

Creating Stability: National Preferences and the Origins of European Monetary System

Mark Aspinwall
Department of Politics,
University of Durham
Durham, DH1 3LZ England

tel: 0191-374-2810

fax: 0191-374-7630

m.d.aspinwall@durham.ac.uk

Abstract

This essay compares the preferences of France, Italy, and Britain on the creation of the European Monetary System in 1978-1979, especially the Exchange Rate Mechanism, which stabilised nominal exchange rates. My claim is that the different conclusions reached by the governments (France and Italy in, Britain out) cannot be explained by economic circumstances or by interests, and I elaborate an intervening institutional variable which helps explain preferences. Deducing from spatial theory that where decisionmakers 'sit' on the left-right spectrum matters to their position on the EMS, I argue that domestic constitutional power-sharing mechanisms privilege certain actors over others in a predictable and consistent way. Where centrists were in power, the government's decision was to join. Where left or right extremists were privileged, the government's decision was negative. The article measures the centrism of the governments in place at the time, and also reviews the positions taken by the national political parties in and out of government. It is intended to contribute to the growing comparativist literature on the European Union, and to the burgeoning literature on EU-member-state relations.

On March 13, 1979, the European Monetary System (EMS) began operation. It was set up to rectify the problems of floating currencies following the collapse of the Bretton Woods system and the weaknesses of the Snake, and it contained an important device – the Exchange Rate Mechanism (ERM) – which served to dampen nominal exchange rate volatility between the participating countries.¹ Stabilizing exchange rates was perceived to be an important objective for small open economies with high levels of economic interaction, because it reduced transaction costs for those engaged in trade and investment. While exchange rate stabilization was not cost-free, the benefits of reducing transaction costs were deemed by many (but not all) observers to be worth the cost (among others, McNamara, 1998: 124-5 and Frieden, 1997: 251ff contain discussions of the reasons for exchange rate stabilization in western Europe in the late 1970s).

When the EMS was launched eight of the nine then members of the European Community (EC) joined fully (including the ERM). Britain was the one country which remained outside the ERM. The purpose of this paper is to examine the preferences of Britain, France, and Italy toward participation. There are compelling reasons to choose these three states for comparison. They were of similar size in terms of population and economic weight in the EC; all had problems with inflation and had tried with limited success to institute economic reforms in the 1970s; they all had non-independent central banks which constrained technocratic control over prices. And yet their decisions on whether to join differed; France and Italy did so, but Britain did not, despite the urging of French and especially German leaders (and later Italy). This paper will examine the role of institutional powersharing and centrism at the national level as causes of their decisions.

My claim is as follows. First, the position of political parties and therefore governments on the EMS can be derived from their location in left-right socio-economic space. Centrists favored currency stabilization. Non-centrists opposed it. Second, the location of decision makers in left-right space is not an accident: electoral systems and presidentialism determine whether decisionmakers are centrist or not. The upshot

is that institutional arrangements privileged pro-EMS voices in France and Italy, but not Britain.

This research contradicts a largely settled literature which assumes the relevance of economic issues and historical/cultural attributes in the formation of national preferences. It overlooks ideological competition within states on matters of international economic competition and the similarities across states in the positions of ideologically-compatible parties. Moreover, the approach taken here is potentially generalizable beyond these three states, beyond currency cooperation, and beyond purely contemporary issues. For example, the alliance of far left and far right to international economic cooperation has been illustrated in the United States (NAFTA), Denmark (membership of the single currency), and Britain (over continued EEC membership in 1975).

Establishing the EMS

Helmut Schmidt proposed the EMS in April, 1978, persuading French President Valéry Giscard d'Estaing to support the initiative but failing to gain the support of British prime minister James Callaghan.² Schmidt's motivations were several, but primarily it was an effort to redress the effects of an appreciation of the DM due to the weakness of the dollar (on the creation of the EMS and the motivations of the various players see Ludlow, 1982; McNamara, 1998; Goodman, 1992; Kruse, 1980; Moravcsik, 1998: 251ff; Story, 1988; Walsh, 1994). The idea was that by tying other European currencies to the DM, Germany would spread the cost of a weak dollar, and it would also provide a more stable environment for intra-European trade and investment.

A fixed exchange rate system had advantages for highly interdependent economies such as those of western Europe, whether they were weak currency or strong currency countries. Fixed nominal exchange rates would bring greater transparency to international economic transactions and reduce competitive devaluations. However, there

¹ All member states of the European Community were eligible to participate in the EMS.

² The EMS was preceded by another currency stabilization arrangement, the Snake. See Ludlow, 1982. Schmidt's proposal had an immediate antecedent in a speech by then Commission president Roy Jenkins in October, 1977.

were costs as well: the loss of external currency fluctuation would have to be accompanied by reduced domestic monetary and fiscal policy autonomy. The reason is that capital movements would respond to (say) reflationary measures by moving away from that currency, thereby weakening it and causing a reduction in reserves as the central bank sought to defend the exchange rate. Reserves would dry up and the currency link would be broken unless government policy changed.

Loss of domestic monetary policy autonomy raised the important question of who would bear the adjustment costs when currencies diverged from their parity rates. Either weak currency countries would have to adopt the price stability of strong currency countries, or strong currency countries would have to permit inflation domestically, or alternatively the burden would have to be shared. The experience of the Snake had shaken weak currency countries since the system favored strong currencies, and all had been forced out of the arrangement. In the EMS negotiations they were eager to reduce the asymmetry of the system so that the strong currency countries, especially Germany, would bear more of the cost of adjustment.

However, the final agreement on the EMS ensured that asymmetry was built into the EMS. Although Schmidt had hoped to achieve symmetry, he was forced by domestic groups, including the powerful and independent Bundesbank, to insist upon an asymmetrical system. Germany did go some way toward meeting the concerns of the weak currency countries: a compromise system of exchange-rate stabilization was contrived which was a mix between a parity grid system (Germany's preference) and a basket of currencies (the weak countries' preference; on the basket versus the parity grid see van Ypersele, 1984: 48ff; Szasz, 1999: 52-4). The former put the onus on weak currencies; latter would put some pressure on Germany as the DM strengthened because it would act as a divergence indicator, showing the divergence of strong currencies more clearly. Under this so-called 'Belgian Compromise,' intervention was required under the parity grid, while for the basket there was only a presumption of responsibility for strong currencies to adjust (for a description of the workings of the system see Goodman, 1992: 192-4). In practice responsibility fell on weaker currencies to adjust.

Other efforts were made to introduce more equity into the proposed system because none of the three major weak currency countries were initially prepared to accept

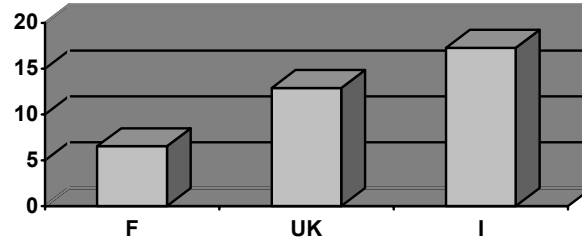
asymmetry without significant tradeoffs (Kruse, 1980: 242). These included especially regional transfers from wealthier members of the EC, which would compensate for economic shocks in poor regions. They also included financial credits. However, several key demands were not met. France demanded that MCAs be phased out - but this was rejected (many have suggested that Giscard was merely posturing for a domestic audience). Italy was unsuccessful in its claim for greater regional transfers. Limits were placed on the amount of credits and transfers that would be made available.

This result raised important concerns in Britain, France and Italy, because if they decided to join, all three would be forced to bear the burden of adjustment, adopting German-style price stability at their own expense. The main puzzle, therefore, is why two weak currency countries agreed to be bound by this system but the third did not. All three knew exactly what was in store: deflationary policies and economic austerity, at least relative to the profligacy of the early part of the decade. If they agreed to be bound by such a system, they would face criticism domestically from social actors harmed by adjustment costs. Linking exchange rates would mean that their currencies would become overvalued in real terms unless inflation was tackled by reducing public sector expenditure and controlling money supply. These measures would inevitably cause some domestic social actors to react negatively, especially those in sheltered sectors and those benefitting from public expenditure.

There were strong similarities in their economic positions (Ludlow, 1982; Emerson, 1979; Moravcsik, 1998). Most importantly, all were high-inflation countries relative to Germany, whose currencies depreciated in a floating exchange rate system to offset the higher domestic costs associated with inflation (see Fig. 1 on the next page). From 1970 to 1977 consumer prices in local currency terms rose fastest in the UK, although after 1977 Italy had the most serious inflation problem. Moreover, while unemployment was rising in all three countries in the 1970s, the problem was most serious in Italy. This is an important indicator, because the EMS was widely perceived to entail employment costs to member states, resulting from the disinflationary policies.

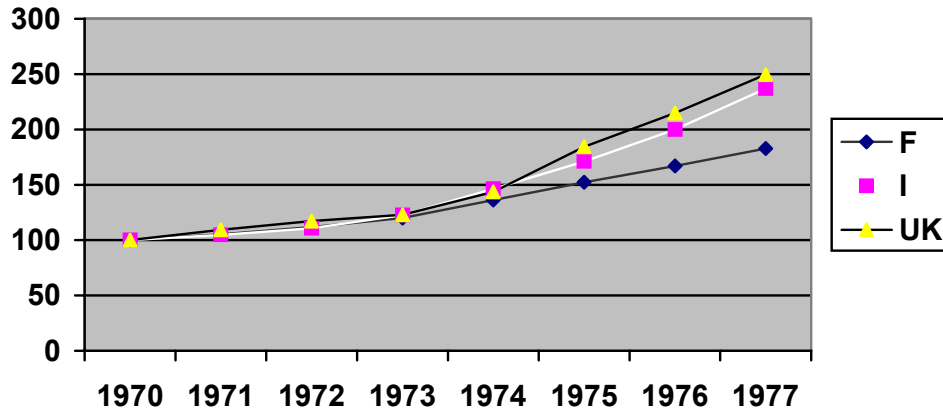
Figure 1 Comparisons of economic data

Average annual depreciation of nominal exchange rate against the DM, 1973-78



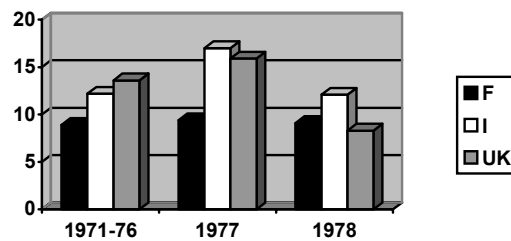
Source: Frieden, 1998.

Consumer price index in local currency 1970 = 100



Source: OECD, 'The International Competitiveness of Selected OECD Countries,' *OECD Economic Outlook*, Paris, July, 1978.

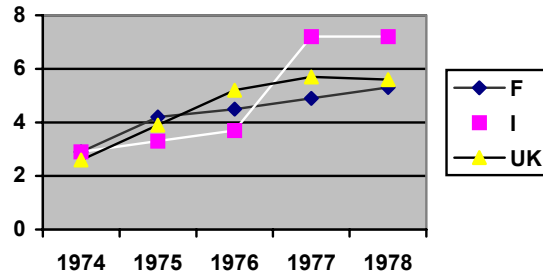
Consumer price increases



Source: OECD, *Economic Outlook*, Paris, 1979, Number 26.

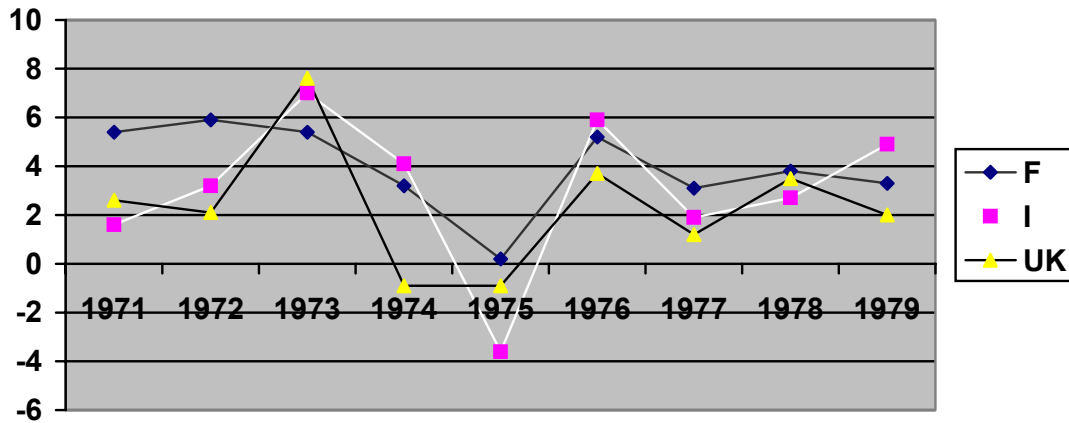
Note: 1971-76 values are average annual percent changes. Prices are not seasonally adjusted.

Unemployment, 1974-78



Source: OECD, *Economic Survey*, Paris, various countries and years.

Growth rates 1971-79, adjusted for inflation



Source: OECD, *National Accounts 1953-82* (Paris, 1984).

Given the outcome, and the similarities in their economic positions, no theoretically satisfactory answer has been forthcoming as to why these countries arrived at different conclusions about the efficacy of the ERM (for an excellent overview of the more general question of what causes variability and volatility in exchange rates, see Frieden, 1998). The majority of observers attribute at least some weight to the greater 'European calling' of Italy and France, or to the special relationship between Giscard and Schmidt, which allowed each of them to make sacrifices for the greater good (on the latter point, see van Ypersele, 1984). The system also purportedly provided external constraints which helped the weak currency countries achieve a desired aim without taking full political blame for the domestic costs. This was especially the case

for Italy, where the value of blame-shifting was highest due to the fragility of the political system.

More specific arguments address the influence of economic ideas, institutions, and interests. For McNamara (1998) a key factor was the emerging neoliberal consensus among west European countries, which pushed them toward stability and austerity. Yet all three countries had begun the process, with varying success, of adjusting to greater international openness, and all three had decision makers both favoring and opposing stabilization of exchange rates. The UK stayed out, she avers, because its trade structure was different (McNamara, 1998: 124). While this was true at the time, it leaves unexplained both the earlier British decision to join the Snake and the continuing refusal (until 1990) to join the ERM despite clearly converging trade patterns. McNamara also underplays the continuing diversity of ideological views in the member states: all still had powerful leftist opposition to monetary integration. Where this was excluded from decisionmaking on EMS membership (France and Italy) the decision to join was positive; where it participated in the decision-making process (Britain) the decision was negative.

For Walsh (1994) institutions played a significant role, particularly the coalition support of executives, and the timing of elections.³ Where executives had the support of coalition partners, autonomy was heightened and the executive could proceed with exchange rate stabilization; without this support, domestic political objectives became more important. Likewise, with elections in the recent past, executives had more autonomy to fix exchange rates; with elections looming, domestic politics reduced this option. The prediction made by this model is that with elections in the recent past and firm coalition support, governments are more likely to join the ERM. This explains British reluctance during the Callaghan government, but by May 1979 Thatcher was in power with an election just finished and a majority of over 100. The conditions for joining were met, according to Walsh's model, but a further 11 years expired before a Thatcher government took the step. Moreover, the model does not explain the consistency of support for the ERM throughout most of its operational life by both Italy and

³ See Walsh 2001 for a view which contrasts the role of capital market versus credit market financing.

France, nor the faltering by Mitterrand in 1982-3 soon after a socialist government was elected.

Little if any other work has linked domestic political institutions or partisanship directly to the choice of fixed exchange rate regimes. However, some research has suggested a strong partisan effect on the level of inflation, which has implications for choice of fixed exchange rate regimes (Frieden, 1998: 24-5; Oatley, 1997: 32-3). By tolerating domestic inflation in order to mitigate against reduced demand, leftist governments are thought to be less interested in entering and less capable of maintaining a fixed exchange rate regime, which requires convergent price stability (assuming the 'hegemonic' anchor currency is a strong one). However, empirical work and real experience indicate that the relationship between simple left-right partisanship and exchange rate stability is not as strong as might be thought. Chirac's reflationism of the mid-1970s and the occasional reflationism of the Conservative governments in Britain before 1974 are examples of rightist governments which are tolerant of inflation. In a quantitative analysis Frieden found no difference between left and right governments over the propensity to depreciate while finding that rightwing governments were *more* likely than left to allow fluctuations in the currency's value.

A final argument concerns the influence of domestic economic opinion on government preferences (see especially Moravcsik, 1998). Moravcsik's main claim is that government preferences were largely the result of the positions of major economic producers, and that differences in the distribution of interests explains the variation in member state preferences. He finds that French opinion and economic decision-making had pushed France toward stability and austerity in advance of the decision by Giscard to join, whereas he finds British business to be negative on the whole. Italy does not form part of his study, though he admits that the Italian case is anomalous. Italian business was lukewarm, the economy was not perceived to be strong enough to accommodate the strains of exchange rate stabilization, and yet Italian decision-makers moved forward.

Space does not permit a detailed consideration of the positions of economic interests. Nevertheless, two points may be raised in reply. First, economic interests were not united in their views of whether exchange rate stabilization was a good thing. This is

evident from Moravcsik's own study. For example, members of peak-level business associations had a number of conflicting views. Large business with international ties tended to favor exchange rate stabilization; small business with primarily domestic activity tended to oppose it. Peak associations included both sets of interests, and the equivocation that resulted from these conflicting views can hardly have provided a solid basis for governmental preferences.

Second, economic interests in many areas have tended to follow the government lead, rather than shape it (Duckenfield, 1999). This means that the positions of economic interests are partly a consequence of, rather than a cause of, government positions. The fact that the positions of economic interests can be inferred from their size and activity, and that this pattern is replicated in all the countries studied here, suggests that their views are shaped not so much by specific national economic circumstances as by their economic activity: mobile labor and capital as well as internationally competitive industry tended to support exchange rate stability at the expense of domestic policy autonomy. Capital and labor that was sheltered or non-competitive (or in nontradeable sectors) tended to support autonomy at the expense of external stability.

The basis of this pattern was the trade-off between exchange rate stability and domestic monetary and fiscal policy autonomy. As stated earlier, opting for external stability means that autonomy is reduced. Those producers (capital and labor) who benefited more from external stability than from domestic autonomy obviously favored the former, and vice versa. Producers favoring external stability tend to be large firms, with import or export business, or with investments in other countries. Exchange rate stability brings certainty to their business and reduces transactions costs. Those favoring domestic autonomy tend to be smaller, with purely domestic markets and non-competitive positions vis-à-vis international competitors (see Frieden, 1994). Thus, the important cleavage was not between capital and labor but between international producers (capital and labor) and domestic producers (capital and labor).

One further piece of evidence casts doubt on the relevance of the views of economic interests, namely timing: in at least two cases, governmental positions favoring EMS membership preceded the support of important economic groups. The Italian government favored membership before Confindustria altered its position in November 1978

to support Italian membership; prior to that change Confindustria opposed Italian membership. British prime minister Callaghan likewise came out in support of British membership initially, then reversed his position, despite longstanding and consistent views among British business and labor that tended to be negative. The reason for his change of heart was not a belated appreciation of interest-group views but a desperate bid to hold together a minority government.

Institutions, powersharing, and government preferences

In all three countries, an unrecognized variable influenced preferences on joining the EMS. The variable (derived from spatial theory) is the location of decision makers on the left-right spectrum. National political parties may be placed on the left-right spectrum by measuring their ideological location.⁴ Their ideological position forms the basis of predictions of government positions on European integration, including the EMS. Far left and far right parties tend to oppose integration, while centrist parties tend to favor integration.

Centrists take economic interdependence as a given and accept the liberal welfare arguments associated with economic openness; they view binding rules within international organizations as a necessary and welcome consequence of interdependence. Centrists within this policy space take a cosmopolitan, cooperative view of integration, seeing it as a useful step to ensuring economic prosperity and peace. Leftists may be divided into ‘old politics’ socialists, who see the EU as a capitalist space, and ‘new politics’ environmentalists and localists, who view the EU as remote, technocratic, anti-democratic, and not green enough. Rightists take a nationalist view, believing the EU to undermine the state’s economic autonomy or national identity (see Fig. 2).

⁴ Expert surveys, Eurobarometer data, and party manifesto analysis have all been used to measure the ideological location of parties in left-right space. See Ray, 1997. Gabel and Huber, 1999.

Figure 2. The spectrum of social opinion on European integration

| | <i>Left</i> ----- | <i>Center</i> ----- | ----- <i>Right</i> |
|------------------|-------------------|----------------------------------|---------------------|
| <i>Ideology</i> | anti-market | liberal/pragmatic | nationalism |
| <i>Position</i> | skeptical | positive | skeptical |
| <i>Interests</i> | domestic labor | international labor & capital | domestic capital |

A number of scholars have described this relationship (among other see Hix and Lord, 1997). A quantitative study done by Leonard Ray (1997), and confirmed in later research (Marks and Wilson, 1998; Aspinwall, 2000) showed a far stronger statistical correlation between support for integration and ideology than support for integration and nationality of party. This suggests that domestic parties react to integration in different ways from one another but in similar ways to ‘fraternal’ parties in other member states. In other words, ideology is an important correlate of party position on European integration. It is not a perfect predictor – Ray finds that agrarian parties tend to be in the center of the spectrum but oppose integration, while Green parties are less predictable. Yet the ideological position of a party is a much better indicator (than nationality) of whether it will be supportive of European integration.

This is a major departure from conventional thinking about European integration, because most accounts claim that social activity drives government policymaking. Implicit in these approaches is the notion that all political parties, regardless of their ideology, would ‘read’ social or cultural signals and arrive at the same conclusion about the ‘national interest’. New research provides quantitative evidence for what seems to be a widely observed phenomenon: that national political parties do not react in a similar way to proposals for European integration, but rather react in a way which is similar to ideologically compatible parties in other member states: far leftists and far rightists reject integration; centrists and moderates accept it. These categorizations

provide a far more satisfying means of sorting out positions on European integration than an assumption of homogenous national preferences.

The qualitative evidence of party and government position provides strong support for the thesis that left-right location influenced preferences on the EMS. Thus, the UDF (Giscard's party) and the Italian Christian Democrats (the governing party) were centrist, while the British Labour party governed with a minority and the leadership needed to satisfy a strong contingent of left-wing members who were hostile to monetary cooperation.

Why were centrists in power in France and Italy but not Britain? The answer lies in the constitutional rules of powersharing. In this case there are two important means of power sharing: the electoral system (in Italy and Britain) and presidentialism (in France). The highly proportional electoral system in Italy ensured a fragmented party system, in which a centrist party (the Christian Democrats) was in control of government formation. Formal coalition theory and empirical evidence both point to centrist government being one result of a fragmented party system (see Riker, 1962; Axelrod, 1970: 165-185; de Swaan, 1973; Laver and Shepsle, 1996; Laver and Schofield, 1990: 113).

In the UK, the first-past-the-post electoral system ensures one-party government, which extends from the center of the political spectrum to the edge; maverick politicians have little electoral incentive to abandon the two main parties. Whatever its other strengths and weaknesses, the FPTP system ensures that Euro-sceptic MPs are part of the governing party, unlike the PR system, in which centrist government tends to exclude Euro-sceptic extremists. When the British government has a low majority, the need to balance the two wings of the party – Euro-positive and Euro-sceptic – becomes especially acute.

In France, the fifth republic ensured a strong president, with a secure position for seven years and with power to decide important foreign policy matters. Therefore, the position of the incumbent French president is likely to be the key institutional variable for French positions on the EMS and other major initiatives in the EC. A centrist French president (like Giscard) would be expected to push for integration. A rightist (like deGaulle in 1965) or a leftist (like Mitterrand in 1981) would be

expected to resist integration. Although the position of the president is the key determinant in France, there is no means of predicting when this institutional feature will produce a Euro-friendly centrist or a Euro-hostile extremist. This distinguishes presidential from electoral systems, which allow for prediction.

Thus, the main thesis is that left-right government location is the best predictor of position on external currency stabilization. However, one potential criticism is that left-right ideological location cannot serve as an independent explanation of positions on European integration because the former is a summary of policy positions (including, potentially, positions on European integration). Therefore the argument would be that a tautology emerges from my argument: namely using a scale which is a summary of policy positions to explain policy positions.

There are two responses. First, as a means of summarizing and communicating ideology, left-right socio-economic space pre-dates European integration. Therefore, when European integration emerged as an issue upon which parties needed to take a position, they had to determine, *based upon their existing beliefs*, what their position would be on Europe. The fact that they did so in a remarkably consistent way across member states (and indeed across the developed world), revealing the cleavages illustrated in Figure 2, is itself deserving of explanation. Second, and even more clouded in misunderstanding, is how governments in some countries tend consistently to be formed from centrist coalitions (and, not coincidentally, also support European integration), while others are less centrist. The mechanisms by which this occurs, and the results for national preferences on integration, are the subject of the next section.

France – presidential centrism

Why did France accept an EMS that guaranteed disinflation? Like Italy, France initially wanted to ensure symmetry in the EMS and also greater transfers of resources to weak currency countries (on the latter point see Spaventa, 1980: 76). Giscard eventually abandoned these demands, leaving Italy in the lurch, partly because he recognised that Schmidt's room for manoeuvre was limited by domestic opposition.

Conventional arguments give great weight to historical, functional (France and Germany were each other's principal trade partners) and liberal understandings of why

France decided to accept the asymmetric ERM. For example, France and Germany were perceived to be the *sine qua non* of a European Monetary System because of their central importance in the EC. The special relationship between Giscard and Schmidt may also have helped to drive forward the EMS project over sharp objections in both countries, and caused the two leaders to make sacrifices they would not otherwise have made (van Ypersele, 1984; Szasz, 1999). In addition, Giscard was concerned to achieve an economic status comparable to Germany, so that France would play a prominent role in the future economic direction of the EC. His motivations have been interpreted as resulting from a desire to be '*plus royaliste que le Roi*' in terms of economic stability (Spaventa, 1980: 78). The lessons of history were also thought to drive French desires to share with Germany a leadership position in Europe: as *Le Figaro* pointed out, Germany had passed from hereditary enemy to hereditary friend (cited in Frears, 1981: 104).

Yet conventional arguments do not explain the differing views of the political parties at the national level. The economic ideology of Giscard, and the principal political factions in the National Assembly, correlate closely to their subsequent views of the EMS. For Giscard, the decision had already been taken to pursue deflationary policies (Moravcsik, 1998: 289-90; Ludlow, 1982: 199; McNamara, 1998: 130, 143). His *plan de stabilisation* dates from the 1960s (see Lauber, 1983: 20ff), and his ideas of liberalism, market orientation, and control of inflation continued with consistency into the 1970s, producing the *plan de refroidissement* shortly after his election to the presidency and later his backing of the *plan Barre*. Giscard's centrist credentials were reflected in an interview he gave with Jean-Jacques Servan Schreiber in October, 1978 in which he explained that France needed to embrace 'economic policies designed to encourage exports ... and reduce inflation' (cited in Ludlow, 1982: 200).

France had twice been forced to withdraw from the Snake due to high inflation. Economic performance had lagged behind Germany's consistently; in the mid-1970s inflation was 6% higher in France, and by 1977-78 corporate profits had declined, bankruptcies were rising, unemployment was about 10%, and budget deficits were significant enough to constrain reflationary measures (Story, 1988: 399). The view of liberal centrists, including Giscard, Raymond Barre, and Jean-Jacques Servan Schreiber, among others, was that in order to promote growth, inflation had to be tackled and ex-

ports encouraged. These men were critical of the nationalism of the Gaullists, and remained committed to internationalism and liberalism. In short, theirs was ‘a policy of economic liberalism at the international level’ (Lauber, 1983: 91).

In monetary policy, Giscard was concerned to maintain the value of the franc and increase exports of high value-added products, and he also favored stable exchange rates (Walsh, 1994; Story, 1988: 410). Giscard’s centrism continued a tradition: French centrist parties had been strongly favorable to European integration since at least the Fourth Republic, and centrists were the target of Giscard’s coalition building in other areas as well – particularly in pushing for direct elections to the EP. The appointment of the technocratic, austerity-minded economist Raymond Barre as prime minister in 1976 helped Giscard to consolidate his economic policy. His approach committed the government to ‘wage moderation, a balanced budget, exchange rate stability, and firm control of the money supply’ (cited in Goodman, 1992: 119; also Lauber, 1983: 89ff; Green with Cerny, 1980: 160). Barre himself called maintenance of the external equilibrium France’s most important objective, and the best guarantee of steady growth and high employment (Barre, 1981: 69-70). He advocated a strategy of price stability and stability in external exchange rates, international competition, lower protectionism, and expansion into international markets. It was precisely this commitment to external stability – a feature of centrist decision makers in all west European countries – that two years later underpinned French support for the EMS. The connection between domestic austerity and external stability was made explicit by Barre (1981: 64).

By contrast to the centrist UDF, Chirac’s Gaullists were advocating a far more nationalist line in economic policy. As premier Jacques Chirac acted in his *plan de relance* to reflate the economy in 1975 to promote growth and stimulate employment, precisely the actions that Mitterrand’s socialists took in 1981-3 (see Goodman, 1992). Chirac sought to slow down the rate of adjustment to the economic crisis, and provide a state-directed buffer to market forces. Growth increased, but so did inflation, and the trade balance worsened. Chirac resigned, but as the elections of 1978 loomed, the Gaullists put forward more proposals of a similar nature. They advocated strong state involvement in the economy, especially investment, wage earner participation in decision-making, and policies favorable to small and medium-sized enterprises. A strong thread

of nationalism, protectionism, and interventionism was apparent in these policies, especially on the part of Michel Debré, a prominent Gaullist. While Gaullist opinion was not unified, a clear cleavage existed between the liberal internationalism of Giscard and the nationalist interventionism of the Gaullist right, despite the fact that the two parties were both part of the coalition government.

The left was equally opposed to Giscard's economic liberalism, though moderate socialists such as Michel Rocard, Jacques Delors, and Jacques Attali were more closely associated with Giscardian liberalism than the Chevenementist group on the left of the Socialist party or the Communist party. The latter two groups advocated consumption-led growth, protectionism, and public investment, including nationalization of industry. In terms of economic policy a cleavage opened between leftist support for intervention, protection, and state-sponsored solutions, and the centrism of Giscard. The focus of both the left and the right on *national* solutions at the expense of international stability set the stage for later positions on the EMS.

In fact, the left and right had given Giscard problems in the late 1970s with other European legislation: in November, 1978, RPR, Communist, and Socialist deputies together rejected a proposal in the National Assembly to alter French VAT in accordance with an EC decision.⁵ A similar group of deputies opposed EC subsidies for the EP election campaign (Ludlow, 1982). The differences between the positions of the extremes and the center undermine the notion that French policy was driven by the new 'hereditary friendship' with Germany, since it is very likely that had a leftist or rightist been president a different preference on EMS participation would have been the result.

The decision to take France into the EMS was Giscard's, not the government's. In institutional terms, a key factor in the French position was the constitutional and practical power of the president. He has power over foreign policy and the power to appoint the prime minister (see Duhamel, 1980). On several occasions the president has been faced with a choice between domestic economic priorities (which conflicted with external stability) and maintaining a commitment to binding EU rules that sought to

⁵ Leftist and rightist opposition eventually came to be known as *l'autre politique*. For a recent examination of left-right hostility to European integration in France, see Evans, 2000.

guarantee stability. Mitterrand in 1981-83 and Chirac in 1995 are the most recent examples. However, Giscard had few domestic political constraints and was a center-right UDF member whose left-right location placed him closer to the center than either Mitterrand or Chirac.

Giscard's hand was strengthened by the March 1978 National Assembly elections, in which the right was returned to power with a majority of 89. He had a government in place that at least partly reflected his goals. The result was a temporary strengthening of the franc against the DM (Story, 1988: 401), as well as a gloss of legitimacy for the *Plan Barre* (Walsh, 1994: 10). Had he faced a cohabitation government, or an election, Giscard may have had more institutional constraints on his power (see the excellent discussion in Cerny, 1980: 26-47). Likewise, a decision of less importance may not have been made by the president alone, and in such a case the position of the governing parties would have been important. But at the time his power was complete, and it is possible to place the responsibility of the decision to enter the EMS at Giscard's door alone.

This focus on stability and internationalism underpinned the president's own preferences for international agreement stabilizing exchange rates, and his constitutional importance in the French political system guaranteed that these preferences would be paramount. He may have moderated his austerity plans in advance of the 1976 parliamentary elections, but his overall strategy was clear from the beginning of his presidency in 1974 when he acted to stabilise prices and restore equilibrium to the current account (Goodman, 1992: 115). Therefore, acceptance of the Schmidt EMS proposal could be seen as natural given the pre-existing preferences of Giscard and his allies, notwithstanding later assertions that it enabled Giscard to claim that his hands were tied by being bound to a Europe-wide arrangement requiring monetary discipline.

An important impact of the agreement for Giscard was its linking of the UDF with pro-EC socialists, and the marginalization of the Communists and Gaullists (Story, 1988: 401; Goodman, 1992: 190). Yet their isolation did not come readily -- in his consultations with the main political parties before the Bremen meeting, he gained the cautious approval of the Socialists and Gaullists, as well as his own UDF (Ludlow, 1982: 142). The RPR was concerned about the effect of the floating exchange rate

system on French farmers, so had some incentive to support the proposal on those grounds; it also approved of the strengthening of a European response against the dollar, about which it had had many grievances (Story, 1988: 402).

However, those on the farthest right were opposed to the EMS on nationalist grounds, and the party showed its reluctance in November, 1978 during the final negotiations (Story, 1988: 411). Earlier in the year, the RPR had begun criticizing Barre's economic policy, despite being a member of the governing coalition. The RPR was opposed to serious austerity. On the left, the working class stood to lose because of the deflationary bias of the system and the strong likelihood of higher unemployment. Leftist parties therefore were divided between those toward the center which approved of the stabilization of exchange rates and those to the left which were concerned about unemployment (the opposition of far left and far right in France is addressed in Frieden, 1994). Both the left and right opponents used nationalist anti-German messages to rally opposition to the plan: for example, the hostility of the PCF was spelled out in terms which suggest that the franc would be subjected to the dominance of the mark and German economic power (le Pors, 1978).

The pattern of leftist and rightist opposition to international economic integration was neither unique to France (the same pattern had occurred in Britain in the Referendum campaign for example) nor lost upon the participants. As one Communist official noted in December, 1978, Chirac's attacks on Giscardian centrism contained

language familiar to us [Communists] ... Should we be irritated by the convergence? Let's speak frankly: we rejoice that in an area decisive for France, the policy of resignation of the government is challenged by an increasing number in the majority coalition. And we have not forgotten that at certain important moments in our history, the Resistance and the struggle against the European army, Communists and Gaullists worked together to defend national independence (cited in Kesselman, 1980: 187-8).

Thus, there was serious criticism of Giscard from both the left and the right, suggesting that he had sold out to German interests. He also faced stiff resistance from French farmers, who had been disadvantaged by the workings of Monetary Compen-

sation Accounts and who used the EMS negotiations to press their case (Ludlow, 1982: 203-5). While he appears to have been unaffected by hostile domestic interests, partisan criticism, or expert pleadings, Giscard did fight the farmers' corner in Brussels in December, 1978, arguing for the MCAs to be dismantled. He failed in this effort, but this did not dissuade him from pressing for the EMS.

In summary, Giscard's centrism is likely to have been a key factor in the French decision to join, notwithstanding claims of increasing interdependence or friendship between the leaders, or desires to bind hands. Unlike the nationalist-leaning Gaullists and the leftist Socialists and Communists, Giscard was a centrist: he wanted international stabilization, he pursued this through the EMS. The earlier anti-integrationism of deGaulle and the later (temporary) anti-integrationism of Mitterrand both testify to the probable fate of the EMS idea had a non-centrist been in the Elysée. Giscardian centrism was of benefit to French economic interests who were export dependent or operating internationally, and accordingly they argued in favor of the move, while others were opposed. Goodman (1992: 190) states that Giscard 'had a strong political incentive to join the EMS – namely the establishment of a broader centrist coalition.' While it may be true that he sought to build support in the center, evidence points to centrism being a more important cause of EMS advocacy than the reverse.

Italy – coalition centrism

Italy, more than most European countries, is believed to need Europe in order to provide legitimacy, prosperity, and handcuffs. Italy suffers under what Luigi Spaventa called a 'Tonio Kröger complex,' in which the purportedly inferior Mediterraneans seek to remain associated with more powerful and successful northern neighbors (cited in Ludlow, 1982: 148). Italians possess a 'near universal consensus ... about the central importance of the European connection' (Ludlow, 1982: 147). As Frederico Mancini (2000: 131) put it, 'in the minds of its people, Italy has been so poorly run from Rome that almost any alternative would be acceptable. And the European alternative has paid off.' EMS therefore could not be avoided. Italy had to join, despite not being privvy to initial discussions, unable to influence the original proposal, and well aware of the constraints it would impose on the Italian economy. Guilio Andre-

otti, the prime minister, was determined 'to take Italy into the system if anything like the right terms could be negotiated' (Ludlow, 1982: 207).

Some austerity measures had been taken in the months prior to the Bremen summit in mid-1978 (McNamara, 1998: 133ff, 143; Goodman, 1992: 158-60; on the role the IMF played in this period, see Spaventa, 1983). Inflation had declined slightly, the balance of payments had moved into surplus, the foreign debt was declining, and official reserves equaled external liabilities (Ludlow, 1982: 146-7). Yet the country remained weak economically. Not surprisingly, the major domestic objective of the team drawing up the Italian strategy was to improve upon the economic stabilization that had tentatively begun (the strategy became known as the Pandolfi Plan). In this objective it was no different from the other two countries in this study. Britain had also begun to attack public expenditure, and like Italy this was partly the result of external pressure from the IMF.

In fact, the commonality of positions between the Italians and British led the former to seek an alliance of sorts with the latter (on Italy's diplomatic strategy see Spaventa, 1980; on their economic similarities see Salvati, 1980). Both had called for greater symmetry in any monetary arrangement that was agreed; both wanted further study of the French proposals; both were concerned about the policy of the EC toward the dollar; and both wanted resources distributed within the Community more equally (Ludlow, 1982: 150-1). There were differences too, notably over the margin of exchange rate fluctuation, which Italy wanted to be large enough initially to accommodate speculation against the lira.

Andreotti, the DC prime minister, left the formation of the Italian negotiating position to a small band of technocrats, and did not draw the other political parties which formed his pact into the discussions until after October, 1978 (Ludlow, 1982: 147). From March onward, the governing DC party had survived by virtue of a pact with the moderate republican party (PRI), and social democratic party (PSDI), as well as the socialists (PSI) and communists (PCI). While this made the achievement of preferences more difficult, it also notably excluded the most extreme opinion from government policymaking -- the MSI and Proletarian Democracy.

Notwithstanding the pact, Andreotti's Christian Democrat party controlled all the Cabinet posts. The Christian Democrats, like many of the other parties, were divided, but their official policy was to favor entry, certainly by December, 1978. The Finance minister, Pandolfi, was concerned that the UK would not join, but Andreotti did not believe that British reluctance should affect the Italian decision. The Christian Democrats also had members, such as Trade Minister Rinaldo Ossola, who were very concerned about the impact of the EMS on Italy. The substance of their concerns was that in a heterogeneous economic area, obligations had to be symmetrical or weaker countries would not withstand the shock.

The Republicans favored entry to the EMS, and threatened to withdraw support from the government if membership were not pursued (on party positions see Ludlow, 1982; Spaventa, 1980). The Social Democrats, also close to the center, welcomed membership, but stated that domestic reforms needed to be pursued along the lines of the Pandolfi plan. The party leader criticised the 'dangerous attitudes of certain trade unionists' (Ludlow, 1982: 212). The party also called for large fluctuation margins of 5-6%, credit facilities of \$50 billion, an adequate dollar policy, further regional funding to offset the costs of participation, and other arrangements.

The Socialist position was initially negative, fearful of the deflationary impact of the EMS and its associated domestic policies, as well as German hegemony. However, the position later moderated somewhat in an effort to distance the party from the Communists, and possibly because of the links with other socialist parties in Europe (Ludlow, 1982: 213). The PSI proposed a delayed entry in order to ameliorate the concerns of the left and help soften the deflationary blow, but Andreotti rejected this.

The Communists were divided internally, like the Christian Democrats. As the second largest party they were very important, yet many Communists were leery of the 'historic compromise' with the Christian Democrats (and vice versa), under which they had moderated their position in order to move closer to power. The PCI took the unprecedented step of coming out in favor of austerity in the 1970s when it joined the governing pact (Goodman, 1992: 214). This accommodation with the Christian Democratic party and the support offered for austerity cost the Communists some

votes in the 1979 parliamentary elections, as disgruntled supporters opted to vote for far left parties.⁶ Nonetheless a number of party officials were concerned that Italy remain at the heart of the European Community and that it help advance the process of European integration.

Parties were highly factionalised but their temporary unity in the historic compromise helps explain some of the unusual consensus on economic reform (on political parties and coalitions in Italy see Pridham, 1988). The PCI's support for moderate wage increases and their generally pro-European attitude contrasts sharply with the French Communist party, and is a good illustration of why party family is not as good an indicator of position on European integration as is party ideology. Yet there were many in the PCI who opposed the EMS, and the splintered parties and movements on the far left were similarly inclined. These positions are what we would expect based on their ideology, which was (like the French Communists) in favor of intervention, statist control, and redistribution. Even if the PCI became more mainstream, the Italian party system would not tolerate a vacuum on the ideological left.

Moreover, when push came to shove, despite the historic compromise and promises of moderation, the official position taken by the Communists on EMS was sharply negative. One of its leaders, Luciano Barca, stated that 'entry into the EMS ... would involve placing the country under German hegemony. It would also reinforce the position of those who were bent on domestic policies that would increase unemployment and lower living standards' (cited in Ludlow, 1982: 214). Indeed, differences of opinion over the EMS question was one of the most important reasons for the breakdown of the historic compromise in early 1979 (Pridham, 1988: 95).

Like leftists everywhere in Europe, the PCI viewed the proposal in terms of its impact on social groups that would be harmed by increased international capitalist activity. Ludlow interprets this position as influenced by the details of the EMS proposal, which the Communists objected to, but not the principal of reducing inflation and increasing productivity. Spaventa (1980: 83) seems to concur when he writes that the Communists' bark was worse than their bite on EMS entry, and that they were re-

⁶ The far left was splintered and the infighting that resulted meant they did not take as many votes from the Communists as they might have. See McCarthy, 1981.

signed to joining. Others suggest that the party was merely upset that it had not been sufficiently consulted on this and other matters and was taking revenge on the government (Wertman, 1981: 92).

Despite these interpretations, the statement made by Barca and the hard-line Communist opposition that continued after Andreotti refused to countenance a delay to Italian membership point to a familiar pattern of left-wing ideological opposition to economic integration, at least among a significant proportion of PCI deputies. The PCI voted against the proposal in the Chamber of Deputies (the Socialists abstained), and in January, 1979, withdrew its support from the government, helping precipitate parliamentary elections in June. Furthermore, the strongest opposition to economic integration came from a party grouping further to the left: Proletarian Democracy, which was not in government.

To be sure, Machiavellian inter-party maneuvering dictated some of the position-taking by Italian parties on EMS (Spaventa, 1980; Walsh, 1994). Yet ideology played at least as important a role in this episode: the centrist character of the Italian government explains a great deal about the decision to join in the face of economic difficulties, and clears up what to Moravcsik (1998) is ‘an anomaly’ and to Ludlow (1982: 217) is a mystery.⁷ Frieden (1994: 32) also notes the broad consensus in the Italian center in favor of joining, but attributes this to the fact that ‘all major parties were more intensely pro-EC than they were anti-EMS’.

Yet the two were inextricably linked. Italian parties had to decide not whether they were more pro-Europe than they were anti-EMS. Rather they had to decide whether they wanted to accept binding supranational rules that would stabilise the external value of the currency and thereby bring gains to those benefitting from international stability, or whether they wanted to retain domestic autonomy over monetary policy. Rightists and leftists decided on the latter; centrists on the former. Centrist government was a result of the constitutional powersharing mechanism in place at the time: the electoral law for Italy stipulated that a party had to win 300,000 votes nationally and at least one constituency seat before it could gain seats in the Chamber of Depu-

⁷ The mystery is why the Italian prime minister refused to link Italy’s membership to Britain’s, despite the urgings of some in his government.

ties (Hine, 1981: 75) This provided an extremely low electoral threshold resulting in a fragmented parliamentary system with government formation and ultimate political power controlled by centrists. The decision on joining ultimately fell to the DC party, since it controlled all the cabinet posts. The DC was a consistently centrist party, and a pro-joining decision seemed highly likely, notwithstanding the weakness of the economy. Rather than being pushed in a pro-EMS direction by the PCI, the positive decision helped undermine the historic compromise and provoke fresh elections.

Italy failed to gain most of its demands regarding symmetry and resource transfer, but nevertheless approved membership without further concessions. Along with Ireland, Italy called for a 'pause for reflection' in December, 1978, but then Andreotti quickly announced to the Chamber of Deputies his intent to take Italy in (see Walsh, 1994; Spaventa, 1980). The positions taken by the Communists, Socialist, Republicans, Social Democrats, and Christian Democrats accord with what we expect based upon their ideological positions, despite claims of cross-party maneuvering as a motivation for party actions. Domestic social actors do not explain the government's preference: Confindustria was deeply critical, at least initially. The timing is crucial: the government had a strong and consistent preference to join the EMS, even before Confindustria changed its position in November, 1978.

Britain – non-centrist balance

A number of specific economic arguments were put forward as reasons for British reluctance to become a full member of the EMS. Prime Minister Callaghan favored retaining the option of stimulating domestic growth despite its inflationary consequences, something that Germany could not agree to; Callaghan complained that as the negotiations progressed the system gradually took on more of the characteristics of the Snake, which was asymmetrical in that the burden of adjustment rested with weak currency countries (Johnson and Painter, 1980: 318). In addition British trade was still significantly less with European partners than with other countries, and this mirrored the traditional British preference for a more global approach to economic management, working with the US in the IMF. Other arguments suggested that oil production and highly liquid capital markets in London made the ERM less beneficial

for the British economy than for the continental member states (Moravcsik, 1998: 276).

Here, then, seemed a clear set of domestic behavioral or policy preferences on which Callaghan could rest British opposition. His instincts were Atlanticist and international, while both France and Germany were having problems with US leadership. The energy crisis and recession had given the UK a good reason to pursue reflationary policies. The British economic position was perceived to be out of synch with the rest of Europe. Denis Healey, Chancellor of the Exchequer at the time, explained that the UK government was committed to a symmetrical system. The government also wanted credits and intervention funds to be made available, among other things (Commons, 1978: 61). Obviously, the reason these incentives were considered necessary was that Britain's high inflation made it extremely vulnerable in a fixed rate regime which was anchored by the German mark. As Moravcsik points out: the 'ability and willingness to participate in a fixed-rate regime was an inverse function of underlying inflation' (1998: 289-90).

However, compromises reached in 1978 on stimulating demand in Germany shifted Callaghan and British Chancellor Denis Healey toward a more favorable view of EMS. At least tentative initial steps toward domestic economic convergence were set in motion, and there were strong voices in the UK favoring exchange rate stability, especially after the disastrous sterling depreciation of 1976. The lack of enthusiasm in the US and Japan for wider monetary cooperation weakens the argument that Britain could pursue a global economic agenda. Moreover, a number of compromises (albeit of a minor nature) made the operation of the ERM more palatable to weak currency countries, including increases in credits, a 6% fluctuation band for countries wishing to use it, and a basket system that would expose strong currency influences on the system. Finally, despite the assertion of fundamental differences in economic structure, Britain was successful in pressing for sterling to be included in the new Ecu basket (Kruse, 1980: 245), which seems strange given that the idiosyncratic British economy purportedly drove sterling in a different direction from continental currencies. In fact, sterling did rise by at least 5% in 1979 in the Ecu due to oil price changes, but its inclusion suggests the economic structure argument was something of a red herring.

British Euro-sceptics often claim that the trade structure of the UK is more inclined toward global, not European, activity. This would forfeit the advantages of currency stabilization with European partners and helps explain both governmental reluctance to join initially and ongoing resistance by many political elites. It is true that British trade with European partners was low by comparison to their levels at the time the EMS was being considered. But when the UK's trade pattern is compared to EU partners over time, controlling for length of EU membership and size of the EU, it is clear that the UK's trade structure does not differ significantly. The trade diversion effects resulting from membership of a regional trade bloc occur gradually. After 20 years as an EU member, British trade to and from the EU as a proportion of all trade was 49% - less than France's 50% but more than Germany's 47% and Italy's 45%.

In a similar vein Jeffrey Frieden (1997) makes the case that it is the trade patterns existing in the early 1970s that determine preference on monetary integration afterwards. Where member states had a large trade balance with the EU, and especially with DM zone countries, the currency fluctuation tended to be quite small. He goes on to say that 'higher levels of economic integration have increased political pressures for exchange rate stability' (1997: 261). Yet this does not explain British entry into the Snake in the early 1970s, when trade to the EC was relatively low, and then (as trade to the EC was rising) continued, and even vociferously hostile, resistance to monetary integration later. British government preferences have often gone in the *opposite* direction of economic activity. If the functional corollary of a rising trade and investment balance with the EU was a voluntary commitment to stabilise exchange rates and forego domestic autonomy, it was missing in the British case. Thus, the factors allegedly inhibiting UK membership were either common to all weak currency countries or were of minor significance.

After the Bremen Council in the summer of 1978, Callaghan expressed cautious optimism in Parliament about the EMS, not surprising perhaps given his endorsement of the joint statement following the meeting. Nonetheless, the British attitude is characterised as one of constructive caution and a rejection of links to Italy, despite the latter's efforts to join forces with Britain and the clear similarities in their economic situation. Britain apparently was unimpressed by the suggestion that wider fluctuation

bands would give time for economic convergence and protect against speculation, preferring that any countries joining the system subject themselves immediately to the disciplinary effects of tight fluctuation margins (ironically, when the UK did finally join in 1990 it was at the looser +/-6% bands).

The intervening influence of domestic power-sharing institutions adds explanatory value to our understanding of British preferences on this issue. Britain's electoral system virtually guarantees one-party government – with the governing party's ranks including both centrists and extremists (and others in between). Callaghan was constrained both by advocates of full EMS membership and by Eurosceptics within his own parliamentary party (on this see Johnson and Painter, 1980: 324-5, 328). With a minority government, in a pact with the Liberals by March 1978, he was obliged to balance these forces to retain a viable government (see Ludlow, 1982: 217-221 for an account of this). The Liberals were unequivocally supportive of the EMS, as we would expect from a centrist party, but the terms of the pact did not include influence over the formation of government policy on this matter, and the Liberal leader David Steel took no interest in it at all.

The forces of negativism included hostile Labour Leftists such as Tony Benn and Bryan Gould, as well as positive Labour centrists such as Roy Jenkins and the Labour Committee for Europe (see the statements of the Labour Committee for Europe and Bryan Gould in Commons: 1978: 120-2, 124-5). In early November, 120 members of the Parliamentary Labour Party signed a motion opposing the monetary system, a view which was echoed by the National Executive Committee, and of course many of those in the Cabinet, such as Tony Benn, Peter Shore, and Michael Foot, who had opposed Britain's membership of the Common Market in the referendum held less than four years earlier. Leftists had rallied behind the 'Alternative Economic Strategy' of Tony Benn in the mid-1970s, a policy proposal of socialist autarky.⁸ On the party's right wing were a number of centrist political leaders, such as Roy Jenkins and Shirley Williams, who were convinced of the merits of economic stability and international cooperation. So deep was their frustration with the power the leftists had

⁸ Interestingly the same title was given to the Gaullist strategy of the late 1970s; though it was different it shared some common features, calling for greater nationalism, protectionism, and interventionism in order to overcome economic privation (see Green with Cerny, 1980: 160, 168-70).

over the Labour party that by 1981 they split, forming the Social Democratic party to contest the center ground with the Liberals, a party with whom they later merged.

Thus, on the EMS, the need was to balance the party's warring wings. As Ludlow (1982: 217) notes, 'there was simply no way in which [Callaghan] could carry the measure in a Cabinet of which the majority were indifferent or hostile, or in a Parliament where he could not expect the backing of enough of the opposition (which was itself divided on the issue ...) to offset the antipathy of a substantial number, if not the majority, of the Parliamentary Labour Party.' Callaghan proclaimed himself to be in favor of the Franco-German idea in general, but noted, 'I could not travel fast. Many people in the Labour Party remained suspicious of what they thought was too close an entanglement with Europe' (Callaghan, 1987: 493). At the Labour party conference in 1978 delegates raised serious opposition to EMS, which undoubtedly created an obstacle to full British participation, and Callaghan reversed his earlier positive opinion and opposed British membership.

If Callaghan had been representing economic interests or the supporters of the Labour party it is unclear why he would reverse himself, first supporting monetary integration, despite consistent opinion in a section of British society - including the grassroots supporters of the Labour party and important trade union supporters of the party -- that it would have negative disinflationary consequences, then changing his mind after strong opposition in the party ranks. It is true that economic interests were equivocal and the message they sent was only mildly negative, yet it did not vary as wildly as Callaghan's position. However, even if his *post hoc* reminiscences about favoring EMS in general are wrong and he never was in favor of the idea, the evidence points to his strong efforts to balance party opinion.

It is not difficult to ascertain what Callaghan gained by stringing along the two main factions within his party. With a minority government, and two camps of fiercely opposing Labour MPs to satisfy, he was required to balance their views as much as possible in order to maintain a viable government. John Major faced the same situation from 1992 to 1997, with the same results. Appearing neither overly positive nor overly negative, the impression Callaghan gave was one of indecision and muddling. In

the end he argued for as close a relationship to the new system as possible, and in fact, the UK joined the EMS but not the ERM.

Institutional refraction and exchange rate stability

Why did France and Italy fully join the EMS but not Britain? One interpretation is that preferences diverged because of underlying differences in inflation rates and the desire to reduce the domestic costs and increase the credibility of disinflation (Moravcsik, 1998: 289-90). France was better prepared for the rigors of austerity. Yet all three member states had problems with inflation and unemployment. Likewise there were differences in the relative desire to dampen exchange rate volatility. This interpretation stresses the greater reluctance of British interests to accept exchange rate stabilization in lieu of domestic autonomy, largely because of differences in economic structure.

Yet there were strong similarities in the position of interests across borders: economic actors in exposed sectors tended to favor international stabilization; in sheltered sectors actors favored domestic autonomy. Moreover, there was a degree of equivocation among peak-level economic interests in all three countries who were forced to represent a broad array of actors in both sheltered and exposed sectors. Industrialists in all three countries had some misgivings about the EMS, but in all three countries the eventual response to high inflation was to advocate currency appreciation (Moravcsik, 1998: 286). Particularly among exposed sectors, a fixed exchange rate regime was seen as the ultimate goal. Thus, a pattern emerged: economic interests that were exposed to international currency movements were the most favorable toward the proposed EMS. These included export-dependent industries and multinationals especially. Economic interests in sheltered sectors were more opposed to EMS. This pattern replicated itself across all three of these member states.

The representation of these interests by political parties also followed a predictable pattern. On the far left, parties opposed the EMS because of the disinflationary impact that would ensue. On the far right, parties also opposed the plan because of loss of national autonomy, and because of the effect on certain social groups. Centrist parties were more favorably inclined toward exchange rate stabilization, giving priority to in-

ternational openness, stability, and rules over domestic autonomy. Crucially, powersharing institutions privileged political parties and ideologies in very different ways in the three countries: in France, the constitutional position of the president was of paramount importance; in Italy, the highly proportional electoral system privileged centrist coalitions; in the UK, the disproportional electoral system favored one-party government, with the prime minister forced to balance the hostile and positive wings of the party, especially with a low majority. The effect of these powersharing mechanisms helps explain the curious difference in preferences between Italy and Britain, both weak currency countries with some strong domestic political and administrative opposition (see Ludlow, 1982: 115, 217-221).

There is no doubt that all three governments represented important sections of domestic economic interests. Giscard, for example, slowed down the introduction of the EMS by arguing on behalf of French farmers who were concerned that French agricultural products would be harmed. Likewise, in the UK, both organized labor and large sections of the business community were opposed to the EMS. Yet the reason some interests were privileged over others is not simply their 'importance' but also the location of governmental decisionmakers. Centrist decisionmaking enabled two countries - France and Italy - to participate in the ERM, while lack of centrism prohibited the third - Britain - despite having an economic profile similar to the other two.

Counterfactually, it is possible to claim, based upon what we know of the positions of Chirac and Mitterrand, that if either had been president at the time of the EMS proposal, France would not have joined under the same conditions. Likewise, if the Italian government had included elements of the left of the Communist party and Proletarian Democracy rather than excluding them, the government's preferences would have been more negative. In the British case, if a coalition of centrists from the Labour and Conservative parties had been in power the country would have become a full member of the EMS immediately (a similar coalition ran the campaign to keep Britain in the EC in 1975, with much success). The reason these things did not happen is not that economic circumstances were vastly different or that history had produced unique outlooks in each place, but that history produced unique constitutional settlements which had consequences for powersharing, and which in turn had unintended effects on national preferences.

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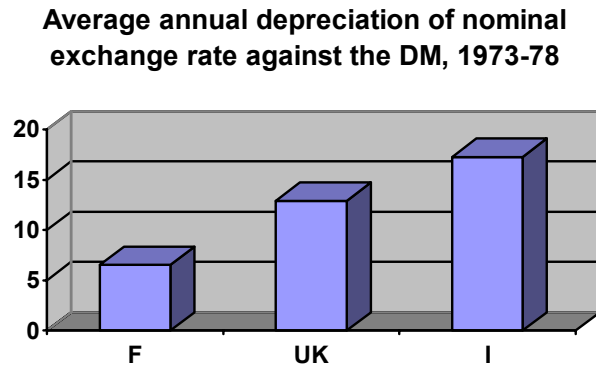
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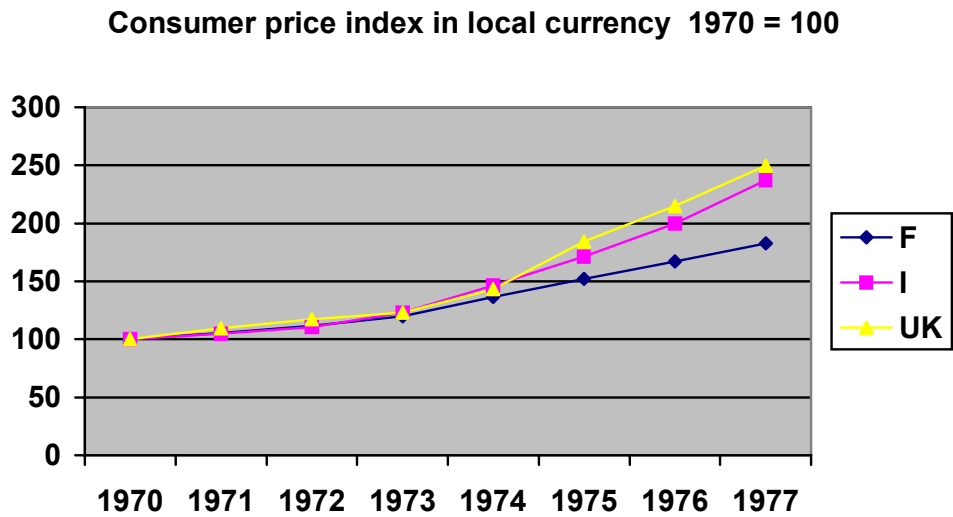
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Figure 1 Comparisons of economic data

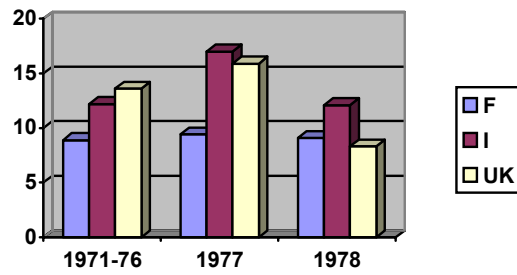


Source: Frieden, 1998.



Source: OECD, 'The International Competitiveness of Selected OECD Countries,' *OECD Economic Outlook*, Paris, July, 1978.

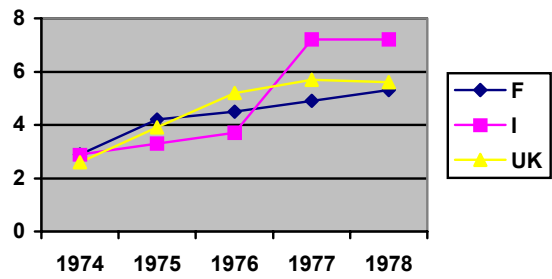
Consumer price increases



Source: OECD, *Economic Outlook*, Paris, 1979, Number 26.

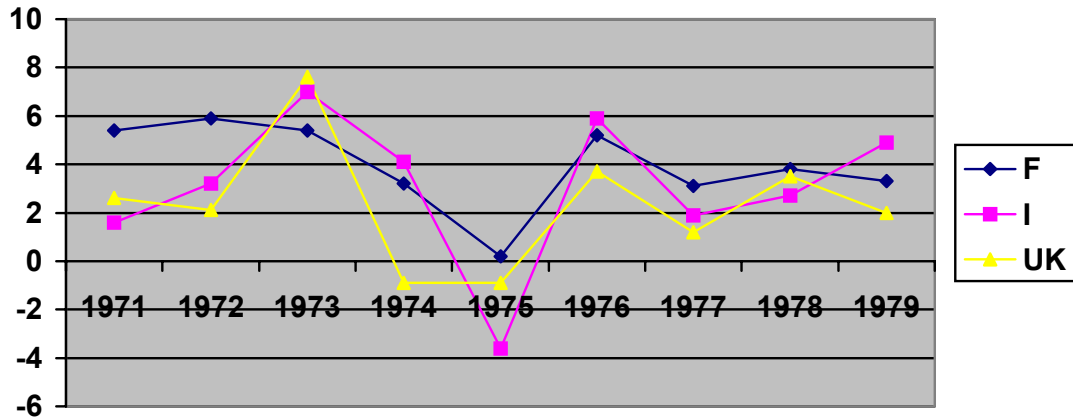
Note: 1971-76 values are average annual percent changes. Prices are not seasonally adjusted.

Unemployment, 1974-78



Source: OECD, *Economic Survey*, Paris, various countries and years.

Growth rates 1971-79, adjusted for inflation



Source: OECD, *National Accounts 1953-82* (Paris, 1984).

Figure 2 The spectrum of social opinion on European integration

Left ----- Center ----- Right

Ideology anti-market liberal/pragmatic nationalism

Position skeptical positive skeptical

Interests domestic international domestic
 labor labor & capital capital