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The Currency of Ideas

MONETARY POLITICS IN THE
EUROPEAN UNION

KATHLEEN R. MCNAMARA

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For Theo

Preface

International monetary cooperation has long fascinated me, for international agreements on this topic seem to reach into the domestic political sphere in profound and important ways. As I began to learn about European monetary integration, it struck me that international relations theory didn't have a ready explanation for the Economic and Monetary Union (EMU) plan proposed in the 1989 Delors Report and later agreed to at Maastricht. Realist theories of international relations would not have predicted that the European Union (EU) states would voluntarily give up the levers of economic sovereignty, but liberal theories of integration seemed too sanguine in suggesting that economic interdependence leads inevitably to the demand for international regimes. The notion that the European states might surrender their national currencies and create a new European money was deeply intriguing to me. This book represents my answer to the challenge that European monetary integration presents to our conventional understanding of state behavior.

To make sense of EMU, I found it necessary to delve into the postwar history of European monetary politics, starting with the experience at Bretton Woods and extending through the two recent European fixed exchange rate regimes. The realists, I discovered, were right to emphasize national interest, but they did not pay enough attention to the ways in which interests can be redefined over time and lead to the extensive institutionalization of cooperation. The liberals, on the other hand, were right to pay attention to the importance of economic trends but underestimated the role that political and social processes,

particularly the development of shared beliefs among policymakers, play in translating the effects of interdependence into political outcomes.

This book will, I hope, help make sense of the progress of European monetary integration to those for whom international economics is familiar terrain, as well as those who are more at home in the study of international or comparative politics. Whatever happens on the road to EMU, an understanding of its fate can be achieved only through the joining of political and economic analysis.

I have been extraordinarily lucky to have received institutional, financial, and intellectual support at each stage in this project. For their generosity, I am very grateful to the Graduate School of Arts and Sciences at Columbia University; the Fulbright-Hays fellowship program; the John D. and Catherine T. MacArthur Foundation; the Center for the Social Sciences at Columbia University; the Eisenhower World Affairs Institute; the Council for European Studies; the European Community Studies Association; the Centre for European Policy Studies, Brussels; and the Center of International Studies and the Woodrow Wilson School, Princeton University. The final revisions were supported by a research fellowship from the German Marshall Fund. Joseph Noto and G. Matt Webster provided excellent research assistance.

I also extend thanks to all the people who took the time to talk to me both in Europe and in the United States about the European Union and monetary integration, and to those who read and commented on endless early drafts of this project. In particular, for their invaluable and detailed comments on the entire manuscript, I am deeply grateful to Peter B. Kenen, Kathryn Stoner-Weiss, George Downs, Michael Doyle, Joanne Gowa, Beth Simmons, Richard Ullman, and two anonymous reviewers. For their advice on various chapters and aspects of this project, I also thank Sheri Berman, Marc Busch, David Cameron, Michele Chang, Jeffrey Frieden, Alberto Giovannini, Daniel Gros, Michal Hershkovitz, Robert Jervis, Erik Jones, Jonathan Kirshner, Paulette Kurzer, Martin Malin, Walter Mattli, Andrew Moravcsik, Jonathon Moses, Wayne Sandholtz, Jack Snyder, and Claire F. Ullman. Peter J. Katzenstein and Roger M. Haydon made the preparation of the manuscript and final revisions a pleasure.

Helen V. Milner and David A. Baldwin have had the largest influence on this work, however. They have continually challenged me to think more deeply and clearly about the politics of international economic relations; the scholarly training and careful mentoring they have given me are gifts too fundamental ever to be repaid.

Finally, my deepest appreciation goes to Tomás Montgomery, for his amazingly steadfast faith and unflagging enthusiasm for both me and this project.

KATHLEEN R. MCNAMARA

Princeton, New Jersey

CHAPTER ONE

Introduction

Why do some international monetary regimes fail while others succeed? Which domestic or international conditions bind nations together in economic agreements, and which break them apart? These are important questions. International monetary cooperation or discord can have significant effects inside states, enabling or constraining societies in the pursuit of their national goals. International monetary arrangements can have significant effects on the international system, promoting political harmony or strife among nation states. In the 1990s, rapidly increasing international capital flows, the integration of world markets, and a rash of dramatic exchange rate crises have brought renewed attention to the political importance of international monetary matters while demonstrating the limits to our understanding of their dynamics.

This book is about the politics of monetary cooperation among the states of the European Union (EU).¹ Such cooperation has long been a concern of European political leaders. Monetary integration, with fixed exchange rate cooperation as its first step, has been seen by many as a way to encourage trade and investment by stabilizing currency fluctuations among the highly open economies of the common European market. Efforts at monetary cooperation also have a purpose beyond the economic realm, acting as a central anchor for debates

¹ The European Union (EU) came into being on November 1, 1993, replacing and encompassing the European Community (EC). In this book, I refer to the EU when discussing the European states in general terms or in a contemporary context and use EC only in explicitly historical discussions.

about political unification in Europe. The final stage of monetary integration—a single currency for all EU member states, scheduled for 1999—has been viewed by many European leaders as a way to ensure a peaceful, stable future for a continent with a history of violent conflict among its states.

Despite this continued desire for monetary stability, the three fixed exchange rate regimes Europeans have participated in have met with widely varying degrees of success. Although the Bretton Woods international monetary system provided stability during the first decades of the postwar era, the European-only currency Snake collapsed after a few short years of operation in the 1970s. Yet, the next European regime, the European Monetary System (EMS), proved relatively durable throughout the 1980s. Indeed, the success of the EMS was a major impetus for the single currency ambitions of the Maastricht Treaty and its Economic and Monetary Union (EMU). A series of currency crises in the 1990s has marred the EMS experience, however, and added to doubts about the feasibility of EMU. This mixed record constitutes an empirical puzzle for those who seek to explain why international monetary regimes succeed or fail.

The evolution of European monetary cooperation also raises a series of broader theoretical puzzles about the changing historical interaction of political authority and economic markets, and how this interaction shapes the conditions under which societies are governed. For example, if a country's currency is an intrinsic component of national sovereignty, as some argue, extensive monetary cooperation of the kind seen in Europe is surprising. Indeed, in the modern era, states have never before voluntarily sought to give up their own monies for a common currency. Why, then, have they proceeded down this path in Europe?

The evolution of monetary cooperation in Europe is equally puzzling for domestic political reasons. Macroeconomic policy has been tied closely to the distinct ideologies and programs of different political parties, from left to right. Why, then, have political actors from socialist to conservative supported an exchange rate regime that in effect gives away economic policy tools and limits their ability to use macroeconomic policy to distinguish themselves in voters' eyes?

Although the workings of exchange rate politics may seem highly technical and at times arcane, they are worth probing in detail, for

the study of European monetary integration has the potential to further our understanding of the role of the state, and the nature of political power, in a world where financial flows seem indifferent to national borders and impervious to national control.

THE ARGUMENT IN BRIEF

The key to solving the puzzle of European monetary cooperation lies in the historic economic policy convergence that occurred across the majority of the European governments beginning in the mid-1970s and solidifying in the 1980s. A neoliberal policy consensus that elevated the pursuit of low inflation over growth or employment took hold among political elites, eventually resulting in a downward convergence in inflation rates. This policy consensus redefined state interests in cooperation, underpinned stability in the EMS, and induced political leaders to accept the domestic policy adjustments needed to stay within the system. Though this consensus was by no means unwavering and may be showing signs of wear, it represented a clear break with the divergent economic policy paths and diverse priorities of the European states during the Bretton Woods era. For students of politics, this European reorientation is particularly notable because it occurred across most of the EU states, regardless of political party or domestic institutional structure.

This explanation raises a further series of questions, however. Why was the neoliberal policy consensus crucial to the success of the EMS? Where did it come from, and what were its political foundations? What might cause cracks in these foundations? And if this neoliberal policy consensus is so important, how were the European states able to stabilize their currencies within the earlier Bretton Woods system before such consensus developed in the 1970s? Is neoliberal policy consensus a necessary condition for fixed exchange rate cooperation in other regions of the world as well?

To answer these questions, this book explores the interaction between a changing international economy, one in which capital flows have increased exponentially, and the domestic policymaking process, particularly political leaders' beliefs about macroeconomic strategy. Both changes in the structure of the international economy and the

ideational factors that shaped policymakers' responses to structural changes are crucial to the story of European monetary integration.

At the international level, capital mobility plays a critical role in determining the conditions under which international monetary agreements can be sustained.² When the level of capital mobility is low, states can both fix their exchange rates and follow their own independent monetary policies, but when capital mobility rises, states must choose between fixed exchange rates or monetary policy autonomy. The following chapters frame the historical evolution of European monetary integration within this macroeconomic constraint, spelling out the basic policy trade-offs states have faced over the postwar era in their quest for monetary stability. This analysis sheds light on more general questions about the effects of capital mobility on domestic policymaking, an issue at the forefront of current debates about globalization.³

In order to understand the evolution of monetary cooperation in Europe, it is equally important to look at the process of policy choice, specifically, how political elites measure the costs and benefits of monetary cooperation within a changing international economic context. The ideas political leaders hold about macroeconomic policy are crucial to explaining the path that European states have taken and where they may go in the future. Ideas are defined here as shared causal beliefs.⁴ Political actors use these ideas to evaluate the costs and benefits

² David M. Andrews, "Capital Mobility and State Autonomy: Towards a Structural Theory of International Monetary Relations," *International Studies Quarterly* 38 (1994), 193-218; Michael C. Webb, *The Political Economy of Policy Coordination: International Adjustment since 1945* (Ithaca: Cornell University Press, 1995); Jonathon Moses, "Abdication from National Policy: What's Left to Leave," *Politics and Society* 22 (June 1994), 125-48; Benjamin Cohen, "The Triad and the Unholy Trinity: Lessons for the Pacific Rim," in Richard Higgott, Richard Leaver, and John Ravenhill, eds., *Pacific Economic Relations in the 1990s: Cooperation or Conflict?* (Boulder, Colo.: Lynne Rienner, 1993); and Louis W. Pauly, *Who Elected the Bankers? Surveillance and Control in the World Economy* (Ithaca: Cornell University Press, 1997).

³ Important recent contributions to this debate include Suzanne Berger and Ronald Dore, eds., *National Diversity and Global Capitalism* (Ithaca: Cornell University Press, 1996); Jeffrey Frieden, "Invested Interests: The Politics of National Economic Policies in a World of Global Finance," *International Organization* 45 (Autumn 1991), 425-51; Geoffrey Garrett and Peter Lange, "Internationalization, Institutions, and Political Change," *International Organization* 49 (Autumn 1995), 627-55; Robert O. Keohane and Helen Milner, eds., *Internationalization and Domestic Politics* (New York: Cambridge University Press, 1996).

⁴ An argument congruent with mine is Peter Hall, "Policy Paradigms, Social Learning,

of monetary cooperation and chart a policy strategy. Policymakers draw on these ideas to formulate answers to questions of values and strategies: What should the goals of monetary policy be? What instruments can be used in pursuit of those goals? The answers will vary significantly over time and place, redefining national interests in international monetary cooperation.

"Ideas," as one author has put it, "do not float freely," however; they arise from actors' experiences with their environment and interactions with other actors, and they survive implementation into policy only if they are politically salient.⁵ Thus, to explain why certain neoliberal economic policy ideas triumphed within the political arena, making European monetary cooperation more likely, I develop a template for understanding why certain ideas become dominant at a given historical point, while others are put aside. A process of policy failure, policy paradigm innovation, and policy emulation unfolded among the states of the European Union, producing a new, neoliberal view of monetary policy in the years between the Snake and the European Monetary System.

In brief, European governments' experience with macroeconomic policy failure in the aftermath of the first oil crisis spurred a search for alternatives to traditional Keynesian policies. The sense of crisis that accompanied the policy failures weakened postwar political and societal arrangements, creating the space for a new conception of the role of government in the macroeconomy. Second, monetarist theory provided a template and a legitimizing framework for a new economic

and the State: The Case of Economic Policymaking in Britain," *Comparative Politics* 25 (April 1993), 275-96, and Hall, "The Movement from Keynesianism to Monetarism: Institutional Analysis and British Economic Policy in the 1970s," in Sven Steinmo, Kathleen Thelen, and Frank Longstreth, eds., *Structuring Politics: Historical Institutionalism in Comparative Analysis* (New York: Cambridge University Press, 1992), although Hall limits his analysis to developments within one country. See also Peter Hall, ed., *The Political Power of Economic Ideas: Keynesianism across Nations* (Princeton: Princeton University Press, 1989); "Knowledge, Power, and International Policy Coordination," special issue of *International Organization* 46 (Winter 1992), edited by Peter M. Haas; Kathryn Sikkink, *Ideas and Institutions* (Ithaca: Cornell University Press, 1991); Judith Goldstein, *Ideas, Interests, and American Trade Policy* (Ithaca: Cornell University Press, 1993); and the volume *Ideas and Foreign Policy*, edited by Judith Goldstein and Robert O. Keohane (Ithaca: Cornell University Press, 1993).

⁵ Thomas Risse-Kappen, "Ideas Do Not Float Freely: Transnational Coalitions, Domestic Structures, and the End of the Cold War," *International Organization* 48 (Spring 1994), 185-214.

strategy that made neoliberal, anti-inflationary policies a priority rather than employment or growth objectives. This policy paradigm, tempered to include fixed exchange rates, provided a solution at a time of great uncertainty about the workings of the global and domestic economies. Third and finally, Germany's success with a pragmatic version of monetarist policy that emphasized a strong and stable currency provided policymakers with a powerful example to emulate. The willingness of other European governments to follow the German example increased the chance that the EMS would hold together, because the German mark serves as its anchor.

By defining the problem, providing an alternative solution, and demonstrating the policy's effectiveness, these three sources of neoliberal change both promoted and legitimated a convergence in policy preferences among European elites. Because this new view of monetary policy deemed domestically oriented, activist policies ineffective, it created the necessary conditions for sustained exchange rate stability under conditions of capital mobility.

The neoliberal consensus was not directly a function of rising capital mobility; instead, it was the product of European political leaders' interpretations of their shared experiences, the influence of the monetarist paradigm, and the German policy example. Other paths were possible, as demonstrated by the many states in the defunct Bretton Woods system, such as the United States and Japan, which moved to floating exchange rates and less stringent monetary policies. Indeed, this template of ideational change also provides some hints of the problematic nature of policy convergence in Europe, whose tensions have contributed to exchange rate crises and may undermine the ultimate durability of European monetary cooperation.

INTERDEPENDENCE AND IDEAS IN THEORETICAL PERSPECTIVE

In arguing that the structure of the international economy shapes the terrain within which politics unfold but that the interpretation of that structure, or ideational processes, dictate the crucial choice of policy content and form, I caution against making assumptions about the effects of economic interdependence on political outcomes without tracing out the linkages between rising trade and capital flows and

policymakers' decisions. Change of this sort is at present understudied: although we know that increasing financial interdependence is important, we still do not understand fully the process by which it interacts with domestic politics to shape foreign economic policies and, consequently, outcomes in the international system.⁶

The argument of this book thus differs from several familiar lines of argument in the literature on international political economy. For example, private economic actors, such as firms and industries, are often assumed to be the driving force for international cooperation under conditions of progressive globalization of national economies. Or the distribution of power in the international system and the dynamics of bargaining games among nation states are assumed to be the source of cooperative or discordant outcomes of international economic agreements. My findings cast doubt on the ability of such approaches to account a priori for the European policy outcomes because they make inaccurate assumptions about political actors' interests in monetary integration. In particular, these approaches fail to address the high degree of uncertainty about the microeconomic costs and benefits of different monetary regimes and the contextual nature of actors' preferences for monetary cooperation.⁷ More generally, they fail to recognize that economic interdependence has multiple effects that need to be carefully traced through the domestic political process if we are to understand the evolution of international economic regimes.

My findings on European monetary integration indicate that uncertainty creates highly fluid conceptions of interest, both national and

⁶ Recent notable exceptions include Sylvia Maxfield, *Governing Capital: International Finance and Mexican Politics* (Ithaca: Cornell University Press, 1990); Jeffrey A. Frieden, *Debt, Development, and Democracy: Modern Political Economy and Latin America, 1965-85* (Princeton: Princeton University Press, 1991); Paulette Kurzer, *Business and Banking: Political Change and Economic Integration in Western Europe* (Ithaca: Cornell University Press, 1993); and C. Randall Henning, *Currencies and Politics in the United States, Germany, and Japan* (Washington, D.C.: Institute for International Economics, 1994).

⁷ A related but more narrowly focused literature in economics has linked uncertainty about means-ends relationships in international macroeconomic policy to difficulties in achieving international economic cooperation. See Richard Cooper, "Prolegomena to the Choice of an International Monetary System," *International Organization* 29 (1975), 63-97; Jeffrey Frankel and Katharine E. Rockett, "International Macroeconomic Policy Coordination When Policymakers Do Not Agree on the True Model," *American Economic Review* 78 (June 1988), 318-40; and Atish Ghosh and Paul Masson, *Economic Cooperation in an Uncertain World* (Cambridge: Blackwell, 1994).

societal. This uncertainty obviously has very real consequences for the politics of monetary cooperation. Because uncertainty can obscure the distributional effects of different exchange rate regimes, it has the potential to "depoliticize" the policy process by lessening societal pressures for particular policies and insulating policymakers from public scrutiny, a dynamic heightened by the institutional independence of many central banks. Congruent with both the broader history of international monetary cooperation and that of European integration, political elites have traditionally exerted a strong influence over European exchange rate decisions. But this "depoliticization" is only superficial: the process of defining the national interest is political in both its execution and its outcomes, as is becoming clearer in the movement toward EMU.

In sum, my goal in this book is thus not to separate ideas and interests as competing causal factors but to show the inherent connection between the two.⁸ By clarifying how evolving definitions of interest can shape states' preferences regarding exchange rate cooperation, I seek to overcome the shortcomings of approaches that take preferences as given and static and leave unexplored how one strategy comes to be viewed as more appropriate than another. By focusing on the reasons one set of ideas becomes politically dominant and is subsequently institutionalized as policy practice, I also contribute to the literature on ideas by specifying how ideas matter and where they come from. Although I delineate a range of economic constraints created by globalization, I reject a deterministic view of the forces of international capital in favor of the argument that the process of interest redefinition has historically been dependent on policymakers' shared beliefs. By showing the importance of both international economic conditions and actors' interpretations of those conditions, this book takes seriously the roles of both economic structure and human agency in the evolution of international cooperation.

⁸ Study of the role of ideas in formulating interests has been advocated in general by Ngaire Woods, "Economic Ideas and International Relations: Beyond Rational Neglect," *International Studies Quarterly* 39 (June 1995), 161–80; in the area of European integration by Thomas Risse-Kappen, "Exploring the Nature of the Beast: International Relations Theory Meets the European Union," *Journal of Common Market Studies* 34 (March 1996), 53–80; and in the area of international monetary politics by David M. Andrews and Thomas D. Willett, "Financial Interdependence and the State: International Monetary Relations at the Century's End," *International Organization* 51 (Summer 1997), 479–511.

EUROPEAN MONETARY COOPERATION IN HISTORICAL PERSPECTIVE

European monetary integration is deeply bound up in the evolving historical interaction between political authority and economic markets. The tension between national policy autonomy and the benefits of economic interdependence, and the key role played by changing norms regarding the value of autonomy versus economic openness, have also been pivotal in earlier studies of international monetary cooperation.⁹ Most centrally, my findings engage John Ruggie's work on postwar international monetary regimes.¹⁰ Ruggie identified the balance achieved in Bretton Woods between domestic intervention in the economy and an open international system as the crowning achievement of the postwar era. He characterized this balance as the "compromise of embedded liberalism" and argued that this compromise constitutes the normative basis that contemporary multilateral cooperative regimes must rest upon if they are to succeed.

The remaining chapters in this book cast doubt on the continued relevance of this view of international monetary cooperation and show a very different world emerging since the late 1970s from that captured by Ruggie. Cooperation in Bretton Woods was based on the idea that a liberal, open, multilateral system did not have to preclude an extensive role for the state in the domestic economy—that market liberalism would be "embedded" within a larger context of social goals, like full employment and the welfare state's "safety net." This premise is no longer viable in the realm of fixed exchange rate regimes, I argue, in large part because of the effects of rising capital mobility.¹¹ The exam-

⁹ See Kenneth Oye, "The Sterling-Dollar-Franc Triangle: Monetary Diplomacy, 1929–1937," in Oye, ed., *Cooperation under Anarchy* (Princeton: Princeton University Press, 1986); Joanne Gowa, *Closing the Gold Window* (Ithaca: Cornell University Press, 1983); and John Odell, *U.S. International Monetary Policy* (Princeton: Princeton University Press, 1982).

¹⁰ John Gerard Ruggie, "International Regimes, Transactions, and Change: Embedded Liberalism in the Postwar Economic Order," in Stephen Krasner, ed., *International Regimes* (Ithaca: Cornell University Press, 1983), 196–232. Ruggie's article provides an astute characterization of the Bretton Woods experience; he does not, however, identify the causal mechanisms that produced the compromise of embedded liberalism. In contrast, I explicitly address the sources of the new norm that made cooperation in the EMS possible.

¹¹ Recent evaluations of the embedded liberalism thesis include John Gerard Ruggie, "Embedded Liberalism Revisited: Institutions and Progress in International Economic

ples of the Snake and the EMS show that such regimes can function only if participating states cease to use monetary policy actively to shape their domestic economy. The substantive effect of this monetary policy requirement is an orientation toward more neoliberal strategies of domestic governance.

To put it another way, for international exchange rate stability to be achieved, a new "consensus of competitive liberalism" is necessary. States must be willing to rule out the use of monetary policy as a weapon against broader societal problems, such as unemployment or slow growth. Instead, governments must be willing to stake their credibility on walking the plank of rigorous orthodoxy—support for exchange rate stability and inflation control above all other macroeconomic goals.

At its heart, this new norm of competitive liberalism is rooted in the view that improvement in the international economic position of the nation state warrants taking harsh steps to adjust to changing international market conditions. Thus, while liberal in its emphasis on market forces, the new consensus and its emphasis on inflation reduction are driven more by concerns with national economic competitiveness than by a commitment to liberal ideology. In this sense the consensus is a pragmatic but not predetermined response to changing international conditions on the part of governments that no longer view the preservation of national policy autonomy as a viable goal. The conservative orthodoxy shared by socialists and conservatives alike in Europe is a "second best" alternative, one that could be manageably sold to societal groups as the appropriate remedy to relieve the traumas of stagflation and Eurosclerosis.

This consensus of competitive liberalism, crucial to the success of any multilateral exchange rate regime in a world of high financial interdependence, also has high social costs. These costs were seen as bearable by domestic political actors heavily influenced by the lessons of the first oil crisis, a pragmatic version of monetarism, and the success of the German example. The limits of those lessons have become

Relations," in Beverly Crawford and Emanuel Adler, eds., *Progress in International Relations* (Berkeley: University of California Press, 1991); Eric Helleiner, *States and the Reemergence of Global Finance: From Bretton Woods to the 1990s* (Ithaca: Cornell University Press, 1994); Philip G. Cerny, ed., *Finance and World Politics* (Aldershot, Eng.: Edward Elgar, 1993); and Webb, *Political Economy of Policy Coordination*.

apparent, however. As I argue in the concluding chapter, the macroeconomic record in Europe shows that the consensus of competitive liberalism can create exchange rate stability despite rising capital mobility, but it cannot assure politically acceptable levels of employment and growth. In addition, ever-higher levels of capital mobility have made adhering to the requirements of the fixed exchange rate regime more costly, as capital markets periodically challenge the credibility of European governments' decision to refrain from autonomous, expansionary monetary policies.

Cooperation, which many analysts tend to assume is an automatic "good," may come to be judged as not always beneficial, at least when it comes to exchange rate stabilization in a world of large and rapidly moving capital flows.¹² And the demands of the next stage of cooperation—Economic and Monetary Union—may well outstrip the consensus that held the exchange rate regime together, particularly if fiscal retrenchment is a criteria for membership in EMU. Whether the neoliberal consensus will unravel depends greatly on what governments and their citizens believe possible in the present economic environment and on the role they see the European Union playing in helping them govern effectively. The ideational factors I have identified as crucial to the development of the consensus will help determine how calculations about national interest are made on the part of governments and the publics they represent.

The European experience with exchange rate cooperation is central to the broader European integration effort and will continue to affect the daily lives of EU citizens, whatever the fate of the Maastricht Treaty on European Union. But this experience also is a crucial story for analysts of international and comparative politics, because it illuminates the more general issue of how domestic politics and international institutions interact in an interdependent world economy. By offering an understanding of the tensions involved in finding a balance between domestic political needs and multilateral regimes, this book may be

¹² Economists have tended to be much more skeptical than political scientists about the automatic value of such cooperation; see, for example, Maurice Obstfeld and Kenneth Rogoff, "The Mirage of Fixed Exchange Rates," *Journal of Economic Perspectives* 9 (Fall 1995), 73–96.

useful in the further development of such regimes, both in an ever-widening European Union and in the regions beyond its borders.

Chapter 2 begins this task by examining in more detail the nature of exchange rate cooperation and theoretical explanations for the variation in cooperation in postwar Europe. Chapter 3 then lays out my argument in detail. Chapter 4 applies the approach to the Bretton Woods international monetary system; Chapter 5 investigates the failure of the European currency Snake; and Chapter 6 examines the European Monetary System. The book concludes in Chapter 7 with an examination of the recent history of the EMS and draws on my findings to speculate on the promises and pitfalls of EMU.

CHAPTER TWO

The Puzzle of Exchange Rate Cooperation

To promote trade, investment, and political unity, the states of the European Union attempted to achieve exchange rate stability among their currencies within three separate monetary regimes over the postwar era. These efforts met with very different results. In the early postwar U.S.-based Bretton Woods international monetary system, exchange rates were stabilized relatively successfully among all the core European states. In the subsequent European-only Snake of the 1970s, however, stability proved elusive and participation in the agreement waned. Yet the next European exchange rate agreement, the European Monetary System, had an impressive track record of longevity and stability and spurred the EU's agreement on economic and monetary union by 1999. This chapter describes in more detail the differences between the European regimes and evaluates some possible explanations for their varying success in stabilizing intra-European exchange rates.

FIXED EXCHANGE RATE REGIMES

To evaluate the two European agreements, one should first consider how fixed exchange rate regimes function to get a better sense of the role cooperation plays in minimizing exchange rate instability. An exchange rate may be thought of as a relative price: the value of one currency in terms of another. There is a range of ways in which coun-