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EUROS, POUNDS AND ALBION AT ARMS: EUROPEAN MONETARY POLICY AND BRITISH DEFENCE IN THE 21ST CENTURY

by

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September 2004

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In the United Kingdom, a central issue of contemporary foreign policy is whether or not to enter into full membership of the European Monetary Union (EMU). Membership has profound implications for the development of the European Union (EU) and the future of the North Atlantic Treaty Organization (NATO) and potentially upon the much heralded Anglo-American 'special relationship'. On a practical level, excluding the political implications of membership, joining the EMU means surrendering the pound sterling for the euro and in doing so the British would also surrender control of monetary policy. This thesis will examine the historical links between British defence and monetary policy and argues that there are strong historical bonds that link the two in the political psychology of Britain. This link has created for Britain twin nationalistic icons in the pound and the military. This thesis illustrates that a paradox exists in that membership in the EMU would improve British defence spending and yet nationalistic forces resist membership. At the same time, forces in Britain in favor of monetary integration, unable to accomplish it but pressured to show they are dedicated to the project of European integration, paradoxically commit to further defence integration thought the Common Foreign and Security Policy of the EU.

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EUROS, POUNDS AND ALBION AT ARMS: EUROPEAN MONETARY POLICY AND BRITISH DEFENSE IN THE 21ST CENTURY

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ABSTRACT

In the United Kingdom, a central issue of contemporary foreign policy is whether or not to enter into full membership of the European Monetary Union (EMU). Membership has profound implications for the development of the European Union (EU) and the future of the North Atlantic Treaty Organization (NATO) and potentially upon the much heralded Anglo-American 'special relationship'. On a practical level, excluding the political implications of membership, joining the EMU means surrendering the pound sterling for the euro and in doing so the British would also surrender control of monetary policy. This thesis will examine the historical links between British defence and monetary policy and argues that there are strong historical bonds that link the two in the political psychology of Britain. This link has created for Britain twin nationalistic icons in the pound and the military. This thesis illustrates that a paradox exists in that membership in the EMU would improve British defence spending and yet nationalistic forces resist membership. At the same time, forces in Britain in favor of monetary integration, unable to accomplish it but pressured to show they are dedicated to the project of European integration, paradoxically commit to further defence integration thought the Common Foreign and Security Policy of the EU.

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I. INTRODUCTION

> Queen: Good Hamlet, cast thy nighted colour off,
> And let thine eyes look like a friend on Denmark.
> Do not for ever with thy vailed lids
> Seek for thy noble father in the dust.
> Thou know'st 'tis common. All that lives must die,
> Passing through nature to eternity.
> Hamlet: Ay, madam, it is common.
> Queen: If it be,
> Why seems it so particular with thee?
> Hamlet: Seems, madam? Nay, it is. I know not 'seems.'[1]

In his exhaustive history of the United Kingdom's involvement in twentieth century European integration, Hugo Young uses two Shakespearean analogies to typify British behavior. The first, from *Richard II*, is the defiant praise of English exceptionalism by virtue of being detached and apart from continental Europe. John of Gaunt provides the soliloquy from which Young draws his title, "This blessed plot, this earth, this realm, this England."[2] The second allusion is found in the conclusion of his examination of British Euro-skepticism. Young considers that, at times, perhaps Britain has been more akin to the elderly King Lear, railing against the storm of European integration, but powerless to prevent it.[3]

In considering the issue of membership in the European Union's Economic and Monetary Union (EMU) in 2004, *Hamlet*, the apogee of the Bard's works, provides a fitting analogy

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[1] William Shakespeare, *Hamlet, Prince of Denmark*, act 1, scene 2.

[2] William Shakespeare, *Richard the Second,* act 2, scene 1.

[3] Hugo Young, *This Blessed Plot: Britain and Europe from Churchill to Blair* (Woodstock, NY: The Overlook Press, 1998), 505.

for British Euro-skepticism.[4] Europe, the comforting Queen, beseeches her distant son Britain to cease his grieving for the lost power of the pound sterling and accept that, '…'tis common…' Indeed not just the loss of power, but the euro too, is common to nearly all the powers of Europe, save Britain. The perplexed queen wonders why it seems so particular for her awkward child, the United Kingdom, while this step has been so easy for the others to embrace. Britain would respond, as Hamlet does, that it does not seem difficult, it is difficult. To comprehend why it is so 'particular' in 2004 for Britain to surrender the pound for the euro requires an understanding of a complex web of economic and political interests.

Rational interests represent legitimate concerns for the future well being of the nation. This thesis does not refute them, but will illustrate the roots of one of the obstacles to EMU; British monetary nationalism. This particular component of British nationalism was born of the deep relationship that existed in Britain, particularly between 1879 and 1973, between defence[5] and currency. Defence embodies the acme of national sovereignty; it is as Alan Milward explains, "… [the nation state's] oldest and primary duty…"[6] Due to the intimate relationship between

[4] Choosing Hamlet for this parallel is clearly thick with irony given that in June 1992 the Danes rejected the 1991 Maastricht Treaty in a national referendum. British euro-skeptics drew great inspiration from this, as the timing coincided with the British Parliamentary debate on the same treaty. It also occurred at the same time as Britain's withdrawal of from the European Exchange Rate Mechanism (ERM) due to currency speculation. The Danes would later pass the treaty in a second referendum but, Young cites the timing of the first Danish rejection as nearly sinking the treaty in Britain and causing Prime Minister John Major's government to fall. Maastricht only passed the Commons 319-313. Young, 392-397.

[5] In this thesis the British spelling of topic specific words like defence, programme and armour will be used.

[6] Alan Milward with George Brennan and Federico Romero, *The European*

money and defence, currency has assumed a pivotal stature in the iconography of British nationalism.

This thesis will explore the historical relationship between British military strength, the international strength of British currency and its impact on British nationalism. The mutually supporting nature of the relationship, prior to 1973, has embossed the two concepts inseparably on opposite sides of the same coin of national sovereignty. This leaves Britain today in a quandary regarding Economic and Monetary Union. This thesis will also illustrate that ironically, in light of nationalistic resistance, the EMU actually offers numerous benefits to British defence. Finally, this thesis will propose that modern British nationalism is a source of two paradoxical realities in contemporary British politics.

The first paradox is a result of the Conservative Party's nationalist wing which places defence and monetary independence on the same plane. Consequently, the Tories remain unable to seize the issue of monetary union as a route to improving national defence. The second is due to the nationalistic sensitivities of the British polity regarding the sovereignty of currency. EMU must be approached with the greatest care by the Labour Party which has, in the last decade, favored membership in the euro. The paradox has emerged from the inability of Labour to bring Britain into full EMU membership and subsequently has

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Rescue of the Nation-State (Berkeley: University of California Press, 1992), 4. The political theorist Max Weber in Volume I of *Economy and Society: An Outline of Interpretive Sociology* (New York: Bedminster Press, 1968), provides the most basic and most common definition of the sovereign state as a political community which exercises legitimate domination over the inhabitants of a defined territory. The modern concept of the state has extended responsibility to not only exercise coercive force over its occupants but also to organize military defense to use force against other states.

caused it to make commitments and a concession on EU defence issues. The objective of these concessions has been to demonstrate its 'Europeanness' and maintain a position of influence in Europe.

A. BRITAIN AND EUROPEAN INTEGRATION

The future of the relationship between Britain and the burgeoning European Union has been a topic of great debate in the United Kingdom for many years. Since the founding of the European Community and through Britain's subsequent membership in the 1970's, the British have wrestled with what it means to be both British and European.[7] The subject of the most significant debate facing the United Kingdom today is membership in the European Monetary Union. Joining the EMU would bind Britain even closer to Europe by adopting the euro as the official currency of the United Kingdom. This step would be greater than the symbolic move of forsaking the long treasured pound sterling for the euro note; it would take the monetary policy out of the hands of British Citizens and give it to the European Central Bank (ECB).[8]

Since the end of the Second World War, the process of European integration has brought the states of Europe closer together both economically and politically. European integration is often credited with making war between the nation-states of Europe inconceivable if not

[7] Young's entire book deals with the many machinations of Britain's political class on the subject of European integration since the Second World War. His primary method is biographical research and primary source interviews. It provides in depth analysis not just of ruling Prime Ministers but of the deeper currents of the opposition party, the fragmentation of parties on the issue of 'Europe' and those political leaders, both in and out of power who have lead Britain both for and against Europe.

[8] The ECB is an independent monetary control authority which prints euro currency and regulates the flow of money in the Euro area.

impossible. Britain has consistently viewed this process with suspicion and skepticism, punctuated only by contradictory fits of enthusiasm.[9] In some ways this dualism is personified by Sir Winston Churchill. In 1949, Churchill, respected throughout Europe as the peerless leader of the day, delivered a speech in Zurich in which he called for the Continent to immediately embark on a project to create a, 'United States of Europe'. For this, he is remembered a step-founding father of the European Union. Despite this championing of unified Europe, Churchill clearly envisioned a 'United States of Europe' as one that did not include the United Kingdom.[10] The chronology that follows is provided as scenery against which to view British behavior concerning defence and monetary policy which will be outlined in Chapter II. It is not an effort to explain British actions regarding European unity.

On May 9, 1950, French Foreign Minister Robert Schuman announced the intent to form the European Coal and Steel Community (ECSC). The ECSC melded the coal and steel producing resources of France and Germany into a single economic entity subject to shared decisions. This announcement, just five years after Great Britain, Europe's unquestioned leader, had emerged victorious from the Second World War came as a total shock to the British. They had not known that France, Germany, and eventually, Belgium, The Netherlands and Luxembourg, would take such an unprecedented step towards economic unity. Britain was invited to participate in this union, but declined to do

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[9] Young, 1-3.

[10] Simon Bulmer, "History and Institutions of the European Union" in *The Economics of the European Union: Policy and Analysis* ed. Mike Artis and Norman Lee (Oxford: Oxford University Press, 1994), 8 and Young, 16-18.

so. Their belief, at the time, was that it would fail and that surrendering a portion of economic sovereignty was unwise.[11] Britain would remain an associate, non-participating member of the ECSC.

The next step towards European economic integration was the 1957 Treaty of Rome which created the European Economic Community (EEC). The EEC established a common market thus eliminating tariff barriers between the member states and opening the markets of Europe. Like the ECSC, the United Kingdom did not join the EEC comprised of France, Germany, Italy and the BENELUX countries that came into being in 1958. Great Britain would resist the EEC while forming a competing trade union called the European Free Trade Association (EFTA). The EFTA was a vain attempt to wreck the entire EEC.[12] After twice having its application to the EEC rebuffed by French President Charles de Gaulle, Britain joined the EEC in 1973.

Five years later, Britain would face another step in economic integration with Europe; the European Monetary System (EMS) with its embedded Exchange Rate Mechanism (ERM). As the functional element of the EMS, the ERM pegged the currencies of all its members in order to maintain price stability throughout the Community. The EMS was founded on the positive experiences of European exchange rate stability of the 1960's. In that period, currencies had nearly fixed exchange rates. This phenomenon was in stark contrast to the start of the 1970's when all European currencies floated against one another resulting in exchange instability.[13] The ERM established a

[11] Milward, 346-347 and Young, 45 and 67.

[12] Bulmer, 8 and Young, 118.

[13] Young, 300-301.

central rate for all member currencies based upon the German deutschmark (DM) with a plus or minus two and a quarter percent fluctuation band. All the ERM member states agreed to maintain the exchange rate of their currencies within this band. Periodic devaluations of member currencies did occur, but the ERM succeeded in keeping inflation stable, for the member countries, through the 1980's.[14] Britain again abstained and did not join the ERM until 1990. Between 1980 and 1990 the pound fluctuated relative to the DM in a band of plus or minus twenty percent.[15]

Britain joined the ERM in 1990 and, for the first year, it had the desired effect of stabilizing inflation for Britain while the economy was in a recession and unemployment was high.[16] Problems emerged as it became clear that the pound had been overvalued in the ERM at 2.95DM/1£ and inflationary pressures in Germany caused by the reunification of East and West Germany.[17] In the second year of its membership in the ERM, the pound continued to fall against the DM as a result of currency speculation. The Bank of England had to take one of two measures to adhere to ERM rules; devalue the pound or raise interest rates to stabilize the currency. Great Britain refused the former on the general principal that the pound did not deserve the same treatment as weak European currencies such as the *lira* or the *peseta*. The latter was also not

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[14] Thomas Pugel and Peter Lindert, *International Economics: Eleventh Edition* (Boston: Irwin McGraw-Hill, 2000), 566.

[15] Pugel and Lindert, 567.

[16] Young, 437.

[17] Robin Bladen-Hovell, "The European Monetary System" in *The Economics of the European Union: Policy and Analysis* ed. Mike Artis and Norman Lee (Oxford: Oxford University Press, 1994), 341 and Young, 365.

possible because it would have been stifling for the ailing British economy. This vicious cycle of logic kept the Bank of England paralyzed. Eventually, when it did raise rates from ten to twelve percent and then to fifteen in a final desperate attempt to keep the pound from sliding further, it had no result. Their failure to maintain its exchange rate left the British government with no option but to withdrawal from the ERM in disgrace.[18]

The Maastricht Treaty of 1991 renamed the European Economic Community the European Union, but more importantly, it created broad economic, social and political modifications to the face of Europe. Economically, Maastricht formed the European Central Bank (ECB), based upon the German Bundesbank model and initiated plans to create a unified European currency.[19] It is of significance that Britain's turbulent experience in the ERM was the backdrop against which vital EU negotiations were being conducted at Maastricht. Citing domestic concerns over the convergence of the British economy with that of the rest of the EU, Prime Minister John Major was able to negotiate an 'opt-out' clause for Britain. This would allow his country to choose to remain outside the EMU even if it met the economic criteria for membership.[20] Britain eventually ratified the Treaty of Maastricht but maintained its monetary independence. Twelve of fifteen EU decided to move ahead with the EMU. Only Britain, Sweden and Denmark elected to 'opt-out'.

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[18] Bladen-Hovell, 342 and Young, 439.

[19] Mike Artis, "European Monetary Union" in *The Economics of the European Union: Policy and Analysis* ed. Mike Artis and Norman Lee (Oxford: Oxford University Press, 1994), 3611 and Young, 388-389.

[20] Bulmer, 23-24.

B. NATIONALISM IN GREAT BRITAIN

This thesis illustrates particular paradoxes of nationalism which exist in present-day Britain. The paradoxes have emerged in part from the changes in British national identity. They have also emerged as a result of the ways in which nationalist sentiment has been tapped by politicians to achieve their political objectives since 1973. These paradoxes revolve around sterling and defence, two institutions which have come to embody the sovereign national identity of Britain. These two icons are by no means the only sources of national identity for the British.[21] Never the less, they are important, and potent in the British psyche when invoked. This thesis strives to illuminate some of the sources and resulting consequences of these powerful symbols. Chapter II will track the changing connection between sterling and defence under varying international currency orders from 1879 to 1973.[22]

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[21] In fact, some contemporary British politicians like John Major have attempted to tap into pastoral, sentimental and indeed more 'English' forms of British nationalism. Major often evoked images of cricket on the green and warm beer, cited from, Kenneth Lunn, "Reconsidering 'Britishness': The Construction and Significance of National Identity in Twentieth-Century Britain" in *Nation and Identity in Contemporary Europe*, ed. Brian Jenkins and Spyros Sofos (London: Routledge, 1996), 86.

[22] The term 'order' is used here interchangeable with 'regime' as Robert Gilpin does in *The Political Economy of International Relations* (Princeton, NJ: Princeton University Press, 1987), 75. The definition of 'order' is the one proposed by Robert Mundell in his article, "The Future of the International Financial System." Mundell makes the distinction between a monetary system and a monetary order in the following way: "A *system* is an aggregation of diverse entities united by regular interaction according to some form of control. When we speak of the international monetary system we are concerned with the mechanisms governing the interactions between trading nations, and in particular the money and credit instruments of national communities in foreign exchange, capital and commodity markets. The control is exerted through policies at the national level interacting with one another in that loose form of supervision we call co-operation. An *order*, as distinct from a system, represents the framework and setting in which the system operates. It is a framework of laws, conventions, regulations and mores that establish the setting of the system and the understanding of the environment by the participants in it…We can think

Chapter III will illustrate, from a dispassionate, non-nationalistic perspective, the reality of the contemporary relationship between the pound and defence. Chapter IV will deal with the evocations of nationalist sentiment on both subjects since 1973 when sterling and defence lost their last practical connection. However, before examining contemporary appeals to nationalism in Britain, a general understanding of nationalism and its form in Britain is required.

Nationalism has risen in large part as a result of the increasing alienation of the industrialized world, solidification of political authority into nation-states and the devolution of sovereign power to the populace through mass democracy.[23] Nationalism has come to its most potent form as a result of the French Revolution of 1789 when the two concepts of patriotism and popular sovereignty were fused together. The elements from which national identity are created pre-date the French Revolution. For the purpose of this thesis, the modern nation, as it first began to emerge in sixteenth century England, will be considered.[24] Nationalism is a force which provides identity to groupings of people who otherwise would have

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of the monetary system as the *modus operandi* of the monetary order." Cited from Ronald I. Mackinnon, "The Rules of the Game: International Money in Historical Perspective," *Journal of Economic Literature*. Vol. 31, No. 1 (Mar., 1993), 1.

[23] There is extensive emerging literature on nations and nationalism as a potent, and often massively destructive, force in the modern era. The objectives of this field of study is not with the intention of forwarding the claims of specific nations but rather to expose its specific attributes, manifestations and periods. See David Miller, *On Nationality* (Oxford: Oxford University Press, 1995), Liah Greenfeld, *Nationalism: Five Roads to Modernity* (Cambridge: Harvard University Press, 1992), E. J. Hobsbawm, *Nations and Nationalism Since 1780: Programme, Myth and Reality* (Cambridge: Cambridge University Press, 1990).

[24] Greenfeld, 4.

nothing in common. This shared identity is partly a psychological phenomenon, but more significantly, a political one. Nationality is, to quote David Miller,

> …a community (1) constituted by shared belief and mutual commitment, (2) extended in history, (3) active in character, (4) connected to a particular territory, and (5) marked off from other communities by its distinct public culture.[25]

The concept of 'nation' is wholly that; a concept, a fabrication, a myth based upon a perceived or imagined commonality.[26] This shared identity is often achieved through the creation of an imagined opposite from which a people can distinguish themselves from others. The 'other' embodies the characteristics which are not attributable to the nation striving to define itself.[27]

In examining the phenomena of nationalism in Great Britain this thesis is pursuing a path of identifying the national character of a nation which lacks a national ethnic cohesion.[28] Linda Colley observes the same reality in her study of nationalism in Britain, *Britons: Forging*

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[25] Miller, 27.

[26] Benedict Anderson, *Imagined Communities: Reflections on the Origin and Spread of Nationalism* (London: Verso, 1983), 6-7 also in Paul Gilbert, *The Philosophy of Nationalism* (Boulder, CO: Westview Press, 1998), 154-169.

[27] Peter Sahlins, *Boundaries: The Making of France and Spain in the Pyrenees* (Berkeley, CA: University of California Press, 1989), 271. Cited in Linda Colley, *Britons: Forging the Nation 1707-1837* (New Haven, CT: Yale University Press, 1992), 5-6.

[28] Peter Scott, *Knowledge and Nation* (Edinburgh: Edinburgh University Press, 1992), 168. British identity is the fusion of what could have been more accurately expressed as four ethno-centric nations, English, Welsh, Scottish and Irish. Despite the strong influences of all these nations on the identity of Britain, British identity is drawn mostly from that of England, Stephen Haseler, *The English Tribe: Identity, Nation and Europe* (London: Macmillan Press, 1996), 28-33 and in Lunn, 87.

the Nation 1707-1837.[29] This is an important point, for in the creation of a nation-state without ethnic cohesion, national myths and symbols become important for unity in different ways. Colley's work is an appropriate starting point as it ends roughly at the point at which this thesis begins. This thesis will extrapolate from the currents that Colley establishes as foundations of British nationalism. She explains that British identity emerged as a result of three shared experiences. The first was a common Religious identity in Protestantism. The second was shared struggle in military conflict.[30] The third was shared interests in trade and the Empire and the Constitutional connections that consequently formed between Scotland and the rest of the island because of the Empire.[31] These foundations helped to generate other rising expectations, which Colley explains, in turn further refined British identity.[32]

This thesis will explore the relationship between two of these threads. The first is military conflict and defence. The second is trade and the Empire which experienced an evolution as the nature of the Empire changed. The gradual shifting away from the exclusivity of mercantilism towards free trade in the middle of the 1800's placed a new premium upon the strength of currency.[33] Thus, the 'cult of trade' became the 'cult of sterling'. The

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[29] Colley, 5.

[30] The military conflicts that most helped to shape British identity were the ones with Catholic France. France here served as the 'other' against which Britishness was shaped.

[31] Colley, 7 and 364-375.

[32] Colley, 371.

[33] P.J. Cain and A.G. Hopkins, *British Imperialism: Innovation and Expansion 1688-1914* (London and New York: Longman, 1993), 73-74.

focus on defence and currency is not to ignore the other factors that Colley presents. However, there is evidence that in contemporary Britain the importance of Protestant cohesion is dwindling.[34] This decline of common identity may be contributing to the modern movements calling for greater Scottish (Welsh and even English) self-governance.[35] Regardless, the changes highlight the significance of examining the nationalist elements of defence and currency in Great Britain.

As will be shown in Chapter II, after 1879, the strength of the pound sterling and the strength of British defence entered into a reciprocal relationship, each working to maintain the other. Thereafter, the strength of sterling became a point of shared national prosperity and pride on par with defence. This new dynamic developed into the norm for the political elite which in turn infused this concept upon the polity. As Colley has shown, British nationalism and patriotism, while a contrivance, is based upon real interests and not simply chauvinistic aggression.[36] Chapter II will show that in using force to back the strength of the pound, Britain had real national interests at stake. Therefore, the extension of British

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[34] Miller, 170.

[35] For example, the Scottish National Party (SNP), a centre-left party favoring Scottish independence from Great Britain, is currently the second most popular political party in Scotland. The SNP achieved minor successes in the mid-1970's, but from 1988 to present it has achieved consistent electoral success passing 20% of the Scottish vote in every general, European Parliament, district and regional council elections. A Scottish Parliament was created by a referendum held in 1997 with the first elections in 1999. http://www.fact-index.com/s/sc/scottish_national_party.html#Electoral%20Performance September 2004.

[36] Colley, 371-372.

nationalism to preserving a strong pound is a reasonable result.[37]

Certainly other issues are critical to understanding British nationalism in the second phase of imperial expansion and into the twentieth century. The experiences of the First and particularly the Second World Wars have heightened the British sense of 'otherness' when looking across the English Channel at the continent.[38] Additionally, there are very real reasons for Britain to approach EMU with caution. There is heated debate on whether EMU is good or bad economically for Britain because of unique conditions. What is clear is that since the collapse of the Bretton Woods order, when monetary and military strength ceased to be one and the same, British politicians have resorted, with some success, to evoking the national icons of defence and sterling as a way of achieving their objectives. The fact that this has been done, and that nationalist sentiment in the population allows it to be a functional tool for those who would employ it, has created the modern paradoxes of sterling, defence and the euro.

C. CONCLUSION

Both literally and metaphorically, the United Kingdom stands on the periphery of Europe. This reality is both a product of physical isolation which has sheltered the United Kingdom from many of the social, economic, military and political forces that shaped the identity of

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[37] Miller, 100-101. He explains that nationalistic dedication to a domestic currency is a realistic extension of the concept of national-self-determination.

[38] Drew Middleton, *The Supreme Choice: Britain and Europe* (New York: Alfred A. Knopf, Inc., 1963), 4-10, Giles Radice, *Offshore: Britain and the European Idea* (London: I.B. Taurus & Co Publishers, 1992), 22-28, Nunn, 88-98

continental Europe. Military strength, diplomatic prowess, early industrialization, and relatively peaceful democratization in Britain have made it the subject of much study and distinction from the modern European identity. Considering these factors it is not surprising that the United Kingdom has not 'fit' with the process of European integration that began with the European Coal and Steel Community. Consequently, the United Kingdom has often been called the 'awkward partner' of Europe.[39] This specifically references the behavior of Britain towards Europeanization and the standoffish position it has taken. The off-shore mentality of Britain has been a common current running through the political class in Britain that, "…the island nation belonged not to the continent but to the world…"[40] Michael Hogan has commented that the British in the late 1940's, "preferred their own room with connecting doors to the U.S. and the Continent and protested when the Americans suggested a suite with the Europeans."[41]

From 1890 to 1945 British military forces played a key role in protecting the pound and its global power through the Empire and Commonwealth. In the decades following World War Two, British behavior shifted little. It continued to act as if it were a great military and monetary power. The United Kingdom met with varying success when it used military power to maintain monetary strength between 1945 and 1973. Increasingly, fiscal

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[39] Stephen George, *An Awkward Partner: Britain and the European Community* (Oxford: Oxford University Press, 1994).

[40] Young, 43-44.

[41] Hogan made the comment upon the publishing of his book, *The Marshall Plan: America, Britain, and the Reconstruction of Western Europe, 1947-1952* (Cambridge: Cambridge University Press, 1987) quoted in Desmond Dinan, *An Ever Closer Union? An Introduction to the European Community* (Boulder, CO: L. Rienner Publishers, 1999), 24.

concerns would be central to defence issues. Finally, in 1973, the collapse of Bretton Woods would sever any connection between monetary and defence policies and leave only a fiscal link. However, at times, currency and defence have been resurrected as national icons of identity in order to achieve political, personal or strategic objectives.

The result has been the creation of twin paradoxes in contemporary British politics. The first paradox is the Tories, the party at present most dedicated to nationalism, cannot seize the euro as a means to improve defence. The second is Labour, the party of the euro, is unable to convince the population of its benefits. Therefore, to prove to other EU states the sincerity of its intentions, Labour enters into military agreements with the EU which it might not otherwise have if EMU membership were possible. These paradoxes and the actions and inactions that result from them present a threat to British power. The dedication to the pound, in keeping Britain out of the EMU is impeding Britain’s ability to retain independent global military power.

II. BRITISH DEFENCE AND MONETARY POLICY 1879-1973

The purpose of this chapter is twofold. The first is to display the economic origins of the United Kingdom's historical preference for credible and substantial defence forces. This will be accomplished primarily through an abbreviated narration of British military efforts and central defence issues from 1879 to 1973. The primary focus will be on the time period from 1945 to 1973. This is not to ignore some of the issues that arose prior to the end of the Second World War. Rather the events prior to 1945 will be used as the template for comparing and contrasting the shifting relationship between defence and currency after. This theme is the second point of this chapter and is of the greater importance.

The second purpose is central to the theme of this thesis which concerns the 'why' and 'how' of British defence forces in the global strategic sense. Specifically, this chapter will examine the connection between British military forces, their use internationally and the international position of the pound sterling.[42] As

[42] A great deal of research has been conducted on British foreign and defence policy between 1805 and 1973 and the intertwined relationship between them and the international position of sterling in the Empire, Commonwealth, Sterling Area and the world economy. Among them are two volumes from P.J. Cain and A.G. Hopkins, *British Imperialism: Innovation and Expansion 1688-1914* (London and New York: Longman, 1993) and *British Imperialism: Crisis and Deconstruction, 1914-1990*. (London and New York: Longman, 1993), Edward Grierson, *The Death of the Imperial Dream: The British Commonwealth and Empire 1775-1969* (Garden City, NY: Doubleday, 1972) and C.J. Bartlett, *The Long Retreat: A Short History of Defence Policy* (London: Macmillan, 1972). For detailed issues relating to the pound sterling and its international role see, Sir Albert Feavearyear, *The Pound Sterling: A History of English Money* (Oxford: Oxford University Press, 1963) and for a general overview of the global context of Great Britian role in the modern world see William R. Keylor, *The Twentieth Century World: An International History* (Oxford: Oxford University Press, 2000).

this chapter considers the status of sterling in an international context, the primary focus of analysis will be on periods in which international currency orders have been in place.[43] This focus is not to the exclusion of periods when currency orders have not been active. In fact, several examples will show how Britain maneuvered during periods of war and inconvertibility of currencies based upon speculation of future currency orders.

The premise of this chapter draws its inspiration from the work of Susan Strange in 1971 on British behavior in international currency orders. Strange asserts that Britain's contemporary behavior in the international economy was shaped by preferences formed in the second half of the 19th century. In this the period of late imperialism the most important factor became the centrality of the pound sterling as an international vehicle, exchange and reserve currency.[44] Sterling was the first currency to assume such a role on a global scale. Strange observes that in the late 19th century the central focus of British commercial activity shifted away from manufacturing and

[43] Ronald J. McKinnon, "The Rules of the Game: International Money in Historical Perspective," *Journal of Economic Literature*. Vol. 31, No. 1 (Mar., 1993): 3. McKinnon proposes a taxonomy of currency regimes since 1879 periods of which will be used to illustrate British defence behavior in context.

[44] A *vehicle currency* is one used to transition from one relatively minor currency to another. For example f one wished to convert Thai bhat into South African rand, because there is virtually no market for doing so, the baht would first be used to purchase a major currency such as sterling, dollars or euros and then use that to purchase rand. An *exchange currency* is one used in international trade transactions regardless because of its accepted international value. For example a nation in South American may use American dollars to purchase oil from Africa. A *reserve currency* is one held in significant quantities by central banks of nations outside the nation which produces the currency for domestic use. A reserve currency is held by central banks for numerous reasons, long term investment, to back the domestic currency or to use in foreign transactions.

industry.[45] Britain developed as the first industrial nation and this domestic capability had been the cornerstone of mercantilism. Britain's move away from domestic industry was the result of greater interest in finance, investment and insurance and was built upon the position of sterling within the international gold system. In this capacity, the City of London served as the center both for the international gold trade and international finance.[46]

From 1879 to the outbreak of the First World War the international monetary order was based upon gold reserves.[47] Sterling in this period is classified as being both a 'top' and 'master currency'. A top currency refers to its status as the première vehicle, exchange and reserve currency. Sterling's status as the international top currency was a product of the substantial gold reserves of the Bank of England as well as its designation within the British Empire as the master currency. A master currency is one that is designated by a political power as the required currency of a given area of territories outside the home nation.[48] In this case, the United Kingdom made sterling the only currency for trade with and within the Empire. Britain controlled directly or indirectly a substantial portion of the world's resources and population at this time.[49] Global trade hinged on sterling and it maintained

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[45] Susan Strange, "Sterling and British Policy: A Political View," *International Affairs (Royal Institute of International Affairs 1944-)* Vol. 47, No. 2 (Apr., 1971): 305-307.

[46] P.J. Cain and A.G. Hopkins, *Innovation and Expansion 1688-1914*, 141-180.

[47] McKinnon, 3.

[48] These definitions of master and top currencies are taken from Strange, 306.

[49] From 1850 to 1914, the Empire, colonies, protectorates and

the preeminent position in the international currency order.[50]

Strange makes the case that the government's preference for maintaining the international position of sterling has its roots in the late 19th century change in focus to international banking, finance and insurance. As the world's banker, lucrative overseas investments shifted Britain's financial interests away from investment in domestic manufacturing. Britain would act less and less as a source of finished goods to the primary producing world as it had in classic mercantilism.[51] This preference changed the reasons for maintaining the Empire, placing an even greater emphasis on monetary policy and maintaining a strong pound. As a result, argues Strange, despite the fact that the post World War Two era showed that the pound was no longer the global top currency, the United Kingdom felt the need to continue to act to protect its monetary strength and took other diplomatic steps to ensure its position.[52]

It is the central proposition of this chapter that British defence policy followed a similar path as its monetary policy. As Britain became the leader in global finance British defence policy and action shifted from

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commonwealth states included in their number Canada, Australia, New Zealand, South Africa, East Africa (Rhodesia), Egypt, Pakistan, India, Malaya, Singapore, Hong Kong and present day Kuwait, Iraq and Palestine. Sterling was the only currency used in these areas.

[50] Strange, 302. This was also observed by Patrick O'Brien and Caglar Keyder in *Economic Growth in Britain and France 1780-1914: Two Paths to the Twentieth Century* (London: George Allen and Unwin, 1978), 195-197.

51 Alan Milward with George Brennan and Federico Romero, *The European Rescue of the Nation-State* (Berkeley: University of California Press, 1992), 392-395 as well as in Cain and Hopkins, *Innovation and Expansion 1688-1914*, 181-201.

[52] Strange, 302.

being in part influenced by protecting and opening markets for manufactured goods.[53] Instead, defence policy and action was used to contribute to protecting the international position of the pound sterling. The critical point is the difference between a fiscal motivation and a monetary motivation. Military action to ensure national access to raw materials and markets is essentially a fiscal equation. Doing so generates capital wealth for the nation's tax base which, in turn funds the government and defence. Military policy and efforts to protect the international strength of a currency is similar because while it generates wealth, notably for the City of London, but it also brings global economic influence through the Bank of England.[54] However, to conduct such a policy requires actions based on different priorities than in classic mercantilism.

This chapter will illustrate how since the Second World War Britain has at times tried to use its military and defence policy as a type of support for monetary policy. The most important insight is that of the glacial shifting of economic realities. Security and defence priorities for the United Kingdom have gradually moved back from monetary concerns to fiscal ones. However, the long standing relationship between the pound and defence has welded the two into a common conception of sovereignty. Just as defence is the most critical definition of national sovereignty for most nations the pound plays a similar role for Britain.

There are three time periods in Ronald McKinnon's taxonomy of currency orders which will be highlighted here

[53] Cain and Hopkins, *Innovation and Expansion 1688-1914*, 73-74.

[54] Cain and Hopkins, *Innovation and Expansion 1688-1914*, 141-181.

and correspond to three periods of international monetary order. The first period is the international gold standard from 1879 to 1914. This period will be used as a type of control group for British military behavior based on Susan Strange's assertion that this period became the norm for British monetary behavior.[55] The second and third periods both occur during the Bretton Woods order from 1945 to 1973. This was a period of critical transition in which British military policy and activity displayed mixed behavior. Security efforts tried to address monetary issues while facing rising fiscal constraints. At the same time defence issues and policy unrelated to monetary objective played a key role often to the detriment of monetary concerns.[56]

To examine British defence behavior in relation to the strength of the pound under Bretton Woods the period must be broken into two halves; 1945 to 1956 and 1956 to 1973. In these two sections defence policy had monetary concerns but with a differing focus on how to best support the pound. From 1945 to 1956 the focus was on maintaining the viability of the Sterling Area with a lesser focus on the United States. From 1956 to 1973 supporting United States security issues were central to maintaining a strong pound with the Sterling Area concerns being ancillary.

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[55] Strange, 306-307.

[56] The ever increasing budgetary (fiscal) pressures generated by defence expenditure as a result of rapidly changing technology since the Second World War apply to all nations seeking the most modern defence systems. An the reality of Great Britain's particular experience with this phenomena can be found in Keith Hartley, *The Economics of Defence Policy* (London: Brassey's, 1991) and will be discussed more in Chapter III of this thesis.

A. THE INTERNATIONAL GOLD STANDARD: 1879-1914

The importance of the gold standard is a recurring theme in British economic history. Indeed Britain had utilized gold to back its currency since the middle of the 18th century. However, McKinnon suggests that the gold standard did not become a global currency order until 1879. At that point every major industrial nation and most agrarian ones backed their currencies with gold.[57] The international gold standard of this period is characterized by the following conditions,

> For a country to place its monetary system on a gold basis it had to agree to fix a gold value for its currency (also known as the 'gold content' of the currency); guarantee the interconvertability between its domestic currency and gold at a fixed official price; allow for a relatively free movement of gold into and out of the country; and ensure that the paper money that it put into circulation, as well as all the other means by which it settled its accounts, were backed by adequate gold reserves. The great appeal of the gold standard was the belief that it kept prices and exchange rates stable.[58]

Within the United Kingdom, the City of London and the Bank of England played key roles in the functioning of this international system. As the center for international trade, finance and gold sales, London became the banker to the world.[59] So intertwined were sterling and gold that the international gold standard as it existed prior to the First World War has often been called, 'the sterling standard.'

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[57] McKinnon, 3.

[58] Russell Ally, "War and Gold – The Bank of England, the London Gold Market and South Africa's Gold, 1914-1919," in *Journal of Southern African Studies* Vol. 17, No. 2 (Jun., 1991): 222-223.

[59] Cain and Hopkins, *Crisis and Deconstruction, 1914-1990*, 148-153. Also in Feavearyear, 314-317.

> …sterling operated as an international currency on equal terms with gold. Sterling was for many countries the normal means of settling trade indebtedness… Apart from this trading use, sterling was used equally with gold as a means of settling international balances between countries… Overseas banks in many countries held working balances of sterling… Moreover in some countries, central banks held part or all their main reserve in sterling, preferring sterling to gold, partly for the interest which the sterling assets yielded, and partly because the bulk of their trade lay with the United Kingdom and sterling balances were a trade convenience.[60]

The stability and strength of Great Britain's international position rested upon the global influence of its currency. Contemporary opinions maintained that this strength could be maintained only if the sterling remained convertible with gold.[61]

A great deal of scholarship has been dedicated to the issue of why the United Kingdom conducted military operation in South Africa in the 1890's culminating in the 1899-1902 Anglo-Dutch South African War, often called the Boer War. J.A. Hobson first suggested in 1900 that the war in South Africa had been stimulated by the need to maintain London's access to the newly discovered gold fields in the Witwatersrand.[62] Scholarship on the subject has illustrated that, in reality, a combination these economic motivations as well as local political and geostrategic concerns were

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[60] W.M. Scammell, "The Working of the Gold Standard" in *The Gold Standard in Theory and History* ed. Barry Eichengreen (New York and London: Methuen, 1985), 104.

[61] See *Pamphlets by the Gold Standard Fence Association*, (London, 1895) cited in Ally, 225.

[62] J.A. Hobson, *The War in South Africa: Its Causes and Effects* (London, 1900), 240.

at the root of the war.[63] None the less, the economic motivations were undoubtedly a factor in the decision to intervene in South Africa. Doing so achieved the double purpose of maintaining the permanence of the London Gold Market and the international stability and credibility of the pound sterling.[64] This example illustrates a critical link between British defence and monetary policy. In 1899 military forces were used to defend the international monetary preeminence of the pound. This would become a template for British defence policies in the future.

B. THE ABSENCE OF INTERNATIONAL CURRENCY ORDER: 1914-1945

This chapter does not seek to explain the behavior of British defence policy during the First and Second World Wars. It is without doubt that more pressing issues such as those of the European balance of power and national survival focused defence policy and military operations in this time period. Moreover, from 1913 to 1945 there was no *de facto* global currency order.[65] Clearly, British policy and the policy of other nations sought to enforce some currency order during the interwar period. Arguably the failure of Britain or the United States to do so successfully contributed to the instability of the period. However, the importance of defending the international

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[63] For a superb synthesis of the material see Ronald Hyam and Peter Henshaw, *The Lion and the Springbok: Britain and South Africa since the Boer War* (Cambridge: Cambridge University Press, 2003), 37-56. The authors synthesize the economic arguments of S. Marks and S. Trapido, "Lord Milner and the South African state reconsidered" in *Imperialism, the state and the Third World* ed. Michael Twaddle (London: Macmillan Publishers, 1992), 80-94 and P.J Cain and A. G. Hopkins, *British Imperialism, 1688-2000* (London: Longman, 2001), with the geostrategic arguments of Iain R. Smith, *The Origins of the South African War, 1899-1902* (London: Longman, 1996) and A.N. Porter, *Origins of the South African War: Joseph Chaimberlain and the Diplomacy of Imperialism, 1895-1899* (Manchester: Manchester University Press, 1980).

[64] Hyam and Henshaw, 37-39.

[65] McKinnon, 2.

position of sterling is highlighted in the United Kingdom's behavior at the outset of the First World War and through to the Second. Through the First World War the Bank of England established special procedures to deal with settling gold accounts and maintaining access to sources of gold.[66] The United Kingdom clung to the belief that retaining the gold standard would also retain the international position of sterling and the wealth and power that brought Britain.

In the interwar period, with its gold reserves having been expended fighting the war, Britain sought to create a 'gold exchange standard'. Under this mechanism, post-war European currencies would be reestablished using the sterling or dollar as the reserve rather than gold which would have aided in returning British finances to stability as well as extending British monetary dominance into Europe.[67] Instead, there was a brief reassertion of the gold standard by the United States from 1925 to 1929. Although not classified as a currency order because only a few nations shifted their currencies to gold in the period, the preeminence of the American economy made this decision a reality every nation had to deal with. The United Kingdom attempted to adhere to it without devaluing the pound in order to retain the strength of the City of London's financial sector. The collapse of the gold standard in 1929 with the Wall Street crash paved the way for a new era for sterling where it could maintain a type of global preeminence.

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[66] Ally, 227-230.

[67] Cain and Hopkins, *Crisis and Deconstruction, 1914-1990*, 63-64 and Keylor, 131.

In 1931, Great Britain, in a landmark decision in international monetary history, shifted its monetary policy away from the Gold Standard, and focused on the Sterling bloc as the basis for international monetary strength. The creation of the Sterling Area and the Ottawa Conference of 1932 marked the descent of sterling from the 'top currency' status which it had prior to 1913 to that of a 'master currency'.[68] The Sterling Area was a new mechanism, created in part by John Maynard Keynes. It established reserve requirements in sterling for nations which had close economic ties with the United Kingdom. Essentially sterling became the gold reserve of the area which encompassed all of the Empire where the reserves were mandatory. This included Australia, New Zealand, Siam (Thailand) and Ireland. Other countries participating in the Sterling Area held balances in sterling but reserve totals were not mandated included British Malaya, Denmark, Lithuania, Latvia, Estonia, Sweden, Finland, Norway, Hong Kong, India, Pakistan, Portugal and South Africa.[69] The Sterling Area would survive the Second World War, with some small modifications to its membership. The Sterling Area, owing in part to its large size and diverse economic production and trade would continue to serve as a base for the sterling's international power.

C. THE BRETTON WOODS SYSTEM: 1945-1973

The 1945 Bretton Woods system was the first international currency order since the 1879-1913 Gold Standard. The painful lessons of cascading international

[68] In the context of the period, global economies were in spasms and inflation was rampant as a result of the cascading effects of the 1929 Wall Street Crash. The Sterling Area established protectionist tariffs to defend the users of sterling world-wide from these effects.

[69] Cain and Hopkins, *Crisis and Deconstruction, 1914-1990*, 76-93.

collapse in the interwar years had convinced even those, Keynes among them (who had earlier vehemently supported the gold standard) that a more flexible international monetary order was needed. The sprit of Bretton Woods had intended to give each nation the ability to establish inflationary and employment goals for their domestic economies. This was to be accomplished by demonetizing gold. In practice, Bretton Woods was a system wherein the dollar was the new gold standard. The centrality of the American economy in the post World War Two environment made dollar reserves an essential factor for maintaining a strong currency.[70]

Britain entered into this new order as the lead nation in its own currency order. Britain was still the leader of its master currency area, the Sterling Area. In this regard, Britain fell into a special subsidiary category of currencies, those which,

> …have slipped from their former status…as top currencies…The issuing state, in order to avoid monetary embarrassment, thus becomes involved in a negotiating posture, offering inducements to users of the currency that may range from profitable rates of interest and value guarantees to commercial preferences or even to non-economic benefits of political assistance or military protection.[71]

In 1945 the global strength of the pound was far from sapped. Even by 1960 forty percent of global trade was conducted in pounds and only twenty-five percent in dollars.[72]

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[70] McKinnon, 13-19.

[71] Strange, 306.

[72] Diane B. Kunz, *Butter and Guns: America's Cold War Economic Diplomacy* (New York: The Free Press, 1997), 73. In the late 1950's and early 1960's there was still incomplete economic information indicating exactly how high a percentage of world trade was conducted in sterling. Some estimates range as high as 50% as seen in Sir Leslie Rowan, *Arms*

The critical difference between the dollar and the pound after the war was that Britain exacted its power from the wealth generated by the use of the sterling as a trade and finance currency. The dollar was based on the strength of the growing American industrial economy which generated wealth from exports. This is illustrated by the fact that one of the most important contributions of the Sterling Area was that of its dollar pooling requirements. Any dollars acquired by Sterling Area countries, mostly through raw material exports to the United States, had to be pooled with the Bank of England. This mechanism, in combination with Marshall Plan aid,[73] allowed Britain to clear its dollar debt to the United States.[74]

The focus of this period will be upon Britain's behavior as head of its master currency area and the military commitments. During the period of the Bretton Woods order, from 1945 to 1973, military policy was used in part to uphold the stability of the pound. This was despite the realities that increasingly defence policy was unable to do so. This is evidenced by the fiscal constraints of defence commitments. This time period will be handled in two halves. The first period was from 1945 to 1956, when Britain sought to continue to use defence policy and direct military intervention to defend the viability of the Sterling Area. The second period was from 1956 to 1973, when this type of intervention became a tool

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and Economics: The Changing Challenge, Lee Knowles Lectures for 1960 (Oxford: Oxford University Press, 1960) 24.

[73] Cain and Hopkins, *Crisis and Deconstruction, 1914-1990*, 273.

[74] Gerold Krozewski, "Sterling, the 'Minor' Territories, and the end of Formal Empire, 1939-1958," *The Economic History Review*, New Series, Vol. 46, No. 2, May 1993): 243-251.

to induce the United States to defend the monetary position of the pound.

The international strength of the pound was a central policy objective of the British government.[75] The purpose of doing so was to retain the importance of the power of the City of London as the central hub for international trade and finance and thus the international strength of Great Britain.[76] To do so, the pound had to have and retain a high value relative to the dollar. The pound's value under Bretton Woods was originally set at $4.03 but faced a major crisis in 1949 that forced it to devalue to $2.80. British governments of the left and right would hold the line on this value until 1967. However, the means of using defence policy to do so would change. From 1945 to 1956 the military defence of the Sterling Area as the anchor of the international position of sterling was a primary concern. However, in the context of the developing Cold War, the British government began to feel the pull of two competing forces. The first was the need to protect the monetary stability of the pound and the second the fiscal

[75] A critical issue of returning the pound to its former strength internationally was to return it to full convertibility with the dollar. Doing so successfully would prove to the global economy that there was equal confidence in sterling as the dollar for international transactions. So important was this objective that the British developed several schemes to do so in secret. The best known, developed in the early 1950's, actually had its own covert code name, like a military operation. Known as ROBOT, the program required a detailed battle plan to gain support from the Commonwealth and then the American (whose financial support in the form of loans was essential). ROBOT was kept secret from the other European nations as they were pursuing the Common Market and relied on British participation in the European Payments Union for financial stability. The execution of ROBOT, as planned, would have shattered European cohesion in its infancy. A detailed examination of ROBOT and monetary strategies of the 1950's in Europe can be found in Alan Milward with George Brennan and Federico Romero, *The European Rescue of the Nation-State* (Berkeley: University of California Press, 1992), 4.

[76] Cain and Hopkins, *Crisis and Deconstruction, 1914-1990*, 265-266.

constraints of defence. The balancing of these two forces would characterize British behavior in the period from 1945 to 1973.

1. British Defence Under Bretton Woods: 1945-1956

An examination of British military interventions between 1945 and 1973 yields a direct correlation between British military action and the Sterling Area. Scholars have observed, with some perplexity, that Britain's militancy in this period defies the logic of a medium power. This is based on the assumption that only a great power would risk war for small objectives. Often such military action is attributed to some sort of Imperial hangover in which the state acts simply out of habit and not a rational decision.[77] However, the three conditions that characterized British limited military intervention in this period make the motivation clear. Between 1945 and 1973 intervention occurred, with only one exception, when established authorities requested assistance, when political violence erupted and when there was an advanced presence of British armed forces. With the exception of the Korean War and the Suez Crisis of 1956, both of which will be addressed later, all military interventions occurred within the former territories of the Empire.[78]

While British military intervention in these regions cannot be explained in terms of balance of power theory, the monetary concerns of Britain provide insight into motivation. Territories such as Malaya and Kenya may not have had an important geo-strategic position or been a major source of trade with the United Kingdom, but the

[77] John Van Wingen and Herbert Tillema, "British Military Intervention after World War II: Militance in a Second-Rank Power," *Journal of Peace Research* Vol. 17, No. 4, (1980): 291.

[78] Van Wingen and Tillema, 295.

regimes in power were part of the Sterling Area. As such they constituted important holders of sterling reserves. As the other portions of the Empire, such as India and Pakistan, moved to Commonwealth status and these lesser territories increased their sterling reserve holdings.[79] Therefore they became of greater importance to the international strength of sterling. Admittedly, there were additional factors that influenced the British willingness to intervene in the former imperial territories. The protection of British citizens was clearly important at times.[80] However, given the rising importance of these minor territories for the global strength of sterling, military intervention by the British government to support the governments dedicated to the Sterling Area and holding considerable balances was in the interest of the British government.[81] In fact, defensive arrangements made with Malaya in the early 1950's to convince them to stay in the Sterling Area continued into the mid 1960's.[82]

The sizable British commitment to the Korean War 1950 to 1953 was in a way an exception to the rule of British motivation for defence policy which has been proposed. The British sought to influence American policy in Korea by contributing to the military effort. Based upon similar lessons from the Alliance effort in World War Two, the British did have significant influence over American decisions regarding the conduct of the war.[83] However, this

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[79] Krozewski, 241.

[80] Van Wingen and Tillema, 292.

[81] Cain and Hopkins, *Crisis and Deconstruction, 1914-1990*, 278-281.

[82] Strange, 309.

[83] Thomas Risse-Kappen, *Cooperation among Democracies: The European Influence on U.S. Foreign Policy* (Princeton: Princeton University Press, 1995), 42-45.

discrepancy can be partly explained by what would later become the essential focus of British defence policy, American economic aid. The Marshall Plan was contributing substantial dollar investment into the British economy between 1948 and 1952 and this assuaged the balance of payments deficit that Britain was incurring.[84]

Not as easily reconciled were the balance of payments problems that the United Kingdom was experiencing vis-à-vis their troop commitment to the defence of Europe. From 1952 to 1955, the German government paid an occupation cost of 600 DM per month to the British government to cover the costs of the nearly one hundred thousand British troops defending Germany against Soviet aggression. These occupation costs became the more general support costs paid by the Federal Republic of Germany from 1955 to 1961. Support costs were various forms of compensation, from direct cash payments to commitments to purchase arms which caused capital to flow from Germany to Britain. The primary motivation was not to pay for the expenses of the soldiers since Britain was willing to cover the costs of paying, equipping and maintaining their troops. The problem for Britain was the balance of payments. Britain argued that maintaining troops in Germany cost the United Kingdom because it had to buy deutschmarks (DM) to pay the soldiers and to provision them. Essentially the troops acted as a large permanent source of foreign debt.[85]

The validity of these claims has been challenged by current scholarship. In *Money and Security: Troops, Monetary Policy, and West Germany's Relations with the*

[84] Cain and Hopkins, *Crisis and Deconstruction, 1914-1990*, 273.

[85] Hubert Zimmermann, *Money and Security: Troops, Monetary Policy, and West Germany's Relations with the United States and Britain, 1950-1971* (Cambridge: Cambridge University Press, 2002), 26.

United States and Britain, 1950-1971, Hubert Zimmermann has shown that problems with British balance of payments resulted only in part from exchange losses due to troop maintenance. What is important to note is not that dollar shortages in British reserves was due to weak domestic industry but that the cost of maintaining troops became the convenient scapegoat for the British government. Thus, regarding the defence policy of presence in Germany, Britain acted as if it were a drain on the monetary strength of sterling. Therefore in negotiations with the government of the Federal Republic of Germany the British constantly threatened to reduce their troop numbers for this reason.[86] Subsequently, the German government agreed, despite its initial intransigence, to pay support costs which were often thirty percent higher per soldier that the Germans paid the American government.[87] The willingness to leverage defence policy to defend the pound illustrates the primacy that monetary strength played in the British political psyche of the day. This example also shows how the British successfully used their military policy to effectively funnel money from Germany to support their own flawed domestic economy.[88]

The critical watershed for British defence policy from 1945 to 1973 occurred in 1956 during the Suez Crisis. The failure to achieve their objectives illustrated three critical points which have shaped British defence policy to the present day. The first was the inability of the military to protect by force what monetary strength was left in the Sterling Area. British motivation for seizing

[86] Zimmermann, 23-45.

[87] Zimmermann, 248-251.

[88] Zimmermann, 27-30.

the Suez Canal was in part a move to ensure trade with and thus the viability of the Sterling Area.[89] The second was that real monetary strength rested in having the support of the United States. The third was that a nuclear deterrent did not assure success in limited war.[90] The first and second points are the most critical to this thesis because from 1956 on British defence policy would be heavily oriented towards the needs of the United States. In this way, the traditional role of the military as protector of the international strength of the pound merely shifted from protecting the viability of the Sterling Area and the Empire to helping the United States to ensure continued American financial support of the pound.

The Anglo-French-Israeli intervention in the Suez Canal zone in 1956 is often highlighted as the low point of relations in the western alliance since the end of the Second World War. What is striking about it is the leverage of economic diplomacy it illustrates; this was not lost on the United Kingdom.[91] Importantly, it was not forgotten by Harold Macmillan, then Chancellor of the Exchequer. Macmillan would succeed Prime Minister Anthony Eden after the Suez debacle and have great influence over the shift in the orientation of British defence.[92] The crisis was initiated by the nationalization of the Suez Canal by Egyptian leader Gammal Abdul Nasser in the summer of 1956. The loss of the Suez Canal Company, and the associated revenues, was not of as great a concern as the

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[89] Diane B. Kunz, *Butter and Guns: America's Cold War Economic Diplomacy* (New York: The Free Press, 1997), 85.

[90] Kunz, 89-93.

[91] Risse-Kappen, 99.

[92] Kunz, 90.

threat it posed to the cohesion of the Empire and the Sterling Area.

The British decided upon military action in the Canal Zone because Nasser's nationalization meant he could close the canal at his whim.[93] This had two potentially choking effects for Britain. First, seventy percent of Western Europe's oil flowed through Suez. Second, and of importance for this chapter, it was the vital sea link with what remained of the Empire and numerous states which held large sterling reserves. Nations such as Kenya, Malaya, India, Australia, New Zealand and Pakistan all maintained sizable sterling balances some because of Imperial fiat and some because of preferred Commonwealth trade status.[94] If the Canal were to be closed, these nations would lose much of their reason for retaining large sterling balances. In 1956, the Bank of England was still maintaining sterling at a value of $2.80. A reduction of holdings by the Sterling Area nations would lead to speculation and threaten the monetary strength of the pound.

Ultimately the Suez intervention was a watershed because it proved to the British that the Sterling Area was no longer the most important factor in the strength of the pound. As soon as the invasion began, there was a run on the pound in international markets. This caused a sudden and massive outflow of British dollar reserves. The Bank of England lost fifty million US dollars in two days. The only way for Britain to remain solvent was to receive a loan from the International Monetary Fund and to get it required American approval.[95] The Americans had been

[93] Cain and Hopkins, *Crisis and Deconstruction, 1914-1990*, 289-290.

[94] Kunz, 75.

[95] Risse-Kappen, 96.

deceived and uninformed about the Suez operation and felt it inappropriate in the context of other events in the Cold War. Therefore, Eisenhower used this monetary advantage to force the British to pull out of Suez. Doing so resulted in a collapse of the entire effort to retake the Suez. Diplomatically, the strain in the Anglo-American relationship resulted in immediate moves by the United Kingdom to repair the breach.[96]

2. British Defence Under Bretton Woods: 1956-1973

Following the Suez crisis the conversion of British defence policy towards its new priorities began in earnest. From 1956 to 1973 the focus shifted away from the protection of the Imperial territories, Sterling Area and Commonwealth as the foundation of the monetary strength of the pound. The former empire would play a role but only in that it would be used as a stage in the greater battles of the Cold War. American concerns over the 'domino theory' would influence British strategy, and British defence policy regarding the former Empire would be shaped by the ability of the United States to continue to underwrite British monetary stability.[97] Additionally, new attention would be paid to rectifying the fiscal issues which plagued and stifled British economic recovery. In this period the first shift in British defence policy as a tool to retain monetary strength can be seen. Increasingly fiscal issues would play a greater role in defence priorities.

The decreasing focus on retaining the power of the City through the international strength of the pound can be seen in several policy shifts which occurred in the wake of the Suez Crisis. In 1958 the sterling was restored to full

[96] Risse-Kappen, 99.

[97] Kunz, 149-179.

convertibility with the dollar. The minor territories, which had been carrying sizable sterling reserves, were given political independence. The last fetters of mandatory sterling reserves were removed. Although preferential trade arrangements remained and thus induced many nations to keep sterling for trade with Britain the quotas and dollar pooling arrangements were finished.[98] With the weak consumption economy in Britain and a strong one in the United States, increasingly the dollar would become the central vehicle and reserve currency of choice. In 1962 the United Kingdom first applied for membership in the European Economic Community (EEC). The unwillingness of the Prime Minister Macmillan to end the system of Commonwealth agricultural preference would ultimately doom the 1962 application.[99] However, the fact that Britain applied for membership in the Community, which it had previously shown no interest in, is of great import. Britain's application illustrates that political and economic interests had shifted away from international finance with the pound as the vehicle and towards industry and trade in the competitive market of Europe.[100]

The tension between monetary strength and the fiscal demands of defence policy can be clearly seen in the British pursuit of an independent nuclear deterrent. Research has shown that rather than being a conscious

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[98] Krozewski, 260.

[99] Richard E. Neustadt, *Report to JFK: The Skybolt Crisis in Perspective* (Ithaca: Cornell UP, 1999), 83-85. Neustadt makes it clear that DeGaulle's claim that the Nassau Agreement (which provided American Polaris missile technology to Great Britain) was his reason for vetoing the British application to the EEC was simply a cover story. Neustadt's evidence is that de Gaulle told Macmillan, prior to the Nassau Conference, that he would veto the application based upon the preferential agriculture policies of the British Commonwealth.

[100] Cain and Hopkins, *Crisis and Deconstruction, 1914-1990*, 289-291.

decision about strategy, the independent deterrent was sought by Britain as an economy measure prior to 1956. In fact the British advocated the development of tactical nuclear weapons in the vein of President Eisenhower's 'New Look Army' as far back as 1952.[101] This vision became reality under Macmillan in the 1957 Defence White Paper introduced by Duncan Sandys. The objectives of the 1957 White Paper was to reduce the high fiscal costs of defence, cutting manpower nearly in half, ending conscription and reducing costs. All of this would be achieved by increasing the combat fire power of ground forces by the introduction of tactical nuclear weapons.[102]

The pressing fiscal realities of defence can also be seen in shifting British attitudes towards European defence procurement cooperation. The 1960's saw the start of numerous multinational European defence procurement efforts. The hope of these programmes, though not entirely fulfilled, was that they would generate fiscal savings through economies of scale and more effective pooling of research and development funds.[103] Three major European weapons systems were started in the 1960's and the United Kingdom was a member of every one; the Jaguar strike aircraft in 1965, the Puma, Gazelle and Lynx helicopter package in 1967 and the Tornado fighter/bomber in 1968.[104]

Despite growing fiscal pressures, British defence policy in this period continued to show that it had some

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[101] Bartlett, 97.

[102] Roger Carey, "The British Nuclear Force: Deterrent or Economy Measure?" *Military Affairs* Vol. 36, Issue 4, (Dec., 1972): 135.

[103] These programmes are lauded in 1958 by Sir Leslie Rowan in his Lee Knowles lectures at Oxford, *Arms and Economics: The Changing Challenge* (Oxford: Oxford University Press, 1960), 27-40.

[104] Keith Hartley, *NATO Arms Cooperation* (London: George Allen & Unwin, 1983), 140-162.

uses in maintaining the monetary strength of the pound. This is evidenced in what has been called the 'East of Suez' debate.[105] The 1965 Defence White Paper highlighted the need to cut spending further and overseas commitments seemed a likely source. By 1966 it became clear to all that any British presence overseas required intense reevaluation. Defending the Commonwealth was no longer a priority and the belief was rampant that Britain should withdraw from commitments east of the Suez Canal. Specifically this meant bases and defence commitments in India, Ceylon, Aden, Malaya, Singapore and Hong Kong. Arguments in favor of this withdrawal highlighted that the Commonwealth and sterling Area only contributed perhaps ninety million pounds a year to the British economy.[106] What those who debated in favor of a British withdrawal missed was the wider context of such an action during a 'hot' period of the Cold War.

American interests in Vietnam were rising and American policy there focused on the fear of a domino effect in the region, where consecutive south-east Asian nations might fall to communist rule. As a result, the 1965 British Defence White Paper prompted concern from the American State Department. British withdrawal, particularly from Malaysia and Singapore were potential strategic

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[105] This was a heated strategic debate in Whitehall, British academia and the press of the 1960's. It was of such significance and question that it is often revisited and contemplated again in later literature. For example in a 1977 book of compilation of writings on British defence policy, edited by John Baylis, called, *British Defence Policy in a Changing World* (London: Croom Helm, 1977), the second chapter is 'East of Suez Revisited' by Phillip Darby.

[106] Maurice Zinkin, "The Commonwealth and Britain East of Suez," *International Affairs (Royal Institute of International Affairs 1944-)* Vol. 42, No. 2 (Apr., 1966): 207-218.

disasters.[107] This defence reappraisal coincided with another sterling crisis. Speculation on sterling placed the $2.80 conversion rate again in doubt and with the pound being fully convertible it was even more exposed to rapid fluctuations on currency markets. Only another loan would keep the pound stable. The American State Department saw an opportunity and Under Secretary of State George Ball conditionally linked American support for the loan with further British commitment to hold their positions in south-east Asia. Prime Minister Harold Wilson acquiesced and the pound was stabilized.[108] The 1966 British Defence White Paper announced that Britain would pull its troops back from Aden but would stay in Malaysia and Singapore. British defence policy had again proved its ability to preserve the stability of the pound by backing American interests.

The 1965 rescue of the pound would be the swansong of British defence policy being used to protect monetary policy. The weakness of the British economy was showing and a crisis the following year would lead to the 1967 devaluation of the pound to $2.40. It would take only three years for Britain to successfully negotiate entry into the European Common Market. Doing so would require further cutting of ties with the Commonwealth nations, but their governments and a small populist movement in the United Kingdom were the only opponents.[109] Convincing France that Britain was sincere about participation in Europe was the real challenge.[110] The lack of concern for

[107] Kunz, 157-158.

[108] Kunz, 158.

[109] Young, 223-231.

[110] Young, 231-238.

the issue of the international strength of sterling in the domestic debate testifies to the limited role the Sterling Area played in the strength it had left. As it turns out the British entered the EC just in time, the collapse of the Bretton Woods system in 1973 allowed all currencies to float. The strength of a currency would now rest upon the confidence it held in international money markets.

D. CONCLUSION

This chapter has illustrated the intimate relationship between the pound and British defence policy. Following the collapse of Bretton Woods and the advent of floating currencies, the final ties between defence policy and monetary strength were cut. The balance of payments became less significant and national monetary policy now had little or no connection to international power. With this end came too a collapse of British foreign and defence policy. The objective of defending the strength and influence of the pound was gone and Britain would twist in the strategic winds of the Cold War. Dean Acheson's claim in his 5 December 1962 speech at West Point that, "Great Britain has lost an Empire and has not yet found a role" was never more valid than in the 1970's. What is interesting is that the issues of monetary and defence policy would remain and reemerge as essential components of British sovereignty and identity. They would no longer be linked in actual function but in nationalist sentiment.

III. THE BENEFITS OF EMU FOR BRITISH DEFENCE

The pound has reached the end of its usefulness for British defence. When considering the choice between it and the euro, the pound has become a hindrance to the fielding and employment of effective military forces. Membership in the European Monetary Union offers substantial benefits to Britain in the area of defence capabilities. These capabilities are essential if Britain hopes to continue to influence world events and contribute to global stability. The euro offers advantages over the pound by providing cost savings to the Ministry of Defence (MoD). These cost savings will come by eliminating transaction and exchange rate losses for MoD for financial transaction involving the eurozone. The euro offers the similar benefits for British defence industries and also should aid in further rationalizing the European defence market. This will bring additional cost savings to the MoD. Overall, this will improve the health of British defence industries while maintaining a necessary amount of strategic independence for Britain.

These claims are based upon three factors which are converging to create a crisis for British defence. These changing circumstances are partially a product of changes in the technological and security environment and are germane to many nations pursuing modern defence capabilities. Of specific import to this thesis is that in contrast to the era prior to 1973, there is no connection between British defence policy and the monetary policy of the pound. Ironically in fact, in strict economic terms, the euro is a favorable currency when considering the needs

of British defence. The first of the three converging factors is the British preference for strong defence capabilities. The historical leanings of the United Kingdom towards the United States on security matters are not likely to shift in the near future.[111] Neither the Tory nor Labour parties are advocating any break from solidarity from the United States, with the Tory opposition party having even stronger leanings towards America.[112] In the mind of numerous British governments of both the left and right, having influence with America on strategic matters has meant providing credible forces to military efforts. This trend is not likely to change in any meaningful way in the near future.

The second factor is more constrained defence budgets which will likely be the same or less, in real terms, as they are now. Simultaneously, the rising cost, in real terms, of the most advanced and capable defence technology. The push and pull of democratic politics in the United Kingdom will certainly inch the budgets up or down

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[111] The 'special relationship' between the United States in Britain has been a very important feature of the post World War Two security environment and a great deal of literature has been devoted to it; John Baylis, *Anglo-American Defnece Relations, 1939-1980: The Special Relationship* (London: St. Martin's Press, 1981), R. B. Manderson-Jones, *The Special Relationship: Anglo-American Relations and Western European Unity 1947-56* (London: London School of Economics and Political Science, 1972), Wm. Roger Louis and Hedley Bull, *The 'Special Relationship:' Anglo-American Relations Since 1945* (Oxford: Oxford University Press, 1986), Richard Neustadt, *Alliance Politics* (New York: Columbia University Press, 1970) and Richard J. Aldrich, *The Hidden Hand: Britain, America, and Cold War Secret Intelligence* (Woodstock, NY: Overlook Press, 2001). The relationship between America and Britain has surpassed that of any two other sovereign nations in terms of intimacy and access. This is illustrated by unprecedented sharing in the areas of nuclear weapons technology, nuclear weapons delivery systems and intelligence along with a myriad of lower level access. The intimate relationship is further illustrated by unprecedented access to decision making such as in the cases of the Cuban Missile Crisis and deliberation on the use of nuclear weapons in the Korean War.

[112] Sharp, 101-103.

slightly, but even the war in Iraq and the war on terrorism has only moved budgets up less than ten percent. The starting assumption of this chapter is that costs will continue to rise and budgets will continue to shrink or stay nearly he same in real terms. These realities force the United Kingdom to deal with maintaining capability in the face of leaner fiscal realities.[113] The euro offers savings to British defence budgets especially considering irrationality in defence markets.

The third factor that will further stress British defence spending is the economically irrational nature of defence markets in general. This is a challenging problem for the United Kingdom in two ways. First is the ability to gain efficiencies from a larger market, while retaining national control over defence technology to be free from foreign interference.[114] However choosing interdependence only poses a second problem. On one side, the enormous and lucrative American market offers profits, but only by working as a sub-contractor for the large American firms. On the other side, the economically irrational European defence market which is trying to integrate but is fraught with inefficiency. The United Kingdom already is driving integration and rationalization of the European defence market.[115] This chapter argues that membership in the euro

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[113] Hartley, *The Economics of Defence Policy*, 1-7.

[114] Hartley, *The Economics of Defence Policy*, 134-142 and in Theodore H. Moran, "The Globalization of America's Defence Industries: Managing the Threat of Foreign Dependence," *International Security* Vol. 15, No. 1 (Summer 1990).

[115] One of the United Kingdoms primary focuses in pushing for a European Common Foreign and Defence Policy, has been to increase in number and efficiency the number of defence procurement projects. The objective is to improve its own forces while also elevating those of the rest of Europe's NATO members. Britain has been a leader in numerous collaborative procurement efforts dating back to the 1960's (Jaguar, Tornado and a family of helicopters). It has also been a key

will create MoD savings by offering efficiencies and spur integration of the European defence market. This integration will have second order savings by making pooling of defence resources easier for Europe. In addition to these savings, the MoD stands to save by making money spent in the eurozone less of a drain on the British economy.

A. DECREASING BUDGETS AND RISING COSTS

Economists often challenge that defence spending is a drain on the profitability of the private sector and public resources of a nation. However, because defence is provided by the government as a public good it is difficult to evaluate its usefulness except in as much as the democratic system provides feedback to the government through elections. This reality makes it difficult to evaluate the cost-effectiveness of defence spending.[116] What is certain is that nations will spend some amount of money on defence in the face of a perceived threat. Additionally, governments have to make choices about how to spend the limited resources they have to provide for national security.

Since the end of the Second World War the United Kingdom has shown a preference for more significant defence spending than its European neighbors. In the past twenty years the United Kingdom has consistently been among the top nations in Europe in terms of defence spending per capita and as a percentage of Gross Domestic Product (GDP). Changes in spending have maintained this proportionality in relation to the

member of the Western European Armaments Group (WEAG), which functioned under the Western European Union (WEU), since WEAG's founding in 1993. Hartley, *The Economics of Defence Policy*, 143-169.

[116] Keith Hartley, *The Economics of Defence Policy*, 30-31.

Continental states, especially following the end of the Cold War.[117] From a peak of 5.3% of GDP spent under Prime Minister Margaret Thatcher in 1986 to 2.4% of GDP in 2000, the British have taken the opportunity to slim down defence spending since the collapse of the Soviet threat.[118]

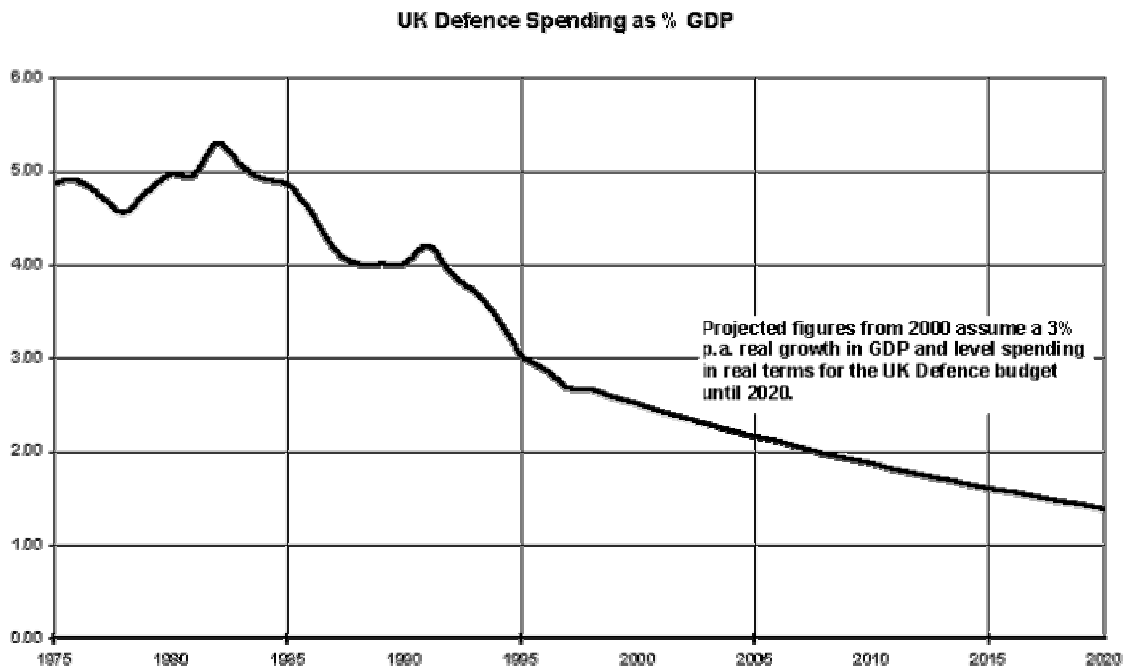

Figure 1. [119] UK Defence Spending as a Percent of GDP

In the present day, only France, Greece, Turkey and Norway spend more as a percentage of GDP than the United Kingdom does.[120] The reasons for the British preference

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[117] Charles Wolf Jr. and Benjamin Zycher, *European Military Prospects, Economic Constraints, and the Rapid Reaction Force* (Santa Monica, CA: Rand Publishing, 2001), 9-15.

[118] *World Military Expenditures and Arms Transfers 1999-2000*, U.S. Department of State Bureau of Verification and Compliance, June 2002

[119] From Michael Alexander and Timothy Garden, "The Arithmetic of Defence Policy," *International Affairs* Vol. 77, Iss. 3, (July 2001): 563. Figures were compiled by the authors from annual MoD White Papers. Projected figures from 2000 on assume a 3% real growth in GDP and level spending in real terms until 2020.

[120] Website, Nation Master, Military expenditure data from the CIA world Fact book: http://www.nationmaster.com/graph-T/mil_exp_dol_fig_gdp December 2003

toward higher defence spending are many, but the fact that the priority exists is the primary point.

The political inclination to field significant military forces is a given factor in contemporary British foreign policy. Considering this, the government and Ministry of Defence (MoD) must then balance how to spend scarce resource dollars in the most cost effective way. Economic predictions and demographic changes in the United Kingdom yield the clear picture that even with the perceived threat of trans-national terrorism; budgets for the MoD are not going to increase by any significant amount in the future. The contribution of the United Kingdom to the American-led Global War on Terrorism starting in 2001 and the invasion of Iraq in 2003 have resulted in modest increases. Most likely they will continue to shrink over the long run.[121] At the same time, the MoD is faced with increasingly complex and expensive defence technology whose costs grow at a greater rate than defence spending.[122]

B. ECONOMIC RATIONALITY VERSUS STRATEGIC INDEPENDENCE

In the face of shrinking budgets and an autarkically inclined defence industry, removing all barriers to a totally rational defence market seems like a certain fix to the problem. However, liberalization of the British defence market is more complex because of the strategic need to retain a modicum of independence. The pursuit of equilibrium between strategic independence and domestic employment on one hand and the rationalization of the European defence market on the other is the critical issue

[121] Hartley, *The Economics of Defence Policy*, 26.

[122] This phenomena is well known in modern defence economics in general an for Britain in particular as seen in John Baylis ed., *Alternative Approaches to British Defence Policy* (New York: St. Martin's Press, 1983), 5, Hartley, *The Economics of Defence Policy*, and in Alexander and Garden, 561-563.

which the United Kingdom now faces. To develop, acquire, maintain and operate advanced defence systems requires a large research and development budget, long project horizons and a defence contractor capable of handling these major and high tech projects.[123] In spite of these rising equipment costs and decreasing budgets the British have continued to pursue a national military capability which is equipped with systems produced in the United Kingdom. While competition on about fifty percent of MoD contracts is open to foreign bidders, national law requires that ninety percent of orders go to domestic suppliers.[124] This preference for maintaining a domestic defence industry is caused both by domestic concerns about employment but also for protecting a strategic capability to produce defence systems and thus retain strategic independence.[125]

A domestic defence industrial complex is important to the United Kingdom for several reasons. First, it provides some level of strategic independence by providing the capability of producing a needed defence system free from the meddling of a foreign government which may have the ability to manipulate the behavior of one of its domestic corporations regarding the needed system. Obviously a nation would not consider purchasing its weapons from its arch rival or most likely opponent, but these types of pressures can come from neutral or allied nations. The worst case scenario is illustrated by the efforts of the United States to block French nuclear weapon development by restricting the export of critical computers by IBM, an

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[123] Hartley, *The Economics of Defence Policy*, 45-49.

[124] Cmnd 1022, 1990, *Statement on the Defence Estimates 1990* (London: Her Majesty's Stationary Office).

[125] Hartley, *The Economics of Defence Policy*, 25.

American corporation, to France in 1966. The blocking of these systems forced French development of a hydrogen bomb, and President Charles de Gaulle's envisioned *force de frappe*, to come to a "grinding halt."[126] However, this need for autonomy must be balanced with the economic reality that even a national market of medium to large size cannot alone support the expensive research and development needed for modern and complicated defence systems.[127] This is clearly the perspective of the Ministry of Defense which extols the economic virtues of improved international defense industry rationalization while retaining supply chain security and key technologies.[128]

The second reason for having a domestic defence sector is actually a condition of the first. If a nation wishes to maintain some strategic independence it must have a defence industry capable of developing and producing the most complex and advanced systems.[129] It is not enough for a nation wishing to maintain strategic independence to have a defence sector; it must have a capable one in the most modern sense. Otherwise the national defence industries simply become "metal bashers".[130] This expression refers to corporations that produce someone else's products or act as a subcontractor, providing only small or insignificant components to larger systems. This again is illustrated by the example of the French nuclear programme in the 1960's. France at the time had a domestic arms industry but it was

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[126] "America Says No," *The Economist*, 16 June, 1966, p.1229.

[127] United Kingdom Ministry of Defence, *Defence Occasional White Paper No. 5: Defence Industrial Policy*, October 2002, 15.

[128] *Occasional White Paper No.5*, 12.

[129] Moran, 97-99.

[130] Interview with Daniel Keohane, 5 November 2004, Center For European Reform, 29 Tufton Street, London, United Kingdom.

not capable of producing the most advanced systems needed to meet its national priorities and thus was subject to the leverage of a foreign government.

The third reason for maintaining strong defence industries in the United Kingdom is that Britain already has a strong defence industry that provides direct employment to 345,000 Britons. Maintaining these skilled workers is not only important to the strategic defence of the United Kingdom but to the economic well-being of the nation in general. The defence industry accounts for three percent of the UK manufacturing output and has a turnover of £15 billion per annum. This industry does not depend upon domestic demand alone; arms export contracts totaled £4.7 billion for the United Kingdom in 2000. This places Britain second to the United States globally in value of arms exports taking fully twenty-one percent of the global market share.[131] The export of weapons accounts for nearly two percent of all exports from the United Kingdom placing it eleventh globally in its proportion of arms exports to total exports.[132] The sale of these advanced systems to other nations helps to improve the profitability of British corporations. The United Kingdom's largest defence contractor, BAE Systems, drew eighty percent of its sales from outside of Britain. This is not unusual for the manufacturers of the most advanced and expensive weapons. Even the United States, with its massive internal defence market, must rely upon the foreign sales of its advanced

[131] *Occasional White Paper No.5*, 7.

[132] *World Military Expenditures and Arms Transfers 1999-2000*, U.S. Department of State Bureau of Verification and Compliance (June 2002).

weaponry to provide much needed profits to its domestic arms industry.[133]

It is clear that a sizable and sophisticated domestic industrial base is an important component of a credible defence capability for the United Kingdom. However, research has shown that it is simply not financially feasible for any individual European nation to attempt to maintain an autarkic defence industrial policy.[134] Therefore, new solutions to the relationship between nations and their defence industrial bases are needed. What must be done is to balance the risk and manage carefully the dependence on foreign purchased weaponry. The best strategy for a nation considering the procurement of weapons for national defence is to diversify outsourced products to improve efficiency while retaining some domestic production to keep foreign dependence down. The objectives of this type of 'globalized' procurement policy are numerous. The first is to maintain some national capability and keep in economically healthy by exposing it to the competitive forces of the marketplace. The second is for the government to acquire the most appropriate defence system at the best cost to taxpayers. The third is to rationalize the process of acquiring defence systems in such a way as to allow choices to be made about what risks from acquiring foreign systems are acceptable to strategic independence and what are not.[135] Membership in the EMU offers aid in a more globalized procurement strategy for the MoD by strengthening consolidation and collaboration.

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[133] Moran, 57.

[134] Terrence R. Guay, *At Arms Length: The European Union and Europe's Defence Industry* (London: Macmillan, 1998), 184-186.

[135] Moran, 57.

The potential for the United Kingdom to field capable and cost-effective defence systems would be substantially improved by membership in the euro because it would improve the health of its domestic defence industry in two ways. Each of the potential effects could be of greater or lesser significance but both offer improved efficiency for the aquisition of defence systems by the United Kingdom. First, British membership would help with further rationalization of the European defence market through the consolidation of the European defence industries. This is favorable to the United Kingdom because its large and capable defence firms are well positioned for acquisition or merger. Secondly, adoption of the euro would also assist in the efficiency of joint European military projects which would offer substantial efficiencies in the market and improved defence systems. United Kingdom defence industries stand well positioned to lead and profit from these joint international projects.

C. THE EURO AND DEFENCE MARKET CONSOLIDATION

The United Kingdom has one major and numerous minor corporations which contribute to its defence industrial base. BAE Systems (BAE) is the largest European defence contractor and has complex interests in numerous international ventures. This includes a subsidiary in North America which has access to the lucrative United States defence market as a subcontractor. BAE will be used here as an example of how membership in the EMU could help the defence industrial base of the United Kingdom. Of the top ten defence corporations in the world, four are European based, BAE, THALES, European Aeronautic Defence and Space Company (EADS) and Finmeccanica. These Big Four collectively drew $32.9 billion in revenue from defence

contracts in 2002 with BAE the clear leader at $15 billion. While able to generate revenue, the Big Four are not profitable when considering their ability to create significant operating cash flow.[136] Of the four, only EADS has an operating cash flow above zero. [137] This creates problems for these firms to acquire debt and thus compete for major projects, make acquisitions and finance research and development. This is illustrated by the fact that opportunities for mergers and acquisitions in the European market are often snatched out from under European buyers by their more solvent American counterparts. This problem of solvency is reflected in financial markets as well, where the stocks of European defence firm consistently perform below those of their American competitors.[138]

A source of the problem of insolvency in the European defence firms is that the market suffers from overcapacity. Consolidation is needed for the defence firms of Europe to continue to survive and thrive. There have been some efforts to sort out what is known as the 'spaghetti-bowl' of defence industries in Europe through acquisitions and mergers. Despite these efforts, industrial consolidation has slowed down at the start of the 21st century. The creation of EADS in 2000 out of three major aerospace corporations from France, Germany and Spain was the last major merger in the European defence industries. Further

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[136] *Operating Cash Flow*: The cash generated from the operations of a company, generally defined as revenues less operating expenses, but calculated through a series of adjustments to net income. OCF is arguably a better measure of profits than earnings are, because a company can show positive net earnings and still not be able to pay its debts. http://www.investopedia.com/terms/o/operatingcashflow.asp July, 2004

[137] Kati Vlachos-Dengler, *Off Track? The Future of the European Defence Industry* (Santa Monica, CA: Rand, 2004), xvi-xvii.

[138] Vlachos-Dengler, 60-65.

consolidation is not likely given the current conditions in the market and the problems of solvency in major defence firms.[139] However, European defence firms are striving to rationalize the market through the final removal of the remnants of nationalization. In 2004 the Chairman of Thales, Denis Ranque, lobbied aggressively to get the French government to sell off its final thirty percent holdings in the company to foster rationalization and consolidation in the market.[140]

By entering into the EMU, the defence firms of the United Kingdom would be better positioned to merge or purchase other eurozone defence firms. For example a major firm like BAE may well be in good position to buy or merge with Finnmechanica, a small firm that is performing above normal expectations and has substantial ties with BAE already.[141] By entering the euro, British defence firms could have access to reduced risk interest rates for capital investment.[142] Currently eurozone interest rates are more than fifty percent less than that of the sterling. The greater size of the Eurobond market, twenty percent larger than the United States, would help provide capital for mergers and acquisitions as well. By being able to denominate all its assets in euros, British firms access these sources of credit more efficiently and without transaction costs. This access to greater debt could help alleviate some of the problems of solvency for a large

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[139] Vlachos-Dengler, xvi-xvii.

[140] Pierre Tran, "Thales Chief Seeks a Government Selloff," *Defence News*, 26 January, 2004.

[141] Vlachos-Dengler, 16-19.

[142] Artis, 349.

British defence firm, giving it increase ability to borrow for acquisitions.[143]

Shifting from the pound to the euro will also aid in acquisitions and mergers by making the process easier and more cost effective. This is not only because the value of the assets of British firms would be in the same currency as those they would acquire. Adopting the euro also removes losses from exchange rate fluctuation. A bid for takeover of another firm could take months to materialize from offer to acceptance. This does not include time for counter offers from other firms, such as large United States corporations. In that time the value of sterling versus the euro could fluctuate significantly. To deal with this contingency, firms must consider purchasing currency futures. Futures help to remove some losses by purchasing currency in advance at a fixed price. However, currency conversion and futures purchases have fees associated with called transaction costs. These fees come from the requirement to pay traders and firms to buy and sell currency.[144]

The British government and Bank of England endeavor to 'shadow' the euro closely to maintain exchange stability and maintain the option to enter the EMU in the near future. Despite this, there has been no requirement for them to do so since they withdrew from the European Exchange Rate Mechanism (ERM) in 1992, and so the problems

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[143] Her Majesty's Treasury, *Eighth Report on Euro Preparations*, Appendix 2 "Memorandum by the Society of British Aerospace Companies Ltd", 15 May 2000.

[144] Artis, 349. Removal of transaction costs is a major component of the argument in favor of the euro. A 1990 analysis conducted by the European Commission estimated that 0.2 percent of the total GDP of the EEC would be saved by removing transaction costs. With the GDP of the EU in 2002 at 8.5 billion euro, 0.2 percent amounts to a hypothetical savings of 17 million euro in 2002.

of transaction costs and exchange rate fluctuation persist. For example, between June 2003 and June 2004 the euro to pound exchange rate has varied by nearly eight percent in value. In attempting to make an offer on a corporation whose stock is valued in euros, this type of fluctuation could alter the real value of the purchase or cause the purchaser to hedge the offer on currency fluctuation.

These overhead costs of doing business in Europe are among the reasons that firms like BAE aggressively lobby the British government to enter the EMU.[145] In a memorandum presented as evidence to Her Majesty's Treasury Select Committee on euro preparations, the Society of British Aerospace Companies came out in favor of the euro stating:

> The introduction of the euro as a global aerospace pricing factor would undoubtedly aid European aerospace. It would reduce the use of costly hedging instruments. The damaging effect of long-term fluctuations on business plans and programme costings would be much reduced. A broader, more liquid European euro financial market could help reduce the cost of borrowing over the long term, matching Boeings ability to find 50-year bonds at reasonable cost. It should also help reduce generally the costs of working in Europe.[146]

And further,

> A strong and stable euro would constitute a powerful tool for the European aerospace industry as well as acting as a catalyst for wider changes in the structure and operation of the defence/aerospace sector. Even to nibble away at some of the dollar's power to dictate the terms of world aerospace trade would bring considerable benefit to the European aerospace and defence industries.[147]

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[145] HM Treasury, *Eighth Report on Euro Preparations*, Appendix 2.

[146] HM Treasury, *Eighth Report on Euro Preparations*, Appendix 2

[147] HM Treasury, *Eighth Report on Euro Preparations*, Appendix 2.

These statements clearly lay out the benefits the euro offers to the British defence and aerospace sectors and are as valid in 2004 as they were in 2000.

D. THE EURO AND DEFENCE MARKET COOPERATION

Membership in the euro could be a helpful step in European defence contractor consolidation. Another positive step in rationalization would be to improve the efficiency of collaborative procurement projects in Europe. Economist Keith Hartley, of the University of York, has stated that a fully rationalized European defence market could save European governments a total of €6 billion per year.[148] Achieving these savings through efficient collaborative projects within Europe is clearly a priority for the British government. The United Kingdom has a long history of supporting multinational weapon systems procurement through bodies like NATO and the Western European Armaments Group (WEAG). This trend has continued recently with the French British agreement at le Touquet in February 2003 which called for a new European defence capabilities agency. After receiving support from all member nations at the EU Summit at Thessalonica, the agency was funded, staffed and named the European Defence Agency (EDA).

The EDA will work to establish common defence requirements, supervise research and development and foster pan-European defence projects. Headed by Javiar Solana, the new EU agency is well positioned to work with the already existing European Joint Armaments Cooperation Organization, known by its French acronym OCCAR,

[148] Cited in Daniel Keohane, *Europe's New Defence Agency*, Center for European Reform Policy Brief (June 2004).

headquartered in Bonn. OCCAR is a non-European Union organization composed of British, French, German, Belgian, Dutch, Italian, Spanish and potentially Swedish representatives working to coordinate military requirements and manage joint arms projects.[149] The most significant OCCAR project to date is the European air lifter, the A400M, being built by Airbus for Britain, Germany, France, Belgium, Spain and Turkey. The British MoD, which intends to purchase twenty-five A400M, has delegated management of the program to OCCAR.[150]

Organizations like the EDA and OCCAR provide mechanisms for creating very lucrative pan-European defence contracts. Additionally, it provides a means to acquire common defence systems which are of the highest quality and are comprised of the most advanced systems. Pan-European systems take advantage of two economies of scale which diversify risk and spread the high research and development costs over a larger number of buyers. A small nation may require only fifty new combat aircraft and is not capable of researching, developing and producing a system of the most advanced and capable quality. A great deal of experimentation is required to produce those systems and is highly expensive.[151] European nations, as well as many nations globally, are then left in a quandary: whether to have second or third class systems or buy from an American firm.

British membership of the eurozone would aid access to OCCAR contracts and collaboration because of the same

[149] US Defense Acquisition website, http://www.dau.mil/pubs/pm/pmpdf99/redama.pdf September 2004.

[150] United Kingdom Ministry of Defence website, http://www.mod.uk/dpa/projects/a400m.htm September 2004.

[151] Hartley, *The Economics of Defence Policy*, 143-166.

exchange rate efficiencies that would aid in European defence firm mergers. Contracts for weapons must be drafted and estimated well in advance and the use of a common currency would make the bids free from currency instability. This is especially true when considering the long time horizon, typically thirty years, when considering a major defence programme.[152] These price stabilities would be beneficial to both the British MoD and British defence firms. The MoD could project future expenditure better if it could remove exchange rate instability from project costs. Defence firms would benefit by being able to provide the most competitive bids possible without exchange fluctuation or transaction costs.

An increased number of collaborative acquisition projects would be particularly favorable to the British defence industrial base. This is true because as the largest and most capable defence sector in Europe it stands positioned to play a lead role in collaborative projects. BAE Systems, as an example, it is particularly well suited to be the leader in a stronger and leaner European defence market. BAE has defence systems as its primary focus. It develops and produces electronic and avionic systems and in recent years has transformed itself into a leader in systems integration. Systems integration is a defence field of increasing importance. Systems integration is critical to interoperability across services and nationalities. Systems integration is also important for managing major projects conducted across national lines because of the physical distribution of design and build teams.[153] By contrast, the next largest defence contractor

[152] Hartley, *The Economics of Defence Policy*, 28-40.

[153] Vlachos-Dengler, 13. As an example of its leadership and skill

in Europe, EADS, does not draw as much revenue from the defence sector as it is the prime owner of Airbus and does not have a specialization in systems integration.[154] Participation in more pan-European collaborative acquisition projects would also have a cascading effect on improved spending of MoD budget resources. Systems which are procured commonly in Europe, especially the most complex and expensive, can be pooled in common support and supply bases, a topic which will be addressed next.

E. MINISTRY OF DEFENCE SPENDING IN THE EURO ZONE

British membership in the EMU offers numerous advantages of which the United Kingdom's MoD could take advantage to provide more capable and cost effective military forces. As has already been explained, British conversion to the euro would help to further rationalize the European defence industries and strengthen an already strong defence sector in the United Kingdom. This would provide the MoD with more efficient spending due to improved competition. Large collaborative projects would provide the MoD with lower project costs because research and development costs could be spread over quantitatively larger equipment purchases.[155]

Defence economists state that increased defence industry rationalization does not necessarily produce a

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in systems integration, BAE is currently managing the extremely complex construction of the United Kingdom's new Type-45 Destroyers. Conventional ship-building is done from the keel up in a single location. However, the Type-45's are being assembled in structural blocks at different locations to reduce cost and distribute work to the ship building firm of Vosper-Thornycroft. This requires extensive coordination and systems integration which BAE is managing. In, Richard Scott, "Taking Shape: A raft of major new construction programmes is under way for the UK Royal Navy," *Jane's Defence Weekly*, Vol. 40, Iss. 10, 10 September 2003, 63-65.

[154] Vlachos-Dengler, 21-33.

[155] Hartley, *The Economics of Defence Policy*, 143-166.

more cost effective product for taxpayers. This is based on the argument that defence is a 'public good' and not exposed to true market forces as is a regular consumer product. Therefore it is impossible to measure what is efficient and most cost effective.[156] This view is certainly persuasive and it is as applicable to a small market as a large one. Therefore, the small and shrinking internal market that British defence contractors now have is just as inefficient and unable to be measured as a larger one. It is certain that a larger market will be able to distribute research and development costs over a larger production run which the smaller market cannot.[157] In the case of the United Kingdom, much of the research and development funding is covered by the government in advance as opposed to it being figured into the final unit price as is done in the United States.

Rationalization of defense industries in the United Kingdom and Europe as a whole are one way to provide the MoD better and more cost effective defense capabilities. There are two additional ways which the MoD spends money where the use of the euro would mark an improvement over the pound. A switch to the euro would make MoD spending more efficient by removing the problems of exchange rate variability and transaction cost from procurement and maintenance of equipment. These benefits are distinct from and additional to the positive effects the euro could have for cooperation in and consolidation of the European defense industrial base. Furthermore, MoD money spent

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[156] Hartley, *The Economics of Defence Policy*, 30.

[157] Michael Quinlan, *European Defense Cooperation: Asset or Threat to NATO?* (Washington D.C.: Woodrow Wilson Press) 2001, 11.

within the euro area to provision garrisoned troops would no longer be a drain upon the British economy.

When making purchases of European manufactured equipment, the use of the euro would remove any currency exchange rate losses due to fluctuation. Currently MoD contracts for equipment purchases may be drafted in either euros or pounds. The MoD reserves the right to price pounds as the purchasing currency in order to minimize exposure to foreign exchange risk.[158] This system, which does give the MoD some more leverage to keep from losing out in currency exchange fluctuation, is still disadvantageous for two reasons. First, it represents a drag on the MoD bureaucracy to have to constantly participate in the currency speculation market. A staff of personnel would have to deal with the prospects of currency variation when considering a contract for weapons or equipment purchased from the eurozone. Over the course of a long procurement of complex systems which can take years from contract to delivery, the price due to exchange instability could fluctuate significantly. Secondly, by deferring contracts to pounds with the option to pay in euros, suppliers are forced to hedge against loss. Therefore, they will likely quote a higher price to prevent loss due to exchange rate fluctuation. This prevents the MoD from getting the most advantageous price from a eurozone supplier. The gains offered in this area are currently modest due to the fact that by law only ten percent of all MoD contracts go to firms outside the United

[158] Ministry of Defence, *Guidelines for Industry: 14 Single European Currency – Preparation for Economic and Monetary Union (EMU) – Introduction of the Euro.* http://www.ams.mod.uk/arms/content/docs/toolkit/ams/policy/gfi/sect14.html October, 2003.

Kingdom.[159] Still the removal of this complexity has benefits in other procurement arenas which are more speculative.

British euro membership could improve competition in the defense marketplace throughout Europe and aid in its further rationalization. One of the areas which euro membership offers benefits is in aiding improved cooperation in defence procurement. As has already been shown the increased cost and complexity of modern defense systems makes the need for the distribution of research and development over a large number of buyers essential. Common procurement through collaborative projects such as Eurofighter, A400M, METEOR air-to-air missile and perhaps even CVF has the additional benefit of creating near identical equipment across national boundaries. The North Atlantic Treaty Organization (NATO) has long struggled to foster equipment standardization to aid in collective defense efforts.[160] Common procurement has another benefit for complex systems by enabling them to be pooled for maintenance and support. Sir Timothy Garden, a retired British Air Marshall, has championed the objective of pooling shared defense assets to generate economies of scale in maintenance and training.

Pooling of assets does not require shared access to equipment collectively owned by multiple nations, as in the NATO Airborne Warning and Control System (AWACS). Instead it simply would provide for a consolidation of bases which support the most complex, usually aerospace, platforms. As an example, numerous European militaries currently use the

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[159] Cmnd 1022, 1990, *Statement on the Defence Estimates 1990* (London: Her Majesties Stationary Office).

[160] Hartley, *NATO Arms Cooperation*, 3-19.

C-130 Hercules, F-16 Falcon and Tornado aircraft. Each nation maintains separate bases for the complex maintenance and repair of these aircraft. Presently, each nation requires a separate contract with the builder for parts and technical support as well as for the training of personnel in each nation's respective armed forces. As the Eurofighter Typhoon and A400M come into use, it is obvious that this pooling of defense assets offers improved efficiencies while maintaining control over sovereign military assets.[161]

The pooling of shared defence resources is fraught with domestic concerns. Clearly, domestic politics will play a role since domestic economic interests will not wish to see their local military bases closed, for obvious reasons. With the large numbers of common assets and numerous nations involved, it stands to reason that consolidation of European airbases could occur to reflect pooled assets. This would likely mean the closing and consolidation of bases in the United Kingdom. However, austerity measures such as base closures are a reality. This is evidenced by the 2004 announcement of force downsizing in Great Britain. Force size will be reduced by twenty-thousand personnel, one dozen ships, three aircraft squadrons and at least one Royal Air Force base.[162] Therefore, with difficult defence decisions being made, the United Kingdom must consider pooling resources for savings.

A pan-European asset pooling effort would bring significant savings to the MoD and could be significantly improved by the adoption of the euro in the United Kingdom.

[161] Alexander and Garden, 564-569.

[162] International Security News Watch, http://www.isn.ethz.ch/infoservice/secwatch/index.cfm?service=cwn&parent=detail&menu=2&sNewsID=9277 July 2004.

Pooling of defense assets would create two beneficial effects that the adoption of the euro use would facilitate. First, common contracts would have to be drafted to pay for support and training. This would require the mingling of some defense monies into a common pot. By removing exchange rate instability from the equation, MoD expenditure could be stabilized and projected with clarity. Secondly, any reorganization of airbases in Europe would likely result in a negotiated settlement which would place more British personnel in eurozone countries. Membership in the euro could have a positive effect on the cost to the British economy of maintaining troops in continental Europe. The prospect of not harming the British economy by having troops stationed outside of the United Kingdom extends beyond the hypothetical of pooled resources to other troops already based in the eurozone.

Currently, the United Kingdom maintains over twenty-thousand troops in Germany. These soldiers, mostly of the UK 1st Armoured Division, compose the bulk of British mechanized and armoured land forces. These troops are forward positioned partly as a legacy of the Cold War when they were part of the British Army of the Rhine but also to provide the land mobile forces to the defence of Europe and the Atlantic Alliance. [163] Paying for the garrisoning of troops in Germany has been a problem historically as mentioned in Chapter II. Between the 1950's and 1970's the British government struggled to pay for the support of its troops in Europe. This was not because the MoD of government could not pay for such a large military; rather it was because the stationing of troops represented a direct loss from the British economy. Troops stationed in

[163] http://www.army.mod.uk/aroundtheworld/ger/index.htm July 2004.

Germany were paid in pounds which they then converted to deutschmarks to provision food, housing and whatever else soldiers purchased. Economically, it was like hundreds of thousands of British tourists on paid holiday to Germany. The provisioning of supplies, food, fuel and sundries by the British MoD also took money away from the British Treasury and put it into the German economy. It became such a drain on the United Kingdom that Germany had to pay money to keep British troops occupying and protecting their country.[164]

All of this occurred during the Bretton Woods monetary system when the movement of currency actually meant the movement of real wealth, in the form of gold or US dollars, from nation to nation. With the collapse of Bretton Woods in 1973, the stationing of troops became less of a problem for the United Kingdom's Treasury, but troops and their families stationed in the eurozone still take money directly out of the treasury and put it into 'foreign' economies as opposed to their own. This is also the case where United Kingdom forces are deployed to areas where the euro is the *de facto* currency. This is the case in Bosnia where three-thousand British soldiers are currently stationed. Membership in the euro would make the payment, provisioning and support of these soldiers contribute to the British economy in a way that they do not now. As a member in the EMU, British troops garrisoned in Europe would spend their money in the closed system of the EMU. This would contribute to the overall health of the eurozone. While this is still not as favorable as if the money went back into Britain, it is at least a neutral effect. Under the current regime with Britain outside the

[164] Zimmerman, 11-31.

euro, money spent in the eurozone is a direct drain on the pound and contribute to the British balance of payments deficit.

F. CONCLUSION

The benefits of the euro over the pound are numerous when considering the potential effects upon the ability of Britain to field credible defence forces. The positive points include immediate savings when procuring equipment from the eurozone countries and housing, paying and provisioning troops garrisoned there. The effects euro membership would have upon the British defence industry are more long-term in nature. In all, they present benefits to the domestic defence industry and potential savings to the Ministry of Defence in procuring equipment from a more rationalized and competitive European defence market. The cost savings offered by pooling resources are a more long term but also beneficial savings in the face of much constrained defence budgets.

Two additional factors make euro membership and a more consolidated European defence industry attractive to the United Kingdom. The first is the movement in the United States towards a 'Buy America' posture in defence procurement. The second is the successful eastward expansion of the EU. The first factor highlights the need for British defence contractors to diversify their markets in the face of possible increased American protectionism. The second further illustrates the lucrative nature of the future European market. Although ten new accession states in the east[165] are not in the EMU, in all likelihood they

[165] The ten states which joined the EU in 2004 are Estonia, Latvia, Lithuania, Poland, the Czech Republic, Slovakia, Slovenia, Hungary, Greek Cyprus and Malta.

will join in the near future. Most of these nations need to modernize the militaries they inherited from prior membership in the Warsaw Treaty Organization. Given the recent accession of eight of them[166] to NATO as well, it will be of even greater importance for their militaries to integrate with the western alliance states. The same is true for new NATO states such as Romania and Bulgaria which both hope to join the EU in the near future.

[166] Estonia, Latvia, Lithuania, Poland, The Check Republic, Slovakia, Slovenia and Hungary have all joined NATO.

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IV. THE NATIONALISM OF DEFENCE AND CURRENCY SINCE 1973

As much as comparing British monetary and defence policies before 1973 illustrates rational ends-means integration, the juxtaposition of British priorities in monetary and defence policies since 1973 illustrates a paradox. The formal end of the Bretton Woods system severed the two issues of monetary policy and defence policy in a way they had not been for over one hundred years. With the advent of the free floating currency system, the British were unable to use military power and policy to protect the international strength of sterling. The power of sterling would be based upon its value as judged by the international currency marketplace. Either investors had confidence in the value of British money and economy, or they did not.

In 1980, John van Wingen and Herbert Tillema observed that British military interventions after World War Two ceased in 1970. These two authors subtly link this reality to entrance into the EEC, therefore intimating a shift in strategic priorities.[167] Indeed, EEC membership did indicate a shift in British focus, but the implication that somehow EEC membership 'tamed' Britain is false. EEC membership, which Britain had sought since 1962, was the product of a British move towards the EEC focus on manufacturing strength as opposed to international currency strength.[168] As was shown in Chapter II, the latter had been the touchstone of British foreign and defence policy for over one hundred years. Monetary strength was still an

[167] Van Wingen and Tillema, 293.

[168] Middleton, 126-131 and Cain and Hopkins, 291-292.

important objective in 1966, although the British pursued this objective by different means after 1956.[169] The collapse of Bretton Woods, which had begun in 1971, confirmed the wisdom of Britain's rejection of the pursuit of strong money.

The paradox is that Britain has, at several points since 1973, acted much as it had before the end of Bretton Woods. When they wrote their article in 1980, van Wingen and Tillema were correct that Britain had not intervened militarily since 1970 but that pattern did not hold. In 1982, Britain retook the Falkland Islands by force from the Argentines. In 1991, Britain was the second largest non-Middle Eastern troop contributor to force Iraq to withdraw from Kuwait.[170] In 2003, Britain again made the second largest troop contribution to the American led military intervention in Iraq. Regarding currency, Britain has remained aloof from stage three of the European Unions Economic and Monetary Union (EMU), the implementation of a common European currency. Particularly from 1979 to 1990, Prime Minister Margaret Thatcher, was utterly belligerent towards the single currency.[171] This opposition did continue somewhat under Prime Minister John Major, from 1990 to 1997.[172] From 1997 to present, Prime Minister Tony

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[169] See Chapter II.

[170] Only two nations contributed more troops, the United States (540,000) which lead the operation and Saudi Arabia (118,000) from whose soil the invasion was launched. For its part Britain contributed 43,000 troops. http://www.desert-storm.com/War/nations.html September 2004.

[171] Prime Minister Thatcher's vehement objections to the single currency are renowned for their intensity and occasional lack of decorum. This is seen clearly in Hugo Young, *This Blessed Plot: Britain and Europe from Churchill to Blair* (Woodstock, New York: The Overlook Press, 1998), 306-375 and in Paul Sharp, *Thatcher's Diplomacy: The Revival of British Foreign Policy* (London: Macmillan, 1997), 141-183.

[172] Young, 412-472.

Blair, despite overtly supporting British membership in the euro, has not succeeded in bringing Britain into the EMU.

This chapter does not intend to suggest that a present day relationship exists between British defence policy and monetary policy. Quite the opposite is the case. Additionally, the British have not displayed a penchant to continue to act as if a connection remains. The British are aware that the relationship between defence and money in their country has only a fiscal dynamic. This fact illustrates the paradox even more clearly. As has already been shown in Chapter III, the euro offers some advantages to contemporary British defence. What this chapter seeks to illustrate is that since its final curtain call on the world stage, 1970 to 1973, the United Kingdom has sought at times to reassert itself as an independent power in global affairs. In doing so, British political elite have been partly motivated by, and have tapped into, British military and economic nationalism. The reasons for these reassertions are manifold and this chapter does not intend to consider all the reasons for action. Indeed, the era from 1973 to 2002 has seen significant contextual changes in both security and economic realms.

In the Cold War, the détente of the early 1970's gave way to the tensions of the 1980's and its eventual end in 1991. The peaceful collapse of the Soviet Union brought other security concerns to the fore, such as rogue and failed states and terrorism.[173] NATO too has changed, from the bulwark against Communist aggression in Europe to a force capable of intervening and stabilizing regions outside the territories of its members.[174] In the same way,

[173] Keylor, 317-340, 382-397 and 451-467.

[174] NATO has provided forces and command organization for the

changing economic conditions are important to the context of British actions. The 1970's oil shocks had significant effect on the global economy and despite its internal oil resources; Britain was a victim of the stagflation of the 1970's.[175] Domestic economic policy reform had significant effect on British attitudes towards the EMU in the 1980's and early 1990's. Tony Blair's Labour party has shifted attitudes on British membership.[176] However, economic realities such as interest rate convergence, an inflexible labor market and mortgage rates remain.

All of these reasons are rational components of contemporary British attitudes towards defence and monetary policies. These rational motivations have been important to shaping the behavior of Britain in the post-Bretton Woods world. This chapter will illustrate that the incentives remain for British politicians to fall back onto nationalist behavior and the population willingly follows.[177] Additionally it will examine when this behavior occurs and the particular form that contemporary British nationalism takes. British nationalism since 1973 has revolved around the issues of defence and currency. This nationalism varies in intensity between overt declarations of sovereignty and policy decisions to subtle percolation through the back-benches of Parliament. Contemporary British nationalism is not the property of one party or the other although the Tory Party is responsible for its most

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stabilization of failed states 'out of area' such as Bosnia-Herzegovina, Kosovo and Afghanistan.

[175] Keylor, 346-347.

[176] Richard Heffernan, "Beyond Euro-scepticism: Exploring the Europeanisation of the Labour Party since 1983," in *The Political Quarterly* Vol. 72, Iss. 2, (April 2001), 180-189.

[177] Young, 506 and Milward, 433 and 435.

overt resurgence. It can be found in the Labour party as well, and importantly, cutting through the entire polity. When playing nationalistic politics in Britain, defence and currency are the two issues which are most easily exploited to achieve a desired political effect. Defence and monetary policy therefore continue to remain linked in the British political psyche as critical issues of sovereignty and national identity.

A. BRITISH DEFENCE NATIONALISM SINCE 1973

One of the most striking factors concerning British foreign and defence policies in the 1970's is that they had strikingly little global importance. Richard Crossman, while serving as Foreign Minister under Edward Heath, commented that British foreign policy in the period was, "all fish and Rhodesia" referring to disputes with Iceland over fishing and Ian Smith's rebellion in the former colony of Rhodesia.[178] Certainly, British foreign and defence policy was not so irrelevant, but the sense of powerlessness and insignificance is well illustrated. Accession to the EEC and the advent of floating currencies resulted in the loss of monetary policy as the root objective of foreign and defence policy. Britain had a difficult time adjusting to the new realities of being a middle-power, in the EEC and located on a small island off the coast of Europe. The 1974 return of Edward Heath as Prime Minister led to no significant changes from previous policies despite aggressive claims while he was in opposition. British defence and foreign policy was adrift without the lodestar of sterling to guide its interests.[179]

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[178] Quoted in Sharp, 14-15.

[179] Sharp, 14-21.

Observers tell us that British foreign and defence policy was reborn under the leadership of Prime Minister Thatcher from 1979 to 1990.[180] Thatcher is not as well known for her foreign policy as she is for her assertive domestic policies. She sought to make Britain competitive internationally by renewing industry and shrinking the social welfare state that had developed in Britain, based upon the post World War Two politics of consensus.[181] Paul Sharp, in his book *Thatcher's Diplomacy*, asserts that Thatcher's contribution to foreign policy was to give Britain a role it had lacked since 1970, the reassertion of an independent foreign policy.[182] Thatcher's defence policies did indeed represent a return to independence, but a desire to play a role and influence international events simply for the sake of doing so in the absence of hard interests is a difficult objective. The use of nationalism to galvanize the population and assure her standing in the eyes of the voters despite her devastating domestic economic policies provided added definition to Thatcher's motivation. This was captured in the attribution of her political recovery after 1981 to the 'Falklands Factor.'[183]

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[180] Paul Sharp in, *Thatcher's Diplomacy: The Revival of British Foreign Policy,* strongly supports Thatcher's foreign policies. He feels it was a reassertion that Britain needed to find a role as a middle power, capable of playing a role. His primary highlight throughout his book is on the concept of 'independence' and that Thatcher's primary success was achieving 'independence' for Britain in the port Imperial world.

[181] For a detailed study of Thatcher's domestic politics see Peter Jenkins, *Mrs. Thatcher's Revolution: The Ending of the Socialist Era*, (Cambridge: Harvard University Press, 1988). In fact in another book by Peter Riddell, *The Thatcher Government* (Oxford: Martin Robertson, 1983), published four years into her government, that purports to cover all components of her policies, only one of ten chapters (the last) and 23 of nearly 250 pages deals with foreign policy or defence.

[182] Sharp, xxvi.

[183] Thatcher herself has highlighted the 'Falklands Factor' as being a significant contribution to her domestic popularity and political

When Argentina invaded the Falkland Islands in April 1982 it seemed possible, especially to Argentina, that Britain would accept the situation as a *fait accompli*.[184] Most colonial powers had shown little desire to fight the retaking of colonial outposts.[185] Britain in particular had signaled a general lack of interest in the Falklands during the 1981 'leaseback' negotiations with Argentina and announced reduction in the Royal Navy's forces and presence in the area.[186] However, Britain rejected the takeover and instead chose to go to war over a few small islands, 8,000 miles away, occupied by 1,800 people and of no economic or strategic value. This was a remarkable act of national will to risk lives and treasure for such a small, insignificant objective. This was emphasized by the fact that the Thatcher government was aggressively pursuing austerity measures which cut social welfare and defence spending and was lobbying the EEC for a rebate of funds contributed.[187] To put the war in perspective, historian Donald Cameron Watt called the Falklands, "…one of the most

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success against the Labour party in Margaret Thatcher, *The Downing Street Years* (New York: Harper Collins Publishers, 1993), 264.

[184] Lawrence Freedman and Virginia Gamba-Stonehouse, *Signals of War: The Falklands Conflict of 1982* (Princeton: Princeton University Press, 1991), 78-79 and Michael Clarke, "Foreign Policy Analysis: A Theoretical Guide" in *Domestic Sources of Foreign Policy: Western European Reactions to the Falklands Conflict* ed. Stelios Stavridis and Christopher Hill (Oxford: Berg, 1996), 35.

[185] In the 1960's Portugal had acquiesced to the Indian seizure of Goa, Diu and Daman and the under pressure from a militant insurgent movement, the Netherlands had allowed the UN to supervise the transfer of West Irian to Indonesia.

[186] Sharp, 57-59.

[187] Thatcher's austerity policies can be found in Jenkins, Young and Sharp. An astonishing insight into Thatcher's willingness to risk her rigorous fiscal objectives could be seen on 10 April 1982, before combat operations had begun. Thatcher said that the operation to retake the islands had to go ahead, '…because the reputation of Britain is at stake' and consequently, '…we cannot look at it on the basis of precisely how much it will cost'. Quoted in Sharp, 67.

incongruous and unnecessary international disputes which has ever broken out between states."[188]

Thatcher's motivation for a military response to Argentina's aggression was in part due to the issue of domestic political stability. Thatcher's domestic policies were wreaking havoc in the British population and cuts in social welfare and high unemployment made her government particularly unpopular. In 1983, her party was to face a by-election which would act as a *de facto* referendum on her policies. The national embarrassment of losing the Falklands would have doomed her to defeat.[189] Instead she chose a belligerent path and, in doing so, couched her policy in the most rousing nationalistic terms. She did so knowing that she had broad support in the population for a military adventure. Additionally, she was presented with feasible military plans from her service chiefs, particularly Sir Henry Leach, the First Sea Lord, who had his own inter-service rivalry objective for suggesting the naval task force which would eventually recover the Falklands.[190] The dispatch of Task Force 317 was greeted by broad support in the public and in the Parliament.[191] Even Michael Foot, leader of the opposition Labour Party and a long-time pacifist, had called for, "deeds not words" on the Falklands.[192]

Thatcher's efforts to recover the Falklands had the desired effect. "Great Britain is great again," was the claim Thatcher made to a crowd outside Number 10 Downing

[188] Quoted in Sharp, 65.

[189] Sharp, 65-66.

[190] Hew Strachan, *The Politics of the British Army* (Oxford: Oxford University Press, 1997), 254-255.

[191] Freedman and Gamba-Stonehouse, 128-129.

[192] Quoted in Sharp, 84.

St. on 15 June.[193] The Conservative party made all it could politically of the success in the Falklands and Thatcher made a dramatic recovery in public opinion polls. This success was despite the fact that domestic economic conditions had not improved and there were threats of a coal miner's strike. Miners had torn Britain apart politically before, and Thatcher's policies towards them would become a hallmark of her domestic political agenda. Despite the domestic problems, the 'Falklands Factor' helped to save her political career.[194] Thatcher had found an effective political use for the British military, channeling its efforts into nationalism. Thatcher had other reasons as well for recovering the Falklands by force, but there is no doubt that her political survival was of real concern. Rallying the nation with a war was clearly an option she was willing to take.[195]

Thatcher strengthened this approach with her consistently nationalistic rhetoric, such as her speech at Cheltenham on 3 July 1982 in which she said,

> We have ceased to be a nation in retreat. We have instead a new found confidence – born in the economic battles at home and tested and found true 8000 miles away…And so we can rejoice at our success in the Falklands and take pride in the achievements of the men and women of our Task Force. But we do so, not as at some flickering of a flame which must soon be dead. No – we rejoice that Britain has rekindled that spirit which has fired her for generations past and

[193] Quoted in *The Times* (London), 15 June 1982.

[194] Harold D. Clarke, William Mishler and Paul Whiteley, "Recapturing the Falklands: Models of Conservative Popularity," in *British Journal of Political Science* Vol. 20, No. 1 (Jan., 1990), 63-81 and Helmut Norpoth, "Guns and Butter and Government Popularity in Britain," in *The American Political Science Review*, Vol. 81, No. 3. (Sep., 1987), 949-959.

[195] George, 163.

> which today has begun to burn as brightly as before. Britain found herself again in the South Atlantic and will not look back from the victory she has won.[196]

This vehement nationalism was supported by the public and much of the press, particularly the popular British tabloids. The nationalism of the Falklands War involved the resurrection of a vision of a Victorian era Britain, of strength, pride and sovereignty. The Falklands would be identified as critical turning point for the history of Britain as Thatcher argued above.[197]

Thatcher's successes spawned a new generation of nationalist politicians in Britain, they called themselves 'Thatcher's Children' and their effect can still be seen today. This new breed of Tories would make their political careers on the coat-tails of her electoral victories and later upon a reassertion of nationalistic neo-Thatcherite policies. Strong defence was an important component to their nationalist policies. However, their nationalism would make its mark more in their assertion of Britain's independence from the euro. This was a direct legacy of Thatcher's economic nationalism and it would eventually rip the Tory Party apart and drive it from power.

B. BRITISH ECONOMIC NATIONALISM SINCE 1973

Paul Sharp highlights Thatcher's stance on the EEC as another example of her policy of independence. In many

[196] Thatcher, 235.

[197] A thorough study of British nationalist sentiment in the Falklands War has been done by Kevin Foster in *Fighting Fictions: War Narrative and National Identity* (London: Pluto Press, 1999). As opposed to some writers who have stated that the British military myth of the Falklands has been constructed anew (and in contrast to the realities of the conflict), Foster asserts that the national myth of the Falklands was written before the war was even fought, the images and stories were erected from the British military's past with the intention of evoking a return to greatness for Britain as opposed to the creation of a new role.

ways, Thatcher's approach to the EEC was fraught with contradictions; she opposed most EEC policies and stoked nationalist fires against them while at the same time she oversaw the deepening of British involvement in the Community.[198] Thatcher had little use for or interest in European integration. Many EEC policies ran against her domestic economic reform objectives. She sought to cut the fetters which she felt restricted her ability to transform the British economy.[199] One of her first objectives, fulfilling a campaign promise, was to obtain a rebate from the EEC of monies paid into the EEC budget, to which Britain was a net contributor. The majority of EU funds paid out went to agricultural subsidies for the more agrarian societies in the Community such as France, Ireland and southern Italy.[200] Thatcher was eventually able to obtain a significant rebate which she touted a major victory for British sovereignty and fiscal strength.[201] The issue that incited the most impassioned plea to nationalism was the subject of EMU and a single European currency.

It has been observed that never has British policy been so driven by the particular personality of its Prime Minister as it was under Thatcher. Her deep personal skepticism towards Europe and her little-England narrow-mindedness had roots stretching back to her childhood and

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[198] Young, 306—311. This deepening included the Single European Act and the shifting of EEC voting procedures on some issues from unanimous to majority voting, a critical step away towards the un-democratic procedures in the EEC that were the source of many rows between Thatcher and the Community.

[199] Thatcher, 688-705.

[200] These EU disbursements went under the common title Common Agricultural Policy (CAP)

[201] Young, 311-325 and Sharp, 141-159.

early political experiences.[202] Thatcher viewed the surrendering of monetary control, which is implicit in accepting the EMU, as a sacrifice of sovereignty.[203] She aggressively moved to press this opinion upon the population of Britain. The most famous of her rhetorical outbursts took place in Bruges in 1988 where she openly declared opposition to any centralization of power in Brussels. Further integration, particularly EMU which was being debated at the time, should be with the focus on national independence which, "…preserves the different traditions, parliamentary powers, and a sense of national pride in one's own country."[204]

Thatcher's speech at Bruges was an initiation of a new line of nationalist policy towards European integration. She attempted at first to support her anti-integration instincts with assertions that surrendering control over monetary policy removed the ability of government to protect the value of currency. This illustrates the contradiction of her approach to EMU. The fact that the pound was subject to political influence was the single force which was the cause of its debasement. As a politician who often derided her opponents for not "getting the economics right"[205] before taking a decision, Thatcher's economics were clearly wrong on EMU. Even two of Thatcher's most senior advisors, Nigel Lawson, Chancellor of the Exchequer, and Sir Geoffrey Howe, Foreign Secretary,

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[202] Young, 307-309

[203] Thatcher, 690-691.

[204] Quoted in Sharp, 169.

[205] Sharp, 176.

felt that Britain should move diplomatically towards EMU for economic reasons.[206]

Absent a solid economic argument for why to remain out of the EMU, and its perceived precursor the European Monetary System (EMS)[207], Thatcher turned to the protection of British sovereignty as the touchstone of her policy towards EMU. Her rhetoric became even more imbued with dramatic images of British sovereignty in her speeches to the populace. In 1989, in a speech to Tories in Scotland, she said that Britain was not, "…some flimsy or recent creation…" and evoked images of Britain as a, "…great and ancient citadel…" which had protected its populace for four hundred years.[208] She told parliament prior to a critical EEC summit in Madrid which would deal with the subject of EMU that, "…to run an independent monetary, economic and fiscal policy lies at the heart of what constitutes a sovereign state."[209] This nationalistic opposition to EMU left Thatcher increasingly isolated in the EEC and in her own cabinet. Lawson and Howe would both leave their positions in Thatcher's government in 1989 after the Madrid summit. Howe was dismissed and Lawson resigned.[210] This

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[206] Sharp, 175-176.

[207] The EMS agreement had an embedded Exchange Rate Mechanism (ERM) which required member states to maintain the exchange rate parody between currencies in a narrow band. ERM was seen as a necessary step in harmonizing economies in Europe in advance of the implementation of a single currency.

[208] Quoted in Sharp, 176.

[209] Quoted in *The Times* (London), 13 May 1989.

[210] Thatcher had grown increasingly inpatient with these two members of her cabinet which she regarded with suspicion because they seemed to have formed a 'cabal' against her position on ERM and EMU. Thatcher and her personal advisors dismissed these two with great flippancy as can be seen from their own statements. In her memoirs Thatcher states, "Something had happened to Geoffrey (Howe)" intimating that his dismissal was in part caused by the fact that he may have gone slightly off his rocker, Young, 356. The issue that provoked Lawson seems to have been a comment by Thatcher's special advisor, economist Alan

aggressively nationalistic anti-Europeanism would ultimately be the pretext for her removal from the leadership of the Conservative Party.

The more moderate wing of the Tories felt her radical tendencies were too extreme and she was challenged in the 1990 Conservative leadership campaign by Michael Heseltine. Heseltine was more in favor of European integration and was backed by Lawson who derided Thatcher's European policy in his endorsement speech.[211] She would resign in the face of Heseltine's palpable challenge. In a final effort to ensure the future direction of the party Thatcher successfully endorsed John Major, whom she felt was closer to her politically than Heseltine.[212] Thatcher was deposed by a movement within her own party, but she had not lost the support of the populace. Her successes in general elections are testament to her popularity in Britain. Her public image as staunchly defending Britain was vital to this broad support, especially given the unpopularity of her domestic policies.[213] Thatcher was gone, but the philosophy of Bruges had embedded itself in the electorate and the Conservative party. It is an irony that new Conservative Members of Parliament (MP), often called 'Thatcher's Children', started to come to power just as Thatcher herself was undone.[214]

Walters, who called the ERM, and implicitly those who supported it like Lawson 'half-baked', Sharp, 177.

[211] Thatcher, 839.

[212] Thatcher, 860-861.

[213] Thatcher entered government in 1979 at the head what was considered and unassailable Conservative majority in the House of Commons, 43 seats. In 1983 that majority was expanded to 144 seats and in 1987 the majority was still 102 seats. United Kingdom election data is from www.election.demon.co.uk/strengths.html September 2004.

[214] Young, 383-388.

Thatcher's indelible mark on the Conservative party was to empower its deeply Euro-skeptic wing. Allied with older nationalist politicians in the Tory Party, such as William Cash and John Biffen, these younger MP's had a decisive impact upon the actions and the eventual collapse of John Major's government. The deep divide in the Tory party, between those opposed to the single currency and those in favor of it, became a central issue for Major in 1992.[215] In an attempt to hold the party together Major obtained an exemption for Britain from automatic membership in the EMU. This 'opt-out' clause in the 1992 Maastricht was aggressively campaigned for by the neo-Thatcherites. They consistently resorted to Thatcher's extreme form of nationalism to appeal to the British population and challenge Major's leadership. One of the lasting legacies of these 'bastards', as Major referred to them, was the issue of national referendum on membership in EMU.[216]

The nationalist half of the Conservative party succeeded in destroying party unity over the issue of EMU and dragging John Major down with it. More importantly for

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[215] Young, 388.

[216] In July 1993, John Major conducted a taped interview with ITN's political editor Michael Brunson. After the formal interview concluded, the tape continued to record, unbeknownst to Major. Major bemoaned to Brunson the problem he faced in the euro-skeptic members of his government (Michael Howard, Peter Lilley and Michael Portillo), "Mr Major: 'Just think it through from my perspective. You are the prime minister, with a majority of 18, a party that is still harking back to a golden age that never was, and is now invented (clearly a reference to the time of Mrs. Thatcher's leadership). You have three rightwing members of the Cabinet who actually resign. What happens in the parliamentary party?'" Major explained that this problem is compounded by the fact that he cannot dismiss these Ministers. This was because they would become a greater force for disunion outside of his cabinet. "We don't want another three more of the bastards out there." This story was broken by BBC and further fueled the euro-skeptic divide in Major's government. Quoted from Paul Routledge and Simon Hoggart "Major hits out at cabinet," *The Guardian*, 25 July 1993, http://politics.guardian.co.uk/news/story/0,9174,534415,00.html September 2004.

their objectives, they succeeded in embedding the concept of a national referendum on EMU in the expectations of the population. Given Britain's democratic traditions and the fact that initial membership in the EEC went to a referendum in 1975, it might seem that EMU would naturally require a national vote. Actually, no European treaty since initial accession in 1975 had. The issue of the referendum on EMU was a product of the Tory nationalist and Euro-skeptic wing. This powerful party faction in Major's government demanded, during the 1992 debate on the Maastricht Treaty, that a referendum be held if Britain were ever to enter the EMU.[217] As Hugo Young puts it,

> An issue thus was born, Yes or No to a referendum, which was to invade Tory politics for the duration, the litmus-test of his honour, his nationalism, his respect for party – his whatever – that Major kept facing for the next five years.[218]

Major would, with much resistance from his cabinet, acquiesce to these calls for a referendum.[219] In order to maintain their populist credentials, Tony Blair and Labour Party, despite being overtly in favor of the euro, declared they too would hold a referendum on EMU.[220]

C. CONCLUSION

This chapter has helped to illustrate that defence and currency are powerful symbols of national identity in British society. It is not surprising that defence maintains such a place and the myth of war is a common tool in the hands of politicians who would use it. The

[217] Young, 428-430.

[218] Young, 428-429.

[219] Young, 464-465.

[220] Young, 486-487.

Falklands War is an example of how symbols of British greatness and national identity were resurrected in the 1980's. The domestic battle over membership in the single currency illustrates what a similar sense of nationalism revolves around the pound sterling. Retaining an independent currency may lack solid economic objectives at times, as it did for Thatcher, but it never lacked the ability to evoke nationalist support from the population.

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V. CONCLUSION

A. THE PARADOXES OF BRITISH NATIONALISM

The first paradox of British policies on defence and the EMU should be clear by now. The EMU offers Britain real savings on an already shrinking defence budget. However, the Tory party, which paints itself as the party of nation, sovereignty, strong defence, NATO and solidarity with the United States,[221] is unable to seize the issue of EMU. The Tories have elevated defence and currency as two symbols of the nation, neither of which can be surrendered without undermining the other. As has been shown, at one point in British history, the linkage of defence and currency was a reality. The two maintained a symbiotic relationship for one hundred years. Now they remain linked by the fact that they both reemerge in nationalist rhetoric.

The Conservative party is presently trapped in opposition, only able to shout down Blair's policies and keep the flame of nationalism alive.[222] The hope of the extreme nationalists in the Tory Party hope is that, in a perverse resurrection of Guy Fawkes,[223] they can use that

[221] Interview with Sir Timothy Garden, 4 November 2003.

[222] The speeches of Michael Portillo, the shadow Chancellor of the Exchequer for the Conservative Party are a good example of this. His objections to Blair's policies on the EMU are primarily nationalistic in tone. He constantly highlights his assertion that EMU is the first step to subordinating national sovereignty to European political union in some sort of federal state. Economic arguments take second place in his speeches against Blair.

[223] Guy Fawkes led a conspiracy to blow up the Houses of Parliament on 5 November 1605 when the King was to address the House of Lords. His motivation was to kill the Protestant King and restore a Catholic monarch to Britain. Comparing the Conservative party to Guy Fawkes is with tongue firmly in cheek as Fawkes has been vilified in nationalist sentiment ever since and November 5th is celebrated in Britain as a type of independence day from popery and Continental conspiracy.

flame to ignite the referendum powder-keg that Blair has had to rest his EMU policy upon. If the Tories can stimulate enough nationalist sentiment to kill EMU in a referendum they will have achieved their anti-Europe goals. The paradox is that at the same time they will have undermined an effort which could bring Britain more effective and capable armed forces. If the Tories were able to seize upon EMU as a way to strengthen national defence they may be able to lead Britain into the EMU without surrendering any national military independence.

The second paradox for Britain and the EMU faces the Labour Party and their leader Prime Minister Tony Blair. Blair openly supports British entry into the EMU when economic conditions are right. However, Blair is held captive to the vacillation of public opinion which must be secured for the referendum to pass.[224] On the issue of monetary sovereignty, that opinion can be easily manipulated by nationalist forces which can resurrect the ghost of Margaret Thatcher as needed. Therefore, Blair treads gingerly around the subject of EMU and is careful to present a very clear and careful case on the subject.[225] Blair and his Chancellor of the Exchequer, Gordon Brown, have established five very clear tests to judge whether the euro is good for Britain. These tests exist not just to make a careful assessment of the EMU but to assure the public that EMU is the absolute best choice. In 2003, the Blair government announced its first assessment on the five tests. The report found that two of the five tests had been met. However, it reported that the economy of Britain still lacks appropriate convergence with the eurozone, the

[224] Interview with Sir Timothy Garden, 4 November 2003.

[225] Young, 492-495.

labor market is not flexible enough and that EMU does not, because of the failure of the flexibility and convergence tests, offer assured stability in growth and employment.[226]

The paradox arises for Blair in that his validity as a protector of British sovereignty competes with his credentials as 'pro-Europe' with other European leaders.[227] In order to bridge the gap between his stated objective of membership in the EMU and his ability to make it happen he has had to give ground where he can. Defence emerged as a policy area where he could show that he was in fact dedicated to the European project. The British have sternly rejected many efforts to build the defence pillar of Europe. Anthony Eden had opposed the European Defence Community and his lack of support for it meant its undoing.[228] The British have stayed aloof any European defence organization projects which exist outside the NATO

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[226] Her Majesty's Treasury, *UK Membership of the Single Currency: An Assessment of the Five Economic Tests* (CM 5776). The five tests established by Her Majesties Treasury to assess the viability of euro membership are: 1. Are business cycles and economic structures compatible so that we and others could live comfortably with euro interest rates on a permanent basis? 2. If problems emerge is their sufficient flexibility to deal with them? 3. Would joining EMU create better conditions for firms making long-term decisions to invest in Britain? 4. What impact would entry into EMU have on the competitive position of the UK's financial services industry, particularly the City's wholesale markets? 5. In summary, will joining EMU promote higher growth, stability and a lasting increase in jobs? The report is an interesting statement on the lack of importance of the pound as an international currency and the transformation of the City of London into an international finance service center. The report found that the euro is actually better for the City that the pound. This is profound in consideration of the fact that the City had always demanded a strong pound as necessary to its investment interests.

[227] Shortly after coming to power (October 1998) and despite his optimism on EMU, Blair was snubbed by France as not being in a position to be one of the 'big three' leaders in Europe because they had not decided to enter the EMU in time to participate in the initial implementation of the euro http://news.bbc.co.uk/2/hi/uk_news/187271.stm September 2004

[228] Milward, 386-387 and George, 23-26.

construct.[229] Tony Blair however, in order to show his 'Europeaness' to his continental counterparts initiated a revival of the Common Foreign and Security Policy (CFSP).[230]

The joint Anglo-Franco declaration at Saint-Malo was a major shift of British policy. Articles one and two of the declaration state,

> 1. The European Union needs to be in a position to play its full role on the international stage. This means making a reality of the Treaty of Amsterdam, which will provide the essential basis for action by the Union. It will be important to achieve full and rapid implementation of the Amsterdam provisions on CFSP. This includes the responsibility of the European Council to decide on the progressive framing of a common defence policy in the framework of CFSP. The Council must be able to take decisions on an intergovernmental basis, covering the whole range of activity set out in Title V of the Treaty of European Union.
> 2. To this end, the Union must have the capacity for autonomous action, backed up by credible military forces, the means to decide to use them and a readiness to do so, in order to respond to international crises.[231]

The declaration does go on to reaffirm the importance of NATO, but this was a notable shift from historical British policy. Blair was partially motivated at Saint-Malo by the Kosovo crisis and Europe's inability to act

[229] The studies on this behavior are extensive and most attribute this British foreign and defence policy stance to the objective of keeping the Americans involved in European security matters. NATO is the primary mechanism whereby this objective is accomplished; therefore no structures which marginalize NATO are accepted. See H.C. Allen, *The Anglo-American Predicament: The British Commonwealth, The United States and European Unity* (New York: St. Martin's Press, 1960), George, 30.

[230] http://www.eupolicynetwork.org.uk/research/dover2.pdf September 2004 and interviews with Sir Timothy Garden, 4 November 2003 and Alexander Nicoll, 5 November 2004.

[231] Franco-British Summit Joint Declaration on European Defence, Saint-Malo, France, 4 December 1998, http://www.atlanticcommunity.org/Saint-Malo%20Declaration%20Text.html September 2004.

alone to prevent crisis and genocide on its own soil.[232] This explanation lacks complete explanatory power because the Balkans had been rocked by genocide and European paralysis, save the galvanizing force of NATO, for seven years with little British movement on CFSP. Notably, Blair had made no indication of a shift on CFSP prior to his election when Europe had failed to act in the Balkans.

Blair has continued to reaffirm the Saint-Malo declaration with support for European rapid reaction forces at the le Touquet declaration in 2003.[233] These steps toward greater European defence collaboration have been met with resistance both in the British populace and across the Atlantic in the United States. Blair has been decried by his Euro-skeptical opponents as helping to create a 'European Army' and undermining NATO. Blair has had to meet all these challengers with fierce refutation that CFSP does any of these things.[234] The critical difference is that CFSP is not subject to a public referendum. CFSP has been a step that Blair has been able to take, as opposed to the euro, with only parliamentary support and not subject to the nationalistic sentiments of the populace. Therefore, the first paradox of British defence and the euro is that the party in favor of the euro is unable to join. Therefore it has strengthened the military component

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[232] This is the explanation offered by many pundits. Blair has lent credence to it by publicly declaring that Kosovo Crisis was why he felt the need to bolster CFSP. Michael Quinlan, *European Defense Cooperation: Asset or Threat to NATO?* (Washington D.C.: Woodrow Wilson Press, 2001), 29-30. While asserting that Kosovo was the source of Blair's shift, Quinlan acknowledges that Britain not participating in the euro was an influencing factor for Blair.

[233] http://news.bbc.co.uk/2/hi/europe/2726111.stm September 2004.

[234] http://news.bbc.co.uk/2/hi/uk_news/politics/3231820.stm September 2004.

of the EU, a policy shift which had previously been completely avoided.

B. SUMMARY

This thesis has illustrated the dynamic nature of the relationship between currency and defence in the United Kingdom. The principle of strong British money has had specific consequences for defence policy. From the late nineteenth century until the collapse of the Bretton Woods system, Britain has distinct national interest in maintaining the international strength of sterling. Under varying international currency orders, British governments over this period used all the levers of national power to accomplish this goal. This was achieved through direct military intervention or general defence policy to bolster the position of sterling. After 1956, this was also accomplished by providing military support to United States policies. The Americans would then in turn, buttress the pound. The advent of floating international currencies in 1973 broke the relationship between British military and monetary strength.

Only a fiscal, not a monetary, relationship exists today between British currency and defence. The British government can only spend more, or less, on defence based upon preference. Defence policy, programmes and operations require fiscal commitments, and they do not provide Britain with monetary power. Conversely, an internationally potent pound, because it does not generate the national wealth it once did, no longer funds a strong British military. In much the same way that the EU offers benefits to British industry, the EMU offers Britain the potential to improve defense spending. Membership of the euro will generate savings in transaction costs and minimize losses due to

exchange rate fluctuation. These advantages will aid in: consolidating the European defence market; improving the health of British defence industries; making pan-European defence programmes more efficient; and making the spending of MoD money in the eurozone less of a drain on the British economy. None of these benefits offer massive savings to British defence budgets. However, the important point is that the euro is good for British defence, even if the benefits are small. This is a profound change from the period before 1973 when the strength and independence of the pound was essential to British defence.

Despite the removal of a connection between defence and currency and the present-day benefits of the euro to defence, Prime Minster Blair's case for EMU membership does not highlight the benefits to defence. This is true because British nationalism continues to be a potent force. Defence and currency persist as powerful imagined icons of former British greatness. Military and monetary nationalism is deeply embedded in the minds of the polity and is understood by politicians. The resurgence of military and monetary nationalism under Thatcher has shown how useful they can be to achieve political objectives. Monetary nationalism has called into doubt the success of a referendum on EMU. Consequently, Prime Minister Blair has altered British policy regarding European Common Foreign and Security Policy and Common Security and Defence Policy to display his 'European' credentials. Meanwhile, the Tory opposition, because of their monetary nationalism, is unable to seize the issue of EMU as a means to improving British defence. The politics of nationalism have tied a Gordian knot in contemporary Britain, and there is no Albion Alexander in sight to cut it.

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