Brexit beginnings

First innings – bowled out by Goldsmith

Simon Matthews

There are many opinions about the origins of Brexit. Historians will point to the importance of English exceptionalism; the gradual acceleration of the free-market nationalism espoused by Powell, Thatcher, and their followers, including those based off-shore; the disinformation spread by much of the UK media; and the simple lack of understanding amongst the political class about the options available, if you leave the largest and most prosperous trading bloc in the world.

What is less remarked on is that had the UK joined the European Single Currency (Euro) in 1999 – or indeed or at any date thereafter – Brexit would have been unthinkable. Leaving the European Union could then only have happened in any meaningful way if a new currency – presumably a Pound mark 2 – had been launched . . . a course of action that would have been as practical, and sensible, as scrapping decimalization, and considerably more expensive. In this context, the steps that led to the UK not joining the Euro deserve to be better understood.

The UK joined what was formally called the European Exchange Rate Mechanism (EERM) but which is universally referred to as the ERM, in October 1990 when John Major was Chancellor of the Exchequer and Margaret Thatcher Prime Minister. This committed the UK to eventual membership of the Euro and was supported at the time by many in business and the media. However, the UK economy was weaker than that of either France or Germany, the two other major players in the ERM. Specifically, inflation was three times greater, interest rates higher, and labour productivity lower.

The UK insisted on valuing the pound at a high level when it entered the ERM. Partly as a means of attracting money into the City of London and its various trading and speculating markets, and partly in the belief belief such a high valuation would help reduce inflation.[1] This lead to a noticeable mismatch

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[1] In his *The Autobiography* (London: HarperCollins, 1999) John Major wrote on p. 163:

> We entered the mechanism at the market rate . . . . If we had sought to enter at a markedly lower rate we would have been rebuffed by our European partners.

Note the weasel word ‘markedly’.

between the actual value of the currency and its supposed/preferred value.

Joining the ERM entailed operating within a framework set by its various members states: control of the currency was no longer solely in the hands of the UK government. Because of this, it was clear that once inside the ERM the overvalued pound would, over time, gradually decline in value.

This potential weakness was quickly spotted by currency traders, including George Soros, head of the Quantum Fund. He calculated that the UK Treasury, which operated on the basis that the only significant function of a national bank was to keep inflation low, would, for political reasons, neither lower interest rates nor allow the pound to float so that it could establish its real value. It was an opportunity to make serious money. Taking the view that the Bank of England did not have sufficient foreign currency reserves to sustain the value of the pound, should a 'run' on the currency commence, Soros began 'shorting' the pound. This entailed buying the UK currency at its artificially high value and then exchanging it for German marks – with the intention of buying back the pounds, once their value had fallen. The financial 'bet' in this situation was a prediction that the value of the mark would do better than the pound. By the autumn of 1992 Soros and Quantum had 'shorted' $10 billion in UK pounds, and a 'run' appeared to be underway on the currency.[2]

To prevent any further depletion of its financial reserves, the UK voluntarily exited the ERM on 16 September 1992. The pound was devalued, from $1.77 to $1.50, with Soros making $1.8 billion in profit from his trading activities. As had been the case in previous devaluations (1949, 1967), the drop in the value of sterling helped manufacturing exports by making them cheaper to overseas buyers**,** strengthening that section of the economy.

The pound had been kept at an artificially high level for three main reasons: it was partly political prestige, partly to reduce inflation and partly to reinforce the trading activities of a small number of people in the City of London. Nothing that happened in 1992 showed a particular weakness in either the ERM or the Euro. What it it did demonstrate, however, was that maintaining the artificially high sterling value had been foolish and ill-conceived. Far better, surely, to concentrate on making manufacturing exports competitive, and by so doing strengthen employment and increase income from overseas. (As a percentage of UK Gross Domestic Product, the manufacturing sector was then roughly six times the size of the financial services sector.)

[2] Soros, a Hungarian refugee, moved to the UK from France in 1948 and subsequently studied at the LSE under Karl Popper. Prior to emigrating to the US, he worked 1954-1956 at Singer and Friedlander, a merchant bank. He was thus well aware of the psychological outlook that existed in the City.

Enter Goldsmith

Post-1992, the official position of the Conservative government remained that the UK would rejoin the ERM as soon as was practicable. The problem was Major never had enough Conservative votes to execute such a policy. Elected with a majority of 21 in April 1992, by-election defeats and whip removals had reduced this to zero by July 1993. Matters were further complicated when Sir James Goldsmith, who was neither an MP nor an MEP for any UK constituency, announced the formation of the Referendum Party in November 1994.

Goldsmith wanted a referendum on withdrawing the UK from the EU. Given the UK's electoral system, it was clear that this was unlikely to happen quickly. In the meantime, though, he demanded, and got, the agreement of the three main political parties at Westminster that they would hold a referendum prior to rejoining the ERM. It's worth pondering how easy it was for Goldsmith, who had no locus in UK politics, to extract such a concession.[3] That, though, was the tri-partisan position when the country went to the polls in May 1997.

Labour was elected with a comfortable majority. On the day they took office, each of the cabinet ministers in the incoming Blair government had meetings with the senior civil servants in their respective departments. Custom and practice at these inaugural meetings is for civil servants to provide advice about the specific policies contained within the incoming governments manifesto. In the absence of any specific commitment, they discuss with their new minister the options available, and invite the minister to advise them on the path to be followed. On the question of the ERM, whatever briefings were given off the record by advisers, or even Alastair Campbell, the Labour manifesto was clear: the UK would seek to rejoin but would hold a referendum prior to doing so.

That they didn't hold such a referendum – and the ways found to avoid it – are discussed by the late Giles Radice in his book *Trio: Inside the Blair, Brown, Mandelson Project* (London: I.B.Tauris, 2010). Contradictions rose early on. Peter Mandelson, Minister without Portfolio, was tasked with circulating around European capitals, as Blair's special emissary, reassuring EU partners that although Blair was 'strongly pro-European', because of the need to hold a referendum, the UK could not re-join the ERM immediately. It would therefore miss the January 1999 date for the Euro's launch, but would join . . . eventually. This remained consistent with Labour's manifesto and was also in

[3] Goldsmith was resident in Mexico from 1987 and sat as a French MEP 1994-1997. His financial affairs were the subject of much media comment, with many of his companies being domiciled in tax havens. The UK famously has no rules on holding referenda, which happen at the discretion of the Prime Minister or Parliament.

line with the Bank of England's 1996 Annual Report, which stated that it was committed to playing its part in European Monetary Union.[4] On 19 October 1997 *The Guardian* noted:

> The last Tory Chancellor, Kenneth Clarke, now makes no secret of the fact that he deeply regrets the day when, under pressure from right-wing Cabinet colleagues, he agreed to commit the Tories to holding a referendum on a single currency, virtually forcing Labour to match the promise. Clarke now thinks that when economic conditions are right the Government should grab the chance. At heart, Brown probably agrees, but now that the referendum has been promised, it will have to be held, making it the overwhelming certainty that entry will be delayed for at least five more years.[5]

Given that Brown announced on 27 October that five economic tests had to be met before the UK joined, it seems unlikely he agreed in the way stated in *The Guardian* article. As for the tests, considering the assumptions behind them is very revealing. To summarise, they were:

(1) Whether there can be sustainable convergence between Britain and the economies of a single currency.
(2) Whether there is sufficient flexibility to cope with economic change.
(3) The effect on investment.
(4) The impact on our financial services industry.
(5) Whether it is good for employment.

On (1) 'convergence', a requirement of the Maastricht Treaty, this would have required the UK to harmonize its interest rates with the Euro Zone. In 1997 Brown fretted that this was neither possible nor desirable . . . they were 7% in the UK and only 3% in Germany and France.[6] Had the UK adopted French or German level interest rates it would have made borrowing money easier and cheaper for manufacturing. Lurking in the background here was another consideration, namely the scale of the UK budget deficit. Convergence would also have required this being reduced, and in orthodox economic terms that could only have been possible by either cutting spending or restoring personal income tax levels back to something like the level they had been at pre-Thatcher. The argument that economic growth would raise the tax take (a larger working population pays more taxes) and lower the deficit over time

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4 See <https://tinyurl.com/4pj6dua9> or <https://www.bankofengland.co.uk/-/media/boe/files/annual-report/1996/boe-1996.pdf >.

5 See <https://www.theguardian.com/world/1997/oct/19/euro.eu3>.

6 2023 interest rates are 5.25% (UK) and 4% to 4.75% in the euro zone.

appears not to have been considered.

Point (4) placed the City of London – rather than manufacturing, research or agriculture and fisheries – firmly in the driving seat. Similarly (3) and (5), on investment and employment respectively, though couched in grave terms, were both, surely, simple to answer. Yes – the UK would benefit from investment if it were part of the Euro zone (why wouldn't it?). And yes, if that were so, and interest rates lower, and more attention given to productive areas of the economy, it would be good for employment. In his speech to Parliament Brown was never specific about why employment might be threatened by the UK joining the Euro, merely saying

> The Treasury assessment is that, in vital areas the economy is not yet ready for entry, and that much remains to be done.[7]

He did not specify which vital areas, what, exactly, needed to be done, or the timescale over which this might have been accomplished.[8]

Finally, item (2) looks like a permanent get out of jail card. What exactly does 'sufficient flexibility to cope with economic change' mean? Was Brown worried that something might happen in the Euro Zone that couldn't have been predicted? This was absurd. If that were so it would preclude the UK joining any international organization.[9] Brown concluded by saying it was 'sensible for business and the country to plan on the basis that, in this Parliament, we do not propose to enter a single currency.' This immediately invalidated whatever talks Mandelson was conducting, and pushed back the date of the UK joining the Euro to post-2001. In his book, Giles Radice makes the best of this. His critique of Brown is mild. But his narrative makes it clear that subsequent attempts to press for further information, or a date for a referendum, were rebuffed with either patient explanations about the political difficulties of timing a referendum or sad admissions that the Euro Zone still failed to meet UK requirements. Eventually the issue was kicked into the long grass by the impact of the 2007-2008 global financial crisis.

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[7] Column 585 to the top of Column 586 at <https://tinyurl.com/hyh6ndkw> or <https://publications.parliament.uk/pa/cm199798/cmhansrd/vo971027/debtext/71027-06.htm>.

[8] The verbatim text of point 4 was: 'What impact would entry into the EMU have on the competitive position of the UK's financial services industry, particularly the City's wholesale markets?' This indicates that the UK was kept out of the Euro at the request of the City of London.

[9] For all his solemn caution about the Euro, Brown did not foresee the 2007 run on Northern Rock Building Society, caused in part by reckless lending, which in turn fuelled house price inflation to the extent that in the years that followed the majority of the public were priced out of the market.

The reasons advanced for staying out of the Euro were largely spurious.

The practicalities for doing so, given a referendum had been promised, were another matter. The opinion polls on this were never promising.[10] But surely, a determined Blair, enjoying stratospheric popularity after 1997 could – I would argue should – have taken a long-term view. Instead, Brown, who according to Radice ensured that the decision on the Euro remained solely in his hands, carried the day. The UK stayed out, accepting higher interest rates and an over-valued pound as a result and an economic policy that remained centred on the City of London. Some illuminating comments were made in later years about the context in which this decision was made.

Firstly, Bryan Gould, no supporter of the EU, noted on 12 April 2013:

> It was always the (usually unspoken) guiding principle of the Blair government that the Thatcher legacy was too well-entrenched, and too valuable, to be challenged – and it is clear from this latest effusion that this remains the cardinal principle of Blair's politics. [. . . .] His response to the apparent Thatcherite hegemony, now and when he was in government, is and was to move the whole of Labour's agenda rightwards. The values of our opponents were affirmed; the principles and policies that the voters knew were those that Labour had always stood for were abandoned. [. . . .] It is true that Tony Blair never showed much interest in economic policy and seems to have . . . overlooked its importance.[11]

Secondly, Ed Balls, quoted in *The Independent* on 18 March 2016 was even more revealing.

> I don't think Tony Blair really wanted to join. He didn't think it (the referendum) could be won. He actually understood the economics. His credibility in the European Council depended on being a good European, and that depended on saying you wanted to join the euro. He had the Foreign Office breathing down his neck, but most of the time Tony Blair and Gordon Brown were on the same page.

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10 There were no polls carried out on the issue of the UK joining the Euro until June 2003, when the first – by YouGov – showed the public 33%-61% against. Both Denmark (2000) and Sweden (2003) conducted referendums on joining the Euro, and voted against in both cases.

11 See <https://bryangould.com/tony-blair-gives-the-game-away/>.

Gould was Shadow Chief Secretary to the Treasury 1986-1987 under Shadow Chancellor Roy Hattersley, and then Shadow Secretary of State for Trade and Industry 1987-1989 with John Smith as Shadow Chancellor. He resigned from Smith's Shadow Cabinet in September 1992 when they rejected holding a referendum on the Maastricht Treaty and in protest against Labour's support for joining the ERM. Gould's 2013 remarks were made after Blair's warm and embarrassing comments on Thatcher's death.

> Before the 2001 election Tony Blair met [former Australian PM] Paul Keating. He told Gordon and me that one of the things Keating had said was, “Whatever you do, don’t join the effing euro.” Why would he tell us that? He didn’t say it as if he disapproved of it; he said it as if he was thinking, “Smart guy.” [12]

A synthesis of the two provides us with: Blair understood that Thatcherite economics had underpinned economic decision making in the UK since 1979, and regarded these as both inviolable and in many ways desirable. On a significant issue like the UK joining the Euro, he would pretend at the European Council to be a good European whilst he privately endorsed advice from a former Prime Minister of Australia.

With a bit of hindsight, it’s not fanciful now to consider that the path that led to the UK leaving the EU in 2020 began with conceding a referendum on joining the Euro to Sir James Goldsmith in the mid-90s. Blair had no reason to comment when Goldsmith made his demands. Had he said nothing, it probably wouldn’t have prevented him becoming PM in 1997. Reinforcing both Balls’s views about the Euro and Gould’s views about general economic policy, we should note that Blair also followed Thatcher’s line in agreeing to maintain the Schengen opt out. In fact, much of what Blair did in the sphere of political economy avoided making (or changing) long-term strategic decisions. Conversely Goldsmith, from his narrow point of view, certainly was thinking long-term: unless you blocked accession to the Euro you’d never get the UK out of the EU. He was right.

Second innings: **Starmer and Reeves go in to bat**

At the time of writing (October 2023) everything points to Sir Keir Starmer becoming Prime Minister of a Labour government after the next election. Will this result in any significant change in the UK’s relationship with the EU?

Starmer is certainly playing down expectations on that front. At the recent Labour Party conference, delegates were told that circumstances were so bad his government would have to do as much as Attlee, Wilson and Blair combined over a ten-year period. Which shows commendable realism. Consider though the advantages that each of those had: Attlee, Prime Minister of a country that controlled the economies and natural resources of much of

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[12] See <https://tinyurl.com/2j6ramb2> or <https://www.independent.co.uk/voices/comment/how-the-blair-government-decided-against-adopting-the-euro-a6937736.html>

Keating was Labor Prime Minister of Australia from 1991 until his defeat in the 1996 election. Note that on Iraq, in 2003, Blair preferred the opinions of the President of the US to those held by the leaders of France and Germany or the United Nations Secretary-General. Unlike France and Germany, Australia took part in the US-led invasion and occupation of Iraq alongside the UK.

Africa, the Caribbean and Malaya, levied income tax at a standard rate of 45% and secured a large Dollar loan to assist in post-war reconstruction. Then Wilson, still in command of an immense manufacturing economy and with income tax at 42%. And finally Blair, with the UK extracting and exporting oil from the North Sea, a full member of the EU, enjoying a substantial property boom, and income tax at 25% – too low, but higher than it is now. None of the above applies today.

Balls, Gould and many others may have been right in 1997 in doubting whether Blair and Brown understood much about economics. We must assume Starmer and his Chancellor (presumably Rachel Reeves[13]) are painfully aware that unlike Blair and Brown – who opted to coast through their first term with the economic policies of the preceding Conservative administration – they will need to take decisions early on.

Assuming further cuts and raising the standard rate of income tax are ruled out, despite the rhetoric about 'making Brexit work' there will be some opt-ins, the most obvious being the Erasmus scheme. A Veterinary Agreement on livestock trade will also happen. But none of this will produce growth for the economy. Nor will it affect most people. At some stage the issue of re-joining the EU Customs Union and Single Market will have to be raised. Which brings us to whether, at that point, Starmer and his colleagues will exhibit the same overblown view of the UK's position that has been common amongst the countries political class for most of the post-war period.[14] In this context the re-emergence of Blair, Brown and Mandelson as behind-the-throne figures is significant, but hardly reassuring. Their assumptions between 1997 and 2010 – that they had credibility with the EU, whilst being honest critics of its failure – were doubtful then, and hardly marketable now. It is possible that some members of Starmer's team think a grateful EU will wave the UK through on a fast track to membership of the single market and customs union. But why would the EU have any appetite for this? Why would it show the UK more deference than that accorded to the nine other countries that are already

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[13] Interestingly, Reeves has an MSc in Economics and previously worked at the Bank of England. Should she hold the post, she will be the first UK Chancellor ever to have such qualifications. She adheres, apparently, to 'modern supply-side economics'. This rejects tax cuts and deregulation in favour of boosting growth via an increase in labour supply and improvements in infrastructure, education and research. Increasing the size of the UK labour force, whilst remaining outside the single market, implies importing a substantial workforce from countries further afield than Europe. Perhaps this is what she and Starmer have in mind.

[14] Part of which is the continued belief that the UK has one of the richest economies in the world. Frequently described as being the '5th richest', it is actually about 27th.

formal candidates for EU membership?[15] A more likely scenario is that Starmer will attempt – as he has said he would – to 'renegotiate' the 2020 EU-UK Trade and Co-operation Agreement.

Exactly what this would achieve is not clear, nor is the timescale over which such talks might last. Even if some benefits accrued, would Labour MPs, the party membership, trade unions, commentariat and wider public accept such limited gains? Assuming that we are not about to experience a New Labour tribute act, what we have looks like a Starmer bluff: pretend negotiations that produce little, followed by a statesmanlike admission that the UK must join the single market and customs union. We might even see Lord Mandelson given another specially created cabinet post with a brief to hold private meetings across Europe, as he has done so often in the past, assuring key EU players that the UK is serious in its intentions. If we do, then at least he (or whoever undertakes such a task) will not, as far as we know, be encumbered with a hostile Chancellor back home who yearns to be Prime Minister. Leaving behind the soap opera of the Blair/Brown years and being a bit more grown-up would be welcome.

The UK's troubled and self-defeating relationship with the EU is about to become centre stage again.

Simon Matthews' most recent book is
BEFORE IT WENT ROTTEN
The Music That Rocked London's Pubs 1972-76
(Harpenden: Oldcastle Books, 2023)

[15] These are Albania, Montenegro, North Macedonia, Serbia, Bosnia and Herzegovina, Moldova, Ukraine and Turkey – with Georgia and Kosovo as 'potential candidates'. See <https://commission.europa.eu/strategy-and-policy/policies/eu-enlargement_en>.