CHAPTER 7

Expanding the Argument

This final chapter has two purposes. The first is simply to summarize the major arguments and findings in the previous chapters. But most of the final pages are devoted to a second purpose: discussing some broader implications of the theory and results presented in this book. In particular, I will relate the book's basic argument about policy divergence to a major academic debate in the field of international relations and also to an important policy question in Western Europe. On the academic side, the theory and evidence presented in this book speak directly to certain conclusions that have emerged from two decades of debate concerning international cooperation theory. On the policy side, these findings make some interesting and somewhat pessimistic predictions concerning the future of the Economic and Monetary Union on the European continent. Finally, this chapter concludes by discussing how the analysis presented in this book could be extended beyond the OECD countries.

1. Summary of the Basic Argument

This book has been organized around two primary research questions. First, given sound operational measures for domestic monetary policy autonomy, can we find much evidence of systematic monetary policy convergence among the OECD states in the post–Bretton Woods era? Second, given no evidence of such systematic policy convergence, can we explain the related patterns of policy divergence, including monetary policy divergence, since the early 1970s?

In many ways, the monetary convergence hypothesis represents the last stand for the broader theory of macroeconomic policy convergence, which was first advanced by political scientists in the early 1990s. While the broad macroeconomic policy convergence logic has been widely attacked—and even disproved—in a number of issue areas (notably with regard to government spending and other fiscal policy decisions), the narrower hypothesis of monetary policy convergence has remained a conventional wisdom within certain circles of political science. Indeed, even scholars who have been critical of the broad policy convergence proposition have acknowledged that monetary convergence represents the strongest case, or issue area, for the broader theory of macroeconomic policy convergence with international capital mobility.[1]

With regard to this book's first research question, chapter 2 discussed a number of theoretical problems facing confirmation of the systematic monetary policy convergence hypothesis. Chapter 3 showed how little empirical support this hypothesis eventually receives once we employ sound operational measures for domestic monetary policy autonomy and the related concept of national exchange rate stability. As one scholar wrote, it is desirable to be in the position to "either write the first article on a subject or the last one" (Schrodt 2004, 886). Clearly, this study has not been the first critique of the monetary convergence hypothesis, but it does have the potential to be the last. When this misleading monetary policy convergence proposition can be put to rest (once and for all), the discipline can move ahead with explaining related patterns of policy divergence.

After chapter 2 showed how the post–Bretton Woods era is better characterized by the concept of monetary policy divergence, the next three chapters explored national differences with regard to nominal interest rates and exchange rate stability, addressing this book's second research question. Chapter 4 linked the evidence of monetary policy divergence to the well-established fact of fiscal policy divergence among the advanced industrial democracies since the early 1970s, offering the policy mix framework. When governments spend more for economic growth with public goods and/or income redistribution, they must also raise nominal interest rates for inflation control. A higher domestic interest rate tends to increase the national interest rate differential, leading to greater exchange rate variability. This policy mix framework shows how exchange rate stability can be treated as endogenous to the government's spending and interest rate decisions, thus helping to explain the observed disconnect between de jure and de facto exchange rate regimes.

Chapter 5 then explored certain determinants of government spending, nominal interest rates, national interest rate differentials, and exchange rate variability in the post–Bretton Woods era. The statistical results showed the importance of government partisanship, a finding that runs contrary to most policy convergence arguments, which predicted that partisan factors are largely

1. On this point, see Garrett 1998a, 802; Drezner 2001, 75.

irrelevant in terms of policy outcomes and even policy instruments. For certain indicators, such as economic growth and actual inflation, partisan differences may well be insignificant, but this fact does not mean that partisan governments have also converged in their use of fiscal and monetary policy instruments and the related policy outcome of exchange rate stability. Chapter 6 further illustrated the concept of partisan policy divergence with regard to government spending, nominal interest rates, and exchange rate variability by focusing on two important case examples: the French Socialists and the British Conservatives.

2. International Cooperation Theory and Macroeconomic Policy Coordination

The partisan argument advanced in chapters 5 and 6 concerning exchange rate stability and the related use of fiscal and monetary policy instruments has some important implications for established international cooperation theory. To understand why this is the case, it is useful to start at the very beginning of the international cooperation debate. Scholars working on this broad topic have always been careful with their definition of *cooperation,* with the term usually defined by Keohane's classic description (1984, 51): "when actors adjust their behavior to the actual or anticipated preferences of others, through a process of policy coordination."

Cooperation is thus obviously not *discord,* which occurs when actors do not adjust their behavior. But it is also different from *harmony.* Axelrod and Keohane (1986, 226) later stated on the subject: "Cooperation is not equivalent to harmony. Harmony requires complete identity of interests, but cooperation can only take place in situations that contain a mixture of conflicting and complementary interests." In *Cooperation under Anarchy,* Oye (1986, 7) made a very similar point, cautioning that scholars must first rule out a simple harmony of national interests to demonstrate convincingly that genuine international cooperation has occurred.

Scholars have regularly identified the 1978 Bonn summit and the 1985 Plaza Accord as examples of genuine international cooperation.[2] Indeed, as Sterling-Folker (2002, chap. 4) argued, much of international cooperation theory, especially the neoliberal institutionalist version, has been built on these examples of great powers involved in macroeconomic policy coordination. Yet the partisan

2. See, for example, Gilpin 1987, chap. 4; Putnam and Bayne 1987; Putnam 1988; Putnam and Henning 1989; Webb 1991; Cooper 1994; Webb 1995.

argument offered here suggests that these events may not be as cooperative as many have argued. This is true for two reasons. First, much of the macroeconomic policy coordination can be explained by a simple harmony of partisan economic interests. Second, where partisan economic interests were not aligned, discord emerged, with notable defections from international cooperation. To illustrate these points, I will first discuss the 1978 Bonn Summit and then the 1985 Plaza Accord.

The 1978 Bonn Summit

The 1978 Bonn summit is an example of fiscal policy coordination among the G-3 (Group of Three) governments. At this time, two of the G-3 economies were governed by the political left: the Democratic Carter administration in the United States and the Social Democratic Schmidt government in West Germany. A rightist government (the LDP) held power in Japan, the other G-3 economy. The partisan model presented here makes two predictions with regard to such macroeconomic policy coordination. First, there should be a relative harmony of interest between the United States and West Germany, especially with regard to fiscal expansion. Second, Japan should resist any outside pressure from these leftist governments for increases in government spending and should ultimately defect on the terms of the summit agreement.

There is support for both of these predictions. With regard to the first, Putnam (1988, 428) acknowledged in his case study of cooperation at the 1978 Bonn summit: "the Bonn deal was not forced on a reluctant . . . Germany. In fact, officials in the Chancellor's Office and the Economics Ministry, as well as in the Social Democratic party and trade unions, had argued privately in early 1978 that further [fiscal] stimulus was domestically desirable, particularly in view of the approaching 1980 elections." Other scholars, such as Iida (1993), have suggested that the Schmidt government was reluctant to cooperate with Carter's demand for fiscal expansion. The German government had to be persuaded; hence, the Bonn summit represented real international cooperation, not just a harmony of interests. But Putnam (1988, 429) also wrote: "Publicly, Helmut Schmidt posed as reluctant to the end. Only his closest advisors suspected the truth: that the chancellor 'let himself be pushed' into a policy that he privately favored." Furthermore, Iida (1993, 447) conceded: "Hans Matthoffer, who replaced Hans Apel as [Schmidt's] finance minister at the beginning of 1978, was much more audacious in fiscal policy making. Presumably, his view of fiscal policy was much closer to that of Keynesians in the Carter administration."

With regard to the second prediction, there is ample evidence of an LDP defection after the Bonn agreement. Despite the promise by the Japanese prime minister Takeo Fukuda to achieve a domestic growth target of 7 percent, Henning (1994, 128) concluded that Japanese expansion, if it occurred at all, took place only on the monetary side, consistent with the LDP's partisan preference for monetary expansion over fiscal expansion. Cargill, Hutchison, and Ito (1997, 187) argued: "The Ministry of Finance is indeed conservative in the sense of being very reluctant to use fiscal policy to manage aggregate demand [i.e., promote economic growth]. This reluctance to use discretionary policy, known in Japan as the 'Ministry of Finance view,' may be characterized as anti-Keynesian. It is rooted in the early postwar experience with near-hyperinflation and in the wild inflation [of the early 1970s]." As a Japanese government official stated, the LDP finance ministry "never compromises to foreigners on fiscal policy, only on monetary policy" (quoted from Henning 1994, 174). Thus, Smyser (1993, 18) concluded: "Fukuda did not stimulate the Japanese economy as much as he had promised. Germany stood alone in carrying her share of the bargain." This latter fact can be explained by a simple harmony of partisan interest between the then-leftist governments in the United States and West Germany.

Discord between the rightist government in Japan and its leftist counterpart in the United States went even further at the 1978 Bonn summit. In the year before the summit, the Japanese government had been pushing the United States to make greater efforts toward exchange rate stability: "Fukuda argued that without a stable exchange rate system, domestic expansion was undesirable and achieving world economic stability improbable" (Suzuki 2000, 82). But with regard to this external policy objective, the Carter administration was largely indifferent, as the partisan policy mix framework predicts for such leftist governments. U.S. Treasury secretary Michael Blumenthal publicly stated on the subject: "I would like to see a free floating—apart from smoothing out ragged movements—and allow the exchange rate between the dollar and the yen and the dollar and the Deutschmark to settle down where it does in that context. Whether or not that point has been reached, time will tell, and I would be quite happy to live with whatever the result is."[3] Indeed, Sterling-Folker (2002, 154) concluded, "U.S. policymakers [would] make no commitment to stabilizing the dollar because they were suspicious of Japan's real commitment to the growth target." Given the Carter administration's relative disinterest in exchange rate stability as a policy end in itself, "[e]xchange rates were largely

3. Quoted in Rowen 1977.

neglected as a topic of conversation at the [Bonn] summit" (Henning 1994, 268).

The 1985 Plaza Accord

Exchange rates were the main topic of conversation at the Plaza Hotel in New York seven years later. The Plaza Accord that was reached in September 1985 emerged out of U.S.-Japanese negotiations. Both the United States and Japan were governed at this time by rightist parties with strong ideological interests in exchange rate stability and with powerful interest group pressures to work harder on behalf of this external policy objective. Their negotiations proceeded relatively smoothly, largely due to this partisan compatibility. Suzuki (2000, 141) wrote on this point, "part of the explanation undoubtedly rested in the fact that Japan was now negotiating with a predominantly conservative group of foreign leaders"—beginning with the United States and later including West Germany and the United Kingdom.

There was certainly more friction in the negotiations leading to the Plaza Accord when the United States and Japan finally approached their European partners. Funabashi (1988, chap. 5), for example, has written about the pre-Plaza disagreements between the United States and West Germany. But as his account makes clear, there was no disagreement about the goal of achieving greater exchange rate stability for the world's major currencies. Indeed, the Germans had long been asking the Reagan administration to pay greater attention to the dollar's movements and steady appreciation. Instead, U.S.-German disagreements centered on the details of planned multilateral intervention into international currency markets. Since West Germany had already conducted unilateral interventions directed at realigning the dollar-mark exchange rate, the Kohl government simply wanted to see the second Reagan administration assume a greater share of the joint intervention effort.

As the partisan model presented here predicts, these rightist governments would eventually succeed in reaching and then executing an agreement for exchange rate stability. But such an agreement would not necessarily indicate genuine international cooperation; instead, it reflects, to a very large extent, a partisan harmony of interests. Perhaps the Plaza Accord would represent cooperation if a leftist government with different policy interests had put its domestic concerns aside and worked with the rightist governments in the United States, Japan, West Germany, and the United Kingdom for external currency stability. But, on this point, it is again worth noting that France—the only G-5 economy led by a leftist government at this time—played only a "secondary" role in the 1985 Plaza Accord (see Funabashi 1988, 173).

To be certain, the French government became more active in working for exchange rate stability and was instrumental in achieving the 1987 Louvre Accord. But this fact does not indicate Socialist cooperation with the rightist G-5 partners. As mentioned briefly in chapter 6, it instead reflects the logic of French cohabitation, a period from March 1986 to March 1988 during which the French political right governed the national economy, with Jacques Chirac as prime minister. Similarly, U.S.-Japanese monetary coordination during this period can be attributed to a harmony of interests. Henning (1994, 156) wrote: "The perception is now commonplace [especially] in Japan that interest rates were kept at all-time lows throughout 1988 out of deference to the Reagan administration and international cooperation. . . . But there is no evidence of either overt or covert American pressure on Japan [at this time]."

3. The Uncertain Future of the EMU

The analysis presented in this book should be of interest not only to academic theorists, as discussed earlier, but also to national and regional policymakers in Europe and elsewhere. The policy mix framework speaks directly about the potential viability of the Economic and Monetary Union (EMU) in Europe. Unfortunately for euro-optimists, its logic suggests that the EMU faces an uncertain and potentially problematic future. This is true not because the EMU is a weak and flexible institution (as were the European Snake and the EMS) but because the EMU entails a wide array of domestic policy constraints, some of which have clearly been difficult for many European leftist governments to accept, while others are becoming increasingly unpalatable even for certain European rightist governments. It is also important to discuss further this new regional monetary institution because my analysis of European monetary cooperation necessarily focused on the region's first two post–Bretton Woods monetary regimes, the primary institutions studied by scholars first advancing the monetary convergence hypothesis in the early 1990s. The European Snake and the EMS were shown in earlier chapters to have functioned as relatively flexible monetary arrangements, allowing member states to retain a significant measure of domestic policy autonomy within these regimes.[4]

The EMU, however, appears to be a very different animal. Participation in this third post–Bretton Woods European monetary regime required governments to give up their national currencies, adopt a common regional currency, and take the interest rate set by the European Central Bank. EMU membership

4. Indeed, the flexibility of the EMS is often cited as a primary reason for its longevity (see, e.g., Froot and Rogoff 1991, 307).

(unlike that of the European Snake or the EMS) would seem to represent a clear policy choice for regional exchange rate stability, with the corresponding loss of domestic monetary autonomy. Indeed, EMU domestic policy constraints potentially extend beyond the monetary side. To preserve the contractionary fiscal policies facilitated by the Maastricht convergence criteria, the 1997 Stability and Growth Pact required, at least in principal, that EMU governments keep their national budget deficit below 3 percent of GDP or face huge fines of up to 0.5 percent of GDP as a penalty for excess fiscal looseness.

As the Maastricht convergence criteria and the Stability and Growth Pact illustrate, the EMU came about on largely neoliberal policy terms. This is not surprising, since the final plans for the project were drawn up in the early 1990s, when the political right dominated national governments in Western Europe. This is a very important historical fact, since it helps explain how an institution pushing for neoliberal policy convergence could emerge in the post–Bretton Woods era, which has been characterized by macroeconomic policy divergence.[5]

This understanding—that the EMU was constructed to facilitate the political right's preferred macroeconomic policy objectives—suggests that right-wing and right-centrist governments would enthusiastically decide to join the EMU, while left-wing governments would decide to remain outside the new European monetary institution. Indeed, this is almost precisely what happened in 1997, the so-called drop dead date for entry into the third and final stage of the EMU (see fig. 23).[6] Nineteen ninety-seven was the year that the convergence criteria had to be satisfied; thus, if any government was to be initially excluded, as was Greece, it would be based on its continuing economic policy divergence at that point in time.[7] Likewise, if any government was to play its opt-out card, as did Britain, this option would have to be activated in 1997.

Of course, leftist governments returned to power in certain countries where right-wing governments had already made commitments to enter into the EMU. Two important cases are Germany, with its Social Democratic and Green Party coalition government that assumed power in 1998, and France, with its Socialist cohabitation government beginning in late 1997. Why did these new leftist governments not renege on the EMU commitments made by

5. I thank an anonymous reviewer for pushing me to acknowledge more explicitly this apparent contradiction.

6. The exception is Portugal, which was led by a leftist government in 1997 but nonetheless decided to enter into the EMU. However, Portugal was one of the first EMU member states to run afoul of the Stability and Growth Pact, a problem that will be discussed shortly.

7. Greece was permitted to join the EMU in 2001, but it now appears that Greece had misled the European Union about the extent of its fiscal policy divergence.

	Enter EMU	Outside EMU
Right-centrist government in power in 1997	Germany, France, Italy, the Netherlands, Belgium, Luxembourg, Ireland, Spain, Austria, Finland	
Leftist government in power in 1997	Portugal	Britain, Denmark, Greece, Sweden

Fig. 23. 1997 Decisions concerning the EMU

the previous right-wing governments? In the French case, this would have been a very difficult political decision to execute, since cohabitation meant that French foreign policy—with the EMU being treated as a foreign policy issue (as discussed in chap. 6)—was controlled by the rightist French president Jacques Chirac, although there is evidence that the Socialist prime minister Lionel Jospin nonetheless considered ways to keep the French national economy outside of the EMU (see Ross 2001, 38–45).

For other leftist governments, such as the Schroeder government in Germany, there was arguably no immediate need to renege on the country's EMU commitment. In the late 1990s, and perhaps uniquely so, economic growth in Europe (and elsewhere in the global North) was relatively strong, and inflationary pressures were surprisingly weak. Under such favorable economic conditions (i.e., noninflationary growth), there were correspondingly weak societal demands for domestic policy autonomy, and the choice for neoliberal policy convergence appeared relatively costless, at least in the short run. Thus, it was possible for certain leftist governments to stomach the prospect of neoliberal EMU policy constraints in order to demonstrate their commitment to European institutions, norms, and the broader regional integration process. Of course, for other leftist governments, arguably less committed to these European goals, the potential EMU policy constraints were unacceptable even with noninflationary growth, leading Britain, Sweden, and Denmark to stay outside the Eurozone.

The favorable economic environment that existed in the late 1990s has changed markedly in the new century, as economic growth in Europe declined, unemployment rose, and inflationary pressures returned.[8] Not surprisingly,

8. See, for example, *Economist* 2004b.

societal demands for domestic policy autonomy have remounted. Several European governments—including, but not limited to, those on the political left—have hit the fiscal limits set by the Stability and Growth Pact.[9] Frustrated with this situation, European Commission president Romano Prodi publicly predicted a future "crisis" if member states did not recover some of their lost policy autonomy.[10] Indeed, as his frustration grew, Prodi pronounced the Stability and Growth Pact to have been a "stupid" agreement.[11]

With the pact becoming an embarrassment for many national governments in the region and for the European Union itself, reforming the Stability and Growth Pact becomes an obvious policy option. There are several ways this could be done. One possibility would be to raise the budget deficit ceiling from 3 to 5 percent of GDP. Another possibility would be to make the fiscal limits adjustable to fit the differing conditions in EMU national economies. For example, the fiscal limit could be expanded in areas where economic growth has slowed, and then tightened as economic growth becomes stronger.

But reforming or even scrapping the Stability and Growth Pact might only delay a future EMU crisis. The very fact that there are different economic conditions among EMU member states reveals how Western Europe simply does not fit the basic criteria for an optimum currency area. Perhaps the European national economies were in the same phase of the business cycle during the late 1990s, thus making a common regional monetary policy appear appropriate given temporarily homogenous growth and inflation conditions on the Continent. But this economic homogeneity has effectively disappeared, if it ever really existed at all. Furthermore, Scheve's (2004) research has shown that even if national economic conditions were once relatively homogenous, national policy preferences, especially with regard to inflation, have never really been so.

This fact is critical because if the EMU project allows member governments to assert greater fiscal autonomy and if there are also varying preferences concerning government spending and its side effects (i.e., inflationary expectations), then fiscal policy divergence is certain to grow within the Eurozone. Furthermore, if there is greater fiscal policy divergence within the Eurozone, it will become even more difficult to find a common monetary policy appropri-

9. Thus far, Germany, France, Italy, and Portugal have clearly run up against the fiscal limits set by the Stability and Growth Pact (see *Economist* 2003c). In 2001, Ireland was also rebuked by the European Commission for its fiscal looseness (see *Economist* 2001a). In late 2004, Greece's budget was shown to have likely exceeded the limits set by the Stability and Growth Pact (see *Economist* 2004d). Together, these countries comprise more than 75 percent of the Eurozone's collective GDP.

10. Quoted in *Economist* 2002a.

11. Quoted in *Economist* 2002d.

ate for all participating national economies, putting the perfect exchange rate fixity offered by a common regional currency under increasing stress.

In fact, even with relatively limited fiscal policy divergence in Europe, the common regional monetary policy has already come under political stress. At first, it was criticized primarily by left-wing governments, who wanted a looser monetary policy to compensate for their apparent loss of fiscal policy autonomy through the Stability and Growth Pact.[12] But now the common European monetary policy has even drawn fire from right-wing governments, who prefer monetary expansion over fiscal expansion and see the European Central Bank's monetary stance as too tight given the recessionary economic environment in many parts of Europe.[13] To accommodate these governments, some observers have suggested that the European Central Bank raise its inflation target to something above 2 percent.[14] This would permit a lower nominal interest rate for the Eurozone, perhaps boosting private investment and helping to pacify increasingly dissatisfied right-wing governments. But this reform would remain a second-best economic expansion option for left-wing parties and their domestically oriented constituencies who demand the public goods afforded through greater government spending and that are likely to be undersupplied with only lower interest rates.

Another policy option that may become increasingly attractive, especially for leftist governments desiring greater policy autonomy to address domestic economic weaknesses, is to follow the example set by the British Labor Party and the Swedish Social Democrats, who elected to stay outside of the EMU. One might argue that exiting the EMU and giving up the common European currency entails high political and economic costs. This statement is certainly true, but it ignores the fact that remaining inside the EMU may eventually pose even greater opportunity costs for certain European governments. As the recent examples of Britain and Sweden further demonstrate, domestic policy autonomy is not at all inconsistent with strong macroeconomic performance. Since the final stage of the EMU was launched in 1999, GDP and employment growth in Britain and Sweden have been stronger than in most Eurozone national economies, with equally good, if not better, inflation outcomes.

If this gap continues or even widens, EMU exit may suddenly emerge as a very feasible policy option. Indeed, the failure to ratify the EU constitution in 2005 has allowed—even led—certain national policymakers in Europe to talk

12. See *Economist* 2001b.
13. See *Economist* 2004a.
14. See *Economist* 2002c, 2005a.

more openly about reintroducing the old national currencies.[15] If core EU states, such as Germany or France, exercise their exit option, then staying inside the Eurozone would become even less attractive for the remaining EMU member governments, with a potential ripple or cascade effect leading to the end of the supranational institution.

4. Extending the Research beyond the OECD

With the most recent expansion of the European Union, the new member states from Central and Eastern Europe are expected to move toward the EMU convergence criteria and eventually enter their national economies into the Eurozone, to the extent that this monetary arrangement remains functional.[16] This expectation raises a new research question not directly addressed in this book. Given international capital mobility, how do democratizing and nondemocratic governments resolve the trade-off between domestic policy autonomy and exchange rate stability?

This book necessarily has focused its attention on the OECD governments, because, as discussed in chapter 1, these national economies—more developed and more democratic—represent the theoretical domain staked out by the systematic monetary convergence hypothesis. Less-democratic polities with less-developed economies had perhaps not yet entered the capitalist global economy and, thus, were not subject to the same pressures for external monetary convergence. But the OECD states are the core of the capitalist global economy and, as such, they should have been subject to all the pressures, both external and internal, for monetary policy convergence to achieve greater exchange rate stability. Since one of the primary objectives of this book was to examine this systematic monetary convergence proposition, it was necessary to test it on its most favorable theoretical domain. In focusing on the most developed and most democratic capitalist states in the international political economy, I have also left some theoretical and empirical space for scholars who may wish to explore similar research questions concerning nondemocratic and democratizing governments. For such scholars, I have provided some tractable operational measures that will assist in measuring domestic monetary autonomy and exchange rate stability for this larger set of states in the international system, although scholars should take care in assessing the validity of these measures,

15. See *Economist* 2005b.

16. On the difficulties facing these new EU member states as they adjust to the Eurozone, see Sadeh 2005.

given the more extensive capital controls that exist in many of these less-developed national economies.

In concluding this book, I will briefly speculate about how autocratic governments and democratizing states may resolve the trade-off between domestic policy autonomy and exchange rate stability as they fully enter the capitalist global economy. Although my conjectures build from the logic offered earlier in the book, I offer them only as very provisional hypotheses. Scholars may well prove them to be false.

I predict that nondemocratic governments will favor the choice for exchange rate stability and be more willing to accept the loss of domestic policy autonomy. This should be true for a couple of reasons. First, many autocratic states obtain political support from business interests in their national economy. Inasmuch as these favored business interests have cross-border commercial activities and, thus, expected preferences for exchange rate stability, they may be the only societal group able to transmit their economic policy preferences through the autocratic state bureaucracy. Second, since autocrats do not risk losing their political power in a popular election (although they do risk losing power in other ways and hence need political support from wealthy business interests), they should be more able than their democratic counterparts to ignore and even suppress the societal demands for domestic policy autonomy that inevitably emerge during periods of national economic weakness.

There is already some limited empirical support for this prediction. Although he offered a different logic to explain the result, Broz (2002, 873) demonstrated that states with a lower polity score (i.e., more autocratic) make exchange rate commitments that are more fixed in their character. While I have shown here that fixed exchange rate commitments are not good predictors of actual exchange rate stability for the developed economies (and this should be doubly true for developing ones), such political commitments may nonetheless indicate the autocracy's interest in external currency stability and its potential willingness to sacrifice domestic policy autonomy for this end.

I also predict that democratizing states may favor the choice for domestic policy autonomy. As societal groups obtain an increasingly important political role in setting national economic priorities and as they organize political parties to advance their economic policy preferences, it should become increasingly difficult for state leaders in transitional democracies to ignore societal demands for domestic policy autonomy and to maintain the commitments made by previous autocratic governments for fixed exchange rates. With reference to the interwar years, when many of the now-advanced industrial democracies were more akin to transitional democracies, Gilpin (1987, 129) observed how governments began to subordinate the external goal of exchange rate stability as they were forced to pay greater attention to "domestic welfare objectives such as [internal] economic stability and full employment."

Gilpin and other scholars have interpreted this interwar development, much like other such episodes of domestic policy autonomy, as a breakdown of international monetary cooperation. In many of these analyses, there appears to be a subtle normative argument that exchange rate stability is cooperative and good and that domestic policy autonomy is defective and bad. On this point, however, it may be very misleading to treat exchange rate stability as an unambiguous public good. Certainly, monetary policy choices have a distinct "public" character, but the choice for exchange rate stability is certainly not "good" for all citizens within democratic polities, both transitional and consolidated. Indeed, for the very large segment of the national political economy without strong cross-national business interests, exchange rate stability—with implications for both monetary and fiscal policy choices—may function largely as a "public bad." On this basis, the choice for domestic policy autonomy is not inconsistent with many important democratic ideals.