exist, the public must perceive that their MP's were in authority, even if they were not totally in control. At the same time, they should possess effective sanctions to impose their will if they are unsatisfied with the performance of a particular party in office. The problem with ERM membership was not just that it had generated irresponsible government, but that the Conservative leadership had exposed the 'reality' of the unrepresentative nature of elite rule in graphic terms. Euro-sceptics feared that Europeanisation would produce a real public backlash against British politicians who would become little more than 'lightening conductors' for popular frustration and discontent (Buller, 2000, pp.157-63). Whether this argument had any validity or not is of less importance. What mattered was that it was articulated and gained a certain currency at this time. Chris Gill, speaking in a House of Commons debate on the Maastricht Treaty probably best sums up the message:

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

Writing on the challenge of EMU, John Redwood prophesied that Britain's membership of this policy would lead to precisely the same consequences as 'Black Wednesday':

...the electorates will want to make their views known. In this system (Economic and Monetary Union) there will be no way of letting the pressure out. The valve in the pressure cooker will have been soldered over, and as the temperature rises, as people become more disenchanted with the economic and monetary policy being pursued, the pressure will build up (Redwood, 1997, p.187).

Finally, it is possible to detect an underlying connection between these arguments and the present reluctance of the Blair Government to join the Single Currency. In other words, this narrative concerning the institutional misfit between the ERM and Britain's political tradition may also be partly responsible for the Treasury's continual aversion to experiment with Europeanisation in the area of monetary policy since 1992. Perhaps the first point to note in the context of this argument is the achievement and maintenance of credibility remains an important governing objective for New Labour (see for example, Brown, 1997; Balls, 1998; Robinson, 2000; Balls 2002). At the same time, depoliticisation – the process of placing at one remove the political character of decision-making – is still the principal method of realising this aim. Almost every speech uttered by Gordon Brown and his Treasury colleagues has stressed the importance of macro economic stability and fiscal prudence. By creating these conditions, only then can the party can escape the charge that it is 'unfit to

govern': a verdict that plagued its electoral chances throughout the 1980s and the first half of the 1990s (Rawnsley, 2001, p.38).

However, if credibility continues to be the main ambition driving the conduct of monetary policy, 'constrained discretion' has become the new philosophy designed to achieve it. As we have seen, one of the problems with monetarism and ERM membership was the adherence to fixed rules could be destabilising as they were undermined by external shocks from the global economy (see also Balls, 1998, p.121; HM Treasury, 2002, pp.94-95; HM Treasury, 2003, p.15). However, as Balls has noted:

The rapid globalisation of the world economy has made achieving credibility more rather than less important, particularly for a left of centre government which has been out of power for two decades' (Balls, 1998, p.122).

The question for New Labour was how to design a framework that allowed policy to react flexibly to unanticipated events without harming credibility. The answer was to move away from a strict reliance on rules and create a broader set of institutions that were able to manage a delicate balance. On the one hand, they must allow politicians some freedom of manoeuvre so as to avoid repeating the mistakes of Black Wednesday. At the same time, these institutions should constrain politicians in such a way that the markets and public would always be confident that politicians would never be able to use this autonomy to manipulate the economy for their own ends (HM Treasury, 2002, p.95).

In practical terms, this philosophy of 'constrained discretion' has been operationalised by two sets of reforms since 1997 in the area of economic policy. On the monetary side, the power of ministers has been curbed by the granting of operational independence to the Bank of England. While the Chancellor remains responsible for formulating the objectives of monetary policy (in this case an inflation target of 2%, measured by the harmonised Consumer Prices Index), a new Monetary Policy Committee (MPC) of independent experts is charged with implementing this goal. It should be added that this inflation target is symmetrical: deviation either side of 2% is looked on unfavourable by the Treasury. Finally, the minutes as well as the individual

voting records of the MPC are published shortly after each meeting. On the fiscal side, the search for credibility has been buttressed by the development of two rules designed to remove suspicion of political interference in this policy area. The 'Golden Rule' states that on average, over the economic cycle, the government will only borrow to invest and not to fund current spending. The Sustainable Debt rule stipulates that debt will be held over the economic cycle at a 'stable and prudent' level. The stipulation 'over the economic cycle' is crucial here. This condition is designed to give Brown a certain amount of flexibility to vary policy in a way commensurate with economic circumstances.

Why then is New Labour disinclined to join the euro? After all, in many respects, the institutions of the eurozone would appear to be just as suitable for the purpose of building credibility in monetary policy. Responsibility for the pursuit of low and stable inflation would still be devolved onto an independent central bank. Indeed, the independence of the ECB is enshrined in EU law. Under Article 107 of the Maastricht Treaty, it is explicitly forbidden from taking any instructions from any other organisation or body. At the same time, the Growth and Stability Pact has rules designed to prevent national politicians from manipulating fiscal policy in a way which affects the maintenance of price stability in the eurozone. In particular, a government's budget deficit should be close to balance or surplus and certainly not exceed 3% of GDP (although recent revisions to this policy in November 2002 specify that this position will be judged over the economic cycle). At the same time, a country's ratio of government debt to GDP should not exceed 60% (Radice, 2003).

However, viewed through the narrative of Representative and Responsible Government, it is clear that certain features of the Single Currency come into conflict with this understanding of Britain's domestic institutional tradition, especially in the light of the ERM episode. We can begin by highlighting the legal mandate of the ECB. To recall, the politico-administrative strategy for achieving credibility through depoliticisation involves that act of placing at one remove the political character of decision-making. However, if 'Black Wednesday' conferred one lesson on policy-makers in the Treasury, it was to ensure that the mechanisms of depoliticisation are conditional and reversible if politicians become unhappy with the results. The problem with the current structure of the ECB is that it is *too* independent. Not only is

this status entrenched in EU law, changing it is likely to prove difficult, as such an act would require a unanimous vote at an Intergovernmental Conference. Moreover, as we have already seen, it is not guaranteed that British politicians will be able to off-load blame onto EU institutions if things go wrong. If legitimacy is to work in this context, other actors that are affected by the policies of the ECB will require a general stake in these arrangements. These arguments can be found in a number of papers surrounding the Treasury's thinking on this subject (Currie, 1997; De Grawe, 1998; *Financial Times*, 19 December, 2001; 10 June, 2003).

A second institutional property which is perceived to affect the legitimacy of Europeanisation in this area is the goal independence of the ECB. As already noted, the ECB is responsible for implementing monetary policy in the eurozone. Where the Bank is different is that it has a policy formulation role as well. Article 105 of the Maastricht Treaty states that the prime objective of the ECB is the maintenance of price stability: no numerical target for the level of inflation is specified. Initially, the Bank committed itself to an asymmetrical figure of 2% or less, although this has recently been revised to 'close to, but below 2%' (*Financial Times*, 9 May 2003). One problem with such a goal is that, unlike the Treasury's symmetrical target, it runs the risk of producing policy with a deflationary bias. More fundamentally, as long as the ECB retains this goal independence, it will be judged not only on its inflation record, but also on its success in balancing the requirements of price stability with the need to maintain and expand industrial output and employment. Failure to manage this trade-off successfully may provoke criticism from member states and the legitimacy of the ECB will suffer. Indeed, evidence of such discontent already exists as France and Germany have publicly exhorted the ECB to cut eurozone interest rates further in response to sluggish economic growth (HM Treasury, 2003, p.44; Islam, 2003).

If the institutional features of the eurozone are perceived to pose a threat to the conduct of representative and responsible government as constructed and understood in British politics, the fiscal rules of the Growth and Stability Pact (GSP) are thought to be too rigid by the Blair Government. Treasury ministers and their advisers have continually argued that trying to balance the budget year on year could actually be damaging to the economy. Politicians could find themselves having to cut spending or raise taxes (or both) at the time of a recession. Moreover, such measures are likely to

generate domestic opprobrium and discontent. Indeed, it is clear that complaints about the inflexibility of the GSP from France, Germany and Italy stem in part from concerns about the domestic effect of Europeanisation in this area. Looking at these events from the outside, it is easy to see why Whitehall might make some sort of a connection with Black Wednesday. Moreover, while it is possible to cast doubt on the constraining nature of the Treasury's own fiscal rules, it is clear that their great merit is that they will help guard against the loss of autonomy that British politicians experienced on 16th September, 1992 (HM Treasury, 2003, Chapter 4)..

Conclusions

This paper has generated three broad conclusions. First, the temporal path of Europeanisation in the area of British monetary policy has been uneven, to the point where we may begin to ask whether it has been reversed for the foreseeable future. This finding raises the issue not only of how we explain patterns of Europeanisation across time and space, but how we understand moments when this process becomes contested at the domestic level. Second, preliminary work here suggests that Europeanisation becomes controversial not just during 'objective' conditions of institutional misfit, but when groups are able to construct and employ narratives of institutional misfit which resonate with the past experiences of those involved with policy. Third, if these first two conclusions are accepted, future work on Europeanisation needs to better combine its present focus on institutions, with a greater attention to the role of agency and discourse.

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