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Explaining Europe's Monetary Union: A Survey of the Literature

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This article offers a survey of the literature on European Economic and Monetary Union (EMU), in particular works that deal with the question why EMU happened and, based on this literature, what one might be able to conclude about its sustainability. It reviews the literature by dividing up the analyses into four categories: those that explain EMU at the global and at the European Union (EU) levels of analysis, explanations at the national level, and explanations at the domestic level of analysis. The review suggests that EMU was a particular European response to global developments, which was possible because of existing EU institutions. EMU was causally motivated by a Franco-German deal, balancing national interests. Domestic motives reflect essentially opportunistic motives, and thus, cannot explain EMU. In our judgment the review suggests that Europe's single currency will remain sustainable as long as the Franco-German political deal sticks, the belief in the ''sound money'' idea remains hegemonic in Europe, and the losers from EMU are underrepresented in national and EU institutions. While opportunistic domestic motives cannot explain embarking on a long-term project, they can definitely be sufficient to derail such a project.

With Europe in turmoil over the double rejection of the European Constitution in referendums by the French and Dutch electorates in May and June 2005, respectively, there was talk of the so-called ''eurozone'' being about to collapse. An Italian politician suggested that Italy should abandon the euro, Europe's single currency, and reintroduce the lira (Minister Raises Questions over Italy's Eurozone Membership 2005:3).[1] Even before the outcome of the Dutch referendum was known—and thus before Italian ministers started their musings—there were signs in Germany that over half of its citizens wanted the deutschmark back. The German government openly criticized the euro for having caused low growth in Germany. These spring 2005 criticisms culminated in Lucas Papademos, Vice-President of the European Central Bank (ECB), suggesting that the eurozone had caused low growth in Europe and might collapse in the future (ECB Fears Euro Has Hurt Growth 2005:1).

[1]Italian Welfare Minister Roberto Maroni made this statement in a newspaper interview on June 3, 2005. He was soon supported by another Minster of the Northern League, Minister Roberto Calderoni, who also criticized the euro, stating that it had failed. Calls for reintroducing the lira resurfaced again in the summer and fall of 2006.

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British commentators often emphasize the diverse economic fortunes of the member states of the eurozone and express concern about its future viability (Black 2006; Stormier Weather Ahead 2006:33; Tilford 2006). Prominent economists, even euro-enthusiasts, such as Paul De Grauwe, are on record in suggesting that EMU is doomed to fail if its institutional structure remains unchanged (Eurozone Faces Governance Conundrum 2005). These events might lead one to pause for a moment and reflect on the viability of one of the European Union's most ambitious projects: Economic and Monetary Union (EMU).

What were the causes underlying the creation of EMU in Europe? What affects its sustainability?[2] These are two related yet different questions. Factors that led to the birth of a currency union can be expected to play a persistent role in its sustainability. Yet, once a currency union is in place some factors may lose their importance, or change their meaning. Other factors may become more important and endogenous dynamics generated by the union may affect its sustainability.

The purpose of this article is to survey and take stock of the literature on these two questions. Our answer to the first question is that EMU was a particular European response to global developments, which was possible because of the existing setup of EU institutions. EMU was causally motivated by a Franco-German deal, balancing national interests. Domestic motives reflect essentially opportunistic motives, and thus, cannot explain EMU.

As for the second question, in our judgment the review suggests that the single currency will survive as long as the Franco-German political deal sticks, the belief in the ''sound money'' idea remains hegemonic in Europe, and the losers from EMU are underrepresented in national and EU institutions. While opportunistic domestic motives cannot explain embarking on a long-term project, they can definitely be sufficient to derail one.

There are a number of ways to categorize the literature on the causes of EMU and its sustainability. One is to classify contributions along a scale running from rationalist theories to gradualist theories (Verdun 2002b). A classical political-economic distinction is between Marxist and market-based explanations. Another possible method of classification is a distinction between high and low politics (Kaltenthaler 2002). Possibly, one could use philosophical distinctions, such as the underlying ontological and epistemological logic of the different approaches to EMU (Adler 1997). Finally, some scholars of the political economy of EMU prefer to analyze the causes of EMU, which made it happen and affect its sustainability, along three levels of analysis: EU, national and domestic.[3] This survey will follow the latter tradition, but add a fourth level—the global one.

Compared to some of the other categorizations, the levels-of-analysis method has two advantages. First, it is well established in the research agenda of International Relations. While the theoretical divisions suggested above reflect important disagreements among scholars, it is generally accepted that any issue can be analyzed at a number of levels. Second, rather than presenting various approaches as irreconcilable ends of a given continuum, it presents them as compatible arguments, coming at the issue from a number of angles. It offers a useful framework within which this literature review on EMU can elaborate on

[2]The term sustainability is mostly associated with the work of Benjamin J. Cohen (1994), who uses it to argue that great power politics explain the currency union phenomenon more than any institutional design or economic cost-benefit analysis. We borrow the term but used in a wider context, referring to the ability of EMU to survive and maintain itself.

[3]See Eichengreen and Frieden 1993; Eichengreen, Frieden, and von Hagen 1995; Frieden and Jones 1998. By ''domestic'' we mean political developments inside nation states and within their institutional context. Thus, ''domestic'' is to be distinguished from ''society,'' which can develop outside the nation state's institutions, even if within its territory, and is too wide a concept to apply in this case. We use ''national'' to mean at the level of nation states.

the various theoretical arguments and diverse methodological tools used in the study of European monetary integration.

With three exceptions this survey is limited to literature from the mid-1980s onward (for earlier literature see, among others, Story 1988; Verdun 2002b). For lack of space, and since the political economic literature on the origins of EMU is substantial, this survey is also limited to major publications in refereed journals, books and edited volumes.[4] For the same reason literature on the general process of European integration is also mostly absent from this survey. It also skips the narrative of the evolution of European monetary integration, which is well-known (Dyson and Featherstone 1999).

The remainder of this survey is structured as follows. The next two sections discuss global-level and EU-level explanations of EMU. Section four reviews the analyses that trace EMU back to the nation-state level. The subsequent section looks at various actors and mechanisms at the domestic level, and the sixth section provides conclusions.

Global-Level Explanations of EMU

We start our journey into global-level explanations of EMU with one of the first explanations suggested for it. According to Hegemonic Stability Theory, any international regime, monetary regimes included, depends for its survival on the predominance of a major power (Gilpin 1987), willing and able to use its influence to sustain monetary cooperation. And while economic factors can support a currency union, they are neither sufficient nor necessary for its sustainability (Cohen 1998, 2000, 2004).

For most of the postwar period the United States (US) was perceived as the global hegemonic power, maintaining the international financial system through the International Monetary Fund (IMF). However, many Europeans regarded US policies of cheap money as abusing this dominant role. Indeed, the European monetary integration process can be seen as a continental quest for stability, in which episodes of progress coincided with destabilizing US policies (Henning 1998). In other words, since the hegemonic power at the global level was unable to provide monetary stability, the EU member states decided to provide this public good on a regional basis.

Indeed, French decision makers sought European monetary integration since the late 1960s in order to limit US unilateral monetary influence for the benefit of greater national freedom to manage domestic redistributive policies (Howarth 2001). And it was easier for European Union (EU)[5] member states to push Germany into greater monetary integration whenever it found itself diplomatically isolated by a conflict of interests with the United States (Story and de Cecco 1993:329–333). Transatlantic tensions formed a backdrop for the establishment of the EMS during 1978–1981 (Ludlow 1982; Story 1988:402–403). Other examples include the 1985–1987 events that led to the Basel-Nyborg accord and the negotiations on EMU during 1990–1992. Sometimes transatlantic conflicts were mirrored by cross-channel ructions, because of the close relationship between the United Kingdom and the US. For example, EMU can be seen as a continental response to British obstruction in negotiations on reform of the EMS (Andrews 1993:111; Sandholtz 1993b:127).

[4]Thus, we leave out conference papers and web pages and books that deal only in passing with the issue of EMU.

[5]The European Union only formally came into being on November 1, 1993. However, for the sake of simplicity we will refer to the period before also as EU even though it would be correct to refer to it as European Community. Likewise, the period before 1990 was characterized by two Germanies: East and West Germany. For simplicity we will refer ''Germany'' for the entire period, even though in the pre-1990 period we actually are discussing ''West Germany.''

However, if the United States was abusing its power to issue a global monetary standard, EU member states were clearly not the only countries to be affected. So why was it in Europe, of all places, that a club of countries formed to isolate themselves of the vagaries of US policy and issue their own common currency? The transatlantic argument seems more helpful in explaining the timing of the different phases of the process of European monetary integration. However, for the underlying causes of the process we must search elsewhere.

A more specific global-level explanation of EMU is that it is in Europe that the global balance of power changed, as the Soviet Union disintegrated. The main winner from this development was Germany, the two parts of which united to form a new power. Some decision makers felt unsure about the nature of this new Germany. Would it keep its Western political and cultural orientation? Or would it seek to selfishly change the European order?

EMU may have been designed to strengthen the binds of the newly united Germany to the western nations.[6] After all, the Treaty on European Union (commonly known as the Maastricht Treaty) did not only establish EMU and deepened economic integration of the European Community but also created a Common Foreign and Security Policy as well as formalized cooperation in the area of Justice and Home Affairs. These three pillars would bind Germany to Europe by increasing transparency and trust among the members and preventing free-riding. High defection costs would ensure cooperation even when national interests changed. Specifically, EMU would make it difficult for Germany to be over-assertive or to raise the ''German problem'' in Eastern Europe, because it is very difficult to sustain a major military effort without having a national currency. Thus, Germany agreed to EMU in return for international legitimacy for its unification and to prepare the then European Community to its eventual enlargement to the east.[7]

Such a Realist explanation is rejected by many scholars, who believe that war in Europe was unthinkable and already quite impossible in the early 1990s, given the existing web of economic and technical ties among the nations of the continent at the time. It is true that Helmut Kohl, Germany's chancellor for most of the 1990s, was an overt champion of the EMU-for-peace cause. But perhaps he was just trying to scare his citizens into giving up the successful Deutschmark? If war was unlikely in Europe, what other reasons could there be to establish EMU?

Some authors explain EMU in the context of a globalizing world, where trade and financial flows increasingly constrained state policies and influenced decision making. According to this reasoning, globalization had already limited the autonomy of national monetary policy, and lowered the opportunity cost of giving up the national currency, especially for small states (Jones, Frieden, and Torres 1998). Furthermore, EMU offered a policy instrument that could be used to influence monetary policy that many had accepted as no longer under the control of national governments (Verdun 2000a).

Without engaging in the debate about whether globalization is a reflection of US hegemony, it is important to remember that as the Bretton Woods system of exchange rates collapsed, and capital flows were gradually liberalized around the world, the choice policy makers were facing was increasingly between floating exchange rates and currency unions. Such financial external constraints clearly

[6]Note that the Delors Report that contained the blueprint of EMU was published in April 1989 and was endorsed by the European Council in June 1989—well before the fall of the Berlin Wall in fall of 1989 and thus before the prospect of German Unification came onto the horizon (see Verdun 1999). However, we accept the fact that the Treaty on European Union was negotiated in the wake of these global changes and also that the actual creation of EMU only occurred in 1999.

[7]See Hanrieder 1989; Pauly 1992:102–103; Andrews 1993; Garton Ash 1993; Sandholtz 1993b; Story and de Cecco 1993:336; Dyson 1994; Campanella 1995; Grieco 1995; Sandholtz 1996:94; Tsoukalis 1996; Dyson and Featherstone 1999.

compelled France in 1983 to adopt restrictive macroeconomic policies. This change in French policy famously initiated a period of economic convergence and greater exchange rate stability among EU member states, which was a prelude to EMU. For the French, EMU was a convincing scapegoat on which to blame this unpopular policy of greater monetary integration with Germany (see Loriaux 1991:229, 231; Andrews 1993, 1994; Cohen 1993/2000; Helleiner 1994). But again, arguing that EMU is a reflection of globalization leaves us with the question posed above—why only in Europe?

Perhaps EMU can be explained in terms of a global ideological shift away from the Keynesian paradigm, changing ideas about the government's proper role in monetary policy-making, and rising capital mobility (see, inter alia, McNamara 1998; Young 2002; McNamara 2006). According to this explanation monetary integration demanded a pooling of monetary policy, which required a cognitive convergence in Europe. This was made possible by the rise of the ''sound money'' idea—a growing consensus among the rich nations that Keynesian policies have failed and that Neo-Liberal policies were the key to lower rates of inflation and unemployment, as well as higher growth rates (see Dyson 1994; Cameron 1995a; Marcussen 1997; Verdun 2000a).

Constructivists argue that the 1970s oil shocks challenged the shared knowledge structure on macro-economic issues and prompted decision makers to look for new knowledge to structure, inform and legitimize their discourse and action. This enabled transnational experts and epistemic communities, such as central banks, to influence policy makers and to diffuse ''sound money'' ideas since the late 1970s (Dyson 1994; Verdun 1999; Marcussen 2000). Some authors argued that rather than being based on consensual knowledge, powerful interests used EMU to impose these ideas on the European public. Thus, they expected a legitimacy problem for EMU (Minkkinen and Patomäki 1997).

However, these cognitive shifts were not confined to Europe; and they coincided with the global rise in capital mobility and the loss of monetary policy autonomy, which were referred to above. Thus, it is difficult to distinguish the cognitive effect from the financial-globalization effect, and the question remains: Why in Europe?

EU-Level Explanations of EMU

Studies that focus their attention on the EU level analyze the way in which the power structure, as well as the institutional and ideational structure of the EU, channel nation states and decision makers into accepting membership in EMU. Rather than emphasizing that leaders of nation states seek to optimize their interests, EU-level explanations suggest some systemic or structural logic or process that turns membership in EMU into some kind of inevitability for the states.

We start our discussion with the EU's power structure, or more specifically, with the thesis of German dominance of monetary policy in Europe. This thesis is a more specific version of the broader claim that it is German interests that drive the EU project in general, with which we do not engage. In the monetary issue area, hegemony involves not only a correlation between the stability of the regime and the preponderance of a great power. Rather, the important features of a hegemonic monetary power are its overwhelming financial market power and it being the major source of liquidity for the regime and a lender of last resort (Eichengreen 2000).

Indeed, during the 1970s and 1980s it was common to describe the European monetary regime as being dominated by Germany. Much was written on the asymmetry in the European Monetary System (EMS) of the 1980s, the ability of the German authorities to set their monetary policy independently from other member states, and the tendency of the latter to follow the German policy (see for

example, Smeets 1990; De Grauwe 1991; Herz and Roger 1992; Congdon 1993; Fratianni and Von Hagen 1993; Bajo-Rubio and Montáves-Garcés 2002). It can also be argued that the rules of EMU reflect German views and interests (Dyson 1994).

However, the German monetary authorities neither sought to ''lead,'' nor is there evidence that they purposely tried to influence other monetary authorities, except perhaps for crisis episodes. In fact, the Bundesbank objected to the EMS from the outset, and obtained the infamous ''Emminger letter,'' which allowed it to renege on its commitments if it deemed price stability in Germany to be in danger. In securing their commitment to the EMS other monetary authorities simply followed (or paid close attention to) German monetary policies (Maes and Verdun 2005). The Bundesbank was from the outset similarly cautious about EMU, if not critical of it. The Bundesbank was not the only one with this stance; a considerable part of the German public, both laymen and experts, were skeptical of EMU when it was being created (see Barkin 1996; Bulmer and Paterson 1996; Markovits and Reich 1997). In December 1991, after the negotiations of the Maastricht Treaty had been completed, the *Bild Zeitung* ran a front-page header explaining that the end of the Deutschmark was near, which caused great distress among the population.

Independent of whether German decision makers may or may not have had a desire to dominate monetary policy in Europe, Germany never possessed the power to actually coerce EU member states into accepting its rules, or to punish those who break the rules (McNamara 1998:26–27). The only sanction available to Germany at the outset was not to agree to the establishment of EMU or to stay outside. Once inside EMU, the only effective sanction at Germany's disposal is to leave EMU, but this is a very extreme measure, and not a very useful one. Thus, Germany was not a hegemonic leader in the traditional sense.

Similarly, Germany was not a source of liquidity for the EMS. The Bundesbank kept sterilizing its foreign exchange interventions, taking measures to prevent them from affecting the money supply. Indeed, econometric studies show two-way causality between the German money supply and that of other European economies (see the literature review in Gros and Thygesen 1998:170–174). Furthermore, while there can be no doubt that the German money market was important throughout the EMS period, the center of gravity in European finance was arguably in the City of London. The Bundesbank was suspicious of market innovations and kept German money and finance markets tightly regulated. The Bundesbank did set its interest rates independently of international developments, but causality tests do not support the hypothesis that it actually determined interest rates for all EMS members throughout the EMS period.[8]

Germany was not a lender of last resort for the EMS either. The Emminger doctrine was reflected on a daily basis in the fact that most intervention activity in the EMS was undertaken by other central banks (Gros and Thygesen 1998:169–170). The same doctrine was put into practice in the September 1992 and the July 1993 crises, when the Bundesbank failed to come to the rescue of Italy and France respectively. All told, it seems that the available literature easily refutes the German monetary dominance thesis.

If Europe was lacking a power structure that would force EU member states into establishing EMU, might there have been a technical or functional structure that worked to this effect? Though discredited in the 1970s, the Neofunctionalist arguments came back with a vengeance in the early 1990s in the wake of the euro-optimism that followed the hype of ''completing the Internal Market Program'' aimed for December 31, 1992. Neofunctionalists argue that trade

[8]The exception is exchange rate realignment periods when German interest rates probably did determine other European rates, and also during 1983–1986, when the EMS functioned as a disciplinary device (see the literature review in Gros and Thygesen 1998:174–177).

integration among the EU member states created technical spillover for monetary integration. After completing the internal market project national currencies were responsible for some of the few remaining trade barriers, such as exchange commissions and exchange rate risk. Since full capital mobility, national monetary autonomy and exchange rate stability form an incompatible triangle, the liberalization of capital flows as part of the internal market meant that exchange rate stability could only come at the expense of national autonomy. Thus, a currency union was a natural extension to the internal market project (Padoa-Schioppa 2000). Neofunctionalists arguments were especially prominent in EU documents supporting the cause of a single currency (see Padoa-Schioppa 1987; Committee for the Study of Economic and Monetary Union 1989; Commission of the European Communities 1990; Pauly 1992:101; Sandholtz 1993a, 1996:94; Cameron 1997; Verdun 2000a).

A number of scholars emphasize how the early stages of European monetary integration at least were needed to smooth the operation of the complicated mechanism of the EC's Common Agriculture Policy (CAP) (see Tsoukalis 1977; Story 1988:401–402; Story and de Cecco 1993:329; McNamara 1998:99–104). If the CAP were to collapse, it might have caused serious damage to the entire EC system, because CAP was an important incentive for France's participation in the EC, and bought its farmers' support (Dyson 1994:77–78; Kaltenthaler 2002).

Indeed, it does not take a Neofunctionalist to argue that the degree to which a country is integrated into EU trade and finance has a major impact on its willingness to make the sacrifices necessary to pursue monetary integration. Statistical evidence indicates that greater integration of goods and capital markets is associated with greater success in fixing national exchange rates against the German mark (Frieden 1996).

However, Neofunctionalist accounts of EMU too easily explain away the setbacks in the process (such as the early 1990s exchange rate crises) as passing storms, unimportant in the long term. Preferring to focus on periods of successful integration Neofunctionalists are mostly unable to explain periods of stagnation in integration, nor the exact timing of processes. More specifically, the Commission has placed a lot of political capital on the assumption that exchange rate volatility is an important trade barrier. However, though theoretically appealing, decades of empirical research have produced inconclusive evidence to support this notion (see Edison and Melvin 1990:19–28).[9] Did international trade not continue to grow uninterrupted in the wake of the collapse of the Bretton Woods system of exchange rates in the 1970s? And how likely is it that the removal of the exchange rate barrier was truly the main motive of EMU, when its effect was estimated at a mere 0.4% of the member states' gross domestic product (Commission of the European Communities, 1990)? In retrospect, the good economic fortunes of the member states that stayed out of the euro zone—Denmark, Sweden and the UK—seem to underscore this point. It is hard to argue that their participation in the internal market is meaningfully impeded by exchange rate volatility. In fact, these three countries may have actually benefited from staying out of the eurozone that emerged in part because the eurozone was a market for them to engage with (Baldwin 2006).

If the power and technical structure did not make EMU inevitable, perhaps EMU should be understood in the context of the EU's broader institutional structure. After all, EMU is embedded in a network of international compromises spanning many issue areas. These issue linkages are very potent at increasing the costs of defection from EMU because they enhance the long-term

[9]Frankel and Rose (2002) is an often-cited example of studies supporting the exchange-rate barrier notion. However, they use a dummy variable for currency unions, rather then a direct measure of exchange rate variation. Thus, their finding may owe to other factors.

dimension of its obligations. Issue linkages allow a country to explicitly or implicitly trade concessions in one issue area for gains in another. According to this explanation the poorer EU member states accepted EMU, which was important to post-unification Germany, for the sake of greater European political and economic integration. In return they would receive transfer payments from the wealthier member states through the Cohesion Fund (Martin 1993). And these binds still left sufficient national room for maneuver, because of the decentralized configuration of the European System of Central Banks (Howarth and Loedel 2005).

However, some scholars argue that stronger EU institutions (perhaps a European economic government) are needed to bind the commitment of member states to EMU, especially given their diversity, and possibly to spread more evenly the costs and benefits of EMU (see Crouch 2000; Begg 2002; Verdun 2003). The sustainability of EMU may also depend on strengthening the European Parliament, in order to reduce the democratic deficit of the EU (Martin 1993), the accountability problem of the ECB (Buiter 1999) or the fact that EMU is based on output legitimacy (Verdun and Christiansen 2000, 2001). Or the EMU system may be too focused on the German model and inappropriate for other member states (see Kaufmann 1995; McNamara and Jones 1996).

Moreover, even if EMU were a natural evolution of the wide array of EU institutions, that is not the same as suggesting that EMU was indispensable in ensuring this evolution. Some institutionalists do take a more deterministic view of EMU and emphasize how the course of monetary integration was historically determined. Path dependency advocates argue that as the process proceeds, the costs of changing its course are compounded, and the likelihood of continuing the process increases. For example, at least in one recorded instance the French President Mitterrand has in retrospect expressed regrets that he had not taken France out of the Exchange Rate Mechanism (ERM) of the EMS in the early 1980s, and explained that his aids kept warning him of the increasing costs of doing so (Cameron 1996; Pierson 1996). However, while the path dependency approach may go some way in explaining gradual advances in integration, it is much less relevant to new beginnings, such as the establishment of the EMS, or dramatic developments, such as the inclusion of EMU in the Maastricht Treaty.

Path dependency explanations seem more potent when they are combined with ideational explanations. After all, institutions are based on ideas, which affect policy by providing either road maps (prescriptions for action), or focal points, adopted when actors perceive a need to cooperate but face a multitude of cooperative solutions (Goldstein and Keohane 1993). Once ideas get institutionalized they have long-lasting effects on policy, much after the circumstances that brought their adoption have changed, generating what looks like a path dependency.

The diffusion and institutionalization of ideas is associated by many scholars of EMU with the activity of transnational actors. Transnational actors form a middle way between intergovernmental and supranational politics. Specifically, the committee of governors, the monetary committee and independent central banks were powerful transnational actors in the 1988–1990 events leading to the Maastricht Treaty (Cameron 1995b, 1998).

The Commission, and its president in his personal capacity, was important in promoting the EMU idea, in the establishment of the committee of governors, in supporting the 1974 Barre plan and in launching the 1977 Jenkins initiative (Andrews 2002). The Commission insisted on the inclusion of the vision of EMU in the preamble to Single European Act, mediated between European leaders and was important in overcoming British opposition to EMU. The Commission kept the vision of monetary union in Europe on the agenda at times when

governments were opposed to the idea. Domestic political fragmentation enabled the Commission's president and various EC expert committees to play a major role in the ideological struggle that shaped EMU (see also Pauly 1992; Sandholtz and Stone Sweet 1998; Verdun 1998, 2000b).

European central bankers promoted consensus over the merits of macroeconomic discipline, price stability as the prime policy objective and central bank independence from politicians. These ideas became the foundation for EMU (Sandholtz 1993b; Dyson, Featherstone, and Michalopoulos 1995). EMU was also supported by more subtle processes involving non governmental organizations (NGOs) and the emerging European civil society (Collignon and Schwarzer 2003).

Based on interviews with many of the key informants Dyson and Featherstone (1999) conclude that the establishment of EMU was a core-executive activity and the monetary and financial elites were keen to limit the discussion about EMU to the narrow focus of monetary and financial affairs. Ideas were important and EMU was part of the ''sound money'' paradigm. The process was dominated by experts and political elite. The agenda setting power of policy entrepreneurs' elite was crucial too.

The prominent role played by transnational actors in establishing EMU raises deeper questions: did some transnational actors become epistemic communities? Did they engage with powerful interests to shape the public discourse and present EMU as based on unquestionable truths or as a reflection of an evolving collective identity? In other words, was there a European cognitive structure that channeled Europeans into establishing EMU?

Some scholars find evidence in this direction. For example, the Delors Committee—the group of mainly central bankers that drafted the EMU blueprint that lay at the basis of EMU in the Maastricht Treaty—can be regarded as an epistemic community (Verdun 1999). Others emphasize the role of collective identity in the establishment of EMU. For example, collective identities are argued to have been dominant in shaping the discourse regarding EMU in Britain and Germany. Germany's continental identity led it to endorse EMU, while Britain's Atlantic identity led it to reject it (Risse, Engelmann-Martin, Knopf, and Roscher 1999).

EMU can be understood as a process of Europeanization, with the euro zone not only as a set of institutions that political actors manipulate, but also the arena within which the actors and their strategies are constructed (see Dyson 2000a, 2000b, 2002, 2008; Quaglia 2006). Indeed, it does not take a constructivist to argue that monetary policy coordination with Germany was politically more palatable to French socialists when it was done in the name of greater European integration (Sachs and Wyplosz 1986:294–295). Furthermore, EMU may have endogenous effects on collective identities, if the single currency can weaken national identities and help foster a pan-European identity (Helleiner 2002). However, arguments about collective identity are general in their nature and their vindication awaits more detailed research.

As the review of the literature in this section shows, EMU is neither the result of German monetary dominance, nor an inevitable and necessary evolution of the general process of European integration. However, if the EU's general institutional setup did not motivate the establishment of EMU, it probably helped EMU, with its abundance of idea diffusing transnational players. Thus, while financial globalization and the end of the Cold War may have encouraged many countries around the world to integrate, as is argued in the previous section, it was in Europe that this response was most likely. And yet, explaining the likelihood of a certain event taking place falls short of a full causal explanation. Was there a more deterministic reason for the establishment of EMU?

National-Level Explanations of EMU

Classic political science explains international relations as a reflection of the selfish pursuit of national interests. From this point of view, was EMU a result of some grand bargain among European nation states and their governments? And by establishing EMU were the states trying to gain economic efficiency and material prosperity, or achieve some other political ends?

Let us start with the economic national interests. According to the classic Optimum Currency Area (OCA) theory currency unions enhance trade and income by reducing the exchange rate trade barrier, at the expense of independent macroeconomic policies (Mundell 1961). Thus, currency unions would be efficient among major trade partners with coordinated business cycles, open economies, flexible prices, high labor mobility, and financial market integration (the so-called optimum currency area criteria, see Tavlas 1993; Artis 2002). The ''New optimum currency area'' theory, which developed in the 1980s, argues that fixing a weak currency to a strong currency also benefits the credibility and success of disinflation policies, and reduces the costs of capital (see Giavazzi and Pagano 1988; Tavlas 1993; Steinherr 1994; Kenen 1995; Kaelberer 2001; Schelkle 2006). Economists argue that inefficient currency unions are costly to their member states and unsustainable in the long run.

In the 1990s economic discussion has shifted to endogenous effects of currency unions on optimum currency criteria. Frankel and Rose (1998, 2002) calculated that currency unions can potentially triple trade among their members. They also argued that high international trade enhances business cycle correlation among countries, although this effect has so far been empirically supported only for developed countries. Obviously, sharing a common monetary policy administered by a common authority narrows the gaps in the rate of inflation among the member states. All of these effects should automatically help make a currency union more sustainable. Countries who participate in a monetary union can actually become more aligned with one another by their very act of joining (De Grauwe 2006).

Rigorous economic analyses of the classic OCA sort, backed by substantial empirical evidence, found that EU member states are not perfectly efficient candidates of a single currency (see Eichengreen 1997; Frieden, Gros, and Jones 1998; De Grauwe and Lavrač 1999; Ljungberg 2004). However, such analyses downplay ''New optimum currency area'' arguments and endogenous effects of single currencies. Considering such effects produces a more nuanced picture. Balancing EMU's credibility gains against its adjustment costs, the non-Mediterranean pre-2004 member states are found to be potentially unstable members of the euro-block, as are a few of the new EU member states (Sadeh 2005).[10]

A number of studies looked at the economic aspect of inter-state relations leading to the establishment of EMU. Such studies typically describe the official entry criteria that needed to be fulfilled by national economies (Watson 1997) or provide factual accounts of economic developments that led to EMU (Ungerer 1997; Apel 1998; Overturf 2000), sometimes with a longer economic history perspective (Vanthoor 1996). Gros and Thygesen (1998) could well be described as the economic history of European monetary integration up until its publication.

OCA theory and other economic analyses have many critics, who argue that it is irrelevant to explain EMU, because EMU is mostly a political project, which is not driven by considerations of efficiency (Eichengreen et al. 1995; Andrews and Willett 1997; Willett 2000). Indeed, regions within many countries (which are currency areas in themselves) often also do not form an optimum currency area

[10]For a detailed review of optimum currency area literature with respect to EMU see also Artis (2003).

(Eichengreen 1997), and as such the lack of forming such an optimal currency area within state boundaries usually does not call into question the stability of those currencies.[11]

Critics argue that OCA theory may be useful only in the case of small states, which tend to fix their exchange rates, or micro-states, which tend to give up their currencies all together. The greater willingness on the part of small states to give up their monetary autonomy can be attributed in turn to their limited power. The Realist optimum currency area is wherever sovereignty reaches, that is, the borders of the state. This approach is empirically well supported, Realists contend. The prevailing phenomenon can be summarized as ''one country, one currency.'' It is rare to find one state with many currencies, or a few states sharing one currency. Since monetary integration in EMU is not matched by sufficient political integration among EU member states it is expected to fall apart (Goodhart 1998; De Grauwe 2006). Currency unions tend to fall apart in times of war or on the eve of major conflict or break up of a political union. Feldstein (1997) takes this argument a step further and predicts that EMU will actually provoke conflict in Europe.

In fact, one does not need to go that far to admit that there are many stable political arrangements that involve economic inefficiency. Jones (2002) goes even further to argue that the diversity of participating countries in EMU is a strength rather than a weakness, and that Europe's single currency helps to maintain such diversity rather than to eliminate it. So if EMU is not about gains to the national economy, what political ends does it serve?

State-centrists, such as Moravcsik (1997, 1998, 1999), reject economic efficiency as an explanation of the establishment of EMU. They argue that national governments acted rationally in negotiating each of the steps in the evolution of the EU. Rejecting Neofunctionalist, transnational and constructivist arguments about the origins of EMU Moravcsik argues that the establishment of the EMS at the end of the 1970s and the Maastricht Treaty in the early 1990s are a result of careful negotiations and bargaining of national governments, reflecting in particular the interests of the most powerful member states. National governments ceded sovereignty only as much as they calculated was in their interest (Levitt and Lord 2000).

Moravcsik's intergovernmental approach differs from traditional political realism in accepting that foreign policy goals of national governments vary in response to shifting pressures from domestic societal groups (Moravcsik 1993:481). However, he asserts that domestic politics merely act as a filter between the international economy and national governments. Since he attributes agency in international affairs to national governments his approach can still be considered state-centered.

Most state-centered explanations of EMU analyze specific member states. The most common argument here is based on some Franco-German deal. The German government may have been interested in preserving the stability of currency links in a financially liberalized Europe, which were advantageous to German producers. A single currency would better isolate Germany from US and Japanese policies. In addition, winning international support for German unification by accepting the proposal for EMU, which was supported by the French and others, was expected to help reduce the enormous costs of German reunification (Garrett 1993). Indeed, some German policy makers may have considered EMU as a mechanism for sharing the costs of unification with other EU member states Sandholtz (1993b:113–114), just as the EMS was argued to be a shock-absorber mechanism, distributing shocks coming from the rest of the world among its member states (Gros and Thygesen 1998:150–155).

[11]See also the critique on the exchange-rate-trade-barrier argument made above.

Such views were particularly prevalent in the German Chancellery and foreign ministry, which were interested since the 1960s in using monetary integration as a way of improving Germany's relationship with its European neighbors, particularly France, in order to overcome the security dilemma with those countries. They were able to overcome the opposition of the Bundesbank and the finance ministry to monetary integration whenever they could convince the German industry and banks that a foreign policy crisis had to be averted. This led to important breakthroughs, such as the 1969 Hague summit, the establishment of the EMS and the Maastricht Treaty (Kaltenthaler 2002).

For France and the Mediterranean member states, EMU was meant to disguise a softening of their currency link with Germany, because policy discipline would be enforced by a committee rather than the rigors of the market (Garrett 1993). In other words, in addition to their aversion to US hegemony, French decision makers also sought European monetary integration since the late 1960s in order to limit German economic and monetary dominance for the benefit of greater freedom to manage domestic redistributive policies (Howarth 2001). Kaltenthaler (2002:80) argues that the French made it clear to German government officials that as an occupying power France could actually block or delay German unification if its interests were not accounted for. However, it is hard to imagine that France, or any other EU member state, could really have prevented this union.

Where was the UK in all this? The British government clearly saw EMU as not in the national British interest, and at least theoretically had the veto power to block this project. Instead, it preferred to negotiate a specific ''opt-out'' clause (Verdun 2000a). Was this for fear of antagonizing Germany, or because the British government's inability to appreciate the intentions of other EU member states in the negotiations that led to the Maastricht Treaty (Forster 1999)? Verdun (2002a) combines case studies on national preference formation in France, Germany and Italy with emphasis on the importance of EMU as part of the larger process of European integration.

Some studies emphasize the benefits of EMU to small states (Jones et al. 1998) and even suggest a bargain between countries at the bottom of the European economic hierarchy, such as Portugal, which were already locked in fierce price competition, and those at the top, such as Germany, which derive their competitive advantage from skills and product quality (Lipietz 1996). However, it is doubtful that the small states were crucial to the establishment of EMU. Once France and Germany led breakthroughs in monetary integration, the other EU member states could either join or abstain, but not stop the process. So the Franco-German bargain seems a plausible explanation.

These country studies allow a nuanced look at specific forces and interests that gave birth to EMU and help sustain it, but their weakness is of course their external validity. What can we learn about EMU from looking at a single country or a subset of countries? And as Jones (2002) argues the costs and benefits of EMU may be associated with cross-border cleavages more than with individual countries. This suggests that some inconsistency is built into the structure of EMU, where decisions are derived from national policies but costs and benefits are not accrued at the national level. Perhaps EMU is better explained at the domestic level than at the national one? Indeed, the more nation-specific the analysis gets, the more prominent domestic level explanations become.

Domestic-Level Explanations of EMU

At the domestic level variations in the ability of EU member states to fix their exchange rates since the early 1970s as well as the establishment of EMU are explained mostly in terms of a balance of power among competing domestic interest groups. Of additional importance are the political business cycle, the

influence of domestic institutions and cabinet duration, partisan policies, and populist arguments. We review such explanations of EMU below in that order.

Exchange rate policies in general and currency unions in particular redistribute income among interest groups. Redistribution could take place by exchange rate manipulation, monetary policy (that is, interest rates and the rate of inflation) and/or fiscal policy. Thus, interest groups struggle to influence the choice of policy, including membership of currency unions. National decision makers mostly respond to domestic pressures (Milner 1995; Duckenfield 2006).

What determined the stance of various groups to EMU? Frieden (1998, 2000) argues that European producers and trade unions in the tradable goods sector, especially in traditional industries and domestic oriented ones, favored manipulating the exchange rate. By contrast, consumers, workers and producers of non-tradable goods, multinationals, international investors and producers of high-tech products preferred fixing the exchange rate. Thus, support for establishing EMU and maintaining its sustainability depended on a strong coalition of domestic interest groups. In the 1980s, changes in the balance of power among French and Italian political parties that represent these cleavages explain the evolution of exchange rate policies of each of these countries, in favor of greater monetary integration. Likewise German industry always stood to gain from fixed exchange rate with its competitors in Southern-European inflationary countries (Hefeker 1997). Evidence for the 1973–1995 period also supports the notion that exchange rate policies of EU member states were determined by distributional considerations (Frieden 2002). Even individual voting patterns in referenda on joining the euro zone can be affected by material expectations (Jonung 2004; Jonung and Vlachos 2007). A number of studies conclude that European monetary integration is led by a combination of domestic distribution factors, issue linkages, interstate bargaining (Eichengreen and Frieden 1993, 2000; Kenen 1995).

Frieden links direct gains from exchange rate changes to policy attitudes. But some scholars see distributional cleavages in the EMU debate that are sensitive to other effects of EMU. For example, member states' long-term support for EMU may depend on the extent to which it helps domestic groups to maintain hegemony in their societies. Thus, following this logic British opposition to EMU may be explained in part by the hegemonic position enjoyed by the City of London in British society. The City suspected that EMU is an attempt to give rise to a competing European financial center. British industry, however, was interested in EMU in order to share hegemony with the City, but ultimately failed to bring this about. In Italy the financial sector was dependant on the industry's profits and both financiers and industrialists did not enjoy hegemony within Italian society; thus, they were interested in EMU in the long term, as an external source for domestic hegemony. However, in the medium term Italian industry definitely had an interest in periodical devaluation of the currency and the result of these conflicting interests is the inconsistent Italian approach to EMU. In both countries employees were too weak to influence the EMU debate (Talani 2000).

EMU can also be explained as a result of domestic bureaucratic cleavages. For example, in Germany the relationship between its government and central bank (the Bundesbank) is key to understanding how and why EMU was achieved (Heisenberg 1999). This relationship may be especially useful in explaining EMU when combined with an analysis of Germany's bargaining strategies at the EU-level and the transatlantic tensions (Loedel 1999).

Some scholars combine national-level game theory with bureaucratic cleavages to explain major decisions on the path to EMU. If these decisions can be characterized as coordination games, in which the prime preference of the national actors was to cooperate rather than cheat on each other, the distributional conflicts on the specific format of cooperation were settled by domestic-level factors.

Especially, the German central bank's independence from the government enabled it to dictate the details of EMU (Wolf and Zangl 1996; and Hosli 2000).

Verdun (1996, 2000a) broadens the discussion from German cleavages to cleavages in other large member states, and how they interacted with global developments. Monetary authorities in Britain, France and Germany wanted respectively to be part of the process, to contain the Bundesbank, and to model EMU on German monetary institutions. Employers' organizations in all three member states were cautiously in favor of EMU provided that it gave birth to a strong currency and did not involve more regulations or high transfer payments to poor countries. Trade unions saw EMU as a way to improve growth and employment prospects in Europe and were concerned that it would be created with or without their consent and that supporting EMU offered an opportunity for them to remain serious negotiation partners in a Europe in which unions were losing their importance. Globalization and financial market integration made domestic actors in these three large member states realize the limited room for maneuver in macroeconomic and monetary policies.

However, many of the interest groups studies fail to explain why one particular interest group prevailed over the others in supporting or objecting to EMU. Cameron (1996) is an exception, explaining why France continued to observe the exchange rate commitments of the EMS during the Mitterrand presidency and opted for contractionary macroeconomic policies. In the early 1980s French labor was weak and divided, its importance within the socialist party diminished. The export sector lacked influence and a clear voice for or against a strong currency. The financial sector was in part publicly owned and controlled. Against this backdrop officials at the treasury were powerful and authoritative in promoting the strong franc policies and persuading Mitterrand to pursue them.

Another problem with the interest groups explanation is that there was relatively little observed domestic debate in the member states about the merits and costs of EMU, its principles and details. Domestic actors in Europe grew more involved in the EMU debate after the Maastricht Treaty was signed, but their influence on the shape of EMU remained (Youngs 1999). In the short term, each sector preferred others to pay for EMU and the reforms it entailed, but public opinion remained on balance in favor of EMU. Domestic opposition to EMU was mostly opportunistic, not ideological, and any domestic schism was overshadowed by international divisions as well as divisions within societal groups. At the end of the day the effects of monetary policies are too complicated for domestic actors to formulate a clear position about them, and the nature of monetary policy-making remains top-down.

The political business cycle literature stresses the role of interest groups and latent power of the electorate during various stages of the electoral cycle. In other words, it views the timing of elections as a variable that mediates between policy and the power of interest groups. The traditional political business cycle theory of the 1970s assumed that the economy is described by an exploitable Phillips curve and concluded that the incumbent government stimulates the economy prior to elections in order to be reelected.

According to the rational political business cycle theory of the 1990s, governments try to avoid inflation and devaluation of the currency before elections, and delay them until after the elections to finances perks that the incumbents enjoy in office or the transfers to their constituents. Pre-election inflation and devaluation are avoided by accumulating debt, which is visible to the electorate only with a lag. Therefore, pegs are especially hard to sustain around elections. The implication is that frequent elections and unsynchronized electoral cycles among the member states can destabilize exchange rates and make currency union less sustainable.

Is there a political business cycle in Europe? Alesina and Roubini (1997) studied the sensitivity of unemployment, growth, output and inflation to changes of government and to their political orientation in eleven of the EU-15 member states (as well as seven non-EU countries) during 1960–1987. They found that while elections did not have real effects, inflation did tend to increase immediately after elections. This could potentially produce differences in the rates of inflation among EU member states, as the timing of elections varies, but such pressures should be temporary and not a threat to the stability of EMU.

Other studies found that during 1990–1999 whenever they maintained fixed nominal exchange rates the ten new EU member states tended to manipulate their economies in election years by running larger budgets (Hallerberg, Vinhas de Souza, and Clark 2002). And the correlation of electoral cycles among 26 EU member states and candidate countries was significantly related to exchange rate variation and to the correlation of budget cycles among them during 1992–1998 (Sadeh 2006a). Thus, coordination of electoral cycles among EU member states would make their membership in the single currency easier.

However, even if a political business cycle exists in Europe, and even if it can create difficulties for maintaining EMU, it cannot explain such a long-term project as EMU. The launching of EMU is unlikely to have been a short-term opportunistic policy.

The extent to which policymakers are sensitive to the demands of interest groups also depends on various institutional features. Domestic institutions define the preferences and political influence of interest groups. Policy choice is a function of how industrial firms, banks, and labor unions organize and deploy their political resources.

For example, institutions explain varying exchange rate policies since the 1970s in Britain, France and Italy, against a similar backdrop of high inflation (Walsh 2000). Some scholars of EMU point out that that in countries with credit-based financial institutions such as France, Germany and Italy, where firms raise capital mostly through bank loans, the industry and the banking sectors should in theory support a strong currency policy and membership in EMU in order to make debt repayments easier. By contrast, in Britain, where capital is raised mainly through issues of bonds and equities, there should be little support for EMU (Talani 2000; Walsh 2001). However, in reality France and Italy persistently differed from Germany in their preferences regarding the institutional makeup of EMU.

Domestic political institutions also play a role in exchange rate policies. For example, multi-party government coalitions in unitary rather than federal systems may give up monetary autonomy because it is hard for each player to target the benefits of monetary policy directly at its constituencies. Players would rather use fiscal mechanisms for redistributive policies and opt for fixed exchange rates (Hallerberg 2002). According to this explanation Belgium, Denmark, Finland, Ireland and the Netherlands are expected to support European monetary integration. In contrast, in federal systems such as Germany a significant portion of government resources is commanded by local governments and the incentive of the federal government to fix exchange rates is weak. Britain, which has a one-party cabinet in a more or less unitary system, is not expected to be a great fan of EMU. French semi-presidential system makes it a half-way case between single and multi-party cabinets with the resulting consequences for its commitment to EMU. The implied conclusion from this theory is that domestic institutions in France and Germany undermine the sustainability of EMU.

Electoral institutions can also be important. Politicians in countries with high electoral defeat costs and exogenous electoral timing may be less willing to fix exchange rates and forgo their discretion over monetary policy (Bernhard and Leblang 1999). In addition, political uncertainty in parliamentary democracies

has a special tendency to increase exchange rate volatility. While political events often increased volatility during 1979–1998 for the British, Belgian, French and Swedish currencies, participation in the ERM stabilized exchange rates (Leblang and Bernhard 2006).

Political uncertainty is related to cabinet duration. According to the literature cabinet duration in Europe is simultaneously associated with exchange rate variation. On the one hand, fixed exchange rates cause political stability, serving as focal points for policy agreement and bargaining or as credibility anchors, and helping politicians manage intra-party and intra-coalition conflicts (Bernhard and Leblang 1999; Frieden 2002). For example, there is evidence that during 1972–1998 fixed exchange rates improved cabinet durability in EU member states (Bernhard and Leblang 2002b).

On the other hand, stable cabinets are more likely to fix exchange rates in the first place because maintaining a fixed exchange rate may require politically difficult adjustments and long decision-making horizons. For example, there is evidence that exchange rate risk premiums in Belgium, Britain, France, Germany, Italy, and the Netherlands existed between 1974 and 1995 more often when the government's tenure in office was not secure, because economic agents found it hard to forecast exchange rate movements (Bernhard and Leblang 2002a). And the probability of speculative attacks on the exchange rate increased in EU member states (as well as five other countries) during 1970–1995 when the probability of a cabinet dissolution was high (Leblang and Bernhard 2000).

The two-way causality that the literature highlights between cabinet duration and exchange rate variation makes it difficult to tell whether EMU is a cause of greater cabinet duration or a result of it. Sadeh (2006b), based on a sample of 43 member states and candidate and neighborhood countries during 1992–1998, shows that the effect of cabinet duration on EMU can be isolated after controlling for that two-way causality, as well as for optimum currency area variables. However, cabinet duration and various domestic institutions are more likely to have been features that facilitated EMU rather than a driving motive for its establishment.

The choice of exchange rate policy is also part of a political agenda, sensitive to the ideological or constituency bias of the ruling coalition. Is EMU a project for right-wing governments? Many scholars see EMU and the history of the EMS as reflecting a monetarist agenda, redistributing income from labor to capital (Grahl 1997; Oatley 1998).

Under the rules of EMU and the Stability and Growth Pact such policies are supposed to be more difficult to pursue. The fiscal constraints imposed by EMU, central bank independence and setting price stability as a prime policy goal isolate policy makers from the pressures of domestic politics and accountability, promote a hospitable investment climate, and maximize the power of capital. Furthermore, some argue that EMU was created by elite males in large financial houses and firms, government bureaucracies and EU organizations. EMU is part of a process of deepening social inequality to the detriment above all of women and children (Gill 1992, 1997; Young 2002).

There is indeed evidence that during 1967–1990 left-wing governments in EU member states did tend to accumulate more debt in their attempts to cushion their electorate from the effects of international trade, and had a greater tendency than other governments to place capital controls (Garrett 1995). Alesina and Roubini (1997) also found long-term partisan differences in inflation, especially in two-party systems.

However, these studies relate to the 1970s and 1980s. Some authors claim that in the 1990s support and opposition to EMU cut through all European mainstream parties, suggesting that a right-wing agenda is not a criterion for membership in the single currency. Still, other scholars find evidence for partisan bias in

support for EMU even in the 1990s. Greater similarity in the 1990s between the partisan biases of European countries was associated with greater diversity in their fiscal positions, in accordance with the expectation that left-wing governments are more inclined to run budget deficits (Sadeh 2006a).

Some of the confusion with regard to partisan exchange rate policies can be clarified by controlling for institutional features. For example, in Britain and Sweden labor employed in transnational business, and feeling politically weak, is shown to have been in favor of EMU, expecting it to strengthen its ties to continental trade unions. By contrast, labor in national-oriented business opposed EMU because of its perceived deflationary bias (Bieler 2008). However, all told, the empirical evidence on the partisan bias of EMU is indecisive.

Populists make the claim that political, economic and intellectual elites, most often dynastical families, conspire to take advantage of working *men*, which are considered as individuals, not as a class. This approach is centered on men with a lesser emphasis on women and great suspicion of state bodies.

Connolly's (1995) populist approach caused quite a stir at the time, not least since he was an insider, serving on the Commission's DG II. This book took the cause of the perceived oppressed to argue that EMU is an anti-Anglo-Saxon corporatist project that was devised by French civil servants and multinational corporations against individual freedoms to keep the same families and castes in political and economic power.

Conclusions

Scholars of EMU tend to reject the idea that Germany was or is a regional hegemonic power. However, the establishment of EMU, and perhaps the tenacity of its member states to sustain it, could be explained as a collective continental attempt to minimize the destabilizing effect of US economic and foreign policies. In other words, the worse the transatlantic relations are, the more sustainable EMU is. Likewise, EMU could be seen as an attempt to regain some hegemonic power, or at least pool sovereignty and thus increase the influence of ''Europe'' in the international context. While the literature that makes such arguments is still thin, no work has yet provided strong evidence to refute it.

Other arguments have suffered greater criticism. Neofunctionalists argue that exchange rate volatility is a trade barrier worth demolishing. However, it is not self-evident that exchange rate management, or a single currency, is needed to secure various parts of European integration. Institutionalists argue that EMU is designed to bind Germany to the western nations. EMU is embedded in a network of international compromises spanning many issue areas. These issue-linkages increase defection costs especially because they give a long-term dimension to obligations. The conclusion seems to be that strong EU institutions are good for EMU. However, some institutionalists believe that strong and centralized institutions would upset member states by encroaching on their sovereignty, and argue that weak and de-centralized ones are better for EMU's sustainability. Thus, beyond the general claim that ''institutions matter'' the institutionalist message on EMU is ambivalent.

It seems hard to reject the thesis that the establishment of EMU and its long-term sustainability are associated with common principled and causal beliefs about the role of money in society and how best to set the common monetary policy. However, it is hard to control for national governments and interests in evaluating the role of these actors. Did interested governments make way for them or were the governments forced to accept their activity?

Although ideas may have been crucial, the role of national identities in the establishment of EMU may not have been as important, at least not in some of the member states. Either Europeans accepted that money is a technical

institution, not a symbol of nationality (and thus worth giving up), or nationality became less important all together in the 1990s, as individual and local identities were cultivated. Either way, this analysis suggests—by the same token—that the single currency should not necessarily be considered to be a strong promoter of a pan-European identity.

Overall, the global and EU-level explanations are compelling. The weaknesses, however, are that their logic is sometimes circular—using the same concept to both define and explain phenomena. Constructivists also face a difficulty in separating agent action from its structural conditioning.

Turning to the national level of analysis it is hard to find conclusive evidence for the economic benefits of EMU. Efficiency considerations do not explain the ebb and flow pattern in the process of monetary integration in Europe. Scholars agree that EMU was, and remains, essentially a politically motivated project. That being said, it is still expected that with time EMU will endogenously become less expensive for its member states and generate more benefits. Anyway, even if the costs and the benefits of EMU are obscure or difficult to estimate, it would be hard to argue that cost-benefit calculations about EMU were absent from the considerations of member states leaders and their populations.

State-centered political approaches view a currency union as a political alliance that depends on a balance of national interests. According to the literature in EMU Germany traded monetary prudence for international legitimacy, lower costs for its unification, and economic advantage for its industry. France won greater control of interest rates in exchange for a unified and more powerful Germany. For both France and Germany EMU served anti-American interests. However, realists believe that EMU would eventually be undone if it fails to lead to a full political union among its member states.

At the domestic level of analysis it is suggested that EMU was brought about by, and still is dependent on, a dominant coalition of interests. EMU is supported by big business, multinationals, high-tech industries, employers' organizations and the non-tradable sector against the interests of small and traditional industries and even most trade unions of large member states. EMU also facilitates the maintenance of common policies such as the Common Agricultural Policy. The power of these sectors in Europe can be expected to remain stable in the foreseeable future.

However, studying interest groups' effect on exchange rates without good idiosyncratic proxies for their pressures runs the risk of measuring simultaneous relationships. Domestic opposition to EMU was mostly opportunistic, not ideological, and any domestic schism was overshadowed by international divisions as well as divisions within societal groups. Indeed the sustainability of EMU cannot be based in the long term on a coalition of domestic actors because domestic alliances change. Some of the EU member states, notably Italy, have volatile domestic politics. Can domestic politics provide a long-term explanation for EMU? While domestic politics convincingly explain certain phases in the EMU process, such as the macroeconomic convergence period of the late 1980s, other phases are not well explained by this approach. Often the evidence is anecdotal.

There is no evidence that suggests that the political business cycle in the EU affects real variables such as output and trade. There are of course short-term variations in the rate of inflation and budget deficits, which should be easily overcome with proper institutions. Yet, there is agreement among scholars that the extent to which policy makers are sensitive to the demands of interest groups does depend on various domestic institutional features. EMU is explained by and should be more sustainable with independent central banks, unitary rather than federal political systems, multi-party rather than single-party

systems, and endogenous electoral timing. Stable cabinets in the EU are more likely to fix exchange rates and support EMU than short-lived cabinets. Yet, some scholars believe that EMU has an endogenous effect of making cabinets more durable.

While partisan differences regarding European monetary integration can be observed before the 1990s, it seems that since the signing of the Maastricht Treaty a right-wing agenda is not a criterion for membership in the single currency. Some scholars nevertheless see EMU as an income redistribution policy from labor to capital, from women to men and from the young to the old. Have the established European left-wing parties betrayed their constituents? The disenfranchised groups may not be well represented in parliaments. If that is the case EMU might suffer a legitimacy crisis, which would undermine its sustainability.

It should be noted that very few of the arguments and approaches surveyed above were empirically tested with the ten new member states that joined in May 2004 or the two that joined in 2007. There are hardly any books and articles on the effect of interests, perceptions, institutions and domestic politics of these countries on EMU's sustainability. Further development of the literature on EMU's origins and its sustainability should address this want, as well focus on integrating explanations from more than one level of analysis. The literature could also benefit perhaps from attempts to move from single country studies into larger datasets.

Two questions were posed in the introduction to this article: what caused EMU and what affects its sustainability. Our answer to the first of these questions is that EMU was a particular European response to global developments—globalization and the change in the balance of power at the end of the cold war. This response was possible because of the existing setup of EU institutions and transnational actors. This institutional setup made Europe different from the rest of the world—the existing EU made it cheaper and easier to establish EMU. EMU was not about German dominance and not really about economic efficiency and furthering trade. Rather, EMU was causally motivated by a Franco-German deal, where the Germans got international legitimacy, lower unification costs, and economic advantage for their industry, and the French won some freedom from the rigors of currency markets and greater influence over interest rate setting in Europe. Domestic factors are important in shaping the cost/benefit balance of EMU, but most of them reflect essentially opportunistic motives, and they do not amount to a causal explanation of EMU.

As for EMU's sustainability, in our judgment the review of the literature suggests that the single currency will survive as long as the Franco-German political deal sticks, the belief in the ''sound money'' idea remains hegemonic in Europe, and the losers from EMU are underrepresented in national and EU institutions. While opportunistic domestic motives cannot explain embarking on a long-term project, they can definitely be sufficient to derail such a project.

Thus, although doomsday scenarios have been the talk of the town since the negative referenda on the Constitution in 2005 and the Irish ''no'' in the referendum on the Lisbon Treaty of June 2008, Europe's single currency can be expected to stick around for quite a bit more time in spite of its obscure balance of costs and benefits and its failure so far to inspire a common European identity or political unity.

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