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Neomercantilism and the Structure of the Eurozone Crisis, 1945-2012

DISSERTATION

submitted in partial satisfaction of the requirements
for the degree of

DOCTOR OF PHILOSOPHY

in Sociology

by

Robert MacPherson

Dissertation Committee:
Professor David A. Smith, Chair
Professor Nina Bandelj
Chancellor's Professor Charles C. Ragin

2017

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DEDICATION

To

Julee and Roland

what used to be done for me, or worse, for the world
is now all for you

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CURRICULUM VITAE

Robert MacPherson

2001 B.A. in Linguistics (Japanese), Florida Atlantic University

2010 M.A. in Sociology, Florida Atlantic University

2017 Ph.D. in Sociology, University of California, Irvine

FIELD OF STUDY

Political Economy, Globalization, Social Movements, Economic Sociology

PUBLICATIONS

MacPherson, Robert. 2017. "Antisystemic Movement Analysis: Tracing the World-Scale Determinants of Syndicalism." Forthcoming in *Social Problems*.

MacPherson, Robert. 2014. "Antisystemic Movements in Periods of Hegemonic Decline: Syndicalism in World-Historical Perspective." Pp. 193-219 in *Structures of the World Political Economy and the Future Global Conflict and Cooperation (World Society Studies Volume 2014)*. Edited by C. Suter and C. Chase-Dunn. London, UK: Lit Verlag. (2013 World Society Foundation Award Winner).

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ABSTRACT OF THE DISSERTATION

Neomercantilism and the Structure of the Eurozone Crisis, 1945-2012

by

Robert MacPherson

Doctor of Philosophy in Sociology

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Professor David A. Smith, Chair

Since 2008 the countries of the Eurozone have seen social upheaval and economic crisis on an unprecedented scale. Sociological explanations for European development and crisis have relied either on an neoinstitutionalist approach, seeing the region as a coalescing "field" of social interaction, or an approach a collection of disparate "varieties" of economy, supposing that Southern European states were profligate in their spending or wage policies compared to Germany and other Northern states. In contrast, this study uses global political economy and post-Keynesian economics to analyze the sharp inequalities between Western Europe's economies, the unusual structure of pan-European economic governance institutions, and the way these interacted to cause the post-2008 crisis. I argue that Europe's uneven political economy, in which a "neomercantilist" North centered on Germany has grown by extracting export surpluses from the debt-addled South, is a crucial component of any explanation for why Northern and Southern member states display such divergent models of social development and why pan-European institutions took their current form.

I use Qualitative Comparative Analysis (QCA), a software-aided method of case comparison, as an initial test of competing crisis explanations, mapping the Eurozone's Northern

and Southern blocs over the 1999-2007 period. This revealed bloc structure then informs a multi-chapter historical case study of European development since 1945, putting the neomercantilist explanation in dialogue with competing sociological theories at each step. Comparative-historical methods are employed to demonstrate that pan-European institutions such as the European Central Bank (ECB) were shaped by this neomercantilist relationship between Northern and Southern countries and thus tend to exacerbate between-country inequalities. More fundamentally, I argue that the disparate social models found across Europe were also shaped by this neomercantilist relationship, rather than being a *sui generis* result of each country's own particularities. Explaining who won and lost in the wake of the crisis therefore depends, at base, on this neomercantilist linkage, and the way it determined both the social models installed in each European country and the restrictive institutional framework of the Euro itself.

Chapter One

Introduction

After 2008 the world economy slid into crisis and then stagnation on a scale not seen since the 1930's. The so-called "Great Financial Crisis" first became visible in 2007-08 as the byzantine tower of financial instruments built on the back of the US housing bubble collapsed. Turmoil in global credit markets followed quickly, exposing the over-leveraged condition of both private and public sector actors across the developed world; governments, banks, and households all found themselves vulnerable.

Yet this was not to remain a short and traumatic shock; nearly a decade of protracted illness suggests there are deeper pathologies at work. The symptoms were nowhere more evident than in Europe, where the 2008 crisis kicked off capital flight and the costs paid by European governments to finance their public spending began to wildly diverge. International capital is notoriously fickle, and any member of the European community that lost the confidence of investors saw its borrowing costs shoot upward; Greece, Ireland, Italy, Portugal, and Spain all saw increases in the yield on their government debt sufficient to threaten the possibility of losing the ability to fund their operations.

In parallel with, and partially due to, the "Great Financial Crisis" having mutated into this "sovereign debt crisis" the traditional scourge of capitalist economies, unemployment, began to mount. Within three years unemployment in Spain and Greece reached nearly thirty percent, with youth unemployment in some regions breaching fifty percent. At the same time, expert opinion was revealed to be deeply mistaken about the severity and duration of the crisis. Initial estimates by the International Monetary Fund (IMF) were that even the worst hit economy, Greece, would contract by 2.6% and then begin the process of recovery. Instead, Greece's GDP

contracted by 23% between 2009 and 2013, while Spain contracted by 9% and Ireland by 6.5% over the same period.

For these countries, devaluation of their currencies might be expected to relieve some of this suffering, making their exports more competitive and thus giving a boost to their economies. Alternately, large public spending programs could help, with the state acting as "spender of last resort" in economies in which shrinking employment and investment cutbacks decimated aggregate demand, leading to further drops in investment and employment and a vicious recessionary cycle. However, both of these options had been foreclosed years earlier; the states of Europe were now locked in institutional fetters of their own design. After 1999, the twelve original member states of the so-called Eurozone embarked on an unprecedented experiment: replacing their respective sovereign currencies with the shared Euro, and relinquishing their ability to issue this new currency at will by creating a European Central Bank (ECB) independent of any single state. As a result, when the crisis caused overindebted banks and firms to cut back on investment and unemployment increased, any moves taken by European governments to stabilize their societies via fiscal means were constrained. The countries of the Eurozone, rather than being able to create their own spending as needed, became like just another household or firm, dependent on borrowing funds needed for their most basic operations.

This shared institutional framework also wound up extending the length and severity of the crisis. Europe as a whole suffered two drops into recession; just as the continent began to stabilize in 2010 it collapsed under the weight of austerity policies recommended by the "Troika," an emergency crisis-fighting entity comprised of the executive branch of Europe's supranational institutions, the European Commission, together with the ECB and the IMF. It was supposed that countries having trouble borrowing on the sovereign debt market and beset by

unemployment should "tighten their belts" and reign in their spending – again casting the supposedly sovereign Greek, Irish, Spanish and other states as more akin to a household than an independent state. The result of this double-dip recession was six quarters of negative growth in 2012-13 and years of stagnation since.

All of this came as a shock in a region lauded as the preeminent example of international integration. On the eve of the crisis even sociologists, often skeptical of institutionalized power structures, could proclaim that a Europe integrated via pan-European organizations such as the Commission and the ECB "might remain the best global model available of a liberal, sufficiently socialized, appropriately regionalized economy and society; a model that best fits this still only partly post-national world" (Favell 2008:501).

Regardless of these shocks to liberal sensibilities, popular explanations of the crisis quickly converged on a story of profligate Southern European economies living beyond their means (Grant 2009; The Economist 2010, 2011; Cohen 2010). Its very classification as a crisis of "sovereign debt" already assumes the root cause: unsustainable public spending leading to a high ratio of public debt to GDP. This was often connected in a hazy manner to the idea that these countries also allowed wages and asset prices to rise irresponsibly, living the carefree grasshopper's life even while the industrious ants in other, more abstemious, European countries prepared for winter.

Such explanations tended to operate within a short time horizon, beginning with the installation of the Euro as the common currency in 1999. On this account, sharing the Euro was too much of a temptation for profligate countries and their bad behavior was revealed in October 2010, when Greece's incoming socialist government revised estimates of the government budget deficit, nearly doubling to 12.7% of GDP. By April of 2010, Eurostat (the European Union's

statistical agency) revised this estimate upward again, and the Greek government requested financial assistance when skittish investors seemed unlikely to roll over existing state debt. The result was panic amidst the banks, investors and other European states that held Greek government bonds. Over the next two years, the yields on Greek government bonds went on a chaotic roller-coaster ride, climbing from the previous stable 4% to over 20%. Contagion effects followed; worries about the large deficits and debt trajectories of other Eurozone countries resulted in similar investor panic that led to wild fluctuations on Spanish, Portuguese, Italian and Irish rates.

The Eurozone countries that bore the brunt of the crisis were dubbed the "PIIGS" (Portugal, Ireland, Italy, Greece and Spain) in a thinly veiled bit of explanation-*cum*-propaganda. The high yields that investors demanded on their bonds was, in the words of German Federal Minister of Finance Wolfgang Shäuble, simply the "markets becom[ing] the bearer of bad news" that their practices were unsustainably spendthrift and therefore "austerity is the only cure for the Eurozone" (Shäuble 2010). Instead of sensibly balancing their budgets as Northern Eurozone countries were thought to have done, their overspending now led to a reckoning in which the overgenerous social provisions of the PIIGS must be reversed via austerity policies. The Troika soon collaborated to craft various austerity policies. In some cases, these "debt reduction programs" were the conditions attached to receiving much-needed liquidity or debt restructuring deals. In others, they formed the core of a set of recommendations that governments, both of the left and right, imposed upon their own populations over mounting protest (Patomäki 2013). Roger Cohen (2010) typified the elite consensus:

> "Such profligacy for the PIGS is over. For all these countries, austerity looms. Ireland has led the way by slashing public-sector wages by 7 percent. Greece needs to follow suit,

but whether labor unions will allow that is unclear. Unless Athens cuts back, it's not going to persuade people to buy its bonds"

Both this explanation of the crisis and the recommendation of austerity as its cure are justified through a pair of shaky assumptions. One is a moral judgment that those countries struck hardest by the crisis are the only ones responsible for their state, grounded in an attribution of each country's debt to the cumulative choices of each national population. Here, debt is thought to be the result of unsustainably generous public spending or high wages, and therefore austerity measures that reduce wages, lessen employment protections and the power of labor unions, and slash retirement packages or other forms of social spending are needed in order to restore competitiveness. This focus on "competitiveness" reveals the second assumption, an economic model in which each country should be competing with its neighbors to succeed in implementing a low-wage, low-state expenditure model of growth (cf. Alesina and Ardagna 1998).

As this study will reveal, both of these assumptions are highly suspect. The moral dimension only retains plausibility if we remain within the short-term timeframe of these popular explanations. Once we follow the causal chains of European development backwards from 1999, attributing responsibility for deficits and debts to the inhabitants of any single country becomes much more difficult. In the same manner the economic dimension relies on a specific way of conceptualizing the European regional economy, one which sees the Eurozone countries as a collection of independent units whose development is only a function of their own internal situations and decisions. This leads to overstating the degree to which these states make their

policy choices independently both of their European partner states and the pan-European institutions which govern matters such as trade policy and the Euro itself.

This mainstream explanation is fragile even on its own short-term grounds, however. Heterodox economists, not beholden to the assumption that low-wage austerity-driven growth is the only road to success and failure, have shown the mainstream narrative to be misleading. Perhaps the most recent sign of the austerity narrative's weakness was the rise and fall of a popular paper by Reinhart and Rogoff (2010), which purported to show that public debt in excess of 90% of GDP causes negative growth effects. This paper, touted by economists and politicians as support for austerity, has been shown to be replete with errors of both analysis and interpretation (Herndon, Ash and Pollin 2014).

Against the portrayal of state debts as indicative of living beyond one's means, heterodox economists pointed out that there is no solid connection between state fiscal position pre- and post-crisis. In fact, examination of the budget deficits over the medium-term shows that France and Germany were earlier and more frequent violators of the Eurozone's budget deficit guidelines than Spain, Portugal or Ireland (Hall 2012). Moreover, the rules of the Maastricht Treaty and associated agreements governing the amount of acceptable deficit spending and debt should generate praise for Spain or Ireland who, just before the financial crash in 2008, were in budgetary *surplus*. When analysts have bothered to look at the overall trajectory of government debt just before the crisis (e.g. Collignon 2012) they see that supposed paragons such as Germany showed rising debt-to-GDP levels while Spain, Ireland and Italy all showed a *reduction* in debt as a proportion of GDP. Even Greece stayed roughly level since the early 1990s.

This implies that much of the post-2008 debt in areas like Spain is due to bank recapitalizations or automatic stabilizer mechanisms such as unemployment insurance and came

about as a result, not a cause, of the crisis. This also implicates the ECB, due to its inability (or, in the eyes of some scholars, its refusal) to fulfill its proper central bank role as “lender of last resort” and guarantee liquidity to recession-hit states. Here, it remains significant that the sharpest divergence of interest rates after 2010 only stabilized in July 2012 after ECB President Mario Draghi, having activated an Outright Market Transaction (OMT) program to prop up sovereign bonds, announced that the ECB was “ready to do whatever it takes” to preserve the Euro (Wilson, Wigglesworth and Groom 2012). This amounted to declaring that the ECB would finally provide unlimited liquidity to Eurozone member states; yields soon came down[1].

What of the assertion that growth requires using austerity to regain confidence and competitiveness? Against the use of austerity it can be argued that the demand-constricting austerity policies implemented by the Troika paradoxically *increase* the debt burden; as austerity reduces expenditures in the economy GDP contracts and drives the debt-to-GDP ratio higher. There is also reason to think that even if the severe recessions resulted in the hoped for deflationary effects, such as dropping wage costs, not all countries can then experience an export-led recovery. John Maynard Keynes’ “paradox of thrift” implies that it is a dangerous fallacy of composition to think that every country can run export surpluses, given the need for total surpluses and deficits to balance such that each country winning a surplus must, simply as a result of accounting, result in a corresponding deficit (Lavoie 2009). Moreover, evidence suggests that the oligopolistic structure of European industry initially kept prices from falling along with wages, further strangling effective demand and spiking the unemployment rate (Artus 2012).

[1] This by no means guarantees the end of the sovereign debt phase of the crisis. Continuing legal and political wrangling is required to keep the OMT effective against divergence in sovereign bond spreads. The most prominent example is the battles around a series of German lawsuits against the ECB that question the legality of OMT altogether; these have now been referred to the European Court of Justice (Wagstyl and Jones 2014).

The conventional "overspending" explanations of the crisis persist despite these problems. One reason may be that noting that much of the public debt increase among the PIIGS was due to post-2008 spending merely shifts the question one step further back: why is it that these particular countries had such fragile economies that unemployment became so large, why is it that they had so many underwater bank and firm balance sheets requiring recapitalization? Mainstream analyses in the *Times of London*, perspicacious enough to note that "when a country joins the euro it loses the freedom to devalue its currency" still argued that this only becomes a problem for "countries whose economies are too sluggish or inflexible to adjust to unforeseen events" and concluded that the only solution was the "bitter medicine" of austerity and deregulation (Grant 2009).

Clearly, then, a longer-term explanation is needed, one that can reveal why it was the PIIGS that ended up vulnerable to the general crisis of 2008, enough so that they became the prime candidates for austerity "medicine" while other Germany and other prominent members weathered the crisis years with few ill effects. In other words, how did the member states of the Eurozone end up with such different social models, in which the political economy internal to each country was different enough to result in a sharp divide between winners and losers once a global crisis struck? In addition, we might suspect there is something wrong in explanations taking European economies in isolation, since the region has been increasingly interlinked via both goods and services trade and capital flows since the 1950s. A deeper explanation, then, must take into account these trade links between the Eurozone member states. Finally, the involvement of the Euro, the ECB, and the Commission suggests that pan-European institutions and the process of integration they represent must play a part in any deeper explanation.

This study advances just such a long-term explanation for both the general contours of European development since World War II and the post-2008 crisis. Indeed, I argue that these two elements are related; to explain why the countries that eventually made up the Eurozone settled on the types of domestic social models they did, and how the pan-European institutions came to take the shape they did, is to explain the distribution of positives and negatives during the crisis as well. My explanatory framework is neomercantilist in that it is the unequal trade relationships between ostensibly separate national economies of Western Europe that is the major causal driver. One subset of European countries, centered on Germany, accumulated trade surpluses at the expense of those whose trade deficits provided demand to fuel such surpluses. This set of relations, forming a single interlinked regional structure, shaped each country's social model as well as the geopolitically inflected process of European institutionalization that produced a series of regional economic institutions from the European Payments Union (EPU) in the 1950s to today's ECB.

The center of gravity of my explanation is Germany, as it is both the largest economy in Europe and the longest-running accumulator of the biggest trade surpluses in the region. I thus argue that Germany, until 1990 the Federal German Republic, is the center of neomercantilism as a style of social development and that the gravitational power of this neomercantilist orientation warped the fabric of European space around it. For Germany and the smaller surplus accumulating countries, neomercantilism uses external monetary surpluses won through trade to support a distinctive social model premised on highly oligopolized industries and slow growth. As will be explored in subsequent chapters, the social model and the external surplus are self-reinforcing; slow growth, low inflation, and highly concentrated industries help attain a flow of

trade surplus which, once ongoing, serves as a cushion that eases any future efforts to maintain this social model.

This study's neomercantilist explanation thus explains the distribution of winners and loser from 2008's crisis as being synonymous with the members of a surplus-accumulating neomercantilist bloc and their opposite numbers, the countries displaying perennial trade deficits. This deficit bloc, as will be seen, became the PIIGS of the post-2008 crisis narrative: Portugal, Ireland, Italy, Greece, and Spain. The moral dimension of the "overspending" explanation rests on a view of causation which runs from the country, which "decides" whether it will take on a competitive or uncompetitive economic model, to outcomes such as public debt, inflation or, indeed, the state of the external trade balance. In contrast, rather than the type of social model prevailing in each country determining on which side of the surplus-deficit divide it ended up on, I argue that the structural relationship between surplus accumulators and deficit sufferers is co-constitutive of the distinctive features of the German or Spanish social models. That is, the characteristic features of the German model both presuppose *and* encourage a steady external surplus, while the features and limits of the model in countries such as Italy, Spain, or Ireland have been integrally shaped by their perennial external deficits. To put it differently, the social model in any particular "part" only makes sense in light of, and can only exist in relationship to, the "whole" that is the European regional political-economic space.

Moreover, we have seen the crisis involved the institutional particularities of pan-European institutions and these, too, are explained as fundamentally shaped by the surplus-deficit relationship prevailing between Europe's national economies. In all, then, the task of my neomercantilist explanation is to show how the surplus-deficit structure of Europe was born after 1945, how surplus-deficit relations shaped the social models of each country, and finally how

these surplus-deficit relations and the strategies they engendered helped drive the formation of the pan-European institutions that made the post-2008 crisis possible.

When arguing for a specific interpretation of such a long-term, large-scale social process scholars must engage in abduction, making an inference to the best explanation (IBE) of the existing historical evidence (Lipton 2004). IBE can perhaps more properly be called "inference to the best of the available and plausible explanations" since it is most effective as a method of adjudicating *between* competing explanatory frameworks. In this study the neomercantilist explanation is set out against three major competitors: a more theoretically detailed version of the conventional overspending explanation revolving around competitive disinflation, a field approach that sees an endogenous process of pan-European institutionalization as the most important causal factor, and a variety approach that looks to institutional qualities internal to each European national economy as the main reason for their long-term development. The latter two frameworks are full-blooded sociological theories in the same vein as the neomercantilist explanation itself; they advance wide-ranging accounts of how European state politics, European social models, and pan-European institutions come into being, change, and run aground.

In addition, the strongest explanations should display high levels of explanatory depth (they specify causal mechanisms "underneath" the larger processes they explain), explanatory power (a high likelihood that these mechanisms would result in the historical evidence at hand), and explanatory scope (they unify a broad range of phenomena related to the social process in question). IBE is thus ecumenical in its methods, and this study takes several angles of attack toward the question of European development and crisis in an attempt to show the superiority of the neomercantilist explanation.

Chapter 2 reviews the four contending explanations, focusing especially on the theoretical foundations of the field, variety, and neomercantilist approaches. Each has a characteristic view of how causation occurs in social phenomena, and each conceptualizes the units of analysis within the European arena in a different manner. By setting out these deep parameters of each explanation, it will be easier for us to judge the success or failure of each as we move forward to engage with the evidence in later chapters.

Chapter 3 focuses on the run-up to the crisis, using several techniques of Qualitative Comparative Analysis (QCA) to evaluate how well each explanation fits the 1999-2007 period. QCA provides a middle way between the quantitative techniques used in large-*N* social inquiry and the qualitative logic of historical comparison, and is thus well suited to comparing groups of national "cases" in order to determine which of their causal conditions are linked to an outcome of interest. Here, our cases are the member states of the Eurozone and the conditions in each member state that are important to the various explanations are given operational definitions, along with two 2008-2011 crisis outcomes: a severe increase in unemployment or large jump in the cost of government borrowing.

A preliminary analysis of member state deficits and levels of "Europeanization" show these indicators, facets of the conventional overspending explanation and the field approach, poorly fit crisis outcomes. The competitive disinflation, variety, and neomercantilist explanations, all three of which put forward detailed models of the medium-term mechanisms of the crisis, have their proposed models converted into set-theoretic "recipes." Each recipe is an expected combination of conditions typifying the European countries as cases, and these are expected to differ between those cases suffering negative crisis outcomes and those that did not; each explanation thus posits its own distinctive recipes for the negative and positive outcome

case sets. The full QCA then proceeds from two ends: first, a conventional fuzzy-set analysis extracts the most relevant causal conditions associated with both presence and absence of negative crisis outcomes, and then a subset-superset analysis reveals the fit of each competing explanation's ideal "recipe" with the actual combinations found in negative and positive outcome cases. Both techniques conclude that there is little support for either the competitive disinflation or variety explanation, and that the neomercantilist explanation provides the strongest fit to the 1999-2007 situation.

Chapter 4 sets the stage for the historical case studies in chapters five and six by presenting general evidence that neomercantilism shaped European development since 1945. Giving an overview of the phases of pan-European economic institutionalization since 1945, it presents a way to capture these interlinked phases as a process of institutional narrowing that reduced the national autonomy of member states with regard to important policy areas. It then uses longitudinal current account data to describe the scale and evolution of current account imbalances over the period, reinforcing the surplus-deficit bloc membership categories obtained through the previous chapter's QCA. Finally, aggregating current account balances into blocs and charting them over time reveals a pattern of oscillating divergence and convergence between the surplus and deficit blocs that is exacerbated with each phase of European institutionalization and increases in a secular manner over the long-term.

Chapter 5 comprises the first half of our analysis of Europe as a case of neomercantilist development, running from 1945 (with special reference to interwar conditions) to the end of the Bretton Woods system in 1973. The dual aim is, first, to show how the differing social models of the various European countries were strongly conditioned by the presence or absence of external surplus, and, second, to demonstrate how these surplus-deficit concerns shaped the development

of pan-European institutions. Germany is the focus, as the largest economy and central pole of the surplus bloc. I demonstrate the contingency of these arrangements by focusing on interwar similarities between what would later become surplus or deficit countries, as well as the role of political intervention from the US and realpolitik-style strategizing on the part of major players such as France and Germany.

I then analyze the institutional devolution from the surplus-recycling European Payments Union (EPU) to Bretton Woods' politically managed exchange rates. Special attention is devoted to showing how both the German social model, dominated by the export sectors, and the Bundesbank's strategies, with their impact on both Germany's neomercantilist orientation and European institutionalization, were enabled by and in turn centrally concerned with the surplus-deficit structure of the continent. Overall, the evidence shows, against the variety approach, the degree to which national models are a function of the external relation and, against the field approach, the degree to which pan-European institution formation and dissolution was shaped by surplus-deficit concerns.

Chapter 6, the final half of our case study, runs from 1973 until the solidification of Euro plans after 1993's Maastricht Treaty. First, I show how the common context, a global turn away from the "national capitalism" of Bretton Woods and towards the anti-labor policies of neoliberalism, conditioned both surplus and deficit countries alike and influenced European institutionalization. The role of central bank-imposed austerity and the tactical use of unemployment are examined; this serves as an additional critique of the field approach given that pan-European institutions facilitated and, indeed, encouraged such neoliberal tactics. Further, attempts to explain European dysfunction as rooted in differences in wage growth, common to both competitive disinflation and variety approaches, are shown to have both theoretical and

empirical difficulties. In contrast to the institutional devolution outlined in chapter five, in this era I follow an increasingly comprehensive sequence of pan-European institutional frameworks, presenting the monetary "Snake" of the 1970s, the European Monetary System from 1979, and the final plans for the Euro as again shaped by the concerns of surplus-deficit relations and becoming more restrictive of national autonomy at each step. I illustrate the increasing lock-in of member states into the surplus or deficit blocs using longitudinal charts of aggregate profit in important national economies, such as Germany, France, and Spain. The two processes established in chapter five, the increasing differentiation of European national economies due to regional surplus-deficit relations and the shaping of pan-European institutions by the strategies entailed by this same surplus-deficit divide, are shown to be major determinants of the European situation going before 1999.

Chapter Two

Competing Sociological Theories of European Development and Crisis

Abstract:

Here I review four competing theoretical frameworks. One, the popular policy-guiding theory of competitive disinflation, is not a true sociological theory but remains useful as the most well argued version of the mainstream “overspending” account of the crisis. The three remaining theories stand as true sociological theories of European development and integration: the field approach, focused on the formation of pan-European institutions and the Europeanization process, the variety approach, focused on how and why European states come to have different social models of capitalism, and the neomercantilist approach, positing that the region’s surplus-deficit structure was a major influence on both regional institutions *and* each country’s social model.

The neomercantilist explanation of the Eurocrisis can only be evaluated against the strength of its major explanatory competitors. This chapter begins by examining a stronger, more coherent version of the popular "unsustainable spending" explanation based around competitive disinflation, placing it alongside two major sociological explanations: the field and variety approaches. This is followed by the basic outlines of the neomercantilist explanation, after exploring its foundation in theories of global political economy and post-Keynesian economics.

Comparing each explanation requires evaluating its underlying theory along two axes. First, each hashes out particular causal mechanisms describing how the different member states of the Eurozone and pan-European institutions have developed, which thus imply equally particular accounts of the crisis. A second axis of differentiation involves the units of analysis and the type of relationship between them. Are the member states of the Eurozone thought to be a collection of independent actors, choosing from a shared menu of possible strategies? Or is the region a single zone of multiple "social arenas" in which national boundaries are less important? Or, as this study contends, are both nation *and* region intertwined, where the member states make up a set of internally related parts of a larger regional political economy?

Competitive Disinflation and Twin Deficits

Popular explanations of the crisis revolve around unsustainable fiscal spending, unsustainable wage rises, or unsustainable social welfare measures. This often centers simplistically on "tight-fisted Germans" and "profligate Greeks, Irish, and others" with precious

little detail about precisely how, and why, these supposed policy missteps came to be differentially distributed among Eurozone member states (The Economist 2010). A single unifying theme is a commitment to expansionary austerity, assuming that stringent government saving, strict monetary policy such as high interest rates, and lower wages are the preconditions for stable social development or are the best way of jumpstarting growth after a crisis. This is more than simply a framework for explaining the crisis, as later chapters will show that such thinking has also served as a justification for policy choices in many European countries from the 1970s onward; most of these policies intended to, and usually succeeded in, redistributing national income from workers to capitalists. For our purposes, we will focus on the most coherent version of this framework, wherein countries are thought either to win success via "competitive disinflation" or to encounter difficulties if they suffer "twin deficits" (Fitoussi 1993; Palley 2015).

Competitive disinflation is the "virtuous" path in such explanations, and can serve as a shorthand name for this entire explanatory framework. The key to successful competitive disinflation is that real wages must fall and the state must cut spending. Once wages fall, domestic firms have two choices of how to use the increased profits. If firms keep their prices stable while wages fall, the resulting larger profit will spur increased domestic investment. This improvement in investment should lead to increased employment and growth. An additional benefit, improvement in that country's balance of payments with the rest of the world, should follow once the increased investment leads to improved productivity, making domestic firms more competitive. Alternately, if firms drop their prices as wages drop, then the balance of payments should recover first as their lower prices make them more competitive relative to other

competitors in the world market. This increased external demand should then spur domestic investment.

In either case, both domestic investment *and* the current account[2] should improve, though this virtuous circle can be cut short by state spending. Crucially, this explanation relies on the acceptance of Say's Law, that mainstay of classical economic so savagely critiqued by Keynes. Say's Law holds that all saving always translates into investment and, in its stronger forms, that the economy is nearly always at a full employment level of production (Sardoni 2012). Say's Law underpins the direct relation outlined above between lower wages and increased investment, assuming that the larger profits won when the real wage drops will be used for increased investment. It is also the reason that cutting state spending is required for the mechanism to work: with the economy already fully employing all resources, any increased spending by the state will only "crowd out" the increased private investment that the wage drop was supposed to allow. In the same way, state spending would keep the current account balance from improving, since the extra spending power added by the government would increase imports relative to exports.

A similar situation prevails when explaining negative outcomes of the crisis. Media accounts often equate "profligate" public spending and negative outcomes; the impression is that states can simply become "bankrupt" by taking in less in tax revenue than they spend (Cohen 2010; The Economist 2011). This does capture something important about states that have lost the ability to issue their own currency, such as Euro-using members of the EU. These states have incurred a massive loss of autonomy by giving up their own currencies. Sovereign currency issuing states can always determine the interest rate paid on their public debt, but those giving up

[2] In national accounts, the current account records incomes from (mostly from exports) and expenditures flowing to (mostly from imports) the rest of the world. Consult pages 44-46 of this chapter for more details.

their own currencies in favor of the Euro lost this crucial power. This opened up the possibility that a high public deficit could result in the loss of financial market confidence and increases in states' borrowing costs, impeding the ability to further fund public spending or even service existing debt without applying austerity measures to lower the deficit and win back this confidence. This dynamic was at work in the post-2008 crisis, with the PIIGS seeing huge jumps in the cost of government borrowing and, partly because of the ensuing austerity, large jumps in unemployment. Of course, the idea that a country that issues its own currency can ever similarly "go bankrupt" has been definitively undermined on both logical and empirical grounds (cf. Wray 2012). The competitive disinflation framework usually fails to make this vital distinction, even though it suggests the effects of pan-European institutions and the historical process by which these states came to do away with their own currencies are of prime importance.

Setting aside that latter point and remaining within this framework's own short-term reasoning, failure is modeled in a manner that is the mirror image of competitive disinflation. It is here that the emphasis on fiscal overspending in popular accounts comes to the fore, through a condition referred to as the "twin deficits." Again there is a reliance upon Say's Law; here the assumption that private sector production is already at a full employment level allows the twin deficits theory to draw a direct relationship between the public budget and the country's balance of payments with the rest of the world. We can see this if we start from the logic of national accounting, where the inverse of the current account deficit (the "saving" of the rest of the world), the private sector's net saving, and the public sector's net saving *must* sum to zero.

$$S_g + S_p + S_{row} \equiv 0$$

Where S_g is government saving, S_p is private saving, and S_{row} is the saving of the rest of the world (again, the inverse of the current account balance). Fixing private saving at any pre-determined level yields:

$$S_g + S_{row} \equiv 0$$

Since by assumption all private resources are employed in full, the private sector's level of net saving, which would usually mediate the relationship between the government's saving and the saving of the rest of the world, is fixed and is thus dropped from consideration. It follows that a direct inverse relationship is established between government saving and the rest of the world's saving. Restated in terms of the current account surplus or deficit, any increase in the government's deficit increases the current account deficit one-for-one, resulting in "twin deficits." In the Eurozone's case, this state spending is thought to combine with excessive labor protections that allow "out of control" wage growth. When the budget deficit combines with wage hikes the situation becomes truly dire: the budget deficit worsens the current account both by stimulating import demand and pushing up inflation, while rising wages make the country's exports less competitive. From here, the negative impacts follow as the profligate behavior results in either voluntary or market-imposed austerity.

In this study, we should remember that overspending theories in both their popular and more complex forms are not *social* explanations. This is thanks to their assumptions about causal mechanisms and temporal scope: the acceptance of Say's Law and the extremely short time span covered by these explanations. Adhering to Say's Law squeezes out any space for choice or ambiguity out of this explanation's mechanisms. All available resources are employed, lowered

wages result immediately in higher profits, profits are translated directly into investment, and states are budget constrained as if they were a private firm or household. The institutional particularities or class conflict that might be expected to "loosen" the connections between any of these relations are simply glossed over. Keynes expresses the reasoning well in his famous attack on the assumption that savings (or, what amounts to the same thing for firms, "profits") lead directly to investment:

> "An act of individual saving means — so to speak — a decision not to have dinner to-day. But it does *not* necessitate a decision to have dinner or to buy a pair of boots a week hence or a year hence or to consume any specified thing at any specified date. Thus it depresses the business of preparing to-day's dinner without stimulating the business of making ready for some future act of consumption….The absurd, though almost universal, idea that an act of individual saving is just as good for effective demand as an act of individual consumption, has been fostered by the fallacy…that an increased desire to hold wealth, being much the same thing as an increased desire to hold investments, must, by increasing the demand for investments, provide a stimulus to their production; so that current investment is promoted by individual saving to the same extent as present consumption is diminished."

With Say's Law constraining the causal mechanisms of the explanation, it is further limited by the time frame in which these mechanisms are supposed to play out. Essentially, the successful move toward competitive disinflation (or the unsuccessful slide into twin deficits) is a symptom of the post-1999 Euro era. The explanation relies on poor governmental choices taken

within a pre-given institutional framework, wherein which countries fell into which path is completely determined within the 1999-2008 timeframe. Starting the clock in 1999 is seductive, and buttressed by the fact that most Eurozone member states converged on similar fiscal balances, similar rates of inflation and a single shared interest rate as the 1990s drew to a close. The institutions of the Eurozone itself are largely banished from the explanation, and the institutional peculiarities of the European Central Bank (ECB) are taken for granted. The specific social configurations of each member state are likewise unexplained.

Finally, how does the competitive disinflation framework theorize its units of analysis? Here each country is an independent actor, selecting its growth strategy from an abstract menu of choices. There is little sense that the choices of these countries can constrain each other, leaving the proposed mechanism vulnerable to a fallacy of composition. Competitive disinflation is touted as a general strategy even though it might seem a logical impossibility for *all* countries to have positive net exports (barring exports to some extra-planetary destination).

Sociological Explanations of the Eurozone's Development and Crisis

The social sciences have not neglected the need for longer-term explanations for the Eurozone's current form. Over the last few decades, sociological research on European integration and the region's political economy has followed many trajectories. This section presents three distinctly sociological approaches: a neoinstitutionalist perspective that focuses on markets and institutions as "fields" of social action, a variety approach focused on differences between different national models of capitalism, and the neomercantilist approach employed in this study.

All three are outgrowths of broader schools of social research, each grounded in a characteristic set of mechanisms thought to fundamentally structure social change. Below, I review each of these approaches, showing how their substantive explanations for European development and crisis rest on their respective general theoretical foundations. As with the competitive disinflation explanation, I evaluate each in terms of its preferred causal mechanisms, temporal frame, and, most importantly, how each conceptualizes its units of analysis. Along the way, I situate these sociological contenders in regards to the related field of European studies, specifically the well-known split between supranational and intergovernmental models of integration.

The Field Explanation

In this work, field approaches are those analyzing Europe as a single regional whole, comprised of many overlapping region-wide arenas of social action. These arenas, dubbed

"fields," are collections of interacting *concrete* institutions (organizations) even while they can be said to be *abstract* institutions in their own right. That is, cohesive sets of rules, practices, and meanings that structure the actions of organizations within them (DiMaggio and Powell 1983; Bordieu 1985). These fields can be specific product markets, such as telecommunications or health care, as well as spaces of political and economic action delineated by or administered by regional institutions such as the European Commission and ECB. The interactions encouraged within and shaped by these Europe-wide fields are the fundamental driver of integration, and the institutions that congeal as a result of these interactions are thought to be increasingly taking over from older nationally-bounded fields. This regionalism is the strongest aspect of this approach; analyzing Europe as a set of gradually converging fields that cut across and, increasingly, disregard national boundaries orients us toward seeing Europe as a single entity. This is an advantage when set alongside popular explanations and their portrayal of each national economy as an autonomous actor making policy choices in isolation. It also directs our attention appropriately to the Eurozone's governance institutions such as the Commission or ECB as ur-fields which are *primes inter pares*, conditioning and making possible the other region-wide social fields.

In economic sociology, field-based theorizing has been worked up into a general theory of market society itself (Fligstein 2002). At the same time, the perspective's most extensive empirical application has been precisely in the sociological study of European integration, where it has become a major research tradition rivaling older theories of European integration and makes the case that integration is a self-perpetuating process of convergence (Fligstein 2008; Sandholtz, Stone Sweet, and Fligstein 2001). However, when theorizing possible crises occurring due to integration, the perspective is often thrown back on a national population-based

analysis. Here it is the proportions of European populations assenting to the Europe-wide institutional order that are theorized to be a source of conflict or institutional breakdown, in a process Fligstein (2008) has called "Euroclash."

Many other convergence-oriented theories of European integration have a functionalist flavor, especially those focused on the classic mechanisms of "spillover" in which European institutions were thought to expand via the extension of rules "from already integrated fields into other, functionally associated areas, set off by causal connections which present themselves politically as factual constraints (*Sachzwänge*) that merely require ratification" (Streeck 2012). Despite this similarity, the field approach generally eschews functionalist assumptions thanks to its neoinstitutionalist pedigree.

To be sure, all three of the "sociological" frameworks in this study advance explanations involving institutions. Yet this particular perspective warrants the "neoinstitutionalist" moniker, as more than others it puts forward interactions between and within institutions as the bedrock causal element.[3] Neoinstitutionalism as a distinct research tradition arose once organizational research, concerned with relatively concrete elements of organizations such as formal rules and inter-organizational competition, became joined to the perennial sociological interest in the social construction of norms, ideas, values, and meaning (Meyer and Rowan 1977; Luckmann and Berger 1991). More importantly, while institutions remained the primary social entity of interest, neoinstitutionalism moved toward a more abstract conception of institutions as sets of meaning-laden rules and practices that enfold organizations, and argued that variation in institutional form was determined less by functional necessity and more by the shared meanings, informal rules, and processes of imitation growing out of interactions within or between institutions themselves (DiMaggio and Powell 1983).

[3] See the discussion of what makes a "true" institutionalism in Amenta and Ramsey (2010:21).

Meanwhile, sociological research had begun to breach the wall separating neoclassical economics and sociology, and neoinstitutionalism found a ready home in the resulting subfield of economic sociology. Neoinstitutionalism resonated with the research tradition initiated by Granovetter's (1985) seminal contribution on the social embeddedness of nominally "economic" organizations; soon progress began to be made linking changes in participants' conceptions of institutional practices to changes in the way firms and states organize economic action (Dobbin 1994; Fligstein 1993). Initially, neoinstitutionalism in economic sociology focused on intra- or inter-firm relations and the organizational "population" of various corporate sectors (Fligstein 1993; Fligstein and Freeland 1995).

This middle-range scope soon broadened, preparing the ground for engagement with and use of the field concept. One stimulus for this expansion was a realization that the "new economic sociology" in which neoinstitutionalism played a major part must re-engage with the concept of "capitalism" as mode of social organization (cf. Arrighi 2001). The move to expand neoinstitutionalism's spatial and temporal scope went some way towards addressing this concern, with collections such as Nee and Swedberg's (2005:xxxv) calling for attention to "the inner workings of capitalism as an institutional order." This encouraged research on the dynamics of market institutions at the largest geographic scales (Mudge 2008; Fourcade 2009; Nee and Swedberg 2005; Simmons, Dobbin, and Garrett 2007; Krippner 2005, 2011). Krippner's (2005, 2011) analyses of financialization and Streeck and Thelen's (2005) treatment of liberalization were prime example of this "macro-sized" neoinstitutionalism, tracking multi-decade economic processes across multiple countries to arrive at an institutionalist perspective on global economic change.

At the same time, serious engagement with capitalism drew some scholars toward a national or comparative capitalism approach, while still emphasizing the cultural construction or institutional grounding of some aspects of economic activity (Fligstein 1993; Dobbin 1994; Bandelj 2011; Bandelj and Wherry 2011). Nina Bandelj and Elizabeth Sowers (2010:40) note that these works, analyzing the "different national logics of economic organization, or different national economic cultures" are more properly classed together with the variety approach reviewed in the following section.[4]

Some work, however, took the opposite tack and moved toward the field concept as a way of further generalizing neoinstitutionalist insights. Fligstein's (1996; 2002; 2008) work did the most to ground the "supersized" neoinstitutional approach in field-based theorizing. Not only has he developed a comprehensive neoinstitutionalist model of capitalism, he has been a central figure in the application of that framework to Europe itself. He forwards an ambitious theory of the formation, stability and change of institutions as fields, where fields are both abstract arenas of rules and the governing organizations that create and apply such rules, within which organizations and individuals interact and thereby shape these arenas in turn. Indeed, it is fair to say in Fligstein's framework there are *only* fields; individuals, organizations, and relations between them are constructed by the development of the fields in which they are enfolded.[5]

The field explanation's emphasis on continually deepening convergence rests on the two pillars emphasized by Martin (2003) in his comprehensive overview of field theory: a diffuse approach to causation within each field, and a preference for explaining field development as a

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[4] This is especially so with authors moving closer to a "political economy" approach to national "models" of capitalism; Streeck (2010) and Yamamura and Streeck (2003) are prominent examples. Their studies of Germany and Japan, while drawing on some neoinstitutionalist methods and conducted in dialogue with prominent institutional theories, have developed very differently from the field-based approach with its emphasis on the endogenous coalescing of fields.

[5] See his formulation of fields as not just markets but a general theory of social action in Fligstein and McAdam (2011).

predominantly endogenous process. These foundations determine how the field approach views causality and constructs its units of analysis, and thus sets out the boundaries within which field-based explanations for European development are constructed. The penchant for diffuse causation is "intrinsically at odds with mechanistic causation" and means that field explanations tend to set out the cast of organizational participants in each field, theorize as to the effects of innumerable interactions between these actors and the way their aims and strategies are shaped by shared institutional frameworks, and then posit further institutional development as a residue of these aggregate interactions (Martin 2003:10). Further institutionalization then occurs in a gradual process of deepening brought about by interactions of participants. Fields, the specific organizations within them, and the rules that govern them are thus portrayed as "coalescing" more so than they are strategically shaped. This emphasis on diffuse causation leads naturally to the tendency to cast the development process as endogenous; regional institutions become more similar, interrelated and widespread through a process of within-field and across-field interaction in an almost Durkheimian self-generated process (Callinicos 2007). [6]

These two pillars support Fligstein's (1996; 2002:18) general theory of markets, in which "the search for stable interactions with competitors, suppliers, and workers is the main cause of social structures in markets." Outside of the catch-all "exogenous" category, the important causal action here is either internal to these market fields or comes from similar processes overflowing from neighboring fields. When applied to Europe, it results in a

[6] In a sense, this totalizing of the field concept is the apotheosis of the neoinstitutionalist project. The diffuse causation and endogeneity characteristic of the field approach are also two areas in which neoinstitutionalism has been most sharply distinguished from historical or political institutionalism, which often look for path-dependent causal chains or see institutional form as determined by strategic or functional considerations. Seen in this way, fields are simply the broadest, most abstract, and most constructivist definition of an "institution."

macrogeographic view of the entire region as a unified space of overlapping social fields centered on the pan-European institutions themselves.

Understanding the field approach's distinctiveness, as well as that of the variety and neomercantilist approaches, requires that we pause to review the research on European integration. Sociological research on European growth and integration is a relatively new entrant to the field, perennially split into two broad camps. The first, intergovernmentalism, saw European integration and the formation of European institutions as the result of contentious bargaining between the independent European governments. While some scholars emphasized the realpolitik aspects of such interactions (Pedersen 1998; Lieshout 1999), much of this approach relied on rational-choice behavioral modeling (Moravcsik 1993, 1998; Pollack 1996). Here institutions should reflect the "lowest common denominator" in terms of interest; the prognosis was a difficult or halting integration process dominated by the most powerful players. For their part, sociologists pointed out that this rational choice institutionalism was not really much of an institutionalism at all and was quite thin as a *sociological* theory; concerns with "payoff matrices" and game theoretic strategies between member states left no room for social forces and processes (Jensen and Mérand 2010).

Proponents of intergovernmentalism have engaged in a long and contentious debate with the second camp, broadly grouped under the names supranationalism and neofunctionalism, and through this approach "the image of the EU as a unified, single entity, very much like a state, has come to dominate the literature" (Böröcz and Sarkar 2005:154). Some of the earliest attempts to understand European dynamics took a supranationalist view, seeing pan-European institutions and the regional arena as a separate and valid political domain with its own logic. Yet despite the

fact that early pan-European institutional actors had policy objectives separable from any particular national government, it was soon apparent that any attempt to analyze the EU as simply another state with coherent "national" interests was simplistic. Many of these supranationalist analysts looked for functionalist (soon "neofunctionalist") pressures that would endogenously fuel expansion of the EU's powers and competencies, especially via the "spillover" mechanism.

Once the distinctive relevance of the EU institutional arena was established, supranationalist approaches grew along many different lines. Some pursued detailed studies of formal institutional rules while others tracked how specific policy initiative were proposed, fought for, and adopted by the various Brussels players, showing how interest groups specific to the EU level enlarged the effective domain for pan-European institutions (Garrett and Tsebelis 2001). All of these approaches retained a distinctive supranationalist orientation in which the EU institutions were the motor driving further integration, rather than an outcome of market forces or intergovernmental strategizing. At the same time, more sociologically minded scholars attempted to open a space for analyses that were neither restricted to rational interstate bargaining nor over-focused on the institutional minutiae in Brussels. The most sophisticated sociological analyses tried instead to pick out a historical institutionalism that gives idea formation, strategic action, and institutional forms equal attention (Favell 2007; Jensen and Mérand 2010).

Returning now to the field approach itself, it is clear that it offers one solution to this dilemma in the sociology of Europe: offering the social action field as a way to sidestep debates on precisely how ideas, strategies, and institutional forms are articulated. The diffuse causation

within fields redirects our attention to charting the density of interconnections within the field and relates institutional formation to this overall "field strength," making the specific history of causal interaction interesting for descriptive purposes but analytically unnecessary.

It is broadly in the supranationalist camp as it clearly recognizes that pan-European institutions form a new and powerful regional arena. It has less time for EU member states as strategic actors, at least in regards to the process of integration; its concern with states mainly revolves around the risk that important policy categories (e.g. social welfare policies) will remain determined at the national level and thus susceptible to the forces of Euroskepticism (Fligstein 2008:236-240). But when speaking of the long arc of integration itself, the field approach's novelty lies in locating the motive force in a region-wide social process of Europeanization that is shepherded by pan-European governance institutions. This Europeanization process constitutes Europe as a collection of fields in which "European markets are integrated, market rules reflect European rules, European law holds sway over national law, and interested parties continue to push for new rules in Brussels" (Fligstein and Stone Sweet 2002). A series of interconnected "policy domains", each its own social action field, all evince this increasing Europeanization: financial transactions and markets, agriculture, the movement of labor and labor regulations, telecommunications, and so on.

This welter of fields, rich in horizontal linkages between each other, are made possible by and in turn empower the prime field of EU governing institutions; "as firms took advantage of the possibility of producing new economic fields, there was a natural political field in which to discuss their problems" and this supranational institutional field could then "produce new agreements to govern the continued international opening of markets" (Fligstein 2008:7). Fligstein and other field-related theorists have pointed out many specific instances of this region-

wide field interaction (Stone Sweet, Sandholtz, and Fligstein 2001; Fligstein and Mérand 2002; Fligstein 2008). One of the most important examples is the interaction of firms, the European Court of Justice (ECJ), and the European Commission. The Treaty of Rome opened the supranational field as a viable sphere of political interaction, enabling increasing regional trade that then caused a flood of cases for the ECJ to litigate, finally stimulating new EU-level legislation by the Commission and deeper institutionalization of the EU itself. Diffuse causation is thought to operate here, with increased trade, legislation, and litigation all encouraging each other in a shared institutional context that grows as a result of these interactions (Fligstein 2008:51-55).

The above means that the field approach reserves a limited space for strategic considerations in a manner reminiscent of intergovernmentalism. Here the focus is on how actors, including states, exert their interests both from within and outside of European institutions. Actors within European institutions battle over the meaning and implementation of policy, resulting in rule innovation that serves to further formalize the powers of EU institutions. Alternately, "policy entrepreneurs" can pressure institutions from outside, as when the European Roundtable of Industrialists reinvigorated the Commission in the early 1980s. While acknowledging that states are still "the most powerful actors in [pan-European] fields as they ultimately have to agree to the passage of directives" it is argued that the European field has a powerful ability to shape the way states conceive of their interests (Fligstein 2008:252-255). In the final analysis, then, the interactions between states and interest groups at the EU-level are internal to the broader European policy field itself. The interests, prescriptive recipes, and values of within-field actors are not pre-given but rather constituted by field interaction itself (Stone Sweet, Sandholtz, and Fligstein 2001).

A final, and perhaps at first unexpected, element of the field approach focuses on the Europeanization of individuals; this is theorized to result from the convergence of fields at the supranational level and yet implies that problems with integration will appear within national polities. As organizations interact and institutional rules solidify this leads to increasing interrelations between Europeans as consumers of goods traded in pan-European markets, as cosmopolitan professionals relocating across member states for work, and as citizens operating in an economy increasingly governed by supranational regulations and macroeconomic policy. Individuals, especially of the upper middle-classes such as government workers and professionals, have shown a long-term increase in how much they identify as "Europeans," both concurrently with their national identities and, for some, prioritized *over* their national identity (Fligstein 2008). Meanwhile, less Europeanized majorities of each national population persist, and the field approach posits that tension between the cosmopolitans and the more nationally-grounded segments will cause problems for the integration project; given that "most of the policy fields dominated by the EU are oriented towards business" the spheres of fiscal policy, welfare measures, and labor remain areas in which "sitting governments will be pressured by national groups to not cooperate with the EU on particular policy issues" (Fligstein 2008:235). In the field explanation, then, while strategic state action is deemphasized, the supranational process of European institutionalization throws off fault lines that can make themselves visible at the national level.

This makes demands on our later attempts to evaluate the field approach. In effect, the field approach has two separate but related mechanisms at work: while long-term development of the region is thought to be a result of endogenous institutional formation and interaction, the distribution of negative versus positive effects of the crisis will be a function of the differences in

"buy in" to the supranational institutional project across the member states. It follows that the following chapter's QCA of the distribution of the post-2008 crisis effects between member states must look at a relatively individualized, national measure (proportion of populations that are "Europeanized" in each nation), the subsequent historical case studies must then pivot to test field approach claims about the primacy of institutional interaction.

In sum, the field explanation for European integration and institutionalization rests on the same mechanism that Fligstein has used to characterize the markets in general: "[a] feedback mechanism whereby the existence of agreements empowers actors, stimulating the demand for more agreements" (Fligstein 2005:192). Once the regional field is opened up with the formation of the "natural political field" of pan-European institutions, these institutions have their reach and growth stimulated as an increasing number of organizations and individuals begin to operate on the pan-European plane. Actors in each member state become less national and more European to the extent that they become participants in region-wide fields, while at the same time this process creates a divide *within* each country between a cosmopolitan European-identifying class and the recalcitrant localists. Europeanization is thus reflected through this dual mechanism of the opening and stabilization of fields by pan-European institutions and the pulling apart of cosmopolitans and nationalists; realist conceptions of national governmental strategy are sidelined.

The classic field emphasis on endogeneity is apparent, as the entire process is both self-generated (as participants search for stability and thus deepen institutionalization), and "self-reinforcing" (Fligstein and Stone Sweet 2001:55). In other words, "institutionalization constitutes the outcome to be explained, and it partially provides part of the explanation" (Caporaso and Stone Sweet 2001). Diffuse causation, on the other hand, comes through in the

way in which each field is cast as a "meso-level social order" in which all important action comes from the innumerable small interactions between field participants shepherded by major EU institutions (Fligstein 2008:8). Overall, it is the preeminent example of a "more 'sociological' accounts of institutional change where social structure and patterns of agency are more or less co-constituted, or where the actors who have helped to build institutions are then induced to behave in ways that lead to further institutional change" (Caporaso and Stone Sweet 2001: 225).

There are a number of weaknesses, however. Despite the discussions of "Euroclash," the result is a rather rosy picture in which institutional innovation will "solve" whatever crises arise. Given the emphasis on convergence, the view that the form of EU institutions emerged in a field-based version of the supranational spillover mechanism, it comes as little surprise that the overall evaluation of the European project is positive. There are two sources of optimism: the assumption that crises will result in further, not less, institutionalization, as well as the belief that the institutional arrangements which Europe ended up with are an overall positive for the majority of the European population. The former is thought to follow from the way that institutionalization is a result of increased interaction; when discussing possible problems for Europe, even difficulties and crises will result in institutional innovation and further convergence. For the latter, Fligstein essentially portrays the views of upper-middle class professionals and other cosmopolitans, whose increasingly European ideology is a reasonable outgrowth of the benefits their class gained from integration, as true. Throughout there is a general assumption that the specific way integration unfolded has been positive for most of Europe's inhabitants. Outside of the truly threatened working poor and elderly, any remaining nationalist impulses on the part of the broad middle-classes either atavistic chauvinism or a

desire to protect employment, healthcare, and pension systems that are better administered on the European level (Fligstein 2008:22).

Wolfgang Streeck (2009) has pointed out that the field approach contains "an astonishingly unqualified confidence in the social and political virtues of a free-market economy" which leads it to identify national protections, such as hard-won European welfare states, as "outdated national parochialism" (p. 546). Citizens worried about how neoliberal policies, empowered by pan-European institutions and integration, have resulted in sustained unemployment are portrayed as tilting at windmills – they "tend to have a zero-sum conception of job loss" that mistakenly sees relocating production as a national loss (Fligstein 2009:253). This Whiggish perspective on the long-term development of European economics stems from equally optimistic and liberal thinking embedded in the field model of markets more generally, in which increasing institutionalization should increase both prosperity and stability (Fligstein 2002:20).[7]

If the field approach sees European regional growth and integration as an endogenous and beneficial process akin to classic sociological differentiation, where does it locate the causes of possible crisis? Possible structural problems are waved away by appealing to the seemingly irreversible nature of integration; if "[t]he institutionalization of European arenas of governance has occurred through self-reinforcing processes" and when "one set of European institutions has grown up, it has induced integration elsewhere" then it follows that "[i]t is difficult to imagine what would cause them to recast their interests in another way" (Fligstein and Stone Sweet

[7] One can even discern here something akin to Say's Law, given that it is thought the spread and institutionalization of market fields means that "crises in particular markets do not spread very far. Taken together, these forces imply that we are likely to get recession or rolling downturns caused by particular market interactions. But the overall diversity and size of large economies makes them stable" (Fligstein 2002:20). This calls to mind the aspects of Say's Law denying the possibility of a "general glut," that is, of general crisis or persistent stagnation, a notion strongly opposed by Keynes in his battles against proponents of Say's Law.

2001:55). When initially forced to consider what could cause region-wide crises, Stone Sweet, Fligstein and Sandholtz (2001) conclude that any possible obstacles would actually result in deeper institutionalization, more integration, or, at worst, gridlock (pp. 27-28). Even monetary crisis, which is cast in fairly narrow terms as an issue of the ECB maintaining rates that are too high for member states hit by business cycle downturns, is given short shrift since "[if] it were deemed necessary to run temporarily higher budget deficits, Member States would be allowed to do so" (ibid:28). Overall, they conclude that "[t]he most likely response is therefore the preservation or even expansion of current institutions, rather than their contraction" (ibid:28).

Instead, and again echoing Durkheimian processes, it is the Euroskepticism of those who are "left behind" by the integration process which is the problem. In Fligstein's analysis, as a regional whole Europe's population is divided between an upper class fraction that has definitely benefited from integration, a lower class which has been put at risk, and a middle class which has likely benefited but may not know it. He thus emphasizes the crucial role of these middle classes as a bloc of "swing voters" (Fligstein 2008:285). The beneficial process of integration could be put at risk if this middle class bloc falls prey to the siren song of nationalism and allies with the lower classes against the emerging European institutional norms. If the integration project is truly economically and socially beneficial, this implies that countries most committed to following the script of European institutions should be less vulnerable to structurally-determined negative outcomes. In other words, member states with stronger Europeanized fractions should be less affected by the devastation of the post-2008 crisis.

What stands out starkly in field approach discussions of possible crises is the lack of any awareness that EU institutional structures themselves might be defective enough to precipitate problems. Instead, the most serious flaw in pan-European institutions is taken to be the well-

known "democratic deficit," but on the field view this issue itself is due to states attempting to limit the Europeanization process (Fligstein 2008:271). This confidence in the integration process and its institutions is not surprising, given the assumption that Europe evinces field qualities of endogeneity and diffuse causation, and the focus on a "meso-level" character in which global or regional structure is left to one side. When discussing markets in general, these qualities lead to an emphasis on how fields self-stabilize through the interactions of their participants; at the European regional level this tends toward an emphasis on how problems involving institutions are solved with *more* institutionalization. Problems are not located with the institutional arrangements themselves, which tend toward a type of non-functionalist equilibrium, and the approach "does not pay much attention to the inequalities of power either within or across the societies that make up the union" (Favell 2008:500).

Moreover, there is little chance of seeing the serious problems wrought, not by simply the institutional arrangements, but by the macrostructural political economy of the region. On the neomercantilist view, it is this structure, visible most prominently as a series of surplus-deficit relationships the lock European countries together into a single unbalanced whole, which is itself one of the prime shapers of pan-European institutions. These institutional forms can, in turn, aggravate the structural imbalances and drive the respective national economies further apart. Yet little of this can enter into the field approach, given its liberal triumphalism that assumes Europeanization is both an overall positive and an endogenous institutional phenomenon not subject to any larger structural context. The result is that possible crises are reduced to instances where the large middle segment of European citizens mistakenly ally with the "economic losers" of integration and, as a result, fail to properly participate in pan-European institutions altogether. Any regressive or problematic tendencies have, by fiat, been assigned to and make their

appearance via the national level, reserving the region-wide level for a teleological process of institutional development that benefits all even if they do not see it.

The Variety Explanation

While the field approach became increasingly oriented toward seeing Europe as a single multi-field region, a competing form of comparative analysis took the opposite tack. Institutionalist economic sociology had only recently reintroduced the term "capitalism" and, indeed, the field approach preferred only to speak in terms of "market society" in general; in contrast, this competitor acknowledged not only the salience of capitalism as an analytic category, but posited the existence of a variety of capitalist social models.

The variety approach includes intricate analyses of national differences in political and economic organization, national differences in norms and theories of how an economy should operate via a focus on different "cultures of capitalism," and most recently has reconnected with a long-running parallel research tradition on national differences in welfare state institutions (Dobbin 1994; Hall and Soskice 2001; Yamamura and Streeck 2003; Hancké, Rhodes and Thatcher 2007; Rhodes and Molina 2008; Streeck 2009; Bandelj 2011). Considered broadly, the term "variety approach" as used in this study encompasses any of the wide range of studies aiming to uncover the distinct political economy or capitalist culture of each national case; these often, though not always, attempt to sort national economies into a typology of social models. The underlying unity of such approaches is their "methodological nationalism," in which the main determinants of any given country's distinctive model are the qualities internal to that particular country. Chapter 3's QCA will focus specifically on the models proffered by

"Varieties of Capitalism" (VoC) research, given that they provide the most detailed models of each "type" of European capitalism in the 1999-2007 period. The historical case study of European development in chapters 4, 5, and 6 can then "test" the overall variety presumption that European social models are endogenously generated.

While its objects of analysis include institutions and it is a major player in the broadly institutionalist debates about social change, the variety perspective as expressed in VoC literature is less a true institutionalism and more an account of how relationships between workers, firms and other actors play out *through* national institutions. In this respect it is a true "political economy" similar to the neomercantilist explanation. These relations then lead to the formation of concrete labor, corporate and educational institutions. Of course, these "coordinating institutions" do not reduce directly to the strategies of any one actor, and once formed institutions are thought to have their own independent effects. The latter is most obviously seen when the coordinating institutional arrangements resulting from particular labor-firm relations then feedback on the actors' strategies, deepening or constraining the original relation patterns (Hall and Soskice 2001:15).

Prevailing institutional arrangements thus represent equilibrium solutions to political-economic coordination problems. The comparative perspective contends that these institutional solutions are not only found at a sectoral level, but unify entire national economies via "institutional complementarities." For example, in the German social model capital markets provide funding on a long-term basis rather than funding being conditional only on short-term profitability of borrowers. This is an institutional "solution" to the question of bank-firm relations, but this arrangement then complements labor market institutions oriented toward lifelong employment and thus long-term skill acquisition. When a society converges on a set of

such complementarities it results in both institutional stability over long stretches of time and a distinctive comparative advantage *vis a vis* the rest of the world.

The conception of "society" at play here is nationally-bounded. As a national economy develops, institutional "subsystems" within the country mutually reinforce each other (Hancké, Rhodes and Thatcher 2007). Countries attaining this complementarity between institutions can then be classed as one or another capitalist ideal type. This leads naturally to the overall aims of the variety approach: investigating the mechanisms creating and sustaining a national model or set of models and tracing how they change over time. In other words, the broad variety perspective advances an argument for why and how the social models of each country differ.

Despite this fundamental emphasis on self-reinforcing complementarity, change is not taken to be an endogenously-driven process as in the field approach. The panoply of national varieties are, to a greater or lesser degree, stable within themselves and thus change comes via exogenous shocks. Whereas the field approach makes little use of its "exogenous" category, the variety approach spends much of its time charting the way that each national capitalism has reacted to extra-national processes such as the financialization of the world economy, various phases of regional monetary union, or Eastern enlargement of the EU (Hancké, Rhodes, and Thatcher 2007).

Putting together all of the above, we can see that whereas the field perspective rests on diffuse causation occurring in fields that overlap national boundaries, this comparative perspective instead depends on a nationally-bound causal chain that moves from, first, relations between firms, labor, and governments to "coordinating institutions." Attributes specific to each country, not regional fields, are thus the prime determinant of each country's social model that then "reacts" to exogenous processes and shocks. In a further contrast to the field approach, the

drivers of major change are exogenous to the formation of the models themselves; if the field approach displays “methodological regionalism” the variety approach can be said to use “methodological nationalism” (Hay 2009:539).

A foundational example of the variety approach was the earliest detailed VoC model by Hall and Soskice (2001). They contrasted two capitalist ideal types: liberal market economies (LMEs) and coordinated market economies (CMEs). LMEs are rarely invoked when discussing continental countries, being mainly used to describe the US and UK, but they provide a needed contrast if we are to understand CMEs. LMEs are built around a flexible labor market, in which firms prioritize profits and are willing and able to quickly shed employees when needed. This also encourages more “arms-length” relations between firms, with interorganizational relations being market-mediated. Finally, these arrangements work in tandem to discourage long-term worker skill acquisition in favor of low-cost production, and require relatively weak or disorganized labor institutions in order to grant firms the prerogative to cut employment.

In contrast, CMEs live up to their name in that relations are governed less by the market and more by explicit organizational coordination. The CME concept draws on a long-running research tradition highlighting the role of oligopoly and bank cartels in Germany and Japan, as opposed to the supposedly more competitive US and UK (e.g. Hilferding [1910]1981). On this view, the interfirm and bank-firm partnerships that lubricate these relations work in tandem with capital markets geared toward providing long-term finance and a national educational system encouraging workers to invest in technical skills. Together, these institutions, reflecting particular labor-firm, firm-firm, and bank-firm relations, intermesh to enable a high-skill, high-quality production strategy. Archetypal CMEs such as Germany thus specialize in the kinds of

capital goods and consumer durables that demand large investment outlays and a secure workforce with technical skills requiring a long gestation period.[8]

During this perspective's first decade, it was augmented in ways that proved important to the variety explanation for the Eurozone crisis presented in the next chapter. One issue was that Hall and Soskice (2001) put firms front and center, characterizing each type of capitalism as a result of different firm strategies; labor questions were largely limited to analysis of the systems of skill acquisition and firm orientation toward hiring and firing (pp. 4-5). This focus on firms as the main problem-solving actors meant that conflictive class relations were largely missing from the initial LME-CME version of the theory (Pontusson 2005; Jackson and Deeg 2006). One corrective focused on wage-setting behavior, pointing to the role of centralized labor organizations as a vital prop for the capital-labor pacts underlying the technical sectors of CMEs. It was argued that centralized labor agreements that were binding nationwide meant that wage moderation for competitive purposes was easier to achieve. In addition, this suggested that, regardless of wage growth, CMEs would retain a relative advantage in productivity growth given that an agreement to keep real wages rising in line with productivity should act as a spur to productivity growth (Hancké and Herrmann 2008). By reopening the discussion about national labor organizations, the degree of centralization of each country's labor unions became a pivotal factor differentiating types of capitalism.

[8] One major accomplishment of this approach was demonstrating that non-LME capitalisms such as Germany were not simply failed liberalisms but coherent social strategies in their own right. It also served as a vital counterweight to predictions that globalization would quickly lead to worldwide uniformity; instead, the variety approach argued that globalization may be *increasing* divergence between different varieties (Herrmann 2005). On this view, financialization, the construction of the European single market, and other globalization-related "shocks" have been met by novel coordination in certain sectors within CMEs; thus "rumours of the death of CMEs are greatly exaggerated" (Hall 2008: 82). Overall, this cast doubt on the notion that globalization would quickly steamroll over any national differences. Rather, LMEs may become more liberal and CMEs more coordinated as they enacted their respective strategic responses to the same problems.

Two other lines of criticism led to additional changes. First, critics pointed out how little the state seemed to be involved in the early LME-CME account (Schmidt 2002). France in particular, with its tradition of *dirigisme*, proved hard to fit into either the LME or CME boxes. Second, the LME-CME binary was understood as too restrictive and additional "varieties" began to be added. This went beyond arguing that there was internal variation in each type; instead, the messy reality of cases in Southern and Eastern Europe spurred additions to the typology: Mixed Market Economies (MMEs) and Emerging Market Economies (EME). While the EMEs were often developing Eastern European states, it is the MME category that is of interest in this work, as it encompasses those European states that had some of the worst outcomes in the 2008 crisis: Greece, Ireland, Italy, Spain, Portugal, and occasionally France.

MMEs are cast as "hybrid" systems, with elements from LMEs alongside CME elements. Yet they can be said to represent a category of their own; MMEs "mix market regulation with some elements of coordinated regulation as well as state-compensating coordination, sustaining subsystems that are far from 'correctly calibrated' over time" (Hancké, Rhodes and Thatcher 2007:13-14). While there is some debate over how severely this poor calibration affects growth and efficiency, the general agreement remains that the underperformance of Southern Europe results from this "lack [of] pre-conditions for beneficial complementarities and positive spillovers" (Amable 2003; Rhodes and Molina 2008:226).

The introduction of the MME category provided a major impetus for bringing the state into variety models. Initially it was theorized that MMEs to evince "coordination failures" because they combined "non-market coordination in the sphere of corporate finance but more liberal arrangements in the sphere of labor relations" (Hall and Soskice 2001:21). Soon, the definition changed to emphasize the role of the state in compensating for the misalignment between

institutional arrangements governing employment, where protections were strong, and social welfare provisioning, where the safety net was sparse relative to CMEs. This mismatch disincentivized investing in the skills needed for high-technology production, leading to an economy built around small firms competing primarily on price with little chance of moving up to high-technology production. The state, stepping in with direct control via state enterprises and as a "compensator" for these institutional inefficiencies, thus takes on a central coordinating role resulting in a type of "state capitalism" (Schmidt 2003).

This provides us with the detailed VoC form of variety approach relevant for next chapter's QCA. Here, different national types of capitalism are distinguished by differences in their interfirm and labor market relations, in the degree of centralization of their major labor organizations, and finally in the degree to which the state "makes up for" institutional coordination failures. Differences between the successful CMEs and dysfunctional MMEs are the foundation of the variety explanation for European crisis, each type arising from the concatenation of national qualities finding their own equilibrium institutional solution. Britain is the only contender for LME status in Europe, with the Western continental societies taking the CME route (Germany, the Netherlands, Belgium) or the MME route (Italy, Spain, Portugal, Greece, sometimes France).

Once established, each social model reacts to the exogenous context set by pan-European institutions and global economic changes. At base, it "locates the roots of the crisis in an institutional asymmetry grounded in national varieties of capitalism, which saw political economies organized to operate export-led growth models joined to others accustomed to demand-led growth" (Hall 2012:355). Echoing Martin Wolf's (2013) famous description of the crisis as a "bad marriage," the variety approach sees the crisis as an inevitable outcome when the

CMEs of Northern Europe threw their lot in with the MMEs. The variety approach, working from assumptions similar to competitive devaluation, suggests that only CMEs had “entered EMU with institutional frameworks well suited to the export-led growth strategies that offer the best route to economic success within such a union” in which growth was premised on “tight fiscal stances, low wage increases, incremental innovation and the gradual substitution of capital for labour” (Hall 2012:359).

The institutional specificities that made this “marriage” so very bad are analyzed as more a result of a global sea change in economic policymaking than as anything specific to the European political economy itself. One common intergovernmental way of explaining the austere features of pan-European institutions, which lack any ability for states to create their own currency, much in the way of fiscal transfers, or employment support, is that they are the lowest-denominator form acceptable to all member states. The variety contention often builds off this argument, and can further argue that this specific form was deemed viable as a result of general changes in the economic theorizing policymakers used to justify their initiatives. The fiscal restrictions of the Maastricht Treaty, for example, are thought to be a result of the worldwide turn in economic theory from post-WWII Keynesianism to Monetarism and related perspectives skeptical of fiscal solutions to social problems. Likewise, the constant exhortations for structural reform as the only path to Eurozone stability are a result of the general turn to supply-side solutions and the disappearance of activist demand management from economic theory (Hancké, Rhodes and Thatcher 2007).

Given this institutional framework, the crisis was explained as a result of two sequential “exogenous shocks.” The first was the imposition of Euro, kicking off a decade of divergent behavior between CMEs and MMEs (Boltho and Carlin 2013). After 1999, all member states

faced the common pressure of sharing a currency governed by Eurozone institutions that limited fiscal policy, prohibited devaluation, and prescribed supply-side reform. Under this pressure the MMEs, with their relative lack of institutional complementarities and the larger role for the state that this entails, underwent a deterioration in competitiveness *vis-à-vis* the CME countries. When the second shock came in the form of the 2008 financial crisis, this deterioration ensured that MMEs would be hit by the worst crisis effects.

For variety theorists the crisis "seems to stem, after all, more from asymmetric behavior than from asymmetric shocks" (Boltho and Carlin 2013:2). This presents a contrast to the field approach, which had considered but dismissed the dangers of even a more destabilizing form of shock, asymmetric shocks that affect some members more than others, by assuming they would be nullified by deeper institutionalization (Sandholtz, Stone Sweet, and Fligstein 2001). Instead, variety scholars emphasized the interaction of symmetric exogenous shocks with asymmetric national behaviors within the shared institutional setting. On this view, while the 1999 and 2008 shocks struck all member states in a symmetrical manner, each social model reacted differently. After 1999, the MMEs reliance on domestic demand meant they took on more private debt than CMEs, with MME household and non-financial corporate debt rising 75% of GDP over the 1999 to 2008 period (Boltho and Carlin 2013:50). In the realm of competitiveness, the centralized labor institutions of CMEs allowed them to keep a lid on wage growth in a way that MMEs could not, resulting in large MME trade deficits. This relatively higher growth of wages, private debt, and external deficits in the MMEs were then exposed by the Great Financial Crisis.

In short, nationally-rooted relations between firms, labor, and the state created characteristic institutional arrangements that sorted each member state into the CME or MME camp. This binary division, growing out of each country's internal qualities, was acted upon by pan-

European institutions such as to produce an increasing divergence in social development style between member states over the 1999-2008 period. With the coming of the post-2008 shock, this divergence revealed itself and determined how the crisis damage was regionally apportioned.

The variety explanation for both growth and crisis diverges sharply from the field account, and while missing the field-based insights regarding regional *convergence* the emphasis on national *divergence* provides several strengths. While the field account attempts to do away with the national containers and locates the important processes at the supranational level, the variety approach, by contrast, stays squarely at the national level in which government policy responses can be best understood. National-level indicators such as public debt and nationally-decided policy responses do seem to call out for an analysis that is sensitive to the differences between social models, and the variety approach, especially via detailed variants such as the VoC school, offers plausible accounts of how and why these types differ. Importantly, the specific VoC typology looks to match the breakdown of Eurocrisis outcomes; it was indeed the MMEs that were hardest hit by negative crisis outcomes while CMEs escaped relatively unscathed.

Over and above the crisis itself, variety approaches capture important variation between European societies. Highlighting Germany as a special type of social model, very different than the similarly successful economies of the UK and US, is obviously a precondition of any meaningful analysis of European development; any account must grapple with the fact that the largest and most stable economy in Western Europe evinces a peculiar social model (shared, to be sure, with a few close satellites such as the Netherlands). Moreover, the institutional complementarities and distinctive cultural logics emphasized by variety scholars are descriptively rich and empirically sound, especially when describing the distinctive institutional arrangements of major economies such as Germany.

At issue, however, is the assumption that local causation reigns supreme, at least when speaking of the genesis of each country's social model. Each social model is self-generated, and given that each variety is a stabilizing "solution" to national relations between firms, labor, and the state, the forms themselves change in response to general pressures such as globalization, financialization, or the new context engendered by pan-European institutions.

When explaining problems in the regional political economy of Europe, this results in a rather simplistic morality play. The "asymmetric behavior" is the appropriate and uncompetitive wage and public spending behavior of those countries hit hardest. Once a shock such as 2008 hits, it is argued that "rebalancing can only occur if the incentives governing domestic political regimes that sustain imbalances macro regimes drastically change" and these uncompetitive social models have to "take the German cure" – either via wage-lowering or fiscal austerity (Gabor and Ban 2012).

One issue, and one that we will evaluate throughout the course of this study, is whether the purported differences between CMEs and MMEs really do have the qualities that variety scholars ascribe to them; e.g. is state involvement really less pervasive in Germany as opposed to Spain? Is it actually the case that the successful members of the Eurozone and earlier pan-European institutional regimes have had more centralized labor institutions and higher productivity growth than the "failed" members? At one level, this is a merely a matter of empirical adequacy.

Yet there are a deeper weakness of the variety explanation of both differences between European social models and institutionally-mediated crises. First, the "methodological nationalism" holds that models are determined by internal qualities; this precludes the possibility that models such as the German export-led growth approach only make sense in a given external

context and, further, may have only historically evolved due to causal factors external to Germany itself. As will be seen, a neomercantilist approach would instead argue that any social model is formulated in terms of a specific relation to other national economies and to the regional economy as a whole, and therefore it is a methodological mistake to define a model (and look for causal factors sustaining such a model) only within the national "container."

To take one obvious supporting argument, a focus on national causation being the bedrock determinant of a model seems implausible once we take into account the sort of composition effects emphasized by Keynes. The paradox of thrift suggests that, given that any one unit's revenue is another unit's expenditure, when speaking of Europe as a whole attempts by all the Eurozone members to achieve external surpluses ("save") against each other are doomed to failure. In other words, if the "German cure" is dependent on wage or public austerity in order to win an external surplus then it is logically impossible that all can succeed *even if they all were to properly apply such a strategy*; some units must be in net deficit in order that others can be in surplus. It follows that, if different social models are dependent on a surplus for their continued existence, which social model a country falls into may be determined as much by the overall distribution of surplus or deficit states in the regional whole as by its internal institutional makeup.

The Neomercantilist Explanation

This study takes a decidedly different tack than either the field or variety approaches. If the former is rooted in neoinstitutionalism and the latter in a national-comparative tradition, this study's neomercantilist explanation draws on the research tradition of global political economy.

This approach has generally sought to explain economic and political developments over long time spans as a function of global dynamics rather than of the qualities inhering in any one country. The touchstone of such a perspective is the macrohistory of Fernand Braudel (1982a; 1982b). Braudel reconceptualized of the capitalist states of early modern Europe as a single entity, linked together not only by cross-border trade and production but, importantly, a "shadowy realm" of elite high finance that can shape the development of the entire region. While the role of finance will be discussed further on, it is important to note the way this new regional (and later, global) way of casting one's object of analysis cut a theoretical Gordian knot. Instead of analyzing local histories, which took national societies to be largely self-generating, or regional or global "civilizations," which were often cultural or religiously defined in a way that obscured the political and economic heterogeneity occurring within them, Braudel's new object of analysis was what Immanuel Wallerstein ([1976]2011) would later dub a "world-system."

Wallerstein's elaboration of this framework emphasized that these systems display a tightly linked division of labor but *without* a single unifying political authority, thus distinguishing them other multi-national entities such as civilizations and empires. However, most important is his emphasis on how each country's development is more properly explained as a result of its place in the system's overall division of labor, rather than being mostly caused by the particular institutional or structural "recipe" prevailing in each. This is the source of our basic critique of both the field and variety explanations: the field notion correctly perceives Europe as a single regional entity while missing the increasing differentiation and inequality between each national economy, while the variety perspective correctly perceives this differentiation between social models but ascribes this heterogeneity almost completely to factors internal to each country.

Wallerstein, as well as his latter-day epigones, tended to concentrate on a supply-side analysis of uneven accumulation or development, and more recently turning their attention to political-cultural analysis (Bair 2009; Wallerstein 2011). In contrast, this study is informed by Giovanni Arrighi's (1994) somewhat different trajectory, in which he revived a core Braudelian insight: financial dynamics are the true "home ground" of capitalism and can achieve an influence somewhat separate from the "real" aspects of the economy, wherein flows of money and credit can be the main determinant of who wins and loses in the process of development. As will be seen below, this emphasis on financial dynamics over and above questions of the state of real commodity trade meshes with the mechanisms posited to be at work in the neomercantilist account of Europe's surplus-deficit relationships.

Arrighi also extended Braudel's model of capitalism as "the system of the anti-market (*contre-marché*)" in which the system tends not toward perfect competition but rather where success comes from *evading* competitive pressures (Wallerstein 1991:354). This highlighted the role of oligopolistic, even monopolistic, concentration in leading sectors as both endemic to modern economies and often determinative of capitalist success. In this study, the oligopolized nature of export sectors in the neomercantilist countries plays a key role, as it allowed them to control their own price-setting and use lowering wages and currency revaluations in a strategic manner. This is a particularly good starting point because oligopoly is also a basic aspect of the Post-Keynesian models, outlined below, that inform the causal mechanisms of neomercantilism. Large firms in leading sectors act as "price-makers," with both these price-makers and most second-tier firms in each sector able to set their prices and thus profits by a mark-up over costs rather than being at the mercy of supply-demand dynamics (Hall and Hitch 1939; Downward

2000:159-63). In Germany, for example, recent research finds at least 73% of firms set their prices by imposing a mark-up over some calculated measure of unit costs (Stahl 2005:5).

Yet Braudel and Arrighi's analysis of capitalist circumvention of competitive pressure was not limited to considering the level of concentration. It examined the socio-political process whereby states act to control competition to the advantage of dominant firms, both within their domestic economies and in the world market. This has an obvious importance to studies such as this, dealing with the formation of regional economic institutions with the ability to modulate trade and competition between member countries. A dialogue with international relations scholarship resulted in Arrighi's model of states, especially powerful states, as a fusion of "capitalist" and "territorialist" impulses (Arrighi 1994; Arrighi and Silver 1999).

We thus arrive at an understanding of states close to the realist school of international relations, where scholars have continued to point out that states contend as (mostly) unitary entities with more-or-less consistent, long-term geopolitical and economic interests. In particular, this study's neomercantilist explanation conceptualizes state actions in a manner similar to the institutionally-informed realism used by Milward (1984; 1992), Pedersen (1998) and Lieshout (1999) in their analyses of postwar European politics. These authors have put forward forceful critiques of full-on institutionalism, noting the degree to which institutionalization and socialization of actors by institutions can, and have, been used strategically by states. More constructivist or ideational approaches, attempting to explain integration as a state "learning process," have also been undermined by detailed studies showing that state preferences in each round of monetary institutionalization were quite stable (Walsh 2000). Finally, against institutionalists overemphasizing the totalizing and hard to change ("sticky") nature of European institutions, these realist scholars point out that "empirical evidence from European constitutive

politics shows a high frequency of quite wide-ranging institutional change" (Pederson 1998:25). Instead of institutional reductionism, the Arrighian perspective advanced here reserves a role for state "grand strategy" based on interlocking geopolitical and growth objectives of powerful European states.

At the same time, in a neomercantilist explanation we must take into account how European state strategies to enact geopolitical and domestic development objectives are influenced by other institutions powerful enough to contend in the interstate arena; most especially, the ability of the US, the Bundesbank, or the European Commission to influence state actions. The resulting combination of institutional and state interactions remains embedded within the world-economic arena highlighted by Braudel and Arrighi, consisting of structural relations between each national economy. This provides a very different starting point than more conventional approaches in comparative and international political economy, which often models the state as a weighted mix of realist, institutionalized, and ideational elements. This composite state then responds to strategic options forced on it by dint of being an "open" economy subject to interdependent relations with others. Keohane (2009) holds that despite the advances of such syncretic approaches, "[o]ne thing missing…is sustained attention to issues of structural power, as they affect the processes of international political-economic interaction and negotiation" (p. 39). Instead, in this study the structural relations prevailing between European countries form a "structural situation" that at any given moment constrains or enables the formation of particular within-country models of social development, affects state strategy in light of the need to protect or change such social models, and influences the shape of pan-European institutions.

Before moving on to neomercantilism's specific causal mechanisms, here we can note differences from the field or variety views on states and regional structure. All three frameworks

differ from simple state-centric realism but also from any extreme constructivism that sees states only as products of political or economic discourses. For the field conception, state action is less relevant because of the supposedly diffuse, supranational, and self-sustaining nature of Europeanization. States are being hollowed out as formerly "domestic" elements, such as population attitudes, policies arenas, firms, and non-governmental institutions, become increasingly oriented toward the regional level. These elements are increasingly parts of international fields; the coalescing of these fields influences the EU institutions that, in turn, narrow the ideational and strategic options open to states. The variety approach puts forward a very different model, in which the center of causal gravity is located not at the level of pan-European institutions but instead at the sub-national level, in terms of complementarities between labor, firms, banks, and training institutions.[9] States assist with or attempt to paper over flaws in this set of relations, resulting in a distinctive national social model. These national units, in turn, confront the exogenous developments of the global and regional economy, with their responses largely determined by where they stand in the typology.

The above can contrasted with the neomercantilist approach, where the structural situation at any one time advantages some countries at the expense of others. As will be shown below, given the monetary nature of capitalism this inequality leaves its traces in national accounts, especially the surpluses and deficits each country records against its partners. This structural situation serves as the arena in which states pursue political-economic strategies with regard to their neighbors; it confronts states with a set of material constraints that hem in their strategies such as the Keynesian composition effect mentioned earlier. It is impossible, then, to speak of national social models or pan-European institutions as if their successful birth or

[9] Augmented or shaped by, in some sociological analyses, the "cultural capital" (Bandelj 2011) or "culture of political organization" (Dobbin 1994) prevailing in each country.

continued existence can be analyzed separately from this larger structure; social models premised on accumulating surpluses are only parts of a regional "division of labor" relying on models built around continual external deficits.

Despite the differences between the neomercantilist explanation and its competitors outlined thus far, we can agree with the field scholars that a region can form a single organic whole in the sense that, *contra* variety approaches, specifying domestic development apart from regional dynamics is impossible. However, we can also agree with variety scholars that countries form more-or-less coherent social models and can be sorted into types (or blocs) that can become increasingly differentiated from each other even as integration progresses. Of course, this is a description of the world economy at a vast geographical scale but also at a high level of abstraction; the Europe-specific mechanisms at the heart of the explanation require unpacking.[10][11]. This need for specification leads us to the second component of the neomercantilist explanation: post-Keynesian economics.

Post-Keynesian economics is one major current within a set of heterodox economic research traditions that includes institutionalist, Austrian, and Marxian economics. Unsurprisingly, the post-Keynesian approach draws on the work of Keynes, especially in regards his focus on effective demand as the main determinant of growth, crisis, and stagnation in developed capitalist economies. As we have seen with his attack on Say's Law, Keynes showed that the supposed link between profit (saving) and investment is variable and contingent and "we

[10] In other words, this framework alone is too general to adjudicate between our competing explanations. This is even allowing that the centuries of intimate interconnection between European economies and the recurrence of uneven development throughout history serves as background evidence in favor of the neomercantilist interpretation.
[11] Much recent macrohistory is content to describe specific cases or eras in this burgeoning world-system, explaining the historical details of given cases but saying little about the formal mechanisms that might underlie such dynamics. Wallerstein and Arrighi at times attempted to describe formal mechanisms governing the process of uneven development, though more often these mechanisms remained implicit in favor of a detailed historicism.

must remind ourselves there may be several slips between the cup and the lip" (quoted in Kelton 2012:376). Also important is Keynes' argument that, especially in developed economies, investment is the "prime mover" and it thereby determines total income and leaves the total amount of saving in the economy as a residual. This amounted to a Copernican shift in how capitalist monetary economies were seen to function, as it meant that investment determined savings rather than vice-versa. It also implied the by now well-known Keynesian insight that attempts to save, in the aggregate, rather than being needed to enable investment can instead result in stagnation.

Post-Keynesianism is also shaped by Michal Kalecki, the Polish economist and sometime compatriot of Keynes who independently reached similar insights regarding the role of effective demand. Kalecki's influence results in the post-Keynesian contention that, in a mature economy where the state of demand sets the limit of output and growth, it is the so-called "functional division of income" between workers and firms that often determines a country's economic fortunes (Rowthorn 1981; Dutt 1984). This rests on the fact that workers have a lower propensity to save out of income than capitalists and firms. As a result, any shift of national income in favor of the wage share of income, such as when trade unions secure a rise in the real wage rate, will increase total consumption even when the total amount of income is unchanged. The increased consumption demand will induce firms to increase their rate of capacity utilization in order to produce the increased output demanded, leading finally to an increase in investment as firms attempt to re-establish their desired cushion of excess capacity. All else equal, an increase in the wage share of income boosts output and growth, while an increase in the capital share can actually lower output levels and, eventually, investment and growth.

This is another way of framing Keynes' point that attempts to increase saving can be self-defeating, the "capital share of income" being a form of "saving" as it amounts to income not used for consumption. It follows that, while pushing down wage costs allows a single firm to lower its costs, for firms taken as a whole pushing down wages is a self-defeating strategy. This is, to be sure, deeply at odds with the understanding of wages and profits in the competitive disinflation framework and other neoclassical-influenced approaches. However, by now an extensive body of econometric and historical research supports the conclusion that growth, especially in mature economies such as those in Europe, is often wage-led in this way (Stockhammer, Onaran, and Ederer 2008; Lavoie 2009; Lavoie and Stockhammer 2012).

The fluctuations between the capital and wage share of income are, at first glance, a purely within-country phenomenon. Yet the neomercantilist mechanism notes an interrelation between this "functional division of income" in a given country and that country's connection with the rest of the world as recorded in the current account. The current account balance is an item in a country's national accounts that includes the balance of trade, recording "all transactions (other than those in financial items) that involve economic values and occur between resident and nonresident entities" (IMF 1993[2005]:38).

The trade balance is recorded as exports less imports, and this "net exports" measure is then combined with two other net balances to calculate the final current account balance: net primary income, which consists of earnings made on foreign investments less payments made to foreign investors, and net transfer income, consisting of incoming transfers from workers abroad minus transfers paid out. These latter two categories, however, are generally small in comparison

to the trade balance, and it is common to model changes in the current account as simply changes in net exports. Table 2.1, below, lists the three net items that make up the current account. [12]

Table 2.1 Standard Components of the Balance of Payments

1. **Current Account**
    a. Net Exports of Goods and Services
    b. Net Primary Income
    c. Net Current Transfers

2. **Capital and Financial Account ("Capital Account")**
    a. Capital Account
    b. Financial Account
        i. Direct Investment
        ii. Portfolio Investment
        iii. Other Investment
        iv. Change in Official Reserves

Source: IMF 1993[2005], pp. 43-44.

There are a few general aspects of the current account, and the export trade that makes up the bulk of its flows, that we must note here. The way a Kaleckian model conceives of exports resonates with the world-systems view that exports are a function of competitiveness, broadly conceived, and the place of the specific export type in international chains of production. This is in contrast to a view of exports and, by extension, the trade balance or composition of trade, as

[12] The current account is tightly linked to another item, a country's capital account, as seen in table 2.1. In contrast to the goods, services, and profits recorded in the current account, the capital account records purchases or sales of financial assets such as corporate and government debt and securities.[12] In other words, in the capital account "assets represent claims on nonresidents, and liabilities represent indebtedness to nonresidents" (IMF [1993]2005:40). It is true by definition that the current and capital accounts must balance. All else equal, if a country is importing more than it exports and thus has a current account deficit, the foreign currency needed to pay for these imports must be attained from somewhere. If the rest of the world is recording a net gain in its ownership of that country's assets, this results in a capital account surplus for that country and can provide the needed funding for a current account deficit. As a result, a current account deficit is usually accompanied by a capital account surplus, and vice versa. However, this perfectly inverse relationship between the current and capital accounts is only ensured because an important balancing item is included in the capital account: changes in official foreign currency reserves. A country can have a current account surplus *and* have a surplus in items i through iii in the capital account. The country, then, is accumulating foreign currency through both its export surplus and its capital surplus, resulting in a net gain in reserves. This was often the case in Germany, for example, starting in the mid-1950s, who built up large reserves and thus the Bundesbank rarely had any problem funding any of its monetary operations over the decades.

being a *result* of domestic macroeconomic performance. This stance, similar to how exports are treated in the variety approach, would make it difficult to see the battle for external surpluses as a central, or indeed even important, factor in Europe's long-term development. There are theoretical (Kriesler and Nevile 2016:33-39), econometric (Michelis and Zestos 2004; Ma and McCauley 2013), and Europe-specific historical reasons (Frieden 2002) to think the current account balance has an independent and sizable effect on domestic growth and monetary strategy, and is thus an outcome of competitive struggle.

The idea of "competitiveness" in play here is decidedly socio-economic. A less sociological, more purely economic account of competitiveness might be modeled using the Marshall-Lerner condition, in which the difference between domestic and foreign import propensity, relative prices, and domestic demand compared to the growth of demand in the rest of the world determines the balance. However, there is evidence that even this basic price mechanism, which undoubtedly plays a part in the success or failure of attempts to export, is only partially explanatory (Kriesler and Nevile 2016). It is commonplace in even mainstream economics to observe that only "competitive" industries are subject to the so-called "law of one price" in which their prices and amounts sold are dictated by world market competition; industries that are "non-competitive" (i.e. in which firms are price-makers, not price-takers) are not subject to such a clear and direct mechanism (Morel and Steinherr 1978).

In Europe in particular, research on the birth and development of German export dominance has emphasized that their export industries, such as capital goods or automobiles, are highly oligopolized and thus set their prices via a mark-up instead of through competition (Kriele 1977; Leaman 1988; Halevi 2016). All of the above means that the Marshall-Lerner condition is often mediated by political and institutional relationships between each country and its trading

partners. This provides an opening for a sociological analysis, in which a more historical explanation of current account balances can include the political decisions determining the type of exports a given country ends up specializing in, or the outcome of interstate bargaining that shapes global trade and monetary institutions.

In any case, for our purposes the most important aspect of the current account is its link to the domestic situation via the national division of income – in other words, the way a current account surplus or deficit enables or constrains the type of social model prevailing internally in each country. It is the interrelation of two Post-Keynesian elements, the functional division of income within each country and the link with the rest of the world via the current account, that provides the core mechanism for neomercantilism. This is where Swedberg's (2005) advice that sociologists engage with "[t]he two most important social mechanisms in capitalism…*exchange* and *the feedback of profit into production*," bears fruit. It is *profit* that provides the conduit between the division of income, which feeds back as shown earlier into a country's growth prospects via investment, and the current account balance, which represents exchange with the rest of the world.

Kalecki demonstrated this eloquently, with the first step being to identify where profits come from in a developed monetary economy. He surprisingly concluded that, in a closed economy, it is the capitalists' own investment that determines profits. This can be shown if we construct a simple Kaleckian model of a closed economy (i.e. no imports or exports). Here I consider a two-class economy composed of capitalists and workers, and the standard

specification that workers spend all available wages and do not save, while capitalists both save (invest) and consume.[13]

Starting from the identity that total expenditure in the economy must equal total income, we can identify three types of expenditure: total consumption spending by workers, total spending by firms to replace worn plant and to expand the means of production (gross investment, I), and amounts spent on capitalist consumption (C_k).

$$Y = I + C_k + C_w$$

Thus total expenditure (Y) can be disaggregated into investment (I), capitalist consumption (C_k) and workers' consumption (C_w). Total expenditure is also equal to total income, so that:

$$Y = P + W$$

Total income (Y) is equal to total profits (P) and total wages (W). Therefore:

$$P + W = I + C_k + C_w$$

Since total wages are equal to workers' total consumption, W and C_w cancel out and thus profits are equal to the sum of investment and capitalist consumption:

$$P = I + C_k$$

[13] This assumption is made to make the model simple and easy to interpret; giving workers a propensity to consume less than one (e.g. allowing them some amount of saving) does not change the model's conclusions, provided worker saving rates are lower than firms. This has been confirmed empirically (Lavoie 2009).

The important point is how this identity is interpreted. A reading in line with Say's Law assumes that profits set the boundary of investment, and thus increasing capital's share of income at the expense of labor should result in more investment. Instead, Kalecki noted that capitalists could control how much they spend and invest but *not* how much profit they can reap in the following period; we thus read the above equation in reverse. In other words, in any short period investment is the independent variable that determines subsequent profits. This counterintuitive insight is one major reason that investment becomes a central concern in Post-Keynesian economics. Remaining in this closed model, the primacy of investment and higher propensity of workers to consume validates Kalecki's arguments that capitalist economies are wage-led; redistributions of national income away from wages towards capital results not in growth but stagnation.

What happens when the public sector and the "external" areas (the rest of the world) are brought into the picture? This reveals something crucial for the neomercantilist mechanism: supplemental ways that profits can be boosted even without investment, or that investment can occur even with shrinking profits. This yields Kalecki's extended profit equation, used in his studies of US and UK national accounts:

$$P = I + C_k + B + J + H - S_w$$

Here P is gross profits before taxes, I is total capitalist investment, C_k is total capitalist consumption, B is the government budget deficit, J is net exports (total exports minus total imports), H is taxes on corporate profits, and S_w is workers' savings. In this fuller profit equation,

state spending or export surpluses both have the ability to inject demand into the economy even when capitalist investment stagnates or falls. State spending can "prop up" demand and provide a source of profits independent from investment. Current account surpluses (the "external balance") can serve the same purpose. This also implies the inverse: all else equal, a current account deficit represents a drain of profit from firms in the domestic economy.

In modern monetary systems, money is not tied to any tangible commodity (e.g. gold) and can be generated *ad infinitum* by banks and the state. It follows that investment is not fully constrained by a prior stock of profits (Wray 2012). Instead, while firms' savings (profits) remain the safest source for investment, public budget deficits or increasing private debt can act as an additional, if more fragile, source of investment funding.

The way this profit equation links the "external" sector to a country's division of income now comes clearly into view. When considered in isolation, the state of the division of income between labor and capital determines whether the national economy risks recession or growth. However, the external account mediates this relationship. A persistent current account surplus allows firms to reap profits from outside sources of demand even as the domestic economy remains in a situation of low domestic wage growth and investment. Conversely, a persistent deficit means a continual drain of profit from the economy, eroding the safest source for domestic investment. As a result, chronic deficit countries can only maintain investment and thus growth by a set of precarious strategies: running down their savings, maintaining investment or consumption on credit, or having state spending make up the gap. A current account surplus can thus allow a country to follow a "neomercantilist" strategy in which the entire social model is dependent on sustaining the external surplus. When the largest and most influential economy in a region pursues such a strategy, as I contend Germany has within the European arena, we can

speak of neomercantilism as a major determinant of both the domestic situations within each country as well as the overall development of the region.

This cluster of neomercantilist-related concepts is useful for analyzing highly developed capitalist economies because it relies on a monetary, rather than real, concept of surplus. Braudel (1982a, 1982b) and Arrighi (1994) have emphasized the dominant role of *haute finance* and monetary flows as decisive in both determining the contours of uneven development and formulating cohesive national growth strategies. This emphasis on the role of money and credit, *rentier* interests, and recurrent cycles of financialization meshes well with insights from Post-Keynesian economists who have pointed out the multitude of ways that growth in core countries is determined by demand rather than supply. Thanks to the mature industries of core countries, using capital-intensive production and maintaining large margins of excess capacity, these countries rarely run into supply constraints; they are nearly always operating at a level determined by the amount of demand in the economy (Setterfield 2002). In such a situation flows of money (demand) rather than supply constraints become the object of interest.[14]

In line with the above, the neomercantilist strategy cannot be equated with a simple drive to expand exports. Instead, the goal is defined in *monetary* terms: the surplus defined as the difference between inflows and outflows in the current account. The use of the external surplus to keep the economy ticking over relies on this accounting result recorded in terms of monetary value, regardless of the amounts or types of goods traded. Indeed, the surplus holds importance regardless of the overall level of exports and imports in and of themselves. In addition to expanding exports, a surplus can also be obtained by suppressing domestic growth (and thus

[14] It is for just this reason that Keynes emphasized the difference between exchange economies and what he called "monetary" or "entrepreneurial" economies, in which investment activity is undertaken only with the goal to accumulate assets in the form of money and, in fact, can only begin by means of such money-form assets (Carvalho 2012).

imports) so that imports grow at a slower rate than exports. In other words, this is a model premised on the careful management, and at times suppression, of one's own demand. In turn, this demand suppression is enabled by incoming monetary flows from deficit countries, since the presence of a surplus "cushion" makes it easier to slow one's own demand growth without kicking off a sharp recession. Neomercantilism is, at its core, a strategy well-tailored to the demand-determined nature of these mature economies.

In this section, we laid out how a neomercantilist explanation conceives of regional economic structure and how it conceptualizes states and their relation to the political-economic demands thrown up by the structural situation. We then reviewed the causal mechanisms whereby the structural situation, seen via the surplus-deficit relations between European countries, enable some European countries to follow a neomercantilist strategy that involves the state of both the current account and their domestic functional division of income. Taken as an abstract model, it is already apparent that those on the neomercantilist side have a continual advantage as long as they maintain the external surplus, while deficit countries are faced with a choice of accepting lowered demand and possible stagnation or else maintaining investment on fragile, often debt-based, foundations. This basic account of neomercantilism, however, also holds implications for the sequence of pan-European institutions that linked European countries in the postwar period; this connection between the surplus-deficit relations and the institutional integration of the continent will be explored further in chapter 4. First, however, we turn to the next chapter's QCA, which will compare how well each of our contending explanations fit the immediate pre-crisis period of 1999-2007.

Chapter Three

Qualitative Comparative Analysis of the Eurozone Crisis

Abstract:

This chapter focuses on the run-up to the crisis, using several QCA techniques to evaluate how well each explanation fits the contours of the 1999-2007 period. Conditions in each member state that are important to the various explanations are given operational definitions, as well as two 2008-2011 crisis outcomes: a severe increase in unemployment or large jump in the cost of government borrowing. A preliminary analysis of member state deficits and levels of "Europeanization" show these indicators, important facets of the conventional overspending explanation and the field approach, seem to poorly fit crisis outcomes. The competitive disinflation, variety, and neomercantilist explanations, which put forward more detailed models of the medium-term mechanisms of the crisis, have their proposed models converted into set-theoretic "recipes." These are expected combinations of conditions typifying the European countries as cases, and are expected to differ between those cases suffering negative crisis outcomes and those that did not; each explanation thus posits its own distinctive recipes for the negative and positive outcome case sets. The full QCA then proceeds from two ends: first, a conventional fuzzy-set analysis extracts the most relevant causal conditions associated with both presence and absence of negative crisis outcomes, and then a subset-superset analysis reveals the fit of each competing explanation's ideal "recipe" with the actual combinations found in negative and positive outcome cases. Both techniques conclude that there is little support for either the competitive disinflation or variety explanation, and that the neomercantilist explanation provides a stronger fit to the 1999-2007 situation.

Analysis and comparison of cases is arguably the foundational method in modern social science. In the most recent wave of methodological development, theorizing about case-comparative methods and debating best practices has encouraged the development of many methods for identifying social phenomena as cases, analyzing a single case, and comparing multiple cases (McMichael 1990; Walton 1992; Tomich 2004; Byrne and Ragin 2009). In a common type of comparison, a set of cases are compared which differ in terms of some outcome of interest and the presence or absence of conditions thought to bear on that outcome. The aim is to find which conditions "matter" for the outcome, and case comparison in this general sense has been especially useful for historical sociologists whose cases are often the large-scale social entities that Charles Tilly (1984) dubbed "big structures" and "large processes." This line of "macrostructural" research has used case-based methods to investigate social revolutions, democratization, welfare state formation, the mobilization and outcomes of labor or other social movements, and social objects ranging from single firms all the way up to the world economy itself.

Qualitative Comparative Analysis (QCA) is a formalized variant of such case-comparative approaches that uses Boolean logic and set theory to compare cases in a rigorous and replicable manner. QCA recognizes that social phenomena are often best explained as a result of conjunctural causation, in which several conditions combine together to produce

outcomes of interest.[15] This makes a more natural match to case comparison than other social science methods, such as those relying on statistical regression, where the aim is to ferret out the "autonomous capacity" of particular variables to influence the outcomes of interest (Ragin 2006:14). In such "net effects" thinking, "each independent variable is assumed to be capable of influencing the level of probability of the outcome *regardless of the values or levels of other variables*" and the final aim is "the calculation of the non-overlapping contribution of each variable to explained variation in the outcome" (Ragin 2006:14, emphasis in original).

Rather than net effects thinking, QCA's search for conjunctural causation could be termed configurational thinking, where the "effect of any particular causal condition may depend on the presence or absence of other conditions, and several different conditions**...**may be causally equivalent at a more abstract level" (Ragin 2000:40). Causal power is thus thought to inhere in the combinations rather than any particular single condition. QCA outputs a set of "recipes" linked to an outcome by reducing the full menu of conditions present in each case down to only those conditions that survive a process of Boolean minimization.

Basic case comparative reasoning often aims to discover which case qualities were necessary or sufficient to bring about a given outcome. Yet finding a single element that is sufficient or necessary by itself is rare in our world of complex and multi-layered social phenomena (Harvey 2009). Instead, QCA's algorithmic procedure searches for so-called INUS conditions : Insufficient but Necessary elements of combinations which are themselves Unnecessary but Sufficient for bringing about an outcome. Thiem's (2016) example of

[15] This comparison of cases as sets of conditions linked to outcomes is similar to the conventional language of independent variables (IV) analyzed as to their influence on a dependent variable (DV). However, as the following pages will make clear, QCA fundamentally differs from the correlational analyses which use the IV/DV terminology in both the formal mechanics of comparison as well as in terms of ontological assumptions about how causation works. For this reason, QCA researchers recommend the terminology of "(causal) conditions" and "outcomes" rather than IV/DV.

explaining a house fire is instructive. Investigation might reveal a short circuit was not sufficient by itself to cause the fire, but when combined with flammable material and a lack of a sprinkler system, the presence of a short circuit can be seen to be a necessary part of a combination which is sufficient to cause the fire. Still, note that other causal pathways to a house fire might be discovered; the sufficient combination of which the short circuit is a necessary part is itself *not* necessary for all possible house fires.

As a result, QCA makes room for "equifinality" in which several causal pathways, each a combination of conditions, can lead to the same outcome (Olsen 2014: 103-4). This ability to discern multiple conjunctural causation makes QCA particularly suited to research on large social structures such as the Eurozone. Regional or global structures are internally complex; they exist as a unity of many different member states each with their own qualities (the "parts" of our regional "whole"). This functional variation between parts can be used to sort member states into blocs, even while we can expect some degree of important variation *within* each bloc. For example, QCA can reveal combinations associated with a large spike in yields on sovereign debt versus little or no spike, allowing us to apportion member states into two blocs based on this division and examine how the combinations of conditions differ across blocs. At the same time, QCA identifies different causally equivalent combinations even within the group of "large spike" or "small spike" cases. This internal variation can be as valuable a finding as the initial bloc structure itself, provided our theories are detailed enough to meaningfully interpret this variation. Explanations that propose detailed causal mechanisms, such as this study's neomercantilist approach, can use such internal variation to shed light on how subtypes form and persist within the larger bloc typology.

Emenegger, Kvist and Skaaning (2013) note three important steps that frame the QCA "analytic moment." First, prior to analysis researchers should state complex propositions premised on conjunctural causation. Second, these propositions should be reformulated in set-theoretic terms. Finally, after the formal analysis is complete, the resulting "recipes" should be subjected to robustness checks. While robustness will be addressed in our later case studies, in this chapter I will proceed through the first two of these "best practice" steps before moving on to QCA itself. This involves extracting expected combinations for each of our explanations; here I draw on the preceding chapter's discussion of each framework's distinctive causal mechanisms. These expected combinations will be formalized as Boolean equations, matching the syntax of the fsQCA software.

In truth, even before stating the propositions of each explanation, QCA aids analysis by demanding rigor in the process of selecting and calibrating each case's attributes.[16] Choosing outcomes of interest and salient causal conditions requires in-depth knowledge of our competing explanations and preliminary evidence from our cases themselves, relying on "both substantive knowledge and the existing research literature" (Ragin 2006:38). This study uses a flexible "fuzzy set" variant of QCA, allowing more flexible categorization of our conditions than a "crisp-set" approach where conditions can only be present or absent. Once selected, outcomes and conditions are then calibrated by transforming each into a fuzzy-set measure ranging from 0 to 1. These calibrated conditions are set-theoretic in nature; the score for a given case's condition indicates that case's degree of membership in that condition's set, with a fuzzy score of 1 being "fully in" and a score of 0 being "fully out" (with 0.5 being the crossover point where a case switched from being "more out" to "more in"). This formalizes and makes replicable the

[16] While selecting cases is itself also a theory-laden and oft-debated procedure, here it is relatively simple: our cases are cordoned off by an obvious institutional boundary as member states within the monetary union (Walton 1992).

qualitative judgments made in conventional case comparisons, such as when scholars argue that case conditions are "mostly present" or "mostly absent," or rate them as "strong," "moderate," or "weak." This calibration process also encourages the use of unipolar or directional categories; it is more meaningful to calibrate a fuzzy score for "severe unemployment increase" rather than simply "unemployment" (Ragin 2014:91).[17]

As a result of the calibration process, the national cases are redescribed in terms of their degrees of membership in the sets of conditions and outcomes. We can then proceed to the analytic moment of QCA, where "it is necessary to determine whether degree of membership in each combination of conditions is a subset of degree of membership in the outcome" (Ragin 2006:33). This will yield a set of simplified combinations linked to our crisis outcomes, allowing the member states to be sorted into blocs based on shared resemblance of their respective combinations. Importantly, more or less simplified combinations can be attained depending on what assumptions are made about possible combinations that are not empirically instantiated, so-called "logical remainders." As will be seen later in this chapter, making explicit the reasoning behind treating remainder cases in particular ways allows us to examine the resulting combinations from various levels of complexity; we can attain both "parsimonious" combinations that delineate the minimum combination of conditions associated with an outcome, yet also dig down into more complex versions of each combination as needed.

The resulting causal "recipes," grouped into blocs of similar combinations, will provide a view of the Eurozone's surplus-deficit structure and a partial explanation of the crisis. Of course, even if neomercantilist categories and mechanisms provide the best fit to this post-1999 period, the full argument for a neomercantilist explanation of the crisis must be made in cumulative

[17] This matches long-standing methodological practices in global political economy research, where relative differences of interest between cases are best treated not as continuous *variables* but rather as *variates* which have both direction and levels of qualitative difference (Hopkins 1983).

stages, and likewise must include an account of how the surplus-deficit relations and pan-European institutions formed. Later chapters will provide this oft-recommended robustness check where "the different 'causal paths' obtained though the minimal formulae are interpreted, which necessitates a 'return to the cases' and to their narratives" (Rihoux and Lobe 2009:230; Rohlfing and Schneider 2016). This return to the empirical particulars is accomplished in the historical case study of European development in chapters five and six.

Table 3.1 arrays the four competing explanations dealt with in this study, as well as the basic "overspending" explanation. "Overspending," field, variety, competitive disinflation, and neomercantilist explanations all agree that European member states fall into two categories but disagree about the content of this binary. Each framework expects that countries sharing negative crisis outcomes, such as severe unemployment, would all evince specific combinations of conditions that cause them to fall onto one or another side of their preferred classification scheme. In similar fashion, each framework expects certain combinations to be common among countries sharing positive outcomes.

Table 3.1: Categories of Competing Explanatory Frameworks

Explanatory Framework	*Positive outcome group*	*Negative outcome group*
Overspending	States with balanced or surplus public budget	States with chronic public deficits
Field Approach	Europeanized polities that can follow European institutional guidelines	Non-europeanized polities at risk of diverging from European instutional guidelines
Variety Approach	Coordinated Market Economies (CMEs) with centralized labor institutions	Mixed Market Economies (MMEs) with decentralized labor institutions
Competitive disinflation	"Competitive" economies with lower wage share and higher investment	"Non-competitive" economies with higher wage share and lower investment
Neomercantilism	Neomercantilist countries with a continuous current account surplus	Countries with a continuous current account deficit

The aim of this chapter, then, is twofold. First, it amounts to an initial evaluation of the explanatory power of our competing theories. Following Lipton (2004), explanatory power is a core explanatory virtue that encompasses how well an explanation's proposed mechanisms, entities, categories, or processes match the pattern of evidence we are trying to explain.[18] Greater explanatory power should inhere in those explanations whose proposed components are tightly associated with particular crisis and have the highest likelihood of leading to the outcome evidence on hand; if a theory's preferred categories are present and are associated with

[18] For some advocates of IBE, "explanatory power" parallels the "Bayes factor" term in Bayes Theorem; that is, the ratio of how likely the evidence is on a given hypothesis to the likelihood of the evidence on all other pertinent explanations. However, some also hold that explanatory power must also take into account the "efficiency" of explanations. This would imply that explanations that can give more detailed accounts of the mechanisms and entities involved are to be preferred, and especially so if this level of explanatory detail can be reached with a more simple set of proposed mechanisms (provided, of course, evidence for these mechanisms can be advanced and disconfirming evidence dealt with). In that sense, the relatively simpler combinations expected by the neomercantilist explanation would be accorded more relative explanatory power *if* they match the pattern of observed crisis outcomes at least as well or better than competing explanations.

differences in crisis outcomes this is evidence that those categories "made a difference" during the Eurocrisis. Second, while the outcomes of interest appeared from 2008-2012 and the mechanisms involved span the preceding 1999-2007 period, the conclusions of this analysis open a window through which to view and thus analyze the development and integration process of the last fifty years. Establishing that combinations of conditions making up neomercantilist mechanisms match crisis outcomes, and do so at least as well or better than the conditions important to competing explanations, suggests that not only were neomercantilist mechanisms important after 1999 but that they reveal a structured relation within the Eurozone that existed for quite some time. In another manner of speaking, the QCA establishes a plausible connection between neomercantilist mechanisms and the proximate outcomes of the multi-decade process of development that ended in the crisis. It provides an impetus to move back in time, our QCA-generated "map" of neomercantilist and dependent countries in hand, and trace the history of how this internal structure within the Eurozone came to be.

The following section lays out two outcomes, each capturing a moment in the 2008-12 crisis, and explains their calibration for fuzzy set analysis. Then, I perform a simple exploratory analysis of the field and conventional "overspending" explanations, showing that their proposed mechanisms make a poor fit to the distribution of good and bad crisis outcomes. Subsequent sections examine the more elaborate combinations of the competitive devaluation, variety, and neomercantilist explanations. Finally, QCAs are conducted for these three explanations, conditional on both crisis outcomes.

Crisis Outcomes

Our QCAs are conditionalized on two facets of the crisis spanning the period from 2008, the year that the "Great Financial Crisis" struck, until 2012, the year Monti's announcement of "anything it takes" brought some calm to the roiling sovereign debt markets. These outcomes can be thought of as "structural" in that they represent changes in economic measures over the first phase of the crisis (2008-2011) and are less immediately modifiable by short-term policy choices: a severe increase in unemployment, and a sharp spike in government borrowing costs.

Both outcomes, a severe increase in unemployment or a large jump in the sovereign borrowing costs faced by member state governments, are calibrated in a similar manner. Both use data collected by Eurostat on employment and government bond yields over the 2008-2011 period, transforming the raw measures into fuzzy score conditions. A case is considered to have full membership in the severe unemployment condition if the unemployment increased by 100% or more over the 2007-2011 period. The threshold for full membership in the severe unemployment increase condition was set at 100%, with the crossover being any increase of 20% or more. In similar fashion, cases were considered to have full membership in a large jump in borrowing costs if the yield on that case's long-term interest rate, proxied by the yield of each state's ten-year public bond or equivalent, increased over the period by 100% or more.

"Overspending" and Field-based Europeanization

Two of our explanations need not be formulated as combinatorial QCA explanations and can instead be analyzed through a simpler approach. The initial plausibility of the simplest

"overspending" and field explanations emphasizing "Europeanization" can be examined without having to search for complex combinations of causal factors.

On one level these two frameworks could not be more different. The conventional explanation relies on a simple mechanism to explain how overspending leads to bad outcomes, making the analogy between European states and private institutions such as households or firms. Like a household, member states whose revenues do not cover their expenditures go into deficit; they can borrow to cover this gap but may encounter the unwillingness of private creditors to buy new or roll over existing sovereign debts. The field approach, in contrast to this simplicity, tends to generate empirically rich descriptive accounts of how European fields started and subsequently stabilized or expanded. As we have seen, they put forward a wealth of possible interactions among an equally large cast of possible institutional, organizational, and individual actors and argue that diffuse causation operating over time results in institutional deepening.

Yet both have the virtue of positing a single "deep" factor that is determinative of crises. After the crisis struck, the overspending thesis was supposed to explain why some member states encountered bad outcomes after the crisis. Simply put, higher public deficits should be associated with negative crisis outcomes, and member states that showed fiscal restraint should be less affected. Similarly, it is clear in the seminal field model by Fligstein (2008) that while the pan-European institutional formation is a process with progressively less role for nations and national governments, the determinant of future difficulties would hinge upon tensions between Europeanized and non-Europeanized citizens that then translates into differences between Eurozone member states. The field approach's argues that the integration process and pan-European institutions are objectively positive for European growth and social development, and this suggests that the most Europeanized member states, which followed the institutionally-

mandated recipe for success most closely, should be less prone to negative crisis outcomes. The least Europeanized member states should end up facing negative crisis outcomes, such as mass unemployment or fiscal crisis.

Fuzzy-set scores can thus be calibrated for both high deficit membership and for a large Europeanized fraction of the national population. For the former measure (*hideficit*), each state's annual fiscal balance as a percentage of GDP was summed over the 1999-2007 period. The resulting totals, a measure of each state's public deficit (or surplus) over the entire eight years, were then transformed into fuzzy membership scores indicating membership in the condition of "high budget deficit." Cases with cumulative deficits in excess of 32 percent were considered fully in the high deficit condition, as this indicates at least 4 percent deficit or more per year.[19] The latter measure (*euid*) draws on the results of the 2004 European Values Survey as presented in Fligstein (2008: 167). The percentages of each national population self-identifying as either European or European and their respective national identity (with "European" taking priority) were combined to form a single total measure of the population with strong European identity. Having a European identity fraction at 20 percent or more of the national population is the threshold for a case to be considered as having high European identification, especially in light of the fact that this Europeanized fraction is disproportionately composed of economic elites, professionals, and others who would have an outsize influence on both domestic and integration policy.

Given that *hideficit* and *euid* are supposed to shape European events, how well do they match up with our crisis outcomes? Table 3.2 presents the consistency score, a parameter of fit,

[19] The guidelines for "excessive deficits" as worked out in the Eurozone's Stability and Growth Pact set a deficit-to-GDP ceiling of three percent; the 32 percent threshold would thus represent an average exceeding this for all eight Euro years.

for both measures when conditionalized on each of our outcomes. Consistency is a set-theoretic measure capturing to what extent a condition (or combination of conditions) forms a subset of the outcome of interest. It is thus an indication of how consistently those conditions are associated with the outcome, with a high score implying that the condition is sufficient to bring about the outcome; scores should reach 0.75 or above in order to indicate any substantial connection.[20]

Table 3.2 Subset/Superset Analysis of Deficit and Europeanization Conditions

Outcomes	Conditions	Consistency	Raw coverage	Combined
Avoiding severe unemployment				
	~hideficit	0.65	0.53	0.39
	euid	0.82	0.73	0.78
Severe unemployment				
	hideficit	0.41	0.54	0.10
	~euid	0.63	0.74	0.41
Avoiding large rate increase				
	~hideficit	0.75	0.57	0.61
	euid	0.85	0.71	0.80
Large rate increase				
	hideficit	0.43	0.63	0.14
	~euid	0.57	0.76	0.28

The results cast doubt on the generality of any overspending explanation, and provide weak support for the field-based explanation. For the high deficit measure all but one consistency score is well below the 0.75 threshold. This holds whether considering if having a

[20] In contrast, coverage measures the extent to which the conditions (or combination of conditions) is a superset of the outcome. In other words, a measure of how many of the outcome cases are covered by this condition or combination of conditions.

high public deficit leads to either negative outcome or if avoiding a public deficit leads to one of our two positive outcomes (avoiding high unemployment). The high deficit condition reaches a consistency of 0.75 only for the outcome of avoiding a large rate increase; this opens the possibility that *not* having a large public deficit played a role in helping member states escape rate increases. Overall, this poor showing provides evidence against any explanation that enshrines public “overspending” as the main determinant of crisis outcomes. In contrast, high Europeanization approached our consistency cutoff for two out of our four possible outcome categories: the avoidance of negative outcomes. High Europeanization yielded a consistency of 0.82 for avoiding severe unemployment, and a slightly higher 0.85 for avoiding a large increase in borrowing costs. Yet given the low consistency scores when conditionalizing on the presence of severe unemployment or a rate increase there is little sign that lacking high Europeanization leads to negative outcomes.

There is thus no sign that public budget deficits were the fundamental crisis determinant, and being highly Europeanized mattered, if at all, only when avoiding negative outcomes while playing no part in determining which member states were struck with such effects. However, this does not completely rule out any role for the public deficit as a component of more complex relations, especially in light of the fact that the government’s fiscal balance is structurally related to other macroeconomic and social indicators. In the rest of the chapter, the competitive disinflation, variety-based, and neomercantilist explanations provide an auxilliary role for the public deficit, and this measure will reappear in some of the causal recipes expected by those theories.

The Europeanization measure forwarded by the field-based approach is still in play, at least as a possible factor enabling member states to avoid negative outcomes. Still, a high degree

of Europeanization evinces the curious quality of helping member states avoid negative outcomes, even as lacking Europeanization has no role in causing such negative outcomes. The case studies in following chapters will continue to interrogate the field-based explanation in two ways. First, we will look for reasons why the more "Europeanized" member states would be in a position to avoid crisis effects; a neomercantilist argument to the effect that surplus states are those most likely to avoid negative outcomes because they exerted a disproportionate influence on the pan-European institutions mediating such outcomes can be interrogated historically. Second, as outlined in the previous chapter a field-based perspective also puts forward strong empirical claims about how pan-European institutions formed, emphasizing the endogenous process of institutionalization in which states are progressively overlaid by a autonomous, self-constituting set of regional fields. These claims can be historically investigated even if Europeanization as such is only weakly linked to the crisis.

QCA Conditions

We now turn to the three remaining contenders: competitive devaluation, variety, and neomercantilist explanations. QCAs in the following sections will draw on a set of middle-term causal conditions. These are "middle-term" because the measures for each condition are aggregates over the 1999-2007 period, starting when the single currency was introduced and ending in the last pre-crisis year.

Table 3.3: Fuzzy-set QCA Conditions

Condition	Source	Fuzzy calibration*	Framework
Wage share drop (*wagedrop*)	Adjusted wage share total economy (AMECO ALCD0), % change 1999-2007	(-7, 0, 2)	**Competitive devaluation**, variety-based, neomercantilist
Net investment drop (*ninvdrop*)	Net fixed capital formation at current prices of private sector (AMECO UINP), % change 1999-2007	(-33, 0, 10)	Competitive devaluation, variety-based, neomercantilist
High current account surplus *(hisurplus)*	Balance of current transfers with the rest of the world (AMECO UBCA), cumulative % of GDP 1999-2007	(40, 4, -2)	**Neomercantilist**
High public deficit *(hideficit)*	Net lending or net borrowing; general government (AMECO UBLG), cumulative % of GDP 1999-2007	(-32, -8, 2)	Competitive devaluation, variety-based
Labor centralization *(centralized)*	6-level scale of "Degree of Wage Bargaining Centralization" in Herrmann (2005:292), drawing on Traxler *et al.* (2001)	(7.5, 4.5, 3.5)	**Variety-based**

Sources: AMECO, Herrmann (2005), Traxler et al. (2001)

Armed with this set of conditions each explanation can be reformulated as a set of expected causal combinations, and these expected combinations can be expressed in the set-theoretic terms used in QCA. As detailed in Table 3.1 each framework advances a binary typology; by reformulating these binaries as concatenations of conditions our QCAs can serve as an initial step toward evaluating how well each framework's binary matches empirical reality.

First, however, we must set the stage with some remarks about the general state of Europe and its relationship to the rest of the world over the 1999-2008 period. Each contending explanation expects certain combinations of national factors to be implicated in either positive or

negative crisis outcomes, but these expectations are conditional on certain global or regional conditions. For example, the variety approach posits a certain bundle of qualities to characterize CMEs, but the precise state of these qualities can differ depending if one is analyzing the upward or downward swing of an economic cycle. To take one example, the priority CMEs place on preserving aggregate employment, relative to LMEs and their active use of unemployment, becomes an important differentiating condition only in recessionary periods.

For our purposes, there are three important points to note regarding Europe's relation to the rest of the world during the Euro years. First, the Eurozone's current account as a whole stayed roughly balanced from 1999-2007. From this it follows that the winning of external surpluses became a zero-sum game within the Eurozone itself; the only two possible outcomes were either an even balance of payments across member states, or else some amount of separation into surplus and deficit countries. Second, raw material costs were rising worldwide starting in 2000. It follows that producers across Europe faced rising materials costs and a general squeeze on profits coming from the resulting rising unit costs. As will be seen below, these general conditions shaped the combinations each explanation expected.

The Variety Approach

Variety approaches have strong theoretical expectations. This is especially so for the "Varieties of Capitalism" school. A Europe modeled as a combination of coordinated market economies (CMEs) and mixed market economies (MMEs) provides a well-defined pair of combinations expected to be associated with positive or negative crisis outcomes.

As detailed in chapter two, CMEs are understood to have escaped the effects of the crisis, while the largely Southern MMEs bore the brunt. This means that conditioning on a lack of negative outcomes of the crisis should yield QCA recipes approximating the CME "bundle," and conditioning on the presence of negative outcomes should yield MME-like combinations.

Recall that the central characteristic of CMEs for intra-European analysis has been their centralized labor market institutions, thanks to which wage growth can be relatively more controlled across the national economy as a whole. Given that variety approaches have highlighted divergent wage-setting behavior as the cause of the crisis, much attention has been paid to the notion that CMEs are expected to have broad employer-labor agreement such that wage increases are conditioned by productivity (Hancké and Hermann 2008). As a result, wage increases that jeopardize the country's comparative advantage will be eschewed in favor of more secure employment. At the same time, varieties research has emphasized the long-term time orientation of institutions in CMEs. This implies that employers would be expected to swallow a lower profit rate in order to keep wages and especially employment stable; this becomes especially important in a period such as 1999-2007 when raw material costs are rising worldwide and should, all else equal, put pressure on each firm's unit cost. The long-term orientation should work to keep investment from shrinking despite smaller profit margins; firms are more interested in maintaining market share even at a smaller profit rate and capital investment is supported by "patient" bank capital rather than dependent on retained earnings.

The CME bundle can thus be summarized as having a no large drop in wages, stable domestic investment, centralized labor institutions, and relatively small or even no fiscal deficit. Below, this combination is expressed as a set-theoretic "recipe" appropriate for QCA. In these "recipes" listing a condition implies its presence, while prefixing a condition with "~" indicates

negation (i.e. it must *not* be present). Joining two conditions via * indicates a logical *and*, such that conditions joined by * must co-occur, while + indicates logical *or* such that a pair of conditions joined by + indicates substitutable conditions; either one can complete the “recipe.”

~wage share drop*~investment drop*~public deficit*centralized labor

On a variety view, this is the right combination to avoid the worst effects of the crisis. It represents a type of virtuous growth, dealing with the rising input prices and constraints of the single currency by keeping wage increases in line with productivity, continuing or increasing productivity enhancing investment, and allowing the state to retain some measure of fiscal rectitude. Centralized labor institutions provide the key, as they allow keep age growth from becoming excessive and share the orientation of firms and banks toward long-developing technical industry.

Conversely, the MME combination should be associated with the *presence* of negative outcomes such as a state funding crisis or severe unemployment. MMEs rely on state funding to paper over the problems that arise from their half-finished state. Lacking both CME-style labor institutions and the LME ability to “discipline” labor through unemployment should mean that MMEs are unable to control wage growth. At the same time, the lack of institutional complementarity means that there is little chance that the higher domestic demand resulting from higher wages will be translated into increased domestic investment. Indeed, analysis emphasizing the decentralized labor institutions of MMEs posits that the introduction of the Euro in 1999 pressured these regions into low-cost, relatively low investment production. While later chapters will critique the way varieties-perspective model wage costs, at this stage it suffices to

note that in the post-1999 era MMEs are expected to have growing wages yet inadequate private investment, necessitating state spending to hold the system together. As a result, using the QCA conditions we would expect an MME bundle to center around a stable or higher wage share, lower domestic investment, a fissile labor structure, and a larger fiscal deficit.

~wage share drop+investment drop*high public deficit*~centralized labor

It is important to note how, relative to the neomercantilist combinations examined later, the presence or absence of a current account surplus is a secondary condition. This is because variety perspective sees different types of capitalism arising out of *internal* institutional arrangements, with external competitiveness being a result of having the right combination of institutional complementarities.

Competitive Disinflation

The competitive disinflation recipe for success in a monetary union leans heavily on Say's Law. The assumption of full employment means that there are two fundamental relations underlying both the explanation for success and the explanation for failure: a direct relation between rising profits and investment, and between the government budget and the current account. Success in a monetary union is won through disinflating more than one's competitors.

wage share drop*~investment drop*~public deficit

If wage increases are moderated, firms will either lower their prices, achieving a trade surplus which will in turn increase investment, or will keep prices steady and thus reap increased profits that will be translated into increased investment. In either case, the important point is that there should be no fall in investment, in line with the supply-side assumption that a lower real wage is required for expanding investment and employment. It is also essential that the state not "crowd out" possible private investment with its own spending. If state spending continues to add to domestic demand, this would either increase imports, blunting the current account surplus, or crowd out investment directly. This combination thus represents both wage and fiscal austerity.

The direct link between profit and investment, and between the budget deficit and the current account balance, furnishes the following expected combination for failure:

~wage share drop*investment drop*public deficit

In this model, failing to drop the wage share in an environment of increasing input costs leads to either an investment drop due to increased costs compounded by imports overtaking exports. This dysfunctional case also includes an expectation of worse public deficits as the contributing cause of the current account deficit.

One point to note is that, much like the variety-based model, the current account surplus is extraneous. While the perspective certainly includes the current account as a portion of the causal mechanism, unsurprising given the name "*competitive* disinflation," in both expected combinations a current account surplus may or may not be involved. That is, the basic positive

combination *must* include a wage drop, shrinking public deficits, and stable or increasing investment, regardless of the state of the current account. For the failing "twin deficits" combination, the current account deficit is thought to be a function of the public deficit and a lack of wage restraint.

Neomercantilism

The neomercantilist explanation expects a quite different set of causal combinations. It assumes neither Say's Law, as in the competitive disinflation framework, nor an assumption that coordination between firms and centralized labor institutions leads to increased investment, as in the varieties-based framework. Those elements make the current account surplus a peripheral element of both frameworks; surpluses are side-effects of virtuous government austerity or employer-employee "complementarity."

In contrast, the neomercantilist view gives the current account surplus a central place in the explanation. This is in keeping with the long tradition in global political economy of identifying seeming "external" factors that are, in actuality, essential elements of ostensibly self-contained national development strategies. The rejection of Say's Law means that profit *and* demand considerations both play a part in investment decisions, to say nothing of the volatility and subjectivity emphasized by Keynes in his discussion of "animal spirits." It follows, then, that a drop in worker's share of income leads not to investment but rather, *ceteris paribus*, a drop in investment and total income; in other words, an economic contraction or lower growth. Yet if the current account surplus can be relied upon to support profits, a drop in the wage share or investment need not lead to such severe negative effects, at least from the point of view of

economic elites who can continue to book profit while growth remains slow. The external surplus can make possible the other institutional features of export-based national economies, such as centralized labor institutions, rather than being caused *by* such features.

Neomercantilist countries, then, are expected to display this combination:

wage drop*investment drop*current account surplus

Here a dropping wage share, and even a fall in investment, need not lead to recession but instead the neomercantilist country can simply maintain a state of stagnation with relatively high profits. Without the surplus, an economy wide drop in wages and investment would result quickly in a drop in profits, causing firms to lay off workers and likely kick off a rash of bankruptcies and further contraction as firms become insolvent. Instead, the external surplus keeps profits high, keeping the economy ticking over. The primacy of the external surplus means that the public budget can go either way in a neomercantilist country; the inflowing external surplus can help fund the state or can simply be "hoarded" by private companies by sinking the profit into purely financial assets or sending it abroad. The public deficit is thus extraneous, not the external surplus.

The neomercantilist explanation implies that, in the final analysis, the external surplus is *the* pivotal condition that would underlie the distribution of crisis outcomes. There might be differentiation within the positive or negative outcome camps in terms of public budget deficits, labor centralization, or even the exact state of wages and investment, but positive outcome cases should be nearly uniform in having a large current account surplus (and *vice versa* for negative

outcome cases). In QCA terms, the surplus condition should display higher consistency than any others.

The counterpart of the neomercantilist strategy comprises all countries on the other side of surplus-deficit relation. In other words, these countries are expected to have a continual and mounting current account deficit, which acts as both a drain on overall demand created in that national economy and a loss of profits for firms specifically. On this view, we should expect the "~CA surplus" measure to exhibit higher consistency with regard to crisis outcomes than the types of conditions put forward by varieties-based explanations, such as the degree of labor centralization or public deficit.

Why is this? The crucial point is that the public budget balance need not worsen even though the external drain is ongoing. Instead, the private sector itself could be in deficit, either by going into debt or by using up saved financial assets. Recall the three-sector national account discussed on pages 15-16 of the previous chapter, where for any given country the net financial saving of the public sector, the private sector, and the rest of the world (i.e. the inverse of the current account balance) must sum to zero:

$$\text{Public Saving} + \text{Private Saving} + \text{Saving of the ROW} \equiv 0$$

The external drain thus limits the freedom of the other two sectors to net save; if the current account is in deficit, at least one other sector *must* be in deficit. Figure 3.1 illustrates this, showing the sectoral balances of Spain from 2005-2012.

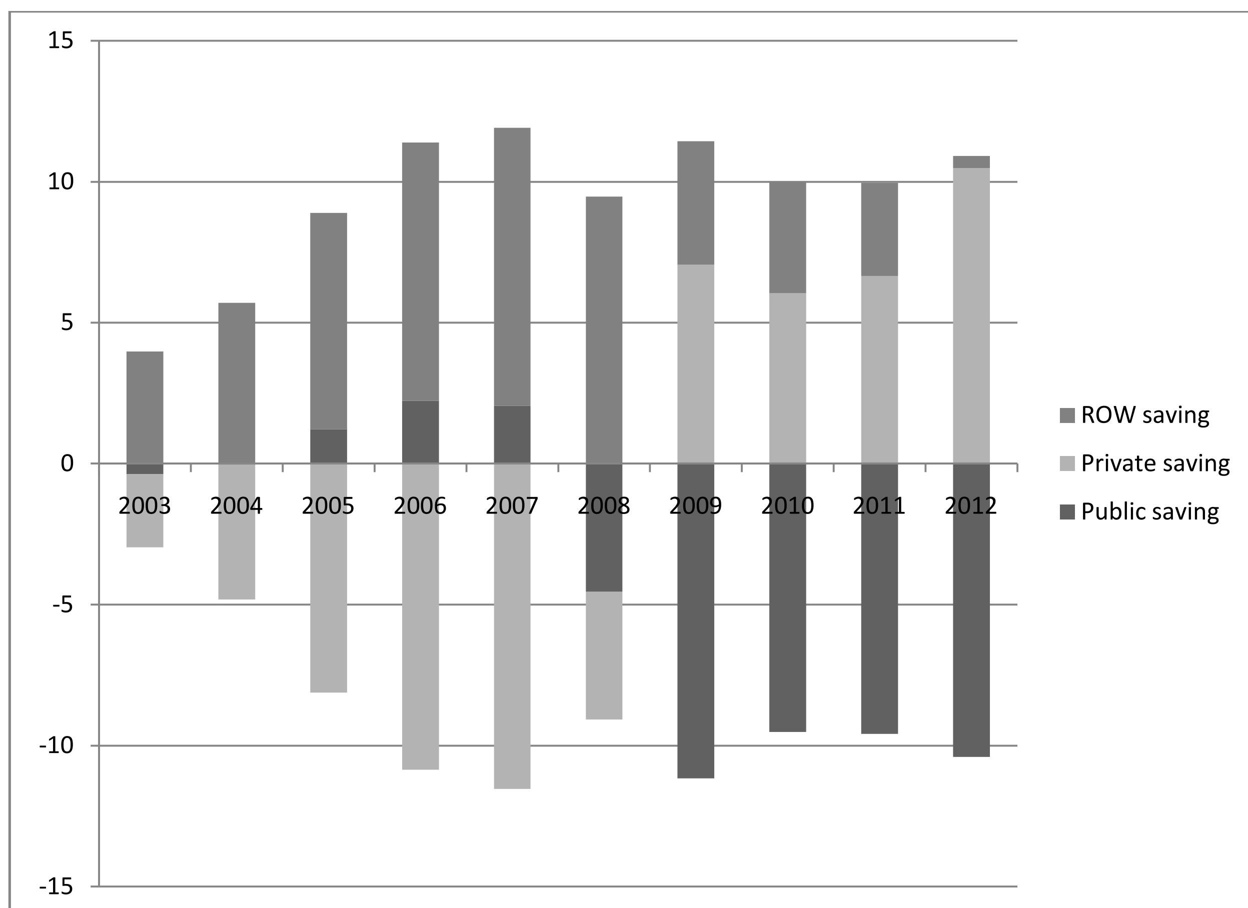

Figure 3.1 Spanish Sectoral Balances as a share of GDP, 2003-2012

Source: AMECO

Here we can easily see how the three sectors are related. The inverse of the current account deficit is the "ROW saving," and the positive bars for this measure from 2005-2007 mean that an equal balancing deficit must exist. In 2005, this balancing meant that both Spain's public and private sectors were in deficit, and over the next four years the government attained a surplus which left the private sector as the only net negative sector. Spain's firms and households were negatively saving, increasing their debt as the Spanish asset bubble grew. In 2008 we return to a situation in which the positive net saving of the rest of the world (again, representing the current account deficit) is balanced by a deficits split between the public and private sector. From

2009 on, the private sector desperately began to heal its balance sheets by saving, leaving the public deficit as the "dis-saver of last resort."

This makes clear that a persistent current account deficit can be balanced either by a government deficit, by a private deficit, or by some combination of the two. If the current account deficit is the most salient factor in distributing crisis outcomes and, as the neomercantilist explanation suggests, the most important identifier for "blocs" of the Eurozone, we would expect negatively affected member states to nearly always show a current account deficit but combine it in various ways with public or private sector deficits.

This also suggests that wages and investment are only loosely determined in much the same manner. All else equal, the demand lost thanks to the external deficit should lower total profits and make firms less likely to invest, but if the public or private sector is willing to go into debt in order to keep profits afloat and demand high we could see a rise in investment. At the same time, the wage share might avoid shrinking if workers are able to extract nominal wage increases that at least keep pace with the country's overall growth rate and inflation. Still, both this expansionary possibility, as with the possibility of a government surplus, mean that domestic actors are either taking on debt or using up their savings to make up for the external drain. This is especially dangerous if the sustaining capital is flowing in from abroad, as in the well known East Asian crisis scenario where Thailand, for example, expanded thanks to dollar-denominated debt with catastrophic results when a change in the baht-dollar exchange rate made the value of these debts more difficult to repay.

A potential objector might note that in the single-currency area of the Eurozone there is no danger of an exchange rate difference between member states. This is precisely the "advantage" that led many to recommend the shared currency and be so optimistic about its

prospects. However, this disguised the very real danger of an increase in fragility caused by using domestic credit, government deficits, or capital from other member states to plug the gap caused by an increasing external drain. The non-neomercantilist countries should thus display maximum fragility with the following combination:

~wage drop*~investment drop*~current account surplus

QCA Results

Structural Outcomes

Each of our contending frameworks provides a well-defined ideal-typical formulation of the combinations each expects for positive or negative outcomes. As a result, we can approach QCA from two opposite directions. First, we can conduct a truth table analysis, using fsQCA's minimization algorithm to detect the combinations most tightly linked to differences in our outcomes. This not only reveals the empirical reality of patterns for each case, but can also serve to support one or another of our explanations to the extent that the resulting minimized combinations match expected patterns. Second, fsQCA's subset-superset tool allows us to proceed from the ideal typical recipes themselves, inputting each expected combination and comparing them based on their consistency and coverage measures.

Table 3.4: Avoiding Severe Unemployment (Parsimonious)

	Raw coverage	Unique coverage	Consistency
Hisurplus	0.76	0.76	0.95

Table 3.4 gives the parsimonious results when avoiding a severe increase in unemployment. These results make clear the dominance of the "hisurplus" condition for avoiding the negative outcome; that is, the condition of having large current account surpluses over the 1999-2007 period is linked to avoiding a severe unemployment increase from 2008-2011. Having a high surplus is the only condition to survive the stringent reduction process used to construct a parsimonious solution, and yields a consistency score of 0.95 while covering a large number of avoiding unemployment cases (0.76). The cluster of member states that consistently accumulated high levels of external surplus *and* avoided high unemployment serves as a list of the neomercantilist bloc: Germany, Austria, the Netherlands, Belgium, Luxembourg, France, and Finland.

Clearly, this initial grouping encompasses a wide range of variation. The history of political wrangling between France and Germany, detailed in chapters five and six, is enough to indicate differences within this putative neomercantilist camp. We can capture this internal variation via the intermediate solutions displayed in table 3.5. The coverage scores for each solution are all quite a bit lower than the 0.76 reported in the parsimonious solution, but this is to be expected given that this intermediate table disaggregates the "hisurplus" set and apportioning only part of the total 0.71 coverage to each solution. The high consistency here is important for solutions encompassing more than one case; this indicates that even for solution 2 (two cases) and solution 3 (three cases) the particular combination consistently avoids severe unemployment.

Table 3.5: Avoiding Severe Unemployment (Intermediate)

	Raw coverage	Unique coverage	Consistency
*1.wagedrop*hisurplus*~hideficit* (Finland)	0.37	0.10	1
2.wagedrop~ninvdrop*hisurplus*~centralized* (Belgium; France)	0.20	0.06	1
*3.ninvdrop*hisurplus*~hideficit*~centralized* (Luxembourg)	0.22	0.12	0.98
*4.wagedrop*ninvdrop*hisurplus*centralized* (Austria; Germany; Netherlands)	0.31	0.16	1

Solution coverage: 0.7139
Solution consistency: 0.994361

Counterfactual assumptions:
wagedrop (present)
hisurplus (present)
~hideficit (absent)

In solution 4 Germany, Austria, and the Netherlands all evince a combination close to the ideal-typical neomercantilist model: a wage drop, a drop in net investment, and a continual high external surplus. At the same time, the presence of centralized labor institutions is also important in this subgroup. This seems to support the variety approach's emphasis on centralized labor institutions as the most important factor in weathering the crisis. Yet from the full solution list it becomes clear that, out of the group of high surplus countries that all avoided high unemployment, the Germany-Austria-Netherlands subgroup are the *only* member states in which centralization played a part – and they did so in combination with wage and investment dynamics that are the opposite of the variety-based expectations.

The remaining solutions sharpen this point. Whenever else the centralization played a role (solutions two and three) it was the *lack* of labor centralization that was important. Moreover, in France and Belgium, two out of the three cases covered by solutions 2 and 3, the

lack of centralization combined with a wage drop. This is at odds with the variety assumptions, which make much of the supposed role for centralized labor in enabling wage restraint. For its part, Finland's solution 1 does not contain a role for either the presence or absence of labor centralization.

In all, the intermediate solutions present a picture of a "core" neomercantilist group, centered on Germany, Austria, and the Netherlands in which wages and investment shrank, labor was organized via centralized institutions, and external surpluses were continuously accumulated over the 1999-2007 period. Three additional combinations round out the surplus bloc. First, solution 2's France/Belgium pairing, in which dropping wages combined with an external surplus, but where net investment did not fall and major labor institutions were not centralized. Finally, unique combinations characterize the cases of Finland and Luxembourg. This equifinality within the surplus bloc will be discussed further in this chapter's conclusion. First, we must address both the cases that failed to avoid unemployment and QCAs conditional on our second outcome, all of which will also exhibit this equifinality.

Table 3.6 and 3.7 present the parsimonious and intermediate combinations associated with a severe increase in unemployment. Table 3.6's parsimonious solution, combining no drop in investment and a lack of surplus, again supports the neomercantilist explanation and contradicts causal expectations of the variety and competitive disinflation models.

Table 3.6: Severe Unemployment (Parsimonious)

	Raw coverage	**Unique coverage**	**Consistency**
~ninvdrop~hisurplus*	0.73	0.73	0.78

The neomercantilist model expects the lack of surplus to be the most important condition leading to a negative outcome. Almost as crucial is the fact that both variety-based and competitive disinflation explanations expect inadequate investment as a cause of negative outcomes. Instead, the neomercantilist understanding is based on the sectoral balances equation and Kalecki's profit equation. It expects that if a current account deficit is draining total profit, and yet investment has not fallen, this can only mean that investment was sustained by mounting private debt or reduced prior savings and thus increasing fragility.

Table 3.7: Severe Unemployment Increase (intermediate)

	Raw coverage	**Unique coverage**	**Consistency**
1.*wagedrop*~ninvdrop*~hisurplus* (Ireland, Spain)	0.43	0.32	0.80
2.*~ninvdrop*~hisurplus*hideficit*centralized* (Greece, Italy)	0.35	0.23	0.79
Solution coverage	0.67		
Solution consistency	0.81		
Counterfactual assumptions: ~hisurplus (absent) hideficit (present)			

The intermediate solutions in table 3.7 resolve into a pair, each covering two member states. Solution 1 includes Ireland and Spain, combining a wage drop, no decrease in investment and a lack of surplus. The second solution, encompassing Italy and Greece, also shares the lack of investment drop and surplus, but in combination with high public deficits and centralized labor institutions. Before moving on to our second outcome analysis, one thing to note is the unusual clustering. Spain, usually held up as the worst of the PIIGS after Greece, is most similar to Ireland, which has been lauded as the "least bad" of a bad bunch. Conversely, one of the

Eurozone's most powerful economies, Italy, partook of a similar combination as one of the smallest and most dysfunctional member states, Greece. At the least, this suggests a more complex variation within the group than conventional understandings expect.

Similar QCAs were performed using the second outcome, whether or not the member state faced a large jump in sovereign borrowing costs. Tables 3.8 and 3.9 present the parsimonious and intermediate solutions for avoiding this outcome. It becomes immediately apparent that these solutions match our unemployment analysis, with slight differences in the consistency and coverage scores. Once again the current account surplus is the only major condition in our parsimonious solution, though now with a higher consistency score (1) and again instantiated in the same grouping of Germany, Austria, the Netherlands, Belgium, Luxembourg, France, and Finland.

Table 3.8: Avoiding a Large Rate Increase (parsimonious)

	Raw coverage	**Unique coverage**	**Consistency**
hisurplus	0.75	0.75	1

Table 3.9: Avoiding large rate increase (intermediate)

	Raw coverage	Unique coverage	Consistency
*1. wagedrop*hisurplus*~hideficit* (Finland)	0.35	0.10	1
2.wagedrop~ninvdrop*hisurplus*~centralized* (Belgium; France)	0.19	0.06	1
*3.ninvdrop*hisurplus*~hideficit*~centralized* (Luxembourg)	0.21	0.11	1
*4.wagedrop*ninvdrop*hisurplus*centralized* (Austria; Germany; Netherlands)	0.29	0.15	1
Solution coverage	0.67087		
Solution consistency	1		
Counterfactual assumptions: wagedrop (present) hisurplus (present) ~hideficit (absent)			

The intermediate solution also recapitulates the combinations present in the unemployment analysis, with slightly lower coverage of 0.67 for all combination but now with a uniform high consistency of 1 across all combinations. The subgroups are again the same, with a "core" subgroup of Germany, Austria, and the Netherlands hewing closely to the ideal typical neomercantilist combination of wage drop, investment drop, and sustained high external surplus.

Analyzing the combinations implicated in the *presence* of a large rate increase yields a slight difference from the earlier unemployment analysis. The parsimonious solution in table 3.10 combines a lack of investment drop, a lack of surplus, and centralized labor institutions. In addition to the new causal factor not present in the unemployment analysis (centralization), the outcome group has changed, with Spain not making the cut as a full "large rate increase" case. As a result, the intermediate solutions in table 3.11 display two combinations split among the three eligible cases of Ireland, Italy, and Greece. For Ireland, its unemployment combination of

wage drop, lack of investment drop, and lack of surplus now includes centralized labor institutions. The combination for Italy and Greece is unchanged, once again implicating the centralized labor institutions as important in this negative outcome of the crisis and flying in the face of variety-based expectations.

Table 3.10 Large rate increase (parsimonious)

	Raw coverage	Unique coverage	Consistency
~ninvdrop~hisurplus*centralized*	0.54	0.54	0.78

Table 3.11 Large rate increase (intermediate)

	Raw coverage	Unique coverage	Consistency
1.*wagedrop*~ninvdrop*~hisurplus*centralized* (Ireland)	0.35	0.10	1
2. *~ninvdrop*~hisurplus*hideficit*centralized* (Greece, Italy)	0.19	0.06	1
Solution coverage	0.58		
Solution consistency	0.78		
Counterfactual assumptions: ~hisurplus (absent) hideficit (present)			

Before discussing these results, we can wring additional information from our cases by approaching from the opposite direction. That is, we can *start* with the ideal typical combinations expected by each framework and extract measures of fit that tell us how well they match the actual observed patterns. The subset-superset procedure in fsQCA allows us to specify the "recipes" in advance, and outputs consistency and coverage scores as another method of deciding which explanations best fit the facts of the crisis.

Table 3.12 lays out these subset-superset results for avoiding negative outcomes in regards to unemployment and sovereign rate increases, and table 3.12 does the same for those cases struck by such outcomes. As before, the consistency score for each combination captures how reliably cases with that combination lead to the outcome, with the coverage scores indicating the proportion of the total outcome set covered by that combination. Under each theoretical category I test, first, the fullest ideal-typical combination for that theory, followed by its most essential single condition.

Table 3.12 Subset/Superset Relations for Avoiding Negative Outcomes

	Avoiding unemployment		**Avoiding rate increase**	
	Cons.	Cov.	Cons.	Cov.
Competitive Disinflation				
wagedrop*~ninvdrop*~hideficit	0.56	0.26	0.69	0.30
wagedrop	0.73	0.76	0.75	0.75
Variety				
~wagedrop*~ninvdrop*~hideficit*centralized	0.55	0.08	0.66	0.09
centralized	0.60	0.57	0.59	0.52
Neomercantilism				
wagedrop*ninvdrop*hisurplus	0.97	0.34	1.00	0.33
hisurplus	0.95	0.76	1.00	0.75

As in the truth table analysis, the neomercantilist conditions and combinations fare best, though one element of the competitive disinflation explanation comes close behind. The competitive disinflation framework yields middling consistency scores of 0.56 and 0.69 for the two outcomes when looking at the full expected combination (wage drop, no investment drop, and no high public deficit). Yet limiting ourselves only to the “core” condition of the framework,

a sustained drop in the wage share, the consistency reaches 0.73 and 0.75 as well as a quite high coverage of 0.76 and 0.75. These results, hovering around the 0.75 minimum for strong consistency, suggest that a wage drop is important when distinguishing cases that avoided negative crisis outcomes.

The variety-based explanation performs poorly here, with consistency of 0.55 and 0.66 for the full combination of a lack of wage drop, lack of investment drop, lack of high public deficit and centralized labor institutions. The coverage scores are also extremely low (0.08, 0.09). Labor centralization, the crucial condition differentiating MMEs from CMEs in the variety-based schema, does a bit better with consistency of 0.60 and 0.59, but well below both the neomercantilist and competitive disinflation explanations.

A neomercantilist combination of a wage drop, investment drop, and persistent high surplus yields the highest consistencies, reaching 0.97 for avoiding unemployment and 1.00 for avoiding a rate increase. The coverage for this combination in each outcome is still relatively low (0.34 and 0.33), though it remains the highest out of the three full combinations. The high surplus condition itself, pivotal to the neomercantilist mechanism, reveals both high consistency (0.95, 0.75) *and* good coverage (0.76, 0.75); the only "fundamental" condition to do so.

Table 3.13 Subset/Superset Relations for Negative Outcomes

	Severe Unemployment		**Large Rate Increase**	
	Cons.	Cov.	Cons.	Cov.
Competitive Disinflation (Twin Deficits)				
~wagedrop*ninvdrop*hideficit	0.46	0.04	0.30	0.03
~wagedrop	0.60	0.54	0.51	0.52
Variety				
~wagedrop*ninvdrop*hideficit*~centralized	0.46	0.04	0.29	0.03
~wagedrop*hideficit*~centralized	0.57	0.14	0.44	0.13
~wagedrop*ninvdrop*~centralized	0.20	0.06	0.08	0.03
~centralized	0.35	0.37	0.23	0.28
Neomercantilism				
~wagedrop*~ninvdrop*~hisurplus	0.81	0.48	0.75	0.50
~hisurplus	0.71	0.94	0.66	1.00

The negative outcome cases in table 3.13 show a similar pattern. The neomercantilist combination and condition evince consistency and coverage far above the other two explanations, though all three explanations generally have lower scores indicating a greater degree of heterogeneity within the smaller negative outcome bloc. The combination of a lack of surplus with no drop in wages or investment, what the neomercantilist perspective would expect to be most fragile, nets coverage of 0.81 and 0.75 with higher coverage than even the positive case solution. The fundamental *lack* of high surplus condition evince slightly lower consistency (0.71, 0.66) but very high consistency. In contrast, the measures of fit for the competitive disinflation (in this case, "twin deficits") and variety-based explanations are quite low. Even the best performing condition, a lack of wage drop, results in consistency well below the 0.75 cutoff.

In all, the subset-superset analysis supports neomercantilism as the strongest determinant of both negative and positive crisis outcomes. The competitive disinflation framework's basic non-wage drop condition warrants further investigation as a factor allowing member states to

avoid a negative crisis outcome, but not in leading member states to such a negative outcome. At the same time, the full competitive disinflation combinations fit our evidence very poorly. The variety combinations and their core labor centralization condition are also a poor fit.

In all, the QCA results provide strong support for the neomercantilist explanation. In this analysis, our *explanandum* is the distribution of positive and negative crisis outcomes. Given the fact that the causes implicated in avoiding an outcome can differ from the causes *of* that outcome, dealing properly with our *explanandum* entails separately explaining both the sorting of cases into the bloc that avoided these negative outcomes and the bloc that was fully struck by such outcomes. This is the underlying aim of the truth table and subset-superset analyses, and both agree that the neomercantilist explanation is a better fit to our final distribution of crisis outcomes than either of its competitors. QCA acknowledges causality as fundamentally combinatorial; showing the conditions match in a way that is close to our expected combination also provides some support to the neomercantilist account of the mechanisms that are thought to be causing the conditions to "clump together" in precisely that manner (cf. Psillos 2014). That is to say, these QCA results can boost our confidence in the salience of single conditions, the full "recipes," and the mechanisms that the theory adduces to bring the two together.

Of course, the empirical results have importance quite apart from the issue of which explanatory framework comes out on top. The presence of a persistent high surplus stands as the single most important condition for avoiding both an unemployment and rate increase. The lack of this persistent surplus is also implicated in *causing* unemployment and rate spikes. The surplus is the only condition to show up on both sides of the crisis outcome ledger, highlighting

its importance. It displays very high consistency scores when analyzing how member states avoided the negative outcomes, with a minimum of 0.95, and in combination with other conditions its consistency as a cause of negative outcomes is 0.78 and 1. The parsimonious analysis thus yields some unequivocal conclusions. The presence of an external surplus is essential to avoiding negative crisis outcomes, whether unemployment or a rate spike. The combination of the lack of a surplus and a lack of an investment drop is tightly linked to a severe unemployment increase, while a combination of lack of surplus, lack of investment drop, and a centralized set of labor institutions is similarly linked to a large rate increase.

Once we move on to look at the intermediate solutions we enter the territory of framework comparison. The intermediate solutions "open up" each of the parsimonious findings, bringing to light variation in each bloc. The becomes useful when comparing the relative explanatory power of our frameworks on the basis of QCA; here, explanatory power is proxied by measures of consistency and coverage, as well as how well each framework explicates the observed internal variation within each bloc. Two dimensions of explanatory power are in play here. First, we must ask how well each framework's combinations match our observed evidence, and second, evaluate the framework's "depth" in terms of being able to provide an efficient explanation of the subtypes found in each bloc. Below I draw out the details of the intermediate solutions and each subtype, and go on to discuss what these results imply when comparing our frameworks along both dimensions of explanatory power.

The fsQCA truth table algorithm extracts intermediate solutions with the aid of specific assumptions about "remainders," the various logically possible combinations that were not substantiated empirically. This is where an analyst's theoretical and case-specific knowledge begins to become important; they must make simplifying assumptions about the effects of

conditions in some of these empirically unobserved but logically possible combinations. To maximize the generality of the intermediate solutions and cement the role of this QCA as a fair comparison between major theoretical frameworks, the analysis used only those simplifying assumptions about remainders that all three frameworks would agree to. When analyzing the causes of avoiding a negative crisis outcome, all three frameworks agree that a drop in wage share, a persistent external surplus, and lacking a high public deficit should help.[21] The truth-table analysis thus used only these causal assumptions, deriving the recipes found in tables 3.5 and 3.9.

These results reveal both a stable positive outcome bloc, and several stable subtypes within that bloc. The bloc itself includes Germany, Austria, the Netherlands, Belgium, France, Finland, and Luxembourg. As we have seen, this resolves into two subtypes, encompassing multiple cases, and two single-case combinations. The main subtype, combining wage and investment drops, a persistent surplus, and centralized labor institutions is closest to the expected neomercantilist combination with the addition of a centralization condition. This combination has a very tight relationship with avoiding crisis outcomes, having a consistency of 1 for averting both unemployment and rate increases. This, together with the very high consistency of the surplus condition in our parsimonious solutions, means the explanatory power of the surplus condition, and of this core neomercantilist combination, is quite high.

Why can this be taken as support for the neomercantilist framework, when elements from the variety-based framework (centralization) and the competitive devaluation framework (wage

[21] Each framework advances different reasons for supposing a lower wage share is helpful. Competitive disinflation posits that the lower wage share would increase export competitiveness while inducing domestic investment, the variety-based perspective that wage control is encouraged by centralized labor and helps CMEs weather crises, and the neomercantilist view sees the lower wage share as part of the surplus-focused strategy. The other two assumptions are simpler: all three frameworks agree that, all else equal, a large external surplus provides a “cushion” of demand that can help blunt crises, and all similarly agree that avoiding a large public deficit gives states more room to maneuver.

drop) are also included in this combination? Looking across our four solutions, while some member states avoided negative outcomes by means of a wage drop, others included a wage rise. In the same way, some cases displayed centralization even while other successful crisis-avoidance cases needed *non*centralization. However, the persistent surplus condition was essential to *all* four solutions, strengthening the argument that the surplus is the *sine qua non* for avoiding the crisis. Another line of argument comes from our subset-superset results in table 3.11. The core neomercantilist combination, even without centralization, is the only one of the three frameworks to display consistency scores above a minimum 0.75 cutoff, and well above the expected ideal-type combinations expected by the competitive devaluation and variety-based frameworks. Indeed, if Luxembourg, the smallest and most anomalous case is removed from the analysis, the centralization measure ceases to appear in the intermediate solution; it converges exactly on neomercantilism's expected wage drop, investment drop, high surplus combination. Finally, when the countries struck by negative outcomes are analyzed, they *also* display centralized labor institutions. Centralization is so strongly implicated in negative outcomes that it forms an integral part of the parsimonious solution.

The above points argue for the superiority of the neomercantilist framework in terms of the first dimension of explanatory power, that of tightly matching the observed evidence. What of explaining positive outcome bloc's internal variation? Here the perspective does markedly better than either the variety or competitive disinflation approach. On the neomercantilist view, the Germany-Austria-Netherlands subgroup forms the Germany-centered core of the North, and is strongly predicted to evince combinations of causal conditions closest to the neomercantilist "ideal type." For variety scholars, this grouping should also display the purest CME attributes, but while it does indeed include centralization it differs on every other measure expected by the

perspective. A successful CME should not, in a period of growth such as 1999-2007, display shrinking wage shares. Rather, variety-based theory expects that one benefit of centralized labor and the long-term, skill-intensive firm-labor relationship is that wages will keep pace with productivity; this should preclude the sort of continual wage suppression we see in the German subgroup. It also should see stable or even increasing investment, an expectation shared with the competitive disinflation approach. Indeed, one of the distinguishing features of the CME model, as against the dysfunctional lack of investment in the MMEs or more volatile LMEs, should be a reliance on relatively high and stable investment. Finally, recall that state spending in MMEs is supposed to "make up for" the institutional efficiencies that prevent investment. On that logic, the CME success recipe should display a stronger fiscal stance than MMEs, and this stance should matter for outcomes; this is belied by the lack of any role for the public deficit condition in this subtype.

The competitive disinflation perspective, for its part, does expect the lowering wage share and yet it is essential that successful disinflation cases see increased investment, either directly from the greater profits afforded by a drop in wage share or export demand. Moreover, they also require reducing or avoiding high public spending, in an even stronger manner than the variety-based approach assumes.

The second major subgroup, France and Belgium, are equally explained through neomercantilist and competitive disinflation mechanisms. Neomercantilist mechanisms would assume the combination of shrinking wages and hisurplus can combine with stable or even increasing investment if there is institutional pressure on firms to reinvest. The importance of non-centralization in this recipe also sits well with neomercantilist expectations, where the strength of workers *vis-à-vis* capitalists is more a function of tightness in the labor market than

centralization per se. At the same time, arguments for a competitive disinflation explanation could be advanced, since the group displays lowered wages, stable or increasing investment, and an external surplus. However, from this perspective the importance of centralization is not explained, and the important lack of public deficit condition is not present. Still, to make the strongest challenge to the neomercantilist explanation we can grant the two perspectives roughly equal force here. They are both definitively stronger than the variety explanation, which would not expect dropping wage shares to accompany combative and non-centralized labor institutions.

The remaining cases, Finland and Luxembourg, are singletons with unique combinations. Both show the high external surplus condition, while only Finland includes a wage drop; this provides difficulties for the competitive disinflation approach with its emphasis on a drop in the real wage. Though both include the lack of high public deficit as a condition, Luxembourg also includes a sustained drop in investment against the Say's Law derived expectations of the disinflation theory. It also stands alongside France and Belgium as another case requiring non-centralized labor institutions. In all, the brevity of the Finland combination makes it equally amenable to a modified neomercantilist or competitive disinflation perspective, while Luxembourg displays an anomalous set of elements that provide evidence against the explanatory power of the disinflation or variety approaches.

Summing up the truth table results for avoidance of crisis outcomes, a neomercantilist explanation best accounts for the parsimonious solutions, sees its ideal-typical combination instantiated in the largest German-centered subgroup, and is supported or at least not contradicted by the remaining combinations. The competitive disinflation approach draws even with the neomercantilist approach when explaining the France/Belgium subgroup, though some of its essential assumptions regarding the importance of the public deficit, level or increasing

investment, and even its fundamental wage drop condition are contradicted by cases that lack these qualities and yet still avoided negative outcomes. A variety perspective fares even worse, with most of its expected conditions and combinations not present in this "successful" case set, precisely where we should expect them. All this suggests that neomercantilism better explains the observed evidence and can better account for within-bloc heterogeneity; its explanatory power is thus greater on both dimensions relative to its competitors.

A similar conclusion follow when we look at analyses conditionalized on negative outcomes; that is, those cases hardest struck by the crisis. Here again the core neomercantilist condition, here the *lack* of a sustained current account surplus, is decisive. The subset/superset analysis in table 3.12 shows clearly that the lack of surplus performs the best of any of our single "core" conditions, while the maximally fragile neomercantilist recipe combining a lack of wage drop, a lack of investment drop, and a lack of current account surplus outperforms any of the other full recipes. This matches the parsimonious results of our truth-table analysis in tables 3.6 and 3.10, in which the lack of surplus combines with a lack of investment drop and, for rate increases, labor centralization.

This strongly suggests that lacking a sustained external surplus, especially when combined with stable or increasing investment, is the surest path to experiencing the negative effects of the crisis. Internal variation within this deficit bloc seems to revolve around two factors: whether the external drain was compensated by public deficits, and whether significant shrinkage of the wage share occurred. In Ireland and Spain, the lower wage share combined with improving public sector balances; rather than state spending making up for the continuing external drain, private sector indebtedness (via asset price inflation and mounting use of private debt for consumption) provided the compensating factor. In contrast, in Italy and Greece it was

the government that provided the major deficit to balance surpluses in the private sector and the rest of the world (i.e. the current account deficit). This way of describing variation within the deficit bloc is premised on the notion that the current account deficit is a prime mover, and the private or public sectors must adjust to this situation as suggested by the three-sector model. The overpowering strength of the current account, considered as a single condition in either the positive or negative outcome analyses, gives us some confidence that this order of causation hold true. It will be the case study of the next three chapters, however, which will more firmly establish the strength of this neomercantilist account of causality, in which the state of the external account is both determinative of the situation inside each national economy even while being a prime object of geopolitical strategizing on the part of each respective state.

Chapter Four

The Structure and Institutions of European Neomercantilism

This chapter sets the stage for the historical case studies in chapters five and six by presenting general evidence that neomercantilism shaped European development since 1945. Giving an overview of the phases of pan-European economic institutionalization since 1945, it presents a way to capture these interlinked phases as a process of institutional narrowing that reduced the national automony and removed useful institutional features in a sequential manner: from the ability to recycle surpluses, to economic and exchange rate coordination, to symmetric obligation to adjust current account imbalances, and finally fiscal and political autonomy. It then uses longitudinal current account data to describe the scale and evolution of current account imbalances over the period, reinforcing the surplus-deficit bloc membership categories yielded by the previous chapter's QCA. Finally, aggregating current account balances into blocs and charting them over time reveals a pattern of oscillating divergence and convergence between the surplus and deficit blocs that is exacerbated with each phase of European institutionalization and increases in a secular manner over the long-term.

Any attempt to theorize about the history of Europe, especially the western continental nations that would one day join the Eurozone, risks summoning the ghost of Hegel. Grand theories of history with a teleological bent have been out of fashion for more than a century now, and rightly so. Yet the late 20th century integration of Europe as a political and economic entity is so momentous, so at odds with, and at the same time so intimately linked to the continent's fractious history of national conflict that it seems to force scholars onto the terrain of grand historical theory. This work avoids wading into such waters, at least as usually conceived. Still, one of my contentions is that the divisions between prominent sociological theories of European development, whether neomercantilist, field-based, or variety-based, are actually representative of even starker differences between broad theoretical traditions relying on very different ontological foundations. Chapter two's review of each theory's assumptions and presumed "background knowledge" yielded provisional conclusions about how plausible each perspective is, even before we consider the empirics of the European case itself. These different foundations become most visible, however, when they are used to try to explain a concrete social process as intricate as European development. It is to the substantive narrative of European development after 1945 that we now turn.

This chapter, then, prepares the ground for analyzing post-WW2 Europe as a "case" of neomercantilist development, and this chapter together with chapters five and six will do so by marking out the distinctiveness of this explanation in comparison with the field and variety explanations. This chapter gives the long-term view of neomercantilism in Europe, presenting

descriptive evidence for the salience of the region's surplus-deficit structure and a bird's eye view of the linked series of pan-European institutions that interacted with and facilitated this surplus-deficit split. The following two chapters then analyze these relations in chronological order; chapter five begins with the earliest moments of Western Europe after World War II and follows the region's development until the fracturing of the Bretton Woods institutional arrangements in 1973. Chapter six finishes our case study, tracking the upheavals of the 1970s, the formation and development of the European Monetary System (EMS) from 1979, and the convergence toward the Euro in the 1990s. This multi-decade labyrinth can only be sensibly navigated because we have a single thread to follow, around which we can build each phase of our analyses: the surplus-deficit relations between European states. QCA served as our Ariadne, demonstrating how powerful of a determinant this relation was in the post-1999 era of the Euro and its crisis. Armed with this analysis of the recent past, we can move back in time to the early 20th century and grasp this guiding thread, following it through the years in order to cement the case for a neomercantilist explanation. Making this argument properly requires meeting two objectives. First, it will be argued that the external surplus-deficit relation, far from being a side-effect of the national "variety" of capitalism in each state, is instead *constitutive* of the kind of accumulation strategy and thus social model pursued in each state. Second, it will be shown that these structural relations were involved in shaping the region's economic institutions, made visible in the shape of each monetary scheme from the operations of the late Bretton Woods system, the monetary "Snake" of the 1970s, the EMS of the 1980s, and the Euro plans formulated in the 1990s.

Table 4.1 sets out a stylized periodization of 1945-1999 in terms of the general regional political economy prevailing in each period. Each period represents a deepening phase of

structural relations between European countries, accompanied and facilitated by characteristic Europe-level institutional arrangements. The immediate postwar period is arguably the most fluid, where Allied powers and especially the United States had the freest hand in determining the region's institutional framework, and indeed even its deeper political-economic structure. Much depended on American political decisions not to allow France a bid to become the preeminent industrial power in the region, to sow the seeds of central bank independence and heavy industry in Germany, and to protect this budding European division of labor both by pressuring France and Italy to join early integration institutions and grease the machinery for these plans via the Marshall Fund. The second period was dominated by the European Payment Union (EPU), and enabled the postwar economic "miracle" by ensuring that surpluses did not build up in any one EPU member state. Third can be called the "late Bretton Woods" period, spanning the end of the EPU in 1958 until the 1973 breakdown of the Bretton Woods arrangements themselves. Here the asymmetries built into the postwar division of labor began to make themselves felt; with a global fixed exchange rate plan governing the European region, yet no surplus-recycling institution such as the EPU, the status of one's current account came to the fore as a major strategic concern for each state. The monetary "Snake," the first Europe-specific post-Bretton Woods monetary institutional scheme, marks the fourth period. Fifth is the period of the European Monetary System (EMS), an even stronger fixed-exchange rate scheme with institutional features that both prefigured the later Euro era and made the final movement toward the single currency possible. Whereas the Snake devolved into a Deutschmark bloc in which Germany linked to only a small set of other surplus countries able to keep parity with the D-Mark, the EMS became the means whereby the German model of austerity-based growth was generalized to all of Europe. Finally, the conditions for the Euro were decided with 1992's

Treaty on European Union, commonly known as the Maastricht Treaty, and were put into practice as the Euro replaced Europe's national currencies in 1999.

Table 4.1: Eras of European Institutional Governance

	Years	*Economic Governance*	*Lost Degrees of Freedom*
Allied Occupation	1945-52	Direct political governance of economic relations	N/A
European Payment Union (EPU)	1952-58	International clearing union ensuring current account imbalances do not stifle growth	N/A
Late Bretton Woods	1958-73	Fixed exchange rates with political mediation of rate changes and policy	Recycling
Snake	1973-79	Fixed rates with exit option	Recycling, coordination
European Monetary System (EMS)	1979-92	Fixed rates with realignments superseded by obligatory intervention to keep rates stable	Recycling, coordination, symmetry
Toward the Euro	1992-	Agree to converge toward a single shared currency and rules binding domestic fiscal policy	Recycling, coordination, symmetry, fiscal autonomy

The historical progression through each of these periods evinces qualities of path-dependence, though in a way rather different than prevailing theories of European integration that rely on "institutional lock-in" (cf. Pierson 1996). Instead, the connection between phases resembles the kind of dialectical relation used by Arrighi (1994) when characterizing sequential phases of hegemony in the world-economy. In Europe, each period's institutional arrangements and the strategies pursued by the major states are in part reactions to the previous phase, and this

reactive action is enacted in an environment of narrowing institutional and strategic options as the deep structural asymmetries governing the region reassert themselves again and again.

This process of institutional formation, disintegration, and regrouping in Europe is one of our main objects of analysis, but it is important to note that this dynamic was conditioned by changes occurring at the global level as well. The most important global factor in this analysis is shift from the 1945-1970s era, described by John Ruggie (1982) as "embedded liberalism" thanks to the ways in which American hegemony imposed a limiting structure on anarchic market forces, towards the current era of financialized neoliberalism, that post-1970s bundle of broadly pro-market global changes that eroded both worker's power and the national constraints on capital that had prevailed under embedded liberalism. The result, shared across the developed countries, includes the rise of private-debt financed consumption, the drive to dismantle national controls on trade and capital flows, the increasing popularity of tying governments' hands by empowering independent central banks, and the drive within each national economy to push down the increased wage share of national income won by labor militancy in the 1960s and early 1970s.

These features of neoliberalism are more than merely contextual elements surrounding the Europe-specific process outlined in table 4.1. They interacted with and, indeed, shaped the regional process itself. The increasing prevalence of debt-financed consumption, to take one example, served to paper over the deflationary impact of the increasing German surpluses in the early Euro era (Patomäki 2013). In the ideational sphere, left and right policymakers and scholars converged on a set of pro-market theories that increasingly dominated each round of institution-building. This included claims of the superiority of independent central banks that could impose austerity regardless of the will of governments (cf. Forder 1998), that the problems inherent in

joining disparate countries into a single currency area can be ironed out after the fact by market forces themselves (cf. Sardoni 2007), or the theory of "hollowing out" that held that there was no stable middle ground between a floating currency and a completely fixed, hard exchange rate peg, contributing to the demise of politically mediated adjusting rate schemes such as Bretton Woods (Hoffmeyer 2000:1). In a similar way the continual attempts by non-neomercantilists such as Italy and Spain to enter into fixed-exchange rate schemes and, finally, to give up monetary autonomy to an independent ECB were influenced by the lionization of independent central banking, the prioritizing of inflation-fighting over solving unemployment, and the need by capitalists to recapture some of the national income gains lost to labor in previous decades.

Moving back to consider the specific dynamics occurring at the regional level, the narrowing of pan-European institutional options can best be captured as the sequential loss of several "degrees of freedom" for member states interacting within European institutions: recycling, coordination, symmetry, fiscal autonomy and, finally, political autonomy. The first attribute concerns the recycling of current account imbalances between members of the institutional framework. As surpluses build up, these are recycled in a timely manner through increased investment, trade credit, or other transfers such that the negative demand effects of external deficits, as discussed in chapter two, are blunted or removed entirely. The second two degrees of freedom are possible strategies for resolving surplus-deficit imbalances between states in the absence of recycling. Coordination here means that the institutional framework makes implicit or explicit room for the *political* solving of macroeconomic collective action problems; this means some hope of avoiding the kinds of "paradoxes of composition" in which "if each country sets [seemingly optimal] policy independently, deficient demand results" (Forder 2007:75). The most common example is a situation in which, if all states can coordinate a joint

expansion, growth can take place without any single state hitting the external constraint that occurs when their own expansion causes them to fall into a current account deficit with respect to their partners.[22]

Symmetry, in contrast, echoes Keynes' advice at Bretton Woods: even if coordinated policy on expansion or exchange rate policy cannot be achieved, the burden of ameliorating persistent current account imbalances should fall equally on surplus and deficit countries. In the absence of any institution or political agreement facilitating symmetry, there is a pressure for balances to adjust themselves as the demand for the surplus (deficit) country's currency causes its value to be pushed upward (downward) and, it is thought, making its exports less (more) competitive.[23] However, Kindleberger (1985[2006]) notes that when relative exchange rates are fixed and central banks have to protect that peg by buying and selling operations, as under the institutional frameworks in table 4.1, "there is, of course, a fundamental asymmetry…: the country with the strong currency can supply its currency endlessly to the foreign-exchange market…; the country with the persistently weak currency must one day run out of reserves and credit" (p. 460). In this light, symmetry is thus secured only when there are institutional arrangements, such as the proposed but never operationalized "divergence indicator" of the EMS, that would ensure that the surplus country's currency does not become the anchor around which all deficit countries have to adjust themselves.

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[22] I thus conceptualize "coordination" in a similar but broader sense than Forder (2007), who has done much to detail concrete policy initiatives of coordination in Europe (as well as their disappearance in the 1980s). Here I am concerned with not only planned or implemented coordination schemes, but also the institutional norms of operation in which exchange rate changes and expansionary or contractionary policy are thought of as properly determined by multilateral political consultation between nations. In other words, these policies are not "outsourced" to an automatic mechanism (as in the EMS) or through the removal of national currencies altogether (as under the Euro).
[23] This process, however, works unreliably; Turner (1986) notes "the lack of any obvious tendency for current account imbalances to disappear" even under fully floating exchange rates (p. 1). However, even Turner and others proposing a role for domestic savings and investment preferences to determine the current account balance admit that exchange rate fluctuations are crucial. This is especially so in the medium-term when considered as a *social* variable impinging on political policy.

The second two degrees of freedom encompass a state's ability to use fiscal or other governmental means to deal with imbalances when coordination or symmetry are already impossible. Fiscal autonomy thus implies having the ability to use discretionary public spending to further national welfare. While available fiscal options are affected simply by the accounting relations revealed in the national sectoral balances (equation 2.X), later stages of European integration agreements such as the Stability and Growth Pact (SGP) further restricted state autonomy in the area of spending, doing so that binds regardless of the state of sectoral balances. Finally, though largely outside of the scope of this study, there are signs that Eurozone institutions have begun to bite into the ability of national polities to elect leaders of their own choice, with the ECB in particular using its control over liquidity provisions to influence elections in Italy and Greece.

The EPU and, to a lesser extent the tail end of Bretton Woods, saw coordination and symmetry balanced precariously with a high degree of fiscal and political autonomy for each state. While moves toward coordination and symmetry continued sporadically throughout the 1970's, hopes of coordination were snuffed out by oil shocks and stagflation. The Snake retained an option for symmetry, if only because entering and leaving the arrangement was an easy and oft-exercised option; this meant that Snake members suffering increasing current account deficits were not automatically pressed into austerity policy. The Snake's successor, the EMS, had little room for coordination and, as the global economic environment changed in the early 1980s and neoliberal principles became increasingly widespread, the EMS lost all semblance of symmetry. Deficit countries were forced to conform to an increasingly dominant Germany, taking on all burden of adjustment by lowering inflation, increasing unemployment, slashing wages, and cutting public spending. The result was the pyrrhic "success" of the EMS from 1987 to 1992, in

which there were no exchange rate realignments at all within the system. Finally, as the EMS was superseded by the 1990s convergence toward the Euro, with coordination and symmetry already unthinkable the guidelines laid down in 1992's Maastricht Treaty increasingly curtailed the fiscal autonomy of European states.

The following section describes the general shape of both the neomercantilist and non-neomercantilist blocs, using current account data to set out in what order member states were drawn into the orbit of either bloc. The case study then proceeds in chronological order, highlighting institutional developments and turning points in the national economies of crucial member states such as Germany, France, Italy, and Spain. The choice of highlighted "moments" is governed by my two analytic aims, as some of these developments and turning points will make the case for the role of the external link in constituting the national models, others will serve as evidence for the role of the external link in shaping pan-European institutions.

We can track the surpluses accumulated by each member state in several ways. A first cut is provided in table 4.2, cumulating each state's current account as a percentage of Eurozone gross national income, starting in 1960 and running until the eve of the crisis in 2007. The patterns reveal the relative weight of surplus accumulation in terms of the entire regional economy. It is immediately apparent that this long-term cumulative measure largely recapitulates the neomercantilist/non-neomercantilist bloc structure, even though different countries definitively "entered" one or another bloc at different times. Germany and the Netherlands are by far the largest surplus cases, with Spain the largest cumulative deficit region.

Table 4.2: Cumulative Current Account Balances by Period, 1960-2007

	1960-72	*1973-79*	*1980-91*	*1991-98*	*1999-2007*	*From entry to the EC*
Surplus Bloc						
Austria	0.01	-0.43	-0.69	-0.50	0.31	0.004*
Belgium	0.70	-0.03	-0.06	1.07	1.43	3.12
Finland	-0.37	-0.36	-0.72	0.23	1.03	1.34*
France	1.11	-1.30	-5.08	1.90	1.29	-2.92
Germany	2.89	2.46	6.55	-2.20	6.06	15.77
Luxembourg	0.18	0.02	0.32	0.21	0.31	1.21
Netherlands	0.83	1.48	2.07	2.00	3.60	10.00
Deficit Bloc						
Greece	-0.38	0.08	-0.17	-0.29	-2.16	-2.66**
Ireland	-0.19	-0.27	-0.46	0.15	-0.12	-1.04
Italy	3.40	-0.46	-2.42	1.44	-0.91	1.05
Portugal	-0.43	-0.53	-1.06	-0.65	-1.61	-3.24***
Spain	-0.42	-0.70	-1.55	-0.88	-5.46	-7.70***

*Joined EC in 1995
**Joined EC in 1981
*** Joined EC in 1986
Source: AMECO, author's calculations

As was revealed in the previous chapter's QCA, by the 1999-2007 period all surplus bloc members moved into sustained surplus and deficit members into deficit. Earlier decades indicate which cases we can expect to be inveterate bloc members and which to be liminal cases that took longer to gravitate to one or another bloc. Overall, beginning from 1991 the general orientation of all Eurozone states came into view; this is despite the fact that Germany itself was pushed into deficit for the nineties thanks to the strain of reunification with East Germany. France and Italy, the two largest European economies after Germany, became cumulative surplus countries in the 1990s, but whereas both had evinced surpluses under Bretton Woods, Italy had an increasing slide into deficits thereafter, with the brief surplus of the 1990s more anomalous than that of France. Overall this support the placing of Italy as only a marginal deficit bloc case, which at

various times had the strongest prospect of escaping the chronic deficit condition, and France as the most precarious member of the surplus bloc. The rest of the deficit bloc shows endemic weakness. Considered in terms of the external deficit, Ireland is squarely in the deficit bloc and has been almost continually since 1960. Tsoukalis (1981) notes that, despite the tradition of grouping Ireland with the developed European Community and distinguishing it from Spain, Portugal, and Greece, in reality Ireland's "inclusion in the privileged group seems to be almost entirely by virtue of its membership of the Community since the stage of its economic development is not substantially different from that reached by the three Mediterranean countries" (p. 17).

Once these balances are mapped in figure 4.1 a clear oscillating pattern can be seen in which the surplus bloc "pulls away" again and again from the deficit bloc. Several important institutional and structural changes are listed, and here we can note the institutional phases, comprising the latter half of the Bretton Woods era (1960-1973), the 1970s currency "Snake," the EMS (1979-1992), and the start of the single currency era in 1999. It becomes apparent that these institutional phases map to oscillations in the inter-bloc surplus-deficit relationship, especially once we move beyond the politically-mediated Bretton Woods years and toward more "automatic" monetary institutions such as the EMS.

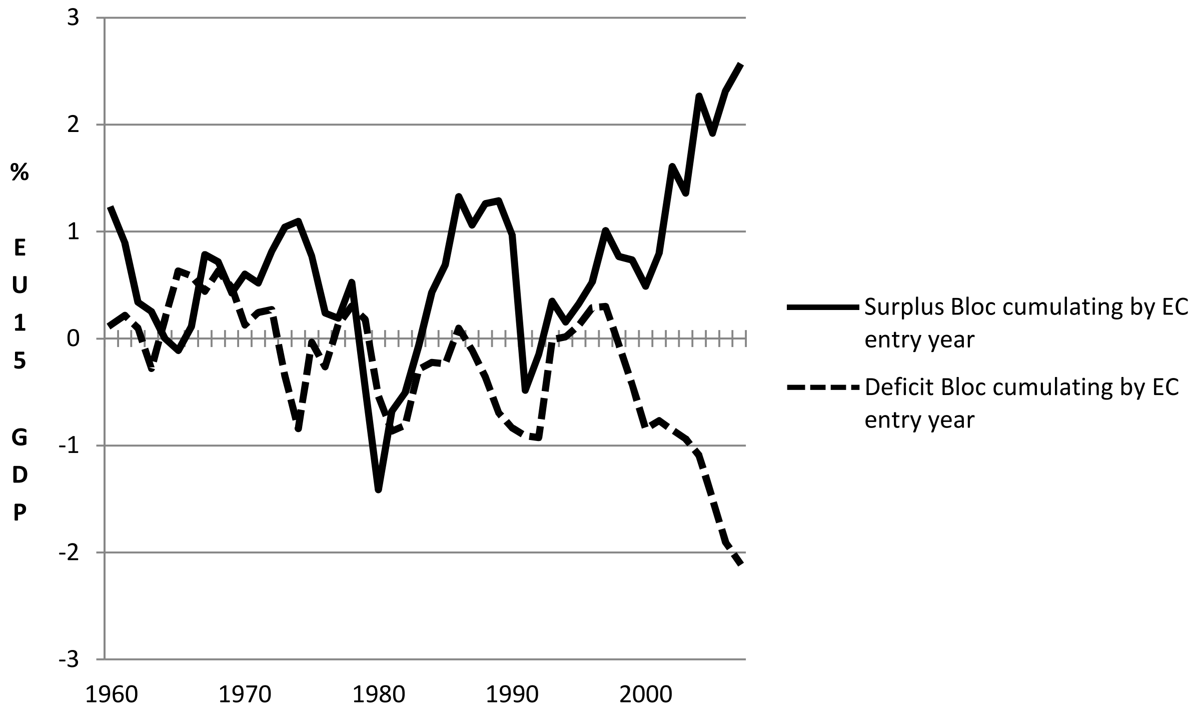

Figure 4.1: Current Account Balances of Surplus and Deficit Blocs, 1960-2007

Source: AMECO, author's calculations.

As can be expected, the prime mover of each phase is Germany, the largest economy in Europe and the accumulator of the largest external surpluses. Even considered here as a portion of the overall EU GDP, the German surpluses show an institutionally-linked pattern. They tended to grow throughout the Bretton Woods years, especially after the brief interlude of domestically-oriented growth from 1961-65; indeed, this interlude was ended by the Bundesbank precisely because it was leading to current account deficits. Germany successfully maintained its surplus through the end of Bretton Woods and the years of the "Snake" which immediately followed, but with the breakdown of institutionalized fixed exchange rates in the late 1970s we see a shrinking surplus accompanied by a recovery from the deficit bloc.

This presents the classic pattern which would repeat in later years: first, the region's surplus-deficit relations are affected by pan-European economic institutions, such as the Snake, and exogenous factors, such as the first oil shock of 1973, both of which tended to reveal and exacerbate the underlying structural divergence between the surplus and deficit blocs. Subsequently, this increasing surplus-deficit gap is then "fixed" in part by the erosion of such institutions, resulting in a convergence between the surplus and deficit blocs as the countries within each bloc approach a more equal current account balance. This pattern repeats under the EMS, from its full implementation in 1979 to German reunification in 1990. It repeats again with the run-up to the Euro, with the surplus deficit blocs diverging from the mid-1990s until the crisis of 2008.

This illustrates the difference in absolute size of these balances, emphasizing particularly the dominance of the German current account. Given the sheer size of the German economy, even surpluses that make up a small part Germany's own GDP are far larger, in absolute value terms, than the surpluses and deficits in smaller partners. Germany's surpluses also represent a relatively large portion of the region's overall value added, and in terms of total amounts of trade Germany provides other European countries with their largest market. This difference in absolute economic power provides an additional reason to focus on Germany's domestic policy and stance toward pan-European institutions, especially as they bear on the winning or losing of external surpluses; the German economy is the "center of gravity" for the region and, when speaking of neomercantilism as a surplus-accumulating strategy, Germany has had a singular amount of autonomy in regards to being able to implement, maintain, and adjust this strategy over time.

Table 4.3 shows intra-European exports of goods as a share of total exports since 1960, illustrating the secular Europeanization of trade for Germany and its European partners.. With each decade and in each subsequent institutional phase each Eurozone member state has seen its trade become increasingly intra-European in nature, a process often highlighted by the field approach. This mirrored the increased impact of exports within the German domestic economy, culminating in 2008, when exports accounted for over 50% of German gross domestic product, a level far above even similar export-oriented countries such as Japan (18%). Throughout the entire 1960-2007 period, Germany's goods exports made up a consistently large portion of the region's total exports; considered both as German intra-European exports as a share of total regional exports and as German total exports as a share of total regional exports, averaged a respective 31.3 and 33.4 percent.

Table 4.3: Intra-EU Goods Exports as a Share of Total Exports, 1960-2007

	1960	*1970*	*1980*	*1990*	*2000*	*1960-2007*
EU 12	47.1%	63.1%	62.6%	69.0%	69.0%	+21.3%
Germany	40.3	59.3	60.6	64.0	65.0	+24.7
Netherlands	61.5	76.6	76.8	86.4	81.4	+16.7
Italy	40.3	55.3	55.8	62.4	62.1	+21.4
Spain	58.5	51.9	54.2	70.6	73.1	+12.4

Source: AMECO, author's calculations.

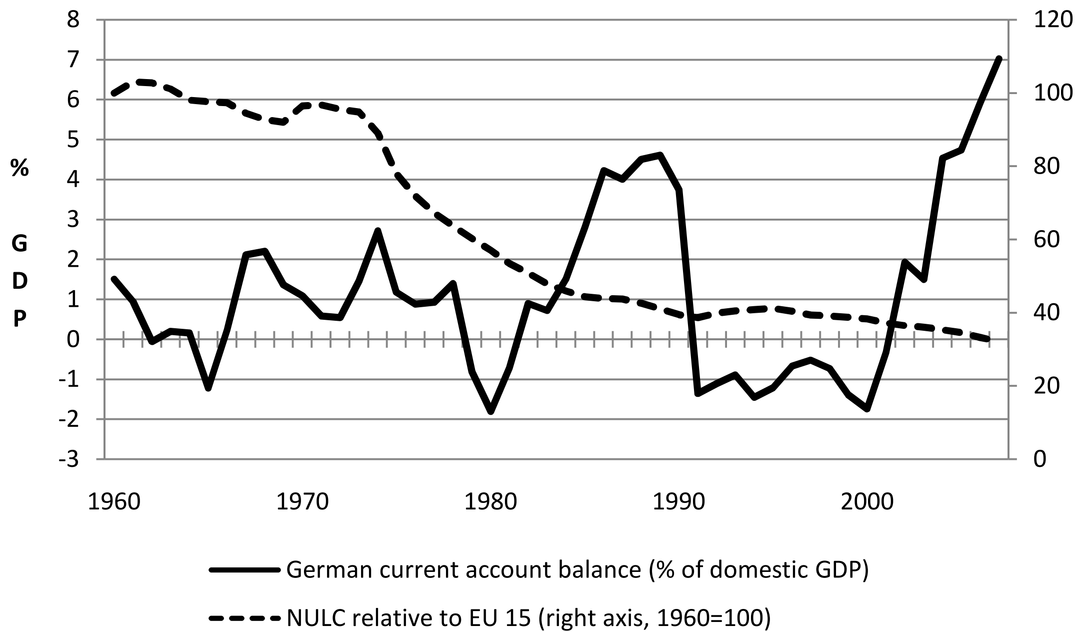

Figure 4.2: German Current Account Balance as a share of GDP and Nominal Unit Labor Costs.*

* relative to export-weighted index of 15 EU member states.
Source: AMECO, author's calculations.

So far we have examined external surpluses and deficits as a portion of Europe's overall GDP, but given the implications of Kalecki's profit equation we must also take into account the weight these balances exert within each country. After all, the impetus for surplus countries to accumulate these balances, as well as the risks faced by deficit countries, come about because these external balances can make up large portions of an individual country's domestic economy. Figure 4.2 shows the German balance as a proportion of German GDP alongside nominal unit labor costs (NULC), a common measure of wage competitiveness, considered relative to fifteen EU countries. It is immediately apparent that the German surplus grows each time it recurs, forming a large part of German GDP, and that unit labor costs have little immediate relationship

to the surplus. This holds also for German NULC relative to the US, the other major German export destination.

The initial surplus period, running from the mid-60s until the recession of the late 1970s, saw Germany's surplus rise to over 2% of GDP in the late Bretton Woods era after 1967. After a drop caused by Deutschmark revaluation the surplus was maintained even through the first oil shock in 1973, shrinking again alongside the shrinking membership of the monetary "Snake" and being driven into negative territory by the large import cost increases accompanying the second oil shock in 1979. In the next surplus phase, strengthening throughout the 1980s as the European Monetary System (EMS) firmed up, surpluses broke the 4% barrier for several consecutive years starting in 1986. 1991's reunification with the German Democratic Republic pushed the external balance into deficit, but when surpluses resumed in the early years of the Euro they quickly climbed toward 7% of GDP. As the shocks of institutional change, recession, or reunification wore off, the surplus accumulating tendency reestablished itself, stronger each time.

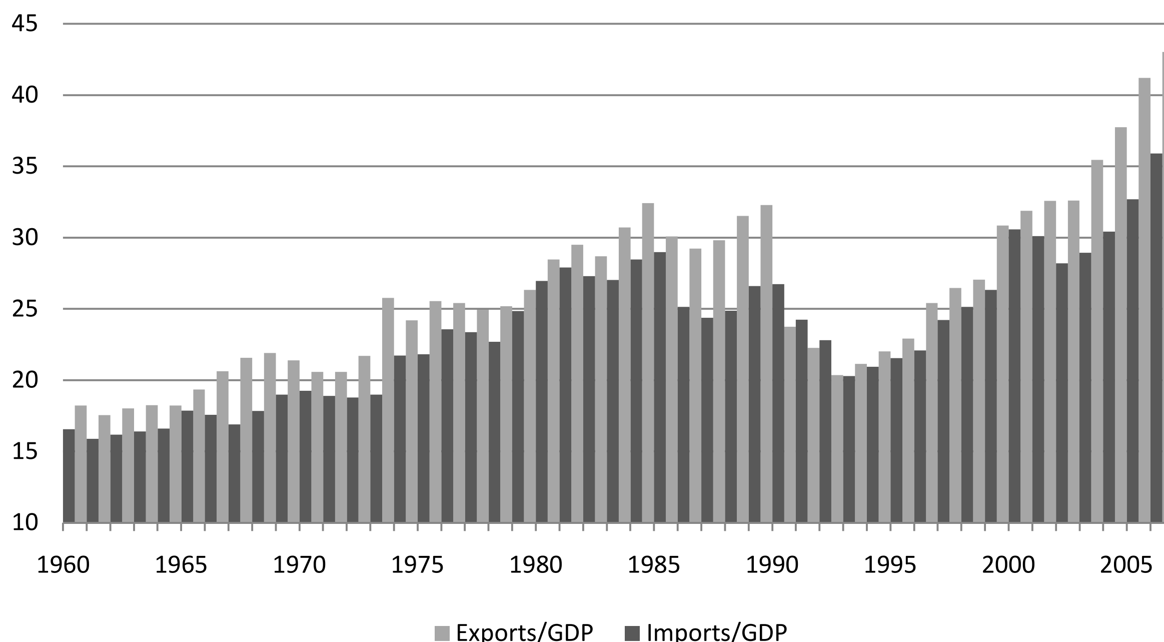

Figure 4.3: German Exports and Imports as a share of GDP, 1960-2007.

Source: AMECO

Figure 4.3 zooms in specifically on the difference in exports over imports, which has made up the bulk of the current account surplus. Viewing the surplus periods in 4.2 alongside the export/import differences in 4.3 suggests that, rather than only changes in NULC, surpluses have been won and increased by a political-economic strategy of suppressing the growth of import expenditures. As can be seen in 1966-68, 1972-74, 1982-3, and 1986-88 these induced either a fall or leveling of what had been a growing level of imports. By lowering the growth of import expenditures relative to export revenue, whether this is accomplished by judicious currency revaluation or monetary austerity, a surplus can be gained or maintained even without any improvement in export growth. As will be made clear later in the chapter, this tactic was known and used by the Bundesbank as early as 1951.

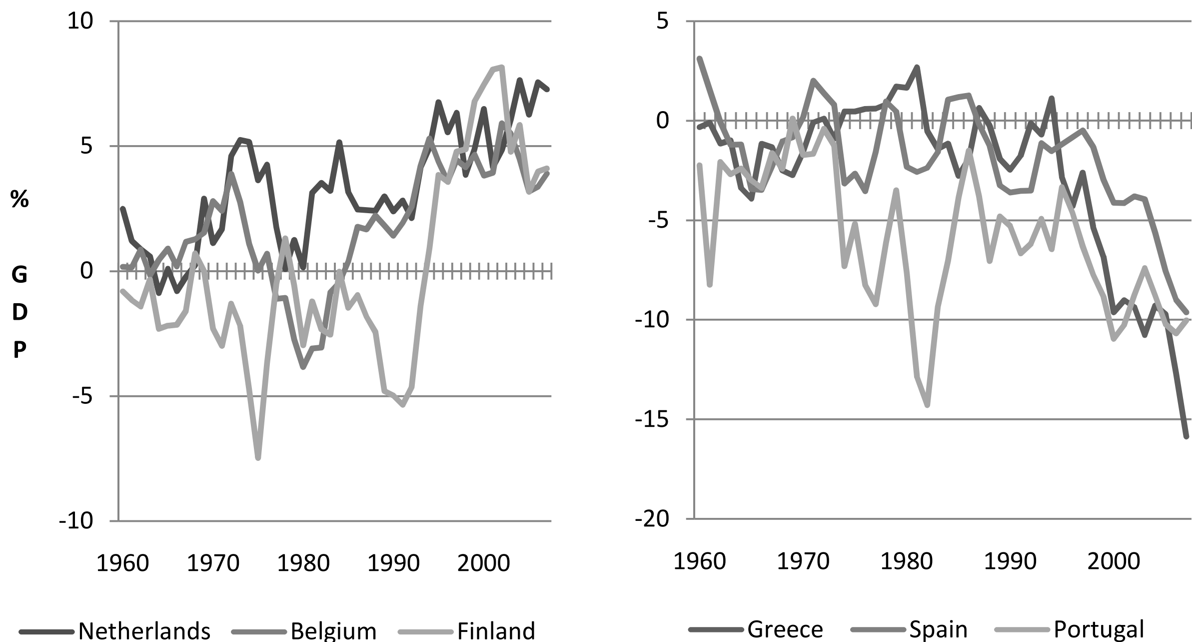

Figure 4.4: Select Current Account Balances as a share of GDP

Source: AMECO

While Germany is by far the leading surplus country, this pattern can also be seen when looking at the other countries that fell into the surplus camp in the Euro era. Figure 4.3 displays the remaining bloc countries, excepting France which will be treated later. The Netherlands and Belgium, in particular, show the same characteristic pattern of surpluses during the Snake, increasing surpluses as the EMS becomes more tightly linked to the Deutschemark, increasing more with the move toward the Euro. Finland, for its part, began its linear climb out of current account deficit from 1990, with Austria beginning its movement toward surplus at the end of the decade. Indeed, for these countries the "convergence" of the 1990s, where all prospective Euro members put themselves under constraints similar to what they would see under the single currency as a condition of membership, resulted in a continuation and intensification of the EMS

consolidation of the late 80s. This suggests that, without the reunification with East Germany, German surpluses would likely have mounted throughout the 1990s as well.

Finally, and perhaps most importantly for the neomercantilist explanation, is aggregating the current account balances as a proportion of each country's domestic economy in the order that they entered the institutional structures of the European Community. Figure 4.5 tracks this for both blocs from 1960 to 2007. Here the cumulative imbalance between the surplus and deficit blocs is starkly revealed; the importance of surpluses and the negative effects of deficits have taken on an increasing weight in the domestic economies of each bloc.

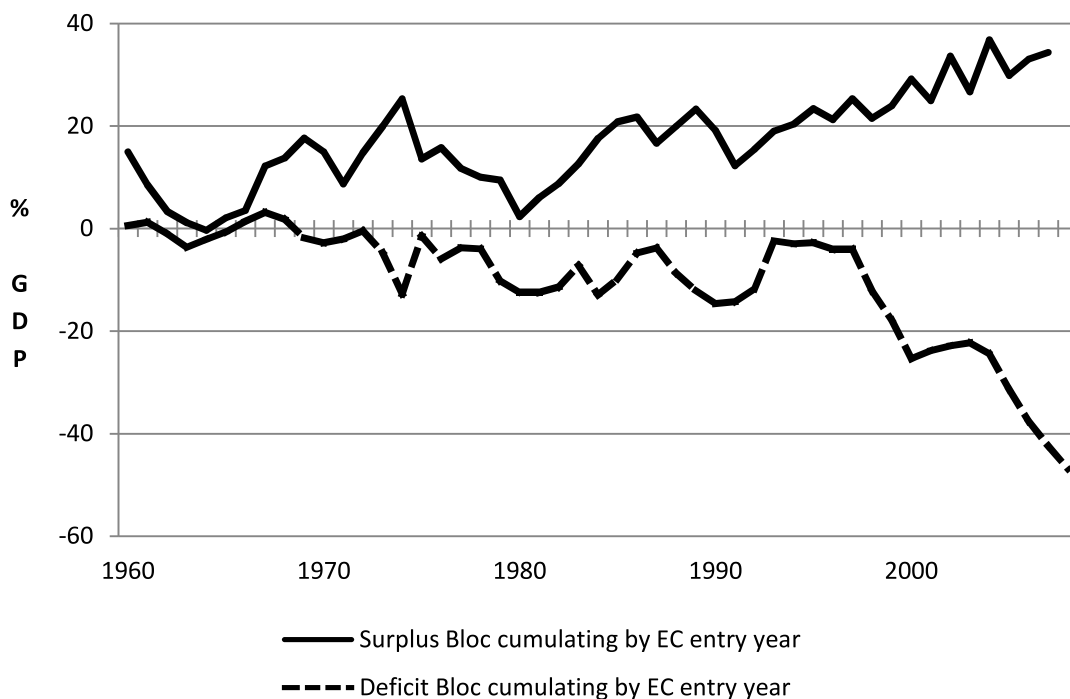

Fig 4.5: Surplus and Deficit Blocs Cumulating from EC Entry Year

Source: AMECO, Author's calculations

All of this suggests that the overall patterning of the surplus is linked to the installation of successive institutional regimes even while largely unrelated to changes in unit labor costs. This relation between the institutional phases of European integration and the spread between surplus and deficit countries is unsurprising, given the dominant role of the external surplus in our Euro-era QCA results. This, then, is the ground on which we can to erect the following chapter's narrative evidence: an oscillating and continually enlarging divergence between a neomercantilist and deficit bloc even as both take in new members, with each divergence phase occasioned by a new pan-regional economic governance regime and only loosely linked to wage-based competitiveness dynamics.

Here we can pause and note several ways in which this pattern is at odds with the field and variety perspectives. Variety perspectives emphasize the differences in competitiveness between CMEs and MMEs, and this should be seen in a link between labor costs and the surplus divergence. Variety-based explanations of the crisis, for example, often reference diverging NULC (Hancké 2011; Boltho and Carlin 2013). In the variety perspective, competitiveness is not, however, usually understood as the suppression of imports or currency realignment as a political-economic strategy as suggested by figure 4.3. Meanwhile, a field perspective expects convergence across member states as the institutional frameworks of region-wide fields solidify. Yet viewed over the long-term we see economic *divergence* in regards to the size of external surpluses, indications that the maintenance of surplus flows is a politically-mediated strategic process, and a series of sequential institutional forms which evince not stable convergence toward field equilibrium but rather a process of narrowing degrees of freedom which, this project argues, exacerbated the structural divergences.

Going forward, the critique of field and variety perspectives advanced here strikes at more fundamental attributes of the theories in four ways. The following chapters will establish, -first, that the formation of the neomercantilist and non-neomercantilist "models" were not natural outgrowths of the qualities of each national society but rather contingent creations of the post-WW 2 period. Second, episodes will be analyzed that establish both the role of neomercantilist strategy in the formation of pan-European monetary institutions, and, in a related manner, the continuing role of strategic power politics on the part of member states. Third, it will be argued that the external surplus (or deficit) condition of major players such as Germany and Spain were constitutive of the types of social models they settled into. To put a sharper point on it, we might say the presence of a surplus *allowed* the construction of the characteristic German model. This strikes against both the claim that the social models of the North or South were *sui generis* results of domestic qualities, and bolsters the earlier argument that strategic jockeying for institutional arrangements that would ensure continued surplus flows played a major role in the shaping of European monetary institutions.

Finally, the temporal order in which these episodes are analyzed develops my overarching explanation of the history of neomercantilist influence on European integration and development, and does so in a way that belies an institutional convergence narrative. The episodic treatment moves from the postwar reconstruction of the German and French economies under Allied occupation, to the proto-EU institutions such as the European Coal and Steel Community (ECSC) and European Payments Union (EPU), into the breakdown of the Bretton Woods systems in the late 1960s and early 1970s. It then proceeds through two successive institutional schemes of monetary integration via the 1970s Snake and the 1980s European Monetary System (EMS), and finally analyzes the political *and* monetary relaunch of European

integration that began in 1985 with the Single Europe Act (SEA) and culminated in the currency union plans agreed upon in 1992.

The pattern revealed by analysis of these episodes is a process of cumulative causation and structural and institutional lock-in. It is lock-in in that the "structure" of the region, the distinctive political economy of both the neomercantilist states and the deficit states, became more deeply rooted over time, while in terms of "institutions" each new phase of European institutions was a reaction to failures and problems with the earlier phases. Who were the agents reacting to these failures? These were, first and foremost, the German, French, and Italian states in a careful dance with the Bundesbank and, increasingly, the directors of the EU institutions themselves such as the European Commission and the Roundtable of European Industrialists. The major states pursued their respective grand strategies that led them to enter deeper into integration in each phase, with Germany, for example, seeking to regain sovereignty via reconciliation with European partners even as it consciously followed a growth strategy premised on external surpluses. What were the "failures and problems"? These were overwhelmingly economic constraints, revolving around balance-of-payments and exchange rate issues that the players would face when they attempted to impose, time and again, institutions that approximated a fixed-exchange rate regime or single currency on the entire region. It is cumulative in that the Europe-specific portions of Bretton Woods, the Snake, the EMS, and the ECB-dominated single currency era are a series of interlocked phases, each building off of and intensifying aspects of the previous phase and each exacerbating the surplus-deficit relation until the region crashed headlong into the 2008 crisis.

Chapter Five

1945-73: Institutional Devolution and the Formation of German Neomercantilism

Abstract:

This chapter comprises the first half of our analysis of Europe as a case of neomercantilist development, running from 1945 (with special reference to interwar conditions) to the end of Bretton Woods system in 1973. The dual aim is, first, to show how the differing social models within European countries were strongly conditioned by the presence or absence of external surplus, and, second, to demonstrate how these surplus-deficit concerns shaped the development of pan-European institutions. Germany is the major focus, as the largest economy and central pole of the surplus bloc. The contingency of these arrangements is demonstrated by focusing on interwar similarities between what would later become surplus or deficit countries, as well as the role of political intervention from the US and realpolitik-style strategizing on the part of major players such as France and Germany. The institutional devolution from the surplus-recycling European payments Union (EPU) to the Bretton Woods politically-managed exchange rate system is analyzed. Special attention is devoted to showing how both the German social model, dominated socially and economically by the export sectors, and the Bundesbank's strategies, with their impact on both Germany's neomercantilist orientation and European institutionalization, were enabled by and in turn centrally concerned with the surplus-deficit structure of the continent. Overall, the evidence shows, against the variety approach, the degree to which national models are a function of external relations and, against the field approach, the degree to which pan-European institution formation and dissolution was shaped by surplus-deficit concerns.

"Foreign trade is not a specialized activity for a few who might engage in it but the very core and even precondition of our economic and social economic order."
- Ludwig Erhard

The processes traced in this chapter have their true beginning in 1945, with the final defeat and occupation of Germany. The devastation wrought on the continent from the war can hardly be overstated. Europe, having damaged itself with the First World War, saw a brief recovery in the 1920s only to slip into the Great Depression after 1929. The Second World War ended the era with a disaster equal in scope to the turbulence of the Interwar period. No surprise, then, that it is common for Germans to refer to 1945 as *Stunde nul* ("zero hour") (Judt 2006:4). There is a sense in which the social arrangements installed by the Allied powers after the war were radically contingent; with a different set of political priorities a very different Europe could have been erected on the ruins of 1945.

This is at odds with the tendency toward an exaggerated path-dependency when analyzing Europe. One well-known source of this is in teleological theories of European integration, in both liberal and functionalist variants, in which increase in commerce, population,

or political interaction is thought to ineluctably lead to tighter integration.[24] This tendency has also surfaced in variety approaches emphasizing the path-dependency of intra-European varieties of capitalism rather than their integration. Explaining national models on the basis of their own internal qualities is a powerful method, and it is made more powerful the further back in time an analyst can extend the causal chains, and discovering "deep" factors that have conditioned a society over centuries is a laudable goal. While some variety research simply takes institutional forms as given (e.g. Hall and Soskice 2001), others have attempted to locate these tendencies in "deep time," exemplified in Martin Schröder's (2013) work that locates the seeds of distinct national varieties of capitalism in the early modern schism between Catholicism, Lutheranism, and Calvinism. More common is Alexander Gerschenkron's (1962) "timing of industrialization" (TOI) thesis, where Germany's attempt to quickly "catch up" to Britain under Bismark necessitated bank-guidance of industry and cartelization. The similarities between this 1870-1914 period and the post-WW 2 German penchant for oligopolized industrial sectors and cooperative bank-firm relationships is then taken as evidence that the form of national models was set as early as the 19th century.

These pre-1945 path dependency arguments downplay both the sharply different early 20th century German economy, as well as the fundamental break that the cataclysm of World War 2 represented for Europe's political economy as a whole and for national models in particular. The heterogeneity prevailing in the interwar period is one indicator that the formation of post-WW2 models was a more contingent development than some variety perspectives suppose. It is plainly true that industrial cartels characterize both the late 19th century period of

[24] The field approach, with its Durkheimian flavor, might seem susceptible to this, but field theorists have mostly restricted their increasing institutionalization model to the postwar founding of the earliest European Community institutions.

fast German industrialization and the model prevailing there since 1945, but even backers of the TOI emphasize that "arguably there was a greater similarity among the institutions of Japan, Germany, and the United States in the 1920s than today" (Dore, Lazonick and O'Sullivan 1999). It is clear that both Japan and Germany, the archetypal coordinated economies, had moved toward a more "laissez-faire" approach banking and finance during the 1920s (Vitols 2001; Werner 2003; Fear and Kobrak 2010). If supposed paragons of coordination had been more freewheeling than expected, the rest of the world was also more coordinated than expected. The 1920s saw a boom in cartelization in most industrialized countries; by 1921 Britain's population of 446 cartels was not far behind Germany's level earlier in the decade (550-660) (Fear 2006:11).[25] Spain pioneered mandatory cartelization in a wide range of industries from 1926, while later in the same decade the Italians, French and British all began to use state power to explicitly encourage firms to join cartels (Schröter 1996:136).

The similarities in financial systems warrant special note. The German stock market before 1914 is known for its unusual stability, in which asset price spreads were small and volatility low (Voth 2001). Yet here again any simple continuity from the pre-World War I stability to the stable bank-driven postwar German model is untenable. In 1910s and 20s size of securities markets relative to GDP in supposed "bank finance" countries such as Germany and Japan was similar to the level prevailing in the "market finance" system in the US, while in all

[25] Lee McGowan (2010) notes that empirical investigation has confirmed that that cartels formed as protection from competition "were more prone to emerge in those large scale and heavy industries that proved costly to run and maintain in the face of open competition," a result in accord with Post-Keynesian theoretical expectations (p. 145). In light of the fact that Britain and Germany were by far the most industrialized of European economies, then, their high levels of cartelization present less of a puzzle, and we would expect cartelization to be roughly proportional to the share of such heavy industry in national industries despite differences in national attitudes towards cartels. Indeed, Schröter (1996:141-2) ranks both future surplus countries (Germany, the Netherlands, Belgium) and deficit countries (Spain, Italy, the marginal surplus country of France) in the top two tiers of his four-level ranking of national levels of positive disposition toward cartelization, whereas the UK is grouped in the third level ("more ambivalent") despite its high number of cartels.

three countries the total amount of bank assets as a proportion of total financial system assets were nearly identical (Vitols 2001). Further disruption cam in the wake of the first World War when the hyperinflation of the early 1920s meant that the capital and reserves of the big banks in 1924 had been knocked down to one-third of the 1913 level, opening the German capital market to large inflows of foreign lending (Detzer *et al.* 2013:37-38).

Weimar Germany was characterized not only by the notorious inflation in the early 1920s, but until the 1930s showed highly volatile and large price swings in asset markets and securities trading. The common TOI supposition that Germany was a "bank finance" economy and would thus evince stability, laid out early by Hilferding ([1910]1981), thus seems to rest on shaky ground. Bank support to firms in Germany did, of course, exist. Yet it was again similar to the approach in the US, with banks conservatively lending mostly to large successful firms in what Richard Tilly (1986) called "development assistance to the strong." Moreover, this lending evinced a pattern nearly the opposite of the classic German postwar model; this bank lending was largely short-term, with long-term finance coming from the securities market (Pohl 1984).

All of the above implies that the Interwar period displayed sharp differences from the postwar order, with the "coordinated" economies rather more laissez-faire and financialized than one would expect and unexpectedly large amounts of "coordination" even within liberal or Mediterranean countries.[26] More importantly, there is a horizon of contingency that is almost impossible for any path-dependency to surmount: the complete reconstruction of the European order by the Allies after 1945. For Germany, in particular, this differed sharply in comparison to

[26] The argument advanced here is that the shape of much of the later 20th century European division of labor stems from Postwar reconstruction era policies, but there is room also for considering the sharp turn taken by many countries during the Great Depression. For example, in the German case strong evidence has been adduced that bank-firm coordination and state guided finance and industrialization really made its first 20th century appearance under the Nazis (Geiger 1994). Of course, such control also characterized Italy, even though it would later often end up on the non-neomercantilist side of the ledger.

the end of the first War; "[i]n 1918, the end of the war found and exhausted country, but the basic framework had been preserved. In 1945, the framework itself had disappeared" (Stolper and Rosscamp 1979:376). To be sure, early narratives of the German *Wirtschaftswunder* ("economic miracle") exaggerated the extent to which German industrial capacity had been destroyed in the war (Geiger 1994:342). The argument here, however, turns only on the radical power of Occupation authorities and how close those authorities came to dismantling Germany's industrial base after the war. Wendy Carlin (1996) puts it plainly: "[f]or Germany in 1945, it was quite unclear if it would become a member of the 'convergence club.' Decisions taken by the Occupation governments between 1945 and 1948 played a central role in establishing membership."

It must be remembered that before the end of the war Allied plans for the Germany took what Robert Skidelsky (2002) called a "Carthaginian turn" with US Treasury Secretary Henry Morgenthau's plan to "pastoralize as well as dismember Germany." Roosevelt and Churchill both signed onto this plan for "industrial disarmament" at the 1944 Quebec conference, which in its strong forms involved permanently severing Germany from the crucial heavy industries in the Ruhr and Saar regions, removing 80% or more of German industrial capacity and reorienting the entire economy around light industry and agriculture (Gareau 1961). In the first few years of occupation the US State Department put in motion a milder but similar plan, suppressing German industrial production and completely reversing the country's export pattern. From a prewar pattern of exporting finished goods and chemicals while importing food and raw material, Germany was now exporting mainly timber and coal (Stolper 1979).

Over and above the possibility of a deindustrialized Germany or a heavy industry-focused France there is the fact that the order that actually did prevail was only made possible and,

indeed, was fundamentally shaped by Allied and especially US involvement after the war. After the initial steps toward de-industrialization and de-Nazification, US authorities and their junior British partners soon executed an about face. The grand geopolitical plan taking shape in Washington centered on the US, as the only Western power not decimated by war, taking and maintaining a hegemonic place in the world economy (Varoufakis 2011). New Deal planners understood that Germany and Japan would have to be moved, paradoxically, from total defeat and occupation to a position of industrial preeminence in their respective regions (Maier 1977). Peter J. Katzenstein (1977), weighing the relative influence of US planners on developed countries after the war, notes that the most extensive intervention occurred precisely in these two countries that would later become export powerhouses (p. 88).

Cold War historiography has often emphasized the security concerns driving the US turn toward rebuilding German industry, especially George Kennan's "Long Telegram" from Moscow in 1946 and 1947's announcement of containment via the Truman Doctrine (Milward 2005). Just as important were short- and long-term economic considerations. In the very short-term the "level-of-industry" approach to reconstruction, which had taken on the Morgenthau-esque objectives of dismantling German industry and removing the Ruhr and Rhineland, faced "collapse…just as the devastating winter of 1946-47 was further crippling the European economies" (Hogan 1982:270). In the medium-term, since the military buildup of the later 30s pulled the world economy out of the Great Depression, there was a fear that the end of hostilities would see the developed world slide back into depression. Before the end of the war this fear provided the impetus for the grand plans formulated at Bretton Woods in 1944, creating the future IMF and World Bank and setting the dollar as the benchmark in a global system of fixed exchange rates, but it persisted as a concern and was effectively used by those arguing against

holding back German re-industrialization. In the long-term, US planners envisaged the dominance of the dollar being supported by the deutschmark and yen; acting as support pillars for the dollar required these two currencies to display high stability relative to others, which in turn meant their respective economies must be installed as the industrial hub for their respective "hinterlands" (Varoufakis 2011; Halevi and Kriesler 2016: 297).

As a result, after two years of industrial handicapping, a new group of planners lead by Dean Acheson and George Kennan began strategizing about integration as the best way to protect US interests (Hogan 1982). This culminated in the European Recovery Program, the so-called Marshall Plan, through which the US transferred $13 billion ($115 billion in 2010 dollars) to Europe from 1948-51 (Delong and Eichengreen 1991). This represented a transfer of two per cent of US GDP, and caused industrial production in Europe, which stood at 87 per cent of prewar levels as late as 1947, to jump to 135 per cent of that level by 1951 (Eichengreen 2010:1). Alongside these funds the Plan created a stable environment for states to pursue reconstruction policies and for region-wide market relations to revive. In this regard the Plan did much more than just fund recovery for recipients; the result was less a series of "parallel national recoveries" than the "politically managed reconstruction of the intra-European division of labor with West Germany as its locational and industrial center" (Berger and Ritschl 1992:2). In other words, both the Plan's funds and the accompanying cajoling and pressure by its US architects acted as the crucial political support for European capitalism's "animal spirits" and gave it a region-wide form by imposing a new division of labor on the continent.

This "support period" lasted far beyond the initial occupation period. The following section will discuss some long-lasting US-initiated institutions, but much like the formal Marshall Plan period these institutional and social support rested on raw financing assistance.

One prominent example occurred when Germany liberalized its international trade in late 1949, resulting in an immediate sharp current account deficit in 1950 and 51, brought on by rising raw materials prices in the world market thanks to the Korean War (Dernburg 1954:535). Germany avoided a balance of payments crisis only thanks to assistance funds, troop expenditures and war-related industrial orders by the US. As Cesaratto and Stirati (2011) make clear, "the Korean War in 1951 – an external event – likely saved Germany from the initially disappointing results of its austere policies and began the export-led success" (p. 16). This will be a recurring theme in the 20th century history of Europe: German austerity at home, employed as a means to slow wage gains or imports, was made possible by either the presence or the quick return of current account surpluses, reinforcing the likelihood that policymakers would continually resort to such deflationary tactics in a strategic manner.

Spain once again provides an inverted example, where Allied plans and the early European institutions played a part in setting postwar Spain on a path toward becoming a chronic deficit state. The dictatorship of Primo de Rivera from 1923 to 1930 introduced major statebuilding and development initiatives in an attempt to fuse Spain's welter of competing class and regional interests into a national whole. Much of this progress was then eroded in the brutal Civil War which ended in 1939 with the victory of Francisco Franco's Falangist and monarchist forces. Franco succeeded in "obtaining a relatively autonomous position *vis-à-vis* the particularistic interests of the preceding epoch" via a corporatist reorganization of the economy (Holman 2005). By the end of WW2, locked out of most postwar pan-European recovery initiatives, Spain embarked on near autarky and a decade of fitful growth. Only after a carefully controlled opening to international trade did the so-called "Spanish Miracle," the 1960-73 period of extremely fast growth, begin.

Considered in terms of its own conditions of development and policy responses, Spain was following Germany's path with only a slight delay. Germany before Bismark and Spain before Miguel Primo de Rivera were both trapped in a similar developmental cul-de-sac. Traditional land owning classes opposed both internationalization of the economy and political modernization, a pattern seen in both the grain producing regions of Castille and, notoriously, in the conservatism of the Prussian Junkers. At the same time, the growing textile-producing bourgeoisie in Catalonia and industrialists in the Basque region were committed to opening to the international economy while sharing with the landed classes a deep fear of any political modernization that might upset the established hierarchy. Underneath these elite factions, both agricultural and industrial workers were becoming more organized and restive. Holman (2005) finds that Thomas' analysis of the causes of the fall of the Spanish Republic is equally informative of why the installation of dictatorial nationalist reformers was needed: "the inability of the politicians then active to resolve the problems of the country within a frame generally acceptable, and, on the other, a willingness, supported by tradition, of some to put matters to the test of force" (quoted in Holman 2005).

In this light, the Spanish and German cases were less different than often supposed. Both seemed to require the sort of figure that Joaquín Costa portrayed as an "iron surgeon," a source of centralized control able to fuse competing regional and class interests into some semblance of a national whole while avoiding conflict arising from below. This political parallel with the Bismarkian and even National Socialist eras in Germany, along with the drive for cartelization, rationalization, and state-guidance pursued by Primo de Rivera, makes clear how close the

German and Spanish state-centric development processes were by the close of WW2.[27] This is not to deny the very real structural differences between the two economies in the prewar decades; most obviously the share of agricultural work in Spain was still well above Germany, which had a head start in building its industrial capacity. The point, however, is one often made by critics of simplistic modernization theories: it was these structural differences that prepared the ground for a divergence *despite* the similarities in terms of political and economic theories, developmental policies, and patterns of institutionalization.

Yet these structural differences, in reality traces of Spain's late start on intensive development relative to Germany, are still not sufficient to explain post-1945 differences given the sharp break in the history of the regional economic order and institutional framework caused by Allied reconstruction. To put it differently, regardless of different development levels in the years preceding "zero hour," if the political reconstruction of the region had been such that Germany was pastoralized and locked out of early pan-European institutions, but at the same time Spain, instead of being excluded, saw its industrial capacity heavily subsidized by the Marshall Plan it is reasonable to suppose the resulting surplus-deficit patterns may have been quite different.

This counterfactual analysis implies, in turn, that the contingency of Spanish neutrality during WW2 and the subsequent turn to autarky that was a major determinant of Spain's later 20th century trajectory. It is clear, in turn, that this move toward autarky was powerfully conditioned by the reactions of Allied powers after the war, specifically, their decision to exclude

[27] This holds *a fortiori* when we consider how the drive toward national consolidation begun by Bismark and solidified with the advent of war in 1914 was partly undone by the extreme chaos of the postwar revolutionary years and the fissile, financialized capitalist tendencies of the 1920s. This explains why critics of the "timing of industrialization" thesis as an explanation of German state-finance-industry ties discount the influence of the Bismarkian era and instead locate the birth of this model in the Nazi years of the 1930s (Vitols 2001).

Spain from the Marshall Plan, the OECD, and the EPU. It was in this spirit that Holman (2005) indicts simplistic liberal narratives in which "the lack of international competition and the excessive role of the regime are held responsible for all the negative elements in the postwar process of economic development, while external factors account for the positive elements" (p. 224). Rather than Spain moving into autarky and thus delayed development with regard to Northern Europe due to some internal qualities of the Spanish state or society, this was in large part a result of the shape of US-led European integration initiatives in the late 1940s and early 1950s. Spain's surviving post-autarky corporatist elements, such as labor's decentralized but state-supported wage bargaining ability cited as an integral part of Spain *qua* MME, spring less from some set of deep Spanish social parameters but rather from the way this corporatism was given decades to solidify under Franquist rule such that, even as left and right parties in subsequent decades attempted to undermine these workerist elements, they persisted into the Euro era.

The examples of Germany and Spain are representative of much of the continent; signs of the deep contingency of the postwar division of labor can be found in nearly every country. Germany was placed in the center of the European division of labor by Allied and, especially, US actions; these were politically mediated grand policy choices that could have gone very differently. Spain was similarly conditioned, displaying a similar contingency with regard to its eventual place in the emerging European order. This is not to deny that there may be behavioral and value differences that work to ensure some measure of continuity within national cultures, ethnicities, or civilizational orders (such as the oft-cited division between Protestant and Catholic Europe). It is simply that there is little evidence that these differences determined the place of each European country within the postwar hierarchy, given both the interwar patterns of

difference and similarity as well as clear evidence of top-down causation via continent-wide processes of planning and reorganization (which, to be sure, never worked precisely as their enactors intended). As will be seen below, the early institutions of Europe, especially the European Coal and Steel Community and the European Payments Union, were formed by strategic interaction of powerful states, created in response to the existing structure of the region's political economy, and then influenced the development of that political-economy in turn.

German-French power politics and early US-installed institutions

While Allied planners "would re-establish the West German economy as the prime supplier of capital goods to Western Europe," it was the early pan-European economic institutions which would maintain Germany its position (Berger and Ritschl 1995:199). The period from the beginning of the Marshall Plan in 1947 to the dissolution of the European Payment Union (EPU) in 1958 was one in which US-sponsored aid and development initiatives, as well as the EPU itself, ensured a rapid German recovery based on export production even while helping to keep that recovery (and the mounting surpluses it entailed) from causing the strains that would plague later decades.

The eleven years from 1947 to 1958 also prepared the ground for later EU institutions, most notably via the establishment of the European Coal and Steel Community (ECSC) in 1951 and 1958's Treaty of Rome. Other pan-European institutions, the European Atomic Energy Community (EURATOM) and the European Economic Community (EEC), were given a separate existence in this period and would later be folded into the ECSC to form the European

Community (EC), the forerunner of the EU. Their respective executives would combine with the ECSC's High Authority to create a single European institutional executive, the Commission. Constructing this web of treaties and piecemeal coordinating institutions was no mean feat, and obviously represented substantial cooperation between European states. Even still, installing these institutions saw forceful and continual political jockeying by the states involved, and even those institutions that functioned well, such as the EPU, became sites of interstate conflict as time passed.

The 1947-58 period thus opens an early window into the continual interstate conflict and strategizing in the context of shared institution-building that characterized Western Europe over the following decades. This section will, first, examine the competitive and cooperative relationship between France and Germany that drove much of the next five decades of institution making. Second, I focus attention on the two most important early institutions, the EPU and the ECSC. The overall aim is to suggest that realist-style state strategizing, explicitly built around political-economic concerns, was a core driver of the formation of pan-European institutions. In addition, this section will emphasize the EPU as the benchmark for managing external surpluses and deficits against which later institutional frameworks can be compared.

Milward's (1984; 1992) seminal works on postwar Europe emphasize that the early pan-European institutions were both the result of strategic interactions between, and themselves worked to save and strengthen, the nation-state as the fundamental macrosocial actor on the European stage. In a manner similar to this study, Milward also emphasizes that states are driven by political-economic considerations and buffeted by structural economic forces, but it is worthwhile to pause to emphasize the fundamental realist element in such a stance (cf. Milward 2005). As in similar studies of European and global economic dynamics (Block 1977; Moravcsik

1991; Pederson 1998; Lieshout 1999; Gavin 2004), time and again the role of states as more or less unitary actors strategically pursuing foreign economic policy objectives surfaces.[28] This seems to sit uneasily with field explanations, as they emphasize how increased within-field interaction expands and elaborates pan-European institutions "behind the back" of states. The field approach, relegating states to an increasingly small area of policy debate on which they have effective power, is apt to miss the role of this strategizing in initiating, ending, and most importantly shaping each round of pan-European institutions.

Next to the initial role played by the US, one crucial driver for European integration has been the contentious yet inescapable connection between France and Germany. During early rounds of institutionalization "the big West European states and notably Germany…appear to have been the most fervent advocates of a federal-style structure, whereas the small states adopted a mainly intergovernmental stance" (Pedersen 1998:77). Still, these negotiations occurred during a period of heavy US influence on EU institutions, occurring via direct pressure and guidance; this contrasts US influence in later decades, with was more often a function of the world-economic role of the dollar and US monetary policy. The French, for example, maintained until 1949 their desire for the industrial handicapping of Germany, and it took a special effort on the part of US planners to bring the French into the ECSC and drop their ambitions to absorb the Ruhr, the German industrial heartland, into what were already substantial French holdings in southwest Germany, the Saar Protectorate (Lieshout 1999).

Overall, the Franco-German relation as it bears on European integration can be characterized as a "grand strategy" of containment by the French and of cooperative hegemony on the part of Germany. Coming out of the maelstrom of two World Wars, France was

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[28] The validity of seeing these interactions as strategizing between states held even once scholars began to "break open" the national container and disaggregate domestic interest groups in the search for their separate influence on European policymaking (e.g. Hefeker 1997; Moravcsik 1998; Walsh 2000).

understandably obsessed with preventing a revival of German military or political dominance. It briefly saw the postwar reconstruction as a chance to itself become the industrial hub of a revived Europe. This hope was quashed by American reconstruction plans and the need to keep Germany within the Atlantic-oriented world and away from the Soviet sphere of influence; the French focus shifted to the conscious use of supranationalist institutions to contain Germany (Milward 1984; Lieshout 1999). As a result "the French were keen to assume the mantle of [European Community] political leader from the very beginning" (Markovits and Reich 1991:10). France's overriding aim was to maintain and assert its political equality with other great powers and keep abreast of German economic development such that France could avoid slipping below the waves into permanent dependency (Pedersen 1998). This provides the answer to the puzzle of why the *dirigiste* and nationalist France of the first few postwar decades would simultaneously be the biggest proponent of the formation of supranational European institutions.[29]

These realpolitik aspects of the French-German relation, supplemented with US pressure and the shifting allegiances of the smaller European states, is not at odds with the macrostructural dynamics at the heart of a neomercantilist explanation. State strategizing is incomprehensible without taking into account the structural situation; as later sections will show, the constraints and opportunities afforded by the structural situation on the continent were often the central pole around which this strategizing revolved. The French-German strategic relation threw off three major effects, each of which are related to the overall neomercantilist relation that governs the region. First, it worked to keep the two largest economies and Europe coming back again and again to the negotiating table, even as each institutional phase went to pieces. Second,

[29] In fact, France would threaten to abandon supranational institutions when their workings became a threat, as in the 1965-6 "Empty Chair crisis" in which France was willing to paralyze the pan-European institutional machinery in order to avoid losing its ability to veto European proposals.

the French drive to contain Germany via institutional enmeshment, even at the cost of continually offering concessions on the shape of European institutions to the Germany, goes some way to explain how the EU progressively took on a monetarist, deflationary character.

The third connection between grand state strategy and neomercantilism can be seen by examining Germany's own "grand strategy" of cooperative hegemony. This was overwhelmingly premised on maintaining economic strength: Pedersen (1998:72) demonstrates how the need to build up *Vertrauenskapital* (capital of trust) and thus extirpate the guilt of early 20th century military aggression became intertwined with the need to ease its European partners into accepting Germany's economic dominance (cf. Markovits and Reich 1991). "Stability" became the watchword of Germany's reintegration effort and was also understood to be the prerequisite for the success of German industry abroad, the one area in which Germany could build up and exert power. Trade liberalization, and the maintenance of liberalized trade against resurgent autonomist and nationalist impulses typified almost every German stance on pan-European economic institutions (Crawford 2009). It is hard to see how this could be otherwise, given that sufferance of German power by other nations was premised on it renouncing any military options, one reason for Willy Brandt's plaint that Germany was "an economic giant but a political dwarf" (quoted in Westerveld 2014:33-34).

To truly understand why Germany's cooperative hegemony went hand-in-hand with a neomercantilist strategy we must turn to Eric Richard Staal's (1999) portrayal of a Germany caught in a political-economic trilemma. The argument is that Germany was "forced" into taking on a hegemonic role thanks to the fact that they required fixed exchange rates with their European neighbors in order to avoid uncompetitive exports, and yet within any such fixed

currency union they would risk importing inflation from their higher inflation partners.[30] As a result, German monetary authority had to be extended, in hegemonic fashion, across the continent; Germany was left with no alternative but to tighten down the bolts on their partners by, perversely, cooperating in European institutionalization while being sure to determine the shape of such institutions.

This is helpful, but not fully satisfying; this political economic analysis is missing the *social* aspects of German development, specifically the formation of a German social model requiring the external surplus. As I will argue in subsequent sections, the nub of the issue is: why was the prospect of less competitive exports such an anathema to Germany, given their early and massive surplus lead over others? In other words, Staal's framing of the trilemma risks forgetting the possibility of a Germany led by domestic demand expansion, in which the current account is allowed to be closer to balance or even negative. This can, of course, occur even with exports making up a large part of national value added – instead, as will be seen, German policymakers seemed concerned to make sure imports remained below exports (in other words, winning a trade and thus current account surplus) and were not afraid to slow domestic growth as needed to maintain this state. Ignoring this aspect allows even those scholars inclined to be critical of the austere influence of German policy to blame it on a collective psychological aversion to inflation, rather than a strategy of social development such as neomercantilism.

Still, even from Staal's model the implications for German "grand strategy" as regards European integration are clear. If the prod to French involvement in institutionalization was the need to use supranationalism to contain Germany, for Germany itself the reasoning was simply

[30] With exchange rates between the Deutschmark and a higher inflation currency such as the lira fixed, the difference of the Italian inflation rate over the German rate would appear in higher prices of Italian imports into Germany. In a flexible or floating system, the higher Italian rate of price increase could be kept a simply nominal phenomenon by devaluing the lira relative to the D-mark.

that "political and social stability became an economic asset of critical importance for the international competitiveness of West German industry" (Kreile 1977:776). Close US ties, via NATO and other Atlanticist initiatives, was an important result of security concerns regarding the USSR and relations with East Germany, but for the political-economic maintenance of Germany as a modern society a specifically West European process of institutionalization was required. German survival and empowerment became, then, a question of economic strength; maintenance of the external surplus became foundational to Germany's approach to social development and, by extension, the one constant element of its strategic considerations when forming economic policy with regard to Europe.

In subsequent sections I detail how sometimes contentious interactions between German governments, the Bundesbank, and German capitalists formed and maintained this export-oriented growth model, but considered from a higher level of abstraction the German strategy resembles Arrighi's (1994) concept of fusion of "territorialist" state impulses with a more narrowly "capitalist" logic. This is, as often noted in regards to the similar evolution of postwar Japan, the continuation of war by economic means. Given this German neomercantilist orientation, we can then put both the interstate relations within Europe and "world-level determinants" such as Europe's relationship with the United States-led global economy into proper perspective. The German strategy was allowed by the Allied decision to *not* dismantle German industry after the war and the postwar division of labor in which German capital goods were accorded a central place. The strategy was helped past its growing pains by the institutional machinery of the EPU, the Bretton Woods arrangements, and other forms of US-led financing. Finally, the strategy became bound up in the integration process, and thus influenced the shape of pan-European institutions, by the particularities of the Franco-German political relationship

and, more importantly when explaining the details of the pan-European institutions, the institutional requisites of the strategy itself: liberalized trade, stable or at least controllable exchange rates, and making sure that other states were forced to adjust to German deflationary policy rather than Germany having to accommodate their more inflationary and domestic-demand led social models.

There is one last peculiarity of Franco-German relations, which is the counterintuitive notion that war of position between two members of the surplus bloc served to sustain the building of institutions governing the entire region. Interaction between the most successful neomercantilist bloc member, Germany, and the least successful neomercantilist member, France, had an outsize influence. In reality, this is unsurprising given the continent's history of uneven development. Wallerstein's ([1976]2011) early works, for example, place "struggles in the core" at the causal center of his analyses of the 16th and 17th centuries. One of the characteristic aspects of core-periphery relations is the dsiproportionate impact that negotiations and conflict between powerful states have on the peripheral ring of weaker states. In this earliest postwar era of institutional formation, there was a substantial gap in decision making power between the US, France, and Germany, on one side, and the rest of the original European members such as Italy, the Netherlands, and the Benelux countries (Pedersen 1998:77).

All of the above suggests that the field approach presents a misleading picture by minimizing how state power politics have time and again both broken the institutional machinery as well as been the major force putting these institutions back together. A field perspective's diffuse notion of causation is, at times, a strength, directing our attention to how everyday actions of private agents can be reoriented toward and contribute to a new "level" of institutional governance. But when forced to be explicit about their major cast of players, states are given

short shrift in favor of hypotheses that the interaction of "transnational society…supranational organizations…and the structure of European-level rules…broadly determine the course of European integration" (Fligstein and Stone Sweet 2001:30). Instead, looking for where integration is sustained by "grand strategies" explains why a cooperative drive remained present in each decade for the only actors with the demonstrated power to weaken or even demolish pan-European institutional frameworks, even in the face of severe institutional problems and different approaches to integration by specific national government.[31] At the same time, when combined with a structural view of the region's political economy it also explain the specific shapes of pan-European economic institutions in a way that a vaguer conception of institutionalization, driven simply by an endogenous process of interaction leading to field stabilization, fails to do.

The European Payment Union deserves attention not only as another example of US assistance fusing French, German, and the smaller member states into a common interest, but because its treatment of surplus-deficit relations serve as a benchmark against which all the later dysfunctional monetary dynamics must be judged. Keynes ([1942]1981) had proposed an ambitious plan for an International Clearing Union which would ease the constraint of surplus-deficit relations on national growth and attempt the "substitution of an expansionist, in place of a contractionist, pressure on world trade" (P. 4). One foundational plank of this (subsequently rejected) effort was that the surplus accumulated by some countries need not wind up

[31] In the most obvious example, the rapid institutionalization of the 1948-58 period was thrown in disarray as soon as de Gaulle came to power in 1958. He prioritized French autonomy, often doing an end-run around existing pan-European institutions in order to advance a more confederalist conception of Europe (Pederson1998:80-83). After the late 1970s, however, there would be even less difference in how nominally right or left governments would pursue integration goals as a centrist neoliberal policy consensus took hold.

"withdrawn from circulation and exerting a deflationary and contractionist pressure on the whole world including the creditor country itself" ([1942]1981:4).[32]

While Keynes' plan never became reality, the manner in which the EPU allowed recycling of members' accumulated surpluses functioned "as close as one could imagine to Keynes' idea of an international clearing union that the US government rejected at Bretton Woods" (Halevi and Kriesler 2016:319). Under the Marshall Plan and the EPU "the hallmark of the 1950s was the organization of European institutions around the productive role of the nation state...devising a system of international relations limiting the autonomy of finance and allowing the easy transformation of export surpluses into commercial credits" (Halevi 2016:376). The basic function of the EPU was easing the problem of surplus-deficit relations; external balances between participating states were no longer cleared on a bilateral basis but instead were combined into a system of multilateral clearing. In addition to multilateralizing all external intra-European balances, it gave deficit countries ample room to grow by allowing a large portion of current account balances to be carried as pure credit, and only gradually requiring increasing settlement of balances in terms of reserve assets (dollars or gold) as any given country exceeded this quota. Considered as a scheme for reducing the pressure of surplus-deficit relations that might distort or limit growth, it was a considerable success:

> "Participating countries had $46 billion in surpluses and deficits against one another during the EPU years. Nearly half ($20 billion) was cancelled multilaterally. Another

[32] A second, perhaps equally important, plank was the need to carefully control international capital flows. Keynes ([1942]1981) was plain that "There is no country which can, in future, safely allow the flight of funds for political reasons or to evade domestic taxation or in anticipation of the owner turning refugee. Equally, there is no country that can safely receive fugitive funds which cannot safely be used for fixed investment and might turn it into a surplus country against its will and contrary to the real facts" (p. 13). This warning is prophetic given that freer capital flows from the 1960s onward increased the pressures of surplus-deficit relations and, as shall be seen in chapter six, the 1980s European removal of capital controls at German behest put strong pressure on all European states to rush toward the single currency.

> quarter ($12.6 billion) was cancelled intertemporally, as countries ran deficits in one month, financing them wholly or partially with credit, and ran offsetting surpluses in subsequent months, cancelling their previous position. Settlement in gold and dollars was limited to most of the remaining quarter ($10.7 billion). Thus, EPU reduced settlement in gold and dollars by more than 75 percent compared to what would have been required under strict bilateralism" (Eichengreen and Macedo 2001).

Once the US helped Germany escape its budding balance of payments crisis 1950-51, the EPU allowed Germany's fast growth by boosting the volume of trade and, importantly, enabled that growth to benefit the rest of the region even though it moved from a total EPU-area deficit of 446 million dollars in 1951 to more than one billion in surplus by 1954 (Dernburg 1954:539). Imports to Germany from the rest of Europe grew more rapidly than exports, the credits eased any dollar shortage that would have stopped this growth, and the investment encouragement helped ensure that growth would be based on increasing real capacity and output rather than financialized speculation (Halevi 2016: 376-377). In addition, the following section will show that the environment enabled by the EPU was a crucial period in the growth of German oligopolistic export sectors. Just as importantly, the clearing function subordinated financial concerns to the needs of real growth; in this sense the EPU amplified the more general tendency of the Bretton Woods era to keep finance more tightly bound to the needs of national development. Delong and Eichengreen (1991) are thus not wide of the mark when they describe the Marshall Plan and its EPU accompaniment as "history's most successful structural adjustment program," provided we recognize its success came not only by turning on the spigots of credit but also by ensuring that investment was productive and imbalances did not gum up the growth engine.

The EPU must be seen in connection with the more well-known European Coal and Steel Community (ECSC). This regionwide coordinating body for steel and coal production was not

created out of pure surpranationalist sentiment. Rather, the ECSC's politically realist character was explicit and foreshadows later episodes of European institutionalization (Milward 1984; Lieshout 1999; Pedersen 1998). The French drive to weaken Germany centered on the desire to annex the coal, steel, and industrial centers in the Ruhr and Saar, but the negotiations culminating in the Schumann declaration in May 1950, in which the ECSC was announced, allowed Adenauer and de Gaulle to instead put these vital industrial inputs under a more neutral Europe-wide governing body. Adenauer's cooperation can be read off directly from the postwar context, where Germany's desperation for *Vertrauenskapital* was greatest; in any case, Germany can hardly be said to have had state sovereignty thanks to the Allied occupation. The French decision, in contrast, was a function of pressure from the new hegemon of the world-economy. Franco-German cooperation satisfied the Americans, who had put firm pressure on France to drop its fantasies of economic preeminence, and in light of this American determination to rehabilitate Germany the more long-sighted French planners, such as Schumann himself, warmed instead to a plan that would at the least deny Germany autonomous control over these resources (Lieshout 1999:93-113; Rosato 2011:124-5).

While the ECSC's birth was accompanied by declarations of a coming "United states of Europe," much of this was revealed as inflated rhetoric as European and American policymakers strategized in a clearly realist style, both in terms of the political conflict with the USSR and in seeing the ECSC as solving thorny economic disputes between the six European states.[33] This solution allowed large steel firms to spread throughout the region, ensuring needed supplies without either ruinous competition or protectionism (Halevi 2016). Given that steel is invariably one of the most concentrated sectors of any economy, and that demand flowed steadily via

[33] The Soviet threat, while active as an impetus to US pressures for integration and some of the overall Atlantic orientation of West Germany once it was within NATO, makes a poor explanation for the specific timing, shape, and sequence of pan-European institutionalization (cf. Lieshout 2012 for a concise argument to this effect).

Marshall Plan and NATO funding, the economic impact of the ECSC "implied the creation of a regular and non-conflicting oligopolistic structure in the main industrial sector, fostering both reconstruction and expansion for the six European countries participating in it" (Bellofiore and Halevi 2007:216). The grounds for the long postwar boom were thus laid in Europe by the ECSC's public subsidies and its prevention of competition between the various nationally-grounded firms, an arrangement that worked in synergistic fashion with the Bretton Woods fixed rates and the surplus recycling function of the EPU.

Finally, the ECSC is well-known as the birthplace of core elements of later pan-European institutions. The negotiation meetings prefigured the European Council, that "intergovernmental" body in which the heads of state of each European nation meet. The ECSC executive would later morph into the European Commission, the home of Brussels-based "supranational" bureaucrats tasked with representing Federal Europe over and above any particular national allegiance. The organization's formation evidenced a supranational policy entrepreneurship: French statesmen Jean Monnet both drafted the ECSC's novel supranational governance capacities that would become part of the Schumann declaration and would later serve as head of the institution's executive "High Authority." All the same, the substance of the ECSC plan had already been proposed two years earlier by both the Americans and the French Ministry of Foreign Affairs, both evincing a basic realpolitik understanding that this unprecedented institutional would be the best way for France to keep a recovering Germany from once again becoming a danger to others (Milward 1984:167; Lieshout 1999:93-94). In all, then, the ECSC already shows, at an early date, the inseparability of state strategizing on political-economic grounds and whatever seemingly "independent" European institutions came into being.

Scholars emphasizing integration often focus on the ECSC as the foundation of the Commission but it here we must note how, after its first decade, the ECSC/Commission became, not more and more powerful, but rather progressively more tightly constrained until the 1980s. Within a few years of invocation of the ECSC's executive "High Authority," a title hinting at supranational pretensions, Monnet had effectively been sidelined by the French themselves. Debate on the EDC in 1950-52, for example, only revolved around intergovernmental concerns as "France quickly backed away from the supranationalism it had introduced" (Lieshout 1999; Parent 2011:135). The High Authority name itself would be thrown aside when the next two pan-European institutional "pillars" were erected, the EEC and EURATOM, after the Rome treaties in 1958. These executives would only be dubbed "Commissions," highlighting their subservience to the (proposed) European parliament and, more importantly, the governmental leaders in the European Council.

The most concrete accomplishment in this period was the completion of the Customs Union between the original six West European members in 1968. Yet the supranational impulse weakened, foreshadowed already in 1963 when Adenauer and de Gaulle joined forces and, against the entreaties of Monnet and EEC Commissioner Walter Hallstein, rejected the British application for EEC membership (Rhenisch and Zimmerman 1996). This weakening of the autonomous power of the pan-European institutions continued despite the fact that in the 1960s the Commission was headed by the ambitious and energetic Hallstein, who attempted to expand the supranational level of governance by consciously emphasizing the "spillover" mechanism (Mazucelli 1997). As the institutional machinery was being streamlined and centralized, Hallstein focused on the question of financing the Common Agricultural Policy (CAP), the scheme designed to stabilize member states' agricultural sectors via price subsidies. Hallstein's

1965 proposal would expand the EEC's budget, the budgetary powers of the European Parliament and empower the Commission itself.

Yet the limitations of the Commission were starkly revealed soon afterward with the so-called Empty Chair crisis. Provisions in the EEC treaty, scheduled to take effect in 1966, would change voting in the Council from mandated unanimity toward qualified majority voting. For France under de Gaulle, this coming change plus Hallstein's expansive ambitions an unacceptable risk to national autonomy; in the summer of 1965 France recalled its representatives from Brussels and stayed out nearly six months. The solution to this crisis was 1966's Luxembourg Compromise, which by allowing exceptions from qualified majority rule in matters of "vital national interest" stopped the growing supranationalization of decision making and reduced the Commission's influence given that its initiatives could always be stalled by a national veto. The brakes placed on the Commission, combined with the later economic chaos of the 1970s, meant that the minister councils became crucial as the forum in which states would negotiate in an intergovernmental manner and the mechanism whereby, outside of certain periods in which the Commission was unusually powerful, national interests held a definitive check upon the Commission's actions.

If the meaning of the ECSC can only be put into proper proportion by looking ahead to the 1960s, to understand the institutional framework conditioning the future dependent bloc countries we must look backward to the contingencies of the 1930s and 40s. More precisely, there was a *lack* of international or regional institutional connections for Spain, Portugal, and Greece. All three entered the 1950s under the control of authoritarian regimes, and even the most stable and capable of the trio, Spain, was decidedly outside the growing pan-European institutional system. Tsoukalis (1981) characterizes this as a "state of international quarantine"

and while he notes this was eventually eased by Spain's usefulness as a Cold War anti-Communist bastion, the linkages established after 1853 with America and while they brought a certain measure of aid Spain was essentially cut off from its closer European neighbors (pp. 75-76). A period of near autarky thus continued until the late 1950s, and Spain, like Portugal and Greece, went without the EPU's powerful reconstructive medicine. The contrast with Italy is striking given her presence at the founding of the pan-European institutions (though without much influence on their form, to be sure) and the fact that Italian reconstruction and growth were able to benefit from the growth of their European neighbors under the EPU.

Overall, when looking at the 1947-1958 interlude the birth of German neomercantilism was enabled by French, US, and Italian support precisely because this earliest stage was carefully managed to the continent's benefit. The French moderated the importance of national autonomy in this period, which would return in the 1960s under de Gaulle, and instead made continual efforts, under US pressure to be sure, to draw Germany into supranational institutions. The EPU aligned national and regional objectives such that "the growth objectives pursued by the governments and the industrialists in each nation state were not in conflict with the expansion of intra-European trade" (Halevi 2016:376). At the same time, the incorporation of Italy in the early institutional structures and the exclusion of Spain, Portugal, and Greece would help set the characteristic internal organization of the deficit bloc, whereby the sometimes export-dominant Italy would emerge as the strongest deficit bloc member.

The Formation of the German Model and the End of Bretton Woods

The end of the EPU marks the next phase of the region's development, corresponding to the fifteen final years of the Bretton Woods system from 1958 to 1973.[34] In 1958 the Common Market was inaugurated with the Treaty of Rome, beginning the process toward free movement of goods, capital, and labor that would be completed with the Single European Act in the 1980s. The 1960s thus represented the first postwar period where free trade, and freer capital movements, began to condition the region's development. More precisely, the fact that this "liberation" of capital coincided with the end of the surplus recycling functions of the EPU means that 1958 to 1973 was also the start of neomercantilism as a *structural* problem for Europe. Surplus-deficit relations came out into the open and, combined with the increasing volume of speculative capital flows drawn to surplus countries like Germany, presented countries with a strategic dilemma: given the need under Bretton Woods to keep currencies pegged to the dollar, pressure on a currency would require either corrective monetary and fiscal action or a politically-negotiated change in the currency's value.[35]

Below I present a brief overview of the way currency revaluation under Bretton Woods progressed over the 1958-72 period. We must then focus on two concurrent developments in Germany, the home ground of neomercantilism, if we are to understand how neomercantilism as a national growth strategy reached its mature form: first, the powerful hold of the export industry

[34] Over and above the fact that it was always conceived as a temporary institution, the EPU also ended due to British and German desires to be free of the EPU's monetary and financing obligations. Britain was by this time adjusting to its new junior position in the US-led postwar global order, but not unreasonably wagering that its chances were better as a sovereign currency issuer and former hegemon free of European monetary entanglements. This became an early example of the British tendency to oscillate on the outskirts of the European economic and institutional development. The German objection is more interesting in light of later developments; Germany objected to becoming a continual creditor in the European Payment System, especially to France.

[35] This is simply a Bretton Woods-specific variant of the notorious trilemma: a country could not simultaneously maintain a fixed external value of its currency, free capital flows, and an independent monetary policy.

and the export-led growth model on German society and, second, the rise of the Bundesbank to dominance and its role in conditioning and maintaining the export orientation. I then move on to discuss the situation for deficit countries such as Spain, Portugal, and Greece in the period. These sections provide evidence that character of distinctive neomercantilist and dependent roles within the European division of labor became more apparent, revealing how these models were formed as parts of a regional whole rather than due only to causal factors internal to each country. Finally, I close with a short discussion of the German revaluations themselves.

The first of these elements, the political mediation of exchange rate realignments, demonstrates the (often implicit) symmetry and coordination that characterized the Bretton Woods era and would be progressively lost as the system disintegrated and disappear from later pan-European institutions. As noted, after the EPU dissolved surplus-deficit relations between the European states and the relation of European currencies with the dollar became an increasing strategic concern. Yet compared to later decades, this occurred in a curious manner: even though pan-European institutions continued to grow, battles over monetary, fiscal, and economic dynamics in the region were "outsourced" to the Bretton Woods framework.

Major European institutional developments, of course, continued; direction of the ECSC, the EEC, and EURATOM were combined under a single entity, the European Commission, soon after the 1965 Treaty of Brussels. Yet as outlined in the previous discussion of the Empty Chair Crisis, this period was one of diminishing power on the part of supranational bureaucrats. The original Treaties of Rome envisioned macroeconomic consultation to maintain full employment, low inflation and equilibrium in the balance of payments, but pan-European institutions did little in this regard (Staal 1999:22). As a result, interstate surplus-deficit relations were negotiated as a part of Bretton Woods; devaluations, revaluations, offset agreements, and the coordination of (or

refusal to coordinate) fiscal policies all became matters for negotiation within the framework stewarded by the US (Gavin 2004).

The US took on an explicitly interventionist role in these matters, even as it reserved its own ability to gear monetary and fiscal policy to domestic needs. The US had enough autonomy in the realm of economic policy that it went ahead with massive domestic expansion in the 1960s, but it could not yet move toward a policy of "benign neglect" in the way it would after 1973. The central pivot of the Bretton Woods system was the dollar, linked to gold at a fixed parity and the other world currencies at fixed but politically adjustable rates. As a result, the US was pressed to constantly monitor imbalances that could bear on the Bretton Woods parities, imbalances made worse by the dollars pushed out into the world economy by US expansion.

By the Kennedy administration the recycling of these dollar balances became a fraught political issue. De Gaulle threatened to implement, and then followed through with, policies to return these dollar balances for gold. In contrast, Germany cleaved uneasily to the US throughout most of the 1960s, agreeing to hold dollar balances and recycle large portions back to the US via "offset agreements" (Gavin 2004:137-141). The result of these Bretton Woods dynamics was a series of politically-negotiated changes to the valuations of major currencies, with the pound devalued in 1967 and the Franc in 1969, and a pair of upward revaluations of the Deutschmark in 1961 and 1969. By the early 1970s, the entire Bretton Woods system was breaking down, leading to Nixon's decision to end dollar-gold convertability altogether in 1973.

The German revaluations served as the crucible in which the mature neomercantilist model was forged, and must be discussed in conjunction with the strategic orientation of the Bundesbank and export interests. These two actors, together with the executive of successive German governments, form the core trio whose interactions determined both Germany's

domestic model and its approach to each phase of pan-European institution building. Whereas the German state's drive for national legitimation provided a very broad impetus to cooperate, the need to protect Germany's export-led growth model explains the specific forms of monetary institutions that German governments called for.

The Dominance of Export-Led Growth

The special capacity of export interests to influence German domestic and foreign economic policy is well known. Beverly Crawford (2009), surveying several decades of German foreign economic policy, noted that "German foreign economic policy is certainly dominated by a politico-economic coalition in favor of export-led growth" (p. 116). As a result "[f]oreign economic policy in particular has been consistent in its design to develop and expand export markets for German industry…accompanied by an 'export mystique' which no relevant social group called into question" (Kreile 1977:777). Moreso than simply the interests of any specific firm, or even the collective will of firms and their associated banks as expressed through policy lobbyists such Federation of German Industries (BDI), this dominance must be seen as the shared objective of political and economic elites to maintain export success as the very basis for *Modell Deutschland*.

In terms of the Kalecki profit equation ($P = I + C_k + B + J + H - S_w$) German policy has often aimed at surpluses by manipulating the J term, net exports. This net term is exports *minus* imports, and thus the surplus can be increased or maintained equally by expanding exports or reducing imports. German actions aimed both for victory in export markets over rivals but also, outside of the few times when it was pressured politically by its trading partners, keeping

demand low so as to not to stimulate imports. The few serious attempts at government-instituted Keynesian demand-led growth, such as the 1966 “Stability and Growth Act,” were only seriously pursued in periods where external conditions allowed the external surplus to expand (Leaman 1988). More, they were scaled back as soon as they threatened to lead to sustained wage increases or loss of the surplus.

This “hunger” for external surplus as fuel for the German model could come as a surprise to analysts as late as 1957, when Liesner correctly diagnosed that a low level of imports compared to the level of exports was the main driver of the surplus but that “the narrowing of the difference in the most recent past has probably led to reduced interest in these problems;” he thought that this gap between imports and exports, at least in the case of the difference between Germany and Britain, could disappear in the near future (p. 4). Yet Liesner (1957) was also already able to perceive the German state’s careful and deliberate attempt to orchestrate export expansion. His insight, corroborated by later research, was that the German “takeoff” in the 1950s was enabled by explicitly pro-export tax and credit policy, tarriffs on manufactured imports, support for investment, and finally the large inflows of refugees from East Germany (Kriele 1977:777; Leaman 2001:116-119) This last element was a major factor in keeping wage increases low and thus a classic example of weakening worker power by importing labor.[36] Overall the wage share shrank by 5% between 1950 and 1960, but the international clearing enabled by the EPU and the state’s pro-investment policies such as 1951’s Investment Aid Law made sure that this lower level of domestic consumption did not lead to less investment (Leaman 2001:119). This enabled the state’s export promotion drive to proceed, premised on a

[36] Moreover, it was simply a result of the pure contingency of the postwar split between the Federal Republic and Democratic German Republic. This historical artifact made the dilution of the labor market more palatable, thanks to shared linguistic and cultural identity between Federal Republic workers and the migrants.

"preferential system of links between the state and core firms" which guaranteed financing for the largest industrial firms but discriminated against smaller producers (Halevi 2016: 377).

In addition to the state's export promotion policies and the role of immigration-led wage dilution, a third essential ingredient was the way the central bank's monetary policy augmented these tendencies toward export-oriented concentration. Subsequent sections detail the many roles played by the Bundesbank in the German economy, but here it suffices to note that central bank action supported the oligopolization caused by the state's attempts to quickly build up high-liquidity firms and banks, particularly through high real interest rates and the encouragement and allocation of productive investment:

> "Interest rates as reflected by prime bank rates of commercial banks were indeed very high. At the same time, however, the German government pursued a low-interest policy for longterm investible funds. While commercial bank rates might be anything between 10 and 15 per cent, long-term capital for approved purposes could be had at a nominal rate of 5 to 6 per cent" (Stolper and Roskamp 1979:391).

Leaman (2009:91-94) has noted how high real interest rates, when maintained over long periods of time, lead to concentration as small firms are weeded out. Overall, German monetary policy in the 1950s complemented both the state-led concentration process and the inherent impetus for concentration stemming from production in manufactured goods. These three streams worked together, resulting in the well-known features of the German system of firm-bank links in which firms "rel[y] mostly on internal resources or bank loans" connected to "universal banks which own significant shares of company stock and exercise proxy voting rights on behalf of small stockholders….enabling banks to play a crucial role in companies' choice of strategy or in their reorganization" (Kitchelt and Streeck 2004:4).

The state, migration, and monetary policies might seem at odds with the oft-emphasized "free market" aspect of the "German miracle." It is true that one of the major architects of the

German postwar recovery, Finance Minister and then Chancellor Ludwig Erhard, was a member of the *Ordo* school of institutionalist-*cum*-liberal economics that combined broad state guidance with a "social market economy" premised on suppressing concentration and in order to foment competition (Stolper and Roskamp 1979:376). Yet a closer look at Ordoliberalism-inspired policies in practice have noted that the "anti-monopoly" plank reduced to attempts to screen or pre-approve instances of formal cartelization and the end of explicit export credits. These failed to stop oligopolization of major sectors in the 1950s, and in the following decades "anti-monopolization" dropped out of sight entirely (Leaman 1988:74-75).

Efforts to control concentration in the 1950s were failures (Fohlin 2005). By the time the EPU ended in 1958 German steel, capital goods, and machine tools had all reached a high degree of concentration. The market share of the four largest chemical firms went from 40 percent in 1952 to 70 percent in 1972, with a similar process in steel expanding the shares of the leading four from 58 to 98 percent over the 1960s (Lucarelli 1999:65). In the latter case, the ECSC was also at least nominally committed to avoiding extreme concentration, and yet even with this supranational institutional support the result was a "tremendous resurgence of the German iron and steel 'Konzerne' Thyssen, Hoesch, Kloeckner and others" (Grabas and Nützenadel 2013:55). Overall, the anti-monopoly plank of ORDOliberalism was hollowed out in a "realist" détente between the liberal, pro-market, pro-export orientation of the philosophy and the need for a high degree of oligopoly as both a result and guarantor of the pro-growth policies.

This "export-led, investment-goods based character of German expansion" from 1950 to 1960 resulted in consumption falling from 64.2 percent of GNP to 57.3 percent, while net government spending fell slightly (14.4 percent to 13.6 percent) (Leaman 1988:109). At the same time, investment increased from 22.6 percent of GNP to 26.3 percent, and net exports rebounded

from a deficit of 1.2 percent to a surplus of nearly 3 percent. This percentage of GNP given over to consumption expenditure was remarkably low for a highly industrialized country, being lower than France, Britain, and the US over the period. This carefully managed dominance of the capital goods sector and heavy industry was, in these early years of the EPU and immediately after, probably a net benefit for European growth as a whole (Halevi 2016:376-78). It is not so much that the ingredients for deflationary bias were not there; even in this early period "a deliberate policy of deflation combined with "income policy from below"…kept inflation rates down and domestic demand checked, so that the drive for export markets was doubly stimulated" (Kreile 1977:777). Even still, the EPU ensured a regular recycling of these surpluses and German import volumes remained above exports. Going into the 1960s, as the wrangling over the balance of payments began to resurface, Germany's trade with the US was still the dominant source of surplus and this balance was reduced by politically-arranged recycling mechanisms such as German purchases of US weapons; this combined with the generally pro-growth global environment of 1960s Bretton Woods policy kept the rest of Europe sheltered from much of the deflationary impact of German dominance (Gavin 2004).

Steinherr and Morell (1978) detailed study of price-setting behavior showed that "the German export industry is not a price-taker on world markets," with the machinery, electrical engineering and electronics, and precision engineering industries being particularly powerful price-makers in their respective domestic and international markets (p. 198-99). The well-known interlocking directorships and cross-ownership between large banks such as Deutschebank and Drezner were both a cause and symptom of this concentration (Lucarelli 1999:64; Dyk 2005). Industrial sector oligopolies were uncontroversial and accepted even by the Keynesian mainstream; the influential architect of 1967's Keynesian policy package, Economic Minister

Karl Schiller, was explicit about the need to accept concentration as a means of making coordination effective (Leaman 1988:182-3). Unsurprisingly, the line between accepting the "fact" of concentrated firm power and tailoring economic policy to the needs of these large firms could become quite blurred.

The highly developed nature of the firm-bank nexus at home meant German industry was oriented toward, and confident of, competing internationally. This is the root of two perennial tendencies in German foreign economic policy. First is that, as Germann (2014) notes, it is "well established in the specialist literature [that] Germany's capitalist class has a vested interest in the maintenance of a fixed-exchange rate system" (p. 776). As later sections will show, this meant that the export elites and government were often united in protecting or initiating fixed rates under Bretton Woods, the EMS, and the Euro, while the Bundesbank demurred. Yet when successful, industry has often then allied itself with the Bundesbank to make sure that these fixed rate systems have a deflationary and monetarist form, thus protecting Germany's current account surpluses (Kaltenthaler 1997).

In a related manner, this has also resulted in a constant push for trade liberalization and a hawkish maintenance of this liberalized environment that made German trade negotiators look with a very jaundiced eye upon attempts to move back toward "protectionism" (Kreile 1977; Crawford 2009; Germann 2014a:708). The increasing concentration of capital goods and mechanical industries gave them advantages of scale and capacity, and once bilateral trade revived in the 1950s Germany emerged as "the major supplier of capital goods to the rest of Europe" which "enabled Germany to attain an oligopolistic position throughout the continent" (Halevi 2016:377). As a result, within Germany itself the capital goods industry expanded faster than any other major sector of the economy. Table 5.1 compares indexes of production for all

industry versus consumer and capital goods. In fact this rate of growth was faster in each five year period than the growth of mining, consumer goods production, public energy, and construction (Leaman 1988:109).

Table 5.1 German Industrial Production, 1950-65 (1950=100)

	1950	1955	1960	1965
All industry	100	176	248	327
Consumer goods	100	167	235	304
Capital goods	100	216	323	423

Source: Leaman 1988:109

By the 1958-72 period, German capital goods in particular were embedded throughout the industrial matrix of its European trading partners (Halevi 2016:377). The growth of export demand relied on this specific sector, as "[m]odernization of the French and Italian economies called for new capital equipment and this was supplied by Germany" (Carlin 1996:470). Within global value chains, essential inputs such as raw materials or, in a similar way, capital goods have a special place in shaping international trade given their "irreplaceable" nature in other country's own production processes. These types of export are less vulnerable to changes in prices given their indispensability, and this would play a part in the change in how the Bundesbank and German state supported exporters at the end of the 1960s.

One example suffices to show the importance of this "dual oligopoly," in which the capital goods sector combines a high degree of producer concentration within Germany and a high degree of market concentration in the European regional market. When the Deutschmark was revalued upward in 1969 and eventually allowed to float entirely in 1971 this did not decimate exports as some predicted: even in the face of the economic chaos of the 1970s, these

revaluations lowered but maintained, and soon even expanded, Germany's external surplus. Using an upward revaluation in this way was only possible because of the oligopolized nature of the export sectors and the embedding of German capital goods across Europe. Moreover, as Steinherr and Morel (1979) demonstrate, this process is self-reinforcing as revaluation tends to most benefit concentrated industries while lowering the profits of more competitive industries.

In sum, the hypertrophy of the export sectors in Germany was the result of state policy to suppress domestic demand while encouraging a very specific pattern of sectoral development, in interaction with the structural market power enabled by the German specialization in capital goods. The overall orientation of German foreign economic policy is consciously focused on liberalization and export-promotion but, as soon as the *domestic* side of affairs is taken into account, it is more specifically geared towards a relative dominance of export revenue above expenditures on imports; as per Kalecki, this margin represents pure profit for German firms. This is important but sometimes forgotten; saying simply that Germany is "export-oriented" does not explain why German policy to balance the current account has not been more aggressive. After all, it is understood that, since Germany is the largest export destination for most European countries, by increasing domestic demand and stimulating imports German exports could grow along with imports at an even pace. A balanced expansion of both exports and imports would leave the current account in balance and become part of a "virtuous circle" passing on growth and demand to everyone else. But instead, all drives toward safeguarding liberalization, toward revaluation of the Deutschmark, and even toward incentivizing imports via tariff adjustments have been undertaken in a fashion that never seriously imperiled the margin of export revenue above imports.

The Bundesbank: Stability, Competitiveness and the Use of Austerity

The precursor to the Bundesbank, the Bank deutscher Länder (BdL), was created by the Allies in 1948. It transformed into the Deutsche Bundesbank in 1958, its independence set out by the famous Bundesbank Law of the previous year (Leaman 2001:105). The real independence of the Bundesbank from government control, and the idea that this independence is a major component of German success, is taken for granted both in the political and business press and much of academia (Alesina and Summer 1992; Quaglia 2007; Tognato 2012:44-45). It is true that the Bundesbank has played a singular role in German development and the shaping of the European political economy; the admiration and awe is encapsulated by the well-known (if possibly apocryphal) remark by Jacques Delors: "Not all Germans believe in God, but all believe in the Bundesbank" (Issing 2002:9).[37]

Whenever the Bundesbank, headquartered in Frankfurt, and the Federal government, until the 1990s in Bonn, came into conflict "[o]ver interest rates, the Bundesbank has nearly always gotten the better of the squabble….On currency adjustment – where, in formal terms, the final decision on revaluation rests with the government – the Bundesbank has also, more often than not, finished on the winning side" (Marsh 1992:170). Yet any detailed look at the history of interaction between the Bundesbank, German governments, and external interests in EU institutions and trading partners shows that this independence and influence is often achieved precisely by being rarely relied upon, by the bank employing its powers at judiciously chosen

[37] The source of the Bundesbank's strength is sometimes portrayed as the simply the support of the German people, but again more knowledgeable scholars have specified that it is really the support of capitalist elites, especially those in the pages of the most influential conservative outlets such as *Frankfurter Allgemeine Zeitung* and *Die Welt*. When Manfred Lahnstein, State Secretary at the Finance Ministry, described his battles with the central bank he noted "I knew how difficult it was – because of the support it receives from the conservative press – to operate against the Bundesbank." (quoted in Marsh 1992:175)

moments, and is often hemmed in by the situation in the world market (Leaman 2001; Quaglia 2007).

Ascribing to the Bundesbank a detached rationality is plainly a mistake. Once we move away from such heroic narratives the bank's strategy, goals, and overall historical trajectory come into clearer view. Below I first note how the Bundesbank combined an eclectic mix of policy with deeper goals of stability and competiveness, making it a crucial coordinator of the industrial firm-bank combinations emphasized by variety scholars. I then note four important phases in the bank's history which resulted in growing power and influence: the way the bank contributed to the oligopolization in the 1950s, its role in allowing and aborting the wage-led expansion of the early 1960s, its turn to the strategic use of Deutschmark revaluation, and its distinctive and highly effective strategy for dealing with European integration. These phases, taken together, support the neomercantilist framework's contention that the Bundesbank was an integral component of a German neomercantilist orientation toward the rest of Europe, involved in both the maintenance of the distinctive German domestic economic model and the formation of Europe's regional economic institutions.

The Bundesbank wielded tremendous institutional influence, and in doing so provided a coordinating function to the tightly connected firm-bank combinations that dominated the export sectors. This influence was exerted through policy flexibility, and from the very beginning was unafraid to use "unorthodox" methods over and above using the traditional central banking tools of interest rate adjustment (Marsh 1992; Quaglia 2007). Like the Bank of Japan it often intervened directly by controlling the amount of credit the major banks create (Leaman 2001; Werner 2003). From a neomercantilist viewpoint, this is little surprise; these institutional powers are to be expected for central banks presiding over an economy centered on oligopolized, export-

oriented manufacturing sectors in which firms and large banks are tightly interlocked. This in turn meant that the Bundesbank was intimately involved in questions of *how* the firm-bank complex would attain financing and some of its actions over the postwar period were taken with an eye toward changing precisely this financing relation, a relation that variety scholars correctly note as crucial to the German ("CME") model.

Through it all, its chartered goal of monetary stability within Germany never wavered. The bank was free from any "dual mandate" that would force it to consider employment alongside monetary stability, and studies of Bundesbank policy preference over time show this stability bias was constant over the entire postwar period (Kaltenthaler 1997). Critical analysis of the Bundesbank's mystique (Leaman 2001; Werner 2006; Holtfrerich 2008; Cesaratto 2011) suggests the stability bias was *not* merely a cultural residue of the Weimar hyperinflation as often supposed. After all, it can be argued that memories of the disastrous deflation imposed by the Reichsbank in the early 1930s should have resulted in an opposite orientation. Instead, from the 1950s the Bundesbank was cognizant that lower wage growth and thus lower inflation in Germany ensured external competitiveness; this was reinforced by the close personnel links between Bundesbank staff and the industry-bank complex (c.f. the detailed profiles of Bundesbank staff in Marsh 1992). Wilhelm Vocke, president of the BdL in the 1950's, characterized this latter strategy as "keeping domestic affairs tight in order to strengthen exports" (quoted in Leaman 2001:115):

> "It turned out that after the first trade and currency liberalisation measures in the wake of the creation of the Organisation for European Economic Cooperation (OEEC) and the European Payment Union (EPU) as a condition for Marshall Plan aid, the government in Bonn and the central bank in Frankfurt chose and pursued a sort of mercantilist policy strategy. As protectionist tools could not be used in this period, when Germany itself was likely to profit from European and worldwide trade liberalisation, a different way of

> achieving mercantilism, namely export surpluses, had to be found. The solution was to keep domestic demand restrained by monetary and fiscal policies, thus keeping imports and domestic inflation low and freeing production resources for more exports. This strategy was contingent on a system of fixed exchange rates, without a self-regulating gold standard including freedom of capital movements. The early Bretton Wood system, without fully convertible currencies and with restrictions on international capital movements, left countries the opportunity to gain in international competitiveness by realising relatively more price stability at home than abroad" (Holtfrerich 2008:34).

In other words, the Bundesbank became the enforcer of a "stop-go" pattern of growth, threatening any expansion in which wages might rise, which might then lead firms to increase their mark-ups to compensate and cause price inflation. This also meant the central bank was carefully preventing the theoretical adjustment mechanism that a surplus should initiate, whereby the surplus increases domestic demand enough to bring down the surplus itself; "[o]verall, German economic policy was aimed at sterilizing the expansionary effect of its balance of payments surpluses and thus prevented them from having the expansionary effect that was necessary to restore equilibrium….[analysis of] national monetary policies in the 1960s…showed that the Bundesbank deliberately and successfully sterilized the expansionary impact of balance of payments surpluses" (Schwaag 1997:222).

It is clear that the bank had an explicit and equally early understanding of the use of demand restriction to defend and secure an external surplus. As often the case when analyzing institutional strategies, the earliest years are also when the strategy's progenitors were prepared to speak candidly; Vocke was explicit that "[r]aising exports is vital for us, and this in turn depends on maintaining a relative low price level and wage level … As I have said, *keeping the price level below that in other countries is the focal point of our efforts at the central bank*, and it is a success of those efforts. That should be born in mind by those who say to us: your restrictive

measures are too tight, are no longer necessary" (quoted by Holtfrerich 1999:345, emphasis added).

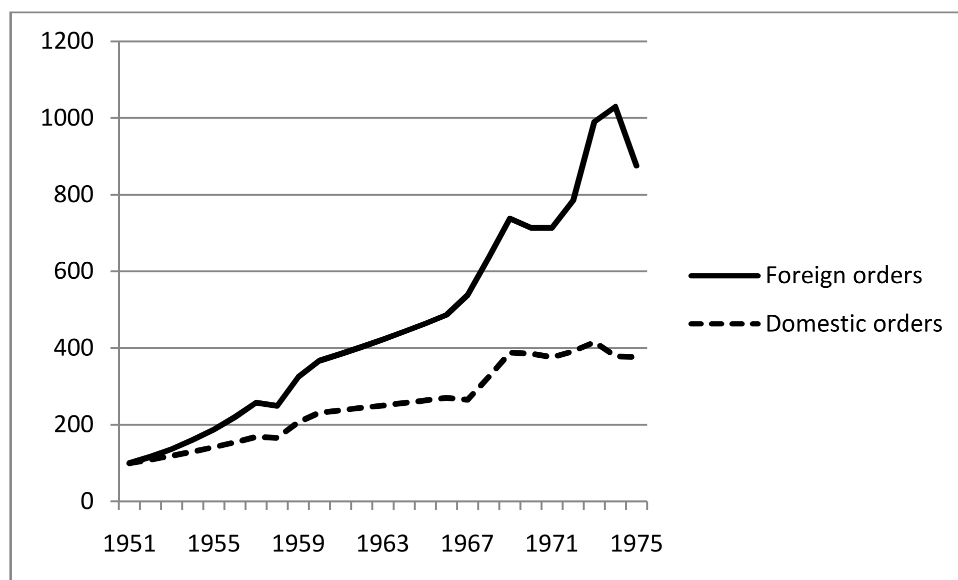

Figure 5.1: Volume of Germany's Foreign and Domestic Industrial Orders, 1951-1975 (1951=100)

Source: Emminger 1977

The power of this strategy is easily seen if we compare growth in German exports, not with imports, but with the growth of domestic economy. Figure 5.1 tracks the growth of domestic industrial orders against the growth of total foreign industrial orders from 1951 to 1975.In nineteen of those twenty-four years, the year-on-year increase in foreign orders was larger than the growth of domestic orders; in seventeen years, the foreign order growth rate was near or above double the domestic growth rate. The result was an increasing gap between the growth of domestic industry and exports, with the share of exports in German GNP increasing from 17 to 28.2 percent over the period (Emminger 1977:6).

The Bundesbank's imposition of a tight monetary stance at home, and the understanding of the relative advantages of such an approach, did not preclude it from encouraging a similar orientation within the domestic economies of its European partners. This is most easily seen in light of the notorious "economists vs monetarists" division, referring to the two opposed roadmaps for European monetary integration that surfaced in the late 1960s and especially with 1970's Werner Report, the first serious European Commission plan for unification. "Monetarists," not to be confused with the economic doctrine associated most with Milton Friedman, were the camp that held that a common currency or at least strong integration measures such as the pooling of reserve assets at the European level were a prerequisite of economic integration. The Bundesbank, instead, never abandoned the "Economist" position; a position often simplistically described as wanting economic coordination before monetary unification. Yet when viewed in light of the economic model imposed by the Bundesbank, in which domestic wage-led growth and its accompanying inflation was an anathema that must be quickly quashed by monetary stringency, the "economist" stance meant in practice that deficit countries must be the ones to shoulder the burden of adjustment given that the German economy and the Deutschmark would "arrive first" as the most stable "anchor" for the entire region. This, combined with the overall preference for trade liberalization, is the key to understanding the German penchant for "exporting stability to its partners" (Kreile 1977:35; Loedel 1999:75, fn87).

Yet this steadfast predilection for monetary stringency does not mean that Bundebank influence and strategy, both at home and abroad, does not have its own distinctive history. Indeed, from the EPU era through to the 1970s the bank's socio-political reach, as well as the strategies it deployed to safeguard its core goals, underwent a seismic shift. The institution's strategic orientation toward monetary integration and maintaining German external

competitiveness came to maturity by the time of 1970's Werner Report, the first large-scale policy inquiry and initiative on integration, and the turn to a floating Deutschmark in the early 70s. As a central institution with a longer time-horizon than election-concerned governments, there is a sense in which the Bundesbank took over key areas of economic policy from the government. In the 1950s the Bundesbank's stability policies were a secondary assistant to the government's industry concentration and export-promotion policies, while by 1975 *Der Spiegel* could declare that those helming the Bundesbank were "the real masters of the economy" (quoted in Leaman 1993:8). Karl Otto Pöhl, Bundesbank President from 1980-1991, admitted the Bundesbank in its ascendancy became "a form of state within the state – an economic policy counterweight to the government" (quoted in Marsh 1992:169). There are four phases to note in this process.

First is the way that the Bundesbank, in the guise of its prototype the BdL, helped build up the distinctively concentrated German export sectors in the 1950s. Bank insiders such as Emminger (1977) called the early EPU era a "happy combination – a so-called 'Mengenconjunktur' (expansion without inflation)" due to a chance combination of internal and external factors. As discussed in the previous section, the concentration of German export industry was enabled by Bundesbank credit and interest policy, combined with the government's own measures. Yet Emminger is correct to emphasize external factors, especially in regards to Holtfrerich's (2008) remarks on how the 1951 reversal of the current account deficit showed the bank that monetary austerity at home could "fix" current account problems. This milestone implies more contingency in both the formation of the export sector and the birth of the independent central bank than many variety approaches, with their functional interlock of "institutional complementarities," might suppose. The 1950s suppression of domestic demand

would have resulted in stagnation if not for the fast growth of world demand, the recycling abilities of the EPU, and US-led financial support. Years of contraction and faltering industrial sectors would have made the 1958 Bundesbank independence law unlikely, given that Adenauer's government was already at odds with the bank over its tight stance at several points throughout the decade.

The second phase runs from the D-Mark revaluation of 1961, where the D-Mark was revalued upward by 5 percent, until Germany's first postwar recession in 1966. This an important interlude because it represents a five year experiment in which the Bundesbank came the closest it ever has to *not* imposing a deflationary counterpressure on the growing economy. That is, from 1961 to 1966 the Bundesbank withdrew from actively responding to "dangerous" growth and, in a way unprecedented before or since, let a mildly inflationary, wage-growth led expansion take place. This "benign neglect," a result of both governmental pressure and the bank turning its attention to defending the newly revalued D-Mark, meant they put monetary instruments into "virtual hibernation until 1964" (Leaman 1988:137). The result was that between 1961 and 1966 the wage share rose and stabilized and new investment hit 16.2% of GDP, the highest levels in German post-war history. The current account registered a secular decline over the period, bumping along near zero from 1961 to 64 and dropping to a negative of over one percent of GDP in 1965.

Once it looked as though the external surplus was well and truly gone the Bundesbank reacted strongly. In 1966 it pushed up its base discount rate to 5 per cent and restricted credit in a way that sunk the then-ruling Erhard government, tripled unemployment, put an immediate stop to wage growth (Marsh 1992; Halevi 2016). Bundesbank President Blessing admitted soon afterward that he wanted to "put things in order with an element of brute force" (quoted in

Leaman 2001:141). Leaman (2001) marked this demonstration of power as “the beginning of a transition for the west German central bank from relative insignificance to politico-economic dominance at home and abroad” (p. 142).

The strategy paid dividends in terms of Germany’s external relations, as “[p]artly in consequence of the sharp domestic downturn, Germany's trade surplus in 1967 more than doubled to around DM 17 billion and increased further in 1968” (Wallich and Wilson 1979:483). Once again it was the quick rebound of the current account surplus that saved Germany from severe recession; Figure 5.2 shows the movement of the current account, the wage share and net investment from 1960 to 1969. The Bundesbank’s engineered contraction resulted in a sharp drop in overall investment from its highs in the early 60s, losing roughly five percent of GDP. Yet in that same year the current account surplus surpassed two percent per cent of GDP. The external surplus was especially important because the central bank removed its monetary brakes rather slowly, and the government budget began moving back toward a surplus from 1968; these two hurdles combined with the investment drop would have made for a more severe contraction in profits and growth without the surplus (Giersh *et al.* 1992:147). So it is true that the Bundesbank “tossed Germany into a recession” but not only, as Gray (2007) supposes, “in order to stave off price increases” (p. 297); indeed, Leaman (2001) notes that the Bundesbank already tolerated several years of inflation and only acted after 1965, the year the flatlining external surplus turned into a deep external deficit. This turnaround would set the path for Germany for a decade or more; from 1966 the external surplus would maintain a positive balance until 1978, cushioning the Federal Republic throughout the chaos of the 1970s.

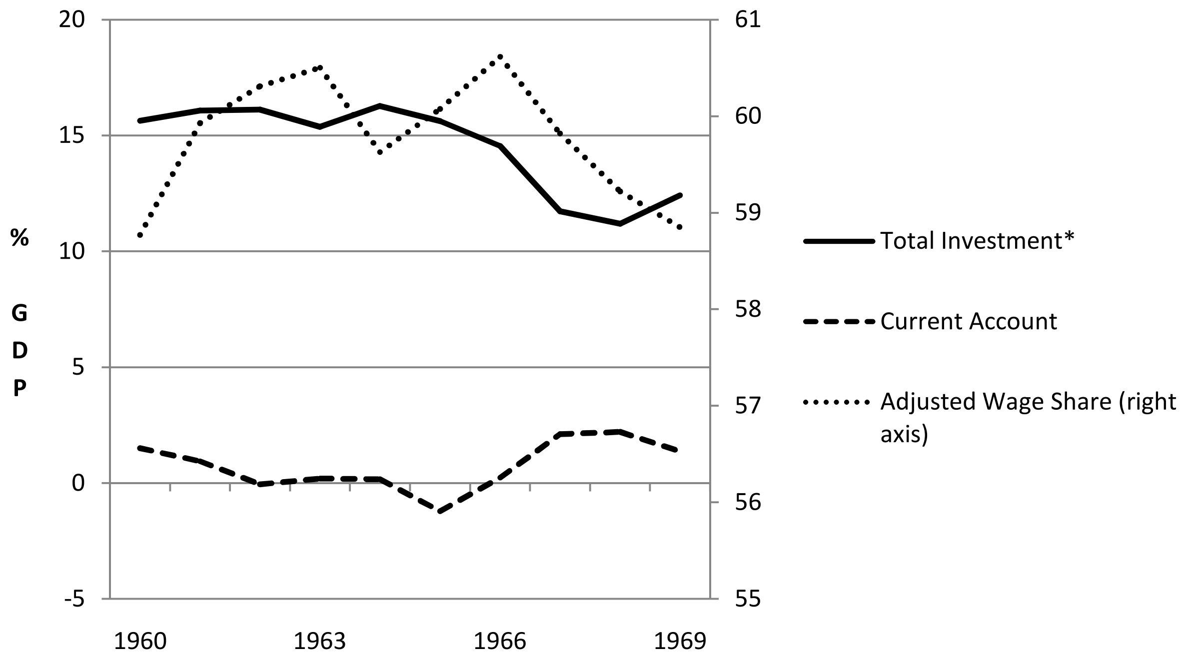

Figure 5.2: German Investment,* Current Account, and Wages as a share of GDP, 1960-69

*Net fixed capital formation, total economy
Source: AMECO

The return of the external surplus was thanks to the place of German capital goods in European production networks, the currency stability afforded by Bretton Woods, and simply the historical path-dependency of postwar development, and moreso than merely blunting recessionary policies it proved to be essential to the German social model. It is common to note that "union wage restraint, an anticyclical economic policy of the state, and most of all a dynamic foreign demand assisted the recovery" but, unlike a variety approach might surmise, the former two elements were enabled by the latter (Jacobi 1985:213). Despite the fact that over the entire period demand for labor outstripped domestic supply, German labor was quiescent until the very end of the 1969 when the real wage finally began a hefty increase. In the 1950s, as we have seen, this was engineered via inflows of East Germans, whereas in the 1960s this role was played by the *gastarbeiter* (guest worker) program. Indeed, the early 1960s upswing saw nearly 70% of all employment growth go to foreign workers, the majority in manufacturing and

construction, and working days lost to strikes over the 1960-70 period amounted to only two million days (Giersch *et al.* 1992: 130). This peaceful climate helped birth the Concerted Action initiative, formed in 1966-67 under the influence of Karl Schiller and bringing together labor, capital, and the state to create corporatist solutions to growth problems. Once again, without the external surplus aiding the post-1966 recovery this period of calm before the "storm" of labor activism in 1969-70 might never have materialized.

The Concerted Action plan, enabling centralized national bargaining on the vital issue of wage and productivity growth, opened the path to the 1972 workplace constitution law that expanded worker's council participation in large firm governance (Ramm 1974). Even allowing for the fact that many of these institutional innovations came under severe strain in the more turbulent 1970s, enough survived and became notable parts of *Modell Deutschland* for us to conclude that the surplus, and the measure of social peace it maintained despite the Bundesbank's contractionary policies, played an integral role in sustaining these practices.

One final irony was that 1966 was the same year an incoming Social Democrat-Liberal Democrat coalition government enacted a suite of Keynesian expansion policies, even while the Bundesbank had turned back resolutely to a policy of strategic domestic constriction and only very slowly allowed interest rates to fall. Thus the most serious Keynesian government effort in the postwar history of the Federal Republic happened in the latter half of the decade, missing exactly the earlier half in which the Bundesbank was uncharacteristically *not* committed to choking off any expansion led by domestic demand.

Whereas the 1966 recession revealed the Bundesbank's pace-setting power for the domestic economy, the third and fourth phases displayed moments of institutional learning which affected the bank's strategies in the coming decades. First, the bank grasped the tactical

importance of upward revaluation. The Bundesbank resisted the first post-EPU revaluation of the Deutschmark in 1961, but afterward the bank became an advocate of controlled upward revaluation and even floating of the currency. This "landmark episode" where the Bundesbank understood "how to harness the counter-inflationary power of a rising currency" is often portrayed simply as a result of Frankfurt's worries over the importing inflation and the large inflows of short-term speculative currency that were attracted to Germany thanks, in large part, to its reputation as a stable surplus country (Marsh 1992:38). The former issue was on the bank's radar quite early; Emminger (1977) admitted that some Bundesbank policies of the 1950s, seemingly designed to lower the external surplus in response to outside pressure, were undertaken just as much to ward off inflation from its trading partners whose prices were rising due to devaluation or their own domestic inflation (p.5).

It is true, of course, that revaluing the D-Mark upward or, better, allowing it to float helped ward off "imported inflation" and speculative capital inflows (Emminger 1977:38-39). However, there was a "shadow side" to this strategy: given the dominance of manufactured goods in the German exports, revaluation meant that the wide variety of imported inputs to German industrial production could be cheapened and export profits could be maintained even in the face of a stronger Deutschmark. Revaluation could, if undertaken in a way that did not diminish the structural "completeness" of Germany's industrial sectors, avoid "imported inflation" while simultaneously strengthening the German export sector in the long-run by reducing costs.

A simplified pricing equation, indicating how firms set a price as a mark-up over production costs, makes this clear. In the basic Kaleckian account of pricing, the average price in non-competitive sectors is given by $p = ku$ where average price, p, resolves to the average unit

cost of production, u, times the firms's average mark-up, k, itself a function of the degree of monopoly enjoyed by firms. In an economy producing advanced industrial goods, average price p becomes a function of this mark-up, the average wage w, and the average cost of raw material and intermediate inputs mp:

$$p = (k)(w + mp)$$

Rising input costs, which is "imported inflation" seen from the point of view of producers rather than consumers, can thus force firms to raise their prices, lower their mark-ups and thus profit, or attempt to lower wages in compensatory fashion. This last option was less an possible in the postwar environment, in which capital-labor pacts prevailed in developed economies. Yet while a stronger Deutschmark could, if its rise was not controlled, make German exports more expensive it could also protect industry from this rising input cost. In the oligopolized export industries, where concentration meant that the markup was imposed by and thus controllable by the large firms themselves, this drop in inputs could allow the firms to make their prices more competitive while largely maintaining unit profit while the low price elasticity of capital goods exports made it easier to weather any drop in demand due to a higher D-mark (Halevi and Kriesler 324-26). In other words, a nominal revaluation of the currency could achieve a real devaluation for exporters. Indeed, from 1964 to 1975 German import prices declined by nearly 30 percent in real terms. Figure 5.3 illustrates this sharp improvement in Germany's terms of trade from 1969 to 1974, attained by keeping a tight lid on rising import prices via successive Deutschmark revaluations. Volumes of exports over imports saw only a slight deterioration despite the higher export prices implied by the stronger D-mark, and the terms of trade improvement meant that when the first oil shock caused an unavoidable rise in German import

costs the terms of trade were only battered down to their 1969 level and not, as happened in countries such as Spain, pushed down to disastrous levels.

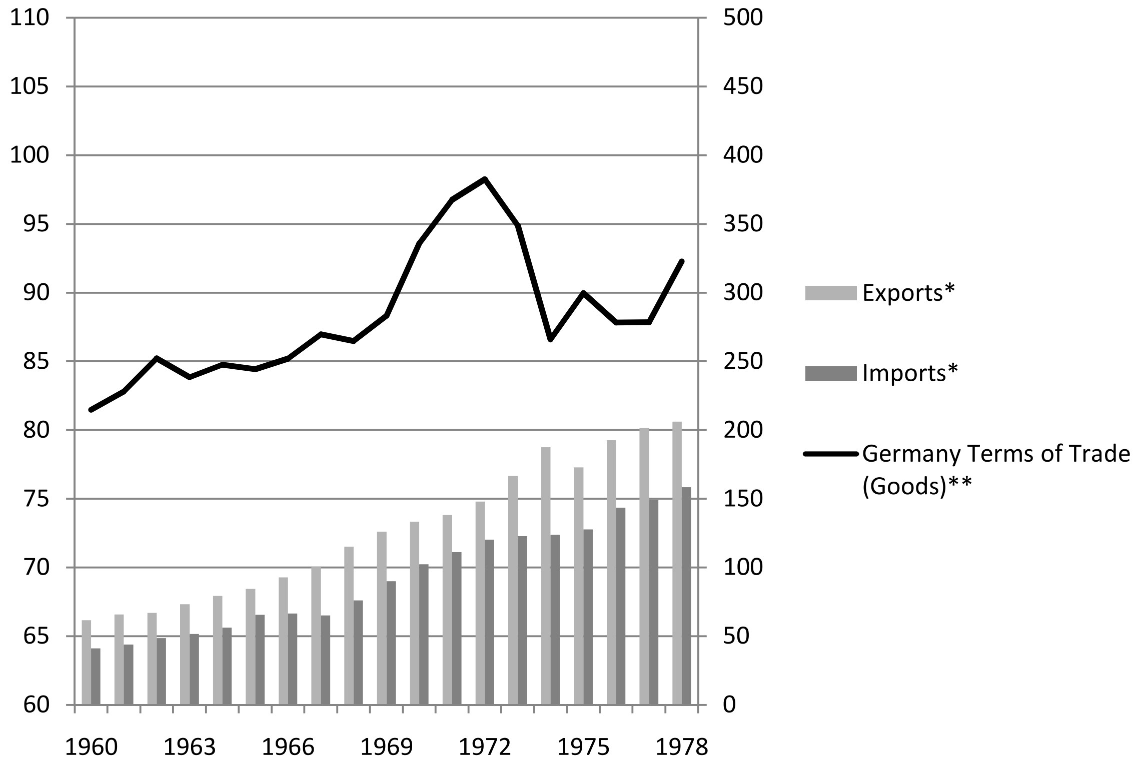

Figure 5.3: German Exports, Imports, and Terms of Trade, 1960-1978

*2010 prices
**2010=100
Source: AMECO

Though this strategy was soon undercut by Italy's devaluations, it allowed the preservation of the vital German capital goods and industrial sectors throughout the tumult of the 1970s, and blunted the impact of rising prices for both oil and intermediate inputs at precisely the same time other countries were being hard hit by oil shocks. It also preserved the long-term orientation of bank finance to the large firms. The strengthened D-mark and high domestic rates pushed German firms in the 1970s to use Euromarket sources for their short-term financing needs, freeing the domestic banking system to provide long-term funds for restructuring to their

closely-related firms and keeping the specter of domestic credit-expansion led growth at bay (Halevi 2016:381-84).

In this area we can discern a clear set of policy priorities used in response to US and French complaints about the size of the German surpluses. The bank first prioritized making foreign capital inflows less attractive, either through various measures to penalize inflowing capital or through contractionary policies which arguably aggravated the surplus by slowing German growth and thus imports. It came to also support various initiatives to ensure capital account outflows balancing the current account surpluses. If this second tactic had worked, Germany could have continued accumulating current account surpluses, booking those as profit, and compensating for the imbalance (at least over the long-term) according to their own preference in foreign investments.[38] Yet throughout its history the Bundesbank stood firm against attempts to increase imports through an increase in the German growth rate, worried as always about the inflationary effects.

Overall, however, controlled revaluation of the Deutschmark became the Bundesbank's preferred strategy for blunting the effects of self-reinforcing upward pressure on the currency, for restructuring and strengthening the core capital goods sector, and for lowering the price of imports as production inputs. Carlin (1996) notes that from 1973 to 79, when the Deutschmark was floating against major competitors in France, Italy, and the US labor productivity per hour in the machinery and equipment sector rose quickly from 90 (compared to the US=100) and by 1979 was 110.7 to America's 100 (p. 476). Rates prevailing in the following decade under the

[38] Moreover, this sort of process has the potential to further increase profits via the current account, as the foreign investments can provide both demand for Germany's own exports or, at the least, profits on these foreign enterprises are booked as a current account inflow. The former was recognized as a potential PR problem by the Bundesbank, but occurred on a large scale in the 1970s and made the current account surplus chronic (Halevi 2016).

fixed exchange rates of the EMS were much slower, suggesting the Bundesbank's strategy of using revaluation to affect industrial restructuring was successful.

Most importantly for our analysis of European institutionalization, the Bundesbank's success with controlled revaluation explains why it stood against each new phase of institution building, even against successive German governments and export interests. The final historical phase, overlapping with the bank's turn to revaluation and coming at the end of the 1958-72 era, encompasses the formation of Bundesbank's stance toward the stages of monetary integration. This means, in reality, its stance toward the construction of the pan-European monetary institutions, starting with the proposals of the Werner Report, the organization of the Snake, the EMS and subsequent stages. Kaltenthaler (1997) has demonstrated that this took on a highly distinctive, stage-like form from the 1970s onward. This can be best understood as a result of the interaction between the German federal executive branch, the export interests, and the Bundesbank.[39] The government had political reasons for going in on the fixed currency system again and again, with these political reasons encompassing both the demands of the Franco-German relationship and pressure from business elites. The export-bank nexus had economic reasons, given the short- and medium-term usefulness of both keeping the Deutschmark low and, especially, preventing competitors such as Italy from using devaluation to make their exports more competitive.

The Bundesbank, however, initially opposed each step. The most prominent reason is a question of simple institutional power and technical competency; it is unsurprising that the most independent and powerful central bank in Europe wanted to avoid becoming beholden to the

[39] Analysts of the formation of German foreign economic and monetary policy agree that the German legislature is largely ineffectual here (cf. Kaltenthaler 1997; Kreile 1977). As a result "peak associations focus their efforts to influence policies relevant to monetary issues on the executive and the Bundesbank and generally bypass the German legislature" (Kaltenthaler 1997:286).

monetary policy desires of foreign central banks (or, worse, governments). True to its "economist" orientation the bank was aware that its European partners were rarely (before the late 1990s) following what the Bundesbank regarded as sound monetary policies, and the Bundesbank was therefore wary of becoming the lender of last resort for the more inflation-prone economies of Europe. Yet whenever the prospect of fixing exchange rates across the region was on the table, the Bundesbank knew the D-mark must be the dominant currency in the system; in the early 1970s "[Bundesbank president] Klasen told central bank governors that the EMU process could achieve 'liberation from dependence on the dollar' only if the new system were to be anchored 'on one Community currency' – the D-Mark" (Marsh 2009:54). Similarly, once pan-European monetary institutions became a live option, whether as the support machinery of a fixed currency system like the EMS or as a true European central bank, the Bundesbank pushed hard for institutional priorities that would closely mimic its own. By the Werner group negotiations in 1970, Bundesbank representatives Karl Klasen, Johan Schöllhorn, and Hans Tietmeyer were the first to connect the "economist" demands that deficit countries take care of their own problems with the creation of an independent central bank that could enforce monetary austerity – "an early indication of German persistence that central banking independence had to be at the heart of EMU" (Marsh 2009:54).

This relationship between the government, export interests and the bank sector, and the Bundesbank thus determined the preferences of the dominant national power in pan-European negotiations. Bundebank influence came in each time in the "shaping" stage at which, if it could not ward off movement toward EMU altogether, its objective of "exporting stability" would finally come back into alignment with the deflationary interests of German industrial and finance capital (cf. Leaman 1988:215). The Bundesbank, at least once it had been converted to backing

limited floating of the D-mark, opposed to each institutional phase of EMU, given that it was convinced it could control the external situation by forcing adjustment on others and deploying revaluation when needed. In contrast, the industrialists themselves had a shorter time horizon, and joined with the German executive to again and again enter into EMU schemes rather than allow their competitors in France, Italy, and Spain to boost their own competitiveness via devaluations. The overall point, which will loom large in the following chapter's discussion of the EMS and Maastrict negotiations, is that once each EMU scheme was inaugurated the Bundesbank would hold the process hostage (with the support of the business community) and turn the institutional framework into an avatar of the Bundesbank itself.

The stance on revaluation and integration were major shifts for the Bundesbank but we must see this institutional learning in proper perspective. It was decidedly *not* a reorientation of the participants' values in line with some larger institutional matrix, whether global or Europ-specific. Instead, the generalized acceptance of Emminger's revaluation strategy by the bank was a rationally-implemented and continually fine-tuned attempt to strategically control the *structural* situation. The Bundesbank's base goal of stability and competitiveness did not change over the decades (Kaltenthaler 1997:272-74). In a similar fashion the bank "assenting to" and then holding hostage each phase of pan-European institution building was not the result of a new value orientation favorable to monetary integration. Indeed, as late as the 1990s a strong case can be made that the Bundesbank consciously torpedoed the EMS when it looked as though it was leading toward an accelerated timeline for integration (Hefeker 1994). Finally, as the neomercantilist framework would expect, the structural relation between Germany and the deficit areas, manifested as the tug-of-war over the external surplus, stands as the best candidate for the

prime causal element at work. Over five decades it remained the "fixed point" around which the strategies of the Bundesbank, the government, and the export sectors all revolved.

How does this steadfast "economist" orientation and strategic approach to shaping future EMU institutions sit with the field and variety approaches? On reflection it poses a puzzle at odds with the expectations of both. The field approach expects a converging institutional logic, and yet the above dynamic between the Bundesbank, German export interests, and the French and German governments the formation of each EMU regime looks more like a process of intergovernmental negotiation. In fact, it resembles the asymmetric imposition of institutional models over the objections of opponents in a way more commonly emphasized in world-systems analysis than the basic intergovernmental bargaining process. One indication of this is how steadfast the German strategy and the French-Italian counter demands were over the years; there is little evidence of learning insofar as this is conceived of as convergence of institutional preferences (Walsh 2000). Another is the temporal "choppiness" of the process, in which the government would open each phase of EMU initiative, often against Bundebank wishes, but then the Bundesbank together with the united business interests would dominate the next phase in which institutional forms were hashed out (Kaltenthaler 1997).

Meanwhile, the variety perspective's focus on the supposed internal causes of Germany's distinctive economy tends to elide the fact that the German model was, from the start, premised on the nature of Germany's links with others. The previous sections have shown that the careful cultivation of the export sectors and the politically-motivated construction of enabling institutions like the EPU. This impression is only strengthened in light of the strategic actions of the Bundesbank both to maintain this framework at home and, through its role in pan-European

institutional negotiation, defend and extend it via control of the institutions governing regional trade and monetary policy.

Turning the latecomers into the deficit bloc

As the neomercantilist model moved toward its mature form in Germany, the 1958-73 period saw future deficit bloc countries connect for the first time to the larger European structure. This connection resulted in growth and, very quickly, the bite of the external constraint as it became obvious that these economies could not function in the larger European arena without the danger of a constant external drain.

As a result "the less industrialized countries with the lowest real income had the largest scope for catch-up industrialization and therefore grew most rapidly" (Grabas and Nützenadel 2013:18). Figure 5.4 compares real GDP growth rates for selected European countries against the US; while Spain and Greece started out at a lower level we can see their growth outstripped Germany and the Netherlands after 1960.

The Spanish peseta devalued in 1967, following the pound, and the Portuguese escudo broke its dollar peg in 1971, with both currencies depreciating more rapidly as the 1970s wore on. The one clear conclusion for these countries in this period was, first, that their rapid social development did not save them from crisis brought on by the surplus-deficit channel, and second, that the ability to devalue their currencies was important in order to blunt the impact of these crises.

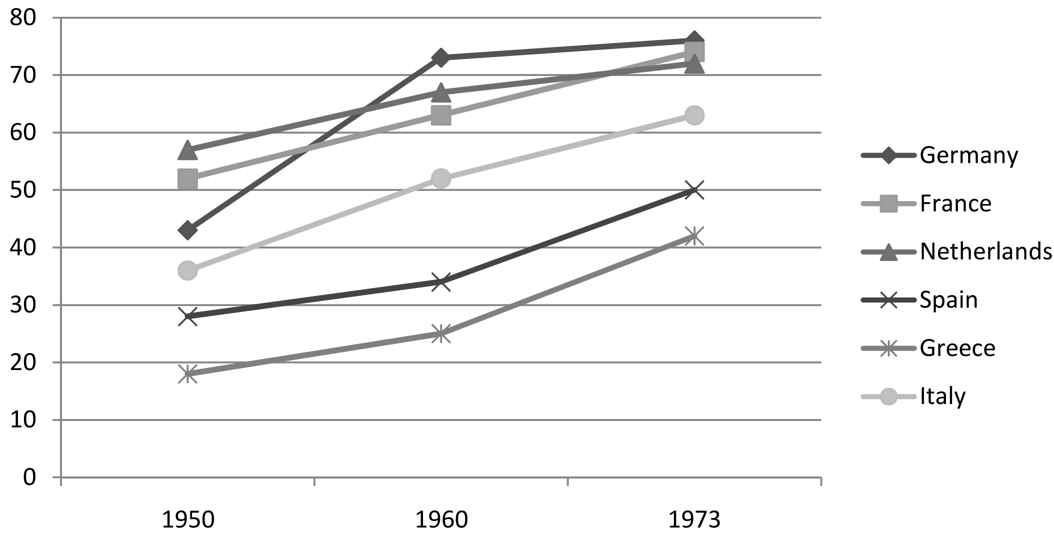

Fig. 5.4: Real GDP per capita compared to the United States, 1950-1973 (US=100)

Source: Grabas and Nütznadel 2013:17

Given the above, it is clear that the Italian, Spanish, Portuguese, and Greek "miracles" that followed the German miracle on roughly a decade's delay were not simply each country's own version of the German experience. Our discussion of Germany has shown cumulative causation at work: Germany's initial industrial focus facilitated an export-bias, leading to state and central bank policy supporting the export stance and hawkishly watching imports. Eventually, the entire social model came to depend on the ready availability of an external surplus in order to make such policies effective without social conflict. In a similar but larger sense cumulative causation characterized Europe as a regional whole, in which the initial German growth and industrial miracle set the boundaries in which the Italian and, later, Spanish and Greek processes could play out.

Table 5.2: Compound Annual Growth Rates of Real GDP per capita and Real Manufacturing Output, Selected European Countries 1950-73

	GDP	*Real labor productivity*	*Real manufacturing output*
Germany	5.0%	3.7	7.7%
France	4.0	4.7	6.5
Netherlands	3.5	3.7	6.9
Italy	5.0	5.2	7.5
Spain	5.6	6.0	9.6
Greece	6.2	8.4	-

Source: Grabas and Nützenadel 2013: 117-123, AMECO, author's calculations

Speaking in terms of the growth of productivity and manufacturing output again gives the flavor of a classical "catching up" process; overall productivity rates in the periphery are larger and less variable than the rates prevailing in Germany, France, or the Netherlands. But again this is an ahistorical way of describing the process, useful in one respect only: as an aid to counterfactual reasoning that helps us see the structural restrictions imposed by the region's division of labor. Much like the possibility of wage-led growth in the 1970s that was choked off by a combination of capitalist fightback and external price shock, one can counterfactually imagine that the patterns of growth in Spain, Greece, and Portugal could be the underpinnings of a successful catch-up process given their "miracles" recalled the fast productivity growth in 1950s Germany. This did not happen even with the advantages of *not* being locked into a monetary union, foreshadowing the later, larger problems the European periphery would face.

Spain's opening is particularly instructive. By 1949 Spain began receiving loans and assistance from the US, which increased with the advent of the Korean War as US planners saw the value of Franco as an anti-communist stalwart (Lieberman 1995:39). Throughout the 1950s "in view of the political hostility of Spain's major European trading partners, Franco sought the country's diplomatic reinsertion in the new post-war international order via Washington;" this

manifested mainly in the area of food and financial aid (Powell 2015:4). In lieu of capital equipment and technological know-how that could have helped update Spanish industry, the alternative was an import-substitution approach that yielded a domestically-focused economy with an average growth rate of 7.9% between 1951 and 1958, lowering inflation down to 4.3% from the high in the 1940s, even while exports as a percentage of national income fell by more than half (Lieberman 1995:43). By 1957 this led directly to a familiar external constraint: with little foreign currency earned via exports, domestic growth caused increased imports of capital goods and raw materials and kicked off a foreign exchange crisis. Moreover, this autarchic growth was accomplished on the back of a shrinking real wage; high profits made possible by reduced wages and investment maintained via government fiat, even as the domestic market stagnated.

The foreign exchange crisis coincided with student and worker unrest, and as a result Spain broke with autarky under the guidance of a group of *Opus Dei*-affiliated technocrats working with the IMF and OECD. Starting with the Stability and Liberalization Plan in 1959, a rapid Europeanization of the Spanish economy took place even though the formal connection with the European Community institutions remained in limbo (Powell 2015:6-9). The core of the Development plans, first introduced in 1962, was a reliance on foreign capital inflows to modernize Spanish industry, increased revenues from tourism, and incoming remittances from Spanish workers abroad. All three of these elements depended more on Spain's European neighbors than the US, resulting in both the "Spanish miracle" and, in an example of what would become a familiar pattern, deepening external deficits.

Institutionally, Spain was already beginning to be drawn into the orbit of the EEC, a trajectory that would be interrupted in the 1970s as Franco's government fell and the

supranational tendencies of the 1960s withered. Despite the fact that it never moved beyond a special trading status with the EEC in the 1960s, the structural processes outlined above and the failure of the competing Britain-centered "European Free Trade Area" (EFTA) kept Spain pinned to European institutions.[40]

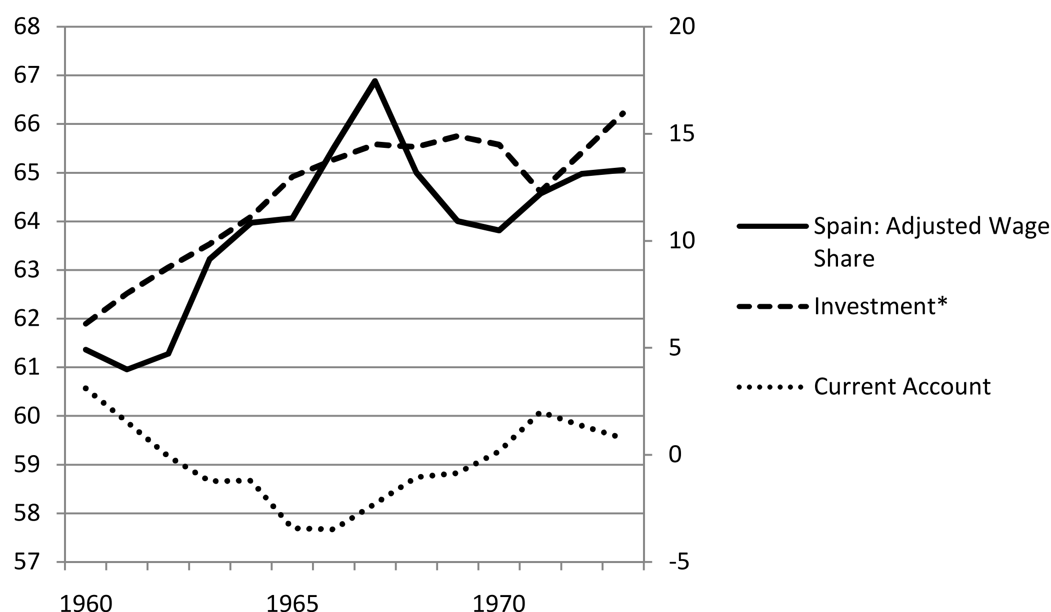

Figure 5.5: Spanish Wage Share, Investment,* and Current Account as a share of GDP, 1960-1970.

*Net fixed capital formation for the entire economy
Source: AMECO

Figure 5.5 shows the development of Spain's wage share, investment, and current account over the period. In Germany the wage share's only period of clear growth before the steep rise of the 1970s was in the brief inflationary growth period of 1961-64, and the 1963 peak of 60.5% of national income was not surpassed for the rest of the decade. In contrast, Spain's

[40] By 1961 it became clear the EEC was to be the only real game in town; Adenauer finally stood with de Gaulle to exclude the British from the EEC in 1963 but the very fact of that the British *applied* in 1961 made clear to all that the alternate EFTA institutions would be no match on the continent for the common market guaranteed through the EEC. This decision came down once again to the "grand strategies" that locked France and Germany into a tight embrace; as Adenauer said the decisive element was "not the relationship between [West Germany] and England, but the relations between us and France."

miracle growth years, as befitting their more domestic orientation, saw the labor share rise from 1960 until 1967, peaking at nearly 67%. Again, this is little surprise if we see the decade for Spain as one of domestic-led growth, with growth rates much faster than in Germany or the Netherlands in the same period, concurrently higher inflation and, in the same manner as Germany during the 1961-64 interlude, few current account surpluses. The difference, of course, lies in the fact that Germany already had prepared the strategy and current account "cushion" to impose austerity, such as in 1966, in order to safeguard the surplus. Spain, as well as Portugal and Greece, were already facing a milder version of the trap they would encounter in later decades. It was "milder" because Spain was not locked into fixed exchange rates, until the early 1970s global demand was still expanding rapidly, and growth was premised on a growing wage as opposed to a shrinking wage share; all three of these advantages would evaporate in subsequent rounds of European integration.

The chronic external deficits caused by growth, especially fast growth, contributed to public deficits. Given the tight interrelation between the external surplus and the private and public deficits, this presents us with the inverse of the German case. In Germany the state budget and social model was safeguarded by the ready availability of the external surplus; distinctive features of the social model such as the anti-inflationary central bank stance and the institutions of labor-capital partnership were enabled by the surplus' quick return and cushioning effect when applying austerity as in 1966-7. In contrast, in Spain growth lead directly to a deteriorating current account balance compensated by peseta devaluations after 1967, as can be seen below in figure 5.6. The incoming wage transfers from Spanish workers abroad covered up a yawning average deficit in goods and services trade of nearly 6% of GDP over 1960-75. A pattern of growth coming up against the external constraint was established, with Spanish authorities

having to impose austerity in 1967, 1970-71 and 1975 (Prados de la Escosura and Sanz 1996:381 fn38-9).

Spain's growth had highly successful elements, and these were often dependent on state direction of investment (Powell 2015). It is hard to see how this could have been otherwise; after all, fifteen years earlier Germany itself had undergone a long period of calculated and extensive state involvement as can be seen in the export- and industrialization-promoting efforts of Adenauer, Erhard, and the Bundesbank. It is curious to suppose that Spain could have "avoided" the kind of state involvement that later led to it being dubbed an MME in the variety approach, somehow attaining the same level of autonomous function as can be seen in German firm and labor relations of the same period.

This is an important supplement to my more fundamental point that, given the actions of the German state and central bank to safeguard the external surplus, a distinction between "autonomous" German CME institutions and "state dependent" MME institutions is misleading. Simply imagine what could have happened if global demand expanded throughout the 60s and 70s while the high value industrial goods and, crucially, capital goods producing "slots" in the world market were not already monopolized by Germany. An advancing semi-peripheral country such as Spain could have continued its expansion without encountering such a severe external constraint and may have quite possibly taken on a surplus-accumulating role itself, with the surplus "cushion" enabling a more autonomous German-style corporatism to take hold as the Franco regime ended.

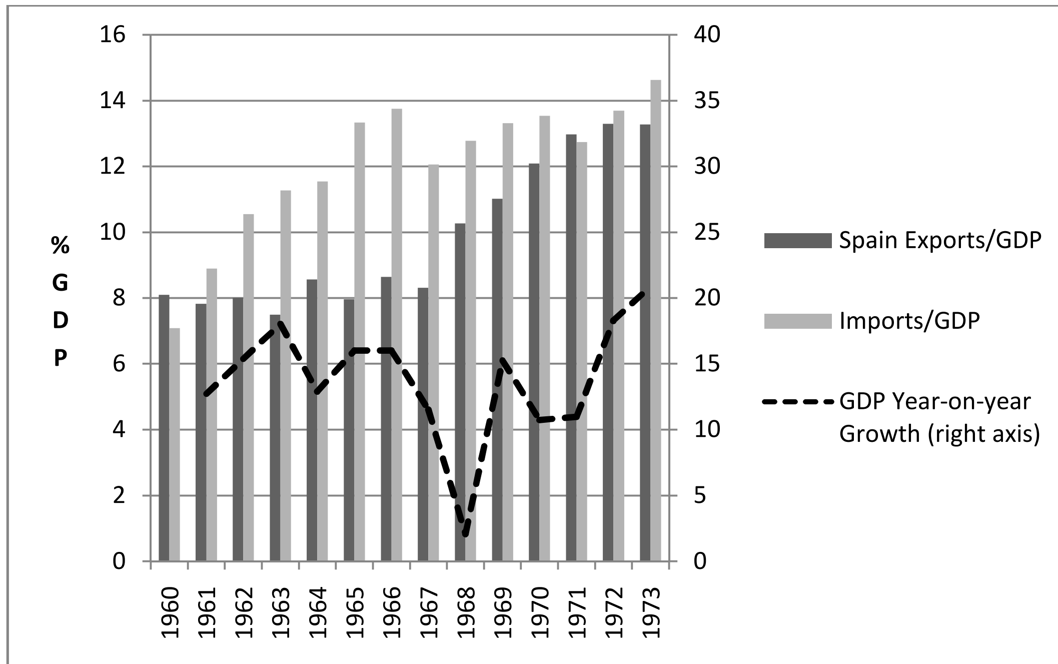

Fig. 5.6: Spanish GDP Growth, Exports, and Imports as a Share of GDP, 1960-73

Source: AMECO, author's calculations.

Once seen in this light, the delayed and then obstructed pattern of Spanish development casts doubt on the variety approach's hypothesis that MMEs are a result of the national society's internal qualities. The post-WW2 Golden Age, in which world demand expanded rapidly, investment was high, and Bretton Woods arrangements helped encourage managed trade only prevailed for a given period; it was, after all, only an "Age" and was definitively over by 1974. For Spain, Greece, and Portugal their delayed opening to the region's postwar expansion meant their fast 1960s growth spurts were limited by the places already occupied by the earliest developers, notably Germany, and the end of the Golden Age itself.

Spain simply followed the French (which was not far from, as we have seen, the German) model of state directed development, and did so quite successfully apart from the external sector. Overall "the French and particularly the Italian 'model' inspired largely the implementation by Franco´s authorities of the already mentioned regional development plans in Spain from 1963 onwards, representing perhaps the most prominent example in Western Europe for transnational

learning and transfer processes for the elaboration of national industrial policy designs" (Grabas and Nützenadel 2013:46). The following chapter will make further comparisons between Germany and Spain in terms of wage, price, and investment growth that show that even into the 1970s it was the external sector, and especially the ability to avoid current account deficits and currency devaluations that would make a major difference between the two economies. As Felipe and Kumar (2011:11) describe with regard to the external constraint on the deficit countries in the much later Euro era, the fundamental problem "is that they are stuck at middle levels of technology and they are caught in a trap."

The Political Economy of Revaluation under Bretton Woods

Our foray into Germany's export-dominated model and the workings of the Bundesbank places us in a position to understand the currency battles of 1958-72 and thus the end of Bretton Woods. While the 1960s are usually considered still part of the "golden age" of Bretton Woods, the problems that would cause the system to dissolve in the early 1970s became apparent "from the moment of full convertibility on current account transactions in 1959" (Garber 1993:461). While Garber (1993) focuses on the growth of liquid dollar holdings worldwide and shrinking US gold reserves, these two elements were intertwined and the regional situation; indeed, their effects were refracted through the surplus-deficit relations between European states.

Here I turn to focus on two dimensions of the revaluation battles: first, the global context in which US policy and European surplus-deficit relation interacted to worsen institutional conflict, and second, the institutional breakdown that becomes apparent as we move from the EPU to late Bretton Woods. Finally, I briefly narrate the German revaluations. Earlier sections showed realist

mechanics playing a role in pan-European institutions, and presented evidence that the domestic models in countries as varied as Germany and Spain were built, in part, around a certain relation to the rest of the region rather than being *sui generis*. Here, the aim is to show how the surplus-deficit structure of the region began to cause turbulence severe enough that, when paired with the global effect thrown off by US actions, institutional breakdown could occur.

The most important element of the global context was simply that expansionary US policy was worsening European imbalances. The US found it increasingly difficult to sustain its role as the system's anchor currency; with all others pegged to the dollar and the dollar itself to gold at 35 dollars an ounce, a "sound money" strategy would imply that the US must function as if it was under the restrictions of the old gold standard. That is, it should not issue paper dollars over and above the global gold supply, otherwise the other Bretton Woods members would be able to begin exchanging their (increasingly plentiful and thus less valuable) dollars for gold and. In other words, the US should have imposed contractionary policies on itself in the 1960s, to avoid either increased downward pressure on the dollar or, at best, leaving its OECD partners with growing dollar holdings that they could not put back onto the market (or exchange for gold).

Instead, the US sensibly refused to squeeze itself according to the deflationary advice of the gold standard advocates. Indeed, it went rather too far in the other direction; given the dollar's reserve currency status the US, unlike most other countries, could export large amount of capital even once its current account sunk below 0.5% of GDP after 1966. As a result, dollars were pushed into the world-economy through military spending, the current account deficit, and capital account outflows of foreign direct and short-term investments. This was compounded by the policy choice of lower interest rates in order to avoid choking off the expansion. The result was discontent over the increasing US multinational presence in Europe, and even moreso over

the out-of-control liquidity this supply of outflowing dollars created (Gavin 2004). In line with the political coordination embedded in the Bretton Woods system, a Gold Pool was established in 1961 in order to shore up the dollar-gold link after the price of gold began to rise alarmingly; this concerted selling of gold to keep its value down unraveled in 1965 when De Gaulle, under the advice of "hard money" advocates like economist Jacques Rueff, withdrew from the Gold Pool and the Banque de France began redeeming dollar inflows for gold (Marsh 2009:43).

One result was the burgeoning Eurodollar market, in which large offshore dollar holdings accumulated and began to be used for currency speculation. These speculative flows followed the surplus-deficit contours; when the French external deficit widened capital flight caused pressure for Franc devaluation, while the opposite end of these trades often clamored for the currency of a stable (i.e. surplus and low-inflation) country which was, of course, the Federal German Republic (Grahl 1997). At times the connection between revaluation pressures and the current account is even more direct, as careful analysts of the period conclude that "[d]espite all the invective hurled against anonymous 'speculators,' it was often corporations, both large and small, that were responsible for the lopsided capital flows…. Companies outside Germany hastily paid off their orders ahead of schedule, while German firms dragged out their own external payments" (Gray 2007:302). For deficit bloc countries the current account and currency pressures were intimately linked in a similar manner; the pressure on sterling did not abate with the 1967 devaluation but rather once the current account started showing a surplus, a process that took more than a year (Marsh 2009:46-7). The role of trade considerations as a major determinant of European state policies toward monetary integration have their roots in this period, and would become increasingly clear in the 1970s Snake and the 1980s EMS periods (Frieden 2002).

The second aspect of this era, institutional degeneration, is often missed by the convergence-heavy accounts given by field scholars. The rocky path from the EPU, to Bretton Woods convertability, to the late 1960s contention between Bretton Woods partners to, finally, the shattering withdrawal of the system entirely and its replacement by a monetary Snake without France or Italy seems at odds with the neoinstitutionalist assumptions that institutional expansion via increased interaction operates as the exogenous engine driving other developments. Instead, it seems to suggest the fragility of these global *cum* pan-European institutions, at least when the institutional rubber met the road of regional economic structure. In terms of formal institutionalization, while the consolidation of the EEC, ECSC, and Euratom under a single European Commission could be said to represent an advance, the Commission only safeguarded its existence by enshrining its policy *irrelevance* after the Empty Chair Crisis. In terms of institutional degeneration we can see political coordination, either of exchange rates or of domestic policy, and even simply adjustment symmetry beginning to slide off the table until, by the early years of the EMS in the 1980s, both would disappear entirely.

The Bretton Woods arrangements evinced channels for the politically-mediated adjustment of exchange rates and encouraged monetary coordination. This was more than merely a formal possibility; the informal institutional norms had real teeth but also encountered difficulties precisely because there was no automatic mechanism governing relations between the partners (Best 2004). The attempts by the US and the UK to get Germany to increase spending and revalue, the Gold Pool, politically negotiated offset agreements, and agreements between central bankers via the bank for International Settlements (BIS) were all short-term forms of

coordination (Best 2004:397-8).[41] Bordo and Schenk note both the presence and inadequacy of Bretton Woods coordination, at least from the point of those who demanded a more automatic framework:

> "The Bretton Woods system is an example of an elaborate effort at institutionalized coordination that failed because of fundamental flaws in the rules underpinning the system….Instead, a set of cooperative initiatives were deployed to prop the system up on an ad hoc basis until the convertibility and exchange rate rules finally gave way in 1973" (p. 16).

Symmetry was often assumed to hold as well, with pressure being brought to bear by those negotiating with Germany and German powerholders themselves taking steps to mitigate the surpluses (even given the German insistence on this occurring in non-expansionary ways) (Gavin 2004).

Two major moments of German revaluations took place in the 1958-72 period, one in 1961 and a series of revaluations-via-floating in 1969, 1971 and 1973. The 1961 revaluation deserves attention as a moment when pressure from the global hegemon, the United States, overcame what was, at the time, the consensus within Germany that no currency revaluations were needed. It is useful to bear in mind as a contrast to later decades, when Germany was strong enough to ignore US monetary and economic recommendations and deal with them separately from its own increasingly hegemonic policies within Europe (cf. Loedel 1999). By the end of the EPU, Germany undertook an attempt to offset the current account surpluses via the capital account – anything to avoid having to have wage and price inflation at home or more imports via

[41] There was, however, a sense in which the Bretton Woods capital controls themselves represented significant coordination; short-term capital flows "were considered disruptive to cooperation and coordination and were sacrificed to enhance domestic monetary policy sovereignty" (Bordo and Schenk 2016:14-15).

growth. This resistance had hardened into "a strong consensus within Germany's economic elite which saw revaluation as the least acceptable option" (127).

All three of the major players, the Adenauer administration, the Bundesbank, and the export interests represented by the BDI, broke under hegemonic pressure; "[r]evaluation, when it came, was an option resisted by both until the last minute and then forced on both by the 'hot money'-market and by the US-government as bloc leader" (Leaman 2001:137). Before bowing to the pressure, the Adenauer government tried all options to solve the surplus issue, with the proviso that the Bundesbank would not allow a simple and direct expansion. The government spent the massive surpluses it had built up under the EPU, the so-called *Juiliustern* ("Julius Tower"), spending on foreign loans via the IMF and military purchases from the US. This latter would be a hallmark throughout the 1960s, with strong US pressure on the Germans to offset their surpluses via such "offset arrangements." In the end, the 1961 revaluation came because of direct US pressure, delivered in a communiqué in which the German reserve accumulation through the surplus was accused of "splitting up the international community" and required instead "equitable distribution of international burdens" (quoted in Emminger 1977:14).

The second period of D-Mark pressure came in 1968-73, which resulted in the Deutschmark being allowed to float freely in 1969, 1971 and 1973. As the current account surplus mounted in 1968, attracting further speculative capital flows, the Bundesbank agreed to a revaluation even while it opposed the government's attempts to encourage imports (Hetzel 2002:44).[42] With exporters in the BDI again opposed, the SDP's Karl Schiller, head of the Ministry of Economics, tried to "enact a 'pseudo-revaluation' with a special tax on exports and tax allowance on imports" (Hetzel 2002:44). The Bundesbank, having learned its lesson in 1961,

[42] As will be seen in the following section, this reaction was in line with the Bundesbank's stance in 1961 (and in subsequent decades) in which they would resolutely oppose any solution to the chronic surplus that involved increasing imports or the German growth rate.

came out against this but, early on, in favor of revaluation. Over the next two years different actors at different times, including the Bundesbank, the CDU politicians in the Chancellery and the Ministry of Finance, and Schiller himself would go back and forth endorsing combinations of the three strategies of increasing imports through tariff reductions and liberalization, currency revaluation, or capital controls. While the incoming Keynesian-informed technocrats such as Schiller could tolerate some moves toward balancing the surplus, the original *ordoliberal* architects, who since WW2 had rarely come under fire for their export-led growth model, began to cast even the Bretton Woods political administration of symmetry as an attack on Germany. Erhard, though out of power by 1968, complained that "[a]ll countries that have lived beyond their means will put in the dock the one nation that has cared for stability, and make it pay the penalty, in a revaluation, for their sins" (Gerber 1969).

By 1969, the Bundesbank and SDP view won out, partially by attrition as CDU resistors like Chancellor Kiesinger left office. As we have already seen, the revaluation battles were the foundation of the Bundesbank's peculiar stance toward monetary integration in which it would oppose and then shape each institutional phase. Here, however, I emphasize that they also explain why the government and export interests, by and large, did *not* share the Bundesbank's enthusiasm. To both the government, with its short-term stability concerns and long-term "grand strategy" of reintegration, and the exporters, with their mostly short-term profit interests, the currency chaos of the floats demonstrated a vulnerability of the German model. Policy makers were again and again pressured on political and prestige grounds, often by their French counterparts, into demonstrating their commitment to being "good Europeans" by supporting integration. The industry-bank nexus, for its part, was wary of the D-Mark rising so much that it choked off exports entirely. This goes some way toward explaining why the government and

exporters became the two poles in the German polity in favor of integration, supporting the initial phases of the "Snake," the EMS, and the EMU against the Bundesbank.

Throughout these battles the Commission, if anything, proved to be an energetic but ultimately ineffectual advocate of monetary integration. As early as 1961 Monet's Action Committee, researching ways of avoiding monetary disturbances, had adopted Robert Triffin's plan for a European monetary fund to be used for countering capital flight (Lucarelli 1999:76). Moreover, the Commission advanced both a Monetary Committee, aiming to be a forum through which to coordinate central banking actions, and a Medium Term Economic Policy Committee in 1964. This latter organ had the goal of forming concerted five-year plans among member states, and was particularly ambitious in the 60s when DeGaulle and Gaullist anti-federalists were in power in France (Lucarelli 1999). Yet these small federalist advances proved toothless in the face of the large monetary disturbances that would unfold in 1967-72.

The Luxembourg Compromise blocked majority rule in the Council and revealed the limitations of the Commission, yet even after the Sterling crisis of 1967 the Commission put forward ambitiously worded statements recommending integration. These culminated in a series of integration proposals: the first Barre report in February of 1969, the previously mentioned Werner report in 1970, a second Barre report later that same year, and the Schiller Plan of 1971. These plans follow the tug-of-war between the "monetarists" grouped around France and the German "economists." 1969's Barre report attempted to split the difference between the two camps, avoiding talk of establishing a European central bank. Still, the proposed expansion of common reserve funds, a measure of adjustment symmetry, was too much for the Germans. The subsequent Werner report of 1970 also attempted this "parallel" approach, but was attacked by both the Commission and Gaullists because Germany, the Netherlands, and Italy managed to

have economist views enshrined in the report which recommended (or, more correctly, *assumed*) economic convergence prior to monetary union (Tsoukalis 1977: 91-110). The second Barre report soon followed, this time thoroughly monetarist and recommending the formation of a common European unit of account as the prerequisite to further integration (Lucarelli 1999:79-80).

The back and forth between economist and monetarist plans spawned a wide range of institutional ideas, some of which would be taken up and used in later decades, but Commission initiatives and responses to national policies were often ill-timed. After the first limited German float in 1969, flouting both Commission and IMF guidelines, the Commission "reacted with shrill alarm" (Gray 2007:303). Soon afterward, monetarist pressure roped German Chancellor Willy Brandt into narrowing the fluctuation bands between European currencies to a mere ±0.6%, just before the next large wave of speculative exchange rate pressure began (Gray 2007).

Thygesen (2013) points out the remarkable federalism in the Werner Report, noting that while it "was a very remarkable document" as a harbinger of regional over global economic institutional order, even while lamenting its limited institutional impact. The two most ambitious new institutional forms to come out of the Werner Plan were the Snake arrangement itself, which the next chapter will show quickly narrowed to a D-mark bloc, and the European Monetary Cooperation Fund (FECOM) (Thygesen 2013:19-20). FECOM was envisioned to be a reserve pooling operation that might, it was "hinted," become a functioning European central bank; in reality it existed as a meeting of European central bank representatives that should have at the least established some connection between national finance ministers, meeting in ECOFIN, and the central banks (Kindleberger 1985:457). But, unsurprisingly as the 1970s saw the spread of the idea of independent central banks as a central neoliberal tenet, FECOM members refused to

accept the “intended guidance” of finance ministers and instead became simply the technical administrative organ of the later EMS (Grahl 1997:57 fn5). In the face of continuing strain even the Werner Plan, by far the most promising of the bunch and formally adopted by all six of the member states, was a dead letter by the mid 1970s (Marsh 1992:232). Despite the welter of Commission ideas (and independent proposals that proliferated in the same period) then end of Bretton Woods, the oil shocks, and the dysfunction of the “Snake” left these ideas adrift until a very different political-economic situation presented itself in the 1980s (cf. Kindleberger 1985:458-9).

Of course, the federalists installed in the Commission had their own autonomous reasons for continuing the push for integration even though they had little real power; in this respect the self-expanding tendencies of the institutional matrix operated as the field approach might expect, but to little effect. Yet for the real engine of the Commission’s power, the French state, the benefits of a monetarist solution seemed impossible to ignore, trapped as they were by their own desire to keep Germany in a tight embrace and forge a European counterweight to what they saw as the inordinate power of the dollar. Outpaced by German economic might, French governments under de Gaulle and then Georges Pompidou from 1969-74 wanted the monetary support of Germany for the franc, such as the Commission proposals for pooling of central bank reserves so that France could draw on the massive treasure chest of accumulated Bundesbank reserves. Yet under de Gaulle and Pompidou this monetarism still had Gaullist roots and was in line with the idea of a federalist Europe not for its own sake but to guarantee *national* autonomy and, in the end, French security; even as late as the 1970s dueling economist and monetarist proposals Pompidou bridled at any German proposals that would limit the economic sovereignty of France (Marsh 2009:55-56). In the next chapter it will be clear that this pattern, of French grand strategy

energizing an otherwise weak Commission, repeated when the European Monetary System was formed in the 1970s, though with important differences due to the more neoliberal inclinations of then French President Giscard d'Estaing's motives.

Conclusion

The previous chapter set out the descriptive evidence for a long-running and increasingly severe divergence between the surplus accumulating countries, centered on Germany, and the deficit countries of the region that would eventually be unified under the Euro. This chapter began to fill-in that descriptive picture with empirical evidence that the surplus-deficit structure of the region shaped both the characteristic social models of European states, such as *Modell Deutschland* or the belated, state-led industrialization of Spain, as well as the shape of pan-European institutions.

The immediate postwar period saw the contingency of Allied occupation open a chasm between the prewar regional structure of Europe and the way that the regional division of labor would eventually settle out. Allied, and especially US, influence on Germany was pivotal in allowing the newly created Federal German Republic to take its place as the preeminent industrial power on the continent, smoothing out early financial difficulties that could have left it with an external deficit, and jump-starting the process of European institutionalization by pressing the French to drop their punitive demands and collaborate with Germany to form the ECSC. All of this, as well as the fairly non-CME-like aspects of Weimar Germany, suggests that, regardless if one is apt to regard the postwar German institutional model as endogenously generated, as the variety approach holds, or dependent on the country's place within the larger

regional structure, as in the neomercantilist explanation, the model itself was a creation of the post-1945 era and cannot only be ascribed to any static 19th century set of national qualities. This observation hold also for future deficit countries such as Spain, whose exclusion from the European economic network of the 1940s and 50s likewise represented both a radical shift from interwar developmental patterns and set the tone of the integration that would follows in the 1960s.

The development of European economic institutions, from the ECSC, the EPU, and the subsidiary institutions that would combine to form the Commission all evinced the marks of realist politicking on the part of the US, France, Germany, and Italy. Indeed, the role of the pan-European institutions was largely ineffectual if we look for signs of actions *not* clearly favored by powerful states, such as the EC's plaintive and ignored calls for monetary union throughout the 1960s. The Commission, effectively neutered after the Luxembourg Compromise, would not become a notable force again until the 1980s. Its major contribution was in the ideational realm, instigating the economist-monetarist debates through the Werner report and keeping the dream of deep European integration alive even as the political-economic situation made these plans increasingly unrealistic.

In the area of institutional frameworks, we can speak of an institutional disintegration or degeneration over the 1950-1973 period as the recycling and coordinating functions of the EPU gave way to inter-country wrangling over the state of their respective current accounts. While the Bretton Woods framework at least provided for political redress of exchange rates, encouraged attempts at macroeconomic cooperation, and carried some norms of symmetric adjustment on the part of surplus states, this already represented a regression when compared to the EPU. Finally,

this framework dissolved entirely, to be replaced by a period of even more fractious exchange-rate fighting in the 1970s.

Germany, the central pole of neomercantilism, was aligned with the Netherlands as a surplus bloc from the first post-EPU revaluation of the Deutschmark in 1961. Over the period it cemented both its distinctive export-led growth model, premised on German industries with a "dual oligopolistic" position both at home and across the continent, and the special role of the Bundesbank as a throttle on growth that ensured imports stayed well under exports. The 1966 recession displayed both the growing power of the Bundesbank, as well as the importance of the surplus itself in enabling the Bundesbank's contractionary policies to be undertaken without crashing the economy. The surplus thus also provided the foundation on which the corporatist institutional innovations of the later 60s, such as Concerted Action, could be constructed, and this paved the way toward the distinctive German expansions in worker-firm codetermination that would take place in the following decade. Overall, then, the neomercantilist core showed itself reliant on the external surplus both when it formed in the 1950s and in order to avoid embarking on a more inflationary style of growth based around expanding domestic demand.

At the other end of the spectrum, in the 1950s and 1960s Spain was already demonstrating that its development was, first, dependent on importing capital and technology from the European core and, second, bound hand and foot by the threat of an external deficit. The Spanish growth miracle of 1960-73 evinced more promise in this early period when "catch up" seemed a possibility, but the fact that it would be sharply constrained by its external balance in the next decade and always be forced into an adjustment mode already hinted at the dependency-style relationship it would later have with the surplus bloc.

To sum up, postwar European growth originated with a large degree of contingency; this throws doubt on the longer-term version of the variety approach which seek to portray the late 20th century regional division of labor as tightly bound by prewar conditions. This growth pattern was a result of political and institutional dynamics of the immediate postwar period, with Germany as the capital goods and industrial hub, France and Italy vying for second place and Spain, Portugal, and Greece excluded. But once set, there was a large degree of path-dependency in a structural, if not institutional, sense: the Spanish and Greek growth "miracles" could not simply recapitulate the German "miracle" given their delay meant that the North would be tend to be in surplus against their own deficits.

Still, the surplus-deficit structure of the region caused fewer problems in this period than it would later, and this difference is due to a particular institutional dynamic that is the inverse of that usually portrayed by the institutionalization narrative of the field approach. The field explanation looks from the ECSC, to the Treaty of Rome, to the expansion of the ECJ's reach and the consolidation of the European Commission in the 1960s, and sees a continual process of institutional advance driven by increased market and legal interaction. Yet as soon as we mark out some of the major monetary and economic aspects of each European state's *structural* position as influenced by the pan-European institutional framework, then we see a very different process of institutional devolution in which the inherent complications and problems thrown up by the surplus-deficit relationship were, in the immediate postwar occupation and during the EPU, administered politically in a more advanced manner than occurred later. Over the 1945-73 period this political and cooperative mediation of the surplus-deficit relation was gradually lost, weakening step-by-step as we move from the recycling functions of the EPU to the political exchange-rate battles of Bretton Woods to the 1970s.

Chapter Six

A Europe Safe for Surplus Accumulation: the Snake, the EMS, and the Path to the Euro

Abstract:

This second case study chapter runs from 1973 until the solidification of Euro plans after 1993's Maastricht Treaty. First, I show how the common context, a global turn away from the "national capitalism" of Bretton Woods and towards the anti-labor policies of neoliberalism, conditioned both surplus and deficit countries alike and influenced European institutionalization. The role of central bank-imposed austerity and the tactical use of unemployment are examined; given that these neoliberal tactics were facilitated by and, indeed, encouraged by pan-European institutions this serves as an additional critique of the field approach. Further, attempts to explain European dysfunction as rooted in differences in wage growth, common to both competitive disinflation and variety approaches, are shown to have both theoretical and empirical difficulties. In contrast to the institutional devolution outlined in chapter five, I chart an increasingly comprehensive sequence of pan-European institutional frameworks, presenting the monetary "Snake" of the 1970s, the European Monetary System from 1979, and the final plans for the Euro as again shaped by the concerns of surplus-deficit relations and becoming more restrictive of national autonomy at each step. Longitudinal charts of the sources of aggregate profit in important national economies, such as Germany, France, and Spain, are used to illustrate the increasing lock-in of members into the surplus or deficit blocs. The two processes established in chapter five, the increasing differentiation of European national economies due to regional surplus-deficit relations and the shaping of pan-European institutions by the strategies implied by this same surplus-deficit divide, are shown to be major determinants of the European situation going into the pre-crisis period after 1999.

"[The French] learned over a period of years a rather ironic lesson: that in order to stand up to the Germans, you had to be subservient to them – by following their lead in key questions of monetary affairs."
-Paul Volker

This chapter continues our analysis of Europe as a case of neomercantilist-influenced development, beginning with the post-Bretton Woods 1970s and ending with the first definitive plans for the Euro as laid down in 1992's Maastricht Treaty. As in the last chapter, my goal is to show how the surplus-deficit structure of the region shaped what are otherwise taken to be domestically-determined European social models, and at the same time exerted a strong, sometimes decisive, influence on pan-European economic institutions. Below I first set out some preliminary remarks on the overall trajectory of European growth and institutional formation going into the 1970s, focusing especially on the global move toward neoliberal modes of policy formation, and move on to address the supposed role of wage costs as an explanation for surplus bloc success and deficit bloc failure.

A look at Europe from the end of World War 2 until the mid-1970s might leave one with a feeling of retrograde motion. Starting with the utter chaos of 1945, a clear and orderly international and European architecture is put in place, with a fast recovery enabled by US programs, the EPU, and expanding global demand. The 1950s and 60s saw the creation and defense of the distinctive export surplus-led growth model in Germany, as well as the delayed incorporation of countries that would later become the deficit bloc. At least for the period of the

EPU, as well as under much of Bretton Woods when deficit bloc countries benefited from technological and capital transfers, it can be argued that Germany's concentrated growth was contributing to the continent's recovery.

Even as each country's style of growth, hinging on the presence or lack of external surplus flows, became more firmly set, the institutional order seemed to degenerate. The end of surplus recycling under the EPU pushed surplus-deficit problems to the forefront, and solving such issues under the remaining Bretton Woods framework became increasingly difficult until the system's dissolution in 1973. As will be seen below, the "Snake" that replaced Bretton Woods started poorly and then sputtered on, dwindling to become a D-mark zone without France, Italy, or the UK. In a parallel manner, we can say that European supranationalism had real momentum through the 1950s and early 1960s. Yet by the Empty Chair Crisis, the irrelevance of the Commission and the true nature of both the monetarist and economist strategies as vehicles for, respectively, French and German national interests became clear. This sidelining of supranationalism in favor of intergovernmental strategizing picked up steam once the states of Europe had to face the price shocks and working class revolts of the 1970s.

Despite all this, by 1978 a new round of pan-European institutional formation began as the European Monetary System (EMS) took shape. This can be best understood in the sense emphasized by Arrighi (1994): a phase of rebuilding occurring not in spite of, but because of and in reaction to, the failures of the previous phase. This encompasses, to be sure, strategic learning on the part of the major players. For example, Germany's approval of the broadened membership and automatic mechanisms of the EMS was, in part, the result of lessons learned from problems brought on by the non-automatic coordination of the Bretton Woods era, which made Germany a political target for revaluation demands, and by the Snake, whose narrow membership did little

to remove the threat of devaluation by competitors such as Italy. Yet it should be borne in mind that such strategizing was a reaction to the structural features of the regional economy, especially the increasing surplus-deficit divide, whose contradictions were heightened and tendencies more exaggerated by each institutional phase. While they assented to different institutional orders with each new round of pan-European institution formation, the strategic priorities of the surplus and deficit states in regards to this situation changed little over the decades. In other words, the increasing heights of the surpluses and depths of the deficits as seen in figure 4.1, and the increasing reliance of the neomercantilists' domestic social model on that external situation, were simply a deepening of the same relations and national strategies that existed from the early postwar period.

Seen in this way, the progressive loss of national autonomy in each phase of pan-European institutional formation makes more sense. The smooth recycling of the EPU could not be maintained given its origin as a stopgap result of postwar recovery and the realization of the gains Germany and France could make by regaining currency convertability. The political coordination of Bretton Woods could not be maintained given that the national advantages opened up by convertibility resulted in a tug-of-war for surpluses, which under the politically-managed Bretton Woods system empowered deficit countries to demand expansion or currency realignment of surplus countries. The reality of the surplus-deficit structure, and especially the strategic response of Germany to this reality, thus helped do away with institutional recycling or coordination. These two elements fell away as the surplus-deficit relation became even more pronounced in the 1970s, and with the formation of the EMS were replaced by a supposedly more automatic process of exchange rate adjustment based around institutional rules that were intended to make adjustment a symmetric process undertaken by both deficit and surplus

countries. This symmetry never operated formally, and even the informal symmetry present in the first few years of the system withered after the French turn to austerity in 1983. Symmetry would thus be the third degree of freedom to fall by the wayside; the EMS became a fixed currency regime that had ineffective recycling of external surpluses, little in the way of political coordination of economic policy or adjustment, and asymmetric adjustment burdens that fell disproportionately on countries with chronic current account deficits while allowing Germany and the Benelux countries to accumulate larger surpluses than ever before.

Overall, this stepwise narrowing of institutional options is explicable as a strategic demand of Germany and the surplus bloc, conditioned at times by global factors such as changes in US policy, and keeping in mind that the German strategy at each phase was formed from the interaction of the government, export interests, and the Bundesbank. The institutional framework converged, decade by decade, not toward some neutral equilibrium but toward the specific institutional contours of the economic and monetary union (EMU) of the 1990s. This was the one "solution" in line with the composite German strategy: a combination of a single currency in the Euro (the most extreme form of "fixed exchange rates"), liberalization of trade and capital flows, restrictions on the social spending and industrial planning capacities of each state, and a deflation-oriented European Central Bank modeled on the Bundesbank.

This naturally raises questions of motivation, as we must account for why other countries joined in on such institutional schemes. In the 1950s and 60s, of course, the more equitable features of the EPU and Bretton Woods, and the undeniable gains to be had from being plugged-in to reviving European trade networks, were enough to make closer pan-European institutionalization attractive for countries in both the surplus and deficit blocs. For the deficit countries other than Italy, all relatively smaller European states with few trading links with each

other when compared to their connection to Germany, the threat of being left out of pan-European institutions carried with it the threat of being shouldered out of European markets; this threat was made explicit from the 1980s (Pedersen 1998:111; Ziltener 2000). It is also clear that one major causal factor was simply the nearly unilateral imposition of elite preferences for joining and remaining committed to pan-European institutions, and Fligstein (2008) has rightly emphasized that pan-European institutional membership was recognized early on as a net economic gain for government elites and professionals.

Moreover, the rise of neoliberalism as a general *social* strategy employed by elites provides us with an additional, perhaps more important, reason. The economic and political upheavals of the 1970s resulted in the abandonment of the nominally Keynesian orthodoxy that had reigned under Bretton Woods. What Fred Bloc (1977) usefully termed "national capitalism" had combined capital-labor-state pacts, highly managed international institutional frameworks such as Bretton Woods itself, and a weak form of demand management built on an uneasy fusion of Keynesian and neoclassical economics. As we have seen, under institutions such as the EPU this could help jump-start virtuous cycles of national growth, enabled and stabilized by the managed trade linkages between countries. Yet after the 1970s, when labor made huge gains in terms of the national distribution of income in almost all the economies of Europe, the near universal drive by elites to reverse these gains became a core tenet of the neoliberal "movement," such as it was. A look at the long-term trajectory of the wage share, as in figure 6.1, makes this plain.

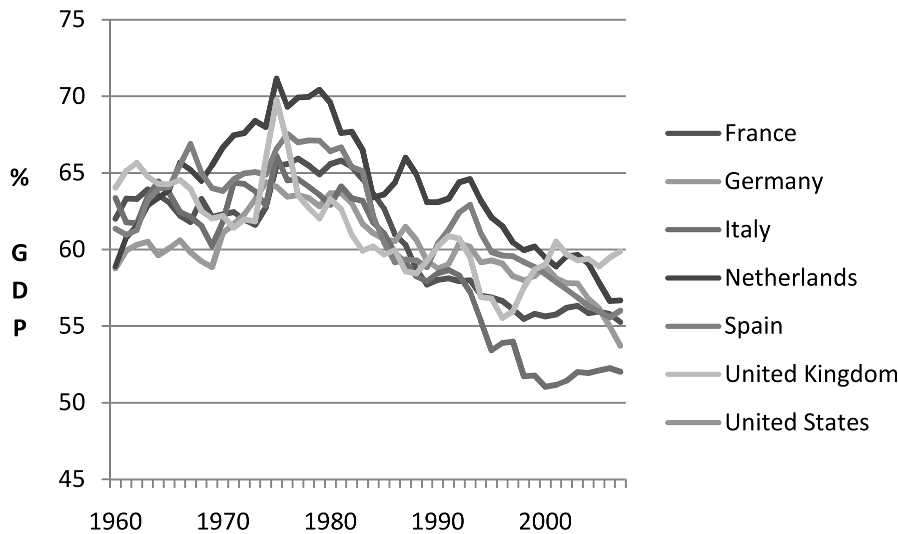

Figure 6.1: Wage Shares in Selected Countries, 1960-2007

Source: AMECO

The 1980s devolution of the EMS and movement toward the Euro should thus be seen as part of the long fightback against labor and for increased profit shares. Putting a leash on "excessive" wage gains became a central plank of neoliberalism, itself "a pastiche of policy prescriptions united by an organizing theme: the liberation of market forces to achieve economic growth and prosperity" (Babb 2007:128; Baccaro and Howell 2011; Tridico 2012). Mudge (2008) has emphasized how neoliberalism as a political phenomenon cut across the traditional right-left divide; in Europe this saw both conservative Christian Democrats and Socialist parties take on neoliberalism's market-based foundational assumptions, and equally entailed a turn away from "Euroskepticism" and toward embracing pan-European institutions (Miró 2017). Reversing the postwar wage gains thus provided a compelling reason for a united front of Europe's center right and center left to continue joining these institutional schemes even as they became more restrictive. On both anti-Eurokepticism and the need to discipline labor (the latter often couched in the language of "inflation-fighting") the large parties of the left and right converged towards a

market-based center and marginalized left-and right-wing Euroskeptics. Over and above concerns with controlling inflation, which in any case ignored the role in corporate mark-ups and monopolization in causing inflationary pressure, redistributing national income in favor of capital was explicitly justified as a variant of the "competitive disinflation" theory in which lowering the wage share would allow larger profits which, it was assumed, would be translated into higher investment and better export performance. In addition to state-imposed labor market liberalization (cf. Howell 2015), central banks were crucial to this process as they used high real interest rates to induce recessionary conditions, causing unemployment to rise and as a result slowing wage growth (Black 1985).

This use of unemployment can be seen by comparing interest rate changes to unemployment levels as in figure 6.2. Across the developed world this pattern played out in a manner so obvious that even those highly critical of labor's 1970s wage gains concluded that "the wresting of cooperative behavior from labor by means of the mailed fist of high unemployment suggests a return of the days of the nineteenth-century robber barons" (Black 1985:17).

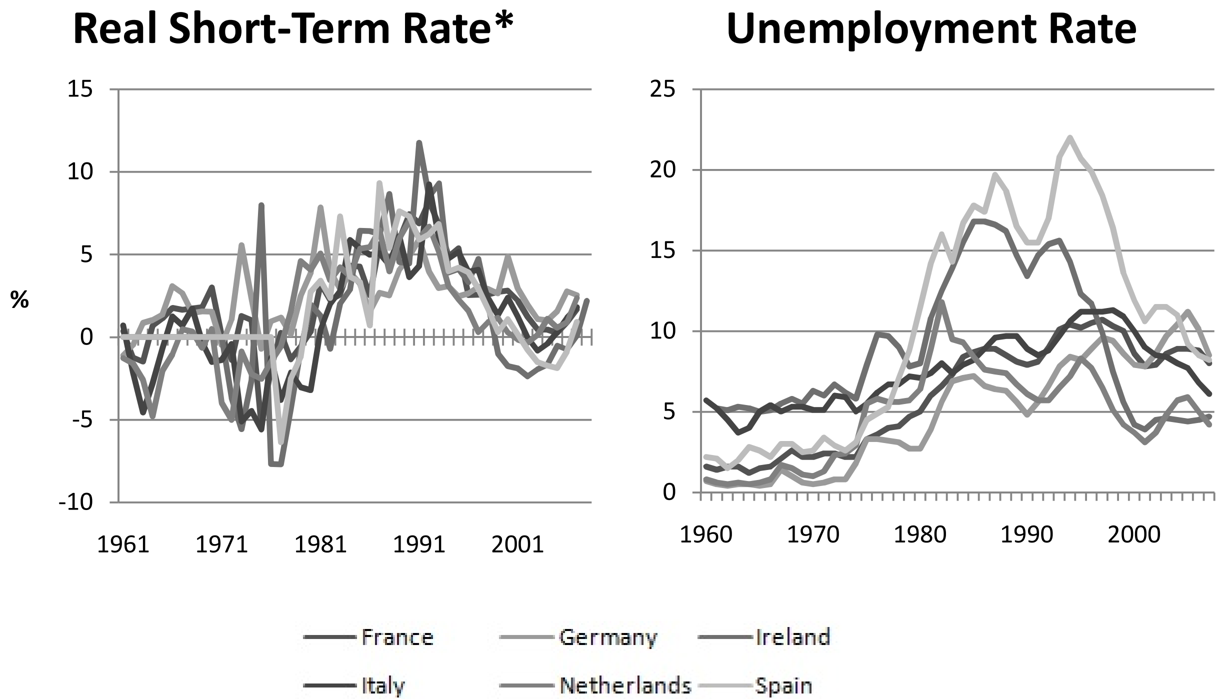

Figure 6.2: Real Short-Term Interest Rates* and Unemployment in OECD Countries, 1960-2007

*GDP deflator
Source: AMECO

In Europe, this process came fully into view in the 1980s as the EMS pushed all central banks of member states to match and exceed high Bundebank interest rates, the emerging neoliberal consensus recommended a uniform austerity-based growth strategy on any member having current account difficulty, and the internal market was completed with 1985's Single European Act. From the above we can see that the austerity applied from the late 1970s and through a good part of the 1980s resulted in mass unemployment, leaving an unemployment overhang that persisted throughout the 1990s and permanently altered the balance-of-power between labor and capital (Potts 2001). This in turn resulted in the wage share curve seen in figure 6.1, peaking in the mid-1970s and continually declining from the early 1980s onward. Given that these first steps of the neoliberal strategy worked so smoothly, how well did this

redistribution of income away from labor stimulate investment? Leaman (2009), in a retrospective on the German experience which could be generalized to the OECD as a whole, summarizes both the aims of this project and its ultimate failure:

> "Since the beginning of the 1980s, German economic policy has instituted supply-side measures of cost-relief for private companies which have resulted in an historically unprecedented redistribution of national income in favour of the owners of capital as inducements to invest. The profitability of German enterprises has been continually enhanced in the hope that enterprises might deploy their additional profits in additional capacity and additional jobs. The twenty-five year experiment has failed: the profits ratio has risen, but the investment ratio has declined" (p. 185).

Other analysts of the same process across Europe concur that the promised investment, and thus employment, failed to materialize (Fittousi 1993; Weiss 1998). Germany makes a particularly apt example because Germany took the earliest lead against labor's income gains, with the Bundesbank using unemployment to, in its own words, "chasten" workers and thus suffering a relatively small jump in the wage share when the first oil shock arrived in 1973 (Johnson 1998:94). Germany's trailblazing strategy preceded the later anti-labor turns in the UK, US, and France; the political establishment across the OECD then took this strategy and ran with it, where the "fight against inflation" everywhere came to mean the slowing of wage growth through sustained unemployment. Theoretically, the shrinking wage share, which is the result of real wages growing more slowly than GDP-per-employee, should have resulted in more "substitution of labour for capital" (i.e. employment) but, in all the developed world, "there was still no observable substitution of labour for capital, at least to an extent that would restore earlier employment levels" (Weiss 1998:90).

One prominent alternative method for keeping wage gains from causing accelerating inflation is the creation of "social pacts," tripartite agreements in which governments join with representatives of firms and workers to hash out a sustainable (or even increasing, if carefully

controlled) wage share level. This sort of agreement would either force capital to forgo raising their unit markups to win back amounts lost due to the higher nominal wage bill, but can become ineffective at stopping inflation if firms grant wage rises but raise markups anyway. Germany again was at the forefront, and made an ambitious attempt with Schiller's Concerted Action program in 1967. By 1970 German workers had come to feel that the policy was keeping wages bottled up while German firms won huge profits abroad. The result was an unprecedented wave of both legal and wildcat strikes and, soon afterward, large wage gains. Germany thus went from a showcase of one of the first and most ambitious tripartite policies in 1967 to one of the earliest monetarist u-turns as the Bundesbank slammed on the breaks only a few years later.

Given Germany's economic weight, this created structural pressure on the deficit bloc (and precarious surplus members such as France) to follow the German example. This pressure aligned with elite sentiment in each country that was looking for a way to stop burgeoning worker power, in both a political sense and in terms of the division of national incomes (Baccaro and Howell 2011). For France, Italy, Spain, Portugal, and Greece the strictures of pan-European institutions came to be seen as unavoidable in the face of global pressures, necessary to ensure access to markets, *and* an effective way of pushing down wage shares via austerity. The resulting turnaround in labor's strength was so complete that by the 1990s, when tripartite agreements were again proliferating, they were now used as a tool for suppressing wage growth in an attempt to conform to what was, by then, the widely accepted neoliberal prescription for growth (Baccaro 2011; Culpepper and Regan 2014; Tridico 2015).

As will be seen later in this chapter, the crucial moment came in the early 1980s with the breaking of France on the wheel of monetary discipline. The surplus-deficit relation became the central axle of this wheel, supporting arguments that austerity was the only viable strategy for

European countries. The worsening French current account of 1981-3 was the spur to austerity, and thus was a major structural obstacle to wage-led growth and, when suitably exaggerated by the economic orthodoxies of the neoliberal era, the main theoretical justification for why wage-led growth was impossible. In the French case the weakest member of the surplus bloc was made into an example that sent a clear message to the rest of the continent, one summarized by Volcker's quotation which opened this chapter: weathering German hegemony required other European societies "to be subservient to them – by following their lead in key questions of monetary affairs."

This common desire to reverse wage gains stimulated European integration efforts in both surplus and deficit countries and would, when interacting with the different external situation faced by surplus or deficit countries, throw off very different social effects. For the surplus countries, stagnating growth as wages and investment shrank, sustained by profits from abroad. For the deficit countries it resulted in fast but fragile growth when capital inflows, winding down their national savings, or debt increases were available to finance the growing external deficit, followed by crises when any of these dried up. As will be shown, there is little room in this process for a simple account of "out of control labor costs" in the periphery and "cost rectitude" in the core.

This conclusion is bolstered when comparing nominal unit labor costs (NULC), an oft-cited competitiveness measure that represents the ratio between the wage rate (pay per worker) and labor productivity (quantity of output produced per worker). The divergent growth of NULC is often cited as both the reason for, and proof of, the deficit bloc's responsibility for the post-2008 crisis (e.g. Boltho and Carlin 2013). Figure 6.3 tracks nominal unit labor costs in Germany and Spain, alongside the manufacturing-only NULC, over the entire 1960-2007 period. The

paths of each country's economy-wide NULCs differ widely, even keeping in mind Spain in 1960 (the reference year) started from a lower development level. It might seem, at first glance, to justify the presumptions of an out-of-control European periphery. Yet looking at NULC only in the manufacturing sector, the trajectory of both Germany and Spain becomes quite similar, with both starting to flatten in the 1990s. The picture that emerges is that differences in NULC, to the extent they exist, are felt most in the non-core manufacturing sector where Spain's NULC increases far outpace Germany's. In turn this implies that, at least in the manufacturing which makes up the bulk of both German and Spanish exports, we cannot rely on an assumption of uncontrolled wage growth to explain the fate of deficit bloc.

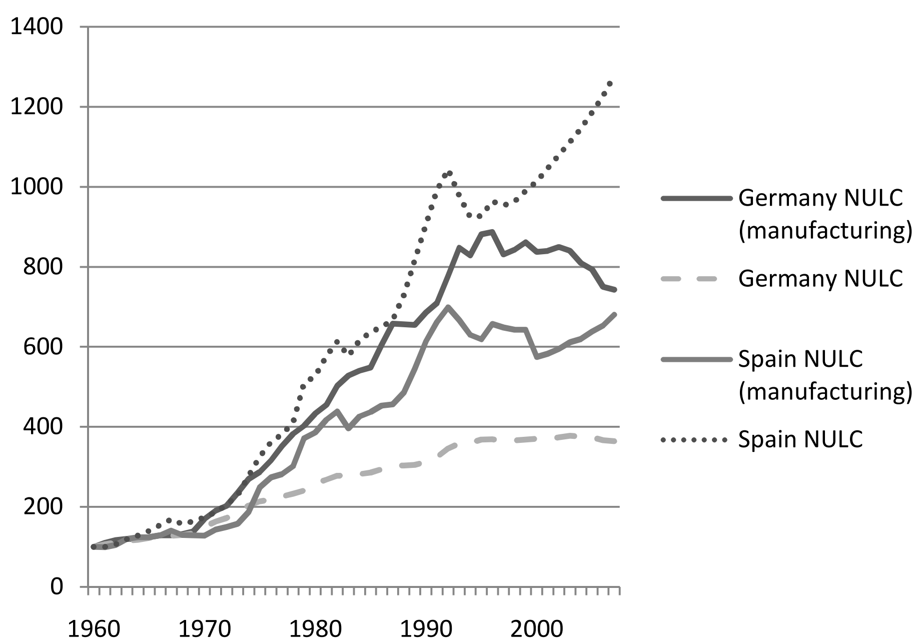

Figure 6.3: Total and Manufacturing-only NULC for Germany and Spain 1960-2007 (1960=100)
Source: AMECO, author's calculations

Over and above these initial doubts, it is surprising so much attention has been focused on wage differentials given the inadequacies of NULC measures. Most glaringly, they measure

the combination of both the wage *and* price effects such that any country with a positive rate of growth and inflation should *expect* increasing nominal unit labor costs, unless the wage share is falling even faster than the rise in the price level and labor productivity. In other words, slowing or falling NULC in periods of growth simply reflects the outcome of domestic class struggles between capital and labor (Felipe and Kumar 2011).

This implies, first, that the gap between German and Spanish economy-wide NULC, even as manufacturing NULC evince much less difference, is less a function of out-of-control wages in Spain and more a result of the higher Spanish inflation rate. Second, it suggests that telling deficit countries to lower their NULC relative to slow-growing NULC countries such as Germany, essentially recommending a flat or even shrinking NULC index, is misguided and dangerous. If the NULC is flat or declining in a situation of growth and inflation, wages must be rising slower than the rise in prices (set, after all, by firms via their mark-ups over production cost) and thus there must be an erosion of real wages and the wage share of national income.[43] In other words, embedded in the very notion that peripheral countries like Spain need slower growing or falling labor costs is a definition of "success" that means transferring national income from labor to capital. This is nothing other than an austerity doctrine in fresh clothing.

This asymmetry, assuming that the very countries losing demand via current account deficits must lower their wage shares, is brought out *a fortiori* once we remember that each deficit country's position *qua* deficit country contributes to their risk of a rising NULC. Price changes can make the *nominal* unit labor cost rise even when the *real* unit labor cost, the wage

[43] Also elided in all of these discussions is that pricing is set via mark-up in oligopolized industries, as mentioned in chapter two. Thus whereas most discussion regarding inflation within variety scholarship has focused on the "problem" of wages rising higher than productivity, we should keep in mind that the only reason this is translated into inflation is the ability of firms to preserve most or all of their mark-up. In other words, "If workers were simply to receive a higher share of national income, it would follow that lower unemployment and higher wages need not cause unemployment at all. It is therefore always and everywhere the case that capitalists, not workers, directly cause inflation when unemployment falls" (Pollin 1998: 9).

share, is falling; these price increases are caused both by firms raising their markups to compensate for wage gains and, for the deficit bloc, the increased costs of imports that occurs when their currencies depreciate. But, of course, deficit countries are precisely the ones which most require devaluation of their currencies and thus struggle with rising import prices. In other words, the trap they are caught in is exacerbated precisely by being caught in it.

The above points mean that the increasing external divergence between the surplus and deficit blocs cannot be understood in terms of diverging NULC. In the end, it merely indicates that the two countries had different rates of inflation. Indeed, as Jesus Felipe and Utsav Kumar (2011) point out, one would be equally justified in creating a "nominal unit *capital* cost" measure which, combining the declining productivity of capital over the decades and the price effect in each country, would blame out of control firm pricing rather than wages for the divergence between Germany and Spain.

What of the idea that differences between surplus accumulators and those mired in deficits are due to the surplus country being abstemious, forgoing consumption in favor of investment? This is equally hard to maintain, especially for this chapter's time period. Between 1979 and 2007, German labor productivity grew an average of 0.94 percent annually compared to Spain at 1.4 percent. While Spanish consumption as a portion of GDP started out at a higher level than Germany (65 versus 57 percent) it fell steadily, converging toward the largely steady German level and meeting it by 2004. Over this same period, despite a similarly falling wage share in both countries, only Spain saw a steady rise in yearly new investment: climbing from 9.8 to 15.9 percent of GDP. Germany, in line with neomercantilist tenets, sourced profit increasingly through the current account and thus needed less investment to maintain domestic profits. Germany therefore saw its share of investment in GDP shrink from 9.3 to 3.2 percent. While we

have enough reason to doubt the simplistic theory that sees all investment as requiring a drop in consumption, Spain has the claim to virtue in any such story.

The 1970s

The Snake

The 1970s have most warrant to be talked of in terms of exogenous shocks. This is because the chaos of the 1970s cannot simply be laid at the feet of the labor unrest of the late 1960s; if the wage growth starting in 1968 was *not* followed up by the inflationary impacts of massive price shocks in oil and other basic commodities there is good reason to suppose a more stable demand accommodating form of growth could have been hashed out (Halevi 2016). Instead, all OECD countries saw the price of oil nearly quadruple in real terms after October 1973, coming fast on the heels of price rises due to a harvest failure; Lucarelli (1999) refers to this as a "singularly most important event which overshadowed all attempts to foster monetary cohesion" (p. 87). In terms of oil alone this amounted to a net transfer to the OPEC cartel of nearly two percent of OECD income and, importantly for Europe, immediately sharpened the division between surplus and deficit countries (Lucarelli 1999:88).

Some analysis highlights the resolve of the Bundesbank or the quick return to smaller public deficits as the major reason that Germany weathered these shocks better than France and Italy (e.g. Mishkin and Posen 1997). But here again a different perspective is supplied by a neomercantilist understanding of the interconnection between the external sector, the saving ability of the private sector, and the ability of the government to run a smaller deficit. Germany's

government deficit jumped from 0.92 per cent of GNI in 1973 to over six per cent in 1975 as automatic stabilizers took effect, but dropped the very next year back under three per cent within two years. Throughout the entire period, however, the current account surplus "cushion" allowed this "healthy" fiscal stance and made up for crashing earnings of domestic firms, who were hit hard by both wage increases and the spike in input costs (Johnson 1998:92). As the full effects of the shocks fed into the worldwide recession of the mid-1970s the German surplus stayed near or above one per cent of GNI until 1978, domestic investment rebounded and the Bundesbank maintained an anti-cyclical stance that would have been dangerous if not for the continued infusion of surplus from abroad.

In this context, the 1973 American decision to dismantle the Bretton Woods system came just in time to hammer the ambitious Werner-plan inspired integration initiatives to pieces. As detailed in the last chapter, the ideational contributions of the European Commission, touching off the back and forth economist versus monetarist debates in the Barre, Werner, and Schiller plans maintained the optimism of the 1960s completion of the customs union. 1971's Smithsonian Agreement ratified the dollar's devaluation and widened the bands of possible fluctuations by Bretton Woods partners against the dollar; with the new widened fluctuation band two European currencies could wind up with a large value divergence of up to nine percent (Walsh 2000:26). In order to bring European currency values closer together, in March 1972 the institutional order in Europe coalesced around a regional fixed rate system, the Narrower Margins Agreement, commonly known as the "Snake." Initially this undertaking, under the auspices of Bretton Woods, was dubbed the "Snake in the tunnel." The jointly fluctuating European members, kept within narrow bilateral bands of ±2.25 percent each other that would resemble and undulating snake if charted over time, were supposed to keep within a wider floor

and ceiling set by their allowable margins of fluctuation against the dollar (the "tunnel") (Grahl 1997; Lucarelli 1999).

In early 1973 pressure resumed as the dollar devalued a second time, and capital was once again attracted to the surplus-laden D-mark (Gray 2007). Italy left the Snake arrangement in March, and nearly immediately afterward the "tunnel" dropped away as the remaining countries, keeping their parities with each other, floated unmoored from any peg to the dollar. This was decidedly not only an action of the Commission or the European institutions; rather, it was an act of monetary survival which included non-EC members such as Norway and Sweden but excluded Italy, Britain, Ireland and Ireland. Those looking for institutional convergence based on shared gains for the member states, such as those using a variety approach, cannot well "characterize this arrangement as a gain for the European Community" given that "much of the bargaining had taken place in Paris, not Brussels; and the composition of the Snake differed substantially from membership in the community" (Gray 2007:321). It did, however, represent the first postwar regional attempt at a form of monetary union, and unlike the wide-ranging and politically-mediated Bretton Woods system the design was plainly austere: the Snake amounted to a parity grid, in which bilateral rates of exchange between European currencies were set with few resources to make their defense a common European initiative.

Stripped of the Bretton Woods tie to the dollar, the Snake was simply the belated imposition of Schiller's old proposal for a joint float against the dollar. Other than the initial inclusion of France the Snake was merely a D-Mark bloc; indeed, pressure on the Franc forced France's exit in 1974; and "France's departure from the Snake marked the burial of the Werner Plan" (Marsh 2009:67). There was thus no surplus recycling as in the EPU, no effective political coordination of rates or policy as under Bretton Woods, though there was an avenue for

symmetry by-proxy precisely because the Snake left so much room for exit; deficit countries were not forced immediately into deflationary policies but instead could leave the arrangement because it was not tightly binding. Conversely, smaller satellites of Germany such as the Dutch were able to more easily negotiate devaluations and bind themselves to German monetary policy. Thus the tendency for analysts such as Hoffmeyer (2000) to refer to the Snake as a "limited success" in which "most countries were able to adhere to the arrangement, but speculative pressures force others – mainly France, Italy, and Sweden – to exit the Snake" (p.4) is belied by the more blunt analysis of Kindleberger (1984[2006]): "by 1976 the Snake resembled nothing so much as a Deutschmark bloc" (p. 458).

The connection of France, Italy, and the UK with the Snake arrangements was short-lived as their more inflationary growth strategies bumped up against the external constraint. With both France and Italy still strong contenders for surplus country status they at first attempted to avoid floating via the Snake, but also tried to maintain high wage growth and an accommodating fiscal stance at the same time Germany was clamping down on its own growth. The predictable result for both was crises brought on by the current account deficit; each of the two times that France left the system (1974 and 1976) were spurred by slipping into external deficit, while Italy was pushed out in 1973 by its deficit and instead embarked on a more expansionary approach to growth, using judicious devaluations of the lira to attain export surpluses later in the decade.

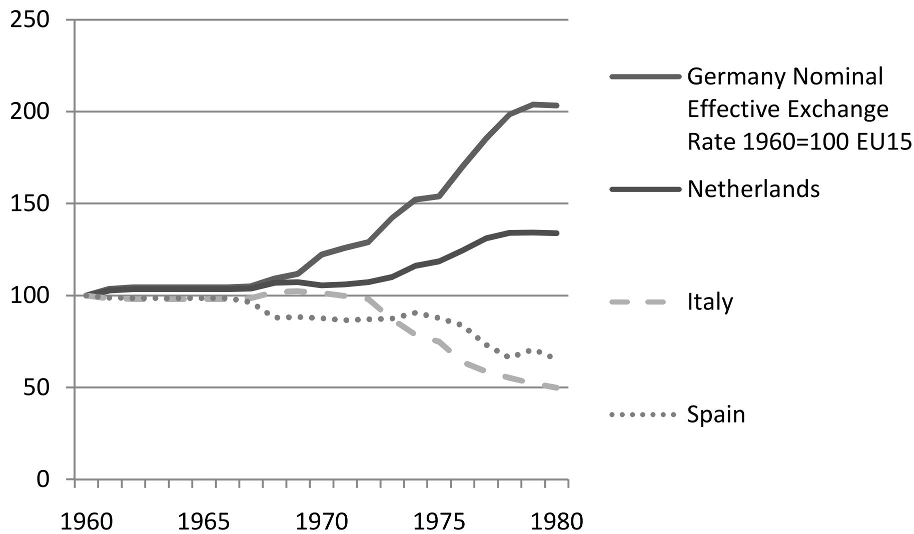

Figure 6.4: Select Nominal Effective Exchange Rates Relative to EU 15 (1960=100)

Source: AMECO, author's calculations

When currencies float with regard to each other, we can expect some measure of current account adjustment would occur as countries with deficits see their currencies depreciate, while those accumulating surpluses would have their currencies appreciate until their surpluses fritter away. While more faltering and slower to take effect than often supposed, this remains an important mechanism of adjustment between European countries with similar levels of development. Figure 6.4 charts select European nominal effective exchange rates relative to an aggregate of fifteen European rates. The stability of the Bretton Woods period is visible up until 1969, when the first floats and, finally, the slowly disintegrating Snake ushers in an era in which the German and Dutch rates ratchet upward while Italy and Spain move downward. Even as this divergence was occurring, and even in light of the exchange rate movements shown in figure 6.4, the German accumulation of surpluses continued through the 1970s. It was only at the tail end of the decade when the surpluses of Germany shrank from a high of 2.7% of domestic GDP in 1974 to enter negative territory in 1979. While the full dive into negative territory must be laid at the feet of the second oil shock in 1979, the dangers that the Snake's limited membership posed for

German surpluses was already apparent (Deutsche Bundesbank 1980). The Netherlands and Belgium saw a similar peak and denouement, shrinking from Belgium's high of 2.51 in 1972 and the Netherlands' of 5.24 in 1973, ending in severe negative territory for Belgium and less than one percent in the black for the Dutch.

The 1970s thus present us with a period of institutional dissolution only slightly mitigated by the Snake. The oil shocks struck the continent from without, while the mounting wage share gains won by workers in each country represented an increasingly unacceptable internal problem. The external balance thus provided a conduit whereby that external and internal structural change (the spike in import prices and in wage costs, respectively) would cause problems that required cutthroat geopolitical strategizing. The Commission's lofty plans of the previous decade came to nothing and it was reduced to playing the role of an ideational placeholder, keeping ambitious notions of monetary and economic integration alive.

The Bundesbank's Pioneering Neoliberalism

To the developed world, lashed by seemingly intractable stagflation, Germany seemed to steer a course through the first three quarters of the decade with relative ease. This success has been proposed as a major reason for the spread of monetarism and independent central banking as popular policy ideas over the following decades (McNamara 1998). Yet here it is important to make note of precisely what these early neoliberal policy ideas were designed to do. In this section I note the way that the Bundesbank's ascendancy, beginning after their successful recapturing of an external surplus via the engineered recession of 1966, culminated in the Bundesbank becoming the arbiter of future pan-European institutional forms and the enforcer of

a more deflationary model for European growth. This demonstrates that, once again, the growth model pursued in Germany and closely linked surplus countries such as the Netherlands was not self-contained or endogenously constructed, either in a structural or strategic sense.

By 1973 "the breakdown of Bretton Woods created a new opportunity for monetary assertiveness in Europe, which the Bundesbank exploited" (Marsh 2009:65). At base, this amounted to judiciously applied austerity in order to slow growth and thereby slow the growth of exports, while also raising unemployment as a means of stopping and reversing wage gains. We have already seen the way that the bank learned the lesson of the 1961 revaluation, becoming a supporter of controlled revaluation or floating as a way to stay ahead of import costs. However, the strikes of 1969 kicked off many years of labor gains, with the wage share jumping from 59.8% of GDP in 1969 to a postwar peak of 64.4% just five years later. This rise came on the back of the already higher wage level common to the Bretton Woods years, and while there is reason to doubt that this would have caused any kind of "profit squeeze" if the oil shocks and ensuing austerity had not occurred, the gains represented an increasingly unacceptable cost of production and social threat. As the intermediate and raw material input component of the price equation (the j term in equation 2.X) increased, and in a way that seemed impossible to stop given the power of OPEC, the larger wage outlays were left as the one controllable element in the price bundle.

The Bundesbank began austerity even before the 1973 oil shock, as low US interest rates caused fresh waves of speculative capital to flow in and put upward pressure on the D-Mark. 1973 saw the benchmark interest rate at 7 per cent by June and money market rates reached 38%

by the next month (Marsh 1992:192).[44] The Bundesbank established its anti-labor *bona fides* after the 1973 shock, when "public sector workers led the wage round, seeking high wage increases. Public sector and then private sector employers acceded to the wage demands – presumably expecting monetary policy to be eased. The Bundesbank refused to budge, with the result that severe deflation was imposed" (Carlin 1996:474). There is no doubt the unemployment caused by the bank was intentional, with Bundesbank senior officials secretly acknowledging it was a "disguised incomes policy" that would cause a "custom-made" downturn and a "chastening dose of unemployment" (Johnson 1998:94-101).[45] The Bundesbank thus forced a long deflationary squeeze in the 70s, helping sink the more employment-focused approaches in France and the UK. Yet again the "buoyant foreign demand" helped in 73 and 74, but even with the shrinking afterward the surplus was still maintained.

Seen in historical perspective, major elements of the ideological turn to neoliberalism began in Germany rather than being an Anglo-American project, as some scholarship has suggested (Germann 2014a). Loedel (1999) even asserts that "the Germanization of the international and European monetary system has taken place" (p. 5). While the engineered recession of 1966-67 "was confronted by a new spirit of technocratic confidence and co-operation" within the decade the international turbulence, labor assertiveness and supply price shocks of the early 1970s caused this Keynesian consensus to completely unravel. It was replaced by "a fundamentally

[44] This latter tactic, in which the money market Lombard rate was suspended, allowing the spike in private lending rates, would be used almost a decade later by the US Federal Reserve when it notoriously refused its normal liquidity-providing function and thus allowed day-to-day interbank lending rates to vary wildly.

[45] The Bank's tactical preferences in this early part of the decade varied as different factions within the institutions fought for control. Staal (1999) notes that some backed capital controls in the very early 70s to go along with the bank's new tactical understanding of revaluation. But this was dropped when it became clear that it was an avenue through which the German government could possibly influence Bundesbank policy (p. 25). Even as some consensus was achieved against the use of capital controls, those within the Bank that were still skeptical of tactical floating and committed to Bretton Woods, including 1970s Bundesbank President Karl Klasen, were definitively bested by the Vice-President Emminger's faction (Marsh 1992).

ordo-liberal approach which sought to reduce the role of the fiscal role of the state and maintain stability through monetary controls" (Leaman 1988:213). The Bundesbank was the first in the OECD to turn directly to stopping wage-rises by causing unemployment using contractionary interest rate and monetary targeting policy. The monetary targeting itself was mostly a failure, as explicit monetarism would be a few years later in the US and UK (Beyer *et al.* 2009). Thanks to the realities of a modern credit economy, money creation is endogenous and not under the control of a central bank – but the bank *can* intentionally cause what it called in 1976 a "correction in distribution ratios" in favor of "entrepreneurial income" (quoted in Leaman 2001:169). When it did so, deficit countries were obliged to follow suit and raise interest rates in order to keep capital inflowing, otherwise they could face disastrous loss of their own currency's value or the inability to fund their deficits.

The affinity between these deflationary, anti-labor tactics and what would later become the neoliberal ideological consensus can be seen in both contemporaneous analyses of the 1970s and in later conventional historiography on "Eurosclerosis." These lines of argument tend to blame three "inflationary villains" for the problems of the 1970s: labor unions, state spending, and OPEC (SVC report cited in Leaman 1988:213; Emminger 1977; Crafts and Toniolo 1996). Such narratives hide the role of monopoly power in sustaining the inflationary cycles; oligopolistic price-setting power allowed firms to make up for both supply and wage-based cost increases, and their ability to pass these costs on in the form of higher prices while protecting profits kept the inflationary cycle going. Even as profit rates and the profit share shrank in this era of working-class power, the largest oligopolies were able to increase their share of important sectors and protect their profit rates (see the table in Leaman 1988:208).

Bundesbank monetarism, protecting these private concentrations of power, operating in the vein of *Ordnungspolitik* ("order politics") in which an automatic framework in which market forces can operate is set out, as opposed to the "process politics" of a Keynesian fine-tuning approach. Viewed in line with world-historic ideologies like neoliberalism, "order politics" "is closely related to neoliberal thinking and thus implies a desire to strengthen market forces and to minimise state interference" (Leaman 2001:157). One might note that this was not wholly identical to the zeal for labor "restructuring" seen in the liberal market economies; Johnson (1998) suggests that Germany's "early but moderate adoption of monetarism" headed off a deeper conservative revolution along the lines of Reagan or Thatcher (p. 104). However, Johnson's own evidence shows that this German ur-neoliberalism was decidedly *more* concerned with fiscal retrenchment and hostile to socially useful deficits, and thus as if not more economically regressive than the Anglosphere's version (1998:106). Moreover, this approach resulted in increasing concentration of corporate power due to the high interest-rate environment. In this area the accomplishments of the Bundesbank are hard to deny, since by "ignoring the relative immunity of corporations with large reserves to monetarist changes in short-term real interest rates and the far greater elasticity of [small enterprise] demand for credit, the Bundesbank contributed to a demonstrable wave of economic concentration" (Leaman 2009:93-4). Given the interlocking institutional tangle of the German political economy, so astutely documented by the variety scholars, it is no great shock that once Bundesbank monetarism "chastened" labor and the incoming EMS helped Germany back to continual external surpluses the conservative turn under Kohl continued "without any significant changes in the contours of Germany's economic institutions" (Johnson 1998:104).

By the end of the 1970s the Bundesbank-dominated German approach was already influencing the other major player in Europe, France. French President Valéry Giscard d'Estaing soon initiated an attempt to emulate, in lighter form, core elements of the Germanic model. Hoping to avoid the franc permanently sliding into weak currency status, Giscard allied with his Prime Minister, Raymond Barre, to formulate a series of austerity measures to reorient the French economy toward the *franc fort* ("strong franc"). Giscard's focus on price stability even lead Van Esch (2009) to refer to him as "the German President" (p. 135). Giscard, presiding over these "Barre plans," thus revealed himself to be a forerunner of the later centrist neoliberal consensus that would come to dominate both right and left in the developed world.

The European Monetary System

Europe was heading toward the 1980s after a tumultuous decade in which labor won large gains even while firms in concentrated sectors were able to fight back by setting higher prices. This class struggle over national income combined with the external price shocks resulted in stagflation, combining high unemployment *and* inflation (Leaman 1988:256 fn 99). The three "decider" nations of Europe seized on the remarks of Commission President Roy Jenkins in 1978, suggesting that a return to monetary integration would mitigate "the direct link between Europe's economic problems and the imperfections of floating rates" (Marsh 2009:77). The float had indeed exacerbated problems for all three: Germany's surplus slowly drifted downward as the appreciation against its main partners continued, France fell in and out of external deficit, and Italy's devaluation-dependent export success resulted in accelerating inflation. Their collaboration created the European Monetary System (EMS) in 1978, with the system in full

operation by 1981. The EMS would seal Europe into an institutional framework more comprehensive and yet, in important ways, narrower and more debilitating than any of its predecessors.

The Construction of the EMS

This section focuses on the construction and technical workings of the EMS, specifically the manner in which its birth showed the continuing influence of state-strategic and political economic concerns informed by the institutional imprint of earlier eras. When this basis of the EMS is understood, neoinstitutionalist models of European convergence such as the field approach seem less compelling, even when taking into account supranational advances such as 1985's Single Europe Act. The next section then zooms in on the French case as a turning point after which which the system's mode of operation narrowed toward total dominance of the surplus countries, both in terms of both the formal institutional framework and the social-political effects the system induced in member states. The third part of this section will then survey the deficit countries over the EMS years, focusing on how they displayed similar anti-labor political climates that were enabled and enforced by the danger of current account deficits. The final subsection examines the EMS as it narrowed, ever more dominated by the Deutschmark, and connects the EMS to the institutional milestone that became the Single European Act.

The EMS was once again a system of fixed exchange rates and, in contrast to the Snake's shrinking membership, it joined most of the future Eurozone countries: Germany, France, Belgium, Luxembourg, the Netherlands, Italy, Ireland, and Greece. Spain and Portugal, whose

bids for European Community membership became serious after 1980, increasingly tailored their policies toward EMS membership even though they were not formal members, especially after their entry into the EEC in 1986. For full members, their currency values were fixed relative to each other via the Exchange Rate Mechanism (ERM), a system of fixed exchange rates combined with institutional rules making intervention in defense of these rates obligatory. This was monitored by a parity grid listing the bilateral rates prevailing between each currency and its partners, with fluctuations allowed in a ±2.25% band above or below par (except for Italy and Ireland, who entered with larger bands of ±6%).

Given these obligatory defense arrangements the operation of the system was, in comparison to the politically-administered EPU and Bretton Woods arrangements, more "automatic;" this automaticity would present a danger as the system's rules tightened.[46] Still, there were several features encoded in the EMS's design that could have encouraged symmetry, and this might have made up for the fact that surplus recycling and political coordination were both off the table. First, the bilateral rates operated in terms of a new composite currency, the European Currency Unit (ECU), which could have contributed to symmetry in the framework if it was used as a new shared and easily attainable way for deficit countries to pay back the debts they incurred when intervening to support their exchange rates.

Second, there was a commitment that, when a bilateral rate moved beyond the allowable bounds, the central banks of both surplus and deficit countries would intervene. At least in its initial design, this formal symmetry was new; under Bretton Woods and the Snake "strong central banks had come to the assistance of weaker ones, but such assistance had typically been

[46] Besides the compulsory intervention and the more elaborate set of monitoring facilities, Halevi and Kriesler (2016) note that the "EMS was not a system of institutionally fixed parities. The agreement to set it up was political but its maintenance required economic measures. Hence the way in which the deficit countries could sustain their external deficits was to attract capital by means of higher interest rates" (p. 328).

discretionary, not obligatory" (Grahl 1997:59). Finally, over and above the ERM there was a novel feature that should have provided even further symmetry: a divergence indicator, which measured each currency's value not in a bilateral manner, but against all the EMS partner currencies together. This could have been a major contributor to symmetry, as there was "democratic" flavor to the indicator; if all the other currencies moved in one direction it could have turned the tables on the D-mark, obliging it to follow the upward or downward movements of the rest of the European currencies rather than itself remain the system's benchmark.

Most of this symmetry never came into effect, and the formal symmetry embodied in the institutional rules fell away over time. Waiting until the obligatory threshold was reached resulted in worse repayment conditions; as a result most of the interventions became intramarginal, with deficit states pressured to intervene on their own before they reached the lower end of the band (Kaltenthaler 1997:272-3, Lucarelli 1999:115-16). During the negotiations any symmetrical features in repayment method were nixed by Bundesbank pressure – one initial proposal was to allow countries to intervene in ECU but pay back debts in their own currencies. Pöhl characterized this as a mere "community of inflation," and instead both he and Emminger pushed Schmidt to enshrine the principle that "debts had to be repaid in hard currency, either in dollars, D-marks, or gold" (quoted in Marsh 2009:82). Other elements, such as the divergence indicator, were eventually removed. The result was that the EMS was established as a more elaborate and more automatic version of a fixed parity framework for Europe, displaying some flexibility and symmetric features in the first half of its life but becoming another avenue for D-mark hegemony by the second half of the 1980s.

This institutional hardening will be analyzed in a subsequent section, but here we can note that some scholars praise the EMS as being more flexible than Bretton Woods and

containing various *de jure* concessions by the Bundesbank (Giersh *et al.* 1992; Grahl 1997:58-60). Halevi (2016), noting instead the *de facto* asymmetric aspects discussed above, concludes:

> "a closer look at [EMS supporters'] arguments reveals that their preference for the EMS is based on the fact that it preserved the Bundesbank's freedom of movement in a context in which the other countries 'did more or less adopt the anti-inflationary stance of West Germany's central bank' (Giersh *et al.* 1992:254). The EMS in fact magnified the limitations of the European Snake by tilting the system of payments in a very anti-Keynesian direction…Within the EMS there is no institutional mechanism by which the weak countries can compel the strong ones to weaken their position, which is precisely what Keynes attempted to avoid at Bretton Woods. A weak currency country must deflate and/or strengthen its currency relative to those of the other members of the system" (p. 386)

Given this institutional framework, what accounts for the politics of its formation? Some view this period as an instance of policy learning, in which countries like the US, UK, France, and Italy burned their hands on the stove of exchange rate floating when attempting expansionary policy; the resulting devaluations and high inflation taught them the superiority of monetary stringency (McNamara 1998; Torres 2009). This resonates with the field perspective's emphasis on how the European field converged on shared institutional forms in order to stabilize interactions, though a field scholar would perhaps add the proviso that the convergence of participant countries' desired institutional forms was memetic rather than rational-instrumental in nature. Regardless, detailed research on each government's preferences going into the negotiations presents a picture at odds with any kind of convergence thesis: there was, essentially, no convergence of preferences on how "strict" the monetary union should be. It is clear that France and Italy wanted an international system of fixed rates as a shelter from the chaotic effects of floating rates but they wanted symmetric intervention rules, wide-ranging balance of payment financing support and the possibility of increasing the symmetry of the system in the future (Walsh 2000:39-40). Of course, on all three of these points Germany, supported by the Netherlands and, to a lesser extent Belgium, differed sharply.

Germany, the final arbiter of the shape of the EMS, had three interrelated motives. Two are outgrowths of global developments that, however, were still connected to the defense of Germany's surplus-oriented growth model. First, there was deep worry over the Carter administration's neglect of the dollar, falling in value since 1976, and the way this weakening dollar drove the value of European currencies further apart.[47] Second, a related hope was that the EMS would increase European monetary bargaining power against the US and thus allow Germany to ward off any American pressures for Germany to expand its domestic demand. In other words, the Schmidt government hoped the EMS would free Germany from any possibility of coordination at the level of the OECD (cf. Loedel 1999). A related facet of this was the desire to "export" the German deflationary model to its European partners and head off any risk of imported inflation, which would then also allow Europe to be an effective counterweight to the dollar (Kaelberer 1996). Finally, and most obviously, "an EMS would give German industrialists a lead in price competitiveness on world markets, as the Deutschmark would be tied to weaker currencies and thus less prone to re-evaluation" (Pedersen 1998:85). As it stood, the EMS

In light of Germany's core neomercantilist orientation, it is easy to see that all three of these motives fit together as a way of sustaining the external surplus. The US, still the global hegemon, was perhaps the only power capable of bringing effective pressure on Germany to take on a more domestic-demand oriented path and accept the higher inflation such an approach entails. Inflationary or wage-led growth was ultimately unacceptable to the Bundesbank and export interests in 1966, and even moreso in 1978 after a decade of worker victories resulted in a high share of income going to labor. Yet eschewing domestic demand expansion meant that in

[47] It is perhaps too broad to take Kindleberger's ([1985]2006) stance that the overall weakening of the dollar's status as a hegemonic currency is a major driver of European integration (Pp. 454-455) but it is correct that periods of dollar devaluation cause capital to flow to the D-Mark and thus pressure its value upward against other European currencies (Lucarelli 1999).

order to avoid recessions the external surplus must keep rolling in, and the EMS promised much in that regard. Within the first two years of the EMS, stability with regard to its European partners helped completely reverse the real appreciation of the D-Mark that had occurred during the years of the Snake (Deutsche Bundesbank 1980:39).

At this point it is useful to take a birds-eye view of German profit over the entire postwar period. Kalecki's profit equation, charted in figure 6.5, offers the best way to capture this, and it clearly shows the long-term increase of the current account surplus as a portion of overall profit. This surplus profit source was especially important when investment fell, usually corresponding to recessionary moments induced by the Bundesbank, and increased in a secular manner in the same way that investment itself fell. This increase was interrupted by German reunification in the 1990s, but resumed soon afterward. In this respect, it is instructive to compare with Germany's perennial surplus partner, the Netherlands, in figure 6.6. Here, without the historical singularity of a reunification-based deficit, the long-term increase of the current account surplus as a source of Dutch profit is obvious. Both Germany and the Netherlands show a steadily decreasing role of the public deficit as a source of profit; the renowned German and Dutch fiscal rectitude was made easier by not having to supplement profit via budget deficits.

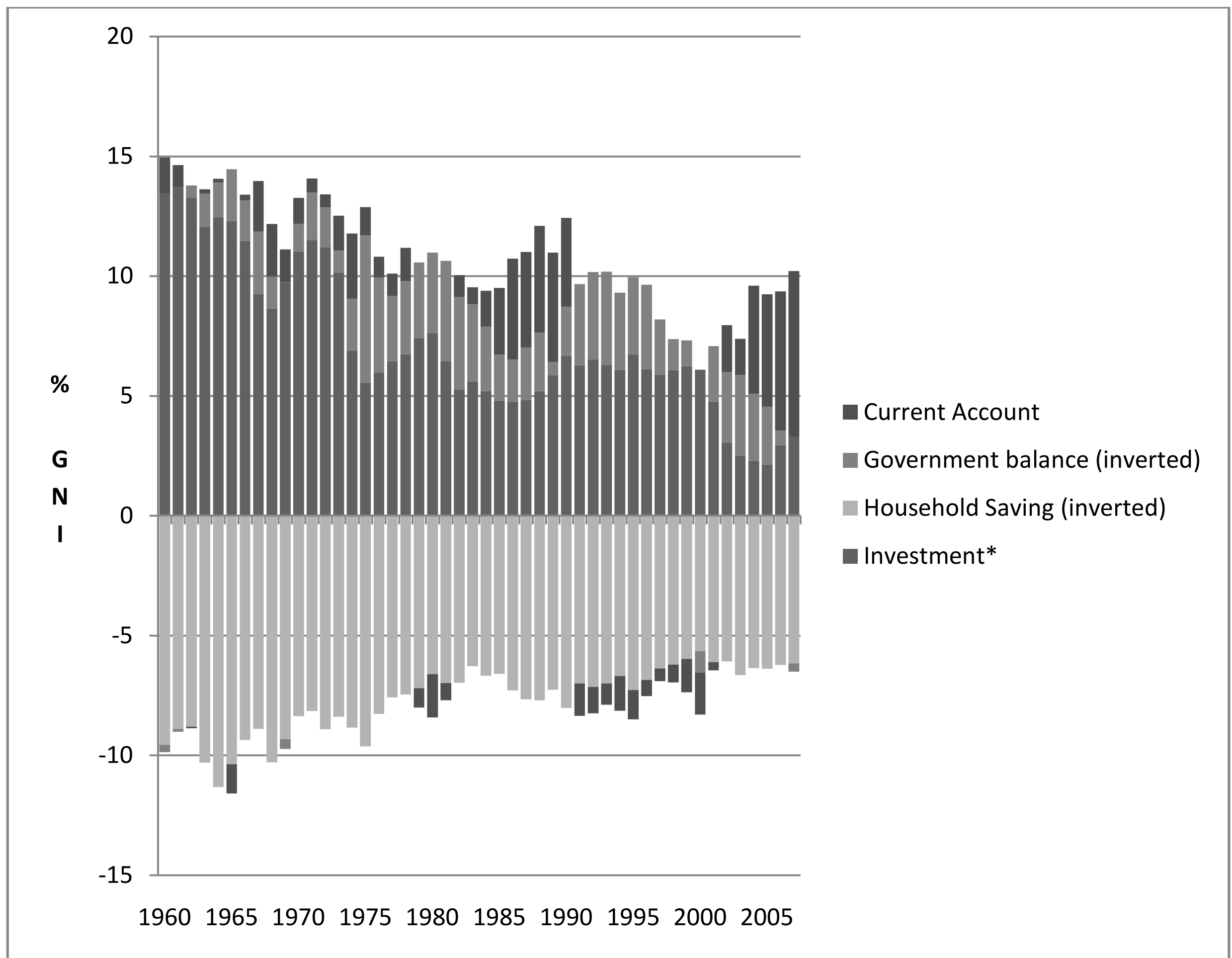

Figure 6.5: Components of Aggregate German Profit, 1960-2007

**Net Fixed Capital Formation, Private Sector*
Source: AMECO, Albach et al. 1973, Glatzer et al. 1992, author's calculations

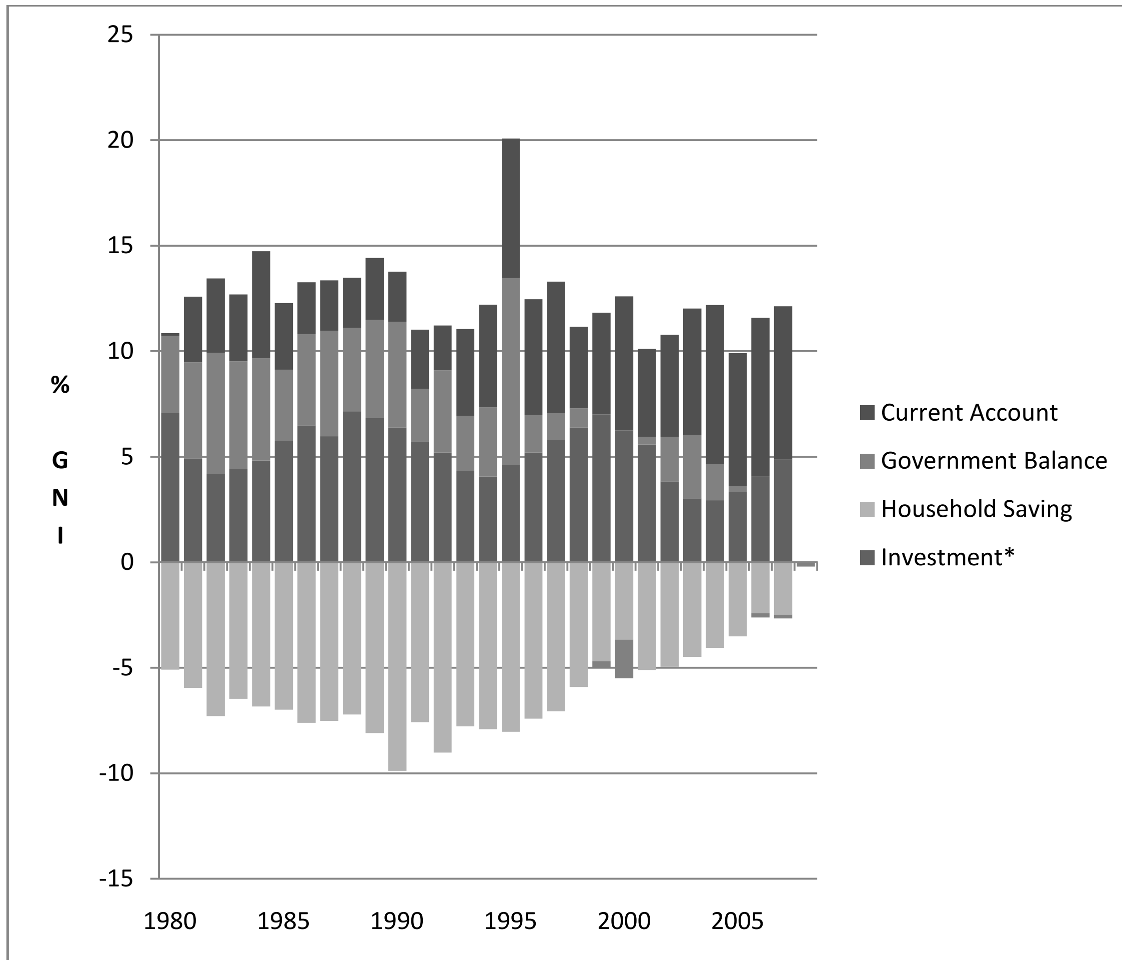

Fig. 6.6: Components of Aggregate Dutch Profit, 1980-2007

**Net Fixed Capital Formation, Private Sector*
Source: AMECO, author's calculations

France shared Germany's geopolitical objective of countering the dollar, having taken a jaundiced view of American monetary power since de Gaulle's denunciations in the 1960s. As we have already noted, Giscard also hoped to equal, if not beat, the Germans at their own neoliberal economic game. Taking on aspects of the German model meant finding a way to push down French wage growth as a means of "inflation fighting," with the EMS serving as a justification for future austerity imposed by the French state or central bank. France shared Germany's dollar-related geopolitical objectives, having taken a jaundiced view of American monetary power ever since de Gaulle's denunciations in the 1960s (Gavin 2004). Still, as in

earlier decades the French recognition of their weaker export abilities and preference for *dirigisme* meant their institutional preferences were more in line with the Italians than the Germans. The initial EMS negotiations gave ample space for Franco-Italian concerns, resulting in the divergence indicator, the ECU, and a proposal for a widely-empowered European Monetary Fund that would have made central bank interventions easier. Yet after committing to the plan in 1978, by that summer there was a "substantial retreat" on the symmetry of the system; "clear signals from the Bundesbank led [the French] to conclude that Schmidt was not in a position to make many concessions" (Walsh 2000:36). How can we best understand this result, in which France and Italy favored a more symmetrical arrangement but were steamrolled by the Bundesbank's own preferences?

Two elements are crucial, neither properly addressed by either field or variety approaches. First is the peculiar tripartite relation between the German government, industry, and the Bundesbank. From the 1970s this created a pattern of the Schmidt and then Kohl governments proposing fairly conciliatory integration initiatives, often against the wishes of the Bank but with the support of industry, which, once accepted by other European states, were pushed by Bundesbank pressure (now supported by German industry) in a much more austere direction (Kaltenthaler 1997). This two-step maneuver seduced France, Italy, Greece (who later withdrew from the ERM altogether), and less austerity-minded German policymakers into putting themselves under the Bundesbank's preferred institutional arrangement in a way they did not initially desire. Schmidt's silk glove hid the iron fist of Teutonic central banking.

Second, despite divergent institutional preferences the process was driven forward thanks to the familiar French and German "grand strategies." Here again we see a deeper neoliberal convergence, centered not on the specific form of pan-European institutions but rather on the

shared understanding that joining together under a fixed rate can be a useful tool in the domestic struggle between labor and capital. As alluded to in the previous section, President Pompidou and especially Giscard from 1974 made a clear choice for the "*franc fort,"* echoing de Gaulle's disdain for devaluations. However, whereas the Gaullists, the latter still a force in French politics in the 1970s, saw a strong and stable Franc as one element of a faintly workerist economic nationalism, Giscard "obsessively" talked of the need to counter German hegemony on the continent while emphasizing the need to beat the Germans at their own economic game (Walsh 2000:34). Giscard emphasized disinflation, export competitiveness, and the need for fixed exchange rates as a confidence backstop to halt to slide in the Franc's value. Giscard, though broadly from the right as was de Gaulle and Pompidou, was also "a leading member of the pro-European, liberal wing of the French conservatives, with a strained relationship with the right-wing Gaullist mainstream" (Marsh 2009:71). In keeping with the strong interlacing of neoliberal politics and epistemic communities, the neoliberal tactics used to discipline labor, first in Germany and later in France and other developed countries, contributed to and then fed on the later economic consensus that both independent central banking and anchoring one's currency to a low-inflation currency such as the D-Mark are essential for growth (Sardoni 2007: 94-95; Mudge 2008; Torres 2009:59-60).

In this light, the rapid climbdown by Giscard during the EMS negotiations appears as the first turn toward a neoliberal national competitive stance. While balancing domestic and external concerns Giscard was "frequently torn between his own pro-European leanings and his need to maintain favour with the French Gaullists who…jealously opposed giving up power to European institutions" (Marsh 2009:72). Giscard's rise represented, in other words, the throwing over of domestic worker's interests in name of an increasingly pro-global business orientation, as would

surface in Germany soon afterward under Chancellor Helmut Kohl and in the UK under Prime Minister Margaret Thatcher. It would also appear on the left as the French Socialists, German SDP, the Democrats in the US, and Labour in the UK would all become increasingly at ease with the wage-suppressing elements of neoliberalism (Hansen and Shierup 2005; Preece 2009).

Especially for continental right and left parties this stance was not incompatible with a strong preference for further European integration. It went hand-in-hand with, and indeed was enabled by, a *rapprochement* with pan-European institutions. On the left, for example, "this represented a break with previous positions that saw dangers in giving up the protections of the nation-state, yet all previously Eurosceptic social democratic parties (the parties from Sweden, the United Kingdom, Greece, Denmark, Finland, Norway and Ireland) carried out an Europeanist turn…while the social democrats of the Six ostensibly increased their Europeanist profiles" (Miró 2017:2). Giscard's plans for a *franc fort* relied upon a more integrated Europe that could form the chessboard on which those newly committed to "beating the Germans at their own game" could play. All of these tendencies shared a neoliberal conception of national interest oriented around, for the center right, international competitiveness that could be obtained by austerity and, for the center left, making the social provisions of Western welfare states "realistic" with regard to global trends. Both would increasingly neglect the defense of wages, employment, social provisions, or smaller domestic producers as a matter of national policy in favor of this more globally-oriented stance (Preece 2009, Bliek and Parguez 2008).[48]

The Bundesbank, for its part, was never really in much danger from the EMS. It is true that Emminger (1976) thought that the freedom the Bank gained with the end of Bretton Woods

[48] Bliek and Parguez (2008) use the term "authoritarian liberalism" for the elements of neoliberalism focused on lowering state spending, wage, and social protections. They locate the roots of this strategy in the interwar period, when European central banks and governments took to austerity as a solution to the economic chaos of the 1920s and 30s. This is useful, but must be connected with the further evolution of this tendency such that, by the 1980s, it was more a globally-oriented competitiveness strategy than one of national defense against market chaos.

was "the recovery of control over the money supply" and "a completely new era for German monetary policy" (quoted in Leaman 2001:153). The bank had learned the uses of floating or, in adjustable rate regimes, strategic revaluation. They did not easily sacrifice this freedom on the altar of a new fixed currency regime, and thus Schmidt implemented a long campaign of persuasion and pressure to get the bank's agreement, culminating in an unprecedented closed-door speech to Bundesbank senior officials. More importantly, this effort included a secret memo that promised the Bundesbank it would not, against the seeming design of the EMS itself, be forced to "endlessly" support the defense of deficit country currencies (Marsh 2009: 82-83).[49] This latter guarantee shows the extent to which Bundesbank power had progressed since their humiliating conflict with the government in 1961. Despite their initial skepticism by late 1978 "there was ample coordination between the central bank and the government….at the defining moments, the Bundesbank ensured that the finished product bore its inimitable hallmark" (Marsh 2009:78)

Over and above its role in shaping the EMS the Bundesbank went from strength to strength. This is amply illustrated by two developments that show both the global and domestic potency of Bundesbank policy preferences. First, in late 1979 US Federal Reserve Chairman Paul Volcker initiated a sharp tightening of US monetary policy resulting in a spike in US interest rates. This caused difficulties for European countries trying to dig their way out from the impact of the second oil shock, though the strengthening dollar mitigated intra-European pressure as the capital attracted to the US dollar by higher yields took pressure off of the Deutschmark for the next few years. What is less noted, however, is that the one source of European influence on what was otherwise a unilateral American policy was a special meeting

[49] Marsh (2009) argues persuasively against the picture, put forward by Schmidt himself in later decades, that Schmidt's threats of changing the Bundesbank's independence law allowed him to heroically force the Bank into agreeing to the EMS.

with Schmidt and Emminger, in which it was made clear to Volcker that the Bundesbank was fully in agreement with higher US interest rates and even gave "recommendations for stern austerity" (Grahl 1997:77 fn4; Marsh 2009:89).

Second, the bank essentially forced a showdown with Schmidt over his government budget in1982; German monetarism was less amenable to allowing expansionary government deficits when compared to its US and UK epigones, and Schmidt's government was persuaded to embark on an ill-fated deficit reduction attempt that cost his party the support of their coalition partner and brought the Christian Democratic Union (CDU) back to power (Johnson 1998: 104-6). Overall, and especially in light of the continued narrowing of the EMS, the 1980s became the decade of "de facto establishment of the Bundesbank as the European central bank" (Hetzel 2002:50). In this way, the "disguised incomes policy" that the Bundesbank imposed on German workers was generalized to the rest of Europe.

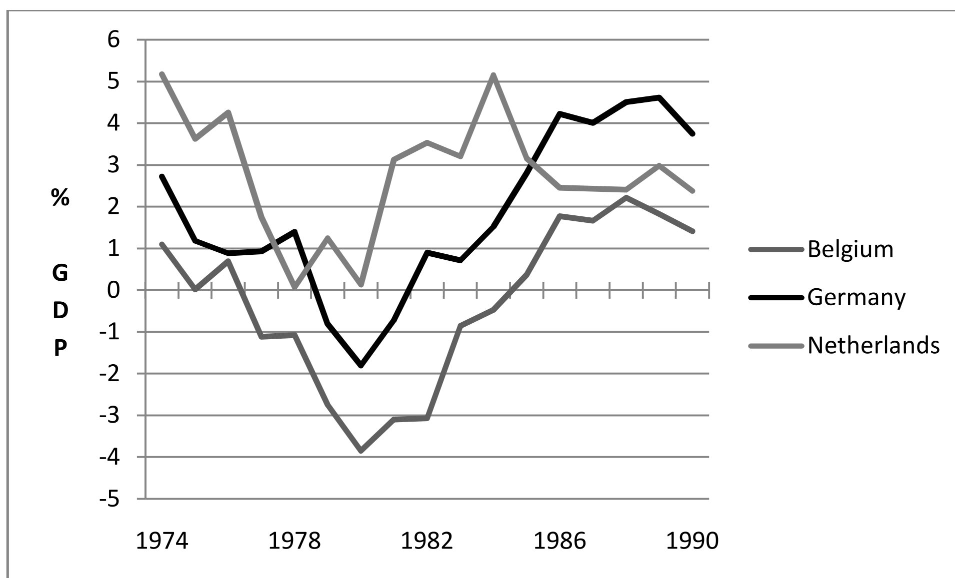

Figure 6.7: Belgian, German, and Dutch Current Account Balances as a Percent of GDP, 1974-1990

Source: AMECO

To summarize, the EMS was put together by European countries who had been given a drubbing by the price shocks and floating exchange rates of the 1970s. They joined together under this institutional framework for disparate and clearly self-interested reasons, though with the shared aim of "adjusting" the national share of income to reverse labor's gains. This goal, a core component of the neoliberalism, tied Germany, France, and Italy together despite their lack of agreement on how symmetric the EMS machinery should be. In the end, German preferences won out; these preferences would give surplus countries the benefit of fixed exchange rates with little risk of being expected to support deficit countries. This was already clear by the first few EMS years: recycling of surpluses was, of course, long dead, politically mediated coordination was discussed but failed to materialize despite American pressure, and the institutional elements intended to impart symmetry were ignored.

The EMS soon produced predictable results. In 1980 the Bundesbank, explaining the rare current account deficit due to an 84% increase in oil prices, noted that this "contraction of the trade surplus is all the more remarkable since exports – taken by themselves – rose strongly…" and the volume of imports hardly increased. In other words, the initial deficit under the EMS was only due to extreme oil prices, and once the shock effects faded there was a marked rebound of the surplus bloc. Figure 6.7 shows the gradual loss of surplus for Germany, Belgium and the Netherlands since 1974 and the powerful rise through the 1980s. This group rise into surplus, which would collect additional members in the 1990s as Austria and Finland became more closely integrated into the future Eurozone framework, was interrupted for Germany when its 1990 reunification knocked it out of surplus status for nearly a decade.

Following sections will show that this institutional framework narrowed further throughout the 1980s and early 1990s under the pressure of the region's surplus-deficit structure.

First, however, we must turn to the French "U-turn" of 1981-5, which the continent's second largest economy reaffirmed its commitment to (attempt to) become a member of the surplus bloc. This is the definitive case in which the political influence of surplus-deficit relations would be laid bare, and would set the tone for all future European integration efforts.

The French U-Turn

The case of France is critically important for understanding the final loss of EMS symmetry. It was France that made a "last stand" for the postwar Keynesian growth-oriented approach, doing so more radically than any of the European initiatives undertaken during the neo-Keynesian Bretton Woods years. The failure of this attempt was a final confirmation of the EMS as a Deutschmark-dominated force for deflation on the continent.

Below, I review the Mitterand U-turn, highlighting its importance as a crucial juncture for both France and the EMS itself. The failure of the expansion program illustrates the way that neoliberalism was taking hold across European countries and the extent to which coordination and symmetry had disappeared as elements of Europe's political economy. At the same time the contingency of the episode is highlighted by France's place as a liminal member of the surplus bloc. The moments before the U-turn, with France suspended between different "varieties" of capitalism, and the country's subsequent bid for membership in the surplus bloc both demonstrate, yet again, the extent to which a supposed stable domestic growth model is conditioned by external structural links.

The U-turn is therefore important thanks to the primacy of France within the region's political economy, the foundational role France plays in the creation of pan-European

institutions, and its marginal status as a surplus country. The 1960s and 70s saw the country move more towards a domestic demand-driven model of growth, with its participation in regional and global governance often more a function of its geopolitical "grand strategy." The combination of *dirigiste* economic practices and grand political motives underwent a profound change in the 1970s under President Giscard, as the two failed attempts at Snake membership, continual current account crises, and faltering growth helped empower the more liberal, market-oriented French right. The Mitterrand U-turn, in which not the French right but the French *left* took on board this neoliberal approach, can thus be seen as a political-social outcome of the combination of the region's surplus-deficit relations, hypostasized by the institutional framework of the EMS, and the France's domestic class battles over wages and profits. In other words, it is a prime example of what Dale Tomich (1990) calls the "local form of world historical processes and the world historical character of local events" (p. 6).

Whereas Giscard and Barre were neoliberals *avant la lettre*, the start of Francois Mitterand's Presidency in 1981 offered a final opportunity for those committed to a truly Keynesian model of growth. Having been "devastated by the shock therapy imposed for four years" by the "Barre plans," the Socialist party swept the election and brought to power a number of radical policymakers (Bliek and Parguez 2008:98). They immediately embarked on an ambitious program that sought growth through domestic demand expansion, with workweek reductions, increased public spending and hiring, and an ambitious industrial policy that included major nationalizations. The growth measures resulted in an immediate real appreciation of the now EMS-fixed Franc against the D-mark and Dutch guilder, followed by increasing current account deficits. The massive selling of the franc pushed Mitterand's government into requesting a series of devaluations within the EMS framework, achieved both by devaluing the franc and

revaluing the D-mark, but these consistently fell short of the amount needed to stabilize the French current account or the currency's value (Walsh 2000:61-63).

Within two years Mitterrand's government executed a sharp U-turn toward austerity and neoliberal reforms, explicitly justified as a way of shifting national income back to firms away from workers in the hope of spurring investment (Bliek and Parguez 2008). The logic of the EMS, which required accompanying any within-EMS devaluation of the Franc with "internal devaluation" by lowering wages and hiking taxes, were cited repeatedly as the reason that the U-turn was unavoidable. This was true, as far as it goes, and especially so by 1983 when the final decision to remain in the EMS and continue applying austerity was reached; having spent years using the Banque du France's foreign reserves to defend the EMS peg, Mitterrand was shocked to learn their reserves were nearly exhausted and would likely require turning to the International Monetary Fund if France withdrew from the EMS (Walsh 2000:65). But as might be suspected, applying austerity in the name of the EMS was more than simply an issue of the franc's value. Even unabashed admirers of the post-1983 *rigueur* state that:

> "The EMS framework was therefore perceived not simply as a constraint reducing the economic policy-making autonomy of the government, but as both a spring-board and a shield enabling the government to carry out drastic reforms considered necessary by the majority of France's decision makers. Linking the disinflation policy to Europe had the dual advantage of providing both a clear and credible framework – that of the D-mark-dominated EMS – and a political justification for the painful but necessary measures to be enacted" (Reland 1998:76).

It thus came to pass that in the summer of 1982, under this nominally socialist government, a four month wage and price freeze was initiated, junking the policy of indexing wage rates to inflation by "politically clever" means that segued into the systematic weakening of labor protections. Between 1984 and 1987 the unemployment rate would reach nearly nine percent and the labor's share of national income would enter into a long decline.

The power of pan-European institutions, as well as the advancing neoliberal tactical consensus, explains this strange state of affairs whereby "the Socialist Party soon abandoned the euphoria of its first year in power and came to preside over a long decade of austerity in macroeconomic affairs and a gradual distancing from the national tradition of central industrial planning" (Fourcade-Gourinchas and Babb 2002:562). The aim was much as that of the Bundesbank nearly a decade earlier: a "rebalancing of income distribution," or in other words, a recovery of the capital share against the gains made by labor in France starting in 1974. If the external deficit was held up as the reason that expansionary policies must end, it was this latter "rebalancing" that was supposed to provide the means whereby austerity could be turned into growth. At this point we can see the familiar "competitive disinflation" theory coming into view. Shrinking wages should mean more income going to capital and thus, assuming something akin to Say's Law, more investment. It is certainly true that French investment was falling as a share of GDP, much as was the case across the OECD, and before Mitterrand it is hard to tell whether this was due to this general neoliberal process or the austerity of the Barre Plans. Once Mitterrand's government introduced the social-Keynesian expansionary package in 1981 the predictable result in an era of increasingly globally mobile capital was capital flight; the government faced "considerable resistance in securing the active cooperation of the 'Patronat,' or French Employers Association, and had experienced a decided withering away of many foreign companies plans to invest in French operations" (Benedetti 1982:50). Firms' mark-ups in manufacturing had fallen to 3.3% during the expansionary experiment, but the U-turn resulted in a quick recovery: this measure of both profitability and the monopoly power of corporations increased to 11% by 1987 (Potts 2001:174).

Yet more than a decade afterward even sympathetic analysts admit that the outcome was "mostly disappointing" in that "the return to high profit shares has not been followed to the same extent by investment and job creation" (Sicsic and Wyplosz 1996:229). One factor here is that the post-1983 austerity policies, like much of the neoliberal "package" installed in other nations, were bundled together with measures freeing finance from post-WW2 regulations. In France, this meant curtailing state encouragement of investment, especially the long French state tradition of administering and subsidizing investment credit, and instead empowering the Paris Bourse (229). The level of capital's share of national income and net private sector investment are charted in figure 6.8, below. This starkly illustrates the failure of the Say's Law-inspired assumptions about any direct connection between redistribution in favor of capital and investment, with French investment continuing its downward trend since the early 1970s despite the fact that capital regained more than 10% of its share of GDP between 1981 and 2007.

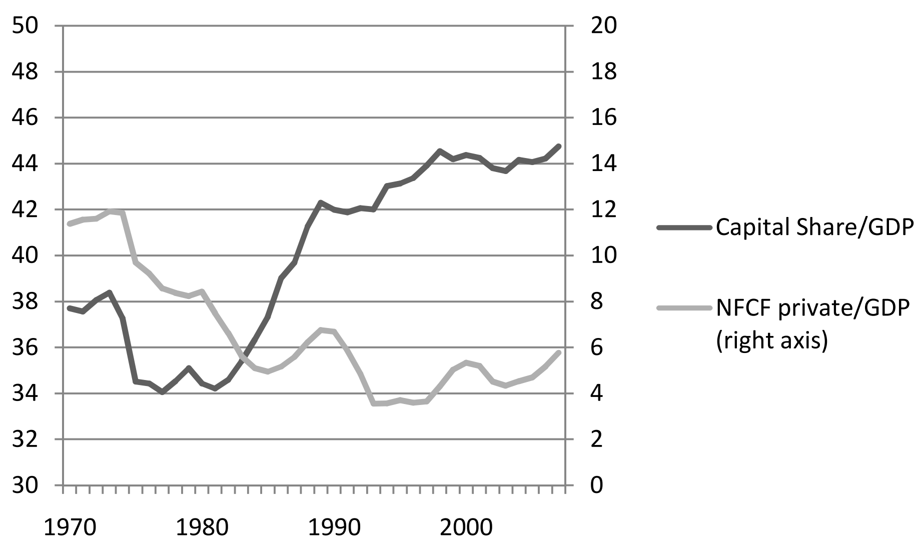

Figure 6.8: French Capital Share of Income and Investment,* 1970-2007

**Net Fixed Capital Formation, Private Sector*
Source: AMECO

There is disagreement whether Mitterrand's decision for austerity was an honest response to a seemingly "undeniable" external reality, or whether his alignment with Marxists like Jacques Attali, who had favored redistribution in favor of profit since the 1970s, meant he was predisposed to take the anti-expansionary path. Bliek and Parguez (2008) hold that the similarities between French Marxists and the hard-money right, especially their shared belief in a Say's Law-style connection between increased profits and investment, meant that the Socialist leadership, especially Economics and Finance Minister Jacques Delors and Mitterand himself, were never truly committed to a Keynesian expansionary approach. Still, Mitterrand's actual decision-making process, in which he vacillated back and forth several times between expansion and austerity, cautions us against a simplistic account of his personal motives (Walsh 2000; Marsh 2009). In any case, there was an increasingly large and influential group of pro-EMS, anti-expansion actors in the government, of which Delors was one of the earliest and most vocal – as early as October 1981 Delors "called for a pause in the [expansionary] reforms" and proposed a slate of austerity measures (Walsh 2000:61; Reichart 2015:32 fn43).

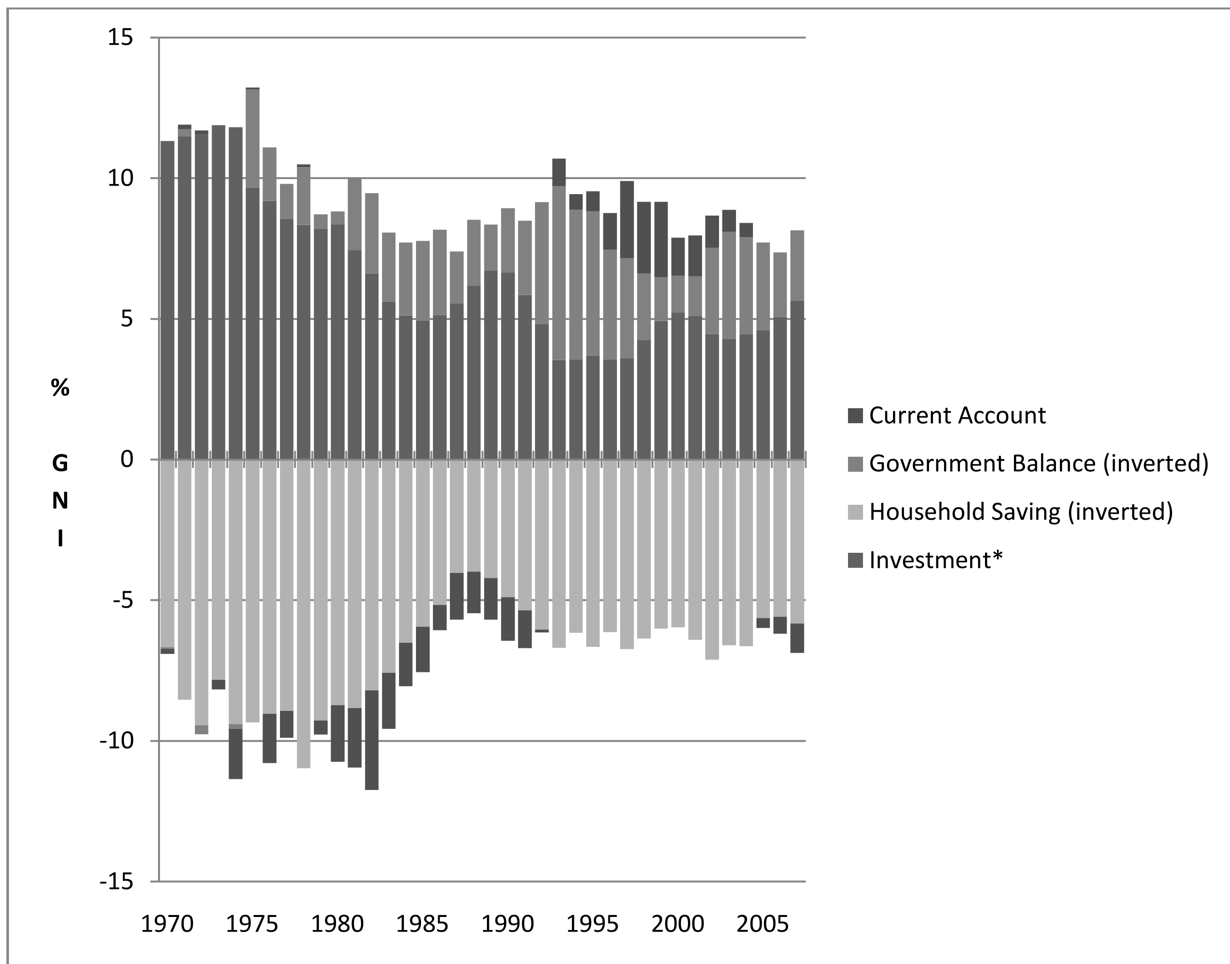

Figure 6.9: Components of Aggregate French Profit, 1970-2007

Source: AMECO, Carrington and Edward 1981, author's calculations

Figure 6.9 shows the components of French profit from 1970 to 2007. In contrast to the German case, we can here see the precarity of French efforts to remain a surplus country. After mostly recording annual external surpluses throughout the 1960s, the 1970s saw France fall into stubborn deficits. This drain on French profit was increasingly made up for by public spending, and the deficit increased until the years immediately prior to Mitterand's election in 1981, where Barre's austerity plans threw the French economy into recession. With Mitterand's initial 1981-2 expansion the government deficit expanded, as did the external deficit, and capital went on strike. Still, from figure 6.8 it is apparent that Mitterand's expansion barely shifted the social

balance in favor of labor, as the capital share remained roughly stable around the level it had already reached by 1975, and yet even as the share of income going to capital greatly increased throughout the rest of the 1980s new investment responded only weakly.

In the end, the "external constraint" was used to bludgeon into submission recalcitrant proponents of wage-led growth or the constructive use of public deficits. Both Bliek and Parguez (2008) and the contemporaneous analysis of Eisner (1983) made clear that the only reason this "U-turn" from domestic demand-led growth to austerity was necessary was the commitment to defend a franc which, it could be argued, was actually overvalued by 20% or more at the time. It is hard to see how, using a variety approach, we can talk of French political-economic development being an outgrowth of a set of inherent qualities, whether institutional or in terms of abstract labor-firm relations. Instead, the entire social model was diverted onto a very different track as a result of the structural relationship with Germany and the rest of the region, the EMS institutions that narrowed French options with regard to that structural relationship, and domestic class struggles between those favoring nationally-focused growth and those committed to the new neoliberal consensus.

The Deficit Bloc under the EMS

The manner in which the EMS sank Keynesian prospects in France was mirrored across the deficit bloc. Here, there was even less prospect of regaining stable external surpluses, avoiding perennial public deficits, or avoiding the need to increase profits by draining income from the wage share. Here I focus on Italy and Spain, and the way the EMS provided both the justification for and enforcement of the restructuring of national priorities, incomes, and institutions in favor

of capital. Parallels in Greece, Portugal, and Ireland abound. Of particular importance is the way the response of elites under the auspices of the EMS weakened labor in these countries, setting the stage for the 1990s in which new "social pact" agreements would be reached in Italy, Spain, and Ireland in a manner that even further disempowered the unions.

Spain, Portugal, and Greece all followed a similar path in the 1960s and 70s, with a fast opening to foreign capital and trade fueling growth, productivity increases, and with looming current account trouble covered up by monetary receipts from tourism and remittances from abroad (Holman 1987/88). These "three miracles" all relied on growing world demand, state direction, and continuing wage increases; they also evinced a lack of regional coordination, a pattern that would be seen increasingly over the next few decades in which there was "very little exchange of goods or ideas between the Mediterranean countries, although each of them has been slowly drawn in by the industrialized core of Western Europe" (Tsoukalis 1981:96).

In all three, the 1970s brought political upheavals that ended dictatorial regimes. The ensuing chaos made any question of easily continued growth moot and, importantly, broke up what had been incipient domestic capitalist classes and began the formation of a new, more transnationally-oriented elite. Up until the 1970s revolutions, "in Spain, Portugal, and Greece, an autonomous, autochthonous (or national) bourgeoisie existed, characterized by strong ties with the state apparatus" and despite ties to foreign business interests there was no question that domestic elites remained independent (Holman 1987/88:18). This is one reason that characterizations such as those of Vergopoulos (1987/88:107) that the "countries of the South had simply succeeded in grafting themselves onto the prosperity of Western Europe" are overly negative, especially when applied to Spain and Italy which saw industrial advances in the decades before 1980. This verdict is closer to the mark when describing the EMS and Euro eras,

in which exchange rate rigidity, together with the increasing financialization of all of Europe, distorted Southern industrial development.

After the early 1980s Socialist party victories in Spain, Portugal, and Greece their trajectories converged with Italy and Ireland. In all five countries, strong union movements crashed headlong into the global context of high interest rates, slow growth, and rigid exchange rates in the Italian and Irish case (and not much more exchange rate freedom for the others, given their increasing drive to converge with EMS members). The result was that center left governments took on neoliberal concerns about international competitiveness and a pro-EMS orientation, and as a result applied fiscal austerity and labor market deregulation while working together with central banks to maintain high real domestic interest rates and thus unemployment (Holman 1987/88; Murphy 1999; Baccaro 2008; Baccaro and Howell 201; Culpepper and Regan 2014).

In Italy, the 1970s saw beginnings of a policy-based divergence that revealed why, despite their similarity, France and Italy would fall on opposing sides of the neomercantilist-deficit divide. In the face of Germany's successful early 1970s attempt to use the upwardly revalued D-mark to lower their import costs, France attempted to emulate this strong currency path by continued efforts to protect the franc, rejoin the Snake, and by the late 1970s began a more austere approach via the Barre Plans. Italy, instead, embarked on a growth strategy built on wage rises, inflation, and the devaluation of the lira in order to maintain external competitiveness (Halevi and Kriesler 2016:324-26). The Italian strategy implied a bid for exports as "the Bank of Italy favoured a revaluation of the lira against the dollar, thereby reducing the cost of oil, and a devaluation against the other European currencies, thereby enhancing Italy's exports *vis a-vis* Germany's" (Halevi 2016:385). Unlike the German strategy, however, Italy's demand expansion meant this export orientation could have been generally pro-growth for all of Europe if it had

been coordinated across Europe. Whereas France languished in external deficit for most of the 1970s, defending its overvalued franc, Italy's strategic devaluations netted it a surplus against Germany toward the end of the decade that would last until the early 1980s**.**

By 1978, the political establishment and Italian business interests were looking to escape this high wage, flexible exchange rate strategy. Employer organizations pushed to join the EMS as a way to attack the *scala mobile*, an ambitious and comprehensive inflation-indexing plan won by Italian labor in 1974 at the apex of its power. The *scala* reduced firms' ability to squeeze wages as a form of cost control and gave unions powerful political leverage; the anti-*scala* motivation was one major plank of the larger demand set of Italian capital, who "urged a transfer of macroeconomic decisionmaking power from the state to the market through the entry in the ERM [Exchange Rate Mechanism]" (Talani 2000:33). Under the EMS, the devaluations that did occur were too small to offset Italy's inflation differential with Germany, resulting in real appreciation of the lira. In contrast to the 1970s, under the new institutional framework Italy's model created a worsening external deficit; as in France, this slide into current account deficit provided the impetus for an anti-labor program (Halevi and Kriesler 2016).

The loss of the *scala mobile* was made possible by continued unemployment that gradually ate away both the structural power of Italian unions and the goodwill of Italian voters toward labor, and eventually created a climate in which labor was so weak that in 1993 a Tripartite Agreement could be concluded that amounted to a wage-suppression scheme. The unemployment was itself made possible by the high interest rate policy pursued by the Banca d'Italia, newly independent after it was largely released from Treasury control in 1981. Finally, this high interest rate policy, squeezing inflation out of the Italian economy via sustained high unemployment, was justified in light of the EMS. Nino Andreatta, Treasury minister in the early

1980s, himself admitted that the independence of the central bank “was born as an ‘open plot’ between the Treasury minister and the Banca d’Italia Governor. Before a coalition of those whose interests were affected could take counter-action, it was a *fait accompli*. It would have been too costly, especially on the exchange-rate market, to go back to the old status quo” (p. 77).

But more important for the interrelation between domestic social struggles and the pan-European institutions, Andreatta concludes that “[t]he divorce [between the Treasury and Banca d’Italia] was an unavoidable consequence of EMS membership” (77). The central bank, which had pulled nominal short-term interest rates up to almost 20 percent, lowered them only slowly as unemployment and wage moderation took hold; real short-term rates, negative for most of the post-WW2 era, reached 5.8 percent by 1984. By 1985, major reductions in the *scala mobile* could be attempted, first via decree by Socialist Prime Minister Bettino Craxi and then supported by a narrow referendum later in the year (Talani and Cerviño 2003:207-8). Here too, pan-European institutions played the dual role: as an enforcer of structural surplus-deficit relations on Italy and as a discursive weapon of use to Italian elites. The multi-stage erasure of the *scala mobile* “was made possible by commitment to the EMS, with all that it implied in terms of strict anti-inflationary policies, which, in turn, both was a consequence of the new dominant position of Italian capitalist groups and contributed to further strengthening their position” (Talani and Cerviño 2003:206).

This process of neoliberal reform, which eroded labor’s tactical options and decreased union density in a high-interest rate environment, parallels the situation in Spain. The Moncloa Pact was introduced after the first democratic elections in 1977, combining an income control policy with an attempt at tight monetary but accommodating fiscal policies. This resulted in stabilization of the inflation rate and a move into external surplus between 1977-1981, though as

we have seen the current account corrections of the late 1970s were helped along by exchange rate flexibility. The resulting "employment destruction represented a severe brake on growth" and, what little growth there was relied on capital accumulation and technological catch-up (Prados de la Escosura and Sanz 1996:373-74). Despite this technological transfer the lack of any full-employment policy meant that unemployment jumped from 11.6 percent in 1978-82 to 20% in 1983-85; this kept capital deepening from being sufficient for industrial upgrading. While these facts are acknowledged by analysts such as Prados de la Escosura and Sanz (1996:373-74) it is not connected to the nature of the Moncloa Agreements as an attempt to come to terms with the external constraint. That is, it seems doubtful that any government could have achieved full employment and the wage growth it implies in the context of a surplus bloc and especially a Germany ready to draw surpluses away from Spain as growth induced an increase in imports.

For Spain, "the post-1982 "'extended relaunch' of the European integration provided both the institutional framework and the external legitimation for the implemented austerity policy" (Holman 2005:125; Lieberman 1995). Holman (1987/88:12) points out that the Spanish left undertook the same strange migration that characterized France and Italy, where "the 'socialist' changes were (Portugal) and are (Greece, Spain) characterized not by spectacular social reforms….the way in which these parties have played a leading role in the so-called 'internationalization of international austerity' is astonishing."

The series of Spanish socialist party governments undertook restrictive monetarist measures and "justified the social costs of its economic policy as the price of deepening integration [with the EU]" (Murphy 1999:56). The rapidly advancing financialization of the era played a part; the process of freeing capital movements was just beginning with Germany's

groundbreaking liberalization in 1981 and the Netherlands in 1986, and this would proceed domino-like until full liberalization for all European member states after 1985's Single European Act (Hoffmeyer 2000:16). With each step Spain took toward closer integration, the more policymakers recognized the need to compete for internationally mobile capital. This increased the pressure to hew closely to the deflationary "sound money" practices that were favored by both finance capital and the EMS framework that Spain hoped to eventually join (Lieberman 1995).

Towards the end of the decade privatization of public firms, as in Italy, became of central importance to Spanish industrial policy, and for similar reasons: "the sale of state assets was the only feasible way that the PSOE could reduce the public deficit and promote the kind of capital investment required to expand the share of Spanish countries in an integrated market" (Murphy 1999: 59). Again we might ask, what made this "the only feasible way" for Spanish development? Spanish policymakers, threatened by both a strong working class and the risk of being shut-out from the increasingly integrating European market, felt no option but to swim deeper into the European institutional waters. At the same time, the currents became ever more demanding and dangerous thanks to rapidly increasing European Community rules against subsidies and regulation, paired with the fact that the Single Market completion created an exaggerated Polanyian total commodification of goods, capital, and people.

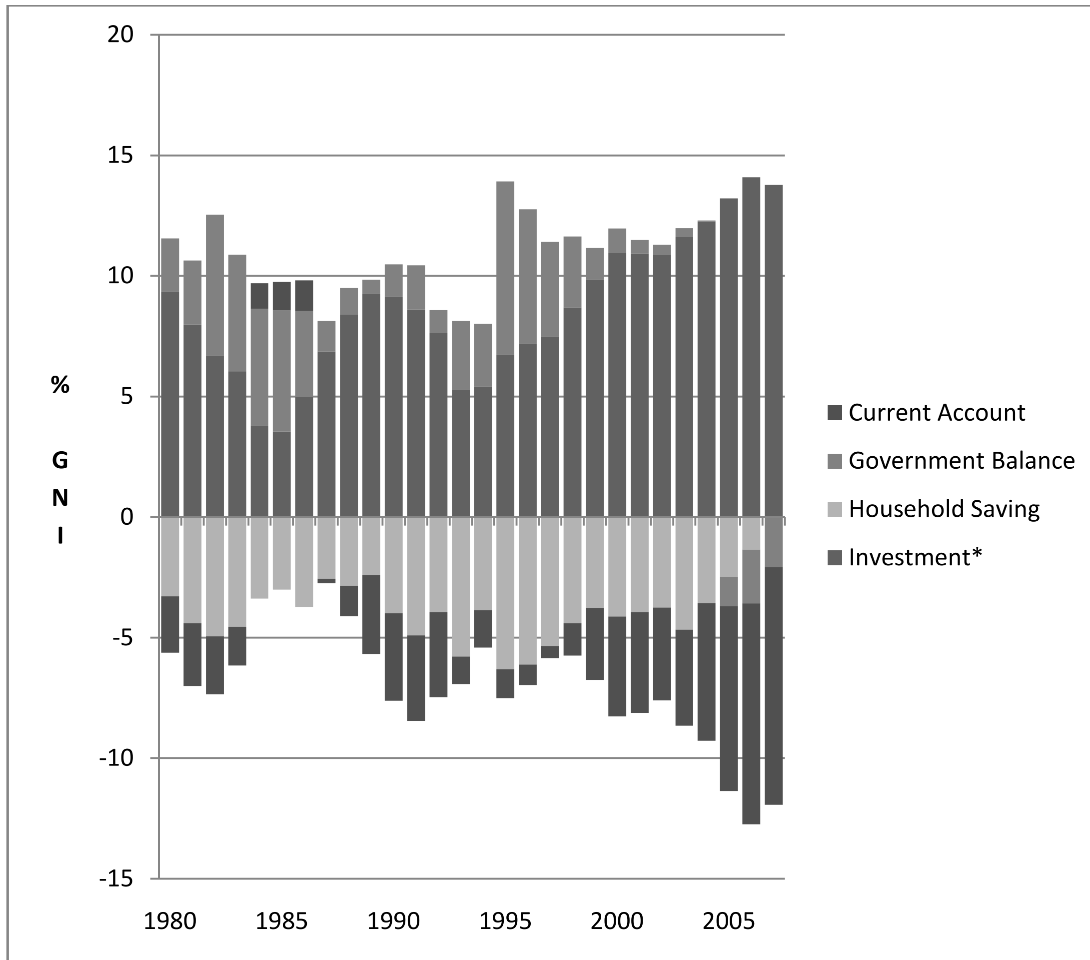

Figure 6.10: Components of Aggregate Spanish Profit, 1980-2007

Source: AMECO, OECD, author's calculations.

Figure 6.10 traces the sources of Spanish profit from 1980 to 2007. The austerity effort of the first half of the decade is apparent, as investment crashed and government spending held level, winning a small current account surplus from 1984 to 86. Yet as soon as investment increased in the latter half of the decade, so too did the external deficit, a drain on profit that would lighten somewhat in the 1990s and then increase sharply once the Euro was adopted. In Spain's case we can see how speculative investment, particularly in their housing bubble, was able to substitute a form of fragile growth for the continuing current account drain. In the Spanish case, unlike the Greek, this private sector debt accumulation took the pressure off government budgets, allowing the state to scale back its deficit spending as a source of profit by

the late 1990s. The most prominent change, however, remains the long-term increase in current account deficit as a drain on profit, an inverse of the German and Dutch cases visible in figures 6.5 and 6.6.

What is remarkable is that this multi-country effort to induce industrial restructuring and win back labor's national income gains across the deficit bloc, only fully succeeded on the latter front. The deficit bloc saw capital productivity begin to fall in the mid-1970s, as firms began to accumulate excess capacity, but the later trend across the EMS years, for all except Ireland, were even further falls in capital productivity which likely indicates increasing misallocation of investment resources. Bellofiore and Halevi's (2007) account of the failed Italian restructuring typifies this general process; they point out that by the 1980s whole sectors had nearly disappeared: nuclear engineering, electronics, pharmaceutical chemical, civilian aeronautical, automotive, steel, and telephony and "no active [industrial] policy was ever put in place, just a 'passive' adaptation to foreign competition" (p. 228). Weakening the Italian labor force through sustained unemployment and letting sectors decay likely contributed to falling productivity, and this left only two routes open to maintain profit rates: to try to increase capital's share of national income via weakening of labor institutions such as the *scala mobile*, or "using public expenditure to help the profitability of firms" which implied increasing budget deficits, privatizations (Halevi 2016:388).

These policies safeguarded profit throughout the deficit bloc, with precipitous drops in the wage share, increases in public deficits, and a rapid move from protected labor markets toward a much higher level of flexibility (Talani 2000). Brief 1980s recoveries of the current account appeared via austerity, especially in Italy and Spain, but slipped away as the EMS narrowed further and German surpluses expanded; at the end of the decade all deficit bloc

countries were registering external deficits. In the increasingly neoliberal policy environment of the 1990s this was taken to signal a need for more of the same, particularly a need for privatization and wage-suppressing tripartite agreements in Italy, Spain, and Ireland. Whereas in the 1980s, deficit countries took the edge off austerity with occasional devaluations, by the 1990s, France, Italy, Spain, and the other deficit countries began to eschew devaluations while applying fiscal austerity in order to lower their deficits enough to join the Euro (Walsh 2000:129,133-37). Once again the Italian case is typical, with the newly privatized service sectors allowing increased monopolization and thus protection of profit (Tropeano 2011; Torrini 2005). The 1993 Tripartite Agreement, pushed through under the pressure of yet another lira revaluation crisis, was sold to unions as a trade off: wage moderation in exchange for increased investment in innovation. Unions were rightly worried about increasing corporate profit never finding its way into useful investment, as we have already seen occurring in France. But this "pact of exchange" was not honored. Social pact promises shipwrecked on the reality that the by-now weakened labor movement could lower its wage claims, but could not force capital to keep its half of the bargain (Culpepper and Regan 2014).

Just as important were two factors stemming from the pan-European institutional framework. First, the 1990s and 2000s saw a succession of plans for a more neoliberal reorganization of European social support and labor protections. Here "flexicurity" was promoted above all else, such initiative appearing in various national settings as a result of the European Employment Strategy of 1997 and the Lisbon Strategy in 2000 (Preece 2000). More often than not, the "flexibility" in hiring and firing increased with little to show for it in the way of employment "security." Second, government and corporate promises of more investment and social support were in direct collision with the standards laid down in Maastrict, which

demanded extreme hawkishness in the reduction of public deficits and debt (Grahl 1997; Preece 2000).

Only Italy and Ireland moved into external surplus in the middle of the 1990s, and only Ireland sustained multiple years of surpluses of nearly 3 percent of GDP. In this latter case, the country briefly known as the "Celtic Tiger" was sustained by its headstart as an FDI destination and ability to leverage its English-language workforce to achieve an important middleman position in financial services (between 1989 and 1998 employment in foreign manufacturing grew 24.8, while employment in services grew by 384.5 percent) (Ó Riain 2000:160). Seen from our post-2008 vantage point, Ireland's capital inflow-fueled growth and housing bubble seem less a "tiger" and more of a harbinger of the problems that would soon appear in Spain and Greece. Some perceptive analysts saw this quite early, noting that "the sources of Irish growth raise questions about its sustainability" such as "Ireland's extreme dependence on foreign investments from a limited range of sectors" (O'hearn 2000:68).

Overall, the deficit bloc under the EMS showed the beginning of the distorted growth patterns that would continue under the Euro. Development occurred, but accompanied with a slew of socially damaging neoliberal measures papered over by FDI inflows, the lessening of current account pressure in the 1990s, maintaining private profit and some degree of the social safety net via increased public expenditure, and the temporary boost to public budgets (and monopoly profit) afforded by privatization. Yet in the same way as the secular current account increase visible in Germany and the Netherlands, the deficit bloc saw a continually increasing drain that was disguised, for a time, by increasingly precarious tactics.

The Later EMS and the SEA

Seeing the French turn to austerity as the turning point in the EMS requires demonstrating that the later EMS regime narrowed its functions and lost room for national autonomy under the influence of the surplus-deficit relations. This section surveys the EMS from the mid-1980s until the system's end and the definitive Euro plans of 1992-93. First, I examine changes to the EMS's rules that helped make the EMS a more Deutschmark-centered system and allowed the surplus bloc to accumulate larger surpluses than ever before. I then connect this structural divergence between blocs and the institutional narrowing of the EMS to another well-known institutional milestone: the 1987 Single European Act (SEA). The SEA was inconceivable without the narrowing of the EMS, and in particular the capitulation of France and then the deficit countries to a more neoliberal style of growth premised on suppressing wages. Tracing this link between the surplus-deficit relation, the narrowing EMS, and the SEA is a prerequisite to our discussion of the Euro's formation in this chapter's final section. The accomplishments of the SEA, especially in terms of freeing capital flows and completing the free movement of goods and people in the Common Market, increased the structural power of German surpluses and interest rates over the rest of the continent. This pressure then worked to spur all states toward the economic monetary union plans that would be formulated at Maastricht.

There is debate over precisely when and how German dominance was asserted over other European countries within the EMS. Grahl (1997) notes that some statistical studies of German influence on European money supply measures, interest rates, and the Bundebank's own monetary sterilization procedures cast doubt on the idea of German dominance in the early EMS

but show increasing influence in the later 1980s Yet we have seen that the structural pressures exerted by Germany's central role in the surplus bloc meant that, first, the institutional settings of the EMS designed to impart some measure of symmetry (such as the divergence indicator or obligatory symmetrical intervention) were rarely used despite their formal existence, second, the formal rules themselves were progressively changed to the advantage of surplus countries, and, third, that the surplus-deficit relations' impact on domestic political decisions undertaken by EMS members is just, if not more, important as an indicator of how unbalanced the regional situation truly is. The French U-turn is a prime example of this last avenue for German structural influence.

The first two of the above elements encompass *de jure* and *de facto* changes in the EMS's functioning that advantaged surplus countries and encouraged all member states to attempt a competitive disinflation stance. The Bundesbank's attack on the proposed European Monetary Fund (EMF) was one harbinger. The EMF would have pooled reserves and made repayment of debts contracted in order to defend rates less onerous – instead, Bank officials made a "special effort" to undermine any reserve pooling scheme and only yielded a small bit of reserves on a "swap" basis recallable and controllable by the Bundesbank's whim (Marsh 2009:234, 333 fn 15 and 16). Another was the manner in which Pöhl, reflecting on his tenure at the head of the Bundesbank, looked back with "satisfaction" at the way they undermined the ECU and its prospects for creating a more symmetric framework: "The Bundesbank turned the original concept [for the ECU] on its head by making the strongest currency the yardstick for the system" (Marsh 1992:233).

Later changes had a similar flavor despite the fact that the French, hoping to fix the system's increasingly obvious asymmetries, were the main instigators of 1987's Basle-Nyborg

reform negotiations. Here again, the preferences of Italy, France, and Germany remained quite distinct, and again the French (and increasingly the Italians) argued for increasing the automatic functioning of the system in hopes of escaping the dominance of the D-Mark. The Basle-Nyborg changes provided increased financing support for intramarginal interventions and allowed partial intervention and repayment in ECU. While this was at first trumpeted as a victory by the French, within a year French finance minister Edouard Balladur sounded the alarm. This would mean even stronger pressure on deficit states, given freer capital movements and the fact that surplus countries could simply sterilize any of their own interventions indefinitely. All the same, the Bundesbank still simply refused to engage in intramarginal interventions, leveraging its structural power (Walsh 2000:87). The most important change at Basle-Nyborg, however, was fully in the German's preferred "economist" direction, and consisted of an agreement for countries to deemphasize market intervention to keep their currencies from drifting; instead, they were to raise interest rates when there was downward pressure on their exchange rate (Grahl 1997:73-4). In light of the Deutschmark's position as "anchor" currency, setting the acceptable floor for inflation and interest rates, this amounted to a recipe for deflationary bias, predisposing deficit countries to raise rates, slow growth, and internally devalue by lowering wages.

Other lines of evidence support the idea of increasing surplus bloc dominance in the EMS. Peter Henning Loedel (1999) undertook detailed analysis of how much, and when, Germany accommodated the monetary and exchange rate demands of its partner OECD countries, looking for differences in how open German decision makers (including the Bundesbank) were to demands from the non-European G7 versus demands from European member states. He finds that after the mid-1980s Germany became more accommodating in European negotiations and tougher in G7 negotiations, where the latter were mainly a venue for

the US-German negotiations. Pöhl, head of the Bundesbank, together with Gerhard Stoltenberg at the Finance Ministry and the representatives of export interests were in agreement that they would, if needed, realign with EMS partners or even, in 1986, lower the German discount rate by 50 basis points. Yet they were also aligned *against* any demands for domestic German expansion (Loedel 1999:72-74). This mix of conciliatory monetary moves and fiscal rigidity only makes sense if we recall that "from 1983 onwards, economic policy orientations were relatively convergent in Western Europe, heading towards austerity" in both France and Italy (Ziltener 2000:41-2). This explains how the Bundesbank could state that it was all for "convergence," with others adopting "fiscal responsibility and monetary stability," but *against* "coordination/cooperation" (Loedel 1999:75, fn 87).

1985's Plaza Accord, in which the US secured agreement from Germany and Japan to support the dollar, must therefore be seen in this light. With coordinated expansion now off the table and not seriously discussed further as a part of European institutional scene, it is significant that the only kind of coordination still undertaken was on the dollar and due to direct hegemonic pressure. Each country's finance ministers took a "secret decision" to coordinate central bank operations, effecting a "soft landing" for the dollar and dropping its value 10-12% (Reichart 2015:23 fn 25). In truth, once the dollar began falling Germany began to marshal its defenses to resist any pressure for demand stimulation, not taking part in the US-Japan talks in October of 1986. More revealing is that, at the meeting of EMS finance ministers and the Bundesbank in Scotland that same year, Germany agreed to EMS revaluations in exchange for its European partners resisting US pressure for demand stimulation and making efforts to strengthen the dollar against US efforts to devalue (Loedel 1999:75-76).

Over the same decade the EMS narrowed the European Commission (EC) regained a strength not seen since the 1967 Luxembourg Compromise. The Compromise had marked the definitive priority of European state ministers, and their intergovernmental negotiations, over the more supranational role of the Commission. Yet with the comprehensive monetary interconnection engendered by the EMS, and especially the convergence of the major players toward a Germanic austerity-tinged growth model, the time was ripe for a revival of an activist Commission. This culminated in the first major revision of the EU's founding Treaties since 1958. The Single European Act (SEA) turned Europe into a true "Single Market" in which goods, capital, and people all moved without restriction. Below I connect the SEA, a vital step toward the single currency, to the French U-turn, the EMS, and the neoliberalism that informed both.

The newly energized European Council worked extensively with, and indeed partially owed its revival to, the European Roundtable of Industrialists (Bornschier 2000). The Roundtable, representing transnational firms, and the Commission, representing supranationalism and an increasingly cosmopolitan continent-wide bureaucracy, exerted a powerful influence on European governments. Like the 1950s under Jean Monet and 1960s under Walter Hallstein, both eras in which the Commission was driven by a talented executive looking to exploit functionalist linkages, the 1980s Commission hit its stride under the Presidency of French political star Jacques Delors. Again like the earlier period, the Commission leveraged its ability to propose and facilitate pan-European initiatives as a way of pushing national governments to undertake difficult integration steps. By packaging the initiatives in take-it-or-leave it "bundles," the Commission cajoled any objectors (Ziltener 2001). Here the concept of a policy "entrepreneur," sometimes mentioned by field scholars but often sidelined in

favor of emphasizing gradual field-like institutionalization, certainly seems to apply to the Commission. In turn, it was the Roundtable that was largely responsible for prodding the Commission into action and "urg[ing] the Commission to act as a political entrepreneur" (Bornschier 2000:xii).

The SEA negotiations still displayed the usual realist-style wrangling. As we will see, national preferences still failed to converge and *realpolitik* was the final arbiter. Still, along with the general neoliberal shift that characterized the era, the empowering of the Commission and Roundtable *did* change the dynamics of the institutional formation in a way that basic intergovernmental models have trouble incorporating (Mazzucelli 1997:9). Sandholtz and Zysman (1992), speaking in the year of Maastricht, reminded scholars overly focused on intergovernmentalism that "[i]n the first European movement that established the ECSC and then the EEC, there were no European institutions shaping and activating the players" (108 ff). Unlike the basic intergovernmental assumption that institutional outcomes are the "lowest common denominator" of rational choice bargaining, here instead there was a strong element of path-dependence that forced governments along. This is both because the Commission's proposals are presented and voted on as "bundles" and because, for the structurally integrated economies of the continent, "in comparison with international regimes, owing to the level of integration already achieved, withdrawing participation in the integration process is tied to much higher costs" (Ziltener 2000:43).

This latter form of institutional lock-in, as well as the supranational and transnational interests embodied in the Commission and Roundtable as detailed in Bornschier (2000), jibes in a general way with the field approach. Yet there are at least two important differences. The interests of the participants *other* than pure Commission bureaucrats seem far from any

endogenous logic of a coalescing field, shared by most participants, and the institutional outcomes cannot be reduced to a process of institutionalization toward a stable equilibrium. Rather, German, French, and Italian governments deployed stratagems in response to the structural situation, especially external surplus-deficit relations, the way these relations would be aggravated by increasingly free capital movements, and internal class conflict about wages and labor flexibilization. Moreover, these actions were undertaken both to ward off institutional innovations each state wanted to avoid, and to coerce or persuade others into supporting institutional innovations that were advantageous. For each state, this balance sheet of advantages and disadvantages only made sense in light of their position in the regional economic structure, and particularly their position as a safe surplus or possible deficit economy. Even the conglomeration of transnationally-oriented European firms represented by the Roundtable had an interest set, revolving around trade and capital liberalization, that was conditioned more by neoliberalism than any specifically European institutional logic; this can be seen in their overriding concern with capital liberalization and labor market deregulation, paralleling almost exactly increasingly globalized capitalist interests in the United States (Preece 2009).

Several aspects of the process lend further support to the argument that structurally-defined and informed state strategy shaped the negotiations. The first, and perhaps most important, is how completely the passage of the SEA and subsequent move toward the Euro depended on the turn by France, Italy, and prospective members such as Spain towards austerity. A Commissioner from the period, Karl Heine-Narjes, states flatly that the integration thrust toward the single market was only a possibility because France "left its course of national, socialist economic policy" (quoted in Ziltener 2000:41 fn5). Such a claim is strengthened when it becomes clear, as we will see, how central Jacques Delors was to the creation of the SEA, the

Delors Report (which revived plans for monetary union), and the outcome at Maastricht – all of which can be said to have flowed from his role as enforcer of French austerity when he was Finance Minister in the early 1980s.

Much like the ambitious Commission plans towards the end of Bretton Woods, the SEA was also enabled by the rosy economic conditions of the era; these conditions often proved short-lived. Volcker's raising of interest rates (and President Reagan's surreptitious fiscal expansion a few years later) caused the dollar to continue to strengthen until mid-decade. As alluded to earlier, the dollar and D-Mark represent close substitutes for international capital searching for a safe store of value, and the strengthening dollar meant less upward pressure on the Deutschmark over the same period. In turn, this meant less pressure driving the currencies apart *despite* the French drama and revaluations of the early EMS (Lucarelli 1999: 104-106). This is precisely the era in which, even though governments retained skepticism toward grand unification plans, the Commission and the Roundtable were building their strength. By September of 1985 the Plaza Agreement ended this auspicious strong dollar period, but this was the same moment that the European states had already fallen into line behind the austere orthodoxy.

Mitterrand's government had been recalcitrant in that it initially limited itself to demanding traditional French-backed confederalism, but after his administration committed itself completely to the EMS and austerity they suddenly announced their receptiveness to revising the foundational 1958 treaty. Pedersen (1998) meticulously charts this changing government sentiment, and holds that "[t]he failure of the socialists growth policy had caused a shift of emphasis from the national to the European level in French economic policy" and, just as importantly, "the European issue was a useful means of sowing division within the right-wing opposition" (p. 90). Even early on, then, pan-European institutional membership became a

weapon in the hands of centrists committed to a neoliberal model against any "protectionist" or "nationalist" domestic-led growth approach.

Finally, state power was the essential starting *and* ending point of the process; most obviously, Delors was granted the EC Presidency by state powerholders because of his central role in the French turn. Procedurally, Germany's had a firmer claim to nominate the next Commission president, but both Kohl and Thatcher agreed because of Delors' role in "rein[ing] in the Mitterand government's initial left-wing policies" (Bornschier 2000; Pedersen 1998:97). . The Roundtable itself, representing the most powerful capital interests on the continent, also pushed for Delors to gain the Presidency (Lucarelli 1999). Moreover, without the successful turn and thus stabilization of the EMS along austerity lines it is doubtful that the SEA and 1992 negotiations would have continued as smoothly as they did, regardless of the collaboration of the Commission and the Roundtable which generated the basic blueprints of integration. After all, the fate of the Werner, Barre, and Schiller plans has already demonstrated how easily ambitious and well-worked out integration plans can shipwreck on the reefs of social and economic upheaval.[50]

From the SEA to Maastricht and the Euro

The return of the Commission and its work with the Roundtable leading to the SEA indicated a revival of supranationalism in European institutions. Yet as earlier institutional frameworks have shown, the impulse toward integration says little about the *form* such

[50] The early 1980s saw its own series of early integration initiatives, from the Genscher-Colombo plan, the early French Socialist plan for a return to majority council voting and confederalism, and the European Parliament's 1984 draft treaty, none of which took hold. Bornschier (2000:46) notes that, given their mutual incompatibility, none of these can be considered viable precursors of the eventual SEA.

integrating institutions will take. When it comes to pan-European *economic* institutions, which in truth make up the heart of the integration effort, negotiations shaping and implementing the institutional outcome reveal the force of realist national politicking and political-economic concerns in a way that belies any rhetoric of cooperation.

This section focuses on the pivotal years between the SEA in 1987 and the Maastricht Treaty in 1992. At Maastricht the underpinnings of the Euro area were put in place. Decisions were taken that put Europe inevitably on the path to having a single shared currency with no possibility of devaluations or revaluations, of giving up any national money creation abilities and ceding this core state function to an independent European Central Bank, and even to binding an even more essential state function, fiscal policy, with the Stability and Growth Pact. This marked a period in which recycling, coordination, symmetry, and fiscal autonomy were all thrown overboard in favor of the hope that all member states could follow the deflationary German method of dealing with surplus-deficit imbalances. This final section, then, takes us directly into the 1999-2007 years that we first analyzed in chapter three, connecting the history of neomercantilism to the era in which its contradictions blossomed into open view.

The character of the Single Market completion was, in a word, neoliberal. The portion of the SEA committing to the full completion of the internal market, the "1992 Project," argued that "[t]he creative forces of free movement of goods, people, and capital, so the proponents of the scheme declared, could never be completely unleashed as long as eleven different national currencies were circulating" (Marsh 1992:229). This is the reasoning famously excoriated by Polanyi (2001[1944]), according to which all human labor and resources, no matter their local particularity, must be regarded as "fictitious commodities" to be moved about as the market dictates. The break with the earlier corporatist models of European growth or even the economic

nationalism of the Gaullists was stark, and this "paradigm shift away from prevailing corporatist forms of State regulation (ie, the welfare state, Keynesianism and industry intervention) coincided with the demands of transnational corporations based in Europe" (Lucarelli 1999:136).

The demands of large corporations, embodied in the Roundtable, were influential because they aligned with German priorities. The Bundesbank's obsession with monetary stringency and the export elite's drive for liberalization became components of a German stance that matched the increasing influence of transnational firms and financial capital worldwide. Time and again in the ensuing negotiations the Germans made it obvious that their core motivation was ensuring total liberalization, not just of remaining trade barriers but of capital flows. Germany had been among the earliest European states to remove capital controls, doing so in 1981, an unsurprising move given the overpowering need for freedom to dispose of their surpluses (Lucarelli 1999).

At several turns they held out various measures as "carrots" during negotiations to achieve this; indeed, even the prospect of monetary union itself was used as a bargaining chip, as "[b]oth the UK and Germany agreed to inscribe the EMU objective into the Single Market treaty in a compromise to encourage other countries, predominantly France, to sign up to a comprehensive liberalisation programme that would include ending restrictions on capital movements" (Marsh 2009:110). Genscher, an early and vociferous advocate of federalism, linked integration to capital liberalization and pressured both Italy and France in this direction, while at an important ECOFIN meeting in 1987 German Finance Minister Stoltenberg made it known the German government would be open to EMU *if* full capital liberalization directive was adopted (Mazzucelli 1997:41). This locked-in timetable for capital liberalization, slated to take effect in 1990, then provided a recursive pressure on France and deficit bloc states to push ahead with integration; free capital flows would make the Bundesbank's decisions on interest rates an

iron constraint on everyone else's policy choices, leaving further integration the only apparent escape route (Lieshout 1999; Potts 2001).

Working at the heart of the negotiations, Delors was aware of the importance of embedding these forms of liberalization in the SEA initiatives to complete the internal market; "[h]e astutely linked internal market reform to EMU by introducing the directive on capital liberalization" (Mazzucelli 1997:41). Grahl (1997:108) portrays Delors as making a "Faustian compact" that allowed him to hasten integration but only if it was given a neoliberal character; despite his weak attempts to incorporate social protections at the European level (which became a dead letter), it is hard to see Delors neoliberal predilictions as out of character given his earlier role in French austerity. Delors used the same "bundle" tactic that worked when forging the SEA to hurry the deficit bloc along, repeatedly holding out the prospect of increased EU funds for the weaker deficit states (Gauron 2000). This was greatly helped by the increasing momentum taken on by the process itself. In part, this path-dependency accounts for why the formation of the SEA, the Delors Report, and Maastricht bear such a close resemblance to each other; by this point "integrative steps previously achieved, via the Single European Act, were 'locked-in' and that the costs of opting out for France and Germany in particular were higher than those of continued involvement" (Mazzucelli 1997:298).

The deep link between the federalist neoliberalism of the center left and the more well-known neoliberalism is highlighted by the strange partnership of Delors and Thatcher. Here we see another "Faustian compact," this one allowing the Commission to enlist the British as allies in pressing for the kind of deregulatory, monetarist-flavored integration measures that were most palatable to Germany. Throughout the 1980s there was still a chance of full British participation in the future monetary union, and Delors' efforts to give the SEA and Maastricht a neoliberal

character brought Thatcher and her right-wing neoliberals on board against French and Italian efforts to have a less deflationary , less deregulated form of integration. Gauron (2000) argues that Delors and Thatcher "were united in their crusade against the state" such that the SEA and later developments toward EMU

> "would not have been achieved without the involuntary complicity between Delors and Thatcher. They were set against each other in every way, because of their reciprocal hostility…and because of their different views of Europe. The first dreamed of a politically unified Europe, the second only wanted a greater market, unified and open to the world….However, to succeed, both had to remove the obstacles of regulations, subsidies, and other state interventions. Both wanted deregulation, even if to Delors it was for the sake of European integration, and to Thatcher, for liberalism" (p. 116).

The neoliberal character of the SEA's Single Market plank thus set the precedent for both the Delors Report and then the Maastricht Treaty. These latter negotiations were again disproportionately driven by Germany, who would stress again and again their role as "paymaster" of the current and proposed European institutions (Pedersen 1997:95). Walsh (2000), looking backward at both the formation of the Delors Report and Maastricht, concludes that "German preference regarding the rules of monetary union were most important in determining the outcome of the negotiations" (p. 103).

In June of 1988 the member states formed the committee that would produce the Delors Report, tasked with being a latter-day Werner Report that could provide actionable steps toward monetary union. Germany appointed central bank presidents to the committee, while France installed Delors as chairman (Lieshout 1999). The central bankers were not merely window dressing; throughout the process the principle drafter of the report was the Bundesbank's own Karl Otto Pöhl, who frankly admitted that he ensured that the committee's proposed ECB would never "be authorized to finance public deficits by monetary creation" or allow the deficit countries to "escape the constraint of adjustment" (quoted in Gauron 2000:140-42). Pöhl's

guidelines are, obviously, prescriptions for a deflationary system biased toward austerity policies. Mild counter proposals by the governors of the Bank of England and the Bancque de France were thrown out, and by the time the Delors report was publically released in spring of 1989 it was "an exact copy of the theses stated one year earlier by the President of the Bundesbank" (Gauron 2000:142). The Delors Report thus saw monetary integration as depending on, first, an independent Bundesbank-style ECB and the convergence of Germany's European partners toward a more Teutonic, low-inflation style of growth.

A final aspect of the Delors Report which confirms its neoliberal character is the curious manner in which social protections were relegated to a series of ill-defined supranational plans and, finally, ended up quarantined away from the more seriously regarded economic portions of the overall scheme. Social protections for those harmed by market policies, as well as measures safeguarding the structural power of labor unions, had of course characterized both surplus and deficit European countries, especially when considered relative to the liberal market economies in the UK and US. It is thus no surprise that the Delors Commission felt it necessary to extend a sop to European labor, with plans for reconstituting basic labor protections at the federal level.

Yet "the final draft of the Social Charter was devoid of any legal force and had become nothing more than an act of symbolism" (Gauron 2000:142). Given that Delors shared the market faith with his supposed opponents such as right neoliberals such as Thatcher, it is hard to decide whether, as Hansen and Shierup (2005) argue, the Commission was employing a "strategy of taking advantage of market-driven integration as a motor for transposing essential features of the national welfare state to the supra-national level" that failed, or whether the pro-social motive was never taken as seriously as the purely economic side of integration. By the early 1990s, the Commission's stance on any elements of a "Social Europe," to the extent they

still included social dialogue or labor protections, were embedded firmly in a competitiveness discourse that saw social protections as a trade-off for "flexibility" (Preece 2009). This, as will be remembered, was the same process that occurred in the social pacts of Italy and Spain: once labor had been enticed into a series of trade-offs exchanging lower wages or loss of protections for the promise of investment or employment, the orientation of such agreements gradually shifted until capital's side of each bargain was laid aside in the interest of competitiveness.

As the pre-summit negotiations for Maastricht began, all negotiators agreed the project would be "based on strict anti-inflation criteria," that this deflationary stance would override any employment objectives, and that the ECB would therefore have to be independent along the Bundesbank model (Marsh 1992:237). The only major issue was the timetable itself, with Germany wanting slower and less firm deadlines versus French demands; this was none other than the eternal recurrence of the situation that held at the end of Bretton Woods, with French power wanting the use of monetary union while a cautious Germany wanted to ensure it could control the growth strategies of other European states. In the end, this was solved by a joint French-Italian proposal, in which Mitterrand and Andreotti argued the 1999 union could go ahead with whoever had met the convergence standards (Marsh 1992:237-8).

In a perverse manner, the Bundesbank's own efforts to slow or stop the loss of the D-Mark helped make the eventual European Central Bank hew closer to the Bundesbank model than ever. The Bundesbank strategized that harsh EMU conditions, both for economic convergence and monetary stringency, would cause other member states to opt out of the process. Pöhl was surprised the other countries went for the deal; "[u]p until the last moment, the Bundesbank did

not realize that, to release themselves from the grip of the D-Mark, the French and Italians were ready to promise almost anything" (Marsh 1992:247).

The outcome at Maastricht was the birth of the Euro framework whose effects were analyzed in chapter three: a regional central bank independent of state control and tasked only with price stability, a single currency shared across all Euro Area member states thus making them no longer issuers of their own currency, an obligation to adjust to current account problems by "internal devaluation" of wages and spending, and restrictions on fiscal autonomy that limited public deficits to three percent of GDP and the ratio of debt to GDP to 60 percent. These last elements thus represented the biggest encroachment on national autonomy, making official the restrictions on social spending policy that the structural relationship between the external sector and the public balance had already exerted. The more perceptive economists and observers of EMU saw problems in locking down each state's ability to decide spending (e.g. Goodheart's Commission report 1993), while neoliberal policymakers and the commission itself analysts saw these restrictions as the perfect way to put private sector agents' backs to the wall and thus force labor market reform (e.g. European Commission 1993; Padoan and Rodriguez 2004). These last elements were progressively formalized through 1997's Stability and Growth Pact (SGP), a direct outgrowth of suggestion made by German Finance Minister Theo Waigel that were intended to inject more of Germany's "Stability culture" into the coming monetary union (Heipertz and Verdun 2004). The SGP demanded not only constrained deficits and debts but also a government budget that was balanced or, what is worse as it results in a net drain from private sector savings in current account deficit countries, in a surplus over the medium-term (Talani and Cerviño 2003).

Some scholars make much of the fact that the SGP budget restrictions were not "strictly" quantitative, binding, and were to be applied intergovernmentally in cases of GDP falls less than two percent (e.g. Segers and Van Esch 2007). Yet this "flexibility" simply follows from the always weak state of European political union in general, and in any case worked to the advantage the only two states powerful enough to take advantage of it. The SGP was always destined to be a politically-applied weapon; little surprise that Germany and, to a lesser extent, France, were able to wriggle out of SGP sanctions when they ironically became the first to violate the SGP in the early 2000s (Heipertz and Verdun 2004; Constantini 2015). The SGP as enforced by the Commission relied, unsurprisingly, on a method calculating medium-term deficits that rejected "by assumption, the idea of contractionary effects via reduction of aggregate demand" and "works as an ex-post justification for further austerity" even while its ad hoc construction "lends itself to allowing for temporary exceptions of a political nature" (Constantini 2015:53). It is enough that a hard budget deficit and debt ceiling had been encoded into the institutional DNA of the pan-European framework, making explicit the neomercantilist model's assumptions that, in the past, could only make themselves felt on national societies through pressure in the current account or through the actions of Europeanist politicians. Regardless of the fact that the SGP fell short of the ironclad arrangement favored by German and Dutch financial elites, installing the deficit and debt guidelines in the very heart of the monetary unification framework meant that expansionary social models were ruled out of court, especially for the smaller deficit states for whom the "intergovernmentally" decided SGP mechanisms would apply with force.

In the end the prospective Euro members used the remainder of the decade to continue austerity in order to meet the budget convergence requirements, with the deficit states boldly slashing state expenditure and hoping that the growth enabled by the shared Euro would make up for the squeeze. A fatalistic momentum took hold as the EMS fell apart even as the Maastricht criteria were being confirmed and extended: after German reunification, the Bundesbank quickly tightened monetary policy in order to head off any inflationary impact of incorporating the less productive East German economy. The removal of capital controls by 1990 made high German interest rates a serious threat to others – with liberalization Germany's partners became vulnerable to speculative pressure as soon as it was clear that they would have to match the historically high Lombard rate (over 8%) or devalue (Walsh 2000:113-14). Yet with the EMS bands soon dissolved and Germany itself in rare current account and public deficits enough pressure was lifted in the second half of the decade to allow the Euro to launch in 1999 and, as we have seen, ignite another round of surplus-deficit divergence.

The SEA, the Delors report, and the Euro and SGP plans shared a general neo*liberal* character, but it bears repeating how the neo*mercantilist* shaping of institutional priorities, encoded into pan-European institutions, caused different effects on the surplus versus the deficit bloc. A surplus country in which central bank-created unemployment erodes the wage share can avoid stagnation from the point of view of firms, as the external surplus helps mitigate the lost profit. A deficit country, on the other hand, must either be prepared to keep wages growing, keep investment high, or at the least supplement consumption with other measures such as public spending or increased spending triggered by rising asset prices. Keeping the wage share or investment up was made harder by the freeing of capital flows, the tripartite agreements which favored capital, in surplus countries by the incorporation of Eastern Europe as a destination for

outsourced investment, and in deficit countries by the rising net migration in the 1980s and 90s. Making market relations binding over and above national autonomy was precisely what Delors and his fellow travelers intended when saying they wanted to "metamorphose" Europe, and it follows that these differential effects, though enabled by the shape of pan-European institutions, could only be dealt with at an increasingly constrained national policy level (Gauron 2000:104).

Conclusion

Europe up until the mid-1970s evinced institutional devolution as the EPU gave way to the Bretton Woods system which then itself fell apart. In contrast, the decades covered in this chapter displayed a curious superposition of states: pan-European institutional frameworks becoming more far-reaching and automatic even as they were simultaneously degenerating with regard to their room for national autonomy and expansionary growth. By the time Maastricht's Euro plans finalized, any sense of symmetrical obligation to correct exchange rate and current account imbalances joined surplus recycling and coordination in the institutional dustbin.

Despite, or perhaps thanks to, the Snake's barebones nature a measure of equanimity was preserved thanks to the ease with which deficit countries could exit the system. Germany took the lead in applying elements of what would become the neoliberal policy "bundle" while France haltingly tried to follow the German example, Italy attempted more expansionary growth strategies, and many of the deficit bloc countries saw their growth "miracles" interrupted by political revolution. As with the developments in the previous chapter, the global context, temporal priority, and the structural position of Germany were major determinants of these various paths. Germany's lowered growth and accumulation of external surpluses allowed it to

stay ahead of the pack in terms of both inflation and the damage wrought by recessions of the 1970s, even while foreclosing Italy's possibility of following that same path.

While Germany weathered the decade's storms better than other developed economies, the fact that its major partners were outside of the D-mark-centered Snake meant the bloc's surpluses were gradually eroded as exchange rate flexibility slowly forced adjustment on the region. Towards the end of the 1970s, the diverging parities between Europe's major currencies brought both surplus and deficit countries back together under the EMS umbrella. The EMS's incipient symmetrical proposals, such as wide use of the ECU and the divergence indicator, were subdued by the German-Dutch preferences dominating the design of the new system. The first few years afforded some breathing room thanks to the continually strengthening dollar, even as the recessionary conditions kicked off by the second oil shock saw a slew of major currency revaluations.

From the early 1980s, however, turns toward austerity occurred in France, the flagship case of such an about-face, and the deficit countries. This turn, though welcomed by elites looking to reverse labor's gains, was also forced upon them by the logic of the surplus-deficit relationship. For those vacillating between austerity and expansion, such as Mitterand, the structurally-induced current account deficit and ensuing currency depreciation became the deciding factor in favor of austerity. For those with a class interest in lower wages, such as business interests in nearly every country, the current account deficit was a useful and seemingly inescapable justification of their calls for labor deregulation and a redistribution of national income in favor of capital. The second half of the EMS thus saw a narrowing of the system, as countries were increasingly committed, and after the Basle-Nyborg modifications expected, to

keep a hand on the austerity tiller in order to make any further member currency revaluations unnecessary.

Starting with the EMS negotiations, each new round of institutional formation echoed the next. The EMS, the narrowing of the system after the French and Italian U-turns, the SEA, the Delors Report, and the Maastricht negotiations all saw deficit country preferences for coordination or symmetry pushed aside in favor of Bundesbank-influenced demands of German and Dutch negotiators. Yet one fundamental demand of the deficit bloc, spearheaded by France in its role as the most precarious surplus country, gained in strength and, in the end, succeeded: the increasingly monomaniacal focus on moving as fast as possible toward monetary union.

This rush toward the single currency made a modicum of sense, since the system was becoming ever more oppressive for non-surplus countries thanks to the fixed exchange rates and disappearance of capital controls following the SEA's Single Market completion. For the deficit countries, and for a France threatened with the prospect of joining them, the only way out was through: "out" of the trap imposed by the power that German surpluses and Bundesbank interest rates wielded over their own countries, and "through" the tunnel leading to a single currency which, it was hoped, would give the rest of Europe more say in its economic future. In the 1990s, German surpluses were weakened by reunification and the resulting demand expansion, and this encouraged France, Italy, Spain, and the rest in their efforts to impose not only wage austerity but fiscal austerity in the hope that they would finally converge on the surplus model of social development.

The ultimate irony is that this supposed "solution" to the problem of German structural power ended up as the fullest expression of Germany's cooperative hegemony. In 1999 both surplus and deficit states entered, with much fanfare, into a deadly arrangement. Losing one's

own currency is a severe enough blow to national sovereignty, but when this currency creating power is vested in an ECB tasked only with price-stability the situation worsens. It is made worse still when this loss occurs in a context in which any hope of surplus recycling, policy coordination, or merely symmetry in adjustment are gone.

To add to this an active infringement of the budgetary, and thus social, autonomy of each member state via the SGP's limits on deficits and debt is to take the last weapons away from those who are already the weakest combatants. The straitjacketing of European states, both in terms of their fiscal room for maneuver as well as their lost ability to issue their own currencies, was thought to be a safe path because increasing labor deregulation opened up the options of "labour mobility" or "increasing the flexibility of labor markets so that wages can be more easily cut" (Talani and Cerviño 2003:203). Polanyi's ghost would sigh in exasperation at the result, in which workers are now commodified in terms of both price and spatial location. Of course, the spirit of Keynes would have speak up and add: the final aim of such complete commodification of European labor, boosting exports to attain a current account surplus, is not even a logical possibility for a Europe whose trade is balanced with the outside world. For the deficit bloc, the final form of pan-European institution thus recommended a host of ineffective tools for reaching an unattainable goal.

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