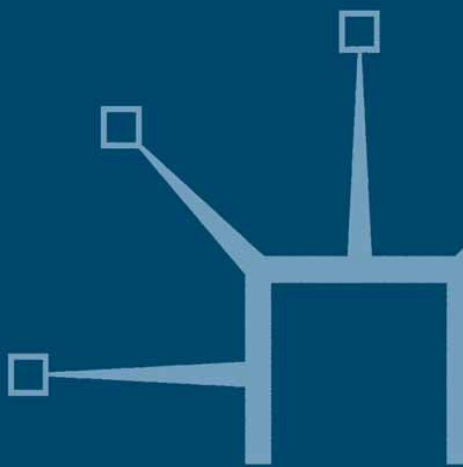


Business and the Euro

Business Groups and the Politics of EMU in
Germany and the United Kingdom

Mark E. Duckenfield



Business and the Euro

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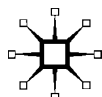
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Mark E. Duckenfield

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*Dedicated to the memory of my father,
Christopher John Duckenfield*

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List of Abbreviations

ABCC	Association of British Chambers of Commerce
AMUE	Association for the Monetary Union of Europe
BDI	<i>Bundesverband der Deutschen Industrie</i>
BDSI	<i>Bundesverband der Deutschen Süßwarenindustrie</i>
BI	<i>Hauptverband der Deutschen Bauindustrie</i>
BIS	Bank of International Settlements
BRD	<i>Bundesrepublik Deutschland</i>
CAP	Common Agricultural Policy
CBI	Confederation of British Industry
CDU	<i>Christlich Demokratische Union</i>
CSU	<i>Christlich-Soziale Union</i>
DDR	<i>Deutsche Demokratische Republik</i>
DIHT	<i>Deutscher Industrie und Handelstag</i>
DM	Deutsch Mark
EC	European Community
ECB	European Central Bank
ECJ	European Court of Justice
EEC	European Economic Community
EMI	European Monetary Institute
EMS	European Monetary System
EMU	Economic and Monetary Union
ERM	Exchange Rate Mechanism
ESCB	European System of Central Banks
EU	European Union
FDP	<i>Frei Demokratische Partie</i>
FRG	Federal Republic of Germany
FSB	Federation of Small Businesses
GDR	German Democratic Republic
HMG	Her Majesty's Government
IMF	International Monetary Fund
IoD	Institute of Directors
LIBA	London Investment Banking Association
LibDem	Liberal Democrats
MdB	Member of the Bundestag
MP	Member of Parliament
MPC	Monetary Policy Committee

NFU	National Farmers Union
OECD	Organisation of Economic Cooperation and Development
PDS	<i>Partei des demokratischen Sozialismus Deutschland</i>
SEA	Single European Act
SPD	<i>Sozialdemokratische Partei Deutschlands</i>
TARGET	Trans-European Automated Real-time Gross-settlement Express Transfer
TEU	Treaty of European Union (Maastricht Treaty)
TUC	Trades Union Congress
UK	United Kingdom
VCI	<i>Verband der Chemischen Industrie</i>

Introduction: Business and EMU

On 1 January 1999, eleven of the European Union's fifteen members entered Stage Three of Economic and Monetary Union (EMU) when they permanently locked their exchange rates and began pricing goods in both their old, national currencies and the new currency of the European Union, the euro. Four members (Britain, Sweden, Denmark, and Greece) remained outside the Euro-Zone, preserving their national currencies. In each member-state, EMU was a controversial issue, evoking both strong support and opposition amongst politicians, business, labour, academics, and the public at large. The strict budgetary criteria for participation in the launching of the euro – which prohibited large deficits and mandated substantial reductions in public debt – only deepened the controversy as political leaders sought to take the fiscal and monetary measures to ensure their governments fulfilled the criteria in the years before 1999. Even in member states that negotiated an opt-out to EMU, governments struggled over whether or not to exercise their derogation.

The proponents of the euro have long promoted the single currency as a major liberalisation of economic policy. A single European currency increases exposure to international trade and increases the role of the market in the allocation of resources in all participating countries. It removes the exchange rate risk between participants and enables consumers and investors to better compare prices across the Euro-Zone. Prior to the introduction of the euro, the costs and risks associated with fluctuating exchange rates had been a major barrier to economic exchange in the years since the collapse of the Bretton Woods system. In 1989, a study conducted on behalf of the European Commission estimated that these costs amounted to between 0.5 per cent and 1 per cent of GDP. In comparison, the

Cecchini Report, the influential Commission paper on the expected gains from removing internal trade barriers with the Single Europe Act, had estimated that the border costs on goods amounted to 0.25 per cent of GDP, half the burden of currency conversions.¹ Their removal eliminated a transaction cost that prevented a ready comparison of prices across national borders. Instead of being confronted with a bewildering array of lira, francs (both Belgian and French), deutschmarks and pesetas, investors and consumers could see prices in only one unit of exchange, the euro. The cost of exchanging currencies would also no longer burden those involved in cross-national exchanges. Under a single currency, individual governments would lose the power to unilaterally devalue their national currency to reclaim competitiveness compared with other EU members. The removal of monetary distortions, reduction in risk, easing of the costs of economic activity, and increase in price transparency will intensify competition and increasingly allow nations and regions to specialise in activities that stress their comparative advantages. This, it is suggested, will lead to a more efficient use of resources, higher growth rates, and greater aggregate wealth.²

The transitional steps agreed to on the road to monetary union also were highly liberal. The member states agreed to practice a high degree of fiscal and monetary discipline. The road to monetary union was laid out as a tough one of budgetary retrenchment, fiscal austerity, and price stability. These policies are not without distributional consequences within and between countries. Political scientists have tended to look at both the distributional consequences of proposed policies and national institutional environments to explain the success and failure of various policy initiatives. Many scholars have focused on the economic characteristics of national economies, sectors, and firms as determinants of their preferences towards liberalising economic policy.³ Most of these explanations have focused on the relationship between increased internationalisation of trade and the extent of support for liberalisation and protection in different countries over time. These works suggest that political pressures emanating from interest groups (particularly producers) influence policymakers to pursue economic policies favourable to politically powerful economic groups. According to these theories, European politicians support or oppose monetary union because these positions will provide particular benefits to specific domestic groups. In this book, I examine the attitudes towards EMU of the political representatives of producer interests, business associations, in Germany and Britain.

As the institutional intermediaries between businesses and the state, business associations have often been taken as passive transmission belts for assumed corporate preferences in particular policy options. My research on the motives and actions of business associations regarding EMU reveals that the causality is actually the reverse of what most existing theories predict. Instead of politicians supporting EMU because of pressure from domestic economic interest groups, the level of support for – or lack of support for – EMU among business associations depends not only on the economic characteristics of the firms they represent, but also on the attitudes of a country's politicians (specifically those in the national parliament) towards monetary union. I find that business associations voice opinions about EMU in response to the positions of the government and the governing parties rather than attempting to push or block EMU on their own initiative. At the same time, the specific areas where business associations do actively engage policymakers provide an indication of the reasons for their relatively reactive policies regarding EMU. Within the constraints imposed by political debates over EMU in the national parliament, business associations are active within policy areas related to monetary union, but in ways that further emphasise the political restrictions on their level of broader EMU activity. Across national boundaries, business associations are usually most active in highly specific and technical areas where their expertise is high and policy is less electorally salient. This maximises each association's chances of success which in turn enables their leaders to point to a number of salient policies of direct interest to the association's membership.

This chapter develops these arguments in six sections. In the first section, I present the puzzle of how similarly situated business associations in Germany and Britain have different policy stances regarding EMU; I also discuss the inadequacy of several alternative explanations for these differences. In the second section, I provide an overview of two relevant literatures, one that deals with the consequences of economic internationalisation for domestic politics, and the other which addresses theories of collective action. In the third section, I introduce the main argument of this book and explain why the strategies pursued and preferences expressed by business associations depend upon the priorities of the business association itself and that these priorities are not necessarily congruent to the relative economic position of the members of the association. The fourth section explains the insufficiency of conventional explanations in resolving the puzzle. The fifth section presents several hypotheses based upon my argument

and the final section discusses the methodology that I followed in my research for answering these questions.

The puzzle

This book examines why, in both Germany and the United Kingdom, business groups in similar economic circumstances did not respond in a manner consistent with their imputed economic interests, either in terms of the strategies they pursued or in terms of the positions they took. For instance, the primary German industry confederation, the Federation of German Industry (*Bundesverband der Deutschen Industrie* – BDI), a group whose membership consisted of many large exporters, was highly supportive of EMU. Although German industry has long relied upon the disciplining influence of a non-accommodating monetary policy, the BDI took this position even when a loose interpretation of the Maastricht criteria appeared likely. In contrast, for much of the 1990s, the Confederation of British Industry (CBI), also with many large exporters as members, was extremely ambivalent about monetary union and resisted even taking a position on British participation in EMU for many years. Only after the Labour Party's election victory in 1997 did the CBI finally agree to a policy stance that modestly supported British participation under certain restrictive conditions. The German Chambers of Trade and Industry (*Deutscher Industrie und Handelstag* – DIHT), the primary representative of small and medium-sized enterprises in Germany, was supportive of EMU entry even though many of its members were domestically-oriented firms with little direct interest in international trade. In contrast, Britain's Federation of Small Business (FSB) not only was adamantly opposed to EMU but had also begun calling for the United Kingdom's outright withdrawal from the EU in 1995. Other business associations in Germany tended to follow policies that were also generally supportive of EMU, while those in the United Kingdom were extremely diverse in their responses to potential EMU membership.

The literature

Two related fields of scholarship address the formation of group preferences and lobbying activity. The first, the economic interest school, poses several explanations for the behaviour of interest groups based around the economic characteristics of a firm or sector. Since business associations claim to represent the economic interests of their members,

it is not surprising that economistic interpretations dominate the literature on the political economy of business preferences. Businesses and business associations might well be expected to make a financial assessment of economic policies such as monetary union and decide whether they support or oppose it based upon whether or not the policy in question increases or decreases their firm's (or members') potential profits. Theories based around this conception of profit-motivated firms suggest that businesses (and associations) that expected to be beneficiaries of monetary union would support EMU while those that expected to lose out would oppose it. The economic character of a firm or sector determines whether that firm/sector stands to receive benefits or be burdened with costs by increased exposure to international market forces. A simple cost-benefit analysis of the anticipated economic effects of the proposed policy will indicate to a firm's managers whether they should support or oppose monetary union or any other economic policy.

The second field of scholarship, theories of collective action, is partially incorporated into many economically-based theories of group behaviour.⁴ Collective action theories usually stress individuals' motivations for engaging in collective behaviour in pursuit of the provision of a public good. These theories tend to stress the exclusive benefits that collective entities can offer their members in contrast to the amorphous, indivisible gains that generally accompany public goods. Economic characteristics of groups can matter, but excludability is the key factor in collective action. If an organisation cannot exclude a non-member from enjoying the fruits of its political activity, then its own members will have an incentive to discontinue their membership and 'free ride' on the successes gained from the contributions of others. Membership must have its privileges for an individual to join a collective endeavour.⁵

Firms are primarily concerned with their ability to compete effectively against other firms in markets. As such, they are interested in economic policies insofar as those policies will help or hinder their competitive position. Politicians and their political parties compete with each other for political power and positions in government. Business associations operate at the intersection between the economic marketplace where firms conduct most of their affairs and the political arena where political parties and politicians are the main protagonists. In Britain and Germany, as in most advanced industrial democracies, firms in similar industries have formed associations to promote their members' common interests before government bodies, provide information to the public about developments in the

industry, promote the commercial interests of their members as a whole, and provide information to their members about the impact of various political and economic events.

Internationalisation and domestic politics

Research on increasing exposure of national economies to international trade has stressed how groups that are adversely affected (or which expect to be made worse off) by increases in trade organise for protection. Peter Gourevitch argues that an economic group's status as a relative importer or exporter has historically influenced its support for and opposition to liberalisation. According to Gourevitch, groups facing competition from imports will support trade restrictions while those who export and can exploit international markets support more liberal trade policies.⁶ Ronald Rogowski expanded on this interpretation, using the Stolper-Samuelson trade theory to finger the relative factor endowments (land, labour, and capital) of a nation and the degree to which a firm or sector uses each to explain support for free trade or protection. In Rogowski's model, groups that utilise factors with which a country is relatively well endowed will tend to support increased economic openness. Groups which use factors with which a country is poorly endowed, relative to the rest of the world, can anticipate increased competition from abroad and will consequently support protectionist policies.⁷

Some scholars have theorised that different national choices about exchange rate regimes and monetary policies reflect the outcome of domestic struggles between competing economic interest groups.⁸ Jeff Frieden applies the Ricardo-Viner theory of specific factors, rather than entire classes, to argue that firm preferences for exchange rate regimes originate with their degree of international activity and asset specificity, that is, the extent to which their factors of production are specific to the task they are performing. Once a world of capital mobility is assumed, there are domestic distributive consequences to the remaining choices confronting policymakers between exchange rate stability and level of the exchange rate. Frieden argues that sectoral cleavages can form along two axes – the first between groups favouring national monetary policy autonomy versus those who favour more fixed rates; and the second between groups that benefit from currency appreciation and those favouring a depreciated currency.

The specific factors, sector-oriented, account of EMU suggests that certain industries would be supportive of a nation's participation in

monetary union while others would be less supportive or opposed. Exporters, multinational corporations, and international investors are expected to be among the most favourable; non-tradable producers the least. On the surface, there is some support for these propositions as well as some evidence that suggests there are broader factors at work. Many leading exporters in Europe have been supportive of monetary union. However, they were not alone in their support – in Germany even non-exporting sectors, such as the small business sector and construction, were favourable. In contrast, the British small business sector was where opposition was the most vocal, even among exporters. Even many British industries heavily involved in intra-EU trade were more ambivalent in their support for EMU than their German counterparts, providing important caveats to their support.

There is a time-based indeterminacy to theories that limit themselves to translating interest from the immediate characteristics of a firm or sector. This is because economic actors can have different preferences on issues depending upon whether they look to the short-term or the long-term. In the short-term, for instance, exporters might be in favour of an institutional framework that allows for a rapid devaluation of the currency as a spur to exports. In contrast, from a long-term perspective, the 'boom-bust' cycle of stimulated demand followed closely by a depressed economy is unattractive due to the economic turbulence and increased risk it provides to investors. Likewise, the nontradable sector might prefer that the government be able to provide an inflationary boost to the economy through the use of lower interest rates in the short-term yet also prefer the long-term reduction in average interest rates that a more consistent anti-inflationary policy promises through a reduction in the currency's risk premium.

Indeed, the particular economic characteristics that influence behaviour are open to much debate; although there is general agreement that those groups with characteristics compatible with increased international competition will favour openness while those that can expect to be uncompetitive will favour protection.⁹ These disagreements suggest that what is in a group's 'economic interest' is a highly subjective and malleable subject. What economic theories agree on is that interest groups, particularly producer groups, organise to promote their interests, whether it is in the tightening or loosening of trade barriers. Although very little micro-level analysis has been conducted to see whether these theories apply to monetary policies, the centerpiece of political economy analysis remains the casual argument that economic interest groups exert political pressure on politicians in order to obtain favourable policies.¹⁰

However, moving from the world of the economy through interest group lobbying to economic policy is not an entirely straightforward matter. An analyst must first surmount a fundamental difference between a business association and the firms it represents – business associations do not compete in economic markets; they are active in the political arena which has both competitive and cooperative dynamics operating simultaneously. A business association provides its members with information about existing government policies and attempts to influence policymakers in obtaining legislation and regulations favourable to its industry. To examine these dynamics, it is necessary to look at the actions of business association through the theory of groups.

Unfortunately, economic theorists tend to offset their sophisticated economic models with a rather impoverished view of government and nongovernmental institutions. Rogowski, for example, relies upon 'simple models of the polity' to support his theory of cleavages and coalition.¹¹ In other models as well, business associations are nothing more than the passive transmission belts of firm (or factor) preferences. These theorists, who are extremely meticulous about how they connect imputed firm preferences with the characteristics of particular industries, often make broad leaps from these preferences to the policies of governments in a way that presupposes the existence of two mechanisms. One is the similarity of business association preferences and the preferences of the firms they represent. The other is the direct translation of influence from economic groups to government policy.

These two assumptions are not entirely consistent with one another when relying upon organisational factors, at least in the case of democratic societies. If the transparency of preference formation that is assumed to exist in business associations actually existed for the political system as a whole, then legislatures would make decisions that were more in line with the electorate responsible for electing them than with the economic power of individual corporations and business associations. The limits of a pure democratic model of policymaking are quite clear to many political scientists; however, theories of economic policymaking appear to rely upon an alternative democratic model that assumes a uniformity of economic interest among associations' members and a clear transmission of that interest through the associations to the government.¹² Why this should be the case for the representatives of economic interests but not for political representatives is unclear.

If, on the other hand, representative organisations produce outcomes through a process that is different from a direct translation of interests

into policy positions, then that suggests that an examination of how these organisations develop their policies is appropriate. Frieden explicitly acknowledges the relevance of these factors when he writes that

‘Strategic’ interest groups can misrepresent their interests, log-roll, and bargain in ways that severely complicate the translation of economic interest into policy position, and I generally ignore this possibility.¹³

Examining economic policymaking in this way preserves some of the advantages of parsimony, but it does so at the cost of completing disregarding politics itself. Strategic behaviour is ‘misrepresentation’ only in a normative sense. Behaviour that is ‘misrepresentative’ can more accurately be termed behaviour about which we have an incomplete understanding of the representative dynamics of interest groups involved. The practitioners of such strategic behaviour repeatedly argue that they are pursuing policies that will best promote the interests of their group in the long-run. Complicating factors such as interest groups and political institutions are what make up the politics of a country and often what account for differences in government policies. In between the attributed economic interests of firms and the policies of governments are business associations of disparate sizes employing an army of functionaries. Scholars ignore the activities and motives of these groups at their own peril. This is where the politics of business takes place. Equally importantly, it is also a politics that has an effect on outcomes.

Collective action

Business associations, designed in part to pursue collective goods for their members, suffer from a collective action problem when it comes to EMU. Even if a business association decides that EMU is unambiguously in the interests of its members, it has little incentive to lobby government officials for positive action on the issue. An issue of such major macroeconomic and constitutional importance is one whose fate one way or the other is unlikely to be influenced by a major lobbying effort on the part of one organisation. Even if it were, the members of the association would only capture a few of the benefits to the entire economy that EMU promises to bring. Groups that could expect to suffer under EMU would be more inclined to counter-mobilise making success even more problematic. Like many public goods, the benefits of EMU are dispersed and the

costs of lobbying to provide it are concentrated. Any pro-EMU group would face the prospects of other pro-EMU associations free-riding on its lobbying campaign, reaping gains from exchange rate stability and reduced transaction costs but contributing nothing to the political campaign to promote it.

Both exchange rate stability and monetary policy autonomy are public goods since the policies are non-excludable. That is, the public good cannot be given to one member of the group of potential beneficiaries and not to the others. Because of its non-excludability, both policies are susceptible to free-riding on the part of those who have an interest in its provision.¹⁴ For example, many firms and sectors might have an economic interest in exchange rate stability. However, if one business association, the automobile industry association, for example, successfully lobbies the government for exchange rate stability, it cannot deprive other industries that have a similar interest, such as the chemical industry, from reaping the benefits. Since the chemical industry can enjoy the gains from exchange rate stability without paying the costs of lobbying activity, it has a strong disincentive to lobby for the maintenance of exchange rate stability. Faced with such potential exploitation, the automobile industry association has little reason to devote scarce resources to a goal that it might not be able to achieve and for which its industry will not be the primary beneficiary. The same logic holds for those interested in domestic policy autonomy.

The leaders of business associations have one over-riding priority: they want to satisfy their membership that the business association is an effective organisation. If the members of an industry group feel that the association is ineffectual, they might suspend their membership or seek alternative ways of achieving their collective ends, and the association will suffer from reduced membership, smaller budgets, and lower prestige. To overcome these tendencies, the leaders of business associations need to provide their members with excludable goods; that is, benefits that they would not receive if they were not members of the association. These members-only privileges might include free or reduced price subscriptions to professional journals (American Medical Association), legal advice in employment disputes (Federation of Small Businesses), and participation in trade shows (Society of Motor Manufacturers and Traders). These sorts of selective incentives provide members of a group something that they would not have if they were not members.¹⁵ The provision of incentives is not the sole activity of business associations. They also seek to provide political services for their members. Members of business associations frequently want

information about government policies and want to influence government to provide a favourable operating environment for their industry. The leaders of business associations attempt to satisfy both of these desires – providing advice on the consequences of new government regulations and attempting to influence policymakers in an effort to obtain beneficial legislative activity.

Business associations have a large number of policies they could pursue to promote the interests of their members. The automobile industry, for example, has an interest in cheap steel, lax emission standards, stable exchange rates, and tax relief for new investments to name but a few of the thousands of regulatory, trade, and tax issues that are of concern to companies operating in the industry. An automobile industry association, however, has limited financial and staff resources to devote to political activity. Within these constraints, its leadership places a priority on achieving specific, identifiable policy successes rather than necessarily lobbying for policies that will maximise the profits of the industry. Paying attention to the concerns of an association's members is a priority for business associations. Often, the priorities are not strictly economic.

Models of interest group preferences stemming from economic interest, while powerful simplifying tools, sometimes lead to causal arguments that run contrary to reality. Part of the work performed by any association is weighing the competing interests of its members. Any organisation that aggregates interests – whether it is a political party, a labour union or a business association – must weigh different issue areas against each other. In this aggregation, different economic issues will compete with each other and with different, non-economic issues for precedence in decision-making councils. The leaders of these organisations have to prioritise the interests that compete for their attention. Steven Vogel has found that Japanese consumer groups do not favour market liberalisation that are in the immediate economic interests of their members in lower consumer prices. Instead, Japanese consumer groups have consistently expressed support for restrictive trade and financial policies out of concern for food quality, security of supply, and health issues.¹⁶ British and German business associations, like Japanese consumers, have a variety of interests that they must represent and aggregate. In doing so, the leaders of a business association have a certain degree of autonomy. They seek issues where they can be successful and where their activities are uncontroversial. Both of these concerns push them in the direction of technical issues of direct concern to their members rather than larger macroeconomic issues.

Conventional explanation: economic interest

Theories of international political economy often suggest that a country's trade flows can play an influential role in determining the political orientation of its domestic interest groups. An examination of British and German trade patterns suggests that this is an unsatisfactory explanation for the different political orientations of British and German business groups. Business associations in both countries represent firms in highly sophisticated, industrial societies. Germany and Britain are at similar levels of industrial development compared with other EU members – a similarity that is especially apparent when they are compared with the poorer Mediterranean members. Most importantly, both countries had similar levels of trade as a proportion of GDP and traded at similar levels with other EU members (Table 1).

Table 1 Levels and Direction of Trade

Country	Trade as % GDP		% exports to Europe		% imports from Europe	
	1988	1994	1990	1995	1990	1995
Britain	40.6	42.4	57.4	57.1	52.7	54.4
Germany	47.7	43.6	62.3	56.6	59.6	54.3
France	35.8	34.3	65.4	63.6	61.6	64.4
Italy	32.2	35.1	62.8	56.9	61.2	60.5

Sources: OECD (1996) *Economic Surveys: United Kingdom* table J; OECD (1996) *Economic Surveys: Germany* table G; OECD (1997) *Economic Surveys: Italy*, Table K; OECD (1997) *Economic Surveys: France* Table F.

Britain's level of openness to international trade puts it in the same league as Germany and substantially ahead of France and Italy. While its proportions of exports and imports directed to other EU members have been lower than France and Italy, again it looks more like Germany than the two other large members of the EU. By the mid-1990s, the direction of trade statistics for Germany and Britain were effectively indistinguishable from each other at the macroeconomic level. Indeed, both Britain's degree of trade internationalisation and European orientation were *increasing* while Germany's level of internationalisation *decreased* during the 1990s as did its European orientation. German unification explains much of these changes in the German trade; yet it only deepens the puzzle. If German unification made Germany a larger, less trade reliant country than it had been prior to unification, would these economic and political changes be

reflected in less German interest in European political and economic institutions? Politicians at the time were deeply concerned about precisely this question.

Another major macroeconomic promise of a European Central Bank was its anti-inflationary mandate. In this realm, German business had little to gain from monetary union as the Bundesbank ensured that Germany had low inflation and a monetary policy oriented towards stabilising domestic price levels. Within the ERM, the deutschmark served as the anchor of the system and other countries followed German monetary policy decisions. The status quo was quite favourable to German business and the risks of monetary union included a European Central Bank that made interest rate decisions with regard to a broader economic area than Germany and the prospect that Germany would find itself in the minority on the ECB board. In contrast, Britain, like France and Italy, had experienced serious bouts of inflation throughout the 1970s and 1980s. To the extent the promise of low-inflation was attractive, the ECB offered a more credible assurance to British business than the British government had previously. It also promised that British domestic interests would be taken into account in determining interest rates, a situation that was absent in the ERM where the pound followed the deutschmark, just like all the other European currencies. Seen in this light, German business should have had a strong interest in the low inflation, domestically-oriented status quo while British business should have found some of the features of EMU attractive alternatives.

These general, national level evaluations of the two countries would suggest that the trade patterns of the two economies are similar – both in terms of the level of trade and proportion of trade with their EU partners. Any inferences drawn from this aggregate level data would have to suggest that business associations, as the aggregators of national economic interests, would respond similarly to a policy that promised to increase the economic integration of the European Union. Seen from an aggregate economic perspective, there is no reason to suspect that the domestic political alignments of business in the two countries would be at all dissimilar. If anything, it would appear that German business would be the one least likely to enter into deeper European monetary integration. Yet, it was British business groups that expressed more resistance to EMU than German business. This suggests that the solution to the puzzle lies within the borders of each country.

Conventional explanation: public opinion

A second conventional explanation is that business associations reflect the opinions of business people, opinions which are in themselves merely a reflection of the opinions of the population at large. The managers of firms and leaders of business associations are members of their particular national society. To the extent that a certain policy initiative is popular or unpopular, business leaders might be expected to hold positions that are similar to the general population. If this is the case, then business opinion is really a subset of public opinion more generally. If this explanation is correct, then the high levels of support that German business associations have given monetary union might simply reflect high levels of popular support for the initiative. On the other hand, the diverse attitudes that Britain's business associations have expressed towards EMU would then correspond to deep divisions in public opinion towards monetary union. Figure 1 demonstrates that public opinion in Britain has run strongly and consistently against the euro from 1992 onwards. But identical surveys conducted in Germany at the same time reveal that Germans were just as divided about, if not as hostile towards, monetary union as the British.

Business associations in Germany were solidly in favour of EMU rather than opposed or evenly split. Disaggregating national level opinion data into subsets can reveal quite different results in different subsets than exist for the national sample. Business leaders in Germany and Britain might have very different attitudes towards monetary union than their fellow citizens – a difference in opinions that leads to differences in the preferences of the business associations of which they are members. Between 1992 and 1995, Euro-Barometer surveys revealed that German executives were opposed to EMU by a 56 per cent to 44 per cent margin.¹⁷ British business leaders were somewhat more hostile, with 60 per cent of respondents rejecting EMU and only 40 per cent supportive. However, these differences are minor when compared with the differences between Britain, Germany, and the rest of Europe. In the same time frame, in the entire European Union, 59 per cent of respondents to Euro-barometer polls expressed support for EMU, and support among business executives was 69 per cent. The similar, tepid response to EMU in Germany and Britain contrasts clearly with the depth of pan-European support for a single currency.

While there is some truth to the argument that business leaders supported EMU more than their compatriots, it is also true that at the

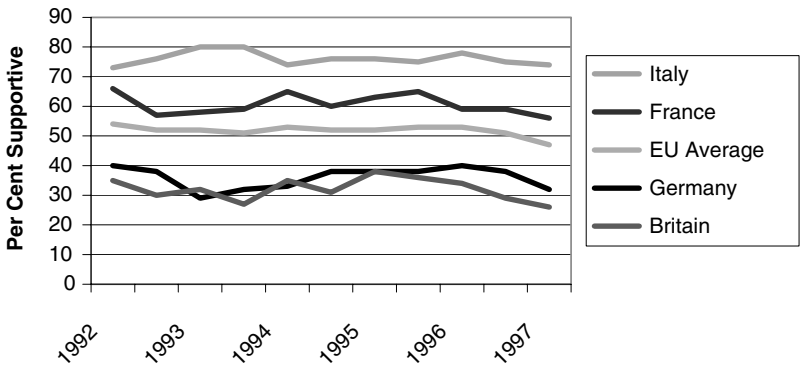


Figure 1 Opinion Towards a Single Currency, 1992–97

Sources: European Commission, *Eurobarometer: Public Opinion in the European Union* (Luxembourg: Office for Official Publications of the European Communities, various years), Nos. 37–47.

mass level, support for EMU among Britain's and Germany's business communities is weak. In Chapters 2 and 4, I analyse polling data from the United Kingdom and Germany to evaluate the economic preferences of German and British businesses. The findings reveal that small firms in both Germany and the United Kingdom opposed giving up their national currencies for a pan-European currency. They also reveal that a company's export status does have a modest effect on the attitude of the firm towards EMU. However, despite some apparent similarities in the attitudes of their members, small businesses in Britain and Germany responded differently when they formulated their positions on EMU. The DIHT endorsed the Kohl government's plans for monetary union while the FSB condemned any movement towards a single currency in Britain.

The argument

If arguments based around economic interest and public opinion are insufficient in explaining business attitudes towards EMU, then how can we explain the differences that can be observed between British and German business associations? This book contends that the associational arena interacts with the economic and political arenas in the formation of group strategies. The conventional wisdom is that a straightforward functional relationship exists whereby the economy transmits price signals to firms which affect their preferences for various policies. Business associations, acting as faithful representatives

of their sector, transmit the preferences of their members to the government. I argue that this model is deficient in three respects. In the first instance, it implies that business associations and their leaders are passive conduits for the expression of their members' undifferentiated preferences. This implication runs counter to what we know to be true of political parties, government bureaucracies, and other decision-making organisations.¹⁸ As an intermediate organisation between firms and politicians, business groups have their own dynamic that operates differently from the dynamics of the political arena and the economic arena. In the political arena, associations, unlike politicians, are not responsible for the implementation of policy. Instead, their role involves representing the interests of their members. This task is neither as straightforward nor as transparent as 'simple models of the polity' suggest.¹⁹ The preferences of members are not always clear and consistent. Indeed, member firms' perceptions of their own interests are often unclear and divided. The leaders of business associations interpret these perceptions of competing interests and weigh them against one another. As an integral part of their representative duties, the leaders of business groups have an aggregating function that provides a framework for pursuing the interests of their members. In this sense, an association's leadership can behave as a Burkean representative rather than as an ambassador for a specific interest.

Second, this model of political activity ignores the role that the political system plays in shaping the battleground of ideas. While politicians do not operate in an economic vacuum, neither do business associations operate in a political vacuum. They are not free-floating entities operating in an unstructured political environment. The reality in which business associations function is one in which parties and politicians stake out and debate a variety of policy positions. Due to the existing national policy debate, some options are not politically viable. The leaders of business associations frequently use their own judgement of the political situation in determining the best strategy for their associations to pursue.

Third, a functional model fails to appreciate that the direction of information and influence is often the reverse of what is conventionally posited. That is, a central function of a business association is keeping its members informed of what public policies the government is implementing or planning to implement. A business group can be the sole source of information about the consequences of government policy for small and medium-sized enterprises. This gap between the capabilities of business associations and multi-national corporations

has diminished in recent years. Nevertheless, in terms of long-term involvement and interaction with policymakers at the national level, business associations retain advantages over even the largest of firms.²⁰ In many cases, the high level of interaction between business associations and government officials gives the leaders of business associations a degree of access to policymakers and expertise in government policymaking that is lacking among their members.

In Figure 2, these three critiques of the existing literature are incorporated into a model of business group activity. This strategic model that takes into account not only the economic interests of firms, but also the limits on members' control over the business association, the ability of the business association to influence its own members through the provision of information and expertise and the strategic incentives emanating from incentives from the political system in shaping the parameters of political debate.

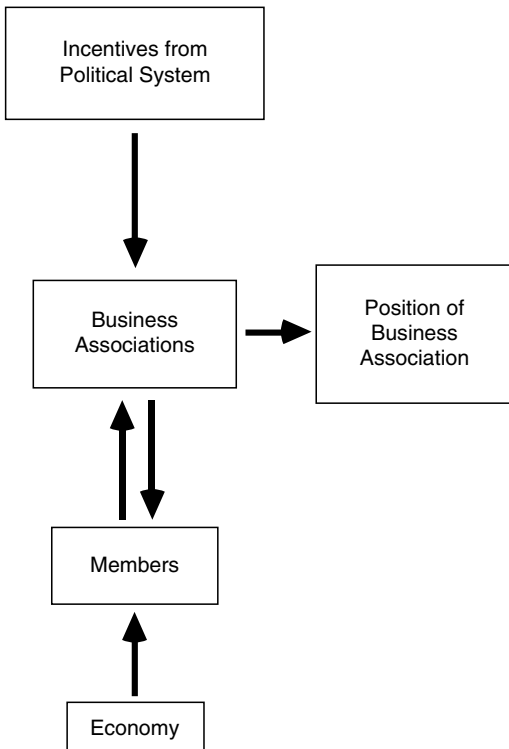


Figure 2 The Model

When business associations pursue their policy interests, they do not operate in an environment consisting solely of economic variables, nor do they slavishly reflect popular attitudes. They are embedded within two different, but related systems: the associational arena and the national political system. In the associational arena, much of an industry group's efforts are devoted not to influencing policy, but to informing its members of what the consequences of government policy will be for their industry. Business associations provide a two-way channel of communication, passing along some of the concerns and desires of their members to the government as well as informing and influencing their members on various aspects of government policy. They also seek to provide services to their members in order to justify individual firms' membership in the association. This environment is inherently political rather than economic. Consequently, an association's most important asset is its ability to 'make things happen' which often depends upon its access to policymakers. This, in turn, depends upon the relationship between the association and politicians. The national political system is where the representatives of business interests must make contact with and maintain access to politicians and government officials as they attempt to influence government policy.

I argue that business associations are political entities and that their leaders strategically pursue policies based more upon calculations of success and failure rather than on the imputed economic interests of their members. The public policies advocated by the leaders of business associations are the results of political struggles and compromises both within the association and between the association's leadership and other political actors. The position in which the leaders of business associations find themselves is analogous to the two-level game metaphor.²¹ On the one hand, they must act in the political arena to pursue the best interests of their members. At the same time, they must satisfy their members that the policies they are pursuing are, in fact, policies which the members desire. Business associations perform the task of aggregating the demands of their members for political activity and representing their members before the legislature, the government, political parties and the public. They must be cognisant of two potentially conflicting arenas – the internal associational arena and the external political arena.

The associational arena: structuring interests

Business associations provide economic and political services for their members. Members of business associations frequently want informa-

tion about government policies and want to influence government to provide a favourable operating environment for their industry. The leaders of business associations attempt to satisfy both of these desires – providing advice on the consequences of new government regulations and attempting to influence policymakers in an effort to obtain beneficial legislative activity. Business associations have a large number of policies they could pursue to promote the interests of their members. An industry association, however, has limited financial and staff resources to devote to political activity. Within these constraints, when the leadership of a business association engages in political activity, it places a priority of achieving specific, identifiable policy successes rather than necessarily lobbying for general policies that will maximise the profits of the industry.

The leaders of business associations do not actually buy or sell their members' products. They 'sell' political action which is an entirely different type of product. This division of labour between the producers of products and the political representatives of their interests leads to what Alessandro Pizzorno has called 'a gap between the interests of the represented and the interests of the representatives....'²² In an analogous analysis of the wage bargaining relationship, Pizzorno argues that union leaders face a trade-off between satisfying union members' calls for higher wages and the potential for increased political power for union representatives (themselves) in exchange for wage-restraint. In the short-run, pursuing hard-line wage demands might satisfy their constituents; but on the other hand, increased political power would give union leaders the potential to trade wage-restraint in the present for more influence over policy in the future.

In their study of the US Congress, Roderick Kiewet and Matthew McCubbins take an even stronger position on the lack of congruence between the interests of representatives and those who are represented. They argue that

there is almost always some conflict between the interests of those who delegate authority (principals) and the agents to whom they delegate it. Agents behave opportunistically, pursuing their own interests subject only to the constraints imposed by their relationship with the principal.²³

Some business representatives can pursue their own ends with scant regard for the interests of their association's members. The leaders of business associations are the political representatives of business and

success as a political activist depends upon being 'at the center of the action', lobbying legislators, making deals and contributing to the creation of policy coalitions. Contributing to their political profile by accumulating political capital for an organisation is understandably in the long-term interests of the organisation, but it can come at the cost of some short-term objectives of an industry. Cathie Jo Martin, for example, found that firms with governmental affairs offices in Washington were more likely to support national health care reform than those who did not have legislative liaisons.²⁴

This has three consequences for lobbying. First, the lobbying objectives of an industry association are those where its chances of success are greatest. This tends to attract associations to specific, technical changes in regulations where the industry has a near-monopoly on knowledge and a great deal of influence with the relevant policymakers. Second, industry associations will generally try to avoid conflict with other organised interest groups, preferring to focus their attention in areas where there are specific gains for the industry and diffused cost to other groups (or society as a whole). Finally, business associations will seek cooperative rather than conflicting relations with politicians. The primary political goal of business associations are policy successes – particularly successes that are visible to their members. Associations try to avoid controversial policy debates precisely because these have a high probability of leading not only to failure, but to a highly publicised failure.

Business associations, as the solicitors of government policies, prefer to have cooperative rather than adversarial relationships with politicians. While they might have disagreements about certain policies, over the course of several years, politicians are in a position to provide a business association with innumerable favourable policy decisions. Preserving political goodwill is paramount to the future success of a lobbying organisation. The immediate economic benefits to an organisation's members are traded off against the future benefits they might receive through enhanced political influence.²⁵ Groups attempt to build political capital so that they can take advantage of it at some later time. Groups that completely ignore the lay of the political land can find that politicians remember their heavy-handed tactics and that their prior arm-twisting has consequences in reduced influence over the long-term. This was the case in the infamous 'Men from Mars' incident in Brussels in the mid-1980s when lobbyists from the Mars Corporation descended on the European Commission and attempted to browbeat EC bureaucrats. The Mars Corporation was still recovering

from the adverse reputational consequences of the episode more than a decade later.²⁶

Officials at business associations can forego the immediate returns of pressing the political position that their members might favour in order to build up their future political influence. Since a myriad of policies affect every industry, association officials are able to choose which policies they wish to address to obtain an outcome quite close to the industry's preferred position. Thus, associations prefer to target specific issues. For example, a national confectionery industry might have a very strong interest in removing tariffs on sugar. Consequently, it would choose to devote its resources to promoting its position on that issue rather than a more general one – such as the overall rate of corporate taxation – that also affects its members. This leaves many other issues open to compromise, particularly in policy areas where an association's members are not entirely in agreement with one another. Divisions within the membership can create opportunities for strategic behaviour on the part of the leaders of business associations.

As they pursue favourable governmental action, business associations attempt to promote strategies where they can have favourable relations with politicians and government officials while simultaneously satisfying their members that they are working on their behalf. The economic uncertainties and the variable consequences of EMU for their members give business associations a great deal of latitude for strategic manoeuvring in presenting the interests of their members to both the government and the public at large.

Business associations ostensibly represent the economic interests of their members in the political arena. This realm is primarily defined by the marketplace and the organisation of the market economy. Determining what is in the 'economic interest' of an economic sector is not necessarily an easy or unambiguous task. Different firms within an association have different economic characteristics and have different preferences for different economic policies.²⁷ Even within a firm, its interest in a particular economic policy might be contingent upon the time frame within which policy is viewed. For instance, a firm that relies on exporting its products to foreign markets might favour a devaluation of the national currency for the cost advantages that it might receive, but at the same time it might also worry about the deleterious side-effects in terms of increased costs for imports, inflationary wage-pressure, the potential for higher domestic interest rates in the long-term, and risks stemming from international exchange rate instability.

Most of the members of a business association probably have not evaluated these issues for themselves, let alone for their industry. E.E. Schattschneider quotes the Congressional testimony of an official from the National Association Against a Tariff on Lumber who testified as to the opinions of the members of his association on the Smoot-Hawley Tariff of 1930:

I would classify them into three classes. There is a small group that are actively out for a tariff, very strongly. There is a considerable group that think it is a bad thing; and the vast majority are in between; they are not very keen for a tariff, but feel that they are not going to do anything to oppose a tariff, and, in a way, they would just as soon see it.²⁸

Similar sentiments were expressed by an official at the London Investment Banking Association (LIBA) when discussing what the members of his association thought about British entry into EMU. In his opinion,

There are different opinions towards EMU in our organization. There are some who are dead set against it, more who are enthusiastic and most who could go either way depending upon how it works out.²⁹

The manner in which business associations aggregate the preferences of their members depends upon the input mechanisms available to firms. Associations have a variety of ways to determine the direction and strength of opinion within the ranks of their members. Many conduct surveys of their members while others conduct an extensive series of consultations with interested members before determining a policy position. This sampling of opinion and the way that it is transmitted to an association's decision-making bodies is an important factor in the strategies that the leaders of business associations pursue. In most associations, an executive committee is responsible for determining a business group's political programme. Business associations have different means of consultation with their members, ranging from solicited consultations, polls of members, self-selected participation, and binding votes of the membership. The way in which individual members can participate in the decision-making procedures of the business association on individual issues independent from the association's leadership is a powerful factor in determining a business group's policy position.

The extent to which a business association is connected or integrated with other business associations can either enhance or diminish the latitude its leaders enjoy. These connections are best measured as the degree to which a business association is part of a hierarchical organisation of business associations. The more vertically integrated a national system of industrial representation is, the more independence a business association's leaders have from their member firms when they formulate and express the perceived preferences of their members. At the same time, the leaders of a subordinate business association have less independence in policy formation vis-à-vis higher-level associations. These tendencies exist primarily for two reasons: the character of representation within a hierarchical structure and the relative division of labour among associations.

Thus, the organisation of the industrial association plays a role in influencing its actions as the representative of its sector. The parameters within which the leaders of associations can act are dictated by the way in which the associational fabric of a country is organised. Political scientists have had a long tradition of scholarship which argues that participation in groups is an important part of democratic society.³⁰ However, contained within these works is a nuanced suggestion that not all associational relationships are the same; that hierarchy and unequal relationships can also influence political discourse. In a study of civic culture in Italy, Robert Putnam found that the vertically organised institutions of such dissimilar organisations as the Catholic Church and the Sicilian Mafia had deleterious effects on civic consciousness. This contrasted with the beneficial correlation between civicness and horizontally-organised associations like choral societies and mutual aid societies.³¹

The vertical integration of an interest representation system limits the space for political manoeuvrability of members at lower levels in the organisational hierarchy. The information they receive from the organisations above them has a privileged status over information that they receive from other sources. The hierarchical relationship contributes to patterns of acquiescence and obedience to traditional sources of authority.³² When an upper echelon organisation makes a decision to support or oppose a policy, it creates a new default position for the subordinate organisations who are content with a tacit acceptance of the leadership's position.

This has the advantage for higher-level associations of enabling them to claim the backing of their entire membership for policies which are, in fact, supported only by a portion of the membership.

When associations attempt to influence government officials, it is in the interests of their leaders to present as united a front as possible. Any admission that the association's members are not nearly unanimous in support of the position being promoted by the association's leaders undermines the ability of the leadership to secure favourable political action.³³ In his critique of the representative role of American trade groups in the Smoot-Hawley tariff legislation hearings, E.E. Schattschneider noted that there was a great variety of interests within industry groups

because of the circumstance that trade associations are often multi-functional and are frequently assembled on a basis that has no relation to the individual interests of the members in the tariff.³⁴

This diversity in interests did nothing to discourage trade associations from acting as the representatives of their industry before the United States Congress. Likewise, internal differences over EMU did not prevent the DIHT and BDI's leaders from expressing support for the German government's policy. For most of the 1990s, the CBI was unable to contain its own internal divisions over EMU and chose to abstain from publicly supporting a particular policy. These different organisational outcomes are in part the result of different organisational capacities; particularly the differing degrees of vertical integration that characterise the German and British associational space.

Some business groups concentrate decision-making power into the hands of managers and directors of specific firms who sit in the national councils of their organisation as representatives of their firms. This is the model favoured in the United Kingdom and, in general, this structure provides a direct link between the interests of specific members and the governing bodies of the association. Because the members directly involved in decisionmaking are also directly involved in the market, they not only experience the immediate effects of government policies on the operations of their own firms, but they also sit on the governing boards of business associations in their capacity as owners and chief executives of their particular businesses. Thus, their interests are specific to their business. This is not the case in Germany where the leading industrial association, the Federation of German Industry (BDI), is organised as an umbrella association for sectoral business groups, themselves organised as an umbrella group of sub-sectoral organisations. While chief executives of individual firms do sit on the governing boards of these associations, they do so not in their capacity

as representatives of their firms, but as representatives of a particular association for a sector of the economy. The chairman of Bayer might sit on the board of the BDI, but he does so not as a representative of Bayer, but rather as the representative of the Association of the Chemical Industry (VCI). This manner of representation mutes the direct effects of any economic policy preference on a specific firm and provides for a broader perspective on economic policy. This diminishes the role of economic factors, particularly firm-specific ones, and enhances the role of national political factors.

The second factor which distinguishes a vertically integrated system from a more diffused system is division of labour between associations. In this, the differences in organisation between the British and German associational systems provide strikingly different institutional capacities. A division of labour in regards to policymaking between the higher-level and subordinate-level associations characterises the vertically integrated system of industrial representation that exists in Germany. Sectoral and sub-sectoral associations use their limited resources in staff expertise for specific policy areas relating directly to the technical and regulatory concerns of their members. Major issues of macroeconomic policy, such as EMU, are not the primary focus of the policymaking organs of the sub-sectoral associations. Issues such as chemical safety, the vegetable fat content of chocolate, and adjustments to building codes are the primary concerns of the leaders of the German chemical, confectionery, and construction industry associations.

This is not to suggest that these associations ignore issues like monetary union, rather that they prefer to deal with policies that are of immediate concern to their members and which they have a particular expertise. The German national federation, the BDI, exercises responsibility over most important national fiscal and monetary policy areas rather than concerning itself with the particular technical issues which agitate the sectoral and sub-sectoral associations. This form of associational subsidiarity provides the BDI with a privileged standing in developing the positions of German industry on major issues of national economic policy. The disproportionate representation of large, multi-national enterprises in the ruling councils of the BDI and their presence in leadership positions in the leading sectoral associations gives the BDI a bias towards the export interests of its leading sectoral associations. In the BDI's formation of policy, there is a tendency to equate the interests of the German economy with the interests of the major exporting sectors and their leading corporations. This was certainly the case with the formation of the

BDI's position on EMU when the interests of small firms were described as a function of the interests of large firms. The division of labour in policymaking exacerbates the preferential position of large businesses, as the BDI's national policies are the default policy of the sub-sectoral associations. A sub-sectoral association, such as the Confederation of the German Confectionery Industry which sought to inform its members about the consequences of EMU, would initially go to the BDI for assistance as it would generally lack the expertise to generate such information itself. Only in the most extreme of circumstances – when its members' interests were clearly and directly threatened – would a subordinate association publicly break with the position of the BDI on an issue of macroeconomic policy. Even the Association of the German Construction Industry, whose members relied heavily on public sector contracts, did not oppose the BDI's call for further budgetary retrenchment in the run-up to monetary union. While budget cutbacks hurt builders, reduced government spending was not enough of a blow to trigger a break with the central association.³⁵ While the specific policies of the BDI on EMU might not have been welcome to many of the subordinate business associations, there were no alternative organisations that provided the same types of political and informational services that the BDI provided its members. In addition, withdrawal from the BDI would have been a major, disruptive undertaking and would have necessitated the agreement of most of an association's members (be they sub-sectoral associations or firms). Thus, the 'exit' option was extremely costly and was not exercised, especially in light of the benefits of membership in the BDI.³⁶

In the United Kingdom, the absence of such a clear division of specialisation in policymaking allowed for an overlap in policy-formation among associations. The outcome was a more heterogeneous arrangement where individual associations could, and often did, develop their own independent position on British participation in monetary union. Like Germany, British associations specialised in providing information and service to their members in highly specific policy areas relating to the core interests of their sector. However, unlike their German counterparts, British associations were not organised in a manner that made them dependent on the national industrial association, the CBI, for the articulation of industry's macroeconomic policy preferences. Where the Confederation of the German Confectionery Industry could rely upon the BDI to provide it with a well-prepared policy on EMU, similarly sheltered sectors of the British economy were left to their own

devices and, if they desired, came up with their own policies regarding monetary union.

In both Britain and Germany, business associations provided their members with information, policy advice, and selective incentives that they could not receive elsewhere. The associations all preferred to provide specialised information and lobby for specific policies tailored to their own individual industry. In this fashion, they behaved as typical collective action organisations that prefer selective incentives over broader objectives.³⁷ This behaviour suggests that the types of issues where national associations will exercise the most influence are those broad macroeconomic issues which have a diffused and perhaps uncertain impact on the financial and competitive position of member firms. However, a national organisation that lacks control over other organs of representation will be less effective in uniting industrial opinion than one which integrates other industrial associations into its existing structure.

The political arena: structuring interests

The corporatist literature provides the insight that groups, in this case business associations, are embedded in societies with interlinked and interactive political and economic institutions. Business groups do not operate in a completely atomised environment but must operate in a political system that has its own set of rules, procedures, and practices which dictate that policies have to follow certain regularised processes for approval and implementation. The leaders of business groups in general lack the ability to act as agenda setters. Generally speaking, they are agenda takers – responding to the debates generated by actors in the political arena. Business leaders can contribute to the debate and act strategically, but they are not usually capable of setting the agenda for national political discourse. They have some ability to initiate government activity in specific regulatory issues affecting their members, but on major issues like EMU they are loathe to over-expose themselves even when the government foists responsibility for a political position onto them, as the new Labour Government tried to do to the CBI in the fall of 1997.

The political arena is the sphere of politicians, parties, parliaments and polls. Some parts of the political system, such as procedures for passing the national budget, are relatively static. Others, such as the particular partisan composition of a branch of the national legislature, are more fluid. How politicians operate within this system

creates constraints and opportunities for strategic behaviour on the part of business groups' leaders. The debate within the political arena structures the options available to the leaders of business associations. This debate, in turn, depends upon two factors: political institutions and party politics.

Political institutions

The relationship between various political institutions shapes the debate within a nation by determining where the initiation points and veto points are for the implementation of legislation.³⁸ Who has political 'power' in a given issue area depends upon whether they belong to an institution that is able to either initiate policy or veto it (and thus prevent its implementation). Groups lack political power when they cannot block or introduce policies or influence the policy-makers who can implement different policies. Control of certain governmental institutions carries with it control over specific government functions. Some government agencies control particular levers of economic policy that similar agencies in other countries do not. For example, the German Bundesbank has responsibility for setting short-term interest rates. In contrast, prior to June 1997, the level of British interest rates was at the discretion of the Chancellor of the Exchequer. An appointed council with a statutory mission of price stability and a democratically-elected politician will face different incentives in formulating monetary policy. Societal pressure groups have a greater scope for political activity when a politician rather than an insulated group of central bankers makes interest rate decisions. Monetary policy is more likely to be politicised in the former case.³⁹ The structure of a nation's political institutions influences which groups' approval must be obtained before economic policies are passed and what paths are open to politicians pursuing particular projects. The most important of these political groups are political parties.

Party politics

Party politics takes two forms – inter-party competition and intra-party competition. Inter-party competition occurs between different parties, primarily in the electoral arena. Perhaps the most important government institution over which groups compete for control is the national legislature. The fight for control over this institution is the battlefield of electoral and coalition politics. As different parties vie for government office, they must influence people, win votes, and find acceptable coalition allies. In pursuing these goals, they will seek to hinder the

programmes of their opponents and enhance their own party's chances of holding government office.

Intra-party competition takes place within individual parties and is often more vicious because the stakes are smaller and the consequences of defeat more depressing. Within parties, different politicians seeking either electoral advantage or career advancement promote different economic policies. The way in which they distinguish their positions from the alternatives helps to structure the form the national debate takes. In Germany, for instance, politicians from the mainstream parties posed opposition to EMU not in terms of hostility to European integration, but in terms of a defense of a strict interpretation of the Maastricht criteria. This had several consequences both for strategy of the governing parties and for German business associations. In Britain, John Major's rivals for leadership of the Conservative Party sought to use issues of European integration and EMU to both undermine his premiership and promote their own prospects of succeeding him as Conservative Party leader. The Conservative Party's paralysis on European policy in the 1990s limited the political options of pro-European businesses in the United Kingdom. Political drift limits the ability of business associations to influence policy because business leaders do not want to alienate government officials.

The political environments within which British and German business associations operated were strikingly different, especially after sterling was ejected from the Exchange Rate Mechanism (ERM) in September 1992. In Britain, a sizeable number of MPs within the ruling party opposed EMU as did former Prime Minister Margaret Thatcher. The Cabinet itself was divided and the official policy of 'wait and see' was a policy that provided no endorsement of monetary union. Opposition to monetary union was a viable policy option that enjoyed substantial support in parliament. This gave business groups, such as the Institute of Directors (IoD) and the Federation of Small Businesses (FSB), many of whose members were antagonistic to the concept of EMU, the opportunity to publicly resist British participation in EMU and support like-minded politicians.

After its election victory in 1997, the Labour Party's commitment to entry into EMU, on the other hand, was not very strong. Indeed, differences of opinion within the Labour Party over monetary integration were about as extensive – although not as divisive – as those in the Conservative Party. This, and the Conservative Party's growing opposition to EMU, provided substantial policy space for business associations to debate the merits of monetary union.

In contrast to Britain, Germany's tradition of coalition government and multiple veto points made abrupt changes in established policies extremely difficult.⁴⁰ The Christian-Liberal coalition was at least as strongly committed to EMU as the British Labour Party was committed to the Social Chapter. The opposition parties, too, endorsed monetary union, although there was some disagreement within the SPD at the sub-national level. Thus, the political landscape for opposing the single currency in Germany was similar to the landscape for business resistance to the Social Chapter in the United Kingdom after 1997. Where British business associations had political opportunities for opposing the euro, German business associations had fewer and more restricted opportunities. In Bonn, there was little room for opponents to monetary union. Of Germany's political parties, only the PDS, the east German Communist successor party, and the far-right Republikaner Party opposed German participation in EMU.⁴¹ Neither of these two parties was seen as a legitimate ally for a respectable business association. Within the parameters of what was seen as legitimate political debate in Germany, a position in favour of a rigorous interpretation of monetary union was the best that an association could do in resisting greater monetary integration.

Business groups attempt to provide their members with favourable policies. To get favourable policies, they need to have good relations with politicians and government policymakers. Their members must consider the policy favourable. On EMU, the first condition is the most important one, as the debates in national parliaments are quite different in Germany and Britain. German politicians in the Bundestag were overwhelming in favour of EMU throughout the 1990s. All major parties (with the exception of the East German regional party) were supportive of EMU. Opposition control of the Bundesrat, the upper house of the German parliament, effectively coopted the Social Democrats (SPD) and the Greens into a shadow 'Grand Coalition'. In Britain, EMU was a much more divisive issue within the governing Conservative Party which faced deep internal opposition from its Thatcherite right wing. The structure of adversarial parliamentary party competition ensured that the main opposition party would not cooperate with the government to ensure the success of integrationist policies.

Because business associations typically shun conflictual relations with politicians unless specific interests are threatened, they focused their efforts in both Germany and Britain at getting positive policy decisions on the technical aspects of whatever EMU policy emerged. This enabled them to take credit for specific beneficial policies for their

members. As a result, business activity has followed the political debate.

In Chapters 1 and 3, I analyse how events in British and German political arenas influenced their public debates over EMU and how this debate restricted the choices available to business groups. Politicians and government officials have formidable rhetorical and institutional resources at their disposal. In comparison, business groups are at a comparative disadvantage in political discussions, having expertise only in their one specific sector of the economy. This does not mean that they are without influence or incapable of political action, simply that their nation's political environment places some limits on their capacity for political activity. Within these constraints, business associations aggregate and represent the economic interests of their members as they see them.

Research design and case selection

Theoretical arguments presented above suggest the following two propositions, which are tested in this book:

Hypothesis 1. The expressed opinions of business associations regarding EMU will follow the national political debate. They will take their cues primarily from the positions of parties in the national parliament. Interpretations based upon economic interest will be secondary to preserving strong relationships with politicians (political capital).

Hypothesis 2. The principal lobbying activity of business associations regarding EMU will be directed at technical details in areas where the benefits are either divisible or will fall primarily to the members of the association.

In this perspective, the organisation of business is an intermediate variable. Groups in an organised, hierarchical system will have greater consistency in the verbal preferences they express than those in a more uncoordinated system. Associations that might normally have been expected to be ambivalent or had no opinion about EMU will defer to the preferences of the peak organisation. However, their action in terms of lobbying for specific EMU-related policies will not be any different from those in a disorganised system – in both cases they will attempt to get specific government policies beneficial to the members of their group.

I operationalised the dependent variable as the political position of business associations on EMU. Because political positions tended to evolve, I used press releases, minutes, testimony before legislative committees, and other public statements from business associations to track their public positions over time. I also conducted interviews with functionaries of the associations to further elucidate the association's activities that received less public attention. The associations that I examined included the major national employers' associations of Germany and Britain (the BDI and CBI), representatives of small businesses (DIHT, FSB), major exporting industries (chemicals), domestic industries (construction), financial services (banks and investment services) and import competitors (farmers and confectionery). These associations were chosen based upon variations in their member-firms exposure to international trade and the degree to which they were part of a vertically-integrated system of interest representation.⁴²

The explanatory variables that I examined are of three varieties: economic, organisational, and political. First, I used economic variables relating to the sectoral and export dependence of particular business associations in order to test the propositions of the economic literature. I analysed business associations surveys of their own members to more directly test general propositions about preferences for monetary union. The organisational variables are the institutional set-up of the national system of business associations – particularly the way in which the peak associations (the BDI and the CBI) are constituted (vertically-integrated or not). I examined a range of documents from business groups and used my interviews with association functionaries to explore the structure of the organisation itself and how it relates both to its members and to other interest organisations. I also looked at how associations have contributed to debates over EMU through direct lobbying of politicians and the offering complementary or supportive policy statements. Finally, I examined two sets of political variables. One deals with the organisation of the state and the status of monetary policy prior to EMU. The second examines the positions of each country's major political parties towards EMU and the content of inter- and intra-party debate over the issue of monetary union. In conducting this portion of my research, I interviewed national politicians from all major parties and used memoirs of leading political figures who participated in the formation of the policies in question. I examined party documents and transcripts of national conference debates, parliamentary debates and committee hearings. I supplemented these primary sources with secondary journalistic sources, which, in contrast

to political memoirs and interviews, had the advantage of being contemporaneous accounts of the ongoing political debates over EMU.

Summary

When the European governments committed themselves to Economic and Monetary Union in 1991, it was a policy that was expected to have serious competitive and distributional consequences – both positive and negative – for every industry and firm in Europe. Over the past decade it has more than lived up to expectations. Political economists expect that major economic initiatives like the Single European Act, the North American Free Trade Agreement, and the Maastricht Treaty will generate intense political debate and conflict among domestic interest groups that stand to benefit or lose out under the new policy regime.

I argue that in the debates over EMU in Britain and Germany, supporters and opponents were not driven solely by economic interest. Rather, economic interpretations of the consequences of greater monetary integration were subordinated to political interpretations in both countries. While politicians occasionally were emboldened by support from business associations and other interest groups, more frequently the leaders of business associations looked to politicians in order to determine what their policy options were. Thus, British groups, like investment bankers, that might be expected to be enthusiastic about monetary union were ambivalent about the prospects of British participation in EMU. In contrast, German groups, like small businesses and confectionery producers, that might have been expected to oppose EMU, were guardedly supportive.

The organisation of national systems of business representation also contributed to the formation of business opinion. The integrated system of industrial organisation in Germany facilitated the peak association's attempts to impose its preferences on its smaller member associations. Britain's lack of an integrated system not only allowed various individual associations to stake out their own positions in contrast to the CBI, but it also allowed at least two other groups (the IoD and the FSB) to stake claims to being the 'true' representative of British business interests. The political and economic environments interacted within a specific institutional structure to affect the political strategies and actions of business groups in both Germany and Britain. Ultimately, the factors that influenced the behaviour of business associations were very similar to those that govern the behaviour of other political groups. They were just not as straightforward as they might initially have appeared.

1

Germany and the Politics of EMU

Of all the members of the European Union (EU), Germany had the strongest interest in the pre-Maastricht status quo. Not only did the Federal Republic's monetary arrangements facilitate low levels of inflation, but its participation in the Exchange Rate Mechanism (ERM) of the European Monetary System (EMS) enabled Germany to enjoy monetary policy autonomy within a zone of relatively stable exchange rates. Replacing a system in which the deutschmark was the anchor currency and Germany the hegemonic power with a system where Germany had an equal vote with Portugal and Belgium was not readily explicable in either domestic political or economic terms. It was thus rather surprising that Germany's political leaders agreed to and championed European-level monetary arrangements. The geopolitical considerations surrounding German unification dictated a reaffirmation of Helmut Kohl's government's commitment to European integration in, among other things, an agreement on Economic and Monetary Union.¹ At the same time, Germany's diplomats laboured under a series of domestic political constraints – electoral, coalitional, and institutional. The broad extent of these restrictions strengthened the position of German negotiators at Maastricht and led to an agreement whose parameters closely mapped German preferences.²

In this chapter, I will first discuss the political institutions that underlie German economic and monetary policymaking. Unlike in the United Kingdom, Germany pursued a consistent monetary policy of price stability throughout the 1990s. There was only one set of German monetary institutions during this period, although they underwent a slight reform in the early 1990s to streamline the functioning of the Bundesbank in the wake of unification. Next I will explore the party

political system within which the national debate over EMU took place and the manner in which that debate was evolved.

Political institutions

The German political system contains numerous veto points whereby different political actors can either block or influence the implementation of policy. In the debate over EMU, the Kohl government had to some extent relied upon either the active support or tacit cooperation of not only the members of the coalition, but the leading opposition party and the Bundesbank. The Federal Constitutional Court also played a modest, but important, role in adjudicating the political process that approved the Maastricht Treaty. These organisations exerted an influence which created an extremely rigid political environment within which the government had little room to manoeuvre.³

The government and Bundesbank

The Bundesbank Council conducts German monetary policy independent of instructions from the federal government. Its independence is established in a series of formal rules and procedures that insulate the central bank's policy decisions from the influence of elected politicians. Members of the Bundesbank Council, once appointed, cannot be removed from office until the expiration of their terms of office, which can run up to eight years. In addition to the appointees of the federal government, each Land appoints one member to the Bundesbank Council. After unification, the Bundesbank Act was amended so that some of the smaller Land governments now share a seat on the Council with other Land governments.⁴ The Bundesbank's statute explicitly makes price stability its central policy goal. To the extent that it does not conflict with the pursuit of price stability, the Bundesbank must also support the general economic policies of the government. Members of the federal government (in practice, the finance minister) can attend Bundesbank Council meetings as non-voting participants but retain only the power to request the deferral of any decision for two weeks.⁵

Recently, various scholars have suggested that the Bundesbank's formal independence from elected officials provides only a partial explanation for Germany's post-war success in fighting inflation. In several of these formulations, Germany's system of coordinated wage bargaining enables unions to respond strategically to the anticipated actions of a non-accommodating central bank. Following a strategy of wage-restraint

enables German unions to preserve employment while at the same time reinforcing the Bundesbank's restrictive monetary policies.⁶ Other scholars argue that the behavioural independence of members of the Bundesbank Council varies depending upon the partisan composition of the federal and Länder governments, with Bundesbank behaviour at its most independent when opposition parties are responsible for the appointment of the majority of the Bundesbank Council.⁷ Some go even further, suggesting that popular support for the Bundesbank's price stability mandate provides the real basis for such long-term success.⁸ This developing literature suggests two related themes: first, that the anticipated actions of the Bundesbank can influence other political and social actors; and second, that the Bundesbank itself is aware of its role in shaping the strategic behaviour of other actors.

The Bundesbank's sphere of independent activity is limited to the conduct of monetary policy. It has no statutory role in issues of fiscal policy foreign economic policy or social policy. Yet, this does not mean that it is without influence – indeed, the Bundesbank is regularly consulted on these issues, and its response to government initiatives can be crucial in the development of policy. Nevertheless, the Bundesbank's success in translating its preferences into government policy varies depending upon the government's domestic political support for its policies. Because the elected government itself does not control monetary policy, its economic policy options in other areas are often restricted by an unaccommodating Bundesbank.⁹ The Bundesbank's informal influence was evident in the case with Economic and Monetary Union, a government policy for which there was no popular enthusiasm.

In developing these non-monetary policies, the government has broad discretionary powers, and the Bundesbank can only react to the general policy direction that the government initiates. The Bundesbank can provide advice about the wisdom and viability of policies, but, as an agency of the government, it cannot initiate political projects itself. While political decisions often have indirect implications for the conduct of monetary policy, the Bundesbank's competencies are technical and economic. Political decisions about the direction of policy remain in the hands of elected officials in the executive and legislature. Within this initial framework, there is still scope for political activity on the part of the Bundesbank Council. The Bundesbank can either support or oppose the government's policy initiatives. When the Bundesbank is supportive, the government's initiative is usually enacted into law. This was the case with

the reform of the Bundesbank Law in 1992, when the Bundesbank encouraged and cooperated in its own reorganisation in the wake of unification, even though the governing parties used the opportunity to reduce the influence of Länder led by the opposition Social Democrats.¹⁰ However, when the Bundesbank opposes a government policy, there are two possible consequences depending upon whether the public is supportive of the Bundesbank's position or the government's. If the public backs the government, then the government is able to forge ahead with its policy in the face of the Bundesbank's concerns, as happened with German Economic and Monetary Union in 1990. If, on the other hand, the public is supportive of the Bundesbank, as it was during the gold crisis and with EMU more generally, the government comes under increasing pressure to accommodate the Bundesbank's concerns in order to forestall domestic opposition to its policy. The government is still able to pursue its preferred policy, but only under conditions that the Bundesbank finds acceptable.¹¹

This can be a major domestic constraint on an elected German government's ability to pursue policies that are both resisted by the Bundesbank and that are domestically unpopular. At the same time, however, the German government can also exploit its own weakness vis-à-vis the Bundesbank to empower itself in international negotiations. In international negotiations, the German government is able to present the opposition of the Bundesbank as a serious impediment to its ability to secure the domestic ratification of any agreement. As a consequence of the limited range of its domestic 'win set', the German government is able to obtain international agreements that much more closely correspond to its own domestic political priorities than it would have if an independent central did not exist.¹²

The Bundestag and Bundesrat

Unlike the first-past-the-post system in Britain, the German electoral system for the lower house of parliament, the Bundestag, contains a combination of majoritarian and proportional elements. In federal elections, each voter receives two ballots, one for their constituency and one for regional party lists. One-half the members of the Bundestag (MdBs) are chosen based upon a plurality of votes received on the individual constituency ballots. The other half of the Bundestag is selected from party lists in each Land based upon the proportion of votes each party list receives on the second ballot. The seats assigned to

parties under the list system are allocated in order to create a proportional partisan outcome for each Land, with all parties winning more than 5 per cent of the vote receiving seats in proportion to their share of the vote. Parties which win three direct elections are also entitled to a proportional share of seats, a variation on the 5 per cent rule which enabled the PDS to receive proportional Bundestag representation in 1994 with only 4.4 per cent of the vote based upon its victories in four East Berlin constituencies. The outcomes are not always proportional as, on occasion, a party will win more direct seats than would be assigned to it based upon a proportional outcome. This has a tendency to happen when one party wins an overwhelming number of the direct mandates in a Land. Parties winning these extra seats are allowed to keep their so-called 'overhang mandates', (*Überhangmandate*) which are added as additional seats to the Land's delegation. This is a matter of some concern in close elections – for example, in 1994, the CDU won 16 overhang mandates while the SPD captured four. With the overhang mandates included, the Christian-Liberal coalition had a small majority (341 out of 672 seats). Without the overhang mandates, they would have fallen two seats short of a majority (325 out of 652 seats).¹³ In 1998, the SPD was the beneficiary of 13 overhang mandates.

Nevertheless, representation in the Bundestag is proportional and, with majority votes for one party being extremely rare, coalition government has been the norm for post-war Germany. This puts an extremely high premium on party discipline. Party managers have a variety of means of influencing Members of the Bundestag (MdB), the most important of which is the power to select and arrange positions on the parties' electoral lists. Party loyalists receive higher places on the party lists. Since a higher position on a party's electoral list increases a candidate's chances of entering the Bundestag, ambitious politicians have incentives to be faithful to their party's leaders. Each Land party controls nominations in the constituencies and arranges positions on the party lists, so each party has clear mechanisms of control over its MdBs.

Most legislation must also pass through the upper house of the German parliament, the Bundesrat, where Minister-Presidents represent each Länder, which can delay or amend government legislation that affect the Länder. This accounts for approximately two-thirds to three-quarters of all legislation, including all international agreements that would alter Germany's constitutional structures. Unlike the Bundestag, the partisan composition of the Bundesrat can change over the life of a Parliament. Whenever a Land election brings a different

party or coalition of parties to power, the new coalition takes over the Land's representation in the Bundesrat. An opposition majority in the Bundesrat can obstruct the legislative programme of the government and force a degree of compromise that is absent when the governing coalition commands a majority in both the Bundestag and Bundesrat. The Bundesrat also defends the interests of individual Länder, so even a friendly partisan majority in the Bundesrat will not necessarily co-operate with the federal government if the central government appears to be threatening prerogatives of the Länder.¹⁴

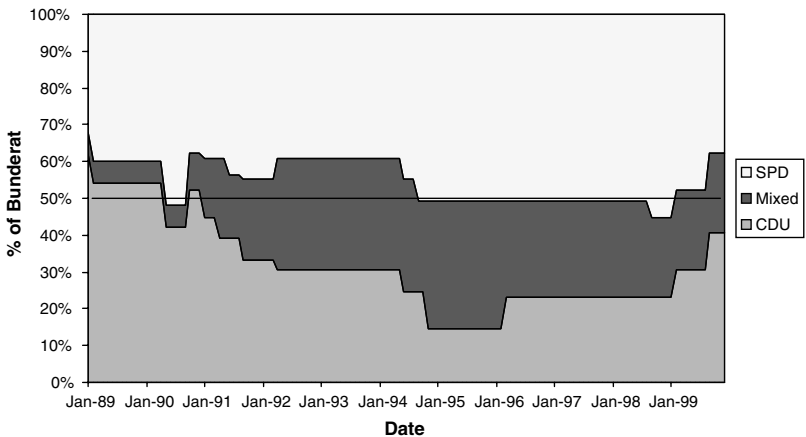


Figure 1.1 Bundesrat Representation, 1989-99

Note: State governments ruled by the CSU, CDU or CDU in coalition with the FDP are counted as 'CDU' Bundesrat delegations. SPD and SPD-Green governments are counted as 'SPD' delegations. State delegations from states with a mixture of Bonn-coalition and opposition parties are coded 'mixed'.

Two-thirds of the members of the Bundestag and two-thirds of the votes cast in the Bundesrat are necessary for the approval of international agreements, such as the Maastricht Treaty, affecting the German Basic Law.¹⁵ Because of the proportional system of representation in the Bundestag and the relative parity of the major parties, this constitutional provision effectively required cooperation between the government and the major opposition party – in the early 1990s, the SPD – in order to successfully ratify the Maastricht Treaty. Thus, parties that are ostensibly in opposition to the federal government also are active participants in both the formation and implementation of government policies.¹⁶

Parties

Political parties in Germany have a constitutionally-acknowledged role in 'forming the political will of the people'.¹⁷ German parties receive funding not only from membership fees and private donations, but also from massive state subsidies. These state funds are under the control of central party officials and are spent for election campaigns, party propaganda, and the maintenance of vast party bureaucracies tasked to develop party policies and electoral strategies. In 1997 – a rare year in which there was only one state election in all of Germany – out of the SPD's total income DM281 million (£102 million), about one-third, DM90 million (£32.7 million), came from the state subsidy.¹⁸ The CDU/CSU received an equivalent amount of support, DM92.6 million (£33.7 million) out of a total income DM275 million (£100 million). The high level of funding (both from the government and from donors) allows each of Germany's major parties to employ a large party machinery which, coupled with a long-term decline in mass membership, has created organisations that increasingly resemble a centralised 'party of professional politicians'.¹⁹

An expert survey of party orientation towards increased European integration reveals that all the mainstream German parties are considered to be strongly pro-integration. Only some of the smaller fringe

Table 1.1 Party Positions and Dissent on European Integration, 1988–96

	<i>Position on European Integration (1)</i>			<i>Importance of Issue (2)</i>			<i>Extent of Internal Dissent (3)</i>		
	1988	1992	1996	1988	1992	1996	1988	1992	1996
Germany									
CDU	6.86	7.00	6.86	3.43	3.86	3.86	1.00	1.57	1.86
CSU	6.29	5.43	5.43	2.86	3.43	3.71	1.57	2.00	2.43
SPD	6.29	6.14	5.71	3.00	3.43	4.00	2.00	2.29	2.86
FDP	6.71	6.71	6.71	3.29	3.86	3.86	1.17	1.29	1.29
Greens	3.71	4.71	4.86	2.57	3.14	3.29	2.57	3.00	2.71
PDS		3.57	3.57		1.86	1.86		1.83	1.60
Republikaner	1.57	1.29	1.29	2.86	3.14	3.00	1.71	1.71	1.71

Source: Ray, Leonard (1999) 'Measuring party orientations towards European integration: Results from an Expert Survey' *European Journal of Political Research* Vol. 36, No. 2, pp. 295, 299.

Notes: (1) Position of European integration is on a scale of 1 (most opposed) to 7 (most supportive).

(2) Importance of issue is on a scale of 1 (least important) to 5 (most important)

(3) Extent of internal division is on a scale of 1 (united) to 5 (most divided)

parties of the far left (PDS) and far right (Republikaner) were consistently opposed. As Table 1.1 indicates, these positions have not been constant over time, with some parties experiencing decreased enthusiasm for European integration while others became more positive. In general, the level of dissent within almost all German parties rose over the course of the 1990s. All Bundestag parties, however, displayed greater levels of support for European integration than the British Conservative Party, which averaged a score of between 3.50 and 3.88 (out of 7.00) between 1988–96.²⁰

Christian Democratic Union (CDU)

The CDU under the leadership of Chancellor Helmut Kohl was the senior governing party in coalition with its junior partners, the CSU and the FDP, from 1982 until 1998. The CDU tended to be a strong supporter of a 'social market economy' as distinct from a neo-liberal market economy. It had a strong labour wing anchored in the Christian trade union movement and was consequently less enthusiastic than the Free Democratic Party about rolling back the welfare state. At the same time, the CDU was the most enthusiastic of the German parties about European integration and EMU. Like Christian Democratic parties elsewhere in Europe, the CDU saw European integration, in part, as a trans-national Christian Democratic project.²¹ However, as a party of the centre-right, the CDU faced some electoral vulnerability from parties of the extreme right on nationalist issues, a political threat which occasionally tempered the party's enthusiasm for greater European integration.

The national party is a federation of Land parties with delegates from each of the Länder voting every two years at the CDU national conference on candidates for party president and the executive committee. Nevertheless, in spite of the high level of internal participation and the party's federal structure, Kohl, the party's president from 1973 until his electoral defeat in September 1998, dominated the politics and operations of the CDU throughout his tenure as party leader. As party leader for a quarter of a century, Kohl's influence over the party structure and the careers of ambitious party members was extensive. While Helmut Kohl's leadership position was briefly challenged on several occasions prior to 1990, throughout the 1990s, at least 90 per cent of delegates always endorsed him as party president at the CDU's biennial national conference. The last challenge to Kohl's leadership came in 1989, just prior to German unification and resulted in his endorsement by 77 per cent of the delegates and the ruthless removal

of his challenger, Lothar Späth, from the CDU's Executive Committee. After German unification, Kohl's position as the 'Chancellor of Unification' made his position within the party virtually impregnable. Kohl's control over the dispersion of national party funds to local party organisations and the existence of a party slush-fund also played a still undetermined role in securing his political position. There remained some pockets of dissent within the party; however, they were almost solely represented in the CDU at the level of the Land parties and their powerful Minister-Presidents, rather than in the party's Bundestag delegation.²²

Christian Social Union (CSU)

The Christian Social Union is the Bavarian sister-party of the CDU. It is more conservative than the CDU on social issues and also has a specifically Catholic, rather than broadly Christian, orientation. As a party that competes in only one Land, the CSU is very sensitive to issues affecting the relative balance of political power between the federal government and the Länder. Consequently, the CSU has traditionally been wary of transferring political competencies to European institutions on the grounds that such transfers diminish the power of the Bavarian government (and the other Land governments). At the same time, it has sought to maximise its influence within European institutions both through engineering the appointment of CSU members and party personnel to EU bodies and through promoting a European role for regional governments like Bavaria.²³

The party's two most powerful figures are the Minister-President of Bavaria and the leader of its Bundestag delegation. Except for a brief period in the 1950s, when all the other parties in the Bavarian Landtag formed a five-party coalition, the CSU has been the governing party in Bavaria. Consequently, the Minister-President of Bavaria, as the highest-ranking elected official in Bavaria, is a very influential member of the party. Preserving its Bavarian majority has always been the Minister-President's primary electoral objective. As a key ally of the CDU in Bonn, the CSU's Bundestag delegation provides access to power in the federal government. When a CDU-led coalition is in power, the leader of the CSU's Bundestag faction is the CSU's most senior national official and is likewise very influential. Maximising the CSU's power within the governing coalition in Bonn is the primary consideration of the Bundestag leader. Usually either the Minister-President or the Bundestag leader also holds the post of CSU party chairman.

The bifurcation of power between the CSU in Munich and the CSU in Bonn caused the party difficulties in developing a consistent policy on EMU. The CSU leader in the Bundestag, Theo Waigel, was the Finance Minister who had negotiated the EMU components of the Maastricht Treaty. He also had pressed his fellow EU finance ministers to accept the Stability and Growth Pact and was responsible for the overall fiscal position of the German government. His extensive personal involvement in the formulation and implementation of the EMU project effectively committed the CSU's Bundestag faction to a favourable position towards monetary union. The CSU in Munich, and in particular the Minister-President of Bavaria, Edmund Stoiber, was less directly tied to the Kohl regime and its major undertakings. Ever concerned about federal encroachments on Land prerogatives, Stoiber and many in the Munich Landtag were openly sceptical of EMU. However, their ability to express these frustrations and influence federal policy was restricted to Bavaria's six votes in the Bundesrat. As the Bavarian-based party was in general supportive of the federal government, its opportunity to obstruct implementation of EMU was limited.

Free Democrats (FDP)

The Free Democratic Party, while polling a mere 5–10 per cent of the vote nationally, was the key coalition partner for both the SPD and the Union parties for almost thirty years (1969–1998). From 1974 until 1992, the FDP's leader, Hans-Dietrich Genscher, held the post of German Foreign Minister. In this position, Genscher played a pivotal role in the unification of Germany and in negotiating the Maastricht Treaty. The FDP's ideology is liberal in terms of economic policy, where it favours lower taxes and the removal of government regulations, and in social policy, where it favours an expansion of civil liberties. The party has been united in support for market-oriented economic policies but suffered divisions in the 1990s over law and order issues. One wing of the party favoured tougher anti-crime legislation, while a dissenting minority emphasised procedural protections. On European policy, the party was a strong supporter of increased European integration with particular emphasis on increased trade and financial interdependence.²⁴

The FDP has won representation in Bonn by surpassing the 5.0 per cent electoral hurdle rather than winning any direct constituency elections. As a result, its Bundestag delegation is selected entirely from regional party lists. The party traditionally concentrated its energies on

preserving its position as a member of the national governing coalition. However, in the 1990s, the FDP enjoyed sporadic success in the eastern Länder. It initially performed quite strongly in the new federal states, in part due to the east Germans' familiarity with Genscher's international profile prior to unification and the popularity of many FDP mayoral candidates. However, after Genscher's retirement and the post-unification economic depression, the FDP suffered massive electoral losses throughout eastern Germany. Thereafter, the party sought to enhance its electoral prospects through cultivating its image as the party of lower taxes and limited government.²⁵

Social Democrats (SPD)

The centre-left SPD is the oldest, most centralised and bureaucratised of the German political parties.²⁶ The party has traditionally supported European integration as part of wide-ranging support for multi-lateral initiatives and international cooperation more generally. The SPD's reaction to the Maastricht Treaty was mixed. While welcoming the Social Charter, the party expressed concerns that the pro-business elements of the Single European Act were strengthened and that the budgetary criteria for compliance with the Maastricht Treaty were a backdoor means of rolling back the domestic welfare state.²⁷ This cleavage between the party's support for deeper European integration and its resistance to reforming the German welfare state provoked a long debate within the party's leadership circles over the SPD's optimal strategy. These divisions on EMU were also reflected in the major German unions, especially the *Deutscher Gewerkschaftsbund* (DGB).²⁸

The SPD's position as a quasi-government party complicated this debate. While it was the primary opposition party at the federal level from 1982 until 1998, the SPD was also the governing party in many Länder throughout the period. Its strength at the Land level translated into a Bundesrat majority briefly in 1990 and from 1992 until 1999. The Social Democrats used their Bundesrat majority, particularly after 1994, to impede the passage of the Christian-Liberal coalition's economic policies, extracting extensive concessions for their acquiescence to any economic reforms.²⁹ When the Federal Constitutional Court ruled that both the Bundestag and Bundesrat would need to approve Germany's final commitment to enter EMU in 1998, the SPD's majority in the Bundesrat meant that it was completely co-opted into sharing responsibility for ratifying the Maastricht Treaty. Of equal importance, the SPD's strength exceeded one-third of the votes in both houses of the German parliament, the minimum necessary to block

changes to the Basic Law. This level of representation meant that its active cooperation was necessary for the passage of the Maastricht Treaty.

Unlike the Christian Democrats, the SPD possessed an extremely centralised party apparatus that exercised a great deal of control over its subordinate bodies. Power was concentrated in the hands of the 13 member party presidium, a group that was itself dominated by party office-holders. In 1992, the party employed over 1,200 staff members (300 in the national headquarters and 900 more in the *Länder*) to develop policy, serve member needs, and conduct electoral campaigns for the party at the local, state, and federal levels.³⁰ Unlike the British Labour Party, the trade unions do not have an official representative status at the SPD's national convention. Only delegates representing different district and Land associations can vote for party leaders and policies. The power of the convention (and hence of the party activists) was limited during the 1990s, and the hands of party leaders were further strengthened through the grant of direct votes on policies, framed by the SPD's leaders, to the membership itself rather than being limited to the activists who attended the biennial convention.³¹

Greens

Germany's post-materialist, environmental party, the Greens, was less supportive of European integration than the other parties. Favouring local democracy and smaller political units, the Greens were wary of transferring additional authority to a European-level institution so far removed from the electorate. However, over the course of the 1990s, the Greens increasingly came to recognise advantages in trans-national cooperation, particularly in resolving ecological problems, and their suspicion of the European Union diminished marginally.

The Greens, as a party of the New Left, were often seen as a potential coalition partner with the SPD, a view which was realised at the federal level after the 1998 elections. The major internal conflict within the Green Party revolved around the degree to which the party should cooperate with the SPD. Those supporting cooperation, the 'Realos', believed that cooperation would strengthen pro-Green elements within the SPD and lead more rapidly to the social and ecological changes that the Greens espoused. Those that rejected the idea of cooperation, the so-called 'Fundis', argued that cooperation with the SPD meant compromising Green principles. Rather, they believed that attempting to broaden social awareness of and opposition to the existing undesirable environmental policies was the preferred strategy for promoting

Green objectives. By the early 1990s, after several successful red-green coalitions at the Land level, the Realos, identified most often with Joscha Fischer, emerged as the dominant wing of the Green Party.³²

The Delors Report

Throughout the 1980s, several European states, most notably France, had tied their currencies to the Deutschmark in the European Monetary System (EMS) in order to provide an external restraint on inflationary forces within their own economies (among other reasons). After a fitful start characterised by frequent devaluations against the Deutschmark, the EMS had achieved a fair amount of exchange rate stability by the late 1980s. Inflation rates in other European countries had also dropped substantially during this time frame. Still, several of these countries chafed at their monetary dependence on the German currency and the position of the Bundesbank within what was intended to be a cooperative monetary framework. While the Bundesbank looked at Germany's economy for its policy priorities, other countries had to follow the lead of the German central bank regardless of their domestic circumstances.³³

An EMU with a European Central Bank (ECB) managing a single currency would give French, Belgian, and Dutch central bankers a seat at the policy-making table on equal footing with the Bundesbank. The European Commission was also strongly supportive of anything that would enhance the powers of European-level institutions. The concept of EMU received support from the German Foreign Minister, Hans-Dietrich Genscher and his Free Democratic Party, and even received rhetorical support from Chancellor Kohl.³⁴ At the European summit in Hanover in 1988, the President of the European Commission, Jacques Delors, was appointed chair of a committee of central bankers and monetary experts which was assigned the task of writing a proposal for Economic and Monetary Union for the European Community as a whole. Karl-Otto Pöhl, as president of the Bundesbank, was on the committee and contributed to the drafting of the report. While Pöhl was wary of deeper monetary integration, he constructively contributed to the discussions. His presence on the committee made him a party to its conclusions and 'bound in' the Bundesbank.³⁵

On the monetary committee, Pöhl's relationship with Delors was rocky, but Delors needed Pöhl's support for EMU if his dreams of a single European currency were to be realised. In the end, when it was released in April 1989, the Delors Report 'represented overwhelmingly

a victory for Bundesbank positions'.³⁶ The document explored the feasibility of EMU and the practical steps that would need to be taken to achieve it. The Delors Report called for moving towards monetary union in three stages, each involving progressively greater integration and culminating in the creation of a single currency under the control of an ECB. The future ECB itself would, like the Bundesbank, have an explicit mandate of price stability and be independent of political influence from either the member states or the European Commission. Pöhl himself thought that the price stability clause was 'the most beautiful statement in the document'.³⁷

German unification and the Maastricht Treaty

German unification fundamentally changed the incentives facing Germany's politicians. This unexpected opportunity to achieve the central goal of post-war West German foreign policy – the peaceful unification of east and west Germany within the existing political structures of the NATO alliance and the west German state – was an accomplishment of fundamental importance to Germany's political and economic elites.³⁸

Popular pressure for unification was extremely high, especially in the east. In early 1990, 84 per cent of east Germans expressed support for unification.³⁹ The Kohl government's rapid movement towards German economic and monetary union was met with overwhelming support as the eastern electorate rejected the SPD's call for caution and gradual unification. The CDU promised that German economic and monetary union (GEMU) could coincide with a favourable exchange of east Germans' ostmarks for deutschmarks. The economic concerns of the Bundesbank that a 1:1 exchange rate between the ostmark and the deutschmark was unsustainable were subordinated to the government's political interest in making unification as rapid and economically palatable to easterners as possible.⁴⁰ Afterwards, the economic measures taken to expedite German unification and make the process politically acceptable to east Germans created serious economic liabilities for Germany; however, at the time, politicians and business leaders believed that the political imperatives were overwhelming.⁴¹

The monetary measures that the Kohl government took over the objections of the Bundesbank were accompanied by a reinvigorated commitment to European institutions and European integration. At the Strasbourg Summit in December 1989, Kohl, under pressure from other European leaders concerned about the consequences of German

unification, agreed to a full Intergovernmental Conference that included EMU as its principle topic.⁴² Kohl sought to start the conference in December 1990, after the first all-German elections, so as to reduce the possibility of injecting whatever concessions he might make at the summit into an election campaign.⁴³

Kohl and Genscher were able to use the geopolitical circumstances surrounding German unification to overcome domestic impediments to EMU. Because of these unique political circumstances, Germany's leaders had greater freedom of action than they would have had in the absence of unification. Andrew Moravcsik's assertion that the Bundesbank's 'power and position remained constant' during this time-frame is not entirely correct.⁴⁴ This is not to say that Kohl and Genscher were unconstrained by domestic factors, particularly the Bundesbank; rather, it is merely to suggest that the Bundesbank's position was stronger both prior to the process of German unification and afterwards than it was during the process itself. Under normal circumstances, the Bundesbank could rally public and business opinion to prevent policies such as a massive expansion of the domestic money supply and movements towards a European central bank; however, in the unique circumstances of German unification, the Bundesbank was limited in its ability to influence the contours of the government's policies. In the case of EMU, rather than being able to successfully resist the policy itself, the Bundesbank had to settle for influencing the shape of the policy.⁴⁵

In the Maastricht negotiations, although the Finance Ministry was the party responsible for negotiations, it worked closely with Bundesbank officials to prepare the German negotiating position. While the Foreign Ministry was very much pro-European and pro-EMU, reflecting the pro-European credentials of Genscher and the small FDP, the Finance Ministry was much more concerned with obtaining an agreement that would be acceptable to German public opinion, and that meant obtaining an agreement acceptable to the Bundesbank. The monetary articles of the Maastricht Treaty clearly reflected German preferences; indeed, the draft ECB statute began as a German text.⁴⁶ The German negotiating position substantially prevailed in almost every major issue area dealing with EMU: an independent central bank with a goal of price stability, strict economic criteria for membership, and a no bail-out clause. In contrast, the German government was unable to achieve many of its objectives for European Political Union (EPU), an issue area where it did not need the Bundesbank's support.⁴⁷ For this perceived failure, Kohl was the recipient of substantial public criticism from the opposition parties.⁴⁸

The particular institutional reforms for EMU agreed to in the Maastricht Treaty on European Union (TEU) entailed a major shift in monetary policy decision-making authority to the EU level with a removal of that authority from the control of domestic policymakers. For several of the weaker currency countries, the treaty also entailed the creation of a new set of macroeconomic priorities. Economic and monetary union created a single currency among the participating states and a common monetary policy. The charter of the planned European Central Bank was modelled on that of the German Bundesbank with its emphasis on price stability and institutional independence. As a result, the overall direction for German monetary policy was relatively unchanged, although the ECB would look at European-wide conditions, rather than solely German conditions, in determining the extent of its anti-inflationary policy.

Like the Bundesbank Law and the Delors Report before it, the Maastricht Treaty is explicit in its declaration that price stability is the primary objective of the ECB and pursuit of this objective shall take precedence over all other goals.⁴⁹ To facilitate obedience to this institutional mission, the ECB's charter goes to great lengths to insulate the institution from political pressures to inflate the currency. The ECB's Governing Council is composed of the governors of the member states' central banks plus an Executive Board of six members appointed by unanimous agreement of the member states (these six include the President and Vice President of the ECB) and will make all the ECB's decisions regarding monetary policy. To further immunise the members of the Executive Board from national political pressures, they are appointed to non-renewable eight-year terms and cannot be replaced during their terms of office.⁵⁰ The power to fire and hire the Executive Board of the ECB is removed from the hands of elected officials. National leaders are also deprived of much of their former leverage over the governors of national central banks. Governors of national central banks will have five-year minimum terms and cannot be removed from office during their term of appointment except for failure to perform their duties or gross misconduct.⁵¹ The ECB's constitution reinforces its independence by prohibiting the ECB and national central banks from receiving instructions from member governments or other Community institutions.⁵²

In the run-up to monetary union, potential participants were required to meet a series of economic criteria, the most important of which were controls on government budgets. The five convergence

criteria referenced in Article 109j(1) of the TEU for EMU required participation from member states that:⁵³

- (1) remain within the 'normal fluctuation margins' of the ERM without devaluing for a period of two years.
- (2) maintain an inflation rate within 1.5 per cent of the average of the best three EU performers for one year.
- (3) maintain long-term interest rates within 2 per cent of the average of the best three EU performers for one year.
- (4) maintain a total public sector debt of under 60 per cent GDP in the year prior to selection.
- (5) run a public deficit under 3.0 per cent of GDP in the year prior to selection.

The inflation and interest rate targets were consistently met by almost all EU members, although the 'normal fluctuation margin' of the ERM was redefined after the currency turbulence of 1992–93 to mean wide bands of ± 15 per cent instead of the ± 2.25 per cent that had earlier been the rule. In practice, most countries' currencies fluctuated within 5 per cent of each other even after the exchange rate crisis. The long recession of the late 1990s put EU public finances under great strain, but the treaty's ambiguous language allowed for member states to be 'approaching' the reference values, with the acceptable rate of approach left up to politicians to judge.

Ratification of the Maastricht Treaty in Germany was relatively uncontroversial, although the manner in which it took place highlighted the extent to which the federal government depended upon support from the SPD and the Länder. The SPD's leaders were primarily concerned with the relative weakness of the EU's democratic institutions, particularly the European Parliament, rather than with the consequences of EMU. The SPD's national chairman, Björn Engholm, accused Kohl of having 'simply buckled at the knees.... Contrary to what he promised in advance, he voted for the European currency, without ensuring that the future European Union will be democratic enough'.⁵⁴ In his failure to insist on linking political union with economic and monetary union, Kohl had, the SPD believed, squandered a key bargaining chip.

By insisting that the constitutional changes contained in the Maastricht Treaty made approval by two-thirds of both the Bundestag and Bundesrat mandatory, the SPD accepted that its support was necessary for the ratification of the treaty. Oskar

Lafontaine's suggestion that the deficiencies in the treaty relating to the European Parliament would justify rejection of the treaty in the Bundesrat were brushed aside by his colleagues as inconsistent with the SPD's declared policy on European affairs.⁵⁵ However, the SPD, while supportive, also exacted a price from the government in exchange for its cooperation. In return for guaranteeing the Maastricht Treaty safe passage through both houses of the German parliament, the SPD demanded a series of amendments to Germany's Basic Law to govern future relations between Germany and the European Union in addition to the technical changes the agreement made necessary.⁵⁶

The SPD's principle demand was for a constitutional amendment that gave the Bundestag and Bundesrat explicit competence over approving future grants of sovereignty to the European Union. They also requested an amendment guaranteeing the Länder's role in negotiating and implementing policies in all issues that were under the domestic control of the Länder. The Länder welcomed the SPD's reforms as they saw the federal government's relatively unfettered ability to transfer power (including the Länder's powers) to European institutions through its monopoly on foreign relations as the 'open flank' in German federalism.⁵⁷ The SPD also extracted a so-called 'eternity clause' that enshrined Germany's priorities for European integration as a commitment to

the development of the European Union that is committed to democratic, social, and federal principles, to the rule of law, and to the principle of subsidiarity, and that guarantees a level of protection of basic rights essentially comparable to that afforded by [the] Basic Law.⁵⁸

The Basic Law was also amended to strengthen the position of the Bundesbank. Where the earlier version of the Basic Law had simply granted the federal government the right to create a national central bank, the revised articles not only granted the federal government the authority to create a central bank, but also situated the bank within the proposed EMU context:

Within the framework of the European Union, [the Bundesbank's] responsibilities and powers may be transferred to a European Central Bank that is independent and committed to the overriding goal of assuring price stability.⁵⁹

This was extremely innovative for three reasons. First, it placed the Bundesbank's competencies within the Maastricht Treaty's framework. Second, it did so with the policy caveat that the European Central Bank had to remain committed to price stability. But perhaps more importantly, it moved the guarantee of the Bundesbank's own independence and goal of price stability from the level of statutory law to constitutional law. Previously, the Bundesbank Law, which was subject to change by a ruling coalition, governed the Bundesbank's position in the German political and economic system. After the adoption of Article 88 to the Basic Law, the Bundesbank enjoyed enhanced protection as only a constitutional amendment (requiring two-thirds votes in both houses of parliament) could alter its status.

Other than the technical changes, the federal government was reluctant to acquiesce to the SPD's constitutional demands. However, it had no alternative means to enact the treaty, and the constitutional revisions relating to the *Länder* were popular with the Union's *Länder* members. The Bavarian CSU was extremely enthusiastic about the proposals for greater *Länder* influence. Only the FDP was resistant, but its opposition, based mainly on its strength at the federal (as opposed to the *Länd*) level and its control over the Foreign Ministry, was easily overridden.⁶⁰

The government was more reluctant to agree to a Bundestag resolution that the SPD proposed which would allow a second vote in the Bundestag and Bundesrat prior to German entry into the third stage of EMU. Rather than joining EMU automatically in 1997 or 1999 as the Maastricht Treaty dictated, the SPD suggested that the German parliament re-evaluate the sustainability of EMU prior to entry. The government was wary of creating a unilateral German 'opt-out', and argued that in spite of the SPD's motion, Germany was still committed to membership in EMU.⁶¹ In a special sitting in December 1992, the Bundestag approved the Maastricht Treaty with an overwhelming vote of 543–17, only the Party of Democratic Socialism (PDS), the East German Communist-successor party, voting in opposition. The SPD's resolution calling for final Bundestag approval was also accepted overwhelmingly as were the constitutional amendments that the opposition and *Länder* had requested. Two weeks later, on 18 December 1992, the Bundesrat unanimously approved the Maastricht Treaty and the necessary constitutional revisions. The SPD's leadership triumvirate of Gerhard Schröder, Oskar Lafontaine, and Rudolf Scharping were among the Minister-Presidents voting to ratify the Maastricht Treaty and EMU.

The politics of convergence

From 1992 through 1998, the centrepiece of Kohl's European policy was German participation in EMU. While Kohl and his coalition were able to steer Germany towards this ultimate goal, the path was not free of conflict. Both the SPD and the Bundesbank at various times threatened the fulfilment of the government's EMU policy. German politicians spent the seven years leading up to monetary union attempting to enforce the reference values as rigid rules, rather than allowing for a flexible interpretation of the criteria. The German constitutional court bolstered the SPD's political position by supporting the Bundestag's resolution requiring final Bundestag and Bundesrat approval for the final stage of monetary union after receipt of a Bundesbank report in 1998 on the proposed members' level of convergence.⁶² The Bundesbank reserved for itself the right, under its obligation to safeguard the value of the currency, to produce a report in 1998 not only on the German government's success in meeting the criteria, but also on the success of all the other potential members in fulfilling the economic targets. Bundesbank support for the government's EMU policy was conditional upon the government obtaining the adherence of other countries to the Maastricht criteria as a set of hard fiscal targets. While the Bundesbank's role was only advisory, it had the capacity to arouse public opinion if it were to write a report that was overly critical of the EMU project.

Public opinion in Germany was only briefly favourable to a single European currency, and then only in the days of heady Europhoria that preceded the fulfilment of the 1992 project. Survey data collected by the European Commission revealed that for a period of six years, from 1992 until the end of 1997, more than half of the German respondents regularly opposed giving up the deutschmark for the euro. The gap between those opposed to EMU and proponents of the single currency was consistently greater than 10 percentage points and often above 20 per cent; the size of the opposition in Germany frequently exceeded the margin of opposition in the United Kingdom.⁶³ Independent media polls in Germany also revealed a lack of enthusiasm for monetary union. Consequently, the threat to EMU posed by public opinion hung like the sword of Damocles over the head of the federal government during the entire period.

The (Growth and) Stability Pact⁶⁴

In response to the German public's reluctance to give up the deutschmark, the Finance Ministry began a massive public relations campaign under the

slogan: 'the euro: as strong as the mark'.⁶⁵ Even with the support of the state information apparatus, the single currency failed to excite any enthusiasm from the German public. Polls in early 1997 showed that nearly two-thirds of the German population continued to oppose giving up the mark for the euro.⁶⁶ Widespread but unmobilised antipathy towards the centrepiece of the German government's European policy existed throughout Germany. Most mainstream opponents of the single currency were reluctant to mount a frontal attack on the European Union; instead, they made their opposition more nuanced, declaring their support for a single currency in principle, but only one where all the member states met the criteria.

When the Maastricht Treaty was ratified in 1992, it did not appear that Germany would have much difficulty meeting the economic criteria for EMU membership. In strictly fulfilling the TEU's qualifications, the government could assuage public fears about the economic risks of EMU while putting itself in a position to pressure other members to tighten their budgets in preparation for EMU. The German government's strategy was mutually reinforcing, but it depended entirely on fulfilling the convergence criteria laid out in the TEU. If Germany strayed on the wrong side of the criteria, its ability to criticise other countries whose deficits also exceeded 3.0 per cent would be seriously undermined. With an uncertain public, a sceptical central bank, and a constitutional decision in its way, the German government would have been hard-pressed to pursue any policy other than a strict interpretation of the Maastricht criteria. German politicians took the convergence criteria as firm targets, and the government was relentless in its declaration that all potential members must meet the targets. While this kept public opinion at bay, it committed the coalition to a very rigid interpretation of the Maastricht criteria that left the government ill-prepared to deal with the political and economic crises that confronted them in the 1990s.

Waigel, who as Finance Minister was responsible for the overall budget position of the federal government, faced additional pressures from within his own party. While Waigel was the nominal leader of the CSU, the Minister-President of Bavaria, Edmund Stoiber, was his chief rival for the position. Stoiber harboured ambitions to lead the CSU and combine the offices of Minister-President of Bavaria with those of the party chairman, the post held by Waigel. Waigel, too, had desired to combine both of these powerful positions in his own hands, but Stoiber had thwarted Waigel's attempt in the early 1990s to return to Munich as Bavaria's Minister-President. The growth of support for

right-wing nationalists, the Republikaner Party, in Bavaria threatened the CSU's absolute majority in the Bavarian Landtag and exacerbated the personal rivalry between Stoiber and Waigel.⁶⁷

With his base of support threatened by a nationalist party whose appeal stemmed at least in part from its populist support for the deutschmark, Stoiber moved increasingly to the right to protect the CSU's electoral position from Republikaner encroachment.⁶⁸ Stoiber staked out a position of strict compliance with the Maastricht Treaty, arguing that anything short of a strict interpretation of the convergence criteria would lead to a euro weaker than the deutschmark. If Waigel could not hold the line on government spending, he would have opened himself up to harsh criticism from Stoiber that could undermine his position as leader of the CSU. This led Waigel to articulate a particularly hard-line view of the convergence criteria, repeatedly declaring when referring to the deficit criteria that 'three point zero means three point zero'.⁶⁹ This position succeeded in holding both Stoiber and the national opposition at bay.

Waigel's strategy also contained an international element which strengthened the German government's negotiating position with its EU allies. At the time of the negotiations surrounding the Maastricht Treaty, the German government had agreed to monetary union with the strict convergence criteria on the assumption that Germany would easily achieve the targets. Since many countries were not expected to meet the criteria, Germany would thus be in a position to select its partners in EMU from those members with solid fiscal and monetary policies similar to Germany's. The debt-ridden, weak currency countries of the Mediterranean could be excluded under a fairly transparent set of selection criteria. However, for this strategy to succeed, Germany itself needed to meet the criteria. Otherwise, not only would domestic opponents of the single currency have an issue to derail EMU in Germany, but other EU countries could resist German demands for austerity and budgetary restraint as preconditions for membership. If, for example, Germany had a budget deficit of 3.5 per cent of GDP, it would be difficult for Germany to attempt to exclude Italy or Spain whose budget deficits might be 3.7 per cent of GDP.

German leaders were concerned not only with pre-EMU compliance, but also with the sustainability of the single currency. While the convergence criteria were generally applicable *prior* to a potential member joining EMU, there was little to prevent a country, *after* it had become a participant in the single currency, from implementing lax budgetary policies. As a result, a 'Trojan Horse' country could enter the EMU zone

and begin running excessive deficits, to the detriment of the currency as a whole. To forestall such a scenario, Waigel proposed that the members of the EU enter into a mutual 'Stability Pact', committing themselves not simply to the Maastricht criteria but to a system of automatic fines for members which exceed the TEU's reference values for public sector debts and deficits. The fines could only be suspended in the event of extraordinary circumstances – such as a natural disaster or a major economic depression – and were extremely large. Waigel's initial suggestion called for the fine to amount to 0.25 per cent of national GDP for every 1.0 per cent of GDP that a country surpassed the Maastricht deficit limits.⁷⁰

Many of Germany's European partners rejected Waigel's call for automatic sanctions, and many of the more deficit-prone countries expressed reservations that a system of fines for countries running deficits would impose additional burdens on countries that were already undergoing economic difficulties.⁷¹ The European Commission fashioned a compromise system of sanctions for fiscal imbalances that had both automatic and discretionary elements. A fixed fine of 0.2 per cent of GDP would be imposed, under the Commission guidelines for breaching the deficit limits. The fines would increase by 0.1 per cent of GDP for every additional 1 per cent of national GDP of deficit. The fines would be capped at a maximum of 0.5 per cent of GDP, with the potential of the fine being returned to the transgressor if it brought its accounts into alignment within two years. Exemptions were allowed only for countries that experienced falls in GDP of greater than 2.0 per cent in a single year.⁷² After nearly eighteen months of disagreements with the French, German leaders were able to gain approval of the European Commission's compromise Pact on Stability and Growth at the Amsterdam Summit in June 1997. Despite Waigel's success, he still came under attack from within his own party for not being enough of a fiscal hawk.⁷³

The March 1996 Landtag elections

The SPD's limited attempt to introduce an anti-EMU campaign theme into the March 1996 Landtag elections in Rhineland-Palatinate and Baden-Württemberg was the only effort to raise EMU as an electoral issue in the years prior to 1999. The SPD had mixed preferences regarding EMU. On the one hand, it hoped that a European Central Bank would be less deflationary and more expansionary than the Bundesbank. On the other hand, it feared that a strict adherence to the

convergence criteria in a time of deep economic recession would be used to reduce Germany's generous welfare state and lead to an intensification of domestic social conflict. While abhorring the cut-backs in the welfare state, the SPD had been reluctant to press the connection between the unpopular cuts and the single currency, even given the depth of national attachments to the deutschmark.

When he assumed the party leadership in 1995, Oskar Lafontaine declared that the SPD was the 'party of Europe' and sidelined his leadership rival Gerhard Schröder, the popular SPD minister-president of Lower Saxony and an EMU critic.⁷⁴ However, the SPD needed a national political issue to differentiate itself from the Kohl government. This became especially true as the SPD's control of the Bundesrat (35 of 69 votes in 1996) meant that it shared responsibility for many of the government's policies. Lafontaine moved to reduce the level of cooperation between the SPD-dominated Bundesrat and the government, effectively blockading much of the ruling coalition's legislation. At the same time, the SPD's leadership (primarily Lafontaine, Schröder, and Rudolf Scharping) sought a national issue to distinguish the SPD from the government. Contrasting the SPD's ideological opposition to reducing the welfare state with the government's proposals to meet the Maastricht criteria through fiscal austerity presented the SPD with a potential wedge issue.⁷⁵

The Baden-Württemberg Landtag election scheduled for March 1996 appeared to be a promising testing ground for an anti-EMU message. While the local economy was highly dependent on exports, it was also suffering the effects of the recession. And while the SPD was traditionally weak in Baden-Württemberg, it served in the government in a grand coalition with the CDU, courtesy of the right-wing Republikaner Party's strong showing in the 1992 Landtag elections. The Republikaner had received 10.9 per cent of the vote in 1992, one of their highest totals ever in a Landtag election. With populist right-wing sentiment expected to be high and a fairly low base of support to begin with, SPD leaders reasoned that a populist message would enable them to make inroads with right-wing voters while simultaneously appealing to the pro-welfare state sentiments of the SPD's traditional voters.

The federal government's coalition parties also faced serious problems in the March elections. At the start of 1996, the coalition only controlled two Länder (Bavaria and Saxony) for a total of ten votes in the Bundesrat.⁷⁶ It had little hope of reducing the SPD's hold on Schleswig-Holstein, and the FDP ruled in coalition with the SPD rather than the CDU in Rhineland-Palatinate. In Baden-Württemberg, rightist

support for the Republikaner party had cut into the votes of both the Christian Democrats and the Liberals and prevented them from forming a government there. The FDP had failed to reach the 5 per cent threshold in eleven of the twelve most recent Landtag elections, a string of defeats that left the party severely weakened at the Land level. Its position in Baden-Württemberg was considered particularly dire as that Land lacked a system of second votes. The three Land elections were considered a crucial bellweather for the Bonn coalition parties. Despite several years of decline following its successes in the first all-German elections in 1990, the FDP had undergone an ideological metamorphosis in the mid-1990s. Beginning in late 1995, the FDP sought to reverse its electoral fortunes and raise its profile with an aggressive emphasis on economic liberalism, particularly tax reduction and privatisation.⁷⁷

With the encouragement and support of the SPD's national leaders, the SPD in both Rhineland-Palatinate and Baden-Württemberg began to campaign for votes in the March 1996 Land elections through appeals for preserving the deutschmark.⁷⁸ However, the local press in Baden-Württemberg was harshly critical of the SPD for its use of several extremely worded campaign posters.⁷⁹ The hostile press reaction exacerbated divisions within the SPD. The party's delegation to the European Parliament denounced the strategy, and national party leaders sought to distance themselves from the anti-European rhetoric of the SPD's local politicians. Posters produced by the local SPD in Rhineland-Palatinate that attacked EMU as a deflationary 'job killer' were suppressed on orders from the national SPD headquarters.⁸⁰ The local Baden-Württemberg party was permitted to continue its anti-EMU campaign, but it suffered from the conflicting pro- and anti-EMU messages that the party conveyed. The absence of a consistent policy position was particularly damaging for the SPD and left it open to charges of electoral opportunism.⁸¹ The CDU, along with the local press, condemned the SPD's 'populist' tactics. The FDP, meanwhile, focused exclusively on tax reduction for their electoral appeals.⁸²

The elections were an unmitigated disaster for the SPD in all three Länder and a triumph for the coalition (Table 1.2). While the erosion of SPD support from the previous elections was least in Baden-Württemberg, it was a serious blow that the SPD lost its place in the governing coalition. That its share of the vote had slumped to under 30 per cent was also particularly shocking for a *Volkspartei*. At the same time, the party failed to make any real inroads into the Republikaner electorate. The SPD's attempts to generate support for an anti-EMU

Table 1.2 March 1996 Landtag Election Results

<i>Party</i>	<i>Baden-Württemberg</i>	<i>Rhineland-Palatinate</i>	<i>Schleswig Holstein</i>
CDU	41.3 (+1.7)	38.7 (+0.0)	37.2 (+3.4)
SPD	25.1 (−4.3)	39.8 (−5.0)	39.8 (−6.4)
FDP	9.6 (+4.7)	8.9 (+2.0)	5.7 (+0.1)
Greens	12.1 (+2.6)	6.9 (+0.4)	8.1 (+3.2)
Republikaner*	9.1 (−1.8)	n.a.	4.3 (−2.0)
Other	2.8 (−1.7)	5.7 (−2.6)	4.9 (+1.8)

*DVU in Schleswig-Holstein

Source: Broughton, David and Neil Bentley (1996) 'The 1996 Länder Elections in Baden-Württemberg, Rhineland-Palatinate and Schleswig-Holstein: The Ebbing of the Tides of March?' *German Politics* Vol. 5, No. 3, pp. 510, 514, 518.

platform in the regional elections backfired badly. Whether because of erratic implementation, unfavourable local conditions, or popular apathy, the SPD's Baden-Württemberg campaign had the worst showing of any post-war SPD Land campaign, obtaining barely a quarter of the votes cast.⁸³ As a trial balloon for a federal election strategy, the anti-EMU campaign was a complete failure.

While the SPD had failed to find a winning strategy, the FDP defied expectations of its early demise and emerged as the big winners in the March 1996 Landtag elections in Schleswig-Holstein, Rhineland-Palatinate, and Baden-Württemberg, easily surpassing the five per cent threshold for representation in all three parliaments and forming part of the governing coalition in the latter two Länder. The FDP's leadership quickly attributed the party's resurgence to its rediscovered opposition to excessive government regulations and high levels of taxation. As the only major party in Germany pledged to lower taxes, the leaders of the FDP felt they had latched onto a position that would differentiate them from the other parties and ensure they received enough votes to return to the Bundestag after the next federal elections. Not long after the spring Landtag elections, the FDP's party conference in Wiesbaden endorsed this strategy as the basis for the FDP's 1998 federal election campaign.⁸⁴

The gold revaluation crisis

In May and June 1997, Germany's commitment to EMU underwent its most serious test when the Bundesbank and the Kohl government clashed openly over the government's plans to revalue the country's gold reserves. Faced with a budget shortfall and strong political

opposition to either tax increases or spending cuts, Waigel attempted to introduce a modest change in the Bundesbank's book-keeping procedures to bring them in line with the standard practices at other European central banks. At the core of the proposed change was a plan to revalue the Bundesbank's gold and foreign currency reserves from the lower cost valuation principle (*Niederstwertprinzip*) to a level closer to their real market value. In addition to making Germany's system of foreign reserve accounting comparable to that of its European Union partners, revaluation would also make the government's bleak budget picture look rosier. However, within the space of a few weeks, what had seemed a minor – and not necessarily controversial – clerical procedure became the centre of a political storm that threatened to bring down the Kohl government.⁸⁵

During the first half of 1997, the German government faced a series of ominous economic trends. While economic growth had returned to Europe, it was the jobless growth that had characterised the late 1980s. The labour market remained depressed with unemployment surging in the winter of 1996–97 to levels unseen since the Great Depression. Higher demands for unemployment benefits and lower tax revenues added to existing pressures on the public finances stemming from unification, the continuing need to rebuild eastern Germany, and rigid labour markets. The level of public indebtedness continued to climb to record levels and threatened to breach the Maastricht criteria (Table 1.3).

Table 1.3 German Economic Figures, 1994–97

	1994	1995	1996	1997
% workforce unemployed	9.6	9.4	10.4	12.2 (Feb.)
budget deficit as % GDP	2.4	3.5	4.0	3.0*
government debt as % GDP	50.4	58.1	60.8	61.6*

* EU Commission estimates.

Sources: Unemployment – OECD, *Main Economic Indicators*, (Paris: OECD, April 1997), pp. 124–5.

Debt and Deficit (1994–96) – EMI, *Annual Report 1996*, (Frankfurt: EMI, 1997), p. 31.

Deficit and Debt (1997) – EU Commission estimates cited by *Handelsblatt* (20 May 1997).

Normally during a downturn in the economic cycle, a government can pay unemployment benefits, provide a modest amount of fiscal stimulus to the economy, and hope for an eventual recovery in the labour market. The German government's commitment to EMU under

an exacting set of economic criteria laid out in the Maastricht Treaty made it politically impossible for them to spend their way out of the recession. While the treaty's ambiguous language allows for member states to be 'approaching' the reference values, this liberal interpretation of the Maastricht criteria ran against the German government's literal interpretation of the convergence numbers. While countries such as Italy and France suggested that a more flexible reading of the treaty would make achievement of EMU easier, the German government could not sell a 'soft' euro to either its sceptical citizens or the Bundesbank.

The German government's finances deteriorated throughout 1996. Slow growth and high unemployment reduced revenues and exacerbated the calls for more social spending. The government quickly exceeded the deficit targets that it had thought it could easily achieve at the beginning of the year. A final, year-end surge of 500,000 in the jobless rolls pushed unemployment over 4.4 million (12.2 per cent of the workforce), the highest number of Germans without work since the final days of the Weimar Republic. High levels of unemployment increased the burdens on the budget. In the first quarter of 1997, the Federal Labour Office needed 12 per cent more money than it had received during the same period in 1996.⁸⁶ In May, the federal budget deficit appeared to be headed for a yearly total of 3.4 per cent of GDP, well outside the Maastricht criteria.⁸⁷

The German government found that it had limited room to manoeuvre in response to its fiscal problems. Putting the budget back towards greater balance could be achieved in one of two ways: raising taxes or reducing social spending. The balance of power in Germany's two houses of parliament precluded either of these two options. CDU and CSU members would have preferred an additional tax levy to bolster the sagging public finances. However, the centrepiece of the FDP's new electoral strategy – lower taxes – precluded their support for such a policy. Strengthened by its victories in the March 1996 Landtag elections, the FDP was unwilling to compromise on what they perceived as an electorally advantageous 'principle'. The FDP refused to accept any form of tax increase to resolve the federal government's budget problems, thus blocking the route of tax increases.

This still left open the possibility of reductions in government spending to bring the budget deficit under 3.0 per cent of GDP. Spending cuts had always been unpopular and a government attempt to reduce coal subsidies in March 1997 had led miners to riot in Bonn. The SPD, meanwhile, controlled 35 of the 69 votes in the Bundesrat and was thus

perfectly positioned both to thwart the coalition's attempts to reduce social spending and to make political points off of the government's failed attempt. On the basis of political party control, the SPD and their Green allies commanded enough Bundesrat votes to block many government actions in 1997. Indeed, the SPD used its majority in the Bundesrat to block passage of the federal budget in February 1997, leaving an unexpected budget shortfall of DM11 billion.⁸⁸ To override opposition in the Bundesrat required a two-thirds majority (448 out of 632 votes) in the Bundestag, and the coalition had only 337 seats. Partisan political considerations limited the government's ability to reduce spending as well.

Waigel sought his way out of this political and fiscal crisis through a clever use of the Maastricht Treaty and a reform of the Bundesbank's valuation of its international reserves. His proposed change to the Bundesbank's accounting methods was rooted in the Maastricht Treaty, which stated in one of its protocols that:

The European Central Bank shall contribute to the harmonization, where necessary, of the rules and practices governing the collection, compilation and distribution of statistics in the areas within its fields of competence.⁸⁹

As part of the integration of national central banks to prepare the way for the European Central Bank (ECB), national governments would need to harmonise their disparate methods of accounting so that all the subordinate central banks would be providing comparable information to the ECB and to each other. Many of these changes were minor adjustments and calibrations, but in the area of valuation of foreign reserves, the method of accounting made a great deal of difference.⁹⁰ The traditional German method of accounting for foreign exchange assets was the *Niederstwertprinzip*, the lower cost valuation principle. Under this principle, when a company or public entity (such as the Bundesbank) made up its yearly balance sheet, the price of an asset is calculated based upon either the price at the time of the item's acquisition (the historical exchange rate) or the prevailing market price at the date the balance sheet is issued, whichever is *lower*.⁹¹ In addition, unrealised gains are not traditionally claimed on balance sheets; only once an asset has actually been sold and the gain realised can bookkeepers record the profit. In contrast, unrealised losses are recorded immediately as the market price of the asset would then be lower than the acquisition price.⁹²

In practice, this method proved an extremely conservative method of valuing assets whose price had appreciated over a long period of time – up to fifty years for some of the Bundesbank's gold reserves. Gold purchased in the 1960s during the Bretton Woods monetary regime when the price was about \$35/ounce (DM125/ounce) remained on the Bundesbank's balance sheet at DM125/ounce in May 1997, when the international price of gold was \$344/ounce (DM588/ounce).⁹³ In 1997, the market value of the Bundesbank's international and gold reserves amounted to DM55.9 billion, yet the official book value of these reserves was listed as a mere DM13.7 billion. The average price of the gold on the Bundesbank's books was a mere DM144/ounce, less than one-third of its market value.⁹⁴ Of the other members of the EU, only Sweden priced its reserves at a level below that of Germany. Indeed, under Waigel's proposed change, Germany would still be valuing its reserves beneath the level that 11 of its 13 EU partners valued theirs.⁹⁵ It was this disparity that Waigel sought to reduce when he requested that the Bundesbank reserves be revalued at 60 per cent of the price they could fetch on international markets.

The European Monetary Institute (EMI), in its yearly report published in April 1997, announced that the ECB would base its asset values on market valuation. Any gains that occurred due to revaluation after the reserves of national central banks were transferred to the European Central Bank would be placed in a revaluation account so as not to list unrealised gains as income. Although the EMI left national central banks free to pursue their own accounting rules for their non-ECB accounts, it would obviously be easier for a national central bank if it simply followed the accounting procedures of the EMI.⁹⁶ The implications for Germany and its undervalued reserves were rather serious. If Germany transferred its reserves to the ECB at their undervalued level, then all the gains from the revaluation would be put into the ECB's revaluation account, of which Germany would have a modest share. If, however, Germany changed its bookkeeping methods and claimed a special gain from the revaluation, it could take advantage of the whole amount of the revaluation for strictly domestic purposes. But this could only occur if the government acted before the creation of the ECB in 1999.

Earlier in 1997, the European statistical agency, Eurostat, had issued a ruling in response to Dutch and Belgian sales of gold. According to Eurostat, sales of gold could not be used to offset government deficits although they could be used to reduce national debt.⁹⁷ Since the government was revaluing its reserves, it would not actually be selling

anything and it would thus be using the 'hidden' value of its reserves instead. Under this technical distinction, the Kohl government would virtually erase the budget deficit that it expected in 1997. Instead of an embarrassing breach of the Maastricht criteria, the German finances would look extraordinarily healthy. The plan had additional political advantages in that it was something that was solely within the constitutional powers of the governing coalition to implement. All that was necessary was enabling legislation to alter the Bundesbank Law, legislation that was necessary in any event to prepare the way for monetary union. The leadership of both CDU-CSU and the FDP were in favour of the change and the advantages it would bring the government in meeting the euro criteria, so the coalition could use its Bundestag majority to pass the new law. Since the suggested accounting changes did not affect the rights of the Länder, the legislation did not require the approval of the SPD-controlled Bundesrat, whose opposition had plagued so many other of the government's fiscal plans. Waigel anticipated minimal interference from the Bundesbank. Even if the Bundesbank disapproved of the revaluation, it had no formal powers for stopping the government legislation. From this perspective, it appeared that the revaluation plan was an extremely clever solution to the government's budgetary woes.

Waigel informed the Bundestag that the Maastricht criteria would not be endangered; the government would meet its deficit target through additional measures.⁹⁸ Regarding the gold revaluation, he argued that

These reserves represent the success of the German national economy over the last 50 years. It is a savings which we have amassed from abroad. It was indisputably proper that the Bundesbank valued gold and foreign reserves with extreme caution over the last 50 years.... The new valuation will proceed with all necessary caution. The financial respectability of the Bundesbank will be guaranteed. Precautions against currency risks and the volume of the gold reserves will remain untouched. Not one ounce will be sold. It follows that not one ounce will finance the budget.... It is both proper and inexpensive to use this 'ancestral credit' to wipe out our historic liabilities.⁹⁹

Not only did Waigel plan to make up for the shortfall with a revaluation of the gold reserves, but he proposed to accelerate the sale of government shares in Deutsche Telekom and its financial interest in three major airports (Hamburg, Cologne-Bonn, and Frankfurt). He also

announced that the government intended to begin the privatisation of the postal bank and a series of highway rest-stops.¹⁰⁰ None of these measures would have been so controversial had they not been accompanied by the announcement of the DM18 billion hole in the federal budget. As it was, this massive sell-off in the wake of such poor financial revelations added a whiff of desperation to the new fiscal measures.

However, the Bundesbank did not acquiesce to the government's plan. Although many members of the Council were close personal friends of Kohl and Waigel, they did not constitute a majority of the 17-member Bundesbank Council. Six of the 17 were affiliated with the SPD and at least three others, including the bank's chief economist Otmar Issing, were politically-independent monetary hawks. Together, this group of nine formed a blocking majority to the government's revaluation plan which they felt was designed to use the Bundesbank to bail the government out of a fiscal crisis.¹⁰¹ On 28 May, following its Central Bank Council meeting, the Bundesbank rejected an immediate revaluation for the 1997 fiscal year declaring that

the detailed special provision for the years 1997 and 1998 envisaged so far in the concept of the Federal Minister of Finance may be regarded as constituting interference in the task of compiling and approving the balance sheet, which falls within the Bundesbank's field of responsibility, and hence as an infringement of the Bundesbank's independence.¹⁰²

Kohl and Waigel had hoped that the Bundesbank Council would shy away from a public conflict with the government over a matter that was mostly about the timing of the revaluation. From the government's point of view, the reserves were going to be revalued in any event, so arranging a time to revalue which was most advantageous for the government was hardly improper. Indeed, it was something that they thought should be within the purview of the legislature. The Bundesbank statement was an enormous setback for the coalition because it forced them to confront another development for which they were unprepared: the extent to which the Bundesbank's public opposition to the revaluation would inflame popular sentiment against the government. The central bank's resistance enabled the SPD to argue that its own opposition was non-partisan, a posture that it would have had difficulty claiming if the Bundesbank had remained silent on the matter.

Aware that the Bundesbank's rejection of gold revaluation created problems for their fiscal plans, the coalition responded rapidly in a massive show of party unity. The Chancellor backed by Finance Minister Waigel, Economics Minister Wolfgang Gerhardt (FDP), and other leading members of the coalition parties reaffirmed their commitment to revaluing the gold reserves and their intent to introduce legislation to compel the Bundesbank to do so during the 1997 fiscal year.¹⁰³ This did nothing to staunch the collapse in public support for the government's position. The nation's national newspapers sided with the Bundesbank and refused to support the government's action. Both *Handelsblatt* and *Frankfurter Allgemeine Zeitung* carried leading editorials at the end of May denouncing the government's attempts to revalue gold. Neither saw the revaluation itself as particularly problematic; rather they believed that such financial moves would encourage other countries to flout the Maastricht criteria. Furthermore, open conflict between the government and the Bundesbank undermined international confidence in the German economy. Other major newspapers viewed the situation in much the same way.¹⁰⁴

The schism between the government and central bank troubled international financial markets, too. Speculators, who had begun to reconcile themselves to the launching of the euro, became less certain that the single currency would begin on schedule. As had often occurred in the previous five years, money began to move from the weaker European currencies to the deutschmark. The mark fluctuated sharply in trading at the end of May. A postponement in EMU raised the spectre of a vastly appreciated deutschmark and the subsequent undermining of German exports on international markets. On the one hand, a desire to 'cap' the deutschmark and stabilise its export markets had contributed to the German government's agreement to monetary union back in 1991.¹⁰⁵ On the other hand, if the government could successfully override the resistance of the Bundesbank, there was the possibility that other nations would follow the German example and come up with ever grander bookkeeping tricks to bring their budgets into balance. This would make the euro an even softer currency than had been expected and thus might trigger a flight out of the deutschmark. The speculators were uncertain about which direction to speculate. The financial unrest resulting from the ongoing argument with the Bundesbank endangered the exchange rate stability the government was attempting to ultimately cement with EMU. Normally loyal business leaders also expressed concern about the open disagreement between the Bundesbank and the government. Hans-Olaf Henkel,

President of the Federation of German Industry (BDI), expressed bewilderment at the government's plan and urged the two sides to reconcile their differences as quickly as possible. The leader of the Federation of German Banks also criticised the government and echoed Henkel's call for compromise.¹⁰⁶ For the government, this financial turmoil both reinforced the necessity of EMU and heightened their awareness of the risks they were running in their public feud with the Bundesbank.

International events also conspired to increase the pressure on the Kohl government. In France, Jacques Chirac's gamble that the right would win a snap election, thus ensuring that they could pass the tough austerity measures needed to meet the Maastricht criteria, backfired badly. The Socialists together with the Communists and Greens emerged with a narrow parliamentary majority after the second round of elections on 1 June 1997. This raised additional concerns in Germany that France would pursue a reflationary strategy. Any German budgets that looked like they contained bookkeeping tricks might be used as precedents for further spending and borrowing in France. Several leading French Socialists, including the incoming prime minister, Lionel Jospin, had indicated they intended to pursue precisely this strategy once in office.¹⁰⁷ This threatened the international dimension of Germany's EMU strategy and promised to make the task of selling the euro to the German public even more difficult.

On 3 June, the SPD and Greens tabled a motion in the Bundestag to debate the revaluation of the gold reserves and asked for a vote of no-confidence in Finance Minister Waigel.¹⁰⁸ There were rumblings on the government backbenches as well and, in the opening days of June, it was not entirely clear that the coalition would be able to win such a vote. The CDU's Minister-President of Saxony, Kurt Biedenkopf, told a television audience he thought the Bundesbank's position was entirely justified.¹⁰⁹ The coalition's floor leaders were not certain that their usually effective disciplinary measures could keep enough members from casting a protest vote against the government. Losing a vote of no confidence in the Finance Minister would have been a politically-fatal blow to Kohl's government.¹¹⁰

While the outstanding differences between the FDP and the CDU over taxes remained unresolved, the coalition quickly agreed that they needed to take a new approach towards the Bundesbank since further conflict with the central bank had become the source of their other political difficulties. The public disagreement had damaged the position of the government and endangered its hold on office. Instead of confrontation, the coalition's leaders capitulated to the Bundesbank's

position.¹¹¹ The truce with the Bundesbank reassured the coalition's Bundestag delegation and robbed the opposition of the issue they needed to break the grip of party discipline. Strictly along party lines, the Bundestag rejected the opposition's no-confidence motion by a vote of 328-311.¹¹²

Ironically, the adverse budget figures which had precipitated the Finance Ministry's panicked response evaporated by the end of 1997. Not only did Germany comfortably meet the deficit criteria with a deficit to GDP ratio of 2.9 per cent, but Italy met the targets as well at 2.7 per cent.¹¹³ As the dawn of the euro era approached in 1998, the Kohl government succeeded in fulfilling its domestic and international strategy of assuring its EU partners' compliance with the relatively strict terms of the convergence criteria. This success disarmed Kohl and Waigel's domestic opponents and opened the path to German membership in EMU.

EMU membership

In the early years of EMU, when the true costs of German unification were not yet apparent, meeting the Maastricht criteria had not seemed particularly difficult. However, as the costs of integrating the East German economy with the West increased into the hundreds of billions of Deutschmarks, the government's task became much more difficult. Government deficits rose in the years between 1992 and 1996 from 2.6 per cent of GDP to 3.4 per cent in 1996.¹¹⁴ A major undertaking in privatisation and tight budget policies held the projected budget for the crucial convergence year of 1997 under 3.0 per cent. Prodded on by criticism from the presidents of several Land central banks, the coalition pressed ahead with its efforts to meet both the EMU timetable and the EMU criteria, although it meant drastic cuts in the public budget during a time of recession.¹¹⁵ The only major misstep in the implementation of this strategy was the aborted gold revaluation fiasco in 1997.

In 1998, the European Monetary Institute and the European Commission released their convergence reports. Unsurprisingly, they stressed the positive achievements of the member states in reining in previously bloated public sector budgets, taming inflation, maintaining exchange rate stability, and forcing the convergence of long-term interest rates.¹¹⁶ More important from the point of view of the federal government was the March 1998 report from the Bundesbank. Although not as positive as the European-level institution's evalua-

tions, the Bundesbank's final report on the convergence criteria made similar points.¹¹⁷ In light of the convergence criteria, the Bundesbank concluded that

entry into monetary union from 1999 appears justifiable in stability policy terms. With regard to the requirement of a sustainable financial position, however, serious concern exists in the case of Belgium and Italy.¹¹⁸

Despite its reservations about these two countries, the Bundesbank avoided a direct criticism of the government's plans for a broad-based EMU, concluding that 'the selection of participants ultimately remains a *political decision*...'.¹¹⁹ With a seal of approval from the Bundesbank, Kohl's government was able to obtain approval for an EMU of eleven members. The Bundestag voted overwhelmingly in favour by a vote of 575–35. All the major parties supported the measure, with dissenting votes coming entirely from the PDS.¹²⁰ Shortly afterwards, the Bundesrat gave its approval in equally overwhelming fashion, 65–4. Saxony's Minister President Kurt Biedenkopf, a long-time foe of Kohl's, cast the only four votes against EMU.¹²¹

Conclusions

The success of Germany's pre-Maastricht monetary policy, coupled with the serious domestic constraints the Kohl government laboured under, allowed the German government to negotiate an EMU agreement that very closely reflected German institutional preferences. The Maastricht Treaty replicated the Bundesbank at the European level. While the purview of the proposed European Central bank was broader than the German-specific orientation of the Bundesbank, German priorities of low inflation and budgetary discipline were imposed on aspiring EMU members as the condition for participation in a monetary union with Germany.

Domestic constraints on ratification of the agreement actually served to enhance the governing coalition's political position. The government, even through the complete mobilisation of its own resources, was incapable of ratifying the agreement without the support of the opposition parties. The strength of the opposition parties, specifically the SPD, meant that failure to ratify the agreement would be blamed not on the government, but upon the opposition. This enabled the opposition to extract certain constitutional

concessions from the government relating to the broad contours of Germany's European policy; however, rejecting the treaty was not a viable option for a 'pro-European' opposition like the SPD. The SPD attempted to thwart the Christian-Liberal coalition's attempts to reduce public spending in order to meet the Maastricht Treaty's budgetary targets. The simultaneous existence of cooperative and conflictual behaviour underpins the German debate on EMU. The country's constitutional provisions created a series of institutional veto points that allowed a large number of different political actors to influence the implementation of policy. Each of these actors extracted concessions in areas that it prioritised – the Bundesbank demanded an independent central bank committed to price stability, the Länder and the SPD called for greater access to European policy-making institutions. Their ability to forestall movement towards EMU meant that in the final analysis, all the major political actors in Germany were complicit in the approval of monetary union.

2

German Business and EMU

This chapter explores the political activities that German business associations took regarding Economic and Monetary Union (EMU) between 1988 and 1998. Three factors influenced the manner in which business associations interacted with politicians on this issue. German associations preferred to concentrate their lobbying activity on particular, regulatory aspects of EMU rather than the issue in its broader context. The high level of centralisation in the German associational arena allowed Germany's peak industrial organisation, the Bundesverband der Deutschen Industrie (BDI), to control the activities of its subordinate members and to provide a level of leadership for the business community that was absent in the United Kingdom. Finally, the unanimity not only of the governing Christian-Liberal coalition, but also the opposition Social Democratic Party (SPD), in favour of European monetary integration restricted the realm of domestic political debate that was available to German business groups and closed off many avenues for opposition to EMU.

To explore how these three variables interacted, I examine five German business organisations, several of which one might expect would oppose surrendering domestic monetary policy autonomy. These groups were selected based upon their level of exposure to international markets and their imputed preferences regarding the level of the exchange rate. The two most internationalised associations were the peak employers' association, the BDI, an umbrella organisation for most of German industry, and the Association of the Chemical Industry (VCI), a major industrial sector heavily involved in exports. These two organisations, to the extent that their members were primarily exporters, would be expected to support increased monetary co-operation and efforts to cap the appreciation of the deutschmark

against Germany's major trading partners. Representing sheltered sections of the economy were the Association of the German Construction Industry and the German Chambers of Trade and Commerce (DIHT), both of which were oriented more towards local rather than international markets. They might be expected to prefer a German-oriented monetary policy and a relatively high exchange rate. The fifth association, the Confederation of the German Confectionery Industry (BDSI), was less internationalised and tended to suffer from import competition from major Swiss and American multinational candy manufacturers. A low exchange rate would provide German confectionery producers with some price protection from their foreign competitors.

Organisation of the associational arena

The German associational arena has its roots in the late nineteenth century during Germany's late drive for industrialisation. As early as 1876, industrialists across Germany created an organisation, the Centralverband Deutscher Industrieller (CDI), to lobby the imperial government and advance their interests in favour of tariff protection. In the wake of the First World War and in the face of civil unrest, employers formed an umbrella 'association of associations', the Reichsverband der Deutschen Industrie (RDI) under the leadership of Gustav Krupp, the Ruhr armaments manufacturer and philanthropist. After the Second World War, during which the RDI had collaborated with and provided extensive support for the Nazi regime, the victorious allies disbanded the RDI as part of their efforts to decentralise, de-cartelise and de-Nazify German society. However, within five years, the RDI had reconstituted itself under a new name, the Bundesverband der Deutschen Industrie (BDI), suggesting a less centralised organisation than had previously been the case.¹

If anything, the new organisation was even more functionally and hierarchically organised than its predecessor. With the post-war division of Germany, the membership base was considerably reduced. This enabled the BDI to be more consolidated and streamlined than the RDI had been. However, the main focus of the BDI remained on economic policy and political activity. Two other organisations, the Bundesvereinigung der Deutschen Arbeitgeberverbände (BDA) and the Deutscher Industrie und Handelstag (DIHT), took up the tasks of coordinating employers' social policy initiatives and vocational training activities. This division of labour amongst the leading employers'

associations enhanced the power of each group within its own functional domain. Rather than competing for members and influence, the BDI, BDA, and DIHT are highly cooperative and are jointly responsible for a series of institutions, most importantly their funding of a think tank supporting the role of private enterprise in Germany – the Institute for the German Economy (IDW). Thus, the main organs for business representation in Germany coordinate their activities and rely upon several identical support institutions. This tends to clarify the position of German industry and enhance the power of German business in Bonn and Berlin.²

The Bundesverband der Deutschen Industrie (BDI)

The BDI is Germany's peak industrial association. In the 1990s, it consisted of 35 sectoral associations (such as automobiles, chemicals, and textiles) covering 90 per cent of Germany's manufacturing enterprises. Each of the 35 sectoral associations is further subdivided into more specialised sub-sectoral associations. For example, the Federation of the German Food Processing Industry is an umbrella organisation for 22 food product associations such as the producers of coffee, fruit juices, and confectionery products. Firms themselves are members of these subordinate sub-sectoral associations.

Almost all of Germany's industrial enterprises are indirectly represented in the BDI through their industrial associations. The BDI indirectly represents about 80,000 industrial firms that employ over 10 million workers. An annual budget in excess of DM40 million finances a large staff (over 300 paid employees) and underwrites the activities of the BDI. The BDI bureaucracy supports its members and promotes the interests of German industry out of its national headquarters, 15 regional offices, and three foreign offices in Brussels, Washington, and Tokyo.³

The BDI's secretariat is divided into fifteen directorates dealing with various substantive issues ranging from press relations and member services to environmental policy. Each directorate is responsible for developing policy on issues in its realm of competency. In addition to BDI staff members, interested parties from the member associations and employees seconded from firms take part in this stage of policy analysis and development. For issues that cover more than one issue area, joint committees or even special consultation groups can be formed. The Directorates for General Economic Policy and European Policy and a special high-level committee, the Industry Forum on

European Monetary Union, were the focus of discussions on EMU.⁴ The President of the BDI himself chaired the Industry Forum on EMU, and its 21 members included the immediate past President of the BDI, three BDI Vice Presidents, and the chairmen of Mercedes-Benz, AEG, Merck, Siemens, Trumpf and Bosch.⁵

The BDI's President serves a renewable two-year term of office. Traditionally, the President has served several consecutive terms and has acted as the public face of German industry. From 1987 until 2000, three men served as BDI President, with two of them serving three terms each. A Managing Director supervises the BDI's staff and is also an active political participant. In addition to these officials, the BDI's Vice Presidents are quite powerful – prior to 1992 there were five Vice Presidents, between 1992 and 1997 there were seven, and since 1997 there have been nine. Between 1987 and 2000, the BDI had only one Managing Director, Ludolf-Georg von Wartenberg. His predecessor had held office for more than ten years. Over the same period of time, the Federal Republic had two Chancellors, four Finance Ministers, and four Bundesbank Presidents. This level of longevity in the BDI's two primary leadership positions provided the organisation with personnel committed to particular policies over a substantial period of time. In contrast to Britain's CBI, the BDI's leaders were in office for a long period of time, were recognised at a national level as authoritative spokesmen for industry interests, and had a public stature similar to that of members of the federal cabinet.⁶

The two primary decision-making bodies of the BDI are its Executive Board and the President's Committee. The Executive Board, which meets every three months, is responsible for the overall direction and approval of BDI policy. In 1998, there were 45 members of the Executive Board, and membership for the vast majority automatically stemmed from their positions as chairmen of one of the BDI's 35 sectoral associations. The other ten members owe their membership to their positions as President or Vice President of the BDI. The smaller President's Committee meets monthly and is responsible for most of the BDI's policies. The President's Committee has approximately 36 members drawn from:⁷

- The President of the BDI
- 9 Vice Presidents of the BDI
- 15 Members of the Executive Board
- 6 Members from the Regional Associations
- The President of the BDA

- The President of the Institute for the German Economy
- The Chairman of BDI Small- and Medium-Sized Enterprises Committee
- Honorary Members (such as former BDI Presidents)

There is clearly a substantial overlap between the Executive Board and the President's Committee. Not only do at least one-third of the members of the Executive Board also sit on the President's Committee, but many of the individuals who are members of both groups are the elected leaders of the BDI as a whole – the President and the Vice Presidents. The two bodies share similar sentiments, and it is almost unheard of for there to be any substantial disagreement between them.⁸ The BDI's leaders tend to come from major multinational corporations. However, the BDI's leaders represent not an individual corporation but a sectoral trade association. When the BDI's Executive Board makes a policy decision, its members, as participants in the formation of policy, generally follow the BDI's policy line. This is especially true on major issues of macroeconomic policy such as EMU. This tends to bind the subordinate member associations to the BDI's policies.⁹

The BDI's executive officers and its major policies are approved at the yearly Membership Meeting. However, the votes of the constituent associations are not given equal weight. At the Membership Meeting, representatives of each member association have a weighted share of the vote, with associations whose members employ more workers having more votes than industrial associations with fewer employees.¹⁰ While this might suggest that the larger associations would tend to dominate the meetings, votes are usually unanimous endorsements of the Executive Committee's recommendations.¹¹

The BDI stresses its political activities in its communications with its members, emphasising the information services it provides for members and the active lobbying of government agencies in which it engages. In its 1988 annual report, for example, the BDI leadership exhaustively listed hundreds of activities that it had participated in over the previous year. In 1988 alone, these included sponsoring 12 symposia for members on the implications of the government's various economic policies, attending 100 foreign trade missions, delivering 71 speeches before business and government audiences, and publishing 84 official documents and 261 articles in the German and international press. In addition, the BDI listed dozens of major meetings it held with government officials in every ministry.¹²

Deutscher Industrie und Handelstag (DIHT)

The DIHT is the umbrella organisation for Germany's 82 local Chambers of Commerce. In Germany, the Chambers of Commerce are public law bodies, and all firms are required by law to join and contribute to the financial support of their regional chambers. This gives the DIHT a compulsory membership of approximately three million firms. The local Chambers of Commerce are responsible for running Germany's vaunted system of vocational training as well as setting standards and providing other supporting services for local businesses that contribute to high skill levels among workers and to the production of quality-competitive products.¹³ The DIHT, given its more local character, is more representative of small- and medium-sized enterprises producing for local markets. However, as it seeks to nurture ties between large multinational firms and local suppliers, it is also sensitive to the indirect role that international markets play in the well-being of domestic producers.¹⁴

In addition to its general administration, the DIHT has seven directorates with approximately 300 employees who deal with various issues of economic policy. The DIHT's vast financial and staff resources are comparable to those available to the BDI. A wide range of other specialised departments provide additional services for members, ranging from advice on environmental standards and taxes to details about foreign import policies and restrictions. An Executive Board of approximately 25 members is responsible for the approval of overall DIHT policy. Representatives of the local chambers, in an Annual General Assembly, elect the members of the Executive Board itself, as well as the DIHT President and four Vice Presidents.¹⁵

Despite the large proportion of small businesses that are members of the DIHT and its own self-perception that it is a representative of the small firm sector, the DIHT's organisational structure ensures that its leaders are, like the BDI's, representatives of associations. Elections for DIHT offices are not usually contentious, and those elected are selected from among the presidents of regional Chambers of Commerce rather than directly from individual small businesses themselves. In addition, there is a large amount of organisational cooperation with the BDI and the other major employers' association, the BDA.¹⁶ This cooperation is so extensive that during the 1990s the three organisations pooled their resources to construct a mammoth office building in Berlin to house their central administrations in the new capital.

Verband der Chemischen Industrie (VCI)

The Association of Chemical Industries is one of the 35 sectoral associations of the BDI. The VCI itself is an umbrella association for 29 branch associations for all sub-sectors of the chemical industry ranging from the Federation of the Pharmaceutical Industry to the Federation of the Adhesives Industry. The VCI indirectly represents approximately 1,750 firms from its headquarters in Frankfurt. Among these firms, the three largest chemical companies in Germany (Hoechst, Bayer, and BASF) are particularly influential within the organisation's councils. The VCI maintains additional offices in Brussels and in Bonn (which moved to Berlin along with the government in 1999) to facilitate its access to government ministries and the legislature.¹⁷

The main issues of concern to the VCI are trade policy and environmental regulation. The chemical industry is one of Germany's most internationally-oriented economic sectors. In 1990, it exported 43.6 per cent of its production, a percentage which grew to nearly 50 per cent by the end of the decade.¹⁸ Because of the effects that chemical plants and products can have on the environment, the industry is highly attuned to the impact of environmental regulations on its members and also the manner in which its members' business practices are publicly perceived, particularly in the aftermath of hazardous chemical accidents. The consequences of even a relatively minor release of toxic chemicals can have a detrimental effect on the industry as a whole; this is especially true if a chemical accident leads to the introduction of more restrictive health, safety, or environmental regulations.¹⁹

Bundesverband der Deutschen Süßwarenindustrie (BDSI)

The Federation of the German Confectionery Industry is one of the 22 sub-sectoral associations that comprise the Federation of the German Food Processing Industry, itself one of the 35 sectoral associations which make up the BDI. As a sub-sectoral association, the BDSI has approximately 250 members who employ over 50,000 workers. The firms themselves are organised into regional associations with a major firm in each Land typically serving as the regional representative and forwarding most issues to the central offices in Bonn. For example, the August Storck Group – manufacturer of Werther's Originals and Merci Chocolates – acts as a postal drop for all correspondence in the Berlin/Brandenburg area dealing with issues of concern to the local confectionery industry.²⁰

The German confectionery industry is highly exposed to imports. In 1998, 20.1 per cent of the confectioneries consumed in Germany were produced abroad.²¹ Even this proportion understates the degree to which the German candy market is susceptible to foreign penetration as major multinationals produce their own branded products on German soil rather than importing them. Because confectionery tastes are highly specific to a particular nation, the sweets that are popular in one country do not usually appeal to the palates of foreign consumers. This is a particular impediment for German exporters as German confectionery tastes do not correspond to those in most other countries.²² Interestingly, American firms operating in Germany compensate for these variations in tastes through the use of different ingredients to appeal to local preferences. The Mars Corporation's M&Ms sold in Germany, for instance, do not taste like M&Ms that are sold in the United States or Britain.²³

Most of the German confectionery companies are small players in the market. The largest company in Germany by sales is Italian (Ferrero) and four of the ten market leaders are foreign producers (the other three are Mars, Nestlé, and Suchard-Tobler). Because German companies produce brands that have particular appeal to the tastes of Germans, there are only small levels of exports. Exports account for only 10 per cent of production and are directed primarily to Denmark, Austria and Switzerland, where consumer tastes are similar to those in Germany.²⁴ The major factor in the consumption level of confectioneries is personal income; as a low-cost, pseudo-luxury product, consumption of confectioneries increases with the purchasing power of the consumer.²⁵ One might expect that an industry that has very little involvement in foreign trade and depends upon high domestic income would express a preference for a monetary policy dictated by German economic criteria.

Hauptverband der Deutschen Bauindustrie (BI)

The Association of the German Construction Industry is the primary representative of construction firms within the BDI. It is organised territorially, with the central association serving as an umbrella organisation for seventeen Land associations (Baden-Württemberg has three associations, one each for the north Baden, south Baden, and Württemberg regions) and four affiliated associations. The leaders of the Land associations sit on the BI's Executive Board with a smaller group of nine members comprising the President's Committee which is responsible for policy.²⁶

Most of the 4,500 construction firms that are members of the BI are small enterprises employing under 100 people that operate within a fifty-mile radius of their home base. As a 'Mittelstand dominiert' industry, the association is not controlled by a few big corporations. As one BI official stated:

We're not like the Association of the Chemical Industry – they make five calls and they know what they think about an issue. We have a lot of smaller firms and a lot of different opinions.²⁷

The German construction industry is thus oriented, like most national construction industries, towards the domestic market. The unification of Germany concentrated the attention of the industry in the early 1990s on the opportunities for major building projects in the new Länder. In contrast, many major foreign construction companies, particularly those in France, took advantage of new Single Market rules to acquire German subsidiaries and expand their operations into Germany. German companies largely missed out on this wave of European consolidation – a missed opportunity that made German construction firms even smaller and more localised relative to foreign firms.²⁸

Economic and Monetary Union

As the 1980s approached an end, the Exchange Rate Mechanism (ERM) of the European Monetary System (EMS) provided a highly favourable international trading climate in which German exporters could operate. The deutschmark held a hegemonic status within the system as the ERM's 'anchor currency' and Germany's participation within the ERM did not pose any real restrictions on the Bundesbank's pursuit of the domestic German economic priority of price stability. The ERM thus provided the advantages of exchange rate stability while committing Germany to very little in the way of obligations to its international partners. The ERM also created something of a 'cap' to the deutschmark's external value which allowed German firms to increase the competitiveness of their products in the European market. As Germany enjoyed relatively low inflation rates compared with the other members of the ERM, the deutschmark tended to become undervalued within the system of semi-fixed exchange rates. As revaluations within the EMS became less frequent, the international stability aspects of the system were further enhanced in the eyes of German industry.

At the same time, as the German Bundesbank set the standard that other countries sought to emulate, the ERM did not require that Germany make any meaningful adjustments to its domestically-oriented monetary policies. While Germany's European partners often complained bitterly about the asymmetry in the system, German business welcomed the external stability and internal autonomy that ERM membership entailed.²⁹

In the late 1980s, the BDI and the DIHT had both expressed support for the concept of EMU as a long-term goal. However, their support for EMU was neither unambiguous nor unconditional. Both groups stressed their preference for prioritising price stability above exchange rate stability and for the long-term convergence of economic variables across Europe prior to a currency union. Domestic considerations remained paramount for both business organisations until German unification changed their political calculus along with that of Germany's political elite.³⁰ The Bundesbank was not the only group susceptible to pressure from the government during the political wrangling over the question of unification. Immediately prior to the Strasbourg Summit meeting, Kohl held a 'Chancellor's Roundtable' with the leaders of the BDI, DIHT, and the German banking associations in which he laid out German agreement to movement towards European monetary integration, albeit under the rigorous pre-conditions set forth by the Bundesbank, as one of the prices that would be paid for German unification.³¹ The leaders of Germany's associations were sceptical of the economic underpinnings of such an agreement, but Kohl sought only their acquiescence, not their advice.³²

While EMU along these lines was not their preferred option, it was hardly an unwelcome choice for Germany's business leaders. In addition to the historic political opportunities, German unification promised a huge new market for Germany's firms. The level of disrepair in the eastern economy and the need to rapidly reconstruct the former DDR held out the promise of a major government-funded building programme accompanied by massive profits, particularly for Germany's construction industry where 'everyone saw that bubble coming and wanted to get their share'.³³ Under Single Market rules, all public procurement contracts over five million ECU had to be published. Nevertheless, preferential treatment of domestic firms remained the reality – less than one per cent of German public construction contracts went to non-German firms, a disproportionate division which persisted after unification.³⁴ As the process of German unification accelerated, the BDI endorsed monetary union under the specific insti-

tutional characteristics of the Bundesbank and the economic preconditions that Germany had traditionally advanced in all international discussions of monetary integration. The BDI put its emphasis on the achievement of sustainable economic convergence around principles of price stability and fiscal restraint. In addition, it explicitly endorsed the Bundesbank model of central bank independence as one that should be replicated at the international level.³⁵ By 'Germanising' the monetary and fiscal policies of other European countries, the BDI sought to export its domestic preferences to the European level. The culmination of the Maastricht Intergovernmental Conference in December 1991 produced a result that was not far from the preferred position of the BDI – if there was to be EMU, the BDI preferred that it be along the lines of an independent central bank committed to fighting inflation. The BDI, along with the DIHT and the VCI, also welcomed a long period of monetary apprenticeship and economic convergence.³⁶ However, they were less impressed with the mechanisms for redistribution – especially Structural Funds for less developed members – contained within the Maastricht agreement.³⁷ The automatic nature of movement to EMU in 1999 at the latest was also a source of concern, particularly for the DIHT.³⁸ While supportive of EMU, the BDI expressed its reservations about these two facets of the agreement immediately after the Maastricht Treaty was signed.³⁹

These concerns were, in part, due to a breach that had opened up between the BDI and the government in 1991 and 1992. During this period, the BDI came into increasingly open conflict with the Kohl government over a range of issues in addition to EMU. The new BDI President, Heinrich Weiss, who first took office in 1991, was such a strong promoter of business positions that he took an exceptionally antagonistic attitude towards the government, publicly questioning the economic competence of the Chancellor and the coalition. Previously, the BDI had enjoyed warm relations with the Chancellery. The BDI's managing director, von Wartenberg, himself a former Secretary of State in the Federal Economics Ministry from the Christian Democratic party, had nurtured the BDI's relationship with the Chancellery since beginning to work for the BDI in 1987. Relations with the government had deteriorated so markedly by mid-1992 that members of the BDI's President's Committee became increasingly concerned that their level of access to and influence over the government would be limited. As Weiss' criticism of the Kohl regime mounted, CDU leaders became steadily less receptive to industry's concerns.

Throughout 1992, Weiss kept up his attacks on the government's tax, spending, labour, and European policies in a manner which alienated not only the government but also his own colleagues. Within the BDI, Weiss and von Wartenberg disagreed over what strategy to take with the government, with von Wartenberg suggesting a less confrontational approach. The two men became estranged when von Wartenberg's attempts to assuage the concerns of politicians in the wake of Weiss' criticisms brought him into conflict with the BDI President. Ultimately, Weiss sought to dismiss von Wartenberg, but his own position within the organisation was not strong. He was a new President whereas von Wartenberg had served five years as the BDI's managing director and had, over the years, accomplished a great deal on behalf of industry and had developed a wide network of contacts throughout the political world. The BDI's Vice Presidents refused to support Weiss' attempt to fire von Wartenberg and Weiss, lacking the support of the President's Committee, was forced to resign.⁴⁰

While the precipitating incident for Weiss' premature departure was an internal struggle over staffing, the staffer in question, von Wartenberg, was in fact, a long-time CDU placeman whose connections with the main government party were considered one of the BDI's most valuable assets.⁴¹ Weiss had served as a chairman of a CDU Business Advisory Group, so he was not without political connections with the governing party. However, he did lack the longstanding and ongoing ties with the party that von Wartenberg possessed. After only eighteen months in office, Weiss was 'no longer welcome' in CDU policy-making circles, an extreme disadvantage for the BDI which traditionally enjoyed a high level of access.⁴²

In Weiss, the BDI had a leader who narrowly promoted the interests of industry, pressing politicians to adopt pro-business policies and denouncing them when they failed to do so. Within a very short period of time, this strategy of aggressively promoting business interests became counter-productive, freezing business voices out of policy discussions and limiting the influence which the BDI's previously less assertive leadership had enjoyed prior to 1991. Weiss' replacement, former President Tyll Necker, saw his most important task as 'rebuilding BDI relations with the government'.⁴³ Necker was something of the BDI's 'Mr. Clean' having served his previous two terms of office immediately after the implication of several leading BDI figures in the Flick Affair and a party finance scandal in the middle 1980s.⁴⁴ Necker had also been one of the Vice Presidents who had refused to back Weiss against von Wartenberg. As a result of his desire for a rapprochement

with the government, Necker was more cooperative and less assertive than Weiss on a whole range of issues.⁴⁵

Within a few weeks of taking office, Necker supported Kohl's call for a 'oui' vote in the French referendum and joined with the DIHT in urging the government to conduct a wide-ranging public campaign to generate support for the Maastricht agreement in Germany and assuage the public's concerns about the Treaty on European Union (TEU).⁴⁶ The BDI's leaders retained their reservations regarding the automatic nature of the final movement to Stage Three of EMU in 1999 and their concerns about fulfilling the convergence criteria. Nevertheless, in the interests of greater cooperation with the government, the BDI's leaders downplayed their concerns and stressed the points of mutual interest they had with the government in exchange rate stability and greater intra-European trade.⁴⁷ As it had enjoyed a less antagonistic relationship with the government in the early 1990s, the DIHT was more forward in its expression of concern about the sustainability of public finances in the move towards EMU.⁴⁸ While the leading associations remained supportive of the political position of the government, independent opinion polls suggested that only 40 per cent of business managers were favourable to the idea of a single European currency, while 49 per cent endorsed retaining the deutschmark.⁴⁹ Regardless of their members' reservations about EMU, once the government had accepted the SPD's and the Länder's constitutional compromise, all of Germany's major business associations – the BDI and DIHT as well as the VCI, the savings banks, and many others – urged the Bundestag and Bundesrat to approve the Maastricht Treaty. They also called for the strict observance of the convergence criteria and the creation of independent central banks in all the participants.⁵⁰

While the German confectionery industry joined other industry groups in supporting the peak association's (the BDI's) position, the industry itself did so only as a subordinate, sub-sectoral member of the BDI. EMU itself was not an issue of major concern to the BDSI, so it followed the lead of the peak association. Given the unanimity among Germany's major parties on EMU, the confectionery industry's officials were sanguine about the prospects of even the major industrial associations taking any position other than one that was, on the whole, supportive of EMU. As one BDSI official explained, 'the politicians are all set on EMU, even the metal-eaters (automobiles, chemicals and steel) can do very little about that'.⁵¹

Instead of expending resources lobbying the government about monetary integration, the BDSI passed along information directly

from the BDI's Euro-information bureau to any of its members concerned with EMU and addressed its own lobbying activities to the principal concern of the confectionery industry in Germany – the high EU sugar subsidy that is a component of the Common Agricultural Policy (CAP). As sugar is the primary ingredient in most confectionery products, the EU sugar regime is particularly costly for confectionery producers. The effects are consistent across the domestic industry because all producers must buy sugar at the EU price; however, the cost disadvantages appear in domestic markets where German confectionery products suffer from the burden imposed by the relatively high price of EU sugar. Although exports are only a small component of the industry's production, the BDSI has traditionally focused its efforts on pressing the Ministry of Agriculture to push for a sugar redemption in the event a firm was exporting out of the EU, to make up for the cost differential between foreign sugar prices and the official EU price.⁵² Rather than pursuing a general, diffused goal such as opposition to EMU, the association pressed politicians for specific benefits to their members in different policy areas.⁵³

From 1991 until 1994, the German construction industry went through a major boom that blinded it to any other policy considerations. A massive influx of public and private deutschmarks boosted building output to levels that would have been unimaginable as late as 1990. Even as production showed signs of slipping in the west, projects in the east more than compensated for any shortfalls in the west (Table 2.1). The benefits that the building trades enjoyed in the years immediately after German unification were immediate and highly concentrated. Western firms were able to take advantage of their access to capital, skilled workers, and quality craftsmen to gain most of the eastern market. The German government and the western trade associations tended to privilege the position of their existing western members at the expense of indigenous eastern enterprises.⁵⁴ As the public sector deficit rose to 5.3 per cent of GDP in 1993, the Bau-Industrie's (BI) members profited from the laxity in the government's post-unification fiscal policy. Meanwhile, their association was concerned about the monetary policy response, as the discount rate rose from a low of 6 per cent in 1989 up to 8.75 per cent in July 1992 as the Bundesbank sought to wring inflation out of the German economy.⁵⁵ Even in the face of a stringent monetary policy, construction output was able to expand through 1994.

However, the increasing levels of indebtedness burdening the German government began to take their toll. Immediately after the

Table 2.1 Growth in Construction Output, 1991–94

Area	Germany			Old Länder			New Länder		
	1992	1993	1994	1992	1993	1994	1992	1993	1994
General	111.8	115.5	126.9	107.3	105.1	109.6	130.6	158.9	199.9
Δ%	+11.8	+3.3	+9.9	+7.3	-2.1	+4.3	+30.6	+21.7	+25.8
Housing	110.3	115.6	131.2	107.7	108.1	115.7	119.7	143.9	193.8
Δ%	+10.3	+4.8	+13.5	+7.7	+0.4	+7.0	+19.7	+20.2	+34.7
Civil Eng.	114.0	115.3	120.6	106.7	100.7	100.8	142.4	175.0	206.4
Δ%	+14.0	+1.1	+4.6	+6.7	-5.6	+0.1	+42.4	+22.9	+17.9
1991 = 100									

Source: Hauptverband der Deutschen Bauindustrie (1995) *Bau-Statistisches Jahrbuch 1995* (Frankfurt am Main: Verlag Graphia-Huß) p. 3.

1994 Federal elections, the coalition began to rein in public expenditure, particularly on civil engineering projects in the east, and increase taxes. Construction output effectively stalled in 1995 as a combination of public spending cuts and high interest rates brought demand to a standstill.⁵⁶ By the end of 1995, construction was in a steep recession; even taking cyclical factors into account, 'building contractors ... assessed their future business prospects in extraordinarily pessimistic terms'.⁵⁷

However, the BI did little beyond providing statistics to the government. Faced with economic decline, the BI held on to established modes of lobbying, pressing for reductions in government labour regulations rather than pushing for reducing the commitment to EMU and the Maastricht criteria or a relaxation in monetary policy. As one BI official explained:

we have to look to the long term and our credibility. The Bundesbank respects and trusts our statistics, so we can't go crying that we're in a bad way all the time. They use our data because we're reliable. We hope they use it the right way.⁵⁸

The leadership of Germany's main construction industry association prioritised their long-term relationship with policymakers and particularly the value that the Bundesbank placed on the BI's statistical services. The BI was aware that economic policy decisions affected many sectors of the German economy, not just construction, and saw it to the general advantage of their association that the Bundesbank

relied upon the BI's statistics as an accurate portrayal of the state of the construction industry, even if the Bundesbank and the Federal government made their decisions based on other priorities.⁵⁹

Despite its economic plight, the sheltered status of the sector, and a high level of opposition to monetary integration among construction firms themselves, the German construction industry's trade association remained supportive of the BDI's position on EMU on the grounds that presenting a united front in favour of one set of economic priorities to the government was better than conflicting messages. The BI's evaluation of their economic interests stemmed from this evaluation of their political position within the BDI, where major exporters were the dominant members. As a result, the BI's position had little to do with the direct impact of the coalition's painful cuts in public infrastructure projects, which the BI assessed as almost entirely negative; rather they argued that their position was based on its expected long-term effect on the economy as a whole. Regarding the government cutbacks, one Bauindustrie official noted that

we knew these cuts were coming with or without monetary union. The convergence criteria just make it easier for the politicians to pretend to be good guys.⁶⁰

The BI's leaders believed that the government, including the Bundesbank, placed particular emphasis on the interests of Germany's exporters rather than construction; however, so long as a boom in exports trickled through to higher profitability for export firms and their workers, construction would ultimately benefit from new investment in plants and new housing construction. The German construction industry looked at improvements to macroeconomic conditions – lower unemployment, GDP growth, and increasing per capita income – generated by the dynamic export sectors to pull them back to profitability.⁶¹

While the BI was resigned to budgetary cutbacks and a prolonged recession, the Federation of German Industry took monetary and fiscal stability as its twin priorities. This was true not only of Germany's deteriorating public finances, but also of the other potential EMU members. Lax budgetary positions in Italy and Belgium led the BDI to call for an emphasis on creating a stable fiscal framework accompanied by a strict adherence to the Maastricht criteria. Even during a period of exchange rate instability, such as gripped the ERM during 1992 and 1993, the BDI argued that domestic stability took precedence over

short-term exchange rate stability. A 'political interpretation' of the budgetary figures ran the risk of leading to an unstable monetary union that would risk the success of the project. The ERM crisis reinvigorated the BDI's interest in exchange rate stability, but only if the proper pre-conditions of balanced budgets and monetary restraint were present. Despite the ERM's troubles, the BDI still retained its commitment to a system of managed exchange rates, expressing concern that the revaluation of the deutschmark in 1993 would make German exports less competitive in European markets.⁶²

The DIHT, in a slight contrast to the BDI, while not abandoning its support for the ERM or EMU, suggested that the system's troubles and the deutschmark's revaluation allowed for an even greater domestic-orientation to Germany's monetary policies.⁶³ This relatively stronger position on EMU was in large measure due to the greater divisions among the DIHT's members over the benefits of EMU. While DIHT polls (Table 2.2) suggested that several key economic sectors that were extremely influential within the BDI (particularly the automobile industry) were highly supportive of monetary union, several of the key sectors that composed the DIHT's membership were more reluctant to proceed with the project.

While a majority of DIHT respondents (54.9 per cent) declared that they viewed German participation in a single European currency as 'desirable', a substantial minority (40.0 per cent) declared EMU an

Table 2.2 DIHT Survey of Firm Opinion on EMU, 1995

	<i>German participation in EMU is ...</i>		<i>EMU starting on 1 January 1999 is...</i>		<i>Non-responsive %</i>
	<i>Desirable %</i>	<i>Undesirable %</i>	<i>Likely %</i>	<i>Unlikely %</i>	
<i>Sector</i>					
All DIHT members*	54.9	40.0	34.9	60.0	5.1
Industry as a whole	59.6	35.9	31.9	63.6	4.5
Automobiles	77.0	23.1	46.2	53.9	0.0
Chemicals	58.4	41.7	27.8	72.3	0.0
Banking	54.1	45.9	48.6	51.4	0.0
Construction	50.0	50.0	33.3	66.7	0.0
Retail Trade	43.8	46.6	19.2	71.2	9.6

* unweighted

Source: Deutscher Industrie und Handelstag (1995) *Deutsche Unternehmen und Europäische Währung* (Bonn: Deutscher Industrie und Handelstag). Numbers do not always add up to 100 per cent due to rounding.

'undesirable' objective. However, because the sample is unweighted, it over-represents large firms relative to the more numerous small- and medium-sized enterprises. Construction firms were evenly divided on the merits of a single currency, and those firms involved in retail trade were more opposed (46.6 per cent) than supportive (43.8 per cent). Regardless of their belief in the desirability of EMU, majorities of every economic sector expressed pessimism about the declared launching date of 1 January 1999. Three-fifths of DIHT members expressed doubts about the EU's timetable, while barely one-third (34.9 per cent) thought the euro would start on time. This proportion dropped to below one-fifth (19.2 per cent) for those in retail trade.

The major cleavage among German firms over support for EMU came not among economic sectors, but rather in firm size. Using the number of employees as an indicator of the size of an enterprise, it is apparent in Figure 2.1 that small businesses were decidedly sceptical of EMU.

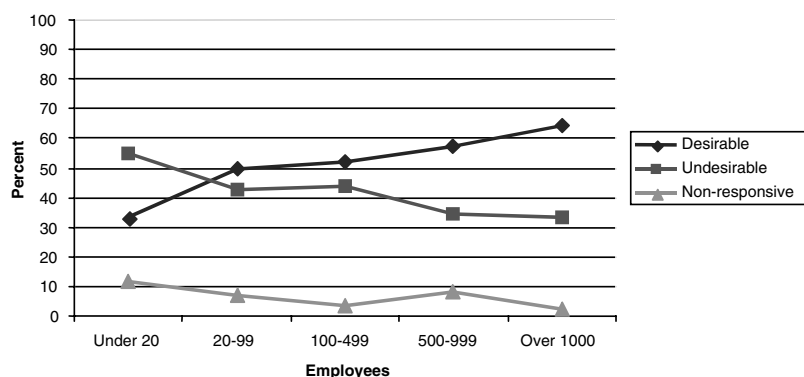


Figure 2.1 Firm Size and Support for EMU

Sources: Deutscher Industrie und Handelstag (1995) *Deutsche Unternehmen und Europäische Währung* (Bonn: Deutscher Industrie und Handelstag).

This is the case even though approximately one in nine (11.8 per cent) of firms employing under 20 workers were either non-responsive or declared that they lacked sufficient information to state a preference about EMU. Even with this sizeable group of non-respondents among small firms, more than half (54.9 per cent) declared EMU 'undesirable' while only one-third expressed a favourable opinion. As firm size increased, however, support for monetary union rose as well, steadily climbing to 64.5 per cent for large enterprises with over one thousand

employees. Larger firms were also more confident in their ability to access whether or not EMU would be beneficial to their corporation.

The relative hostility towards EMU among smaller firms did not translate into a negative assessment of the prospects of monetary union (Figure 2.2). Indeed, the two groups that had the most positive assessment of the likelihood of a successful start of EMU in 1999 were the biggest enterprises, where 42.1 per cent of respondents thought the euro would start as scheduled, and the smallest businesses, where 37.2 per cent of respondents held that opinion.

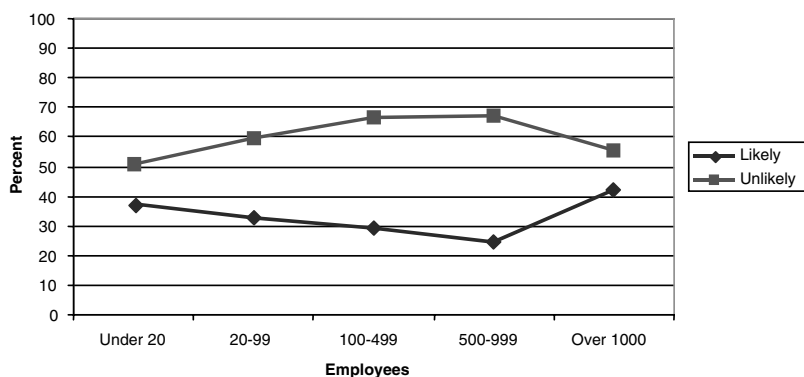


Figure 2.2 Firm Size and Assessment of EMU's Likelihood

Sources: Deutscher Industrie und Handelstag (1995) *Deutsche Unternehmen und Europäische Währung* (Bonn: Deutscher Industrie und Handelstag).

Perhaps reflecting their feelings of political impotency, small firms were the least questioning of the viability of the project, with 51.0 per cent of respondents expressing the belief that EMU would not start on time, a proportion substantially below that of all other groups. Even the pro-EMU auto industry was more sceptical (at 53.2 per cent) about the EMU launch date.

Theories of political economy based on imputed economic interest would suggest that an organisation like the DIHT, which represents mainly smaller firms, would be unenthusiastic about monetary union. The DIHT's members operated predominantly in the domestic economy rather than in a sector exposed to international trade. Survey evidence indicates that of German firms, the smallest ones were opposed to monetary union by a substantial amount. A gap of over twenty percentage points separated those small firms expressing opposition (54.9 per cent) from those expressing support (33.3 per cent) for

EMU. While it is ironic that small firms had the most faith in the government's plans for beginning monetary union in 1999, even the large firms were doubtful that the project was viable under the EU's declared schedule.

Nevertheless, the DIHT officially backed the government's position on EMU. Its support for the Stability Pact and a strict interpretation of the Maastricht criteria had the effect of raising a potential obstacle to Germany's ultimate entry, but was a far cry from outright opposition to abandoning the deutschmark. The DIHT's position was not the result of a simple calculus of some conception of its members' economic interests or even of its members' expressed political preferences. Rather, it was a strategic position designed to take into account its members' resistance to monetary union while accommodating the strong political backing for EMU among the major political parties. The DIHT's position held out the prospects of future resistance to EMU if the political circumstances allowed it, but also enabled the DIHT's leaders to legitimately claim that they were cooperating with the government and Germany's other business associations.

The leaders of the BDI were supportive of the budgetary criteria as well, but not for the same reasons as the DIHT. Necker's successor as BDI President, Hans-Olaf Henkel, sought to emphasise the underlying economic commitments contained in the Maastricht Treaty on the grounds that these conditions contributed to the interests of German industry. The lessons learned from the German Economic and Monetary Union influenced Henkel's perception of the best way to achieve EMU. While GEMU had taken place in an extremely short period of time and under circumstances in which the political alternatives were limited, the member states of the EU had nearly a decade to work out the details of a functioning single currency. While Henkel avoided challenging the underlying policy of German participation in EMU, he sought to use the government's political commitment to the EMU project to advance more narrowly-focused issues affecting the bottom line of Germany's industrialists – lower taxes, deregulation, and limitations on social entitlements.⁶⁴

The deep European-wide recession of the middle 1990s prevented most EU members, including Germany, from consolidating their budgetary positions to the extent called for in the Maastricht Treaty. Several of the member states fell far short of the reference values contained in the Protocols to the TEU. In 1995, Belgium had a gross public debt of 133.7 per cent of GDP and a budget deficit of 4.1 per cent of GDP; Italy's debt was 124.9 per cent of GDP and its deficit a shocking

7.1 per cent of GDP. While Germany managed to stay just beneath the Maastricht reference value of 60 per cent of GDP in regards to public sector debt, the government's inability to completely rein in expenditures pushed the budget deficit for 1995 to 3.5 per cent of GDP, well beyond the convergence criteria's limit of 3.0 per cent. Indeed, in 1996, only one member – Luxembourg which did not have its own currency in any event – met both the debt and deficit criteria.⁶⁵

The inability of European governments to control their public spending and concerns that this inability would undermine the single currency once it was launched in 1999 led Finance Minister Theo Waigel to propose the Stability Pact to extend the budget commitments contained in the Maastricht Treaty into the post-EMU era. The BDI strongly endorsed the Waigel plan for automatic sanctions on profligate states. The BDI favoured strict penalties for wayward states for two reasons. The first was that it shared the government's belief that a strict policy was necessary to bolster the German public's confidence in the EMU project. The second reason was its desire for mechanism that would ensure the stability of the system – German industry, like the German public, needed reassurance that EMU would be a 'zone of stability'.⁶⁶

While Waigel was urging his fellow EU Finance Ministers to show greater restraint in their domestic finances, the BDI also backed the government's position that countries that had not met the strict convergence criteria should not be allowed to participate in the single currency. Indeed, Henkel suggested in the fall of 1995 that while German industry desired a single currency, the Maastricht criteria were too weak.⁶⁷ While the BDI held to this position in 1995 when the German government was under pressure to prove the euro would be as 'strong as the deutschmark', it softened its stance substantially when the time came to actually select participants in 1998.

The political atmosphere during the mid-1990s was reflected in the BDI's concerns that the SPD would use EMU as an election issue. This concern deepened after Gerhard Schröder demanded a delay to EMU and a special treaty dealing with the single currency.⁶⁸ While a new treaty along the lines that Schröder suggested would presumably have strengthened the budgetary criteria and entrenched the Stability Pact, both goals that the BDI had provided rhetorical support for, the Federation did not second the proposal of the SPD leader. Rather, the BDI, relying upon the automatic provisions of the TEU that it had previously criticised, backed the government's call for a 1 January 1999 start-date for Stage Three of EMU.⁶⁹

The Federation of the Chemical Industry followed the BDI position but allowed for a more liberal interpretation of the Maastricht criteria in choosing members. The VCI saw the EMU process as involving a 'tri-lemma' where member states had to choose between adhering to the 1999 timetable, having as many members as possible, and maintaining a basis for euro-zone stability. Any two of the three legs of the 'tri-lemma', suggested the VCI, could readily be achieved but only at the risk of sacrificing the third leg. While the EU could begin the Third Stage of EMU on schedule in 1999 with a large number of members, doing so ran risks of instability given the incomplete state of economic consolidation and convergence among members. On the other hand, starting in 1999 under conditions of stability would also be feasible, but only with a reduced number of members.⁷⁰ The VCI proposed that the member states give priority to starting EMU on schedule and, so as to allow as many members as possible,

when applying the fiscal criteria, the scope left in the Maastricht treaty should be used to admit also those EU member states with a budget deficit still slightly above 3% of the GDP and/or whose debt still exceeds 60% of the GDP.⁷¹

The VCI's priorities were an early completion of monetary union with a large number of initial members. Competitive devaluations from foreign competitors, while infrequent, could undermine years of effort in developing markets and introduce a sharp increase into the cost of chemical inputs for German producers.⁷² The association believed that 'Europe has become the home market of the German chemical industry'.⁷³ An early and broad-based start to monetary union promised to limit the German chemical industry's exposure to currency fluctuation. However, the VCI was highly cognizant of public concerns about the stability of the proposed currency and the need for at least public acquiescence to the successful launch of EMU.⁷⁴ Consequently, it, too, expressed support for the proposed Stability Pact in the strongest possible terms, declaring that

*such a pact must go beyond a loose agreement between the finance ministers.... Failure to comply with the pact must automatically trigger sanctions with noticeable effects, irrespective of the political proportion of votes in the Council.*⁷⁵

Like the other industrial associations, the DIHT believed the Stability Pact was essential to the long-term success of EMU. In contrast to the

chemical industry, however, the DIHT was not in favour of a similarly lax interpretation of the Maastricht criteria. Representing primarily small- and medium-sized enterprises, the DIHT was highly sceptical of softening the convergence criteria, prioritising the domestic German economy in which its members were deeply involved. Nevertheless, the DIHT did not oppose monetary union or even suggest a postponement of the project. Despite their modest differences in emphasis, the DIHT joined with the BDI in calling on the government to provide greater certainty in coordinating the starting conditions of EMU.⁷⁶

In 1996, while the major industrial associations were providing support for EMU and the Stability Pact, the German population had soured on the prospects of replacing their beloved deutschmarks with untested euros. In the European Commission's regular Eurobarometer survey carried out in February 1996, 49 per cent of respondents expressed opposition to the euro with 45 per cent expressing support for the single currency. Five months later, in July 1996, the level of opposition had risen to 55 per cent and support had dropped to 39 per cent.⁷⁷ Other surveys conducted by non-partisan sources revealed even deeper levels of opposition to EMU among the German population as a whole. These levels of dissatisfaction were reflected in a poll of German business managers. Even the leaders of German business associations were compelled to admit that their membership was less than enthusiastic about EMU. The BDI's President suggested that small- and medium-sized members of his organisation were particularly sceptical about adopting the euro.⁷⁸ An opinion survey of BDI members carried out in February 1996 revealed that this assessment of business people's attitudes towards EMU was indeed accurate (Table 2.3).

Table 2.3 BDI Members' Opinion of German Participation in EMU, 1996

Strongly in favour	9%	)	
		)	28%
Moderately in favour	19	)	
Undecided/Uncertain	31	)	31
Moderately opposed	18	)	
		)	38
Strongly opposed	20	)	
Not Stated	3	)	3

Source: Allensbach Institute for Democracy (1996) 'Führungskräfte für die Währungsunion.'

The membership of the BDI fell into three broad groupings. The largest group, comprising just under two-fifths (38 per cent) of BDI firms surveyed, was opposed to German participation in EMU. A second group, numbering just over one-quarter (28 per cent) of firms supported monetary integration along the lines of the Maastricht Treaty. A final group of firms, numbering approximately one-third (31 per cent) of BDI members, held the balance of opinion and was undecided on the merits of EMU membership. A poll of British firms at approximately the same time revealed that British firms were more strongly supportive of monetary union than their German counterparts.⁷⁹ Yet while the CBI held on to a 'wait and see' position on EMU, the BDI was officially in favour of German participation in EMU.

An Allensbach poll of BDI members revealed there was a distinct cleavage between business people as a whole and their industrial representatives. Among a sub-section of the sample, an elite group of 'economic and political leaders' drawn from the leaders of business associations, major corporations, and government, more than three-quarters (77 per cent) were supportive of EMU. At the same time they expressed such overwhelming support for EMU, large majorities of the elite also held deep reservations about the euro. Many simultaneously believed the new currency would be inflationary and less stable than the mark (61 per cent) and that EMU held no economic advantages for the German economy (42 per cent).⁸⁰

The BDI's leadership felt that the split of opinion within the organisation provided them with flexibility in forming a policy position. In Henkel's view, the poll results indicated that various motivations underpinned the different positions of the members: a large number, probably a majority, of firms were sceptical about EMU and worried about inflation and run-away public finances; a second group favoured EMU because they believed that a weaker currency would lead to better export prospects; the third group was also wary of EMU but saw potential advantages if the convergence criteria were strictly adhered to.⁸¹ In their attempts to accommodate both elite opinion (both in government and the business community) and take a position that the members would find acceptable, Henkel and the rest of the BDI leadership found themselves in a position analogous to the position of Kohl and Waigel. The BDI's solution was similar to that of the government – strong support for EMU coupled with a rigorous interpretation of the convergence criteria and promotion of a Stability Pact between members. The BDI's position was not the result of an explicit economic cost-benefit analysis, rather it stemmed from a strategic evaluation of the political options available and the opinions of its members.

In advancing this position, the BDI was in general agreement with the overall thrust of the coalition's political strategy. However, while the government preferred to move towards monetary union with as little public debate as possible, the Federation supported efforts to raise public awareness of the single currency with the aim of increasing the public's acceptance. For firms, this had the added advantage of familiarising enterprises with the technical problems inherent in converting from using one currency to another. In the view of the BDI, German business would be on the 'front lines' when the new currency was introduced. Not only did the BDI call for a public information campaign, but it also sought a coherent national changeover plan and accompanying legislation to enable businesses to take the government's changes into their business plans.⁸²

The BDI also effectively lobbied its own members with an information campaign on the opportunities that the euro posed for business. Still, there was some uncertainty within the organisation about precisely where the priorities of German industry lay. In communications with the BDI member firms (most of whom were small businesses), the BDI's leaders stressed the priority of the convergence criteria and starting with as many members as possible over a religious adherence to the Maastricht timetable.⁸³ Furthermore, the BDI told its members that the advantages of EMU would 'only be realized if the monetary union was also a stability union'.⁸⁴

However, when the concerns of multinational businesses were discussed, the association's leaders shifted the expression of their priorities. When the focus was on these large firms with many cross-national interests, the BDI's leaders noted they would not insist upon a strict interpretation of the convergence criteria because, for Germany's big businesses, it would be extremely costly not to proceed with the scheduled 1999 start-date for EMU. A failure to achieve EMU on schedule and with as many members as possible would mean massive losses for German firms that had spent a major portion of the decade investing in the success of EMU.⁸⁵ An internal BDI paper reported in the German press indicated that the association, despite its occasional communications to smaller firms and its frequent public proclamations to the contrary, did not intend to criticise the government if it ultimately decided to 'take full advantage of the political wiggle room' contained in the Maastricht Treaty for selecting members.⁸⁶

In fact, the BDI did eventually soften its public rhetoric regarding the convergence criteria. While insisting that the criteria would be met, the BDI downplayed the importance of an overly rigorous interpretation and suggested that EU members who did not qualify could

take part in a ERM-II system where non-participants linked their exchange rates to the euro, rather than adopting the currency immediately.⁸⁷ Still, despite the qualms of smaller BDI members, Henkel suggested that this option was less preferable than using the discretionary powers granted in the TEU to allow more initial members, even if the country in question did not meet a strict interpretation of the budgetary criteria.⁸⁸

In 1996, the BDI formed a special committee to provide a 'sober assessment' of the economic costs and benefits of monetary union for German industry. The committee, the Industry Forum on European Monetary Union, operated outside the normal channels of BDI policy-making, and, uniquely among BDI policy committees, functioned under the chairmanship of BDI President Henkel.⁸⁹ The committee consisted of the chairmen of Germany's leading exporters, including such industrial leviathans as Siemens, Daimler-Benz, Krupp, Trumpf, AEG, and Hoechst as well as representatives of the banking and insurance sectors and the chairman of the Institute of the German Economy. Small- and medium-sized businesses were represented by one industrialist. However, this representative, Jan Kleinewefers, was, in fact, the head of a multinational textile conglomerate that had three manufacturing plants in Bavaria, production facilities in the Czech Republic, Great Britain, as well as one in Greer, South Carolina.⁹⁰ Compared with AEG and Daimler-Benz, Kleinewefers Textile Machines Corporation was small, but relative to most German enterprises it was quite large.

The Industry Forum based its primary conclusion that German industry had a compelling interest in exchange rate stability on the huge volume, DM415.2 billion, of German trade with the rest of the EU and the costs that fluctuations in currency values imposed on German exporters. The issue was not the modest one per cent savings in transaction costs trumpeted by the European Commission in *One Market, One Money*, but stability of exchange rates with Germany's primary trading partners. This was particularly true for French participation in EMU. France was Germany's foremost trading partner in Europe. In the BDI's opinion, 'monetary union makes no sense without Germany and France'.⁹¹ For EU members that did not meet the criteria, the BDI reiterated its endorsement of proposals for an ERM-II to provide additional stability to exchange rates for non-euro members. The report suggested that EMU would be especially helpful for small- and medium-sized enterprises, a group that the BDI acknowledged was extremely sceptical of euro membership.⁹²

However, the sole reason that the Industry Forum suggested for smaller firms profiting from EMU indicates that it was not their immediate self-interest that was at stake, but a broader conception of it that included the interests of large firms. According to the Industry Forum, 'although typically their export shares are smaller than those of big enterprises, it is crucial to their [small businesses] survival that the big companies they supply succeed in the export business'.⁹³ In other words, what was good for Daimler-Benz was good for Germany's smaller firms, if not directly, then indirectly through the reflected profitability of multinationals in international competition. The large companies which dominated the Industry Forum looked at what was in the direct corporate interest of their members in an analysis of the costs and benefits of EMU. For their smaller counterparts, they looked not at the immediate impact of EMU on a small firm's bottom-line, but rather at a different conception of small company well-being. These conceptions prioritised the indirect benefits of EMU to small firms through direct benefits to large firms.⁹⁴

The BDI reiterated its call for clear government preparations for EMU so that industry could have some certainty in its plans for the introduction of the single currency. As 1999 approached and firms remained poorly prepared for EMU, the BDI came under increasing pressure from its members to provide them with information about what the changeover from the deutschmark to the euro would entail. The lack of information from the government on this subject was a source of consternation for BDI officials and officials at other industrial associations.⁹⁵

The Janus-faced nature of the BDI's position on EMU was revealed in the manner in which it pitched its report's conclusions to different audiences. For their members, the BDI's main focus was on currency stability and creating a zone of stability within Europe. Fluctuations in currency markets are quite costly for German firms. For example, despite hedging operations and gains from reduced input prices, Ford-Werke calculated that it lost DM300 million (5 per cent of turnover) due to exchange rate instability in 1995 alone.⁹⁶ The Industry Forum's report itself – which was distributed to all member associations and their sub-associations – was rather cautious, and the BDI had to admit that it was unable to quantify the costs or benefits of EMU for German business as a whole. Nevertheless, the BDI's leaders used the report to justify expressing increased optimism both in the 1999 starting date and the number of countries in the first wave of members. While the BDI's leaders provided rhetorical support for fulfilling the convergence

criteria, they also suggested that the budgetary restrictions 'must be applied reasonably and not prohibitively'.⁹⁷ In its more public presentation, the BDI pitched its report in terms of solving employment, an issue identified by 86 per cent of Germans as the number one issue facing Germany in the spring of 1996.⁹⁸

The BDI hoped that the coalition could achieve all three portions of what the Association of the Chemical Industry had termed Germany's EMU tri-lemma: fiscal retrenchment, monetary integration and a specific timetable. The BDI welcomed the ongoing attempts from the federal government to consolidate the government's budget, both as a measure to support the government's European strategy and on the grounds of fiscal prudence. In line with the preferences of its leading members, Germany's major exporters, the BDI also hoped that EMU would begin in 1999 with as many members as possible.⁹⁹

With an eye to the government's budgetary problems, the BDI relaxed its public stance on the convergence criteria in the immediate aftermath of its Industry Forum report. The BDI leadership continued to assert, along with the Kohl government, that they believed Germany and many other EU members would meet the budget targets laid out in the treaty. The BDI argued that budgetary consolidation was essential even in the absence of monetary union, as public deficits could not be sustained indefinitely. However, the BDI also suggested that the room for discretion contained in the treaty allowed for some political judgements. In the BDI's view, whether or not a country could make an exact landing on a deficit of 3.0 per cent of GDP was not a good measure of whether that country had the political will and ability to be a member of a stable EMU. Hans-Olaf Henkel clearly had Italy and Belgium – two countries the BDI's leaders thought should be included in EMU but where actually achieving a deficit of 3.0 per cent of GDP might be difficult – in mind when he suggested that the convergence criteria were not to be taken literally.¹⁰⁰

Unlike the DIHT, which would have preferred to use an egregious failure to achieve the budgetary criteria as a rationale for delaying EMU, the BDI was willing to trade a certain degree of price stability for international exchange rate stability. This preference ordering, similar to that of the coalition, placed the BDI in a political position analogous to that of the government. The coalition's reluctance to pursue a strategy of building public support for EMU weighed heavily on the BDI's leaders throughout 1996. The BDI was completely dependent upon the government fulfilling the convergence criteria in order to complete EMU. If Germany failed to meet the Maastricht criteria, there was no

reservoir of public support for trading the deutschmark for the Kohl government to fall back upon. Thus, the Stability Pact became the political centrepiece of the BDI's public strategy as well.¹⁰¹

Whatever their belief in the beneficial or detrimental consequences of EMU, all of Germany's business associations were in favour of the fiscal restraint embodied in the Stability Pact. At their 1996 annual conference in Petersberg, sixteen of Germany's leading business associations (including the BDI, DIHT and VCI) called for EMU to start at the beginning of 1999. The associations called on their members to be 'politically responsible' and support both the Stability Pact and overall movement towards EMU. They explicitly endorsed Waigel's version of the Stability Pact with automatic sanctions for offending countries – regardless of any political decisions from the Council of Ministers – upon the grounds that the Stability Pact offered the best prospects for controlling what business saw as runaway social costs. Although they called for a strict interpretation of the criteria, they also ambiguously noted that the markets would look not only at whether a country strictly adhered to the criteria's numerical targets, but whether it was taking 'serious and sustainable' measures to bring its finances under control. This left open the possibility that a country might actually fail a strict test of the criteria but be judged to have made such important efforts at consolidation that it should be allowed in. BDI officials suggested this interpretation of the Treaty when evaluating the prospects of Belgium, Ireland and Italy for EMU membership. The associations did agree to oppose budgetary manipulations on the grounds that public confidence in the new currency would be undermined if the member states were seen to be cheating rather than simply making political decisions within the realm of the leeway contained in the TEU.¹⁰²

The BDI sought to use the government's political weakness to its own advantage. Industrial associations were united in their desire for a reduction in the rate of corporate taxation and in the elimination of labour market rigidities. Pursuant to these common interests, the BDI pointed to the benefits for future investment and job creation of a reduction in corporate tax rates and the advantages of flexible labour markets in encouraging firms to create jobs. Although the BDI also called for a reduction in state intervention, industry was less united on the desirability of reductions in government subsidies. Some sectors – most importantly shipbuilding and food products – were heavily dependent on state aid. The BDI's primary public focus was on issues specifically related to the day-to-day operations and profitability of

German industry. Consequently, BDI spokesman primarily called for reductions in corporate taxes and what its members saw as other 'impediments to business'.¹⁰³

The BDI praised the 1997 budget and the coalition's plans for tax and pension reforms prior to the deterioration in public finances that occurred in early 1997. BDI officials felt that the proposed budgetary reforms would reduce the tax burdens on industry and allow for successful budgetary consolidation within the Maastricht framework.¹⁰⁴ BDI leaders made clear that their first priority was the elimination of the tax on capital, while also calling for a reduction in industry's labour costs through a reform of the social insurance system.¹⁰⁵

Monetary union did not figure as the most prominent item on industry's list of policy preferences. The BDI's concern was primarily with the consequences of the government's commitment to EMU rather than with EMU as a policy itself. The BDI had readily used such a commitment to promote fiscal restraint and lower corporate taxation, but had also found that such a course tended to bind the employer's association to the domestic consequences of the government's international commitments. In early 1997, the sudden rise in unemployment and the government's budgetary woes undermined the BDI's ability to promote an elimination of the capital tax. In addition to these political problems, EMU posed technical problems for industry. In this realm, the BDI and its subordinate associations were more consistent as urging technical reforms for the proper functioning of a new currency in Germany avoided more difficult political questions.¹⁰⁶ For a smooth transition to euro-accounting, the BDI suggested that the government would need to make some technical changes to German financial and tax regulations. The successful passage of implementing legislation allowing firms to pay their taxes in euros as well as deutschmarks was the primary request of business. In this respect, the BDI was highly critical of the Federal Revenue Office, arguing that it would be hard for Germany to be in the first wave of euro countries so long as the government did not accept euros for taxes in 1999.¹⁰⁷ The BDI also argued that German firms needed to prepare their computer systems for the Year 2000 bug as well as the advent of the euro.¹⁰⁸

In terms of broader policy, the BDI moved firmly in favour of keeping to the regular Maastricht schedule so that business would have enhanced certainty about the start of monetary union. Moving the starting date would not only bring the whole EMU project into question, but it would also be extremely disruptive – and costly – for businesses which had anticipated a January 1999 launch of the single

currency.¹⁰⁹ The BDI's leaders cast their calls for major reforms to the tax, pension, and labour market systems in terms of its consequences for EMU, a tactic calculated to exploit the government's commitment to monetary union in order to extract concessions in these policy areas favourable to German industry. President Henkel argued that such fundamental reforms would instil the German population with more confidence in the forthcoming EMU. Henkel went so far as to downplay strict compliance with the budgetary criteria, indicating that it was important but should not be overemphasised. This had the advantage of marginally reducing the pressure on the government to balance the budget. At the same time, it also presented the possibility of creating some fiscal leeway to reduce corporate tax rates.¹¹⁰

By the beginning of 1997, 77 per cent of German citizens believed that the introduction of the euro should be delayed while only 18 per cent thought that the government should stick to the Maastricht timetable.¹¹¹ However, the government and major opposition parties all reiterated their commitment to implementing EMU on schedule. As the starting date of monetary union approached, and political support held steady, the level of opposition within Germany's businesses declined. The biggest sceptics remained in construction (34 per cent opposed) and retail trade (38 per cent opposed).¹¹² However, the opposition had declined from previous years. In 1995, half of construction firms surveyed had felt EMU was undesirable and 46 per cent of retail traders had opposed German participation.¹¹³ While they remained divided over the consequences of monetary union for their own enterprises, business had increasingly become convinced of the solid commitment of Germany's political leaders to embarking upon monetary union in 1999.¹¹⁴ Even the DIHT felt comfortable declaring that 'business is taking increasingly seriously the will of the politicians to start the monetary union on schedule'.¹¹⁵ Industry support was primarily the result of politicians' commitment to monetary union and business leaders' desire for consistency in Germany's macroeconomic policy.

The gold revaluation dispute of the summer of 1997 briefly threw the project of monetary union into doubt. The crisis also highlighted the extent to which businesses had come to rely and make plans based upon the government's dedication to a prompt launching of EMU. During crisis, the BDI cautiously sided with the Bundesbank suggesting that the revaluation was not a very good idea. The subordinate associations all backed this position. The BDI did not use the crisis to suggest abandoning the EMU project; rather they suggested that any conflict between the government and the Bundesbank was politically unwise as

it would cast doubt on Germany's commitment to EMU. In tandem with the Bundesbank, the BDI's President argued that even the appearance of controversy would undermine confidence in euro and discourage the governments of other countries from adhering to the Maastricht criteria. The DIHT also opposed gold evaluation and one-time budgetary 'tricks' to improve the statistical measures of public finances.¹¹⁶ The industrial associations believed that the best course of action was for the government and Bundesbank to come to an accommodation on the gold issue and move on to budget consolidation.¹¹⁷ The BDI's concerns during the gold crisis about the implications of German policy on budgetary efforts in other countries highlighted an underlying anxiety of German industry that as many countries as possible be included in the euro-zone. The BDI believed that Italy – the EU member previously the most prone to devaluation – should be in the first wave of EMU but wanted to discourage any further Italian fiscal 'fudging'.¹¹⁸

In the opinion of German industrialists, the gold revaluation and EMU debate was an unwanted distraction from the social and economic reforms – especially those relating to the costs firms paid for labour – that would make an immediate and substantial difference in the profitability of German industry. While the BDI called for a supplemental 'convergence budget' in preparation for EMU membership, it placed a special emphasis on eliminating costly job creation schemes that might undermine the government's commitment to a sustainable reduction in spending and reforms to the social security system. The BDI advocated these positions in order to allow for a reduction in business rates. Fulfilling the Maastricht criteria was more a means to the end of lower taxes than a commitment to EMU as a desirable policy goal itself.¹¹⁹ This motivation was especially true of the construction industry. While industry officials often looked to the export sectors as an engine of growth, other observers saw the stagnant building sector as an additional deadweight on the German economy. In early 1998, the OECD commented that in Germany, 'domestic demand [was] significantly retarded by depressed construction activity...'.¹²⁰ Instead of demanding a lax monetary policy that would eventually trickle through to their sector, leaders of the construction industry concentrated their efforts on reducing the burdens of tax and wages on their member firms.¹²¹

Germany's success in limiting its budget deficit to 2.7 per cent of GDP in 1997 paved the way for an easy adoption of the final provisions of EMU in both the Bundestag and Bundesrat. This and similar

successes in other EU countries in 1998 removed what remained of the uncertainty surrounding monetary union for German businesses.¹²² The DIHT – which had held the strongest position in favour of a strict fulfilment of the Maastricht criteria – and the BDI both welcomed the budgetary figures as evidence of a solid and sustainable fiscal commitment to monetary union.¹²³ Nevertheless, the BDI continued to call for reductions in budget deficit and public spending so as to meet the criteria over the long-term and facilitate businesses' three primary policy preferences of tax relief, pension reform, and movement towards making Germany's rigid labour markets more flexible.¹²⁴

Conclusions

The leading Bundestag parties' support for EMU structured the debate over monetary union for German industrial associations. Of the major parties, the parties in the governing coalition were firmly united in support of monetary union. The main divisions which existed occurred within the main opposition party, the Social Democrats, and this difference reflected divisions between the SPD's national leadership and some of the SPD's Minister-Presidents in the Länder. With the main national parties committed to monetary union, the national debate came to revolve around distributional questions relating to the budgetary consequences of fulfilling Germany's international commitments to austerity in a time of economic recession.

The different economic positions of Germany's associations provided only a modest nuance to their general commitment to backing the government's policies. At one end of the policy spectrum was the chemical industry. The VCI's support for monetary union was the strongest of the German industrial associations surveyed, not surprising for a sector that exported more than half its product to European markets. At the other end of the policy spectrum, the DIHT, representing primarily smaller firms, and the BI, from the construction industry, were also supporters of EMU, albeit with reservations. The DIHT held a strong position in favour of strictly interpreting the provisions of the Maastricht Treaty on the economic preconditions for proceeding with EMU (although the Treaty itself was, in fact, rather vague, and thus not particularly amenable to a 'literal' interpretation).

The hierarchical nature of the BDI enabled its central decision-making bodies to set broad policy goals that its subordinate members followed. The larger member associations, mainly representing export-oriented sectors such as automobiles and chemicals, were

broadly supportive of increased monetary integration. Unlike in the United Kingdom, in Germany the business associations representing small businesses and sheltered sectors were also supportive of the government's European policy. The organisation of Germany's industrial associations enabled the peak associations to focus their efforts on policies such as tax reduction and reduced government regulation over which almost all of their members were united. While both the associations for the confectionery and construction industries represented firms in sectors that had relatively little interest in international trade and a substantial interest in domestic expansion, they followed the policy lead of the BDI on the issue of monetary union and focused their own efforts on issues that had a more immediate impact on their members' competitive positions. This remained true even in the midst of the major economic downturn that occurred in the 1990s. The effects of the recession on the construction industry were exacerbated by the overexposure of the sector to government cutbacks in public infrastructure projects.

Even in the lower-echelon associations where firms were most directly represented, their subordinate status within the BDI (and to a lesser extent the DIHT) circumscribed their ability to present a policy opposed to the peak association's national policy. Because they were integrated into a system of political representation, the construction and confectionery industries had a major institutional barrier to advocating a different policy on major macroeconomic issues. They would have to break with the declared policy of the peak association, the BDI (and in the case of the BDSI with its sectoral association as well). This was an impediment that was difficult to overcome when additional policy options that more directly affected member firms were available.

3

Britain and the Politics of EMU

The most divisive issue in British politics in the 1990s was whether or not to participate in Economic and Monetary Union (EMU). British debates over European policy brought down one prime minister (Margaret Thatcher), contributed to the political humiliation of a second (John Major), and posed a potential threat to the future electoral prospects of a third (Tony Blair). These debates have involved extensive public discussions and controversies among all the major political parties and interest groups. Substantial institutional changes and innovations in the conduct of monetary policy have accompanied these conflicts. Between 1990 and 1999, Britain had four distinct arrangements for deciding and implementing monetary policies. These policies varied in their level of internationalisation, institutionalisation and success. Despite persistent rhetoric about removing interest rate policy from the vagaries of direct political control, all four policies resulted from a highly politicised process. In this chapter, I first examine the institutional environments in which British monetary policy was formed. Then I explore the party politics that underpinned the four distinct monetary policies that the British Government pursued during the 1990s: (1) the Exchange Rate Mechanism (ERM), (2) informal inflation targeting, (3) formal inflation targeting, and (4) an independent central bank.

Political institutions

The debate over EMU in the United Kingdom occurred against a backdrop of a pre-existing framework for monetary policymaking that took place within specific governing institutions. The three-way relationship between the Prime Minister, the Chancellor of the Exchequer and the Governor of the Bank of England, was central to the coordination of

the government's macroeconomic policies. At the same time, this relationship did not exist in a vacuum as governments are tinged both by the demands of maintaining a working majority in parliament and their parties' programmes and ideologies.

The government and the Bank of England

From 1946 until 1997, control over British monetary policy was concentrated in the hands of the elected government. These arrangements, which Andreas Busch has labelled the 'Westminster System', were based around the belief that in a democratic society, such an important economic policy lever as interest rates was too important a tool to be left in the hands of unelected bankers. In a country where Parliament controlled the public purse, control over monetary policy was an important factor in controlling economic policy. According to this point of view, giving control over interest rates to an independent central bank would be tantamount to surrendering Parliament's right to govern Britain.¹

When the Bank of England was nationalised in 1946, no intricate institutional rules were laid out in the Act's three pages. Rather, the Government was given wide discretionary powers with the clause that 'The Treasury may from time to time give such directions to the Bank as, after consultation with the Governor of the Bank, they think necessary in the public interest'.² Although this broad discretionary authority was questioned at the time, all attempts to limit the government's authority over the Bank, including informing Parliament of any instructions given to the Bank, were dismissed. In the 50 years of the 1946 Bank of England Act's operation, the Cabinet member in charge of the Treasury, the Chancellor of the Exchequer, never once had to resort to his statutory power to give directions to the Governor of the Bank, as Bank Governors have never seen it as their responsibility to refuse Treasury requests.³

Given this concern about democratic accountability, it is surprising how ambiguous the British government's procedures were for adjusting interest rates prior to 1994. While the Chancellor of the Exchequer was responsible for conducting the nation's monetary policy and setting interest rates, the lines of authority were not always starkly drawn. Chancellors have a great deal of authority over the government's economic policy; however, they, like all members of the Cabinet, are susceptible to the influence of the Prime Minister, who, as the leading member of government, has influence over any policy that catches his

or her eye. As two of her Chancellors noted in their memoirs, Margaret Thatcher was often a powerful force pushing them to lower interest rates.⁴ This habit of sporadic prime ministerial involvement in interest rate decisions did not disappear when John Major moved into 10 Downing Street in November 1990. Major, while not as assertive as his predecessor, also pressured his Chancellors to either lower or hold the line on interest rates at politically opportune times (such as prior to the 1992 general election).⁵ As a result, interest rate decisions were made irregularly whenever key decisionmakers deemed it politically expedient – which in the 1980s and early 1990s tended to fall just before Conservative party conferences and European summit meetings.

Parliament

A British government's ability to enact legislation rests with its majority in the House of Commons. A ruling party with a large and stable majority has considerable powers to alter the statute books and turn its will into law. Britain's first-past-the-post, winner-take-all electoral system tends to magnify small differences in the popular vote and produce a majority for one of the major parties. Third parties tend to do particularly poorly in terms of translating their shares of the popular vote into parliamentary representation. Consequently, British governments have traditionally been single-party parliamentary majorities relying upon electoral pluralities rather than coalitions relying upon a combined national majority. The Labour Government elected in 1997, for instance, received only 43.2 per cent of the popular vote but won 63.6 per cent of the seats.⁶

While Britain's majority governments do not quite possess the power of an elected dictatorship, their powers are nonetheless formidable. However, a divided government with a narrow majority is in an extremely vulnerable position. Governments in these circumstances find that their hold on power is tenuous. Any issue is capable of creating the internal divisions that threaten their continuation in office. Where governments that are based upon large, stable majorities can shrug off backbench worries about controversial policies, governments with only a few seats to spare cannot. Incapable of mustering the large partisan majorities which help forestall revolt and dissension, these governments are forced to struggle from one government crisis to the next, conveying the impression 'of being in office but not in power'.⁷ James Callaghan's government suffered under this awkward set of circumstances in the infamous 'Winter of Discontent' in 1978–79 and

John Major's government fell victim to an equally fatal erosion of parliamentary support in the final four-and-a-half years of his premiership.

There is very little check on the legislation that can be passed by a majority of the House of Commons. The second chamber of the British parliament, the House of Lords, possesses the ability to delay passage of legislation for three sessions of parliament. Only a bill that would extend the life of a sitting House of Commons can be delayed indefinitely. The House of Lords' limited power to force reconsideration of an issue does not extend to budgetary measures. Since the Lords lack an electoral mandate and hence have no direct democratic legitimacy, they are at a disadvantage in dealing with the Commons.⁸

Within the unequal power relationships between the two houses of parliament, the Conservative Party has traditionally enjoyed a unique

Table 3.1 Party Membership in the House of Lords

<i>Party</i>	<i>1998 (unreformed)</i>	<i>2000 (reformed)</i>
Conservatives	471	232
Labour	164	199
Liberal Democrats	65	63
Crossbench	321	164
Other	115	8
Bishops	25	25

Source: House of Lords Press and Information Office (1998, 2000).

partisan advantage both when it is in government and when it is in opposition. A built-in Conservative plurality in the House of Lords complements Conservative majorities in the House of Commons, allowing for the rapid approval of Conservative legislation. In these circumstances, the House of Lords' meagre powers of delay are rarely exercised against their ideological sympathisers in Conservative governments. When in opposition, the Conservative-leaning House of Lords can carefully scrutinise and obstruct non-Conservative bills.⁹ In 1998, with a massive Labour majority in the House of Commons, the Conservatives had more than 300 more members of the Lords than Labour.

The Labour Party ultimately surmounted the nuisance of the Conservatives' domination of the Lords with a reform of the upper chamber. Over 500 of the hereditary (and mainly Conservative) peers were purged and subsequent appointments were subject to the patron-

age power of the Prime Minister and have consequently been largely Labour supporters.

Parties

Britain's three major parties, the Conservatives, Labour, and the Liberal Democrats, differed in their positions regarding European integration, level of party unity and internal organisation. Over the course of the 1990s, these three factors interacted to influence how the parties responded to the changing debate over Britain's monetary institutions and how they competed with each other. Table 3.2 demonstrates the British results of a European-wide survey of experts on party positions on European integration in 1988 (one year after a general election), 1992 (the year of an election), and 1996 (one year prior to a general election). The results of the expert survey have a high degree of correlation both with similar analyses of party manifestos, with public opinion surveys of voters' perceptions of party positions, and with the conventional impression of party position and level of division.¹⁰

Table 3.2 Party Positions and Dissent on European Integration, 1988–96

	<i>Position on European Integration</i>			<i>Importance of Issue</i>			<i>Extent of Internal Dissent</i>		
	1988	1992	1996	1988	1992	1996	1988	1992	1996
Britain									
Labour	5.50	6.00	6.00	2.88	3.25	3.50	2.38	2.38	2.38
LibDems	6.63	6.63	6.63	3.38	3.38	3.38	2.13	2.13	2.13
Conservatives	3.50	3.88	3.50	3.00	3.63	4.00	2.75	3.25	3.50

Source: Ray, Leonard (1999) 'Measuring party orientations towards European integration: Results from an Expert Survey' *European Journal of Political Research*, Vol. 36, No. 2, pp. 295, 305.

Notes: (1) Position of European integration is on a scale of 1 (most opposed) to 7 (most supportive).

(2) Importance of issue is on a scale of 1 (least important) to 5 (most important)

(3) Extent of internal division is on a scale of 1 (united) to 5 (most divided)

Conservatives

The Conservative Party of Margaret Thatcher and John Major was the dominant political party in Britain throughout the 1980s and into the 1990s. While never winning more than 43 per cent of the popular

vote, the party maintained a sizable parliamentary majority throughout the 1980s. The party began the 1990s with a reputation for tough and effective, if rather hard-hearted, economic policymaking. Conservative governments tended to support increasing the role of markets in the distribution of resources while resisting the expansion of the state's role in the economy. The party was also rhetorically opposed to inflation, although it was only sporadically successful in the pursuit of an anti-inflationary strategy. The Conservatives also defended traditional conceptions of national sovereignty and were reluctant to transfer additional political powers to European institutions for fear that this would impose an additional level of bureaucracy on British business.

During the 1990s, the party became increasingly divided over European policy. One broadly pro-European wing of the party was well represented at the Cabinet level – although, most notably, it did not include Thatcher. The other, less integrationist wing, the Eurosceptics, was most prominent among backbenchers not bound by the collective responsibility of Cabinet members. However, several Cabinet members were sympathetic to the Eurosceptic position, a situation which complicated the formation of a coherent Government policy on monetary union.¹¹ The Conservatives' narrow majority in the 1992 election made this division extremely important as Eurosceptic backbenchers could credibly threaten to thwart the government's European legislation.

The Conservative Party's organisation emphasised the role of constituency parties and provided them a substantial degree of financial and operational autonomy. The party's decentralised procedures for selecting and deselecting parliamentary candidates exacerbated the difficulty of disciplining uncooperative MPs. A series of financial, ethical, and sexual scandals plagued Conservative MPs during the 1990s, but the Conservative Party leadership was powerless to discipline the MPs involved. In the absence of a criminal court verdict, party leaders lacked the power to deselect MPs, even those credibly accused of committing the most outrageous offences. In the wake of the 1997 election defeat, this perceived organisational shortcoming led to a strengthening of the powers of the Conservative Party Central Office (and the Party leader) over local parties and over party nominees.¹²

Labour

The left-of-centre Labour Party was in opposition from 1979–97 and for most of that period was weighed down with a reputation for eco-

conomic incompetence. High inflation and unemployment and a wave of strikes in 1979 had led to the collapse of the last Labour government. As a result, many voters viewed Labour as the party of inflation, indecision, devaluation, and general economic malaise. During the 1990s, Labour's leaders invested great time and effort into rehabilitating the party's image and developing a more appealing economic programme, including acquiescing to the Conservatives' privatisation schemes and culminating in the abandonment of the Labour Party's symbolic commitment to nationalisation of industry.¹³

While the Labour Party in the early 1980s had been highly sceptical of European institutions, its years out of power and the potential for European social legislation led to a less ambivalent attitude towards European integration. The Labour Party supported British participation in the ERM in part because the economic rigours that membership in the ERM implied were particularly attractive for a party seeking economic credibility. Although there were differences of opinion within the party over EMU, the benefits of being in opposition during most of the 1990s enabled Labour to avoid the deep public splits that had so effectively divided the Conservative Party.

In the 1980s, Labour had been riven by faction and leftist extremism. Internal party reforms – begun under Neil Kinnock and continued by John Smith and Tony Blair – reclaimed power for Labour's National Executive Committee and the leader of the parliamentary party and went a long way towards ameliorating impressions that the party was more concerned with 'gesture politics' than with developing effective public policies. Local selection of candidates was curtailed and greater national supervision was implemented, both of which centralised authority and strengthened the position of the leader of the parliamentary party. The centre's ability to discipline and suspend individuals and entire local parties, while extraordinarily divisive when initially implemented, proved decisive in creating a more disciplined and unified party.¹⁴

In addition, the Labour Party's leadership possessed formidable institutional powers, especially in its strong links with the trade unions and the constituency parties that insulated its position from challenge from MPs. Labour leaders and deputy leaders were selected through an electoral college of three unequally weighted parts. The trade unions, which cast their votes as a block, received 40 per cent of the votes. The constituency Labour parties, which each conducted first-past-the-post ballots, received 30 per cent of the votes. And the Parliamentary Labour Party, consisting of individual votes by Labour MPs, received

the final 30 per cent. This system was reformed in 1993 so that each of the three sections of the electoral college cast an equal one-third of the votes.¹⁵

Liberal Democrats

Formed in 1988 from the merger of the Social Democratic Party and the old Liberal Party, the Liberal Democrats are both the smallest and the most pro-European of the major British political parties. Due to the vagaries of the first-past-the-post electoral system, the Liberal Democrats were unable to turn their 10–20 per cent share of the popular vote into more than one or two dozen Members of Parliament prior to 1997. However, even this small representation could prove decisive when the Government of the day had a narrow and precarious majority in Parliament. The Liberal Democrats have long been the champions of electoral and constitutional reform. The party is explicitly federal, both in its own internal organisation and in its political programme. This ideological preference for federal governmental structures extends to Britain's participation in European-level institutions, which the party has, in general, supported, and a commitment to devolution of powers to regional assemblies. The party's leaders were strong and early proponents of British participation in both the ERM and EMU, a position on which the party has been solidly united. The Liberal Democrats' relatively informal methods of candidate recruitment and selection might indicate that the party would have difficulty uniting its parliamentary delegation; however, in practice the small size of the delegation and the rarity of an incumbent Liberal Democratic MP tend to instil a greater degree of unity than would otherwise be expected.¹⁶

Referendum Party (1996–97)

The three major parties' political positions on European integration were complicated by the emergence of the well-financed Referendum Party in 1996. Sir James Goldsmith, the Eurosceptic billionaire financier, created the party and paid for candidates to contest every constituency in the United Kingdom on a single issue campaign to have a national referendum on any attempt to take Britain into a single European currency. Goldsmith received a large amount of media attention both in the United Kingdom and abroad, and the possibility that his party would undermine support for the Conservative Party haunted Tory leaders in the run-up to the 1997 election campaign. Indeed, the massive defections from the agreed cabinet policy on the

single currency in the personal manifestos of Tory backbenchers were widely in response to fears of losing support to Referendum Party candidates. Although it fared relatively poorly in the 1997 general election, obtaining only about 750,000 votes, Goldsmith's Referendum Party had its intended effect on its single issue.¹⁷ All three major parties eventually pledged their support for a national referendum on the single currency.

THE ERM (1990–92)

Margaret Thatcher and the ERM

Margaret Thatcher was opposed to putting the pound in the ERM; however, her position in the Cabinet became increasingly isolated and politically untenable by 1990. Throughout most of her premiership, she resisted efforts to put the pound into the European Community's system of semi-fixed exchange rates, ERM, believing that ERM membership was the first step on the road to EMU, which she adamantly opposed. By the late 1980s, an increasing number of Cabinet ministers came to believe that membership in the ERM would make a significant contribution to price stability in the United Kingdom as well as promote trade and better relations with the other members of the EC. During the late 1980s, Nigel Lawson, the Chancellor of the Exchequer, repeatedly and unsuccessfully pressed Thatcher to take sterling into the ERM. Faced with Thatcher's resistance to a formal link within the European Monetary System, Lawson went so far as to orchestrate the pound's informal 'shadowing' of the deutschmark for more than a year. While the majority of her Cabinet colleagues, the Governor of the Bank of England, the Confederation of British Industry (CBI), most of the economics profession, and the nation's leading newspapers came to support ERM membership by the late 1980s, Thatcher remained opposed – publicly declaring that Britain would join 'when the time was right', privately believing that the time would never be right.¹⁸

In 1989, Lawson and Geoffrey Howe, the Foreign Minister, forced her into accepting that a convergence in British and ERM-zone inflation rates and a liberalisation of Continental capital controls would suffice to make the conditions right for British participation in the ERM. However, Thatcher exacted her revenge for being subjected to the so-called 'Madrid conditions' when she demoted Howe from the Foreign Office to the nominal role of Deputy Prime Minister and

Leader of the House of Commons. Thwarted in his attempts to make membership in the ERM the centrepiece of Britain's anti-inflationary strategy, Lawson eventually resigned from the Exchequer, a post he had held for six years, in frustration in October 1989.¹⁹

Lawson's resignation undermined Thatcher's position in the Cabinet. Thatcher lost the Government's most senior economic policymaker when Lawson resigned and suffered a serious blow to her own position as prime minister. With only Nicholas Ridley (Department of Trade and Industry) from the right-wing of the Tory party supporting her position of remaining outside of the ERM, Thatcher had few remaining high-profile supporters. Lawson's successor as Chancellor, John Major, was in an extremely advantageous position vis-à-vis the prime minister, as Thatcher could not afford to lose two Chancellors in short order. Ridley's resignation in July after a series of offensive and ill-considered comments about German national character and politicians left Thatcher totally isolated within her own Cabinet.²⁰ With inflation climbing towards 10 per cent and pro-European sniping both from within the Cabinet and the backbenches, John Major, then the Chancellor of the Exchequer, was able to convince a politically-isolated Thatcher in October 1990 that the government's anti-inflationary strategy could best be pursued through putting the pound in ERM.²¹

While Lawson had unsuccessfully pushed for membership in the ERM, he left behind a plan for Britain's negotiating position in the European Intergovernmental Conference on EMU. Rather than support a single currency along the lines of the Delors Plan, Lawson came up with a plan for coordination of economic policies and competing national currencies that would allow all twelve national currencies to be treated as legal tender throughout the European Community. Businesses and perhaps individuals would accept the currencies which held their value and spurn weak currencies. It was a market-oriented plan, designed to avoid any movement towards a single currency. Britain's European partners saw it in just such an obstructionist light, and even this modest alternative was effectively gutted when the Prime Minister ridiculed her own Government's plan during Prime Minister's Question time.²² John Major, who inherited the scheme after Lawson's departure from the Treasury, was unable to generate much enthusiasm for the idea, and it was soon discarded.²³

In the wake of the failure of the 'competing currency' plan, Major promoted a similar successor proposal for the development of a *common* European currency (rather than a *single* currency), the 'hard

ecu', that would be managed by a central European institution and which would circulate in parallel with the twelve existing national currencies. This parallel currency would differ from the ecu basket of currencies in that the hard ecu was designed so that it would never be devalued against any of its constituent currencies (hence the name 'hard ecu'). Those who wanted to use the hard ecu could do so, and those who wished to use their traditional national currencies, like the pound, could do so as well. Market forces would dictate the extent to which each currency was used among the citizens and businesses of the member states. The hard ecu option was designed to have a political appeal to pro-integrationists while not threatening those, like Thatcher, who opposed the idea of a single European currency. With Thatcher's blessing, Major was able to present an alternative British plan for European monetary cooperation and integration. Other EC states were suspicious that the hard ecu proposal, like the 'competing currencies' plan before it, was designed to sink any monetary cooperation, but reluctantly agreed to consider it.²⁴

Thatcher's acquiescence to ERM membership in late 1990, given grudgingly and after years of resistance, came when the pound was probably slightly overvalued at DM2.95:£1. However, as her ministers and European partners had all invested so much energy and political capital in overcoming her opposition, no one was willing to argue over the exact details of a few pence and pfennigs when the broader issue of British ERM membership had finally been settled.²⁵ Many also believed that the pound's high rate would provide the sort of immediate discipline to exporters necessary to head off inflationary impulses. Others thought the rate might be too low, as Lawson had earlier attempted to 'shadow' the deutschmark around DM3.10:£1. In part as a result of this uncertainty, the pound was not within the narrow ± 2.5 per cent bands that characterised the French, German, and Dutch currencies; rather it was in the wider ± 6 per cent bands along with the Spanish peseta and Portuguese escudo.²⁶ This, British policymakers hoped, would provide enough flexibility for the new entrant to stabilise its rate against the other major currencies before moving to a more restrictive arrangement.

When Margaret Thatcher agreed to join the ERM, she did so primarily to enjoy the lower interest rates and higher rates of growth then prevailing in Germany. Indeed, Thatcher demanded a 1 per cent reduction in British interest rates on the day of sterling's entry into the ERM.²⁷ While this strategy of attempting to bask in the reflected glow of the Bundesbank's reputation did provide the British government

with some credibility in its attempts to dispel inflationary expectations, the government's policy was, in reality, a gigantic bluff. Britain's membership in the ERM was a classic gambler's bluff as the government sought all the benefits without ever having to reveal the weakness of its hand. In fact, despite ERM membership, British decisions about interest rates were made in exactly the same institutional environment as they had been prior to membership. The Chancellor of the Exchequer still maintained operational control over interest rates. If politicians were reluctant to raise interest rates to ward off inflation for fear of the electoral consequences, the same individuals might well be reluctant to raise interest rates to sustain a nominal currency peg. Rather than holding a stronger set of cards than it had in 1989, the British government held almost identical cards to those that it held prior to ERM membership. This was unproblematic so long as the markets did not call the government's bluff, but it was not a situation that could last indefinitely. In the early stages, however, membership in the ERM did contribute to a reduction in inflation, just as its proponents had hoped. Inflation in the United Kingdom decreased sharply from approximately 11 per cent at the end of 1989 to under 4 per cent at the beginning of 1992. At the same time, interest rates were reduced from 15 per cent before entry to 10.5 per cent just prior to the 1992 election.

Despite agreeing to join the ERM, Thatcher's relationships with her Cabinet colleagues and backbenchers continued to deteriorate. Faced with a revolt on the backbenches, riots in the streets of London over her Poll Tax proposals, and a string of by-election defeats, Thatcher reopened her party's divisions over Europe by disavowing the Cabinet's compromise position on monetary union, declaring to the House of Commons of the Lawson-Major plan that 'the hard ecu would not become widely used throughout the [European] Community'.²⁸ As the British Government had been telling its European negotiating partners that the hard ecu would be widely used and was a market-oriented solution to the desire to create a common currency, Thatcher's repudiation of her own Government's policy was a complete disaster for Britain's negotiating position.²⁹

Soon thereafter, Karl-Otto Pöhl, the President of the German Bundesbank, rejected the hard ecu in a speech before the London School of Economics.³⁰ A Select Committee of the House of Lords followed, not only discarding the hard ecu but endorsing a single currency.³¹ The Deputy Prime Minister, Geoffrey Howe, promptly resigned; a resignation that was symbolically devastating not only because Howe

was the only member of Thatcher's original 1979 Cabinet still in Government, but because he had been her original Chancellor of the Exchequer.³² Thatcher's premiership did not survive Howe's resignation and in the ensuing leadership contest, John Major pieced together a coalition of party loyalists and the Thatcherite right wing to become party leader and prime minister.³³

John Major and Maastricht

Thatcher's resignation and Major's accession to the premiership temporarily smoothed the intra-party difficulties that the Conservative Party had experienced over relations with Europe. At the same time, freed from Thatcher's frequent intransigence, the British government was able to enter into a more constructive dialogue in the 1991 Intergovernmental Conference. While Major was often just as resistant to the creation of European-level institutions as Thatcher had been, he and his government were much less ideologically rigid in negotiations than his predecessor. The hard ecu proposal was rehabilitated in the IGC negotiations, but Major and his Chancellor, Norman Lamont, were never able to generate any enthusiasm for it amongst their European counterparts, and it eventually had to be abandoned in the summer of 1991.³⁴

Entering the final meetings of the IGC in Maastricht in December 1991, Britain's European partners were clearly committed to proceeding with a single currency. Because of Germany's central role in European economic affairs and the deutschmark's position as the anchor currency of the EMS, the Delors Report, which proposed a European central bank designed along the lines of the German Bundesbank, was used as the blueprint.³⁵ There was also general support for the Social Chapter, which the Conservative Party and the Major Government adamantly opposed. John Major was faced with the threatened resignation of a series of government ministers if EMU was either accepted or rejected. Rather than reject a treaty outright, the British negotiators proposed that Britain agree to the Treaty on European Union, but be allowed to defer, without prejudice, decisions on both the Social Chapter and EMU. As the Conservative Party completely rejected the Social Chapter, there was no question that they would opt-in to European social legislation.³⁶

On EMU, Britain explicitly reserved the right to decide whether or not to join only when the other members decided to go ahead with the final stage of monetary union, either in 1997 or 1999. This rather

ingenious compromise had long-term economic advantages as participation in EMU was mandatory for the other EU members who lacked Britain's derogation. Regardless of the state of economic convergence in 1999, the other members would be committed to making participation in EMU one of their foremost priorities.³⁷ However, the state of economic convergence would not be known for between six to seven years, a rather long time frame over which to pre-commit a government. The short-term political costs that Major would suffer were he to make any choice regarding EMU prior to 1997 included the open splitting of his Cabinet between a pro-European wing that included many of the Cabinet's leading figures and a Eurosceptic wing which included the Chancellor (Norman Lamont), many junior members of the Cabinet, and several right-wing acolytes of Margaret Thatcher. Major's opt-out on EMU – which was both derided as a 'whip's compromise' and praised as a brilliant piece of party management – prevented a conflict with either faction and put off a decision until EMU was set to launch.³⁸

However, the British delegation did not stay aloof from the discussions of the economic convergence criteria. Regardless of British participation, the Conservative government had a clear ideological preference for the economic policies membership in a monetary union would entail – fiscal consolidation, reduction in government debt, low inflation, interest rate convergence and stable exchange rates. In this, they were ready allies for the Germans, Dutch and Danes. The institutional framework hewed quite closely to the Delors Report, and thus quite closely to the Bundesbank model of an independent central bank with a federal structure. While publicly agnostic, the British government accepted that, in terms of anti-inflationary credibility and functional necessity, the European Central Bank should be operationally independent. The domestic consequences, granting independence to the Bank of England, were likewise put off five or six years into the future. On this subject there was some division of opinion as Lawson was a supporter of central bank independence while Major opposed granting the Bank of England independence on democratic grounds, but evidently did not pursue the point regarding the European Central Bank.³⁹

During the April 1992 election campaign, the Maastricht Treaty was only tangentially debated and each of the three major parties supported continued participation in the ERM. The Conservatives endorsed both the ERM and the opt-outs that Major had negotiated for Britain at Maastricht. The Social Chapter, about which the party was nearly unanimous in its opposition, was dismissed as 'damaging' and

presented as an example of the type of anti-business European-level legislation only a Conservative Government would resist. On EMU, the Conservatives held a somewhat wary position as they both wanted to praise Britain's ongoing membership in the ERM as 'central to (the Conservative Party's) counter-inflation discipline...' but avoid pre-committing themselves on EMU prior to the evaluation of the economic criteria in either 1997 or 1999.⁴⁰ This position continued the virtuous political-economic compromise worked out at Maastricht, effectively preserving Britain's economic options and ensuring internal party unity within the Conservative Party throughout the general election campaign.

The two primary opposition parties went further than the Conservatives on both EMU and the Social Chapter. Labour endorsed a range of European initiatives, pledging not only to sign up for the Social Chapter, but also to pursue active negotiations about the precise form of EMU, including an emphasis on an expanded set of European institutions, arguing that 'the elected finance ministers must become the effective political counterpart to the central bank whose headquarters should be in Britain'. This clearly signalled Labour's intent to expand Britain's ERM membership to include active participation in EMU, a position that the Labour Party's economic affairs committee informally endorsed.⁴¹ For their part, the Liberal Democrats explicitly endorsed participation in EMU at the earliest possible date (1997), ending Britain's opt-out on the Social Chapter, and proposed expanding the European Union's federal institutions (to accompany the federalisation of the United Kingdom domestically) as well as the enhancement of a common European citizenship.⁴²

The Conservative Party used the issue of ERM membership against Neil Kinnock and the Labour Party. Labour, said the Conservative Party's political broadcasts, could not be trusted to make tough economic choices. Although Kinnock had backed ERM membership since the mid-1980s and had urged Thatcher for years to join, the Conservatives suggested that Labour lacked the anti-inflationary backbone to prevent devaluation.⁴³ They argued that the only way to ensure that the ERM – what Major repeatedly called the 'centrepiece' of Britain's economic strategy for the rest of the 1990s – remained intact was to vote for the Conservatives. During the campaign, the top two issues receiving media coverage on the four (BBC1, ITV, Channel 4 and Radio 4) major television and radio outlets were economic policy and taxation – two of the three issues (the other being law/order) on which the Conservative Party had an electoral advantage over Labour.⁴⁴

John Major's victory in the 1992 general election owed a great deal to the electorate's lingering doubts about Labour's economic competence.⁴⁵ Ironically, it would turn out to be the Conservatives who lacked the will to take the steps necessary to preserve ERM membership. While the Conservatives won the election, they did so with a substantial reduction in their majority. The 102 seat majority that Thatcher had won in the 1987 election was reduced to 21 seats. While a 21-seat majority would have provided a comfortable margin for a united party, one, like the Conservatives in 1992, that was highly factionalised and plagued by chronic in-fighting would find it a perpetual source of tension. European legislation in general, and the Maastricht Treaty in particular, provided just such a source of intra-party conflict for the Conservatives. On issues of taxation, social policy, law and order, pensions and a whole host of other issues, the Conservative Party was firmly united. Over Britain's proper relationship with its European partners, the party was hopelessly divided.

The Maastricht Crisis

The divisions within the Conservative Party over Europe were brought to the forefront within a month of its narrow election victory. Parliament had been dissolved on 14 March 1992, barely a month after the signing of the Maastricht Treaty (7 February 1992). Consequently, consideration of the Maastricht Treaty was the first important item on the Government's post-election agenda. Even with the Government's reduced majority, the initial consideration of the Maastricht Bill after the election was uneventful. While some Conservative backbenchers were determined to oppose the legislation, the opposition parties provided the Government with a reservoir of support, either through deliberate abstention or outright support. Neil Kinnock had pledged the Labour party's cooperation in ratifying the agreement, intending on holding only a symbolic vote of opposition to the Government's opt-out on the Social Chapter. Labour's Shadow Cabinet agreed that the party's parliamentary delegation would abstain on the primary vote for the legislation rather than oppose the Maastricht Bill. Their opposition would be confined to a variety of amendments, most importantly the Social Chapter. There was, however, some significant dissent within the party, especially among the left-leaning Tribune Group, many of whose members saw Maastricht as a plan for a deflationary, 'bankers' Europe' rather than as a potential 'social Europe'. The Liberal Democrats, while also favouring inclusion of the

Social Chapter and EMU, pledged to support ratification. In line with their general support for an expansion of democratic accountability, the Liberal Democrats also supported a national referendum immediately following parliamentary approval. On 22 May 1992, with most of the Labour Party abstaining, the Maastricht Bill passed its second reading by a vote of 336-92 with support drawn from the Conservative and Liberal Democrats (2 pro-European Labour MPs supported the Government) and opposition from 59 Labour MPs, 22 Conservative MPs, and 11 Ulster Unionists.⁴⁶

Smooth approval of the Maastricht Bill collapsed when the Danish electorate unexpectedly rejected the treaty in a referendum on 2 June. The Danish referendum result threw the European Union into a deep crisis and stalled the ratification of the Maastricht Treaty. Within Britain, it emboldened Eurosceptics in all parties and forced Parliament as a whole to reconsider approving the Maastricht Bill. Eurosceptic Conservatives circulated a motion calling for a 'new approach' to Europe in light of the Danish referendum which, despite the cajoling and bullying of Government whips, gathered 69 signatures.⁴⁷ With at least one-fifth of the Conservative delegation potentially opposed to the leadership's European policy, this level of dissent clearly jeopardised the Government's majority in the House of Commons. Labour's policy of official abstention was also cast in doubt, as more than 40 Labour MPs signed another Early Day Motion calling for the renegotiation of the Maastricht Treaty along the lines of socialist, rather than monetarist, principles.⁴⁸

Disagreement over Maastricht seriously divided the Labour Party which was in the midst of a leadership election after Neil Kinnock's resignation as party leader. John Smith, the Shadow Chancellor, supported the Shadow Cabinet's existing pro-European strategy. Not coincidentally, in 1972, Smith had defied the Labour leadership and voted for Britain's original entry into the European Community, a personal history which gave him unimpeachable European credentials and which he frequently mentioned in press interviews.⁴⁹ Smith was challenged from the Left by Bryan Gould who advocated abandoning the Maastricht agreement in favour of one that emphasised more democratic structures of governance, especially a European central bank that was democratically accountable and devoted to growth and employment.⁵⁰ With almost unanimous support from the union and constituency sections and more than three-quarters of the votes from Labour MPs, Smith was elected by a wider margin than any previous Labour leader.⁵¹

The Conservative leadership enjoyed neither Labour's disciplined mechanisms of leadership control nor the luxury of opposition. Major's Cabinet decided to delay consideration of the Maastricht Bill until the European situation had clarified itself. This decision effectively placed the Maastricht Bill into a state of parliamentary suspended animation until after the French referendum in September 1992. In the House of Commons, Major dismissed the Liberal Democrats' calls for a referendum but promised a parliamentary debate on the implications of the Danish vote once the leaders of the EU member states had determined a new policy.⁵² This debate eventually took place in November 1992, but not before an economic crisis added fuel to the simmering political fire.

'Black Wednesday'

Joining the ERM at the time it did quickly posed two particular problems for the British government: upward pressure on interest rates and downward pressure on growth. The first occurred because Britain experienced a real appreciation in the value of its currency so long as inflation rates in Britain remained above those in Germany and so long as Britain was committed to defend a nominal peg to the low-inflation deutschmark. In a floating system, the deutschmark-pound rate would sink to allow for the inflation differential, but in a fixed rate system (as ERM was perceived to be in 1990–92) Britain would have to maintain interest rates above German levels to compensate for higher rates of inflation. Events in Germany exacerbated this undesirable situation.

When West Germany absorbed East Germany in 1990, it did so with an exceptionally generous monetary settlement on the old East German currency coupled with promises of no taxes to the West German electorate. While the government of Helmut Kohl was able to ride the wave of political optimism to a huge electoral triumph, the economic consequences of its unification strategy diffused throughout Europe. After the immediate inflationary boom that intra-German monetary union created, the Bundesbank sought to deflate the inflationary bubble with high interest rates. As the Bundesbank pushed interest rates higher, other European governments had to either push their own interest rates up or experience a drop in the value of their currency against the deutschmark. If their currencies dropped too low, they would press up against their lower bands and be in danger of falling out of the European Monetary System (EMS).⁵³

Increasing interest rates might have been bearable if the British economy had been expanding, but with interest rates at 10 per cent in September 1992, Major's government faced the second of its ERM prob-

lems: low growth. Britain was converging towards the rest of Europe in a recession. Every key macroeconomic indicator in the UK had started to synchronise with those on the Continent between 1990 and 1992. Inflation and interest rates were both beginning to track those in Germany and France quite closely. However, unemployment and growth were also headed in the European direction – that is, upwards for unemployment and downwards for growth (see Figures 3.1 and 3.2).

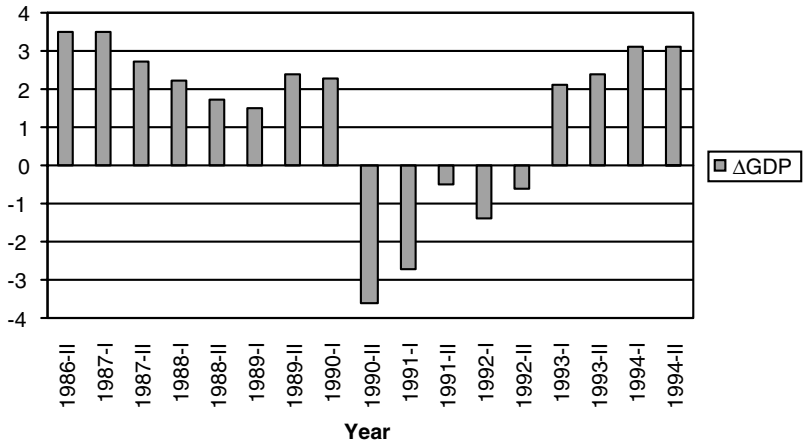


Figure 3.1 GDP Growth, UK, 1986–94
 Sources: OECD (various issues) *Economic Outlook* (Paris: OECD).

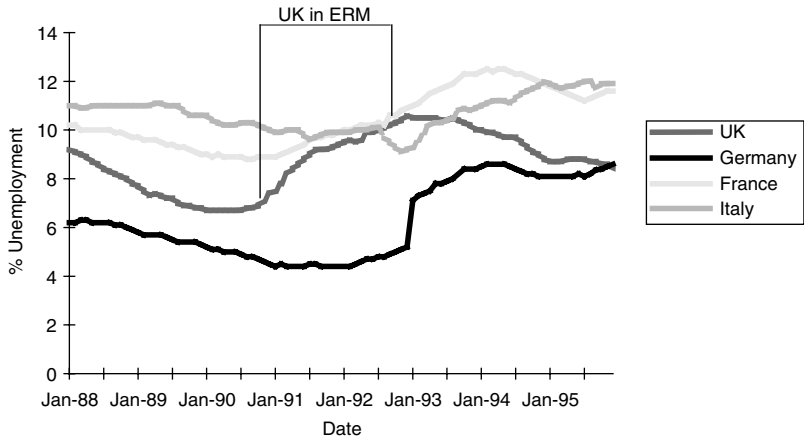


Figure 3.2 Unemployment Rates, 1988–95
 Sources: OECD (various issues) *Quarterly Labour Force Statistics* (Paris: OECD). Period of British ERM membership highlighted in figure. Prior to January 1993, German data is for West Germany only.

With inflation sharply reduced in a time of rising unemployment and sustained high interest rates, the British economy did not appear to be synchronised with German economic conditions. The upward trend in German interest rates was particularly unwelcome in Britain, where the consequences of interest rate increases were passed rapidly along to homeowners in the form of higher mortgage rates. Not only was home ownership more common in Britain than in Germany and France, but 90 per cent of British mortgages were variable-rate compared with only 10 per cent in both Germany and France where mortgages are traditionally taken out at fixed rates.⁵⁴ Nevertheless, the British Government declined to publicly acknowledge considering any policy alternatives save remaining within the ERM. Lamont ruled out a revaluation of the deutschmark, a devaluation of sterling, interest rate cuts, and abandoning ERM – everything except the status quo.⁵⁵

With the British housing market in a state of depression throughout most of 1991–92, higher interest rates in Britain meant that more hardship would be piled on the shoulders of homeowners, a group that had become a core Conservative Party constituency in the Thatcher years. During the downturn of 1988–92, the amount of money spent on house repairs and maintenance decreased by 14.4 per cent, the value of private residential housing dropped 28.6 per cent, and the value of new starts plummeted 47.5 per cent – all record reductions.⁵⁶

International currency traders started speculating against the pound shortly after the 1992 general election and the pound began to drift towards the bottom of its exchange rate band. Still, the government was unwilling to raise interest rates, hoping instead that the Germans would loosen their monetary policy and reduce the pressure on the other ERM currencies, including the pound. When the Danes rejected the Maastricht Treaty on 2 June 1992, the mirage that the Maastricht Treaty would be effortlessly approved and implemented throughout Europe was dispelled. Instead of progressing steadily to fruition, the future of the whole project was suddenly and very publicly cast in doubt. With the attention of international markets focused on the fate of the Maastricht Treaty, François Mitterrand embarked on an unnecessary referendum campaign in France. What Mitterrand had expected to be an easy victory that would shore up the treaty and rehabilitate the French Socialist Party quickly became a contentious campaign whose outcome was in doubt until the final vote on September 20.⁵⁷ Investor confidence, which had become increasingly wary even before these political shocks and uncertainties were introduced, evaporated in the run-up to the French election.

Speculation was not confined to the pound, but extended to most of the countries in the EMS. However, as pressure built up against several of the ERM currencies, the British authorities found that the financial markets realised the political pressures the Major government laboured under and had grouped the pound with the 'weak' currencies.⁵⁸ Rather than raise interest rates or pre-emptively devalue the pound within the existing framework of the ERM (a course of action suggested repeatedly by Bundesbank officials), Major and his Chancellor of the Exchequer, Norman Lamont, staked the reputation of the government on maintaining the pound's parity around the central rate of DM2.95. In late August 1992, the government began publicly intervening in support of the pound. In early September, Lamont secured a loan of £7.2 billion (10 billion ECU) from the Bundesbank in an attempt to convince investors that the Bank of England would have the resources to fight off a speculative attack on the pound. However, this had the perverse effect of signalling the government's concerns that its own commitment to the pound's parity lacked credibility.⁵⁹

The British government believed that neither interest rate hikes in the UK nor a devaluation of the British currency was necessary to reduce the strains the EMS was putting on the British economy. Rather, they determined that their salvation lay in a reduction in German interest rates that would reduce the costs that the divergent German economy was imposing on the EMS.⁶⁰ With German inflation rising, the Bundesbank would not cooperate and there was no political mechanism to compel its compliance. With its cherished reputation for independence and anti-inflationary zeal, the Bundesbank could easily resist foreign pressures to lower interest rates. At least three times in July and August, Major and Lamont (as well as their French and Italian counterparts) urged interest rate reductions on the German Government. All three times they were rebuffed. Still, during an acrimonious meeting of foreign ministers and central bank presidents on 4 September in Bath, Lamont repeatedly pressed Helmut Schlesinger, president of the Bundesbank, to lower Germany's interest rates. Schlesinger repeatedly refused and the meeting ended in an impasse with the French unwilling to contemplate altering their parities in the midst of the difficult Maastricht referendum campaign, the British refusing to either raise interest rates or change their parity, and the Germans unwilling to loosen their monetary policy.⁶¹

Meanwhile, the British housing market continued to slump. By 1992, the Bank of England estimated that one million homeowners owed more money on their houses than they could sell them for. By the fall,

the number of households with negative home equity had risen a further 20 per cent. These drops in home prices were particularly visible to Conservative ministers as the impact of the collapse in the housing market was concentrated in the southeast and the Home Counties, traditional bastions of Conservative strength.⁶² Base rates, which the government had cut eight times in the twenty months before September 1992, were at 10 per cent, too high a level to trigger a recovery in the housing market; yet, they were also too low to support the pound against the deutschmark.

As the date of the French referendum approached, speculators targeted a series of ERM currencies, including sterling. The Bank of England, along with other European central banks sought to support the pound, but in a few brief days the Bank of England had exhausted its own reserves, run through more than £10 billion in loans from the European Monetary Cooperation Fund, spent the £7.2 billion line of credit it had received from the Bundesbank, and still failed to keep the pound above DM2.778. Only at this point did the British raise interest rates and the sudden 2 per cent hike on 16 September signalled British policymakers were panicking rather than acting decisively. When this failed to stop the haemorrhaging, a further increase of 3 per cent was announced but never implemented. At the end of trading on 16 September 1992, 'Black Wednesday', sterling's participation in the EMS was suspended. The pound promptly slid from DM2.778 to under DM2.50. The British government lost an estimated £4–6 billion in its failed attempts to prop up the pound in the days before the devaluation.⁶³

Over the course of 1992–93, currency speculation forced nine countries to either devalue or suspend their membership in the ERM. Against this background, Britain's economic experience differed little from those of the other EU countries that were forced to devalue. Only the Conservative Party's political circumstances were different. After declaring that ERM membership and the DM2.95 parity were an irreplaceable component to their economic strategy, the Conservative government made no effort to re-enter the ERM after it was forced to abandon both the DM parity and the ERM. In his address to the House of Commons in the wake of sterling's suspension from the ERM, Lamont initially indicated the government's intention to rejoin the ERM when German and British interest rates were at more compatible levels, although he did not hold out hope that this would occur in the near future.⁶⁴ Likewise, within days Treasury civil servants began to discuss conditions for re-entering the ERM at a lower and more stable

rate.⁶⁵ However, as the government's problems ratifying the Maastricht Treaty mounted, this goal was permanently abandoned.

Parliamentary ratification

The political repercussions emanating from the economic shock of 'Black Wednesday' merged with the simmering discontent over the Maastricht Treaty to create a full-blown crisis for the two major political parties. While Major and Lamont survived a vote of confidence in their economic policies with only eight Tory abstentions, 75 Conservative MPs subsequently signed a new 'Fresh Approach' motion.⁶⁶ In the Labour Party, Bryan Gould resigned from the Shadow Cabinet immediately after 'Black Wednesday' in order to promote a 'people's Europe' and oppose the Maastricht Treaty rather than being bound into the Shadow Cabinet's policy of abstention. In this endeavour, he had the support of approximately 60 Labour MPs.⁶⁷

However, Smith was extremely effective at replacing troublesome individuals from Labour's governing institutions with his own subordinates and supporters, thus consolidating support for Labour's post-ERM policy position – a return to the 'fixed but adjustable rate' ERM.⁶⁸ Smith was able to fight off Gould's challenge to Labour's pro-European policy and at the same time strengthen his position as party leader. At Labour's annual conference in September, barely a week after 'Black Wednesday', Gould and his supporters on the Left of the party were systematically purged from the National Executive Committee (NEC), and the union block vote was utilised to crush motions from the floor that called for a referendum and for the parliamentary party to oppose the Maastricht Treaty. In the constituency ballots for seven places on Labour's National Executive Committee, seats which had once been the preserve of the Labour Left, the party leadership's candidates defeated all the remaining dissident elements with the sole exception of Tony Benn who finished seventh. Even Benn's survival on the NEC was barely even symbolic as he lacked any colleague to second his dissenting motions.⁶⁹

Because John Smith was not responsible for a legislative programme, Labour had the luxury of choosing when to oppose the government and when to cooperate. Basing his strategy on the consequences for the Labour Party unity, Smith chose to cooperate with the Government in opposing a referendum and opposed the Government on specific procedural matters with amendments supporting the Social Chapter on which Labour was united.

The Major Government faced the reverse situation – a festering back-bench rebellion that could not be pacified by opportunistic parliamentary

tactics and an unreliably cooperative opposition. On the key procedural motion to begin committee consideration of the Maastricht Bill, the so-called 'Paving Motion', the Government effectively made approval of the motion an unofficial confidence vote in the Government, a strategy which allowed the Labour Party to officially oppose the Government rather than abstain. Thus, Labour was able to solve some of its own internal differences on the grounds that the legislation was really a *de facto* partisan political vote rather than a vote on the Maastricht Treaty. Despite the quasi-confidence motion nature of the vote, 26 Tory MPs, encouraged by the recently ennobled Baroness Thatcher, rebelled against the Government.⁷⁰ However, because Government ministers officially declared that the vote was a substantive rather than a confidence measure, the Liberal Democrats were able to support their party's historic pro-European position. The votes of 19 of the 20 Liberal Democratic MPs enabled the legislation to pass with a majority of only three votes (319–313).⁷¹

Labour opposition did not extend to final approval of the Treaty. Parliament finally approved the Maastricht Bill in May 1992 on a vote of 292–112. However, 41 Conservative MPs opposed the Government, and an additional five abstained on the Bill's final reading.⁷² Labour officially abstained but suffered its own rebellion as five MPs supported the Government, and 66 voted against the Treaty in protest at the exclusion of the Social Chapter. The Liberal Democrats remained solid supporters of European integration, with only one of their MPs opposing the Maastricht Treaty. Opposition in the House of Lords from Baroness Thatcher was brushed aside as the Government called in its hereditary peers to support the Government, creating a majority of 269.⁷³

The Tory rebels extended their revolt after the Maastricht Bill to an 'unholy alliance' with Labour and the Liberals in support of a resolution that would have prevented ratification of the Treaty without the inclusion of the Social Chapter. With 24 Conservatives voting in favour of the Social Chapter, the resolution carried against the Government's opposition. Rather than ratify the Treaty with the Social Chapter (the preference of Labour and the Liberal Democrats) or abandon it altogether (the preference of the Eurosceptics), Major demanded a vote of confidence in his Government's policy on the Social Chapter. A dissolution of Parliament would not have been to the Conservative Party's benefit. Its poll numbers had collapsed since 'Black Wednesday' and in June 1993 had hit an all-time low of 24.2 per cent, putting them in third place behind the resurgent Liberal Democrats. To make matters worse, the Conservatives had lost a by-

election in May on a swing of 28 per cent to the Liberal Democrats. Faced with what one newspaper called a 'hijacker's ultimatum ... "Take me to Maastricht or I kill us all"', all but one of the Eurosceptics supported the Government in the confidence motion rather than confront the devastations of a general election.⁷⁴

Informal inflation-targeting (1992–94)

When sterling fell out of the ERM despite drastic, last-ditch increases in British interest rates, the Conservatives' economic strategy lay in ruins. Conservative proponents of the ERM had heralded membership as a 'lifeboat' which would rescue the British economy from chronic waves of inflation. Strict though the deflationary medicine might be in terms of unemployment and interest rate hikes, an exchange rate link with the deutschmark, the ERM's supporters had argued, would provide the surest path to sustained price stability. Devaluation threatened a cascade of rising import prices, wage pressures, and ultimately an increase in inflation. In the aftermath of the pound's forced devaluation – the first it had ever suffered under a Conservative government – the British government was faced with the task of reconstituting its economic strategy in the absence of what had been its central pillar, the ERM. Two years of ERM membership had enabled the government to cut the inflation rate substantially (from over 11 per cent to under 4 per cent); however, with a sudden 15 per cent reduction in the external value of the currency and the loss of the deutschmark anchor, it was feared that the country faced an imminent bout of inflation in 1993.

In the new, floating era, the government for the first time decided to target the inflation rate itself rather than some intermediate target as it had in the past when it had focused on reducing the public sector borrowing requirement, the growth in the money supply, or the exchange rate. In all these cases, the government had believed there was an underlying causal relationship between the variable targeted and inflation, yet had never actually targeted inflation itself.⁷⁵ Declaring a clear target against which to measure the government's performance had the advantage of providing a focal point around which economic actors could base their expectations.

The target itself was, in fact, not precise, but it was much more specific than had previously been the case. In place of vague promises of 'reductions' in inflation, Lamont declared that the government would attempt to take the measures necessary to keep inflation within a range of 1–4 per cent, a 1.5 per cent band around a 2.5 per cent target

with the aspiration of pushing inflation below 2.5 per cent prior to the 1997 general election.⁷⁶ Lamont's new institutional arrangements also called for a greater degree of policy transparency. While interest rate decisions before Black Wednesday had rarely been explained beyond the government's press releases and background briefings of reporters – both of which encouraged rabid speculation throughout the media and in the City – Lamont authorised the publication of substantial background data on his interest rate decisions. In addition, the Bank of England was to publish its own quarterly *Inflation Report*. Initially, this took the form of a chapter of the Bank's quarterly bulletin, but as the Report gained greater credibility, it was upgraded to a publication in its own right. This made it harder to quietly do away with the *Inflation Report* if it revealed unfortunate trends about the government's success or lack of success in fighting inflation. Cessation of a chapter in an existing publication would have been rather simple, but discontinuing an entire government publication would be much more difficult. Previously, the Treasury had carefully massaged the Bank's reports on monetary policy. Under the new arrangements, Treasury supervision of the report would cease, and the reports would reflect the expert opinion of the Bank. Nevertheless, the new arrangements did little to regularise the conduct of monetary policy in the United Kingdom.⁷⁷

Formal inflation-targeting (1994–97)

The 'Ken and Eddie Show'

The appointment of Kenneth Clarke to the position of Chancellor of the Exchequer in 1993 brought further institutional reforms. In the pursuit of greater policy transparency, Clarke decided to regularly publish detailed minutes of the monthly meetings between the Chancellor of the Exchequer and the Governor of the Bank of England six weeks after each meeting. Any divergence of opinion between the two officials would quickly be revealed to the markets, Parliament, and the electorate. While this did not preclude disagreement, it guaranteed that a more complete account of the decisions behind changes in interest rates would be publicly provided. The Chancellor would at a minimum have to defend any decisions that went against the advice of the Governor. For three years, from 1994–97, British monetary policy was conducted under this set of arrangements. For the duration of this arrangement, Kenneth Clarke was Chancellor and Eddie ('Steady Eddie') George was Governor of the Bank of England. The Chancellor and Governor's monthly interest rate meeting quickly came to be

known in the media as the 'Ken and Eddie Show', a sobriquet that called attention to the personalised nature of the decision-making process. While previous decisions had been the responsibility of the Chancellor, and to a lesser extent the Prime Minister, now a new interaction took place. To some extent, the highly public meetings and subsequent publication of minutes liberated the Chancellor from the influence of the Prime Minister; however, these new measures preserved the political power of the Chancellor, subjecting him only to the advice of the Governor.

In practice, Clarke frequently disregarded George's advice on the direction of interest rates. In each of their nine meetings immediately prior to the May 1997 election, George recommended increases in interest rates. Clarke ignored all but one.⁷⁸ This reflected a broader pattern, where the Chancellor accepted the Governor's advice for either keeping rates unchanged or decreasing rates, but rarely accepted his advice for rate increases. Between January 1994 and April 1997, Clarke and George held 39 monthly meetings. In those meetings, George twice recommended a reduction in interest rates and Clarke accepted his recommendation both times (100 per cent). Nineteen times George advised no alteration in rates, and Clarke agreed seventeen times (89 per cent), reducing rates on the two occasions (11 per cent) when he disagreed. Finally, the Governor urged the Chancellor to raise rates in eighteen of their meetings but his advice was accepted only four (22 per cent) times. The other fourteen times (78 per cent), Clarke held rates steady (Table 3.3). While the new system imposed some restraint on the Chancellor and provided some regularity to the conduct of monetary policy, it still did not immunise interest rates from political manipulation.

Table 3.3 Governor's Recommendation and Policy Decided, 1994-97

		<i>CHANCELLOR'S DECISION</i>	
		<i>Agreed</i>	<i>Disagreed</i>
RECOMMENDATION	Decrease	100%	0%
	No change	89%	11%
	Increase	22%	78%
	Total	59%	41%
		(n = 23)	(n = 16)

Sources: Data compiled from Bank of England (12 January 1994 through 10 April 1997) 'Chancellor's Monthly Meeting with the Governor of the Bank of England' (London: Bank of England).

A dwindling, divided majority

The ratification of the Maastricht Treaty did not resolve the conflicts within the Conservative Party, it only signalled the beginning of a bitter, four-year-long truce between the party's factions. The Government's opt-out on EMU was preserved in form, but the substance remained a matter of great contestation within the Cabinet and within the ranks of the party. The Eurosceptics who had opposed the Maastricht Treaty wanted to immediately exercise the opt-out of EMU. So, too, did a handful of relatively junior Cabinet members. Within the Cabinet, senior Cabinet members like Kenneth Clarke, Douglas Hurd and Michael Heseltine were all solidly in favour of greater integration. After the sacking of Norman Lamont from the Exchequer, Major was in a position that was synonymous with the one Margaret Thatcher had been in when he had become Chancellor. The devaluation of sterling had destroyed his economic credibility and the passage of the Maastricht Treaty had exhausted his political authority. Major could not lose another Chancellor of the Exchequer and remain in office as Prime Minister. As Clarke was an avowed Europeanist and a major supporter of Britain's participation in monetary union, Major could not afford to alienate (or lose) his new Chancellor by capitulating to the Tory rebels and ruling out participation in EMU.⁷⁹

At the same time, the Conservatives' majority in Parliament was very slender. Major could not rid himself of the Eurosceptics within the Cabinet, thus increasing his intra-party problems. As Major noted in an unguarded moment with a journalist:

the real problem is that one has a tiny majority.... I could have done these clever and decisive things that people wanted me to do and I would have split the Conservative Party in smithereens. And you would have said: 'Aren't you a ham-fisted leader, you've broken up the Conservative Party'.... Think it through from my perspective. You are Prime Minister. You have got a majority of 18. You have got a party still harking back to a golden age that never was but is now invented. And you have three Right-wing members of the Cabinet actually resigned. What happens in the parliamentary party? ... Oh. I can bring in other people into the Cabinet ... but where do you think most of this poison has come from? It is coming from the dispossessed and the never-possessed. You and I can both think of ex-ministers who are going around causing all sorts of trouble. Would you like three more of the bastards out there?⁸⁰

This Cabinet and Parliamentary stalemate within the Conservative party led to a situation where, for three years, the Government's official policy on EMU was that it would 'wait and see' whether the conditions were appropriate for entry. Eurosceptics were dissatisfied that this position implied that participation in EMU was a valid option, a stance they rejected in principle. The topic of EMU was so divisive that the Government could take no position other than 'wait and see' without provoking both a crisis within the Cabinet and an uproar within the Parliamentary party. The resulting policy drift and political infighting caused extensive damage to the party's standing with the electorate.⁸¹

Public discontent with the Conservatives was reflected in the by-election defeats which eroded their majority over the next four years, as the Tories became the first governing party in British history to lose every single by-election contest held during its term of office. The by-election losses provided a constant reminder of the government's low standing in public opinion polls. During the life of the 1992–97 Parliament, the Conservatives lost eight seats to by-elections while gaining none and suffered four defections without gaining any in return. This continual erosion of support only deepened the five-year-long crisis that Major's Government faced over European issues as its ability to hold a parliamentary majority was constantly in question.

Local election losses were equally severe, and the Liberal Democrats replaced the Conservatives as the second-largest party at the local level after the 1995 local elections. Despite this unprecedented decline in local support, the Conservatives continued to slip in council elections held in 1996 and 1997, as the national party's unpopularity undermined the electoral chances of its local affiliates. Going into the 1997 national election campaign, the Conservatives controlled a mere 13 of the 465 county councils in the United Kingdom.⁸²

The 1997 general election

Although the Conservatives went into the 1997 election campaign with favourable economic conditions, they were abysmally unpopular. Their standing in opinion polls never recovered from the pound's devaluation on 'Black Wednesday' (see Figure 3.3). From September 1992 until the May 1997 election, the Conservative Party was always at least 10 per cent behind the Labour Party. For a brief period immediately after the parliamentary debacle surrounding the ratification of the Maastricht Treaty, they even trailed the Liberal Democrats.

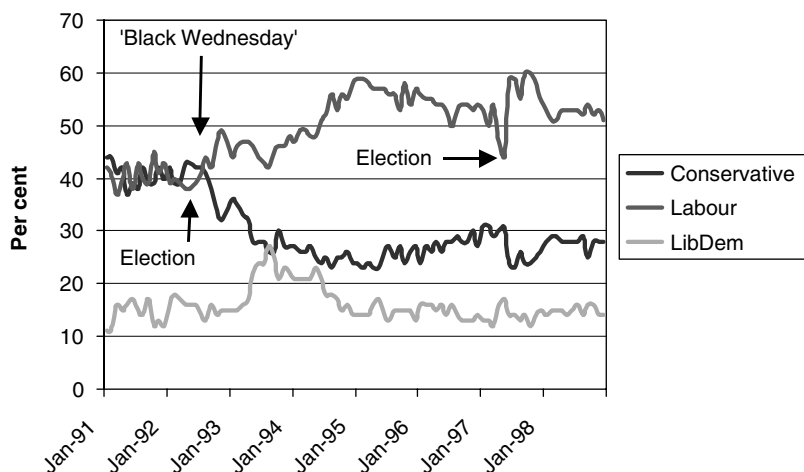


Figure 3.3 Parties and Public Opinion, 1991–98

Sources: Opinion polls cited in *British Elections and Parties Yearbook*, vols. 1–9 (1991–98).

Sir James Goldsmith's creation of the Referendum Party in 1995 was designed to foster debate within the United Kingdom over whether Britain should take part in a 'federal Europe' rather than what Goldsmith and his supporters saw as the more appropriate 'association of sovereign nations that are part of a common trading market'.⁸³ Goldsmith paid the expenses of Referendum Party candidates in over 550 constituencies across the country. As single issue candidates opposed not simply to the single currency but to increased European integration more generally, they appealed to voters who were inclined to vote for candidates based solely on opposition to the expansion of European-level institutions. Courtesy of £20 million in campaign funds from Goldsmith, the Referendum Party distributed videotapes attacking the European Union and the major parties' positions on it to every household in Britain and ran full-page advertisements in all the major national papers.⁸⁴

The Conservatives, for whom the Referendum Party posed the greatest threat, continued to try and finesse their party's internal divisions. Their manifesto declared that

If, during the course of the next parliament, a Conservative government were to conclude that it was in our national interest to join a single currency, we have given a guarantee that no such decision would be implemented unless the British people gave their express approval in a referendum.⁸⁵

The promise of a national referendum on Britain's entry into a single currency in the party manifesto was not enough to garner support from MPs. Conservative divisions over the single currency remained the most prominent feature of the campaign. Major had negotiated a 'wait and see' policy with the disparate factions in his cabinet, but many Conservative backbenchers were ideologically loathe to accept the compromise. Conservative candidates fled from their leadership's position in droves. Even some junior cabinet members had difficulty sticking with the government's position. As the campaign progressed, more and more backbenchers flouted the leadership's line in their private manifestos, and the press kept a running tally of the rising number of defectors. The spectre of the Referendum Party and a standing offer from another Eurosceptic millionaire, Paul Sykes, to pay up to £5,000 of Conservative candidates' election expenses further undermined the cabinet's authority over the parliamentary party on the issue of the single currency.⁸⁶

Two weeks before the election, the haemorrhaging of support had become so great that Major was forced to make a dramatic appeal to the voters to support his policy.⁸⁷ His announcement did not stem the tide of defections and by April 21 Sykes was able to announce that a total of 232 of the 336 Tory candidates eligible for his support had voiced opposition to monetary union. Since collective responsibility for government policy bound the 89 Government ministers to Major's wait and see' line, that meant under 20 candidates in Conservative seats had failed to oppose a single European currency.⁸⁸ In the face of public disagreement among several of his cabinet members, Major was forced to concede that he would allow MPs a free vote on any decision to proceed with monetary union.

In contrast to the Conservatives' public divisions over their party's European policy, Tony Blair's 'New' Labour Party was willing to overlook any internal differences in its quest for its first electoral triumph in nearly 25 years. The Labour manifesto, like the Conservative manifesto, placed the ultimate decision point for entering the single currency far in the future, declaring that

There are three pre-conditions which would have to be satisfied before Britain could join during the next Parliament: first, the Cabinet would have to agree; then Parliament; and finally the people would have to say 'Yes' in a referendum.⁸⁹

Labour canvassers argued that this manifesto commitment provided a 'triple lock' against giving up the pound. While indecision and

infighting wracked John Major and his party over precisely the same policy, the Labour leadership was able to convince its candidates that the issue of the single currency was distinct from the 1997 election campaign. The commitment to a future referendum was a promise to anti-euro Labour candidates that the 1997 election would not prejudice the party in favour of monetary union. Whatever the merits of the promise, it had its effect in muting Eurosceptic Labour candidates.

Even the Liberal Democrats, the country's only solidly pro-European major party, endorsed a referendum, arguing that

Britain should participate in a successful single currency. ... However, three conditions must be met before Britain can join. First, the single currency must be firmly founded on the Maastricht criteria. Second, Britain must meet those criteria. Third, the British people must have agreed to it in a referendum.⁹⁰

The Liberal Democrats' support for a referendum fit closely with their advocacy of greater democracy and more transparent government structures within Britain and the European Union. Long supporters of proportional representation for elections to Westminster, the LibDems also campaigned for referendums on Scottish and Welsh assemblies, regional English assemblies, a democratisation of the House of Lords, and an expansion of local government.⁹¹

Unlike the 1992 election, the final results closely reflected the final polls. Nationwide, Labour won over 43 per cent of the vote and 419 seats. While the electoral retribution for 'Black Wednesday' was not swift, it was massive. The Conservatives failed to win a single seat in either Wales or Scotland and suffered huge losses in their English heartland. Tory electoral hegemony ended in the most comprehensive electoral defeat in modern British history. Seven cabinet ministers lost their posts, including the leading right-wing Eurosceptic contender for the party leadership, Defence Minister Michael Portillo. Conservative losses went even deeper than the national swing of 11 per cent indicated. The first-past-the-post system, which for 18 years had preserved large Tory majorities in the face of a divided opposition, finally worked against the Conservatives as voters voted tactically to defeat Tory candidates. In particular, the previously dispersed support for the Liberal Democrats became geographically concentrated in the west and southwest, resulting in a doubling of Liberal Democratic seats in spite of a reduced vote total. Plaid Cymru held onto its four Welsh seats and the Scottish Nationalists picked up three seats, doubling their representation in Westminster.

The scale of the Labour landslide not only cost several Conservative cabinet ministers their parliamentary seats but also derailed their ambitions to lead the party. With no MPs from either Scotland or Wales and only 165 seats in England, the rump of the party faced a choice between the Eurosceptic wing of the party and the pro-European wing. Out-of-office and demoralised, the Conservative Party turned to the right. Its new leader, William Hague introduced a shadow cabinet including such leading Eurosceptics as Michael Howard and Peter Lilley and relegated Europhiles Clarke and Heseltine to the backbenches. In addition, he introduced a new line on monetary union for the party, ruling out membership in the single currency for the duration of the 1997–2001 Parliament.

Central Bank Independence (1997–present)

Within days of winning the election, Labour's new Chancellor of the Exchequer, Gordon Brown, raised interest rates and gave the Bank of England operational independence in the pursuit of the government's inflation target.⁹² Independence in some form or another had been stalking the Bank for nearly a decade. Two of the three Chancellors of the Exchequer before Gordon Brown, Nigel Lawson and Norman Lamont, revealed in their resignation speeches how two successive Prime Ministers, Margaret Thatcher and John Major, had each turned down their advice on granting operational independence to the Bank.⁹³ In 1993, a select committee of the House of Commons had also endorsed such a reform; however, no action was taken.⁹⁴ The Labour Party, while vague on exactly what role the Bank would play in its economic policy, had called for reforming the relationship between the Bank and the government. In 1993, in the wake of the ERM devaluation, Labour had called for greater openness in the Bank's decision-making procedures.⁹⁵ By 1995, Labour was calling for a new monetary policy committee with responsibility for fulfilling an unspecified mandate (although the inference was that it would be price stability).⁹⁶

While Brown's reforms took more than a year to be introduced in legislation, the Chancellor made the principal changes effective from May 1997. The primary features of the new monetary framework were:⁹⁷

- an inflation target set by the government
- the creation of a nine member monetary policy committee (MPC) with operational independence and a price stability mandate

- publication of the MPC's minutes within six weeks of its monthly meetings
- publication by the Bank of a quarterly *Inflation Report*

The reforms that Brown implemented evolved from the policies he inherited from his Conservative predecessors, particularly in the realms of accountability and transparency. Where the Tory government had a target range of ± 1.5 per cent around a central target point of 2.5 per cent, Brown hardened the target to a specific 2.5 per cent with the statutory requirement that if the underlying inflation rate deviated by more than 1.0 per cent on either side of the target, the Governor of the Bank of England would have to write an open letter to the Chancellor explaining why the MPC had failed to fulfil its mandate and present a case for remedial action to bring inflation within the designated range.⁹⁸

The 1998 Bank Act gave the MPC relatively unfettered control over interest rates. The Chancellor retained the power to overturn MPC interest rate decisions, but only in 'extreme economic circumstances' and only if a separate Act of Parliament ratified the Chancellor's action.⁹⁹ This 'safety valve' for Parliamentary control over monetary policy raised several politically-costly hurdles that did not exist prior to 1998. Prior to May 1997, while the Chancellor had to listen to the advice of the Governor, the power to make decisions about interest rates was still directly in the hands of the government. After Brown's reforms, the initiative on setting interest rates passed to the MPC. To overturn an MPC interest rate decision, a Chancellor would have to both admit the existence of 'extreme economic circumstances' and go before the House of Commons for implementing legislation. The Chancellor lost his ability to directly administer interest rates.

The MPC itself is composed of nine members. The Governor and both Deputy Governors of the Bank of England all sit on the MPC and are appointed by the government (in practice, the Prime Minister in consultation with the Chancellor) to five-year terms of office. After consulting with the Chancellor, the Governor appoints two members of the Bank of England's executive with responsibility for monetary policy analysis and operations to three year terms. Finally, the Chancellor appoints four outside experts to three year terms.¹⁰⁰

Of Brown's four initial appointees, two were not British citizens and one of those had once worked for the Central Intelligence Agency. Ironically, when informing the House of Commons of his proposals, Gordon Brown had announced that 'The reforms ... represent a British

solution to meet British needs'.¹⁰¹ What the reforms represented was Labour's attempt to divorce the political cycle from the monetary cycle. Creating an independent central bank served to exorcise the inflationary spectre that had haunted Labour for decades while also giving the government some credibility in the realm of economic competency. While setting up a framework that provided a short-term boost to New Labour's economic reputation bore similarities to the miscalculations of the Tory's entry into the ERM seven years earlier, granting independence to the Bank of England created a convenient scapegoat for the Labour government in the event the economy deteriorated.

Brown preserved the previous administration's practice of publishing the minutes of the decision-making meetings on monetary policy. Since the new arrangements call for the MPC to make decisions about interest rates, the relevant minutes are of the MPC's monthly meetings which are published six weeks after the MPC meets. The Bank remained responsible for publishing the *Inflation Report* as a record of its analysis of the monetary situation and the future path of inflation. Displayed in a probability distribution around a projection point for a period up to 24 months in the future, the *Inflation Report* is designed to give a 'best estimate' of future inflation, with an emphasis on the inexactness of predicting future behaviour. The lack of a specific prediction leaves observers with a fair amount of uncertainty about the future course of inflation. It does, however, also reflect the uncertain environment within which policymakers operate. Some members of the MPC itself expressed concern that the probability 'fan' displayed in the *Inflation Report* lent itself to misinterpretation.¹⁰² However, outside observers rated the Bank of England's conduct of monetary policy as among the most transparent in the world.¹⁰³

The British economy experienced robust growth throughout 1997–98. Had interest rates remained under the control of the Chancellor rather than the MPC, the short-term political costs of increasing interest rates would have been reduced by a prosperous real economy. Gordon Brown did, after all, increase interest rates within days of taking office without any demonstrably negative consequences for Labour. In five of its fifteen meetings following independence, the MPC increased interest rates. In four of the meetings where rates were not increased, a sizeable minority of the MPC favoured increasing rates.¹⁰⁴ Inflation hovered approximately around the government's target.

These institutional changes addressed one part of the short-term problems in conducting monetary policy in Britain – the Chancellor of the Exchequer's control over interest rates. Political pressure for inter-

est rate changes has been deflected from the government to the MPC, thus relieving the government of any blame that might be attached to making the 'wrong' monetary policy decisions. This was politically advantageous, especially in a time of rising interest rates and the ongoing appreciation of the pound.

Labour's policy regarding monetary union was less decisive, but no less politicised. Labour's 179-seat majority insulated the government from any backbench rebellion. The extent of Labour's victory meant that many of the influx of new MPs were extremely new to the party and particularly loyal to Tony Blair. There were also 46 Liberal Democrats, a group who could be counted on as a reservoir of support for any pro-integration policies the new Labour Government might choose to embark upon. Cooperation between the two parties extended so far as to include the participation of leading Liberal Democrats on a joint Cabinet Committee.¹⁰⁵

In 1998, although Britain easily met the strict budgetary convergence criteria laid out in the Maastricht Treaty, the Blair Government decided to exercise John Major's opt-out and remain outside the proposed single currency zone. Furthermore, they erected an additional series of political barriers to membership. Labour pledged itself to a series of political hurdles that would have to be met before Britain would join EMU. The so-called 'triple lock' of the Labour Manifesto committed a Labour Government to winning majorities in the Cabinet, Parliament, and in the country (through a national referendum) before signing up for a single currency. The inclusion of a referendum in Labour's 'triple lock' helped the Government circumvent the constitutional questions relating to sovereignty that surrounded potential British participation in EMU.¹⁰⁶

In October 1997, Gordon Brown announced that the Labour Government would couple these political tests with a series of additional tests that while ostensibly economic, also allow for political interpretation. Under Labour's new policy, Britain will join the euro zone if it meets five methodologically vague economic tests.¹⁰⁷ The tests themselves were

- (1) whether cyclical convergence with Europe has been achieved
- (2) if sufficient flexibility exists to deal with economic problems in the euro zone
- (3) if EMU will provide better long-term investment prospects
- (4) if joining will have a positive impact on The City of London
- (5) if membership is positive for employment.¹⁰⁸

Of these tests, the first is perhaps the only one that can be determined with any accuracy. At the time Brown presented his tests, Britain and the other members of the EU were clearly not on the same business cycle – Britain was booming while the Continent was mired in recession. The government further suggested that it would be difficult to tell if the British and European economies had converged before the next election, which conveniently fit Labour's electoral goal of removing EMU from the realm of public debate during the 2001 election campaign. Polls indicated public reluctance to join EMU. By promising a referendum and setting up a series of tests that could only be evaluated after the next general election (or the one after that), Labour leaders prevented the discredited Tory party from using EMU as a potentially popular campaign issue. The other four tests were either highly subjective or could already be answered in the affirmative – the City, for instance, had long been a supporter of monetary union.¹⁰⁹

In the meantime, the new Bank of England Act provided a framework for monetary policy generally similar to that of the European Central Bank. Nevertheless, while the recently-passed legislation made the Bank of England much more independent from political influence than it had been previously, it still fell short of the rules laid out in the Maastricht Treaty for full independence.¹¹⁰ In particular, the government's ability to instruct the members of the Monetary Policy Committee on the inflation target would need to be eliminated to bring British legislation into conformity with other central banks in Europe. The three year terms of office for the appointed members of the MPC are likewise insufficient given the Maastricht Treaty's five year minimum term of office.

Conclusions

While Britain shared its European partners' concerns about inflation, on the whole, it remained aloof from most of the European monetary institutions erected to combat inflation and promote economic and political integration. Still, British policymakers increasingly identified the Bank of England's lack of independence from the government as a weakness in the pursuit of a successful anti-inflationary strategy. The perceived need to reform its institutions to eliminate this inflationary tendency in policymaking led different British governments to attempt a variety of rule-oriented policies and institutional alternatives to the politically administered and personalised system for setting interest rates that existed before the 1990s.

After several years of flirtation with the Exchange Rate Mechanism (ERM), Britain belatedly joined the ERM in October 1990. However, it actually participated in the system for only two years before massive speculation against the pound forced sterling out of the ERM. In the wake of the collapse of the ERM strategy, the Conservative Government used a system of inflation targeting and policy transparency. While this mechanism had a fair amount of success, it remained susceptible to traditional means of political manipulation in the run-up to the 1997 general election. However, the political consequences of the 1992 devaluation were so extreme that the Conservative Party's reputation for economic competence had been shattered beyond all hope of repair. Even five years later, at the peak of a prolonged economic recovery, the electorate refused to credit John Major and his government for the lowest unemployment and interest rate figures in more than a decade and gave the opposition Labour Party the greatest electoral triumph ever witnessed in the United Kingdom. Learning from the mistakes of its predecessor, the Labour government sought to remake monetary policy in order to remove politicians from control over (and also responsibility for) monetary policy and granted operational independence to the Bank of England. The Labour government, even though less hostile to EU institutions than its Tory predecessor, continued to be ambiguous about its intentions towards the euro.

To a degree perhaps greater than that of any other country, the structure of the British government has relied upon the gradual accumulation of formal and informal changes over time. As a new century dawns, British politicians continue to debate the question of whether adding an independent, Teutonic central bank to the 'horrid mixture of features'¹¹¹ that characterises the British Constitution will banish inflation from the British economy while promoting economic growth and employment.

4

British Business and EMU

This chapter examines British business associations' political positions and their strategies towards European monetary integration during the 1990s. I argue that three variables influenced the evolution of business associations' attitudes towards economic and monetary union (EMU) from the Treaty of Maastricht until the British decision to opt-out of the first wave of EMU in May 1998. The first is the decentralised nature of the British system of industrial organisation which pushed business associations to promote specific, technical policies that would exclusively benefit their own members rather than more generalised macro-economic policies with a less restricted group of potential beneficiaries. The second is the decentralised political organisation of British business, which meant that the leaders of associations tended to make narrow evaluation of policies rather than considering their broader implications. The third is the governing party's stance towards monetary union, a stance which to a great degree was determined by the party's ideological divisions.

I trace the interaction of these three factors on the behaviour of five business associations in the United Kingdom that standard theories of political economy suggest have different economic interests in monetary integration. These groups were selected based upon two characteristics: their exposure to the international economy and the impact of the exchange rate on their activities. Associations whose members were heavily internationalised would be expected to have a greater interest in forms of international cooperation in monetary affairs, while those in more sheltered sectors could be expected to resist a diminution of domestic economic priorities in monetary policy (Table 4.1). The sensitivity of a group to the level of the exchange rate reflects the intensity with which it might be expected to push the government to pursue an

Table 4.1 UK Business Associations

		<i>Exposure to International Markets</i>	
		<i>Low</i>	<i>High</i>
Preferred level of the exchange rate	<i>Low</i>	Institute of Directors	Confederation of British Industry
	<i>High</i>	Federation of Small Businesses (indifferent to level)	National Farmers Union London Investment Banking Assoc.

active exchange rate policy. The primary employers' association, the Confederation of British Industry (CBI), represents many major corporations and is both internationalised and in favour of a low exchange rate because of its effects on export prices. The two representatives of groups that tended to produce primarily for the domestic market are the Institute of Directors (IoD) and the Federation of Small Businesses (FSB). The members of the FSB tend to be in non-tradable sectors of the economy such as retail trade. In contrast, the IoD, whose members are all directors of corporations, have a broader range of activities and are more likely to suffer from import competition. The members of the London Investment Banking Association (LIBA) are highly internationalised, merchant banks, which might be expected to prefer a stable international environment. The National Farmers Union (NFU) represents a major protected sector of the economy which primarily operates under the auspices of the European Union's Common Agricultural Policy (CAP), where farm support prices are generally calculated in ecu.

Organisation of the associational arena

Prior to the 1960s, three major employers' organisations operated in the United Kingdom. The three had had problematic relationships with each other for most of the middle years of the twentieth century. The Federation of British Industry (FBI) had been created in 1916, during the First World War, to facilitate the war effort through greater government-industry coordination.¹ The British Employers' Confederation (BEC), founded in 1919 as the National Conference of Employers' Associations, dealt primarily with matters of industrial relations between large enterprises and the unions. As trade union activity became increasingly political, particularly after Labour's victory in the

1945 general election, the BEC began to expand its area of operations and increasingly encroached into what the FBI considered its more political territory. In contrast to the FBI and BEC which both tended to be forums for large employers, the National Association of British Manufacturers (NABM) was composed primarily of small businessmen. By the 1960s, all three organisations had come to the belief that a national association of employers would be more effective at representing the interests of British industry than the continued existence of three separate organisations.² Encouraged by a Labour government that preferred the simplicity of dealing with one interest group representing British industry, the CBI was created in 1965 when the FBI, the BEC, and the NABM merged together.³

Seven years later, the CBI and the Association of British Chambers of Commerce (ABCC) commissioned a special inquiry on the status of industrial representation in the United Kingdom. The commission's report, the Devlin Report, argued that the high level of disaggregation within Britain's industrial associations handicapped British businesses in their attempts to influence government. The extreme level of fragmentation existing in the British trade association system means that while there are over 1,500 trade associations in the United Kingdom, nine-tenths of them lack enough funding or staff to provide effective political representation. The absence of a systematic representational structure prevented each sector from having one clearly identifiable body to represent its interests before government and encouraged various different business groups (down to the company level) to compete – rather than cooperate – for political influence. As a result, the political positions advanced by business were either muted or a cacophony of calls for various policies, both of which tended to reduce business's influence within Whitehall. In countries with a more organised system of industrial representation, such as West Germany, business associations can work to formulate a common position – a situation which strengthens the hands of business when it deals with government ministries and politicians.⁴

The Confederation of British Industry (CBI)

The national employers' association in the United Kingdom, the Confederation of British Industry, has over 10,000 corporate members and two hundred trade association members who indirectly represent another 250,000 firms. In 1994, its affiliates employed over twelve million people in Britain while the CBI itself had an operating budget of approximately £17 million (\$27 million) and employed 292 staffers.⁵

The two primary decisionmakers in the CBI are its President and the Director General. While CBI staff members with specialties in taxation and other fiscal issues have frequent contact with Whitehall ministries, particularly the Treasury and the Department of Trade and Industry (DTI), the CBI's President and Director General are the primary political liaisons for the organisation. The Executive Director is a full-time position with responsibilities for the day-to-day management of the organisation and presenting employers' views to government and media. The President of the CBI holds office for a mere two years and has never been re-elected. The institutionalisation of this rate of turnover led to 18 different men serving as CBI President between 1965 and 1998. In contrast, the CBI's seven Directors General since 1965 have an average tenure in office of 4.7 years. This compares with a 3.1 year average for 11 Chancellors of the Exchequer in the years since 1965. In the 15 years after its creation in 1983, the DTI's portfolio has been assigned to 12 different ministers, an average term of office of slightly more than one year.⁶

While serving a relatively short period of time as the CBI's leading official, CBI Presidents have tended to come from Britain's largest corporations. Former CBI Presidents have included the chairmen of Unilever, British Airways, Cadbury-Schweppes, and Rentokil. The CBI's President has generally enjoyed a high profile within both the political and business communities, but has not been able to exploit his position to its fullest political potential due to the limitations that a brief tenure imposes. Directors General, on the other hand, have had long periods of time in the same position, which can facilitate many political activities. The CBI has a bifurcated leadership where the individual with a high degree of political stature, the president, is not in office very long. The person who does serve in the same post for a prolonged period, the Director General, is a functionary of the association and lacks the authority to make political commitments on major policy issues on behalf of the entire organisation. This encourages the association's staffers to become involved in the technical issues of policymaking rather than making commitments to major political projects. Individual presidents can endeavour to achieve such ambitions, but their two-year term of office severely restricts their ability to do so.⁷

Two years is a very limited period of time for either initiating or abandoning a major policy position such as a stance in favour of entering the Exchange Rate Mechanism (ERM) or participation in EMU. Both formal and informal policy-making mechanisms characterise the way in which the CBI takes a position on political topics.

CBI policy is debated in the approximately 22 standing committees and 50–80 working groups, panels, advisory forums and steering groups that are operational at any given time. The groups have a broad range of responsibilities ranging from the simple to the sophisticated. The influential Finance and General Purposes Committee consists of members of corporate boards and is tasked with controlling the CBI's income and expenditures and regulating its regional organisations.⁸ CBI professional staff drawn from five directorates (Human Resources, Business, Environment, Economics, and Manufacturing & International) support the work of these committees.⁹ The Directorate for Economics was primarily responsible for assistance on issues of monetary policy.¹⁰

The CBI adopts policies only after a long policy-making process is fulfilled. First a policy is assigned to a particular policy-making committee where the committee's members examine the implications of different positions for British industry. Issues relating to EMU and British participation in the ERM fell within the purview of the Economic Affairs Committee and the Europe Committee. The Economic Affairs Committee (EAC), known as the Economic and Financial Policy Committee prior to 1992, has up to 20 members with specialist economics ability drawn from the board level of member corporations. The EAC is responsible for monitoring the British economy with an eye to anticipating issues that will have major implications for economic and financial policy and to make policy recommendations that would benefit industry. The Economic Directorate prepares papers on major economic developments for the members to debate at their six or seven meetings per year. The EAC's main responsibility is preparing the CBI's presentations on public spending and the yearly Budget.¹¹

The Europe Committee has approximately 15 board-level members assigned the broad task 'to co-ordinate and promote CBI policies in relation to the European Union'.¹² Members tend to come from firms with European interests and from trade associations with specific European interests. The National Farmers Union (NFU) and the Construction Confederation, with their interests in the Common Agricultural Policy and public procurement policies and projects, are also represented. The European Affairs Group, a subordinate branch of the Communications Directorate, services the Committee. The Europe Committee, in close consultation with the President and Director General, has been the principal venue for developing the CBI's position on EMU.¹³

Once a standing committee agrees on a change in policy, it passes its recommendations to the President's Committee, a group that evaluates proposals from the specialised committees. This Committee advises the President on the CBI negotiating tactics and the management of its relationships with other organisations. In addition to debating the specific details of a policy, the President's Committee performs two additional roles: that of opinion aggregator and strategist. The President's Committee seeks to sample opinions both directly from the member firms and from the CBI's thirteen regional subdivisions in order to develop a consensus for one policy position. At the same time, it attempts to predict any potential political problems that might develop from advocating certain policies. For example, prior to the 1998 referenda on Scottish and Welsh devolution, the CBI had a strongly unfavourable view of creating additional, subordinate layers of government with tax powers (in Scotland) and regulatory powers (in both Scotland and Wales) with upwards of 80 per cent of their members opposing the Welsh Assembly.¹⁴ Rather than issue a public policy statement or campaign against devolution, the President's Committee opted not to take any action.¹⁵ The CBI 'did not come out campaigning [against devolution] because it felt, "This might go through. We do not want to be seen opposing the democratic will of the people."' ¹⁶

The President's Committee has approximately 60–70 members drawn for a highly restricted list dominated by large companies:¹⁷

- the President and Deputy President of the CBI
- 14 Chairmen of the 20 largest CBI members
- 35 Chairmen of the next 50 largest CBI members
- 8 further Chairmen of major members selected at the President's discretion
- 6 or 7 Regional Chairmen
- the Chairman of the Finance and General Purposes Committee (FGPC)
- the Chairman of the Small and Medium Enterprises Council
- the Chairman of the Trade Association Council

The vast majority of these individuals are *required* to come from the 70 largest companies in Britain. If the President, Deputy President, Chairman of the FGPC, and members of 'major Members' are included, then 60 of the Committee's membership come from extremely large corporations. Up to 8–10 members might come from small firms,

although only one is required to do so. Representation of trade association members is also restricted to one person. The President's Committee seeks to alleviate this bias through careful consultation with the members, including commissioning polls on a variety of topics.¹⁸

Policy proposals from the President's Committee are passed to the CBI Council for discussion and approval. The Council is the ultimate policy-making body of the CBI. It approves or rejects the policy proposals of the President's Committee and is the final authority for official CBI policy statements. It meets four times a year and has strict rules for membership, which, like the President's Committee, is weighted heavily towards big businesses. Its up to 210 members are drawn from:¹⁹

- The President and Deputy President
- 35 from the 75 largest member companies
- 75 from the next 250 largest member companies
- 25 from other members (including subsidiaries)
- 14 representatives of small- and medium-sized enterprises
- 13 Regional Chairmen
- 36 from trade associations
- 10 allocated at the discretion of the President

Over two-thirds (145) of the National Council's members come from *Times* 500 corporations with an additional 36 working for trade associations based in London. The Council's large size and short meetings (two hours) make debate difficult. In practice, it tends to follow the recommendations of the President's Committee, several of whose members also sit on the Council.²⁰ Decisions of the National Council are, however, binding as CBI policy. Lengthier discussions of various topics generally take place at the CBI's annual conference – held every November, usually in Brighton. The annual conference, however, is not empowered to overturn Council decisions, although controversial exchanges and debates are widely reported in the national media.

The CBI promotes itself as the primary representative of all British industry and stresses to its members its access to policymakers and the public role it plays on behalf of business interests. In 1998, for example, the CBI's *Annual Review* went to great lengths to demonstrate the association's high profile. Under a picture that contained copies of headlines reading 'Brown bows to CBI pressure', and 'CBI's new chief shows he means business', the CBI informed its members of its exposure in newspapers and the broadcast media over the previous year.²¹

Federation of Small Businesses (FSB)

The aptly-named Norman Small founded the National Federation of Self-Employed and Small Businesses in 1974 to resist taxation targeted at shopowners and the self-employed.²² Since then, the organisation has grown to approximately 96,000 members. Membership is limited to those who are either self-employed or who run businesses employing under 200 employees. The organisation is geographically subdivided into 31 separate regions. The FSB operates 13 offices and employs approximately 50 staffers on its yearly subscription income of approximately £7 million. The FSB sees itself as the 'true representative' of British business interests, contrasting itself to the CBI which it views as an 'Establishment organisation' representing the interests of a few multinational corporations at the expense of tens of thousands of small- and medium-sized enterprises.²³

Policymaking in the FSB flows through one of 21 policy committees whose members, while nominally appointed by the National Chairman, are in practice volunteers whose membership is based upon personal interest in the issues area. The policy committees tend to mirror the Cabinet departments, which facilitates following legislative affairs. For issues relating to European and EMU, the relevant policy units are the Economic Affairs and European Affairs Committees. The Economic Affairs Committee tends to follow the activities of the Treasury closely, while the European Affairs Committee is directed more towards activities in the Commission and European policy more generally. To instigate FSB policy changes, a policy committee must submit a report to the Executive Board, a national-level body of the FSB which consists of the association's five national officers (the National Chairman, two Vice Chairmen, a Secretary, and Treasurer) and the chairs of the FSB's six standing committees. The Executive Board approves reports for the governing body of the FSB, the National Council. The Council meets every two months and is composed of representatives from each of the 31 regions and the five national officers. They make policy decisions for the organisation as a whole, although it generally adheres quite closely to the recommendations of the Executive Board. At the FSB's Annual General meeting, the membership debates and votes on the decisions of the National Council. While these votes are non-binding, the National Council (whose principal officers are directly elected by the membership) pays close attention to the votes and opinions of the membership.²⁴

Institute of Directors (IoD)

The Institute of Directors has served as a professional organisation for the directors of companies since 1903. Its members are individual company directors who tend to come from medium-sized companies. Membership is more along the lines of a social club than a political pressure organisation; indeed, the main attraction of membership is the private club and business centre in the IoD's national headquarters located on Pall Mall, adjacent to Trafalgar Square in London. The IoD's regional centres in Manchester, Edinburgh, Nottingham, and Leeds are also associated with business clubs. The IoD employs a staff of approximately 180 in its London headquarters and its four divisional offices. Its 54,000 members are supported by 33 branches – 30 in England and one each for Wales, Scotland and Northern Ireland.²⁵ It operates on an annual subscription income of approximately £10,000,000.²⁶ The IoD is in many ways a rival of the CBI in that both view themselves as representing the interests of British business. The IoD itself lays claim to representing directors in their personal capacity in contrast to the CBI which represents corporations (and to a lesser degree associations). In this manner its differences with the CBI are similar to those of the FSB.

For policymaking, the IoD has a specialised staff which produces policy papers and economic surveys for discussion by its National Council. These reports and surveys are also distributed to the members for consultation. In addition the IoD conducts extensive opinion polling of the members, as well as soliciting individual directors' opinions through seminars and conferences on issues of major importance. While the Council decides issues of IoD policy, its members also can pass resolutions on policy issues at the annual general meeting which are seen as binding on the organisation. IoD Presidents tend to remain in office for lengthy terms, and Directors-General serve three-year contracts, both of which provide them with more control over the IoD's policy than their counterparts in the CBI.²⁷

London Investment Banking Association²⁸ (LIBA)

The London Investment Banking Association's (LIBA) membership consists of approximately 60 of the world's largest and most active firms in the investment banking and securities industries. LIBA's members include firms not only from the United Kingdom but from the United States, Europe, and Asia, including Barclays Bank, Goldman Sachs, J.P. Morgan, Rothschild & Sons, Nomura International, and Deutsche

Bank.²⁹ It employs a staff of eleven in the City of London and concentrates its efforts on regulatory issues.

Because of the modest size of the staff and the relatively few members in the association, the bulk of LIBA's policy work is carried out in committees composed of employees seconded from various interested members. The chairman's committee coordinates individual working groups for different issues as they arise. The chairman appoints the members of the working groups, but only after a period of consultation and with the aim of creating groups with both a geographic mix (United States, Japan and Europe), and skills (information technology, law, economics, etc.) in order to generate a range of opinions. The groups operate on the basis of general consensus since dissent by 'even a handful is a large proportion of [LIBA's] membership'.³⁰

National Farmers Union (NFU)

The NFU was founded in 1908 in order to fight for the interests of agriculturists threatened by cheap foreign grain and a declining standard of living. By the 1990s, it had more than 120,000 members, approximately three-quarters of the British farming population. Approximately 75 corporate members and 35,000 countryside affiliates supplement the base membership. With an operating budget of £16.6 million (1997), the NFU employs a London staff of 140, with an additional 140 as regional staffers at local offices scattered throughout the England and Wales. An additional field force of approximately 500 sells insurance for the NFU Mutual Insurance Company. A separate branch, the National Farmers' Union-Scotland (NFUS), represents farmers north of the Trent River.³¹

Decision-making authority in the NFU is concentrated in the hands of the President, who, along with two Deputy-Directors, is responsible for the operations of the organisation. The membership votes on the President; however, NFU Presidents serve long six-year terms of office. Between 1945 and 1998, there were seven Presidents of the NFU, an average term of office of 6.1 years.³² An 80 member National Council makes decisions about NFU policy; however, the Council meets only four times a year and rubber-stamps decisions of the President or the NFU's policy committees. No specific committee is tasked to deal with issues of European integration or EMU, so these issues primarily fall to the President and the NFU's executive staff. The NFU itself is a trade association affiliate of the CBI and either its President or Director-

General attends CBI Council meetings. The NFU has tended to track the CBI position on EMU; however, the organisation does not consider that it is in principle bound to follow CBI positions on every topic, although as one staffer noted 'it is helpful if we can come to similar positions'.³³ However, being a party to CBI decisions does create some external pressure for the NFU to collaborate in having a similar policy as the CBI.

Business strategies: membership in the ERM

From 1985 onwards, the CBI's leaders had urged the British Government to place the pound into the ERM in order to gain the anti-inflationary credibility that membership seemed to provide the ERM's members, as well as limiting the ruinous swings in the pound's exchange rate against the dollar and the deutschmark. Internal association polls revealed that the CBI's membership was extremely concerned with exchange rate stability, a feeling that was strongest among smaller companies which did not have the opportunities to hedge transactions to the same extent as large multinational corporations.³⁴

In 1989, the CBI's National Council commissioned a special working group operating out of its Economic and Financial Policy Committee (EFPC) to produce a report on the proposals outlined in the Delors Report and to assess Prime Minister Thatcher's argument that the time was not right for entry into the ERM. The working group's remit was specifically limited to providing the CBI and its members with 'an input from a business perspective (as opposed to a political perspective) into the wider debate of economic and monetary integration within Europe'.³⁵ Nevertheless, the group's conclusions were highly political rather than economic. The group endorsed the ERM as an institution in which governments might press for realignments in multilateral exchange rates, a political option, rather than resolving the underlying economic question of what should be the appropriate rate for the pound. Declaring an interest in exchange rate stability over the level of the exchange rate, the group declared that 'it would be wrong to delay entry any further in search of the "right" rate.... as a last resort, there is room for realignment, though this reduces the degree of stability provided by the system'.³⁶

Indeed, in its discussion of what an appropriate rate for sterling within ERM would be, the working group clearly placed entry into the

system ahead of concerns about the level of the exchange rate. As the group argued in its assessment,

Another reason given by some commentators to delay UK entry into ERM is that sterling should not be entered at a level that will prove to be 'uncompetitive' to business. However, there are difficulties involved in determining just what a 'competitive rate' is, given that the structure and experiences of UK companies differ widely. Furthermore, the ERM is now over 10 years old. If the UK delays entry any longer, waiting for the 'right rate,' it may never join the Mechanism, particularly when sterling outside the ERM might also be subject to misalignment.³⁷

The CBI prioritised the least contentious part of the ERM, the limits membership would place on the volatility of sterling, and sought to put off any debates where its members would have severely conflicting opinions. To the extent the group supported a particular exchange rate, it suggested that CBI members would 'welcome' maintaining the existing exchange rate capped around DM3.00, which, coincidentally, was also approximately the rate at which Nigel Lawson had shadowed the deutschmark two years earlier. The working group succinctly summarised the CBI's evolutionary position towards EMU in its declaration that 'the transition to a common currency will depend upon success of the regime of fixed exchange rates and must therefore be seen as an evolutionary process'.³⁸

The conclusions of the CBI's report, approved by the National Council as CBI policy in October 1989, were in general a recapitulation of the so-called 'Madrid conditions' that Howe and Lawson had forced upon Thatcher four months before. Thatcher had agreed, in June 1989, to enter the ERM after British inflation had declined and Britain's partners had abolished their restrictions on the free movement of capital.³⁹ The CBI endorsed a reduction in the inflation rate differential between the ERM currencies and sterling as the primary statistical test for the appropriateness of membership. The working group discounted the need for further liberalisation of exchange controls in Continental economies on the grounds that the controls that did exist in the ERM countries dealt primarily with personal savings rather than corporations' access to capital. Their position was not so much that concern about capital mobility was unimportant, rather that the conditions had been met for all practical business purposes. Likewise, the CBI's evaluation of the Delors Report and EMU did not stray far from the initial

response to the Delors Report articulated by the Chancellor and the Treasury. In terms of movement beyond the ERM, the CBI staff repeated, almost verbatim, the conclusions of the Treasury's evaluation that the success of the ERM needed to be assured prior to movement on deeper integration. Furthermore, they deliberately singled out the Chancellor's argument that a common currency would not require centralised fiscal controls on member country budgets.⁴⁰

Soon after the National Council solidified its position in favour of the Madrid conditions and early participation in the ERM, the CBI presented its formal position in testimony before the European Communities Committee of the House of Lords, which had solicited testimony on ERM participation.⁴¹ The Lords' report in favour of EMU participation proved particularly embarrassing for Thatcher's government, coming as it did from a group with impeccable Conservative, business, and financial credentials. However, it did nothing to shift Thatcher away from her opposition to the fixed exchange rate system.

By late 1989, the Government had hiked interest rates up even further, to a peak of 15 per cent, in an effort to bear down on inflation. Since inflation was running at an annual rate of almost 10 per cent and showed few signs of moderating, base rates remained at this level for a full year. However much the CBI hoped it might persuade the Government to change its policy, the Government – whatever its internal divisions – fully intended that its policy would force a change in industry's behaviour. During this period of high interest rates, John Major, then Chancellor of the Exchequer, lectured industry on the need to practice wage restraint, telling a CBI audience that 'higher pay and higher costs squeeze profits...'.⁴² As a result, Major argued, industry would have to do its part to enforce pay restraint, a practice that the external constraints imposed by ERM membership would make more necessary once Britain entered the system. If industry remained incapable of reigning in inflation, then there would be no early relaxation of monetary policy, the Chancellor argued, and the Government would be forced to continue beating down inflation with high interest rates, reducing corporate profitability, and ultimately creating further increases in unemployment.⁴³

In 1989, the CBI had had little time to even consider Nigel Lawson's original EMU counter-plan of a market-based approach of competing currencies before that plan was dropped. The next, more long-lasting, proposal to emanate from the Government was the so-called 'hard ecu' plan in which a European-wide common currency, managed by an independent European Monetary Fund, would compete with all twelve

national currencies. With Cabinet support for ERM entry only just overcoming the Prime Minister's resistance, the hard ecu was the only plan for a common European currency (as distinct from a single European currency) with even a remote chance of finding favour with a majority of the Conservative Party. Sir Brian Corby, President of the CBI, recognised the realities of the government's position when he chose to back the hard ecu over the Delors Plan, promising John Major that the CBI would 'take every opportunity to support the Chancellor's proposals in discussions with other European business associations'.⁴⁴

As 1990 progressed, the CBI leadership confronted two conflicting views of the relationship between ERM membership, inflation, and interest rates. The first economists' view, promoted primarily by the CBI's staff economists, saw ERM as an external restraint that would provide backbone both to the government and to industry in the battle against inflationary expectations. Maintaining a stable parity with the deutschmark within the ERM would necessitate high interest rates that would gradually wring inflation and inflationary expectations from the British economy. The short-term policy prescriptions of the economists' position called for a continuation of the tight monetary policy that was punishing British industry, fuelling bankruptcies and foreclosures, increasing the jobless rate, and stifling growth. Credibility from a commitment to an exchange rate peg had to be earned and would require short-term sacrifice before unions and employers truly believed in the rigidity of the external constraints on British policy.⁴⁵

A second political view, held by many on the CBI National Council, was that ERM membership was a commitment mechanism that would simultaneously allow for both lower inflation and lower interest rates while at the same time providing exchange rate stability. By borrowing the anti-inflationary credibility of the Bundesbank, the British government could break the inflationary expectations of wage bargainers and inflation could be reduced without resorting to onerous interest rate hikes.⁴⁶ Credibility was assumed to flow from the system and would quickly be passed along to the government once it joined the ERM, allowing for a swift reduction in interest rates and a decline in inflation, accompanied by growth, employment and external balance. Both the economist and political positions favoured ERM entry and, as cognitive models for how the economy functioned, were not necessarily inconsistent with one another over the long-term. However, if the CBI promoted the position advocated by its own staff economists, it would need to lobby the Government to hold the line on interest rates in order to preserve the pound's parity with the deutschmark. On the

other hand, the political position had the enviable short-term advantage of promising an immediate reduction in interest rates. For businessmen hard-pressed by a deteriorating economy, the political position proved an irresistible option. CBI spokesmen increasingly pressed for both entry into the ERM and an accompanying reduction in interest rates as the summer wore on.⁴⁷

In this endeavour, their position was identical to that of the overwhelming majority of the Conservative Party both on the Government backbenches and in the Cabinet. After Nicholas Ridley's forced departure from the Department of Trade and Industry in July 1990, Margaret Thatcher was completely isolated within the Cabinet in her opposition to participation in the ERM. In September, John Major prevailed upon her to accept British participation in the ERM. On October 5, after the foreign exchange markets had closed, John Major was able to announce Britain's long-awaited entry into the ERM within the broad bands (± 6 per cent, rather than the ± 2.25 per cent of the narrow bands) coupled with a 1 per cent cut in interest rates.⁴⁸

The CBI was overwhelmingly enthusiastic about the government's decision, praising both the entry into the ERM and the reduction in interest rates.⁴⁹ With inflation still above 10 per cent and a fairly high central parity of £1 to DM2.95, there was a strong potential for a rapid deterioration in British competitiveness. Despite the CBI's official endorsement of the move it had long advocated, some manufacturers privately bemoaned the consequences of a stiff exchange rate selected under political conditions rather than the economic conditions, which called for a strict convergence in the relative inflation rates of sterling and the deutschmark prior to ERM membership.⁵⁰ However, in private, the CBI had requested that Thatcher and Major join at an even stiffer rate of DM3.00 to the pound.⁵¹

Although it had not lobbied for ERM membership, LIBA strongly welcomed entry into the system of managed exchange rates. They viewed entering the ERM as a way to keep London's financial sector from being marginalised from the rest of the European Community.⁵² Despite the City of London's overwhelming dominance of international foreign exchange markets, financial firms were worried that if the United Kingdom remained aloof from European movements towards monetary union, then London would suffer serious competitive disadvantages in the potentially lucrative ecu-related transactions. If monetary integration on the Continent deepened, the members of LIBA wanted to be in a position to exploit it to the fullest. The consensus opinion among the members was that British participation in the

ERM would preserve London's position and even enable them to exploit the City's existing strengths in foreign exchange – particularly euro-dollar trades – and derivatives.⁵³ Continued non-involvement in the ERM, LIBA's members feared, would undermine the financial advantages of the City. Exchanges such as Frankfurt and Paris, located as they were in countries where there was no question about their governments' commitment to deeper integration, would reap the benefits of Britain's non-involvement.⁵⁴

Like LIBA, the FSB had not engaged in any active lobbying on the ERM. The FSB's chairman thought that ERM entry was premature given the disparity between Britain's inflation rate and the inflation rates on the Continent. However, in a poll of member firms, inflation was rated near the bottom of a list of 20 problems facing small businesses while interest rates were rated as one of the top three problems facing small firms.⁵⁵ The FSB welcomed the initial reduction in interest rates that accompanied joining, and its president suggested that ERM membership held out the promise of lower interest rates and improved the prospects of small firms for importing and exporting. Prior to 1990, the FSB had never polled its members on their import/export prospects. Indeed, they did not poll their members on international trade issues then or later.⁵⁶ At the 1990 national conference, the FSB, which for 15 years had been solidly pro-European, for the first time debated (and rejected) a resolution calling for Britain's withdrawal from the European Community. Interest rates were the primary determinant of the FSB's long-term position on ERM membership. Because the major source of financing for small businesses is a mortgage on the family home, interest rates were of paramount concern. So long as the ERM was associated with lower interest rates, the FSB remained favourably inclined towards participation.⁵⁷

The IoD was warily supportive of ERM membership, viewing the lack of convergence between the British and German inflation rates as an indicator of potential future volatility. This disparity in inflation rates, which the IoD did not think would be overcome until 1993, led the IoD to caution that October 1990 was too early a date for Britain to join the ERM. The IoD preferred an independent exercise of counter-inflationary discipline prior to accepting the rigours of an international monetary constraint such as the ERM. Immediately prior to Britain's entry into the ERM, the IoD's Council had called on the Government to hold off reducing interest rates in order to ensure that inflation was indeed falling; however, the reduction in interest rates that accompanied entry into the ERM was welcomed as a growth-inducing measure for the stagnant British economy.⁵⁸

The National Farmers' Union was extremely supportive of entry into the ERM, in large measure because the farming sector was already highly integrated into both European institutions and into European monetary arrangements. The CAP's system of price supports was calculated in ecu so large swings in the pound-ecu rate had a major effect on the domestic, pound-denominated, incomes of farmers. Protections built into the system in 1984 to protect German farmers from the revaluation of the deutschmark created an artificial 'green ecu' that was in reality pegged to the value of the strongest European currency, the deutschmark. Revaluations of the deutschmark against the market ecu led to an effective devaluation of all the other 'green currencies' raising incomes for farmers and prices for consumers in all other member countries.⁵⁹

This had its advantages for British farmers in periods when the pound was depreciating against the deutschmark. However, European-level production quotas prevented farmers from marketing products with an aim of exploiting the green rate differentials. With farming both extremely open to the international environment and heavily regulated, the NFU sought stability. At the same time, farmers, like small business people, borrowed heavily against the values of their homes and farms in order to obtain funds for investment and modernisation of their facilities. The NFU's leadership had a great deal of experience operating within the environment of European institutions and saw ERM membership as another means of stabilising the economic situation for farmers.⁶⁰

Unlike the Government and other interest groups, they were more open to the possibility of a revaluation of the pound within the ERM, having had experience with several revaluations of the green ecu over the course of the 1980s. The NFU leadership did not conduct extensive consultations with its members over the desirability of membership in the ERM as most farmers, farm economists, and politicians were critical of the volatility of the pre-ERM system for British farmers. With prices set at the European level (and subject to readjustment once a year), it was relatively easy for the NFU to determine the consequences for farm profitability of a given exchange rate. While the NFU was in favour of ERM, it expressed some concern about the rate of entry of DM2.95:£1.⁶¹

Participating in the ERM was the first step in an evolutionary process towards what many observers in the early 1990s, quite presciently, saw as progress towards a single currency for the European Union.⁶² In welcoming membership in the ERM, the CBI declared that 'this gives a clear indication of the commitment of the Government to greater

monetary union'.⁶³ Given the strength of anti-integrationist sentiment in the Conservative Party, actively campaigning for the Delors Plan for monetary union, however, was not on the CBI agenda. Even as the Select Committee on the European Communities of the House of Lords was backing the Delors Plan, the CBI remained officially supportive of the hard ecu.⁶⁴

The 1990 CBI conference took place at the congruence of three important political events: Britain's entry into the ERM, the final Cabinet crisis of the Thatcher government, and the preparations for Maastricht Intergovernmental Conference (IGC). As such, it provided the CBI leadership with a forum to air its views on European political and economic issues, particularly the Commission's plan for European social policy and further monetary integration. Relying heavily on a relatively unregulated workplace, British industry was solidly in favour of keeping European authorities out of areas that the organisation felt were best left to managerial discretion. The conference approved a resolution calling for continued opposition to further 'unnecessary [European] community legislation, for example in the social affairs fields'.⁶⁵ However, the question of economic and monetary union was more divisive, both for the members of the CBI and for the Government. While the CBI officially backed the Government's hard ecu policy, its leaders were concerned that the Government's internal division blocked the successful promotion of any policy at the European level, the consequences of which might be a 'two-tier' Europe.

If a pro-business British government were excluded from influence over key policies, the CBI's President argued, then that would be seriously detrimental to the interests of British industry. John Banham, the CBI's Director General, urged the Government to continue engaging with its European partners and pledged to the delegates that the CBI would 'continue to do all that we can to get the Chancellor's hard ecu proposals considered as seriously as they need to be'.⁶⁶ Banham further warned that divisions within the Government threatened to have not only damaging economic consequences, but also threatened the Conservatives with electoral defeat at the hands of the Labour Party, a possibility that caused some consternation among CBI members. Banham's support for the Government and concern over the electoral prospects of the Conservative Party were hardly surprising. Prior to becoming the CBI's Director General, Michael Heseltine had appointed him to the Audit Commission. Shortly after his tenure at the CBI ended in 1992, John Major's Conservative Government

appointed him to the Local Government Commission.⁶⁷ Corporate CEOs were particularly sensitive to backbenchers' political concerns as a steady flow of anxious Conservative MPs were at the time exploring the possibility of obtaining non-executive directorships on corporate boards in the event the party lost the next general election. The only specific policies singled out for criticism were the Government's decisions to increase the Uniform Business Rate and its failure to further reduce high interest rates.⁶⁸

Margaret Thatcher's ouster from 10 Downing Street in an intra-party coup less than one month later did not resolve the deep-rooted ideological divisions over Europe within the governing Conservative Party. It did provide a break from the public divisions that had characterised the final Thatcher years and would later come to be associated with John Major's premiership. Monetary union, in the form of the hard ecu, enjoyed a renaissance in Government circles. As a result, British interest groups that favoured greater monetary integration were pressed towards the Government's soft EMU option as a possible economic path to monetary union that was politically achievable. Although the CBI's official statement on the Intergovernmental Conference negotiations supported the ultimate, long-term goal of establishing a single European currency, the only specific plan that the CBI endorsed as a means of reaching this objective was not the single, merged currency of the Delors Plan. Rather, their support remained with the Treasury's hard ecu common currency plan.⁶⁹ The CBI thus provided explicit political support for a policy that British leaders were using to delay movement towards a single currency. As one CBI functionary stated:

There are many roads to economic and monetary union. The Government was only willing to go along one route [its own hard ecu plan]; supporting another [The Delors Plan] would have been pointless.⁷⁰

Even after Bundesbank President Karl-Otto Pöhl rejected the hard ecu and it became apparent that Britain's European partners had little sympathy for the scheme, the CBI continued to place domestic political priorities at the top of its lobbying strategy. Whatever the hard ecu's status in foreign capitals, it remained the only negotiating policy that could survive the internal divisions of the Conservative Party.⁷¹

The Allied victory in the Gulf War and the removal of the 'Thatcher Effect' from the Conservative Party led to the government's recovery in

the polls even as the economy dipped into recession. By February 1991, a mere four months after entry into the ERM, inflation had dropped dramatically, industrial production was down, and interest rates were at 13.5 per cent, down only half a point from the day Britain entered the ERM. The pound was trading at DM2.90, slightly below its central parity. The CBI trumpeted its industrial survey as indicating a slowdown in pay settlements and called for lower interest rates within the ERM.⁷² For the first time since 1987, the organisation suggested that its members limit pay settlements in order to live within the rigours imposed by the ERM. It also called upon the Government to reduce interest rates to provide relief as the economy worsened.⁷³

As inflation dropped, the Government's evolutionary strategy towards monetary integration appeared to be a success. With the government apparently united over European policy, the CBI recommended that the pound should move into the narrow band of the ERM in order to intensify the Government's anti-inflationary strategy. This proposal was followed with the hope that the evolutionary strategy would eventually lead to a European central bank and single monetary policy. CBI spokesmen had avoided such a forward position on monetary union during the more divisive years of the Thatcher era. In the year after her departure, with the ERM apparently functioning smoothly and inflation coming down, officials at the CBI were more forward in promoting the ultimate objective of EMU. They reinforced their position with the argument that British participation in EMU would enhance the Government's ability to resist schemes involving the Social Charter, industrial policy, and more European control over the functioning of labour markets.⁷⁴

Within the CBI there was near unanimity on resisting encroachments from Brussels in the social sphere. During the preparations for Maastricht, the CBI directed its attention to the added costs that a European social policy would pose for British business. In this, they were united with the Government against what both businesspeople and Conservative leaders saw as their mutual and traditional adversary – the trade unions. Additional European regulations and changes to the labour laws would undermine the rollback in union power that employers and the Conservative Government had achieved during the Thatcher years.⁷⁵ At the CBI's annual conference, held just prior to the Maastricht summit, Banham urged the Government to resist the encroachments of the Social Charter during negotiations, arguing that 'if the price is too high, don't sign. If it's a bad deal, walk away'.⁷⁶

During the Intergovernmental Conference leading to the Maastricht Treaty, the CBI placed greater priority on avoiding British membership in the loathed Social Charter than on other aspects of the negotiations.⁷⁷ Business leaders saw 'Social Europe' as a threat to both managerial prerogatives and the competitive position of British industry. The Conservative Government shared this view wholeheartedly without any of the internal divisions that characterised its position on EMU.⁷⁸ Despite a concern among some CBI members that its Europe Committee had 'gone native' on EMU, the CBI did not move towards a more ambitious set of targets for monetary union in the run-up to the IGC, preferring to support 'progress towards economic and monetary union', a vague policy that satisfied both its own members and prevented awkward conflicts with members of the Government. This CBI position complemented Major's negotiating position that would permit other member states to pursue EMU at their own pace while allowing for a British opt-out.⁷⁹

The IoD supported the Government's hard ecu plan, but clearly preferred the ongoing use of the existing basket ecu (the IoD policy group frequently urged its members to make greater use of the common European currency in their transactions with European suppliers and customers). The IoD also supported, as it had for many years, granting independence to the Bank of England as the most appropriate mechanism for fighting inflation in the United Kingdom. While unenthusiastic about a European central bank, they looked favourably upon the Delors Report's call for the bank to be independent.⁸⁰ The Social Charter was of utmost concern to the IoD, as it threatened to open a backdoor for introducing European social legislation that business had successfully resisted domestically.⁸¹

The FSB, too, opposed the Social Charter and was specifically concerned about the possibility of extending the social sphere to include part-time workers, who were a mainstay of the labour force for many small firms. Although most of the FSB's attention was directed at domestic regulations and the deprivations suffered at the hands of banks, the organisation also expressed its long-standing concerns about the burdensome effects of European rules and regulations on small firms. There was little discussion of EMU among either the membership or the leadership of the FSB at this time. Interest rates, which had eased from their highs of 1990, remained above 10 per cent throughout 1991 and the ERM received much of the blame.⁸²

With Britain in the ERM, London's merchant banks were most concerned about the potential threat of long-term exclusion from any

European-wide financial and monetary arrangements that might be negotiated at Maastricht. Monetary union entailed different changes and adjustments for the different markets in the City, ranging from those that would suffer major reductions in activity (foreign exchange) to those that would be virtually unaffected (gold bullion).⁸³ Given the City's overwhelming dominance of European financial markets, the merchant banks held the belief that so long as discriminatory measures against non-participants were not included in the Maastricht Treaty, their existing advantages in financial services would enable them to expand their market shares. The Conservative Party's antipathy towards EMU made it politically infeasible for Britain to promise full-scale participation in EMU. Because EMU would not happen for nearly a decade under the best of circumstances, whether or not Britain had 'a political opt-out did not make much difference back then'.⁸⁴ Most merchant banks believed that one of two scenarios would develop. The most desirable one, in the view of LIBA's leaders, was that the British would gradually become acclimated to membership in the ERM and evolve into joining EMU. The second, less desirable scenario was that EMU would collapse for unforeseen reasons. In either event, guaranteeing that Britain would not be excluded was a satisfactory outcome for LIBA. That John Major and Norman Lamont saw it as not having a single currency 'imposed' upon Britain made little difference to merchant bankers.⁸⁵

The NFU had little interest in the monetary arrangements of the Maastricht Treaty, concentrating all its resources on the various proposed reforms to the CAP. European treaty modifications always posed great risks to the CAP, the single largest component of the Community's budget. Compared with threats of reducing the CAP's share of the Community budget, the details of price support per hecta-acre of arable land for various products, and potential challenges emanating from the GATT negotiations, a change from a satisfactory monetary arrangement was of minor importance. British participation in the ERM had resolved many of the immediate issues of price stability that had plagued agriculture in previous years, so arrangements for a single currency were not a high priority. The NFU's president expressed support for EMU, but the organisation's energies were spent on more immediate concerns.⁸⁶

The Maastricht Treaty

The outcome of the Maastricht Treaty proved to be extraordinarily successful from the point of view of the Major Government. All the issues

that were either electorally troublesome (the Social Charter) or that divided the Conservative Party (EMU) had carefully been placed into categories where the British Government reserved the right to opt out. The political benefits of the opt-out clauses were immense as they enabled Major to go through the 1992 elections without seriously debating the Maastricht Treaty or its consequences. The CBI, which had expressed its concern over a 'two-tier' Europe where some nations proceed along a more integrationist path than others, also greeted the Treaty as a success. The Director General of the CBI felt comfortable declaring that 'The Prime Minister achieved exactly what business needs: agreement on economic and monetary union, which has left the way open for UK participation in a single European currency, steps to secure more even enforcement of Community legislation, and no extension of Community powers (primarily the Social Charter) that could threaten international competitiveness'.⁸⁷

In the wake of Maastricht, the Bundesbank's decision to push interest rates higher put other ERM currencies under pressure to raise their rates as well. However, as the pound drifted towards the lower half of its fluctuation band, the Chancellor, Norman Lamont, ruled out devaluation.⁸⁸ As the ERM was the centrepiece of the Conservative Party's economic strategy, abandoning it with an election no more than four months away would have been politically disastrous. For the CBI, the re-election of the Conservative Party to power was of paramount importance.

The Maastricht Treaty thus not only united Eurosceptics and Europhiles in the run-up to the 1992 general election, it also made the CBI completely dependent on the continuation of the Conservative Party in power. A treaty with options was a treaty whose options could be exercised. John Major's opt-out on the Social Charter would become Neil Kinnock's opt-in if Labour or a left-centre coalition triumphed in the upcoming election. The extent of the CBI's concerns about what a Kinnock Government might impose were clearly spelt out in Corby's open letter to all CBI members:

The CBI will ... oppose policies which compromise the continuing control of inflation, any winding back of industrial relations law, any increases in taxation for middle management, ... any re-nationalisation of companies now in the private sector, any external interference with the way conditions of employment are determined, any wasteful public spending, and any acceptance of a national minimum wage or directives of the European

Community Social Action Programme which would reduce employment opportunities in the United Kingdom.⁸⁹

While the CBI President's Committee rejected a £1 million campaign on behalf of the Conservative Party as potentially counter-productive, the employers' association did embark on a dramatic series of public criticisms of Labour policies. In the final month of the election campaign, when polls were predicting a slight Labour majority in the new House of Commons, the CBI began its thorough-going critique of Labour's social and fiscal policies. A CBI report issued one week prior to the elections suggested that a minimum wage along the lines proposed by Labour would throw 150,000 Britons out of work.⁹⁰

After the Conservative Party's narrow election victory, rapid parliamentary approval of the Maastricht Treaty appeared certain. Major's unexpected triumph at the polls and the Cabinet's unity on the Treaty appeared certain to guarantee ratification over the objections of the small group of demoralised Eurosceptics. However, the Danish referendum shattered the apparent inevitability of ratification and quickly led not only to economic instability on the exchange markets, but also to political chaos in Westminster. Overnight, there was an apparent collapse of backbench support for ratification, and the Labour Party shifted tactics and opposed the Treaty in order to 'bloody the government's nose'.⁹¹

Nevertheless, the Government could count upon substantial support from the business community in its efforts to revive the wounded Treaty. Despite the change in international political circumstances, the Treaty itself still pointed in a positive direction for Britain's largest companies. Maastricht allowed for evolutionary progress towards EMU and protected business from the Social Charter through the opt-out. Unlike the situation in the last years of Thatcher's premiership where sharp differences of opinion on the ERM existed between the Prime Minister and her senior colleagues, John Major's senior ministers were unanimous in their determination to ensure that the Danish 'no' vote did not derail the Treaty. Finally, in June 1992, the government's influence over the CBI was at least as substantial as that of the CBI over government. The new CBI President, Sir Michael Angus, openly speculated about his strong desire for a peerage. The new CBI Director General, Howard Davies, had served on Nigel Lawson's staff in 1985-86 before being appointed to the Audit Commission. John Major subsequently appointed Davies to be Deputy Governor of the Bank of England after his stint at the CBI was completed.⁹²

The NFU was already anxious about interest rates, so they welcomed the interest rate cuts of 1991 and 1992. However, the high rate of the pound was limiting the incomes of farmers while high interest rates were imposing heavy burdens on those who had borrowed. The 'scissors effect' of low incomes and high interest rates drove many farms out of business in 1991 and 1992. As early as February 1991, a mere four months after Britain joined the ERM, the NFU leadership specifically called upon the government to devalue the pound within the ERM, much as the green currencies had been revalued with regularity in the 1980s. The NFU took this position because while it desired a system of managed exchange rates, it also wanted a system where the rates translated into a beneficial level of support payments for farmers.⁹³

A poll of FSB members revealed that the most important issue facing members was high interest rates.⁹⁴ Barely a year after Britain joined the ERM, inflation had dropped to approximately 5 per cent while interest rates remained at 10.5 per cent. With tens of thousands of firms failing and the small business sector in a state of distress, the FSB targeted the ERM and 'Europe' as a main cause of small businesses' economic plight. By the middle of 1992, the FSB had reached the conclusion that 'the only impact European integration was having on the Federation was the importation of "daft legislation" which would harm their futures. Interest rates were crippling the UK economy'.⁹⁵ Using the Danish referendum as both a catalyst and an example, the FSB National Council urged the Major Government to put the treaty up for a referendum, in the hopes that the British people, just like the Danes, would vote to reject it.⁹⁶

While the CBI continued to support both the Government's commitment to the ERM and Maastricht, it was not in a position to enforce these commitments on other business associations. In the aftermath of the first Danish referendum and the growth of the Eurosceptic rebellion in the Conservative Party, the Institute of Directors began to back away from its rapid, pre-election endorsement of Maastricht.⁹⁷ At this time the IoD was actively encouraging the Government to make the Bank of England independent in a move it hoped would be both anti-inflationary and would bolster the Government's credibility.⁹⁸ Despite their concerns about the exchange rate of the pound and the interest rates necessary to sustain it, they remained supportive of the ERM. However, the Director General of the IoD, Peter Morgan, made clear the shallowness of the Institute's support when he declared on BBC Radio that

We now have the choice of leaving the [ERM] club, which we think would be even more damaging, or playing by the rules The rules appear to require us to put up interest rates. It is the economics of the madhouse, but we have agreed to play by the rules.⁹⁹

With most small businesses financed through home mortgages, the members of the FSB were extraordinarily sensitive to the effects of high interest rates. According to both government statistics and the FSB's own surveys, hundreds of small businesses were failing every week. In 1991 alone, fifty thousand small firms filed for bankruptcy.¹⁰⁰ Consequently, the FSB was much less restrained than the IoD leadership in its criticism of the Government and the ERM, charging that the Chancellor was 'acting like a kamikaze pilot who is determined to reach his goal (low inflation) whatever the cost'.¹⁰¹

As the Black Wednesday drama unfolded, the CBI repeatedly endorsed the Government's support for sterling's position within the ERM, rejecting the devaluation option. Even as reserves flowed from the vaults of the Bank of England into the accounts of speculators, the CBI followed the Government's lead. Shortly after trading on the foreign exchanges began on 16 September 1992, the CBI National Council publicly endorsed the Government's decision to raise interest rates by 2 per cent in order to defend against a devaluation of the pound.¹⁰² They echoed Lamont's position that the economic fundamentals in the British economy, especially inflation indicators, did not justify a run on the currency. However, the basis of their support was not economic, it was political. The CBI's leadership recognised that it was really less the currency than the Government's credibility that was under attack by uneconomic speculation. President Angus stressed this point to the press when he commented hopefully that

Now that the Government's commitment to hold the value of the pound against other European currencies has been emphatically demonstrated, we hope these higher borrowing costs will prove short-lived.¹⁰³

Most other trade associations provided political support for the Government's attempts to prop up the pound. Even though its support was clearly half-hearted, the IoD recognised the necessity of the Government's rate increases on Black Wednesday. Investment bankers were notably silent, although many merchant banks were making millions of pounds per minute speculating against sterling. The NFU

was wracked by conflict because the interest rate increases piled additional debt servicing costs onto farmers; at the same time, cooperation with Britain's UK partners was essential in adjusting the value of the 'green pound', which determined the level of support farmers received for their produce.¹⁰⁴ Only the FSB called for reductions in interest rates regardless of the consequences for sterling's international position.¹⁰⁵

Black Wednesday represented not only the complete discrediting of the Government's economic policies but also the collapse of the evolutionary strategy for monetary integration that the CBI had championed. The CBI initially kept open the option of rejoining the ERM at an unspecified date in the future, the same 'flexible' position as the Major Government.¹⁰⁶ However, the narrowness of the French government's majority in its Maastricht referendum did little to dispel the uncertainty surrounding the fate of the treaty. Had the French voted 'no', John Major would have abandoned the treaty as well.¹⁰⁷ Although the CBI's leaders, particularly those associated with developing the CBI's European policy, felt that not ratifying Maastricht would lead to increased protection and a collapse of the single market programme, there is some evidence to suggest that the CBI anticipated its position on Maastricht in the event of its rejection in France.¹⁰⁸ When the French voted in favour and Major proceeded with the Paving Motion, the CBI came out strongly in support of the Prime Minister, lobbying Conservative backbenchers to support the recently re-elected government and circulating a joint letter among leading industrialists in support of Maastricht and the Prime Minister.¹⁰⁹

On the other hand, the IoD saw no rush to ratify Maastricht and viewed the completion of the Single Market on 1 January 1993 as an inevitable development regardless of the fate of the treaty. While the Danish referendum had broken their ambivalence towards Maastricht in June, devaluation pushed the IoD in a decidedly more sceptical direction in October and November. Nevertheless, the IoD still suggested that its members use the ecu as a common currency for transactions with European firms, seeing the ecu as a useful hedge against currency fluctuations. The IoD policy staff publicly questioned the merits of ratifying Maastricht within one week of Black Wednesday. They saw the November 1992 Paving Motion debate as merely a political conflict over the survival of John Major as Prime Minister. They did not see any broader implications for European economic integration; consequently, they did not press Conservative MPs to vote either for or against the motion. The narrow passage of the Paving Motion in the House of Commons, in which the extent of the Eurosceptic rebellion

was clear, encouraged the IoD to develop an even more sceptical line on the content of the treaty following the vote. Within the week of the Paving Motion, Sir Peter Walters, President of the IoD, had declined to sign the CBI's round-robin letter in support of Maastricht ratification. The division between the CBI and the IoD only intensified when the IoD elected a committed Thatcherite, former Trade and Industry Minister Lord Young, as their President in early 1993.¹¹⁰

After the pound's suspension from the ERM, the CBI undertook an extensive review of British monetary policy, an inquiry that coincided with the House of Commons' Treasury and Civil Service Select Committee's examination of the possible benefits of granting independence to the Bank of England as an alternative anti-inflationary institution. Like the select committee, the CBI examined the role of an independent central bank, possibly in conjunction with movement towards joining a single currency.¹¹¹ The CBI's submission to the Select Committee came prior to any CBI policy decisions on central bank independence. It was not until a month later, after the Select Committee had already prepared its preliminary report, that the CBI National Council endorsed a new position that the EAC had prepared. In November, shortly after the Select Committee had concluded its report, the CBI came out in favour of creating a 'more independent' central bank. They also expressed industry's concern about the usefulness and comparability of national inflation statistics. CBI economists stressed their desire that the Government ensure that British statistics reflected the underlying inflation rate and not contain anomalies that would obstruct the development of a coherent monetary policy.¹¹² Where the initial CBI testimony before the Select Committee had been tentative and inconclusive, the policy the National Council approved was closely in line with the conclusions of the Select Committee.¹¹³

The IoD had long supported an independent central bank, even prior to the ERM period. The re-evaluation of its position on monetary policy after the Black Wednesday debacle was less a reappraisal of a failed policy than a recapitulation of a preferred option. The failure of the ERM and the evolutionary option reopened the issue of an independent central bank – a policy path that successful participation in the ERM had earlier foreclosed. Coupling an independent central bank with the resurrection of the hard ecu provided the IoD with a series of policy proposals that would, in its view, guarantee British business the benefits of a low-inflation regime and a trans-European currency without the risks that fixed exchange rates might entail.¹¹⁴

Economic and Monetary Union

For the CBI to present a position even modestly favourable to monetary union depended upon a favourable political climate, something which was entirely absent after the passage of the Maastricht Treaty. Despite a CBI report showing that 80 per cent of CBI members favoured the eventual adoption of a single currency, the Confederation's leadership shied away from pushing this view during their 1993 conference.¹¹⁵ Davies briefly broached the issue of how Conservative Party divisions prevented industry from pushing a variety of European-related issues (including the single currency):

We are rather nervous about the way the debate in the Conservative Party has moved, such that it is almost impossible to talk about it. What some of our big members are anxious about is the notion of a single currency on the other side of the Channel and Ukrainian coupons over here.¹¹⁶

The ensuing criticism from both government ministers and backbenchers led Sir Michael Angus to disavow Davies' comments and insist that the position of the CBI and its members regarding monetary union was 'very much in line with many of the feelings of the UK Government'.¹¹⁷ That is, that as the member states were unlikely to fulfil the Maastricht timetable for EMU, Britain should refrain from making any decisions about either re-entering the ERM or a single currency, until an ill-defined time in the future. Notably, the CBI did not press the Government to create a more independent Bank of England or to target the exchange rate for a re-entry into the ERM, policies for which the CBI had at one time expressed support.¹¹⁸

Indeed, after the passage of the Maastricht Treaty, the absence of a clear Government policy on monetary union prevented the CBI from developing a strong position on the issue itself.

A survey of 579 member firms in 1994 indicated that 84 per cent thought that EMU would have a positive impact on business, a third of the favourable respondents (28 per cent) thought that EMU was a necessity, while two-thirds (56 per cent) did not see it as essential to future prosperity. A mere 8 per cent thought that the consequences of monetary union would be detrimental to the European economy (Table 4.2).

Despite the belief of a vast majority of CBI members that EMU would yield economic benefits, their view of the political possibilities open to the CBI was much more nuanced, reflecting a clear awareness of the

Table 4.2 CBI Members and the Single Currency, 1994**What is your view of the Single Currency?**

1. Necessary condition of a Single Market in the long term	28%
2. Would help business in the long term, but not a necessity	56
3. Would make little difference to business and trade	7
4. Positively damaging to European prosperity	8

If a group of countries is ready to move to a single currency by 1999, what should be the UK's response?

1. Aim to be part of the leading group	24%
2. Keep open the option of being in the leading group	49
3. Wait and see how EMU develops before making a commitment	17
4. Reject EMU now as an option for the UK	4
5. Attempt to delay any movement to EMU by any country in 1999	6

Source: Confederation of British Industry (1994) *The Single Market and the Future Development of the European Union: CBI Survey Results*, (London: Confederation of British Industry), p. 7 (Exhibits 13 and 14). Responses might not add up to 100 per cent due to rounding.

practical limitations that divisions within the Conservative Party imposed on the Government. The proportion of members who saw a single currency as necessary for the completion of the Single Market (28 per cent) tended to be quite close to the proportion supporting British entry in the first wave of participants (24 per cent). The two intermediate positions of keeping British options open and of evaluating how EMU functioned before deciding – both of which could be termed variations on Major's 'wait and see' position – were the preferred positions. Only a very small minority favoured rejection of EMU as an option; and only 6 per cent favoured obstructing other EU members from pursuing monetary union on their own.¹¹⁹

The CBI's official policy favoured continuing the Government's policy. As the Europe Committee explained in their business manifesto prior to the 1996 Intergovernmental Conference:

The CBI supports the special position secured by the UK at Maastricht. However, the UK Government should continue to leave open the option of joining EMU. It should continue to play a central and constructive role in the technical preparations for EMU and aim to meet the convergence criteria, which are sensible policy goals in their own right.¹²⁰

This policy option, the median point in the polls of the members' political opinions, fell short of either the median or modal position in

terms of the members' economic evaluation of the potential benefits of EMU. However, it was the best result that the generally pro-European CBI leadership could hope to positively promote with the deeply divided Major Government. Like John Major, the CBI leadership had a numerically small, but vocal group of members who opposed greater monetary integration. Even though only one member of the National Council openly suggested rejecting British participation at such an early date, the issue was not one that the CBI needed to take a strong position on. With EMU not even on the Government's immediate agenda, the easiest decision for the CBI was to have a 'wait and see' approach to British participation. On the key political issue of a referendum, the CBI studiously maintained a neutral position, regarding that question as one relating purely to constitutional processes and therefore outside the role of an industrial trade association.¹²¹

There remained a series of economic questions about EMU that were relevant to the CBI regardless of whether the United Kingdom chose to participate or not. These included the issue of whether the fiscal competencies of the European Union would be expanded in order to resolve regional disparities that either might arise from or be exacerbated by the movement to monetary union. On the grounds of limiting tax burdens, which they expected would fall primarily on businesses, the CBI wanted to limit the growth of the EU budget. As a single currency appeared likely to proceed in several countries, monetary union would affect British companies regardless of whether the UK participated or not.¹²² In these circumstances, the CBI pushed for clear national changeover plans that would reduce uncertainty and facilitate a smooth and efficient transition period.¹²³ Of particular concern was the lengthy three-year period (1999–2002) of dual currencies envisioned by the Commission – the CBI was concerned that an excessively long third stage between the launching of EMU and the introduction of euro coins would be destabilising.¹²⁴ Finally, in light of Britain's 'special position', the CBI sought to ensure that other EU governments gave a clear commitment to countries not in the first wave (i.e., Britain) to non-discriminatory participation in EMU if they chose to join subsequently.¹²⁵

The political infighting that undermined the Government's policy was of great concern to industry in the year prior to the 1996 Intergovernmental Conference. Many industrialists, regardless of their position on EMU, were concerned that the government's internecine warfare prevented the UK government from presenting its generally pro-business viewpoint in EU-level discussions.¹²⁶ This, they believed,

was akin to the British government leaving an 'empty chair' at the negotiating table in Amsterdam. In a poll of over 1,500 CBI members, 58 per cent characterised the UK's ongoing political debate over the EU as unhelpful in promoting British interests, while only 21 per cent considered the debate to be advantageous.¹²⁷

In early 1996, the National Council launched a 'Business in Europe' campaign under the auspices of its Europe Committee. 'Business in Europe' was designed to encourage a more constructive debate among politicians, primarily those in the Conservative Party, over European issues. It also aimed to increase awareness of the Intergovernmental Conference among British businesses. As preparation for further policy initiatives, the centrepiece of the 'Business in Europe' initiative was a survey of CBI members on the issues that were expected to come up during the IGC, including enlargement, completion of the single market and the UK's position on the single currency.¹²⁸

Within the CBI, the Europe Committee and the CBI's central staff sought to consolidate a position in favour of joining by emphasising the economic advantages of EMU as a long-term counter-inflationary strategy, one that would have immediate consequences for wage settlements, and one that would promote exchange rate stability.¹²⁹ Those within the CBI who opposed EMU, particularly smaller firms, saw monetary union as 'a political idea in search of an economic justification'.¹³⁰ Those advocating retaining the pound viewed the benefits of exchange rate stability and anti-inflationary policies as illusory. They argued that EMU would lead not to lower wage demands by British unions, but more extravagant demands as labour sought parity with the relatively high-wage workforces of countries like Germany. These wage demands along with participation of monetarily lax countries such as Italy and Spain on the board of the ECB would make promises of price stability equally deceptive.¹³¹

Officially, the CBI National Council endorsed neither position, supporting instead the intermediate option that the UK should retain the option of entering EMU. This, the CBI leadership argued, had two benefits. First, it would allow the British Government to continue to take part in negotiations over the terms of how the ECB would operate. Furthermore, it would enable Britain to wait until the last moment before deciding whether to commit. The British Government would thus have the advantage of being able to judge whether the economic circumstances merited participation.¹³² For the government, it also had the political advantage of avoiding a destructive split prior to the 1997 general election. For the CBI, there were advantages as well. In 1996, the 'screaming nonsense' that convulsed the Conservative Party effectively

prevented the government from taking any action in regard to EMU entry or any European issue. With its own position not firmly in favour of early entry, the CBI was reluctant to conduct any dialogue with the government on European issues for fear of provoking a Cabinet crisis.¹³³

The CBI took an stronger, but more general, position in favour of the British government taking an active part in European affairs. This attitude was bolstered in the European Committee's strong backing for such a position and in a CBI poll that suggested that 87 per cent of members favoured staying in the EU, rather than withdrawing as some on the Eurosceptic right were suggesting. While support for remaining in the EU was extremely high, support for monetary union had waned slightly from previous years. A clear majority of 56 per cent of the members surveyed indicated support for the principle of monetary union while 30 per cent were opposed. However, only 11 per cent were strongly opposed, not strikingly greater than the proportion (8 per cent) that wanted to leave the European Union altogether.

Table 4.3 CBI Opinions on EMU, 1996

'Some European Union member states ... have said that they will be ready and keen to move to Economic and Monetary Union (EMU) in 1999, and to a single currency thereafter. In this situation do you think the UK should:'

1. Aim to be part of this leading group	28%	)	
2. Plan to join at some time, either in 1999, or at a subsequent date	17	)	49%
3. Plan to join at some time, but definitely not in 1999	4	)	
4. Make no decision to join now, but keep open the option of joining either in 1999 or later	26	)	
5. Decide not to join in 1999 and wait to see how EMU develops, keeping open the option of participation	16	)	42
6. Reject EMU as an option for the UK	7	)	7
7. Don't Know/Not Stated	3	)	3

'Overall, how strongly do you support or oppose in principle the UK's participation in EMU?'

1. Strongly support	19%	)	56%
2. Tend to support	37	)	
3. Neither support nor oppose	12	)	12
4. Tend to oppose	19	)	30
5. Strongly oppose	11	)	
6. Don't know/Not Stated	3	)	3

Source: Confederation of British Industry (1996) *Business in Europe 1996*, (London: British Chambers of Commerce and Confederation of British Industry), pp. 4-5 (Questions 10 and 11). Responses do not add up to 100 per cent due to rounding.

However, in terms of policy options, there were three clear groupings of opinion. The first group, EMU supporters, representing approximately half (49 per cent) of those surveyed, was in favour of British EMU membership either in 1999 or at some future date. A comparably-sized (42 per cent) group wanted to 'wait and see' prior to making a decision on EMU participation. Only 7 per cent wanted an outright rejection of monetary union as an option for the UK.¹³⁴

The leadership of the CBI could have used the absence of any substantial objection among its members to joining EMU *in principle* to endorse proposals from a Conservative Government that committed Britain to participation in a future monetary union; however, divisions within the governing party effectively mooted that option.¹³⁵ The consequences of the Eurosceptics' rebellion on the Conservative Party's electoral prospects had not gone unnoticed in Centre Point, the CBI's national headquarters. By the end of 1996, the CBI was anticipating a change in government after the 1997 elections.¹³⁶ The CBI's leaders, who had denounced Neil Kinnock in 1992 and effectively endorsed the re-election of a Conservative Government in 1996, began to hedge their political bets as the 1997 election approached. Both the members of the CBI's National Council and individual businessmen began making overtures to the Labour Party in the run-up to the general election. 'New' Labour, it was hoped, would be less divided than the Conservatives on Europe and thus provide the CBI with 'someone to talk to about European issues' – circumstances which were lacking under the Conservative Government in the years after Black Wednesday.¹³⁷

In the early 1990s, CBI officials had praised John Major's opt-out of the Social Charter in the Maastricht Treaty but expressed concerns about the future. As one CBI leader expressed it:

The opt-out at Maastricht means the UK employer is ... protected from these new threats (the Social Charter) – at least as far as his domestic activities are concerned. None the less, he awoke the day after Maastricht with mixed feelings akin to those of the explorer who wakes up and discovers that during the night the lions have taken all of his companions. Relief that he has survived, of course, but concern for the rest of his party with whom he shares considerable interdependence. And something of a worry that the lions may come back.¹³⁸

These worries had centred on the Labour Party and its manifesto pledge to 'opt-in' to European social legislation.¹³⁹ However, Labour's

efforts to shift to the centre in economic policy signalled a gradual rapprochement between industry and the Labour Party that accelerated as Labour's lead in opinion polls rose above thirty points. John Smith's decision to reinvigorate the previously stagnant 'Industry Forums' composed of Labour politicians, trade unionists, and industrialists provided an institutional arena for business leaders to influence and make recommendations for Labour's economic policies. Tony Blair's pledge to consult business on the minimum wage and any legislation that might emerge out of the Social Charter led to an additional easing of relations between the CBI and the party many had earlier regarded as their class enemy. By 1997, the CBI's fears about the Social Charter had been ameliorated by the discovery that, in practice, 'New' Labour was not a lion intent on devouring profits with the Social Charter and burdensome economic legislation, but was instead a paper tiger.¹⁴⁰

After the passage of the Maastricht Treaty, the IoD stepped up its opposition to monetary union with a three-pronged strategy. In the first instance, it continued to promote the hard ecu as a solution to the desire for a common currency that utilised the free market. At the same time, they continued to push for the British Government to grant operational independence to the Bank of England. The IoD also called for a referendum on the single currency should a British government decide to join EMU at a later date.¹⁴¹ Unsurprisingly, the IoD was unanimously hostile to the Social Charter.¹⁴² The central theme of the IoD's 1996 conference was a debate over EU membership and EU policies, most notably EMU and the Social Charter. In a consultation of members prior to the conference, 94 per cent of the IoD respondents said that the Major Government had taken the right course of action in opting out of the Social Charter. At the same time, most (80 per cent) IoD members preferred to wait until after 1999 before deciding on membership in EMU.¹⁴³

However, it took until June 1995 before the IoD, which had first opposed a single currency during the Maastricht debates, came out with its economic assessment of the case for and against the euro. Its conclusions, which provided an economic case for the political position the organisation had been taking for more than two years, was that 'it would not be in the *economic* interests of the UK to participate in European Monetary Unification'.¹⁴⁴ In contrast, in December 1991, while the Maastricht Treaty was being negotiated, the IoD had prepared a cost-benefit analysis of the Social Charter that charged that it would cost British business upwards of £5 billion a year. Still, the IoD

was strongly supportive of the single market programme and Britain's active participation within European institutions.¹⁴⁵

In part due to an improving economic situation after Black Wednesday (compared with the deteriorating conditions under the ERM), the FSB was even more antagonistic to European integration than the IoD. By 1996, reductions in interest rates had led to a simultaneous reduction in the concerns of small businesses with the level of interest rates. Where the high 12 per cent interest rates of 1992 had been the number one cause of concern for small business, by 1996 when interest rates were hitting a low of 5.75 per cent and a mere 0.5 per cent of small businesses pointed to interest rates as a priority concern.¹⁴⁶ With a domestically-oriented monetary policy delivering low interest rates and the vivid memories of high interest rates under the ERM, small businesses were not about to endorse any movement towards EMU. Indeed, the FSB had become increasingly radicalised on EU issues since Black Wednesday, with its 1995 national conference voting 15,376 to 13,341 in favour of Britain's immediate withdrawal from the EU. The FSB leadership maintained the position that Britain should remain in the EU to promote its economic interests; however, in the immediate aftermath of the 1995 annual conference, the National Council did adopt a motion as official FSB policy in favour of holding a national referendum on Britain's EU membership along the lines of the 1975 referendum on membership in the European Community.¹⁴⁷

London's investment banks were more sanguine about the prospects for EMU, for unlike small businessmen, 'if EMU goes ahead, [the City] will be participating whether the UK does or not'. As Europe's centre for international finance, the City's expertise would be in demand regardless of the domestic status of the British economy. Once EMU looked increasingly likely to happen, LIBA took an increasingly active role in the technical manifestation of the EMU project, despite what the LIBA leadership felt was a wide range of opinion within the organisation on the merits of EMU itself. While EMU was 'not an issue on which there is a clear consensus among LIBA member houses', nevertheless, LIBA became a subscriber to the Association for the Monetary Union of Europe (AMUE) in 1996.¹⁴⁸ The AMUE was founded in 1987 and LIBA's membership nearly a decade after it was founded indicated that LIBA's involvement with the AMUE was not due to a specific commitment to a monetary union. Had that been the case, LIBA would have joined in the 1980s. Rather, LIBA's subscriber status was a part of their information-gathering role as it enabled the association to keep

track of the major issues in the development of Europe's new monetary arrangements and to evaluate the consequences of various proposals for their members.¹⁴⁹

British financial institutions would have to prepare for the euro regardless of whether Britain joined. If London was not to lose business to Frankfurt or Paris, the City would need to have unfettered access to the euro electronic infrastructure and would need to prepare to provide euro-denominated services to everyone who wanted them.¹⁵⁰ The primary concern of the investment banking industry was whether or not contracts denominated in ecu or in pre-euro currencies would be recognised as valid when all contracts were denominated in euros. There was some doubt about whether, in the absence of the appropriate legislation, contracts issued in a currency that was subsequently extinguished and replaced by another currency need be honoured. Many trading houses worried that a debt issued in ecu (or any other euro-currency) would vanish along with the ecu. LIBA lobbied the House of Commons' committee tasked with preparations for Stage Three of EMU for the continuity of contracts, declaring that 'certainty under English law of the Regulation ... which addresses the legal framework for the introduction of the euro, is essential ...'.¹⁵¹ As contracts were subject to the laws of the jurisdiction in which they were issued, London merchant banks (and other financial institutions) had to press governments not only in the EU member states but also in Illinois and New York states, which had control over the Chicago and New York exchanges, on which a great many futures contracts and corporate bonds were initially issued.¹⁵²

Of some concern was access to the Trans-European Automated Real-time Gross-settlement Express Transfer (TARGET) system, the European Central Bank's instantaneous financial settlement system. Non-EMU members were not allowed the same privileged access as EMU participants, but the precise nature of the impediments they would have to bear were open to discussion. As all LIBA institutions had their own networks and electronic payments facilities on which they could rely in addition to existing mechanisms for end of day settlement, this matter was of modest, but not primary concern.

Each of these issues had the potential to hit firm profitability and market strategies, so LIBA and other trade groups in the City placed their priority on them rather than addressing what they saw as arcane debates within the British government over whether the UK would join a European monetary union. Whether Britain participated in EMU or not, the City planned on being an active participant.¹⁵³

Likewise, farmers were participating in an 'agromonetary economy' regardless of whether the United Kingdom signed up to EMU or not. While Black Wednesday had led to a jump in farm incomes of about 30 per cent within a year, the NFU's leadership did not share the view of many in the small business community that suspension from the ERM was, in reality, 'White Wednesday'. This is particularly surprising because during 1993 and 1994, in the immediate aftermath of devaluation, Britain's farmers had their most profitable two years of the twentieth century – due entirely to the shift in price supports and the green exchange rate. Even with the pound suspended from the ERM, support payments were denominated in ecu, providing a major increase in the devalued pound payments that farmers received for their products.¹⁵⁴

However, twenty years of experience with the CAP and fluctuating exchange rates provided the staff and leaders of the NFU with a longer-term perspective on exchange rate policy than their small business counterparts. It also provided them with a different focus – the exchange rate itself rather than concerns solely about interest rates. Not only did the NFU desire a re-entry into the ERM, but, by 1995, they became the first producer group in the UK to call for Britain to enter EMU – believing that 'a lower and more stable exchange rate would be the most desirable outcome for the UK agriculture industry'.¹⁵⁵ The leadership sought to 'educate' their members about the rationale behind this decision, taken by the National Council through a series of informational forums, public addresses by NFU officers, publications, and seminars.¹⁵⁶

In the run-up to the general election, the CBI re-evaluated its position on monetary union so that it could respond to whatever position the government took. In April 1997, the CBI's Europe Committee prepared a wide-ranging consultation of the membership with the explicit 'aim ... to develop a position which commands broad support among the membership, be [sic] setting out the issue from a business standpoint'.¹⁵⁷ The Europe Committee staff prepared briefing papers for the Europe Committee and regional councils on the state of and prospects for the European economy,¹⁵⁸ Continental labour market flexibility,¹⁵⁹ and different scenarios for the UK.¹⁶⁰ The final consultation was deliberately designed to be debated after the May 1997 parliamentary election, primarily to avoid letting the CBI's debate get caught up in the electoral contest. As one CBI member put it

Obviously it would be embarrassing to us if it looked as though we were interfering in the general election. ... That's why we are not

planning to issue our formal position on monetary union until June.¹⁶¹

The consultation process revealed that two different options commanded the support of the vast majority of CBI activists. At the Council of Small and Medium-Sized Enterprises (SME) and the 13 Regional Councils, firms voted overwhelmingly in favour either of EMU entry as soon as possible (42 per cent) or in favour of EMU entry after a brief delay (52 per cent). Only 3 per cent supported continuing the CBI's existing policy that Britain should 'wait and see' how EMU developed. A further 3 per cent wanted to reject EMU participation for the foreseeable future.¹⁶² The CBI leadership was in favour of joining in principle but was not able to say when or how. Its policy was, in fact, a compromise between the member firms that wanted early entry and those that wanted to join EMU when 'the conditions were right', positions which commanded the support of approximately 94 per cent of CBI activists.¹⁶³ Indeed, this position could also arguably lay claim to support from the small 'wait and see' group, as it only ruled in a 'successful' EMU, a pre-condition for those who wanted to observe how EMU functioned prior to making a decision. Only one member of the CBI Council (Stanley Kalms of the Dixons Group) dissented from the new CBI policy.¹⁶⁴

The CBI National Council, consciously aware of the divisions within its members, tentatively endorsed British participation in a 'successful' EMU, declaring that

We support UK membership of a successful EMU, but should join only when the conditions for success are in place. Of course, not all members argued for this specific line – some prefer a more sceptical approach, some an unreserved commitment to early British entry. But our consultation process showed that a large majority can support this conditional commitment to membership of EMU.¹⁶⁵

The CBI's initial public statement of its new policy supporting the principle of conditional participation in EMU remained ambivalent. Government ministers, including Chancellor of the Exchequer Gordon Brown, requested that the CBI not rule out British membership in 1999, a request to which the CBI apparently acquiesced.¹⁶⁶ The National Council consciously declined to specify a preferred entry date for the UK, although it did go so far as to suggest that it was 'unlikely' that Britain would take part in the first wave of EMU participants.

Furthermore, the CBI suggested that other potential EMU participants might want to reconsider their own participation and that 'across Europe, the appropriate conditions for EMU's success and the appropriate timing of the first wave need to be debated dispassionately, and *delay considered if necessary*'.¹⁶⁷ That a statement designed to convey support for a policy also explicitly called for a careful consideration of abandoning that very same policy reveals the tentative nature of the CBI's public position on EMU.

The CBI's public position was clarified and hardened only in the wake of Gordon Brown's statement to Parliament on EMU in October 1997. The simultaneous creation of a national steering committee for preparations for EMU composed of the Chancellor, the Governor of the Bank of England, the President of the Board of Trade, the President of the CBI, and the President of the ABCC, allowed the CBI to consult directly with the Government on the immediate practical concerns that industry had with the implementation of EMU. While the CBI had bowed to Government pressure in its July declaration and only expressed 'doubts' and suggested that it would be 'unlikely' that Britain would take part in EMU in 1999, by November the CBI National Council, in a publication appropriately entitled 'EMU Policy Update', could more decisively declare that it, like the Labour Government, believed that '1999 is too soon'.¹⁶⁸

The National Council also 'recognized that delay is now more unlikely than when the CBI developed its position...'.¹⁶⁹ As the original CBI policy announcement took place contemporaneously with the French elections (June 1997) and the German gold crisis (May 1997), the possibility of a delay in EMU in the summer of 1997 appeared more likely than it had in the fall.¹⁷⁰ Tellingly, the National Council did not need to conduct additional consultations with the Regional Councils, the SME Council, or any of the member corporations before altering its position. The CBI's executive leadership retained a degree of policy-making autonomy that they could exercise under circumstances such as a decisive declaration of Government policy. Likewise, it did not need to seek the approval of the membership at the CBI conference to endorse its change in policy.

To support its evolving position on EMU, the National Council conducted a pre-conference poll of the membership. The survey took place after Brown's October statement and prior to the CBI's annual conference in November 1997. The polling question was deliberately redesigned from the highly nuanced questions of previous years, to a dichotomous question reflecting both the CBI and the Government's new position on EMU.¹⁷¹

Table 4.4 CBI Opinion on EMU, November 1997

'Should the UK plan to join EMU as soon as economic convergence is in place, i.e. once cyclical convergence with European interest rates is achieved, and a competitively sustainable exchange rate exists?'

1. Yes	72%
2. No	16
3. Don't Know/Not stated	11

Source: Confederation of British Industry (1997) 'CBI Pre-National Conference Member Survey Opinion Poll Results, London (9 November 1997) p. 6. Responses do not add up to 100 per cent due to rounding. (n = 734).

While one of the two explicitly listed indicators in the member survey (a competitive exchange rate) was one of the indicators of convergence that the CBI had discussed prior to its policy change in July, the other (interest rate convergence) was first mentioned in the Chancellor's statement.¹⁷² Colin Marshall, the CBI's new President, used the new polling figures to suggest that 'The response on EMU gives a clear message from CBI members, *following the Chancellor's statement to Parliament*. A large majority want the UK to join EMU provided the conditions for success are in place'.¹⁷³

When Labour granted independence to the Bank of England, a long-term policy recommendation of the IoD was realised. In the opinion of the IoD's leadership, it also eliminated the one institutional advantage, operational independence, that a European Central Bank would have had over the Bank of England. With a counter-inflationary set of central bank institutions, Britain, in the opinion of the IoD's policy team, would reap just as many benefits as the euro-zone countries. Likewise, the IoD welcomed progress towards the successful completion of the euro-zone on the grounds that a successful euro could evolve into the parallel currency that the IoD had hoped the ecu would become.¹⁷⁴

While the Chancellor's declaration on EMU and the CBI's modification of its position on EMU put the IoD under some pressure to take a less antagonistic stance towards monetary union, the IoD's leadership was able to interpret the Chancellor's five economic tests as liberally in a Eurosceptic direction as the CBI was interpreting them in a pro-European direction. Because the Government ruled out entry in 1999, the IoD had the advantage of being able to find extremely concrete indicators of Britain's non-convergence in its existing trade, financial, and fiscal circumstances.¹⁷⁵ Furthermore,

The logic of the Chancellor's requirement that certain basic tests be met before the UK enters EMU is that there can be no time-table set

in advance, there can be no promises that the UK will join EMU at any specific time in the future. The Chancellor has given business as much certainty as he can with his advice in respect of the present Parliament: that the planning basis should be no entry into EMU.¹⁷⁶

Where the CBI interpreted Brown's statement as a clear indicator of the Government's intent to enter monetary union under the appropriate circumstances, the IoD interpreted it in line with the IoD's policy of ruling out participation 'for the foreseeable future'.¹⁷⁷

While large firms and directors expressed support for their interpretation of the Government's position, smaller firms were extremely hostile both to EMU and to the European Union more generally. At their 1998 national conference, 78 per cent of FSB voters endorsed the motion opposed to EMU and calling for a referendum.¹⁷⁸ Nevertheless, the FSB also took part in Gordon Brown's EMU Business Advisory Group, where they consistently pointed to the logistical hurdles that would face small firms in adjusting to EMU as well as advocating government assistance for small businesses in the event Britain joined EMU. A survey of FSB members found that they were overwhelmingly sceptical of EMU, fearing that the burdens of adjustment would fall disproportionately on them in terms of adjusting prices and buying new equipment to deal with the new currency. Even among small businesses extensively engaged in exporting and importing (20 per cent of the sample), only 36 per cent thought that EMU would be of economic benefit. Even though the FSB officially opposed the single currency, this did not prevent them from participating in the Government's EMU Advisory Group or from suggesting that 'if the Government does decide to join the single currency experiment, small firms will need special assistance because of the financial implications EMU poses'.¹⁷⁹

Conclusions

The political divisions within the Conservative and Labour parties have largely dictated the terms on which British business groups have debated Britain's monetary relations with Europe. The deep divisions within the Conservative Government of 1992–97, especially in the wake of the Danish rejection of the Maastricht Treaty and the pound's suspension from the ERM, prevented groups such as the CBI from promoting a more integrationist policy. Prior to the political crisis surrounding Maastricht and the economic and political crisis that culminated in Black Wednesday, the realm of debate within the Conservative Party was more open and more in favour of increased

economic and monetary integration. When Britain joined the ERM in 1990, support was widespread among major exporters and opposition was muted to non-existent among domestically-oriented industries.

The Government's opt-outs from both the Social Charter and EMU satisfied elements within the Conservative Party that were resistant to further European integration and were readily acceptable to business groups. However, the Government's diminished majority after the 1992 elections provided anti-Maastricht Tories the opportunity to hinder approval of the treaty and undermine progress on EMU.

Because they were not part of an over-arching structure of industrial representation, the political activities of British business associations lacked central coordination and allowed each group to promote particular interests based upon the economic sensitivities of its members. Groups like the Institute of Directors and the Federation of Small Businesses – where a broad range of members had direct input into the decision-making process – were able to express their concerns about EMU and European integration in highly visible forums such as national conferences. Their national leaders, who, prior to the Maastricht debates and Black Wednesday, had been sidelined, now found allies they could support in the governing party.

The CBI's National Council was broadly supportive of monetary integration and a majority of its members, too, expressed support for a modest degree of increased integration. The CBI, however, was reluctant to take a leading position without support from politicians in the governing party or the Cabinet. When the members of the Government who supported increased integration were forced back to the position of 'wait and see', the CBI lost the necessary external political support for a pro-EMU position. Without any allies willing or able to support movement towards EMU, the CBI became extremely circumspect even though it could have been a proponent of monetary union. Rival business associations – who had clear political allies on the Conservative backbenches – became much bolder in arguing against membership. Other British business associations, such as LIBA, chose to simply avoid taking an official position on EMU membership, preferring to concentrate on the technical issues relating to what the advent of the euro would mean for their members. The National Farmers Union, the only group that monopolises its sector of the economy, was the only pro-EMU interest group in Britain to 'swim against the tide' of anti-EMU political opinion, calling for early entry. It did so at precisely the time when the effects of devaluation of the pound were at their most positive, a position that seemingly ran counter to the immediate experiences of its members.

5

Conclusion

This book examines the question of why German and British business associations representing economically similar firms pursued different policies towards Economic and Monetary Union from 1988 until 1998. To answer this question, I have analysed the decision-making structures of ten German and British business associations which were selected based upon their position in the international economy and their imputed interests in monetary integration. I have examined the evolution of their political positions towards EMU between 1988 and 1998 and compared their changing political positions with the economic positions of firms in the economic sectors represented by each business association. Also, I have analysed the connection between the business associations lobbying and public statements and the policies of governments and political parties. As a result, this study provides both an empirical and theoretical contribution to discussions of interest group behaviour.

Contemporary political economists often present a simplified political role for business associations – and business more generally – in modern political debates. Many functionalist accounts imply that business is one of the most dominant players in economic policy formation. They suggest that because businesses are politically powerful, business associations are merely passive transmission belts of firm interests.¹ This book seeks to correct these ‘simple models of politics’ through a deeper analysis of the activities of business associations regarding the European Union’s central political and economic project of the 1990s, EMU. I argue that business associations are themselves political agents with their own capacity for actively shaping the representation of their members’ interests. The existing political debate, the organisation of the associational system, and

the opinions of their members all interact to structure the ways in which business associations are able to select and pursue their political objectives. That is the central theme of this book. In this conclusion, I will provide an overview of the empirical findings presented earlier and then discuss the theoretical implications of this research.

Empirical findings

This book provides the first substantial empirical investigation of firm and business association attitudes towards EMU. Most academic work on EMU has examined policymakers and the negotiation and implementation of the Maastricht Treaty itself.² Previous works that have looked at business and European monetary policy have either been highly theoretical with limited empirical research,³ confined themselves to one sector or policy area,⁴ or focused on policy formation.⁵ This book examines the evolution of business associations' attitudes across a range of sectors and over a time-frame from prior to the Maastricht Treaty until the late 1990s. As such, it not only provides the first substantial research into the actual activities and preferences towards EMU of a cross-section of business associations, but it demonstrates that their preferences were more malleable and their lobbying less assertive than has generally been suggested. Indeed, the evidence indicates that in regards to EMU, business groups followed the lead of politicians rather than pushing EMU onto, or off, the agenda themselves.

In Germany, the ruling coalition solidly supported movement towards monetary union and provided it with much political impetus. Without encouragement from industry, Hans-Dietrich Genscher, Germany's Foreign Minister, placed EMU on the agenda of the Hanover Summit meeting in 1988 and received a tepid response from German industry and resistance from the Bundesbank. The creation of the Delors Committee and the participation of Bundesbank President Karl-Otto Pöhl in the planning of EMU also occurred without industry input. While the Bundesbank's position in favour of anti-inflationary rigour was well-represented on the Delors Committee, the composition of the committee itself – 12 central bankers, the President of the European Commission and three experts – was not one that allowed interest groups access for lobbying.

German industrial interest groups only began to comment on EMU in the wake of the Delors Report. Previous monetary arrangements under the EMS had served Germany's major exporters well. Because of the Bundesbank's independence and deutschmark's position as the de

facto anchor currency of the EMS, Germany alone among the EMS participants was able to pursue a domestically-oriented monetary policy. This suited both German exporters and the non-tradable sectors of the German economy. Unlike its European partners, Germany never had to face a trade-off between the demands of the domestic economy and the stability of its exchange rate. It was unclear how deviating from such a desirable policy position would be in Germany's economic interests.

However, Germany's political interests in 1989–90 did entail a major commitment to future cooperation with other member states of the European Union, particularly France. With German unification on the agenda as an historic opportunity, Germany's political leaders were highly motivated to further European integration alongside German unification in a way that reassured Germany's neighbours. The imperatives of German unification decisively shifted political debate – and power relationships of the government and Bundesbank – in the Federal Republic. The political prospects of German unification temporarily isolated the Bundesbank and allowed Kohl's coalition to implement monetary unification with East Germany on a basis that was extremely generous to east Germans. At the same time, German unification coupled with other EU members willingness to accept Germany's monetary conditions for EMU undermined the Bundesbank's ability to prevent agreement on EMU.

Firms, like the German population, saw few economic advantages in EMU. They accepted EMU reluctantly and with great trepidation even when the institutional structure of the central bank was made identical to that of the Bundesbank. Both the BDI and the DIHT endorsed the government's negotiating position on EMU – that any monetary union would need to have German institutional features, a specific anti-inflationary mandate and a long convergence period prior to its implementation. They did express concerns, shared with the Bundesbank, about automatic mechanisms for movement towards EMU and the vagueness of the reference values contained in the treaty. Importantly, their major reservations were not in terms of EMU itself, which they accepted, but the mechanisms for potential fiscal transfers between richer and poorer countries embodied in the Structural Funds. These fiscal measures implied the potential imposition of additional taxes on German business, a burden that German business was loath to bear.

All the mainstream German political parties accepted the Maastricht Treaty with the primary criticism of Kohl's negotiating that he had failed to obtain deeper political integration in exchange for EMU. The

major opposition parties, the Social Democrats and the Greens, joined with the governing Christian Democrats and the Free Democrats in support of ratifying the Maastricht Treaty and committing Germany to EMU. Only the successor to the east German Communist Party, the Party of Democratic Socialism (PDS), opposed the Maastricht Treaty, and it did so because it considered the treaty too capitalistic. The far-left PDS, considered politically untouchable by the mainstream parties, would have made an extremely unattractive ally for reputable German business leaders if they had been inclined to oppose EMU.

The structure of business representation in Germany made dissent from the positions of the BDI difficult for subordinate member associations and firms. Once the BDI had determined a policy for the organisation, its sectoral associations were bound by the peak association's policy. Sub-sectoral associations were bound by their sectoral associations and the BDI. The interests of exporters tended to dominate most of the main sectoral associations in the BDI, and these groups had a plausible economic argument in support of the benefits EMU would deliver to exporters in terms of fixed-exchange rates. The main BDI committee assigned to provide a policy document on EMU was composed primarily of representatives of large multinational corporations with substantial export interests. However, even when exports were not a factor in an industry's profile, the leaders of business associations internalised the arguments of the benefits of exchange rate stability. The German BI, consisting of local building firms that epitomised the non-tradables sector, consistently told its members that EMU would be good for German exporters and that would lead to more construction in Germany. This stood in stark contrast to what most construction firms witnessed when public works spending was drastically reduced in the mid-1990s in order to help Germany meet the Maastricht criteria for budget deficits.

Because of the main German parties' political commitment to EMU, there was no alternative policy option on monetary integration available to German business leaders even though a majority of the members of the DIHT in 1995 and a clear plurality of BDI members 1996 expressed opposition to a single currency.⁶ The only policy position available to German business leaders opposed to EMU was to support participation in EMU so long as the Bundesbank's position of a strict adherence to the Maastricht criteria was followed. For many businesses, this is unlikely to have been their true policy preference, but it was the only option available within the restricted space of partisan political debate over EMU in Germany. Even during the gold

revaluation crisis of 1997, the only time when German participation in EMU was seriously threatened, business association leaders restricted their comments to pleas for the government and Bundesbank to cooperate with each other.

In contrast, British party political debates over EMU were much broader. The Conservative Party was fundamentally divided between pro-European and Eurosceptic wings. A major issue of economic debate during the 1980s had been British membership in the ERM. With the notable exception of Margaret Thatcher, the leading members of the Conservative government had favoured British participation in the ERM as a means of controlling inflation. This view was shared by many Conservative backbenchers, industry, the City, the unions and all the opposition parties. Despite over five years of lobbying, Thatcher resisted placing the pound in the ERM until her political position became almost untenable in October 1990. The next year, after John Major replaced Margaret Thatcher in 10 Downing Street, the pro-European wing of the Conservative Party was temporarily dominant in government, but a substantial number of the party's MPs were opposed to deeper European integration.

As in Germany, British business groups did not exert any noticeable pressure in favour of EMU – major exporters and pro-integration politicians had struggled for years to get the UK into the ERM and they had little appetite for a renewed fight over EMU. Major's negotiating triumph at Maastricht, where he obtained 'opt-outs' for the UK on EMU and the Social Charter, were hailed as great successes for British business – especially the opt-out on the Social Charter. The CBI, Institute of Directors and FSB all initially expressed solid support for the government's position in the wake of Maastricht and in the run-up to the 1992 general election. Faced with a Labour Party that supported the Social Charter with the possibility of greater social regulation, British business was united across the spectrum in support of the vocally pro-business Conservative Party. Britain's opt-out for EMU, in addition to maintaining a fragile truce within the Conservative Party, also held out promise both to businesses that favoured monetary union, as the UK retained the option to join EMU seven years in the future, and those that opposed it, as Britain was not obliged to participate.

Prior to Black Wednesday, the CBI remained strongly supportive of membership in the ERM as did the London Investment Banking Association. The National Farmers Union supported ERM membership in 1991–92 but favoured a devaluation within the system so as to boost

CAP payments to British farmers. The IoD has a more complicated view of ERM membership as it was not its preferred anti-inflationary strategy. However it accepted the fact of membership on the grounds that devaluing the pound would lead to worse problems than remaining in the system. All four business associations supported ERM membership up until the moment Britain devalued. Only the FSB was hostile to the ERM as its members' use of home mortgages made them particularly sensitive to the high interest rates necessary to keep sterling pegged to the deutschmark. Only after the Danish referendum, and two months after the British general election, did the FSB advocate a referendum on the Maastricht Treaty in the hopes that it would undermine increasing European integration and free small businesses from what they saw as excessive European-initiated interest rates and expensive Continental social regulations.

The decisive political event relating to EMU was the devaluation of sterling in 1992 and the complete discrediting of the ERM among British policymakers and the public. Prior to that date, the option of the UK joining the euro in the first wave of members was a real possibility provided Britain's experience in the ERM was positive, uneventful and provided for a smooth and natural transition to a single currency. After Black Wednesday, European monetary cooperation was seen through the prism of high interest rates, unemployment, bankruptcy and negative home equity. Devaluation shattered the Conservative Party's reputation for sound economic management and opened up fault lines within the party over its European policy. The Labour Party was able to take advantage of these difficulties in the parliamentary debates over the Maastricht Treaty to exacerbate Conservative differences.

Business group support for the Maastricht Treaty and EMU eroded as the political and economic difficulties mounted. After the Danish referendum and the beginning of the Eurosceptic rebellion in the Conservative Party, the FSB began to press for a referendum on the Maastricht Treaty, a common Eurosceptic tactic designed to prevent British ratification. The IoD shifted its position on the Maastricht Treaty, moving from a heralding of the Treaty in December 1991 to ambivalence in the summer of 1992 to malign disregard after Black Wednesday. While not openly urging the rejection of the Treaty, the IoD's leaders came to suggest that ratification of the Maastricht Treaty was more a political battle than one that would have substantial economic consequences for business. For them, the completion of the Single Market at the end of 1992 was the main European

policy priority, not the ratification of a new treaty. It wasn't until 1995 that the IoD came out against British membership in EMU.

The CBI's position on monetary integration closely tracked the government's position from the early 1990s onwards. They supported membership in the ERM, afterwards they toyed with the idea of returning to the ERM at a new rate, but quickly abandoned that as an option when the government, which itself had contemplated rejoining, rejected that option as politically unfeasible. Although a plurality of members favoured participation in EMU at some point, the CBI avoided urging the government to make preparations for membership. Instead, they supported John Major's 'wait and see' strategy as the best option available to them in the existing political circumstances. The election of the New Labour in 1997 led to a re-appraisal of the CBI's position on EMU; however, this reassessment took place after the new government had announced its own new policy on EMU. Unsurprisingly in light of its previous actions, the CBI found that it endorsed Gordon Brown's Five Economic Tests and the new government's 'prepare and decide' strategy.

In the United Kingdom, business opposition to European initiatives withered away in situations where there was solid political support for a project, even a European social endeavour. After Tony Blair's Labour Party won the 1997 elections, the new government quickly fulfilled their party's manifesto promises to 'opt-in' to the Social Charter. Almost unanimously, business groups had opposed British participation in the Social Charter, believing that it would lead to an escalation of their labour costs and reduce their flexibility in hiring and firing workers. Despite the vehement criticisms that they had heaped on the Social Charter in previous years, business associations (even the usually vocal FSB), when faced with an overwhelming parliamentary majority, muted their opposition to each of these policies, preferring to focus their energies on areas where they would have greater chances of success. Among other things, this included lobbying to make sure that the legislation implemented under the Social Charter was as weak as possible, a strategy that Continental business associations had already been pursuing for several years.

The firm-centric nature of British industrial representation and its relative lack of organisational hierarchy allowed many firms and associations to take independent stances on political issues. The CBI's decision to support a particular policy did not bind its member firms to that position, nor did it bind in other business associations, although other associations did recognise that there might be advantages in coming up with a common position and acting in concert. At

least two-thirds of the CBI's National Council and the FSB's entire National Board consisted of people drawn directly from the management of a specific business. In contrast, the DIHT's decisionmakers were invariably the heads of a subordinate chamber of commerce, not a firm. This meant that the German association tended to represent small- and medium-sized enterprises, placing decision-making authority in the hands of personnel who had only an indirect tie to firms operating in the economy. Their interests and loyalties were thus more closely allied with the business association itself rather than with the interests and financial circumstances of an individual company. Those responsible for foreign economic policy at the DIHT had a full-time staff under the ultimate authority of a DIHT board member – the president of a regional chamber of commerce. The leadership of the FSB and the CBI, was drawn not from a subordinate association but directly from member firms. While performing functions on behalf of the organisation, these business leaders also were responsible for their firms' economic performance. For example, in 1998, the FSB member responsible for writing foreign economic policy briefs for the organisation was usually employed in the day-to-day management of his small publishing company in Shrewsbury.

The occupational distinction between those running a business and those representing the interests of businesses is greater in the DIHT than in the FSB. National policymakers in the DIHT are responsible for the operations of a regional chamber of commerce rather than the success of a particular enterprise. In addition, they need only consult and conduct irregular surveys of their members in order to discern trends in the political opinions of their membership. The FSB's governing body consists of owners of small firms who are actively engaged in managing their own businesses. In addition, the FSB conducted ballots of its members on various issues and is subject to the passage or defeat of specific motions in votes of its members. In consequence of these organisational differences, the DIHT's leadership had much greater leeway than the FSB's leadership in determining its policy positions.

Still, British associations did not have a blank cheque to press all the policies that their members favoured. For example, in 1995, the FSB's membership had voted by a wide margin in favour of British withdrawal from the EU, a position that had no base of support in parliament. The absence of any potential political support made this an extreme position for a business association to take. The FSB's leadership was able to exercise an independent evaluation of the political sit-

uation. While the membership voted in favour of withdrawing from the EU, the FSB's National Council declined to present that as the official policy of the Federation. At the other end of the political debate on EMU, in 1996, a plurality of CBI members was in favour of joining EMU; however, due to the absence of political support for 'opting in' to the single currency, the CBI's official position remained identical to that of the government – it would 'wait and see'. British firms expressed opinions that were very much in line with their German counterparts, yet their business associations represented strikingly different points of view. National differences in their political environment and in their organisation account for these variations, not the sentiments of their members.

The deep political divisions within the British Conservative Party over European integration opened up a range of opportunities for groups resistant to monetary integration and limited the options available to pro-EMU groups. The limitations on groups that would normally be supportive of EMU were most apparent after Black Wednesday. Even with explicit 'opt-outs' on EMU and the Social Charter, the government experienced extreme difficulty obtaining parliamentary approval for the Maastricht Treaty. Support for a limited Maastricht Treaty was the best that a pro-integration business association could advocate within the existing confines of political debate. Pushing for EMU itself was not even on the policy agenda. Business groups remained followers of government on the institutional arrangements for monetary policy. As Britain tried various monetary strategies in the wake of EMU, each was endorsed, retroactively, by Britain's leading business associations.

Theoretical implications

This study emphasises two theoretical points. First, that business associations are political entities themselves and not merely transmission belts of firm preferences or even simple political adding machines. They have a political dynamic of their own. The second point I highlight is that the logic of collective action implies certain political behaviour on the part of business associations. Firms, just like individuals, join organisations for the particular benefits they receive as members, not out of a generalised sense of obligation or duty. The leaders of business associations are well aware of the motives of their members and seek to provide benefits to ensure continued membership and expansion of the membership base.

As political organisations, business associations occupy an intermediate position between firms, which are directly engaged in the economic marketplace, and politicians, who are engaged in economic policymaking, political debate and governance. While representing the interests of firms, the leaders of business associations also want to be effective and to be successful in the political arena, and this often entails behaving strategically based upon existing political realities. This study owes a great deal to the corporatist literature with its emphasis on peak-level negotiation and centralised economic organisations. I share corporatists' interest in the organisation of business as an important political variable, but I research and analyse the policy positions of business groups themselves rather than the macroeconomic outcomes of peak-level bargaining by major social groups. This focus allows for a greater understanding of the political, as opposed to the economic, dimension of interest group behaviour.

This work also provides a contribution to the functionalist literature. Many of my empirical findings about the attitudes of firms are broadly in line with functionalist predictions of political preferences of firm exchange rate policy preferences, for example the small, domestically-oriented firms that make up the British FSB and the German DIHT shared a dissatisfaction with EMU. However, my insistence on providing a closer empirical examination of how these attitudes were represented in the political sphere highlights the tendency of business associations to 'misrepresent their interests, log-roll, and bargain in ways that severely complicate the translation of economic interest into policy position'.⁷ Functionalist models of political activity ignore the role that the political system plays in shaping the economic policy battleground. While politicians do not operate in an economic vacuum, neither do business associations operate in a political vacuum. This provides both a challenge to the simplified notion of politics functionalists supply and an opportunity for a deeper understanding of the political processes at work in the formation of national economic policy. It also allows for a deeper understanding of one important set of economic actors heavily involved in debates over economic policymaking.

Secondly, this work allows for a more nuanced understanding of the logic of collective action. Group organisation can have many advantages and history is replete with examples of highly organised and motivated groups obtaining rents at the expense of a less-organised and motivated broader society. However, an underemphasised aspect of group theory is the way in which groups need to provide special

benefits to their group's members in order to encourage their continued membership. The responsibility for finding these special benefits and providing them to members rests with the leaders of a group, the leaders of business associations in this study. In some cases, obtaining members is not difficult, membership in German Chambers of Commerce (DIHT) is compulsory, for example. In most other cases, business association officials need to come up with 'deliverables' for their members that will justify the expense of membership fees.

In pursuit of this goal, business associations provide economic and political services for their members. Members of business associations frequently want information about government policies and want to influence government to provide a favourable operating environment for their industry. The leaders of business associations attempt to satisfy both of these desires – providing advice to their members on the consequences of new government regulations and attempting to influence policymakers in an effort to obtain beneficial legislative activity when politically feasible as this study has shown. Business associations have a large number of policies they could pursue to promote the interests of their members. An industry association, however, has limited financial and staff resources to devote to political activity. Within these constraints, when the leadership of a business association engages in political activity, it places a priority of achieving specific, identifiable policy successes rather than necessarily lobbying for general policies that will maximise the profits of the industry. As they pursue favourable governmental action, business associations usually follow strategies where they can have favourable relations with politicians and government officials while simultaneously satisfying their members that they are working on their behalf.

Monetary policy is a policy area where the benefits of a policy are non-excludable so there is great difficulty in mobilising a group to pursue changes in policy where the positive benefits are so dispersed. There is a high probability of free-riding by other interest groups and individual firms. Furthermore, there is a strong likelihood that the members of a business association will not be unanimous in their support or opposition to different monetary policies. Taking a strong public position would thus risk alienating a portion of the association's membership, an extremely undesirable option for association leaders. Consequently, business associations in both have tended to confine themselves to providing information on the potential economic consequences of monetary policies and commenting on announced government policies. These pronouncements typically are issued strategically,

in order to establish the credentials of the business association as a contributor to the success of the government's economic policies.

EMU and after

This book has examined how the associational arena has interacted with the economic and political arenas in debates over EMU. Recent developments in European politics, especially in Italy, demonstrate that EMU itself is far from complete or entirely consolidated. Domestic political debates over British membership, at least, are likely to continue as long as the pound remains outside the euro-zone. In Germany, latent and widespread disenchantment with euro membership has not achieved any political salience, although there are occasional sparks of concern among politicians about the long-term viability of EMU. Political arguments over expanding the euro-zone to the east and over possible future British membership at some indeterminate point in the future will inevitably trigger responses from both German and British business groups. The primary objects of this study, business associations, play a central role in many accounts of economic policymaking and they are likely to feature prominently in future studies as well.. The findings presented here suggest that observers interested in their reactions should place an examination of national political debates at the heart of their analyses.

Appendix A – German Bundestag Elections, 1990–98

Party	1990		1994		1998	
	Per cent	Seats	Per cent	Seats	Per cent	Seats
CDU	36.7	268	34.2	244	28.4	198
CSU	7.1	51	7.3	50	6.7	47
FDP	11.0	79	6.9	47	6.2	43
SPD	33.5	239	36.4	252	40.9	298
Greens	5.0	8	7.3	49	6.7	47
PDS	2.4	17	4.4	30	5.1	36
Others	4.2	0	3.5	0	6.0	0
Totals	100.0	662	100.0	674	100.0	669

Sources: Statistisches Bundesamt (1991) *Bundestagswahl 1990* (Weisbaden: Statistisches Bundesamt); Statistisches Bundesamt (1994) *Bundestagswahl 1994* (Weisbaden: Statistisches Bundesamt); Statistisches Bundesamt (1998) *Bundestagswahl 1998* (Weisbaden: Statistisches Bundesamt).

Appendix B – British Parliamentary Elections, 1987–97

Party	1987		1992		1997	
	Per cent	Seats	Per cent	Seats	Per cent	Seats
Conservative	43.4	376	41.9	336	30.7	165
Labour	23.2	229	34.9	271	43.2	419
Lib Dems (1)	31.7	22	17.8	20	16.8	46
SNP	1.3	3	1.9	3	2.1	6
PC	0.3	3	0.5	4	0.5	4
Others	0.1	17	3.0	17	6.7	19
Total	100.0	650	100.0	651	100.0	659

Sources: Author calculations from Butler, David and Gareth Butler (1994) *British Political Facts, 1900–1994*, 7th edition (London: Macmillan), p. 219; Mackie, Thomas T., ‘United Kingdom’, *European Journal of Political Research*, Vol. 24, No. 4 (1993), p. 555; *The Guardian* 4 May 1997. Abbreviations: Scottish Nationalist Party (SNP), Plaid Cymru (PC). Most ‘Others’ in 1987 and 1992 are parties in Northern Ireland; ‘Others’ in 1997 included the Referendum Party.

Note (1): LibDem votes in 1987 includes all votes for the Liberal Party and the Social Democrats (the ‘Alliance’).

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- 116 European Monetary Institute (1997a) *Legal Convergence in the Member States of the European Union As at August 1997* (Frankfurt: European Monetary Institute); European Monetary Institute (1998) *Convergence Report*; European Commission (1998a) *Euro 1999, Part 1: Recommendation* (Luxembourg: Office for Official Publications of the European Communities); European Commission (1998b) *Euro 1999, Part 2: Report* (Luxembourg: Office for Official Publications of the European Communities).
- 117 Deutsche Bundesbank (1998) *Opinion of the Central Bank Council Concerning Convergence in the European Union in View of Stage Three of Economic and Monetary Union* (Frankfurt: Deutsche Bundesbank, 26 March 1998).
- 118 Deutsche Bundesbank (1998), p. 21.
- 119 Deutsche Bundesbank (1998), p. 23. Emphasis added.
- 120 *Frankfurter Allgemeine Zeitung* (24 April 1998), p. 1.
- 121 *Frankfurter Allgemeine Zeitung* (25 April 1998), p. 1.

Chapter 2 German Business and EMU

- 1 Bundesverband der Deutschen Industrie (1956) *Der Weg zum industriellen Spitzenverband* (Darmstadt: Bundesverband der Deutschen Industrie), pp. 89–129; Gerschenkron, Alexander (1962) *Economic Backwardness in Historical Perspective* (Cambridge, MA: Belknap Press); Braunthal, Gerard (1965) *The Federation of German Industry in Politics* (Ithaca: Cornell University Press), pp. 5–31; Shonfield, Andrew (1969) *Modern Capitalism* (Oxford: Oxford University Press), pp. 240–6.
- 2 Shonfield (1969), p. 246; Berghahn, Volker R. and Detlev Karsten (1987) *Industrial Relations in West Germany* (New York: St. Martin's Press), pp. 11–6.
- 3 Interview with BDI official, Cologne (25 March 1996).
- 4 Interview with BDI official, Cologne (25 March 1996).
- 5 Bundesverband der Deutschen Industrie (1996b) *Der Euro: Chance für die Deutsche Industrie*, Report des Industrieforums EWU (Cologne: Bundesverband der Deutschen Industrie).
- 6 Interview with BDI official, Cologne (15 August 1996); Bundesverband der Deutschen Industrie (1990) *Jahresbericht des Bundesverband der Deutschen Industrie* (Cologne: Bundesverband der Deutschen Industrie), p. 60; Bundesverband der Deutschen Industrie (1998a) *BDI-Bericht* (Cologne: Bundesverband der Deutschen Industrie) attachment.
- 7 Bundesverband der Deutschen Industrie (1999) *Satzung des Bundesverbandes der Deutschen Industrie* (Cologne: Bundesverband der Deutschen Industrie) §16(1).
- 8 Bundesverband der Deutschen Industrie (1998b) 'Organisationplan' (Cologne: Bundesverband der Deutschen Industrie); see also, Braunthal (1965), pp. 36–9.
- 9 Interview with BDI Press and Information Officer, Cologne (3 April 1997); Interview with official from German Brewers Association, Bonn (17 April 1997).
- 10 Bundesverband der Deutschen Industrie (1999) §11(3).
- 11 Interview with BDI official, Cologne (25 March 1996) This has evidently been standard operating procedure for the BDI since its early years; see Braunthal (1965), p. 36.
- 12 Bundesverband der Deutschen Industrie (1988) *Jahresbericht des Bundesverband der Deutschen Industrie* (Cologne: Bundesverband der Deutschen Industrie), pp. 401–30.
- 13 Soskice, David (1991) 'The Institutional Infrastructure for International Competitiveness: A Comparative Analysis of the UK and Germany', in A. Atkinson and R. Brunetta (eds) *The Economics of the New Europe* (London: Macmillan, IEA Series).
- 14 Telephone interview with DIHT official, Bonn (24 September 1998).
- 15 Deutscher Industrie und Handelstag (1998) 'Organisationsplan DIHT: 1998' (Berlin: Deutscher Industrie und Handelstag); telephone interview with DIHT official, Bonn (24 September 1998); telephone interview with former DIHT official, Washington (11 August 2000).
- 16 The BDA is primarily responsible for social policy and negotiating wages with the unions. It serves as the umbrella organization for employers'

associations in the realm of collective bargaining, an activity that tends to take place at the Länd-level.

- 17 Interview with trade officer, Verband der Chemischen Industrie, Frankfurt (24 July 1996).
- 18 Verband der Chemischen Industrie (2000) *Die Chemische Industrie in Deutschland* (Frankfurt a. Main: Verband der Chemischen Industrie), p. 7. The exact figure for 1999 is 49.8%.
- 19 For an example of the VCI's assistance to its members in dealing with such unfortunate events, see Verband der Chemischen Industrie (1994) *Crisis Management in Public Relations* (Frankfurt a. Main: Verband der Chemischen Industrie).
- 20 Interview with Bundesverband der Deutschen Süßwarenindustrie official, Bonn (12 August 1996); interview with manager from August-Storck Group [Berlin Süßwarenindustrie], Berlin (27 August 1996).
- 21 Bundesverband der Deutschen Süßwarenindustrie (1999) *Süßwarentaschenbook 1998* (Bonn: Bundesverband der Deutschen Süßwarenindustrie).
- 22 Interview with manager from August-Storck Group [Berlin Süßwarenindustrie], Berlin (27 August 1996).
- 23 I am indebted to John Calhoun for pointing this out to me, it was subsequently confirmed in an interview with manager from August-Storck Group [Berlin Süßwarenindustrie], Berlin (27 August 1996).
- 24 Hölper, Isabelle (1994) *Die Wettbewerbschancen der deutschen Süßwarenindustrie im EG-Binnenmarkt* (Cologne: Verlag Josef Eul), pp. 4, 34.
- 25 Interview with manager from August-Storck Group (Berlin Süßwarenindustrie) Berlin (27 August 1996).
- 26 Interview with Hauptverband der Deutsche Bauindustrie official, Bonn (12 August 1996); Hauptverband der Deutschen Bauindustrie (1996) 'Die Organisation des Hauptverbandes der Deutsche Bauindustrie', mimeo.
- 27 Interview with Hauptverband der Deutsche Bauindustrie official, Bonn (12 August 1996).
- 28 Interview with Hauptverband der Deutsche Bauindustrie official, Bonn (12 August 1996) Hauptverband der Deutschen Bauindustrie (1995) *Bau-Statistisches Jahrbuch 1995* (Frankfurt am Main: Verlag Graphia-Huss), pp. 89a, 89b.
- 29 Gros, Daniel (1996) 'Germany's stake in exchange rate stability', mimeo; Kaltenthaler, Karl (1998b) *Germany and the Politics of Europe's Money* (Durham: Duke University Press), pp. 56–68; Fitoussi, Jean Paul (1993) *Competitive Disinflation: The Mark and Budgetary Politics in Europe* (New York: Oxford University Press); Duckenfield, Mark (1997) 'Getting EMU Off the Ground: The Politics of Monetary Union In Germany and Britain', Paper presented at the Annual Meeting of the American Political Science Association, Washington, DC (31 August 1997).
- 30 Bundesverband der Deutschen Industrie (1989) 'Preisstabilität nicht der Währungsintegration opfern', *BDI Informationen und Meinungen* quoted in Kaltenthaler (1998b), pp. 75, 122.
- 31 *Handelsblatt* (7 December 1989), p. 1; *Frankfurter Allgemeine Zeitung* (7 December 1989), p. 1.

- 32 Interview with Hans-Olaf Henkel in *Süddeutsche Zeitung* (17 February 1996).
- 33 Interview with Hauptverband der Deutsche Bauindustrie official, Bonn (12 August 1996).
- 34 Interview with Hauptverband der Deutsche Bauindustrie official, Bonn (12 August 1996); Kaltenthaler (1998b), pp. 78–9.
- 35 Bundesverband der Deutschen Industrie (1990) *Economic and Monetary Union: A Challenge for Europe* (Cologne: Bundesverband der Deutschen Industrie).
- 36 Verband der Chemischen Industrie (1996) 'European Monetary Union: Economic Assessment', in *European Monetary Union* (Frankfurt: Verband der Chemischen Industrie); interview with European Coordinator, Verband der Chemischen Industrie, Frankfurt (24 July 1996) interview with Foreign Trade official, Verband der Chemischen Industrie, Frankfurt (24 July 1996) interview with Bundesverband der Deutschen Industrie, Cologne official (15 August 1996).
- 37 Verband der Chemischen Industrie (1996), p. 8.
- 38 *Frankfurter Allgemeine Zeitung* (8 April 1992), p. 17.
- 39 Bundesverband der Deutschen Industrie (1991) 'Keine guten Vorbedingungen für den Erfolg einer Währungsunion', mimeo of press release dated (12 December 1991).
- 40 *Süddeutsche Zeitung* (1 September 1992); *Financial Times* (1 September 1992), p. 2.
- 41 Interview with BDI official, Cologne (25 March 1996).
- 42 *Süddeutsche Zeitung* (1 September 1992).
- 43 *Financial Times* (5 March 1993), p. 15; Bundesverband der Deutschen Industrie (1992a) *Jahresbericht des Bundesverband der Deutschen Industrie* (Cologne: Bundesverband der Deutschen Industrie), pp. 9–10, 16; interview with BDI official, Cologne (25 March 1996).
- 44 Kilz, Hans Werner and Joachim Preuss (1984) *Flick: die gekaufte Republik* (Hamburg: Rowohlt Taschenbuch); interview with BDI official, Cologne (25 March 1996).
- 45 *Financial Times* (5 March 1993), p. 15.
- 46 *Süddeutsche Zeitung* (22 September 1992), p. 25.
- 47 Interview with BDI official, Cologne (25 March 1996).
- 48 *Frankfurter Allgemeine Zeitung* (8 April 1992), p. 2.
- 49 *Süddeutsche Zeitung* (9 October 1992) The Ifo-Institute poll was conducted of western business managers only; east Germans have consistently expressed even greater reservations than their western counterparts regarding EMU in surveys.
- 50 *Süddeutsche Zeitung* (6 October 1992), p. 23.
- 51 Interview with Verband der Deutschen Süßwarenindustrie official, Bonn (12 August 1996).
- 52 Schütze, Klaus (1996) 'Auswirkungen des GATT-Abkommens auf die Ernährungsindustrie' (Bonn: Bundesverband der Deutschen Süßwarenindustrie), pp. 6–13; Consumers in Europe Group (1994) 'The EU Sugar Regime', Discussion Paper 94/18; interview with Bundesverband der Deutschen Süßwarenindustrie official, Bonn (12 August 1996).

- 53 Interview with Verband der Deutschen Süßwarenindustrie official, Bonn (12 August 1996).
- 54 Interview with owner Roßberg GmbH, Wildenfels (14 April 1997) Henneberger, Fred (1994) 'Arbeitgeber- und Wirtschaftsverbände in den neuen Bundesländern: Konfliktlinien und Organisationsprobleme', in Josef Schmid, Frank Löbner, Heinrich Tiemann (eds) *Probleme der Einheit: Organisationsstrukturen und Probleme von Parteien und Verbänden* (Marburg: Metropolis Verlag), pp. 119–47. That western firms and personnel had privileged access to profitable activities (economic, political and social) in the east was not something peculiar to the construction industry.
- 55 Interview with Hauptverband der Deutsche Bauindustrie official, Bonn (12 August 1996); OECD (1994) *Economic Survey: Germany* (Paris: OECD), pp. 46, 56.
- 56 OECD (1996) *Economic Survey: Germany* (Paris: OECD), p. 5.
- 57 European Construction Industry Confederation (1996) *Construction Activity in Europe* (Brussels: European Construction Industry Federation), pp. 29, 32.
- 58 Interview with Hauptverband der Deutsche Bauindustrie official, Bonn (16 August 1996).
- 59 Interview with Hauptverband der Deutsche Bauindustrie official, Bonn (16 August 1996).
- 60 Interview with Hauptverband der Deutsche Bauindustrie official, Bonn (12 August 1996).
- 61 Interview with Hauptverband der Deutsche Bauindustrie official, Bonn (16 August 1996).
- 62 *Frankfurter Allgemeine Zeitung* (2 April 1993), p. 17.
- 63 *Süddeutsche Zeitung* (3 August 1993).
- 64 Henkel, Hans-Olaf (1998b) 'What does industry expect from Economic and Monetary Union?' speech delivered at the German-British Chamber of Commerce (16 September 1998) London; Henkel, Hans-Olaf (1998a) *Jetzt oder nie: ein Bündnis für Nachhaltigkeit in der Politik* (Berlin: Siedler); *Süddeutsche Zeitung* (10 April 1993) *Frankfurter Allgemeine Zeitung* (1 June 1995), p. 13.
- 65 European Monetary Institute (1996) *Progress Towards Convergence 1996* (Frankfurt: European Monetary Institute), pp. 5, 21.
- 66 Bundesverband der Deutschen Industrie (1995b) *Europäische Währungsunion: Praktische Aspekte der Währungsumstellung aus der Sicht der Deutschen Industrie* (Cologne: Bundesverband der Deutschen Industrie) *Süddeutsche Zeitung* (13 September 1995).
- 67 *Frankfurter Allgemeine Zeitung* (28 September 1995), p. 19.
- 68 *Frankfurter Allgemeine Zeitung* (6 November 1995), p. 1.
- 69 *Süddeutsche Zeitung* (28 November 1995).
- 70 Verband der Chemischen Industrie (1996), pp. 3–4.
- 71 Verband der Chemischen Industrie (1996), p. 3.
- 72 Interview with Foreign Trade officer, Verband der Chemischen Industrie, Frankfurt (24 July 1996).
- 73 Verband der Chemischen Industrie (1996), p. 4.
- 74 Interview with European Coordinator, Verband der Chemischen Industrie, Frankfurt (24 July 1996).

- 75 Verband der Chemischen Industrie (1996), p. 3. Emphasis (bold-faced text) in original.
- 76 *Frankfurter Allgemeine Zeitung* (14 December 1995), p. 16.
- 77 Ahrendt, Daphne (1999) *Europinion Special: Opinion on the Single Currency* (Brussels: European Commission), p. A-6.
- 78 *Süddeutsche Zeitung* (14 February 1996) interview with Bundesverband der Deutschen Industrie official, Cologne (15 August 1996).
- 79 See chapter 4, 'British Business and EMU', Table 4.4, from Confederation of British Industry (1996g) *Business in Europe* (1996) (London: British Chambers of Commerce and Confederation of British Industry), pp. 4–5 (Question 11).
- 80 Allensbach Institute for Democracy (1996) 'Führungskräfte für die Währungsunion'; *Frankfurter Allgemeine Zeitung* (14 February 1996), p. 17. However, only 21 per cent thought that EMU would led to additional job losses.
- 81 *Süddeutsche Zeitung* (14 February 1996).
- 82 *Frankfurter Allgemeine Zeitung* (6 June 1995), p. 13.
- 83 *Frankfurter Allgemeine Zeitung* (14 February 1996), p. 15.
- 84 Letter from BDI headquarters to all members of Bundesverband der Deutschen Industrie Landesvertretung Saar; 'Grundlagen und Chancen der Europäischen Währungsunion', dated (2 July 1996).
- 85 Interview with BDI Press and Information Officer, Cologne (3 April 1997); *Süddeutsche Zeitung* (18 April 1996).
- 86 *Wirtschaftsblatt* (11 May 1996), p. 6.
- 87 Bundesverband der Deutschen Industrie (1996a) *BDI-Bericht* (Cologne: Bundesverband der Deutschen Industrie), pp. 18–20; *Frankfurter Allgemeine Zeitung* (7 June 1996), p. 19.
- 88 *Wirtschaftsblatt* (4 July 1996), p. 5.
- 89 Interview with BDI Press and Information Officer, Cologne (3 April 1997).
- 90 Telephone interview with Press Officer, Kleinewefers Textilmaschinen GmbH, Krefeld (10 April 1997).
- 91 Bundesverband der Deutschen Industrie (1996b), p. 12.
- 92 Bundesverband der Deutschen Industrie (1996b) *Süddeutsche Zeitung* (4 July 1996).
- 93 Bundesverband der Deutschen Industrie (1996b), p. 11.
- 94 This is particularly the case as the very next paragraph in the BDI report suggested that companies could increasingly turn to foreign supply sources, obviously not a beneficial development from the point of view of a small, domestic supplier to a large multinational.
- 95 Bundesverband der Deutschen Industrie (1996b); Bundesverband der Deutschen Industrie (1996c) 'Der Euro: Umsetzung der unternehmischen Praxis', *BDI Euro-Service-Finanz- und Risikomanagement*, No. 1. The problems posed by the government's failure to provide trade associations with information were raised in interviews with officials at the BDI, VCI, BDSI, BI, the Association of the Automobile Association, the German Brewers' Association, and the Federation of the German Milk Industry. The short-comings of national information campaigns and changeover plans were noted in European Monetary Institute (1997c) *Differences*

Between National Changeover Scenarios and Potential Need for Harmonised Action: Common Policy Messages (Frankfurt: European Monetary Institute).

- 96 Interview with government affairs official, Verband der Deutschen Automobilindustrie [Ford-Werk], Cologne (13 August 1996); telephone interview with Verband der Deutschen Automobilindustrie functionary (BMW) Munich (19 August 1996).
- 97 *Süddeutsche Zeitung* (10 July 1996).
- 98 *Frankfurter Allgemeine Zeitung* (5 July 1996), p. 15; ZDF-Politbarometer poll cited in *Süddeutsche Zeitung* (20 April 1996); Bundesverband der Deutschen Industrie (1996a) *BDI-Bericht* (Cologne: Bundesverband der Deutschen Industrie), pp. 18–19.
- 99 Interview of Hans-Olaf Henkel, BDI President, in *Tageszeitung* (23 September 1996), p. 12.
- 100 *Süddeutsche Zeitung* (4 July 1996).
- 101 *Frankfurter Allgemeine Zeitung* (30 September 1996), p. 3.
- 102 Telephone interview with DIHT official, Bonn (24 September 1998); interview with BDI Press and Information Officer, Cologne (3 April 1997); Bundesverband der Deutschen Industrie (1997) *BDI-Bericht* (Cologne: Bundesverband der Deutschen Industrie), p. 3; *Frankfurter Allgemeine Zeitung* (8 October 1996), pp. 17, 19; *Süddeutsche Zeitung* (8 October 1996).
- 103 *Frankfurter Allgemeine Zeitung* (30 October 1996), p. 1; interview with BDI Press and Information Officer, Cologne (3 April 1997).
- 104 *Süddeutsche Zeitung* (29 October 1996) *Wirtschaftsblatt* (6 November 1996), p. 6.
- 105 *Frankfurter Allgemeine Zeitung* (29 December 1996), p. 1.
- 106 Interview with BDI Press and Information Officer, Cologne (3 April 1997) The same was true of the DIHT, telephone interview with former DIHT official, Washington (11 August 2000).
- 107 *Wirtschaftsblatt* (15 January 1997), p. 7; *Frankfurter Allgemeine Zeitung* (15 January 1997), p. 13; *Wirtschaftsblatt* (25 February 1997), p. 7. The Federal Revenue Office argued that allowing payment in non-deutschmark currencies prior to the selection of euro-zone members would provide only phantom revenues.
- 108 *Frankfurter Allgemeine Zeitung* (30 April 1997), p. 17.; telephone interview with Verband der Deutschen Automobilindustrie official (BMW) Munich (19 August 1996) In the United Kingdom, the LIBA also was of the opinion that the year 2000 bug held more potential problems than introducing the euro. Interview with Director-General, London Investment Banking Association, London (21 August 1998).
- 109 *Süddeutsche Zeitung* (15 April 1997).
- 110 Interview with BDI Press and Information Officer, Cologne (3 April 1997).
- 111 *Der Spiegel*, No. 9 (24 February 1997), p. 41.
- 112 *Süddeutsche Zeitung* (24 March 1997) *Frankfurter Allgemeine Zeitung* (24 March 1997), p. 15; *Financial Times* (24 March 1997), p. 3.
- 113 See Table 2.2, above.
- 114 Interview with BDI Press and Information Officer, Cologne (3 April 1997) *Frankfurter Allgemeine Zeitung* (19 March 1997), p. 17.

- 115 *Süddeutsche Zeitung* (24 March 1997); *Frankfurter Allgemeine Zeitung* (23 April 1997), p. 1.
- 116 *Die Woche* (6 June 1997), p. 11.
- 117 *Frankfurter Allgemeine Zeitung* (31 May 1997), p. 1.
- 118 *Süddeutsche Zeitung* (9 June 1997).
- 119 *Frankfurter Allgemeine Zeitung* (17 June 1997), p. 13; *Tages-Anzeiger* (9 August 1997), p. 24.
- 120 OECD (1998), p. 20.
- 121 *Süddeutsche Zeitung* (26 March 1998), p. 3.
- 122 Telephone interview with DIHT official, Bonn (24 September 1998).
- 123 European Monetary Institute (1998) *Convergence Report* (Frankfurt: European Monetary Institute), pp. 73–81; *Süddeutsche Zeitung* (27 February 1998), p. 1.
- 124 *Süddeutsche Zeitung* (26 March 1998), p. 3.

Chapter 3 Britain and the Politics of EMU

- 1 Busch, Andreas (1994) 'Central Bank Independence and the Westminster Model', *West European Politics*, Vol. 17, No. 1, pp. 53–72.
- 2 House of Commons (1945) *Bank of England Bill*, Section 4 (1) (10 October 1945) I'd like to thank Bill Tompson for pointing this out to me.
- 3 Testimony of Eddie George (Governor, Bank of England) before the House of Lords Select Committee on the Monetary Policy Committee of the Bank of England (30 July 1999).
- 4 Howe, Geoffrey (1994) *Conflict of Loyalty* (London: Macmillan), p. 227; Lawson, Nigel (1992) *The View from Number 11* (London: Bantam), pp. 659–68; Major, John (1999) *John Major: The Autobiography* (New York: HarperCollins), p. 164. See also, Thatcher, Margaret (1993) *The Downing Street Years* (London: Harper Collins), pp. 723–4.
- 5 Seldon, Anthony (1997) *Major: A Political Life* (London: Weidenfeld and Nicholson), p. 239; Lamont, Norman (1999) *In Office* (London: Little, Brown and Company), p. 155, 324–5.
- 6 See House of Commons (1998) *The Report of the Independent Commission on the Voting System*, Command 4090–I, ¶19–43.
- 7 House of Commons (1993) *Hansard Parliamentary Debates* (9 June 1993).
- 8 Blair, Tony (1998) *Modernising Parliament: Reforming the House of Lords* (London: The Stationary Office), ch. 3; Winnetrobe, Barry (1998) 'Lords Reform: The Legislative Role of the House of Lords' (London: House of Commons Library), Research Paper 98/103.
- 9 Interview with member of the House of Lords, London (1998).
- 10 Ray, Leonard (1999) 'Measuring party orientations towards European integration: Results from an Expert Survey', *European Journal of Political Research*, Vol. 36, No. 2, pp. 283–306.
- 11 Baker, David, Andrew Gamble, and Steve Ludlam (1993a) '1846 ... 1906 ... 1996? Conservative Splits and European Integration', *Political Quarterly*, Vol. 64, No. 4, pp. 420–34. These new powers were most prominently used in 1999–2000 when William Hague suspended and then expelled the Conservative Party's candidate for Mayor of London,

- Jeffrey Archer, in the wake of perjury allegations. Archer was convicted and sentenced to prison in July 2001, more than a year after the London mayoral elections (May 2000).
- 12 Interview with functionary responsible for candidate selection, Conservative Party, London (26 May 1999).
 - 13 Bale, Tim (1996) '“The Death of The Past”: Symbolic Politics and the Changing of Clause IV', *British Elections and Parties Yearbook*, David M. Farrell, David Broughton, David Denver and Justin Fisher (eds) (London: Frank Cass), pp. 158–77.
 - 14 Interview with official in Constitutional Office, Parliamentary Labour Party (26 May 1999) For two very different accounts of (primarily) Neil Kinnock's campaign against dissent, see Heffernan, Richard and Mike Marqusee (1992) *Defeat from the Jaws of Victory: Inside Kinnock's Labour Party* (New York: Verso); and also the Blairite account of Gould, Philip (1998) *The Unfinished Revolution: How the Modernisers Saved the Labour Party* (London: Little, Brown and Company).
 - 15 Interview with official in Constitutional Office, Parliamentary Labour Party (26 May 1999) Butler, David and Gareth Butler (1994) *British Political Facts, 1900–1994*, 7th edition (London: Macmillan), p. 137.
 - 16 Interview with Policy Unit official, Liberal Democrats Policy Unit, London (18 January 1999); Interview with Liberal Democrat Parliamentary Assistant, London (19 January 1999); interview with official involved in candidate selection, Liberal Democratic Party HQ, London (27 May 1999).
 - 17 Television interview of Sir James Goldsmith, BBC1 (2 May 1997).
 - 18 See Thatcher (1993), p. 713; Stephens, Philip (1996) *Politics and the Pound: The Conservatives' Struggle with Sterling* (London: Macmillan), p. 153.
 - 19 While Lawson saw ERM membership as conducive to exchange rate stability, he did not favor British membership in the single currency.
 - 20 *The Spectator* (14 July 1990); *The Sunday Times* (14 July 1990), p. 1; Thatcher (1993), p. 722. Interestingly, Thatcher would later implicitly endorse Ridley's comments in her memoirs stating that 'it was an excess of honesty that ultimately brought [Ridley] down', see Thatcher (1993), p. 312.
 - 21 Stephens (1996), pp. 156–75.
 - 22 Stephens (1996), p. 164; House of Commons (1990) *Hansard Debates*, Vol. 174 (21 June 1990) column 1111.
 - 23 Major (1999), p. 139; House of Commons (1989) *Hansard Debates*, Vol. 159 (2 November 1989) columns 491–5; Thatcher (1993), p. 720n; Stephens (1996), pp. 160–1.
 - 24 House of Commons (1990) 'Second Report of the Foreign Affairs Committee: The Operation of the Single European Act, Observations by the Government', Command 1077 (1989–90), p. 4, ¶7; Lamont (1999), pp. 112–3; Major (1999), p. 151; Dyson, Kenneth and Kevin Featherstone (1999) *The Road to Maastricht: Negotiating Economic and Monetary Union* (Oxford: Oxford University Press), pp. 612–5.
 - 25 Walsh, James I. (2000) *European Monetary Integration and Domestic Politics: Britain, France and Italy* (London: Lynne Rienner), p. 120.
 - 26 This meant the pound could range between DM2.7780 on the low end and DM3.122 on the high end.

- 27 Major (1999), pp. 160–1, 164.
- 28 House of Commons (1990) *Hansard Debates*, Volume 178 (30 October 1990) column 878.
- 29 Major (1999), pp. 176–182; *The Financial Times* (31 October 1990), p. 1.
- 30 *The Times* (10 November 1990).
- 31 House of Lords (1990) 'Economic and Monetary Union and Political Union', Report of the Select Committee on European Communities, Vol. 88–I (1989–90), pp. 60, 191–2.
- 32 Howe (1994), pp. 659–68; *The Times* (4 November 1990) *Financial Times* (2 November 1990), p. 1.
- 33 Thatcher (1993), pp. 832–3; *The Times* (29 November 1990), pp. 1. For a systematic analysis of Major's base of support in the 1990 leadership contest, see Cowley, Philip (1996) 'How Did He Do That? The Second Round of the 1990 Conservative Leadership Election', *British Elections and Parties Yearbook*, David M. Farrell, David Broughton, David Denver, and Justin Fisher (eds) (London: Frank Cass), pp. 198–216.
- 34 Lamont (1999), p. 114.
- 35 Lamont (1999), pp. 117–20.
- 36 Major (1999), pp. 264–88; *The Daily Telegraph* (4 June 1993) Leigh, Edward 'The Judgment of Others', *The Spectator* (5 June 1993); see also, House of Commons (1991) *Hansard Debates*, Vol. 199 (26 November 1991) columns 774–8.
- 37 Most of the EU members were forced to deliberately engineer the deepest recession in the post-war era in order to meet the convergence criteria, so the domestic economic consequences of this treaty commitment were both real and substantial. I am indebted to Wolfgang Streeck for a useful conversation on this point.
- 38 Major (1999), pp. 271–2; *The Times* (12 December 1991), p. 1.
- 39 Lawson (1992), pp. 117–23.
- 40 Conservative Party (1992) *The Best Future for Britain: The Conservative Manifesto 1992* (London: Conservative Central Office), pp. 3, 6.
- 41 Labour Party (1992) *It's Time to Get Britain Working Again* (London: Labour Party), pp. 12, 27; *The Independent* (16 September 1991), p. 1.
- 42 Liberal Democrats (1992) *Changing Britain for Good* (London: Liberal Democrats).
- 43 Conservative Party (1992), p. 6.
- 44 Butler, David and Dennis Kavanagh (1992) *The British General Election of 1992* (London: Macmillan), pp. 57, 79, 112, 163.
- 45 Margetts, Helen (1993) 'The 1992 British General Election: Pollsters Despair', *West European Politics*, Vol. 16, No. 2, pp. 196–205.
- 46 Gould, Bryan (1995) *Goodbye to All That* (London: Macmillan); *The Independent* (7 May 1992), pp. 7, 8; interview with Policy Unit official, Liberal Democrats Policy Unit, London (18 January 1999) *The Guardian* (22 May 1992), p. 1.
- 47 Although John Major reports [(Major 1999), p. 350] that 69 Conservative MPs signed the so-called 'Fresh Start' Early Day Motion, in fact, at least 84 originally signed the motion. Fifteen subsequently withdrew their names after pressure from the Whips' Office was brought to bear. Baker, David, Andrew Gamble, and Steve Ludlam (1993b) 'Whips or Scorpions?

- The Maastricht Vote and the Conservative Party', *Parliamentary Affairs*, Vol. 46, No. 2, p. 166; *Daily Telegraph* (5 June 1992), p. 20; Early Day Motion 174 (1992).
- 48 Siune, K (1993) 'The Danes Said No', *Scandinavian Political Studies*, Vol. 16, No. 1, pp. 93–103; Major (1999), p. 347; Baker, Gamble and Ludlam (1993b); *The Guardian* (5 June 1992), p. 2; *Financial Times* (4 June 1992), p. 14.
 - 49 *The Guardian* (6 July 1992), p. 8.
 - 50 *The Financial Times* (11 June 1992), p. 11. Gould also wanted Labour to support a devaluation of sterling within the ERM; see *The Daily Telegraph* (21 May 1992), p. 12; *The Guardian* (14 May 1992), p. 7.
 - 51 Butler and Butler (1994), p. 137. Interview with party official, Parliamentary Labour Party (26 May 1999) *The Independent* (19 July 1992), p. 1.
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- 67 See Bryan Gould, MP. 'Start to be an Opposition', *The Times* (27 October 1992) *The Guardian* (28 September 1992), p. 1; Gould (1995).
- 68 *The Guardian* (24 September 1992), p. 6.
- 69 *The Financial Times* (29 September 1992), p. 12. In addition to Tony Benn, the elected members of the NEC were Neil Kinnock, David Blunkett, Gordon Brown, John Prescott, Robin Cook, and Tony Blair. Left-wing Labour MPs losing a place on the NEC were Dennis Skinner and Bryan Gould.
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Chapter 4 British Business and EMU

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- 98 *The Sunday Telegraph* (30 August 1992), p. 1. Support for an independent central bank was the centrepiece of the IoD's anti-inflationary strategy from the mid-1980s onwards. Telephone interview with IoD functionary, London (June 1998).
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- 111 *The Times* (3 November 1992) House of Commons (1993) 'House of Commons Treasury and Civil Service Select Committee: The Role of the Bank of England', HC 98–I, 98–II.
- 112 Duckenfield, Mark (1998) 'Similar Ends, Different Means? The Evolution of British Monetary Policy, 1990–1998', Paper presented at the Annual Meeting of the American Political Science Association, Boston, MA, pp. 29–31.
- 113 See the CBI's submission and testimony in House of Commons (1993) 'House of Commons Treasury and Civil Service Select Committee: The Role of the Bank of England', 98–II, 1993–94; compare with the policy subsequently approved (24 November 1993) in Confederation of British Industry (1993) *Improving the Conduct of UK Monetary Policy* (London: Confederation of British Industry). As noted in chapter 3, the findings of the Select Committee, echoed by the CBI, were the model for the specific institutional features of Labour's plan for an independent central bank implemented after the 1997 General Election.
- 114 Peter Morgan (Director General of the IoD), letter to the Editor, *The Financial Times* (16 June 1993), p. 19; 'Monetary Union: Small Business and the ECU', *The Director*, Vol. 46, No. 3 (October 1992), p. 101; House of Commons (1993) *Parliamentary Papers* (London: HMSO), HC–98–II, 1993–94.
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- 140 *The Financial Times* (18 November 1994), p. 14; *The Independent* (26 June 1994), p. 8; *The Times* (14 November 1995) *The Financial Times* (5 August 1996), p. 1; see also *The Guardian* (25 March 1997), p. 20 for a reiteration of this pledge during the 1997 election campaign.
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Chapter 5 Conclusion

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