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A Choice for European Monetary Integration: Politics of Growth Models between the EMS and EMU

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Introduction

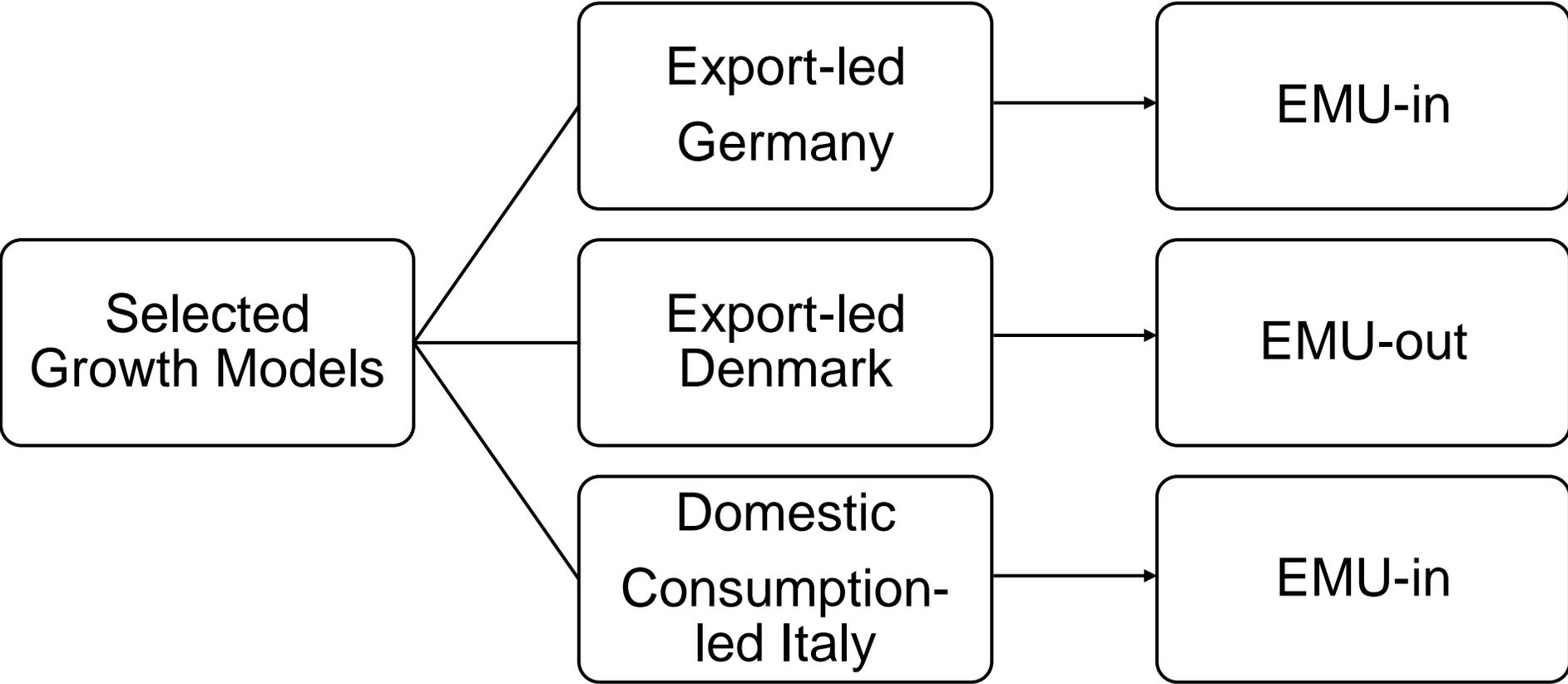
- EMU remains a differentiated policy space (first treaty-based area with a formal opt-out)
- Why is the European monetary integration only appealing to selected MS whilst some opt out?
- EU studies scholars have published extensively on the issue (e.g., Dyson & Featherstone, 1999; Mody, 2018; Moravcsik, 1999; Schimmelfennig & Winzen, 2020)
- The comparative political economy remains relatively silent on the matter (Growth Model approach; Baccaro et al., 2022)

Politics of the Growth Model

- **Growth models (GM)** -> national capitalist variety stemming from the different drivers of the aggregate demand in the post-Fordist era of wage stagnation and rising profit shares (Baccaro & Pontusson, 2016; Baccaro et al., 2022)
- What determines the growth strategies and policies pursued by the GM?
- **Politics of the GMs** -> each GM reflects preferences of a cross-class quasi-hegemonic coalition of producer groups, organized business associations and a fraction of labor seeking to pursue policies that sustain the GM (Baccaro & Pontusson, 2022)
- The fundamentals of GM (relatively) immune to mass politics – quiet politics, cartel of mainstream parties, ideological hegemony (Hopkin & Voss, 2022; May et al., 2024)

Puzzle

- Implicit assumption from Baccaro & Pontusson (2022):
 - Macroeconomic interests of the pivotal sectors upon which the GM relies on should be reflected when deciding on the exchange rate (ER) and monetary integration
 - Macroeconomic interests should be more converged across similar GMs and more diverged across structurally different GMs in terms of the ER policies and monetary integration outcomes
 - Mass politics is practically irrelevant
- Yet...



Absolute & Relative Growth Contributions, 1979-

2003

Period	Country	Exports	Domestic Consumption		Total Growth	Share of Total Growth		
			<i>Household</i>	<i>Public</i>		<i>Exports</i>	<i>Household</i>	<i>Public</i>
1979-1984	<i>Germany</i>	0.52%	0.64%	0.38%	1.53%	34%	42%	25%
1979-1984	<i>Italy</i>	-0.19%	1.62%	0.58%	2.01%	-9%	80%	29%
1979-1984	<i>Denmark</i>	0.98%	0.36%	0.59%	1.93%	51%	19%	30%
1985-1989	<i>Germany</i>	0.11%	1.67%	0.13%	1.92%	6%	87%	7%
1985-1989	<i>Italy</i>	-0.36%	2.16%	0.66%	2.46%	-15%	88%	27%
1985-1989	<i>Denmark</i>	0.24%	0.82%	0.14%	1.20%	20%	68%	12%
1990-1993	<i>Germany</i>	0.21%	1.62%	0.51%	2.34%	9%	69%	22%
1990-1993	<i>Italy</i>	0.55%	0.48%	0.30%	1.33%	42%	36%	22%
1990-1993	<i>Denmark</i>	0.81%	0.50%	0.30%	1.61%	50%	31%	19%
1994-1998	<i>Germany</i>	0.14%	0.78%	0.43%	1.35%	11%	57%	32%
1994-1998	<i>Italy</i>	-0.02%	1.29%	-0.09%	1.17%	-2%	110%	-8%
1994-1998	<i>Denmark</i>	-0.42%	1.57%	0.52%	1.67%	-25%	94%	31%
1999-2002	<i>Germany</i>	0.81%	0.58%	0.22%	1.60%	50%	36%	14%
1999-2002	<i>Italy</i>	-0.39%	0.91%	0.52%	1.04%	-38%	88%	50%
1999-2002	<i>Denmark</i>	1.10%	0.22%	0.61%	1.93%	57%	11%	31%

Source: Ameco Database.

Research Design

- **Sample:** three contradictory case studies (Germany, Denmark and Italy)
- **Aim:** To deconstruct the preferences formation and cleavages in the countries' GM regarding the ER policies and European monetary integration
- **Methods & Data:** mixed-methods approach (archival research, historical accounts of secondary resources, quantitative evidence)
- **Focus:** the European Monetary System and the European Monetary Union
 - *All three MS participated in the EMS and only diverged in their preferences after the Maastricht*
 - *Most important milestone in the post-war ER policy coordination and monetary integration*
 - *EMS marks the crossroads to the post-Fordist era*
 - *EMS (intergovernmental arrangement, ER policy coordination, preservation of domestic currencies) vs. EMU (supranational, irrevocable fixation of ER, abandonment of national currencies)*

Policymaking in GMs

- Circumstances of policymaking arguably more nuanced than a simple reflection of the producers' needs (Bohle & Regan, 2021)
- Co-existence of conflicting views concerning the policy requirements resolved in different political spaces depending on the nature of the policy area itself (Culpepper, 2010)
- Policy salience & the degree of institutionalization

Table: The Policymaking Space in Advanced Democratic Countries

	Informal Rules	Formal Rules
High salience	<p><i>Social partner bargaining</i> Actors: employer and employee associations Issues: welfare and income policies Power resource: public opinion and the “shadow of hierarchy”</p>	<p><i>Partisan contestation (“noisy politics”)</i> Actors: political parties Issues: fiscal, social and labor policies Power resource: legislative seats and public support</p>
Low salience	<p><i>Private interest governance (“quiet politics”)</i> Actors: business and state elites Issues: industrial and competition policies Power resource: structural and instrumental power, finance</p>	<p><i>Bureaucratic network negotiation</i> Actors: policy networks and technocrats Issues: regulatory policies, monetary policies Power resource: expertise</p>

Source: Own elaboration based on Culpepper (2010, p. 181)

Politics of the Exchange Rates

- Non-salient macroeconomic policy (highly technical domain)
- ER policies in principle unconstrained by electoral competition and generally entrusted to independent central banks (technocratic committees)
- The ER should reflect preferences of a GM
- ER policies require a twofold choice for:
 - *ER regime* -> fixed, flexible or in-between (fixed-but-adjustable)
 - *ER level* -> appreciated/revaluated vs. depreciated/devaluated

Table 3: Sectoral Preferences for Exchange Rate

Policies		Exchange rate regime	
		Flexible	Fixed
Exchange rate level	Depreciated	Import-competing producers of tradable goods	Export-oriented sectors of tradable goods
	Appreciated	Sectors producing non-tradable goods and services	International investors

Source: Own elaboration based on Frieden (1991, p. 445; 2015).

GM preferences for ER policies vs. GM preferences for monetary integration

- *Export-led GM* -> fixed ER regime + depreciated ER level
- *Domestic consumption-led GM* -> flexible ER regime and monetary autonomy (appreciated ER level?)
- Monetary integration -> depoliticization and institutionalization of fixed ER policies at supranational level:
 - *Intra-state agreement & coordination (EMS) ~ quiet politics*
 - *Irrevocable (EMU) ~ salient issue*

Politization between the EMS and EMU

- Mass politics suddenly gains a leverage -> “core state powers” (Genschel & Jachtenfuchs, 2016), “constraining dissensus” (Hooghe & Marks, 2009) and an emergence of “political entrepreneurs” (De Vries & Hobolt, 2020)
- Various factors:
 - Effective mobilization of the electorate
 - Available political tools
 - Identity and national exclusivity
 - Credible commitment with / without the external mast

Country Case Studies

Germany: Élite-driven Quest for Institutionalized Competitive Devaluation

- German economy underpinned by a set of institutions seeking competitive disinflation and resistance against nominal devaluation ever since the Bretton-Woods -> “*Undervaluation regime*” (Höpner, 2019)
- Undervaluation regime inherently unstable -> disinflationary environment attracting foreign capital inflows, which leads to persistent pressures towards upward nominal ER realignments
- “External anchor” needed (Germann, 2021, Wansleben, 2023)
- Easing the pressure of the DM revaluation via imposition of austerity on “weak currencies” (Italy, France)

Sectoral Preferences for Stable ER in Germany

- Coalition of large manufacturing firms and commercial banks closely interwoven via corporate governance
- Sectoral interests organized under large umbrella organizations (BDI - Federation of German Industries; BdB, Federation of German Private Banks)
- BDI & BdB -> drivers of European supranational integration & supporters of the idea of Common European currency ever since the Werner report (Tober, 2023)
- Part of the labor coopted as well (DGB, German Trade Union Confederation)
- Bundesbank (also MoF), on the other hand, prioritized price stability (Scharpf, 2018) -> purposefully left out off the EMS negotiations (Mourlon-Druol, 2012)

Germany and the EMS

- Inflationary pressures in the 1970s and the accompanying ER-related instability -> tensions within the German social bloc
- The EMS as a compromise -> institutionalized undervaluation of the German currency relative to its European trading partners
- German pro-export bloc benefiting from the asymmetric nature of the EMS (ERM remained the “d-mark zone”)

Germany and the EMU

- The undervaluation coalition initially skeptical -> already benefiting from the ER stabilization under the EMS
- German export-oriented industries facing increasing price export sensitivity in the 1990s (Baccaro & Benassi, 2016), however, “saw no urgent need to go beyond the EMS” (Scharpf, 2018, p. 34)
- The coalition’s support for the euro on decline -> only reversed after the unification shock caused a fall in price competitiveness in the mid-1990s (Tober, 2023)
- Distaste for the EMU on the part of the Bundesbank -> satisfied with its hegemonic position within the EMS
- Strong public support for the strong DM (Mody, 2018)
- “Germany’s initial motives for EMU must have been more political than economic” (Tober, 2023, p. 1674)

Reasons for Germany's Position Change

- Sudden opportunity for German unification -> German attitudes towards the European single currency strongly shaped by foreign policy goals, which necessarily strengthened the “monetary stability coalition” (Kaltenthaler, 2002)
- Deterioration in REER vis-à-vis the US -> relative benefits of the euro might outweigh that of the DM in terms of competitive devaluation (Tober, 2023)

Denmark: Constraining Dissensus & Business-as-Usual

- Long-history of pursuing quasi-fixed ER throughout the 20th century in Denmark
- Apart from Germany and the Benelux countries, Denmark the only country continuously participating in the Snake and the ensuing EMS arrangement (strong currency country supporting asymmetric readjustments)
- Ideational shift in the 1980s -> transition towards the low inflation and export inducive policy environment
- Wage indexation, sound fiscal policy and fixed ER as the undisputable cornerstones of the Denmark's economic policy
- Pioneered by the *Danmarks Nationalbank* but adopted as a broader elite consensus
- Denmark's economic elites openly in favor of participation in European monetary integration (Marcussen, 2002, p. 125)

Mass Politics Weighting-in

- Constitutional requirement backed by political consensus to hold national referenda on all key EU-related decisions
- The EU integration effectively pulled into the “noisy” political arena (economic advantages vs. national identity)
- Main political players -> stressing the economic benefits
- Broader public -> emphasizing the national identity
- Rejection of the Maastricht Treaty in 1992 (Edinburg Agreement)

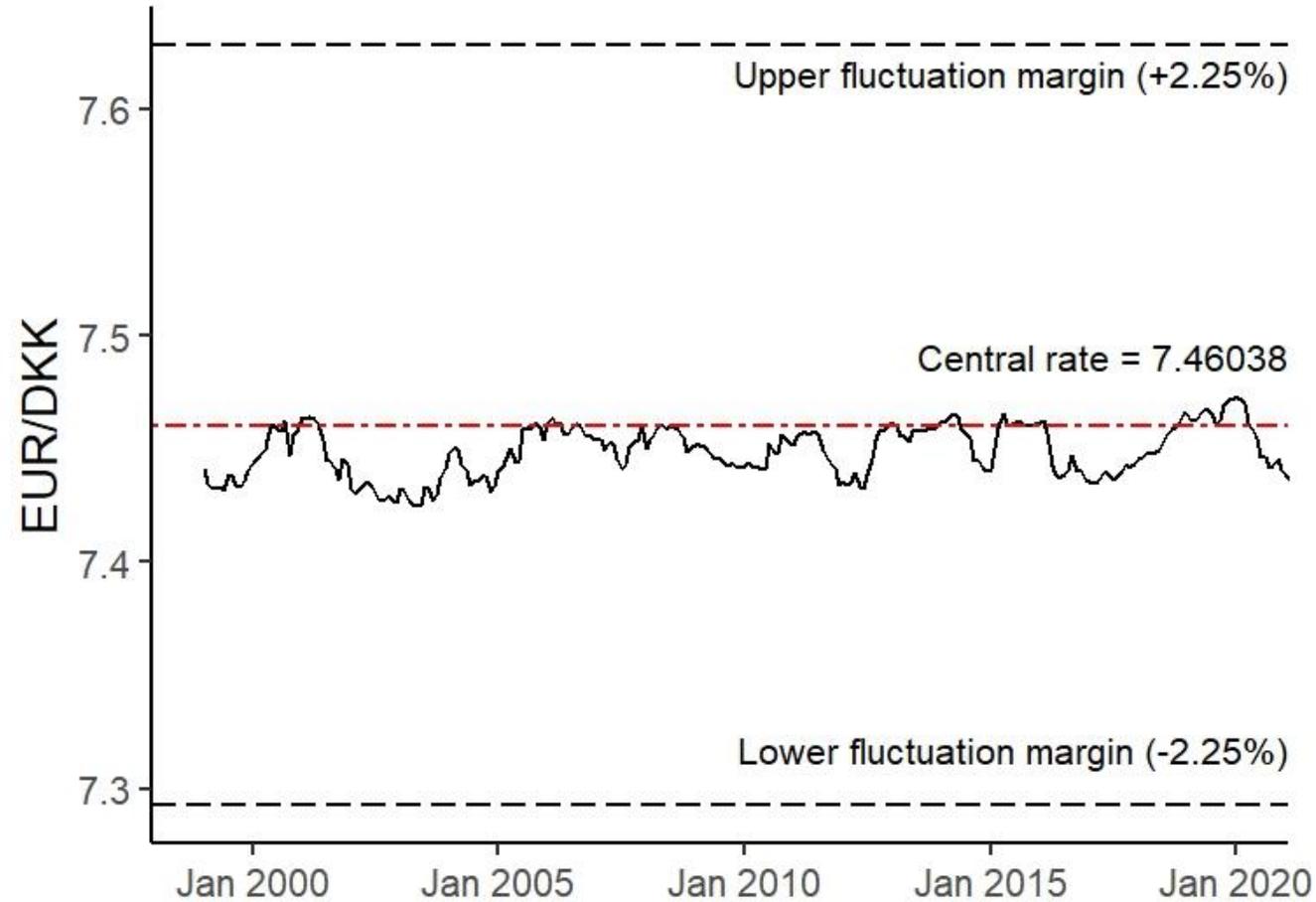
Referendum on the Opt-Out Removal 2002

- Pro-euro campaign had been emphasizing economic arguments for the removal of the opt-out
- Post-referendum surveys -> only a minority of voters took economic arguments into considerations
- Only one out of nine pro-euro voters voted “yes” due to economic reasons (Lykke, 2002)
- Identity issues prevalent (krona as a symbol of national statehood)
- Anti-elite sentiment (large campaign investments)
- The main trade union umbrella organization supporting the EMU membership even though its rank-and-file members were mostly against

Business-as-Usual

- Denmark had been following strict ER peg against the European anchor since the 1980s -> after the introduction of the euro, the krona placed into the ERM II with a narrow ± 2.25 percent fluctuation band (± 15 percent fluctuation band possible!)
- “Adoption of the euro would constitute a de iure change in Danish monetary governance”, not a de facto alteration of the monetary policy (Jupille & Leblang, 2007, p. 769; cf. Danish Economic Council, 2000)

Figure: Nominal Exchange Rates EUR vs. DKK, 1999-2024



Source: Own elaboration based on Eurostat data.

Denmark outside the EMU

- Well-organized electorate constraining elite in their pro-integration attitudes
- Obligatory referendum shifting the issue of European integration into the arena of “noisy politics”
- If Denmark had not developed the referendum tradition, Denmark would probably today have been a [EU] member without reservations” (Lykke, 2002, pp. 385–386)
- Nonetheless, the Danish policymakers followed the same anti-devaluation and austerity economic policies as if they have been a euro member state all along
- “Being a euro-insider would not fundamentally alter Danish macro-economic policy strategy” (Marcussen, 2005, p. 54), other than in the name of coins and banknotes

Italy: Putting Organized Labor into Shackles

- Post-war “economic miracle” in the 1950s and 1960s -> ensued rising indebtedness, consistent inflation pressures and capital outflows
- Ongoing industrial conflicts created preconditions for a period of persistent stagflation in the 1970s (nominal wage increases -> repeating rounds of lira depreciations)
- *Confindustria* succumbing to the union pressure in 1975 -> unprecedented wage indexation mechanism *scala mobile*
- How to slip from the wage indexation straitjacket imposed by the unions? -> turn to the external anchor at the EU level

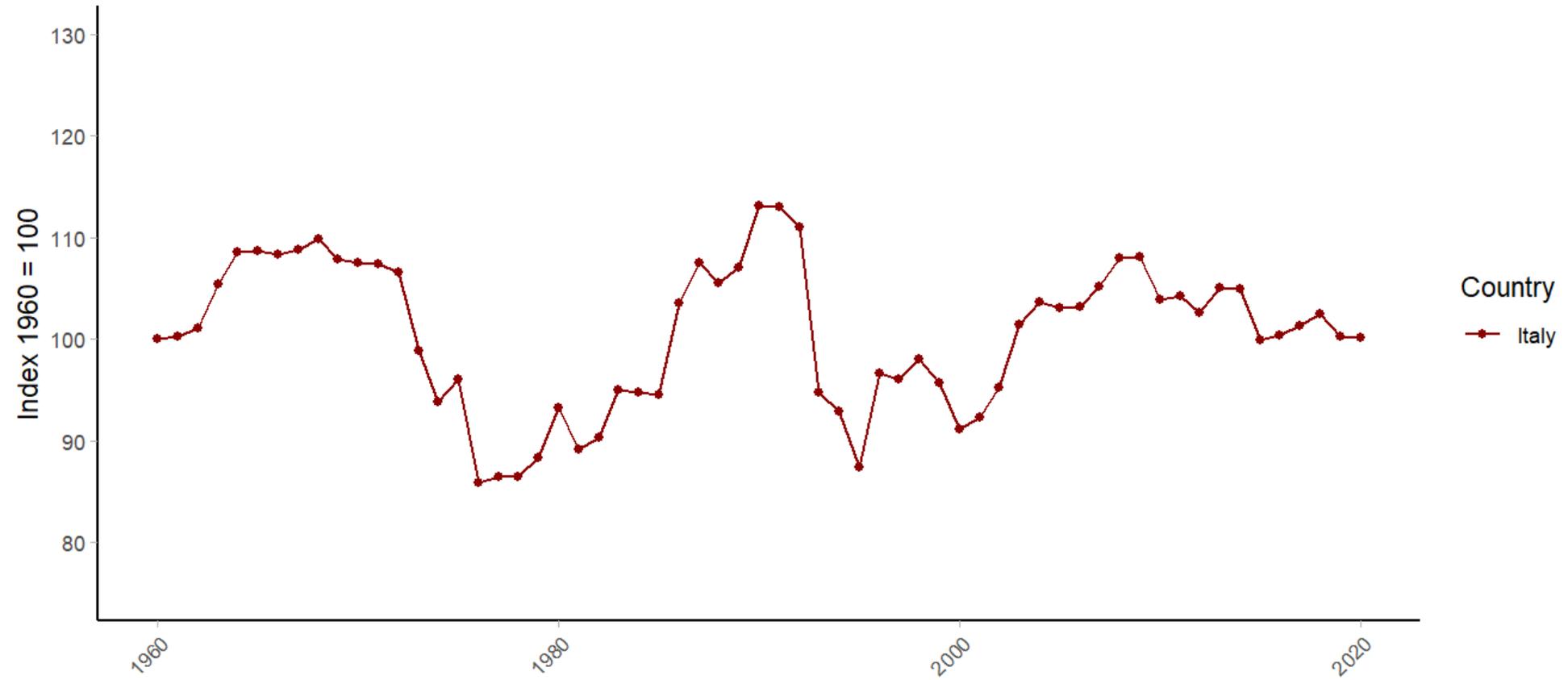
Deciphering Italy's Unexpected Support for the EMS

- Coalition of Italy's producers and bankers -> EMS as a tool of politically sterilizing politically powerful Italian working class
- Shifting the industrial conflict to the European level -> "tying one's hand" (Baccaro & D'Antoni, 2024)
- From the point of view of the growth coalition, the industrial competitiveness more endangered by the rising labor costs than by giving up the possibility of competitive devaluation (Quaglia, 2004)

Political Result of the EMS Membership

- “Divorce” between the Banca d’Italia and the Treasury
- Imposition of austerity
- Lessening ER volatility (“only” three devaluations between 1983 and 1992) and reduced inflation differential
- Ongoing real Lira appreciation -> uncompetitive export-oriented manufacturing (car and textile industries)
- Used to pressure the unions to abolish the scala mobile
- Only afterwards did the government allow Lira to float and regain lost competitiveness (Talani, 2017)
- Between September 1992 and first half of 1995 the Lira devaluated by more than 50% vis-à-vis the DM

Italy's Real Effective Exchange Rate (CPI-based) against 65 trading partners, 1960-2020



Source: Own calculations based on Bruegel (Darvas, 2012).

Italy and the EMU

- Italian industrialists (e.g., Confindustria) & bankers (e.g., Italian Banking Associations) among the fiercest proponents of Italy's participation in the EMU
- Italy's presidency in 1990 managed to enshrine the goal of establishing the single currency into its conclusions
- These positions reinforced in the aftermath of Italy's withdrawal from the ERM -> hope of replicating the success of the EMS
- Only a limited technocratic elite allowed to negotiate on Italy's behalf at the intergovernmental conference on the economic and monetary union (Carli, Padoa-Schioppa, Draghi)
- Support of the no-bailout rule, prohibition of debt monetization and insistence on setting irreversible dates for the establishment of the EMU

Conclusion

- Export-led GMs in favor of fixed ER and monetary integration:
 - Quest for institutionalized undervaluation regime at European level (Germany)
 - Constraining dissensus with business-as-usual conduct of monetary policy (Denmark)
- Growth coalition willing to go against its interests in ER policies and monetary integration to leverage labor in industrial conflict (Italy)
 - Persistent stagnation (Baccaro & D'Antoni, 2024)
 - Bubbling grudge towards the EMU amidst ongoing and future austerity (Baccaro & Bremer, 2021)

Thank You for Your Attention

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