EJW
A JOURNAL OF THE AMERICAN INSTITUTE FOR ECONOMIC RESEARCH

Econon Journal Watch
Volume 7, Number 1
January 2010, pp 56-58

Euro Symposium

A Political Scientist's Perspective

Jeffry Frieden[1]

Abstract

Lars Jonung and Eoin Drea (2010) have given us an excellent survey of how American scholars analyzed the process of European monetary integration in the crucial years between 1989 and 2002. They highlight how common were skeptical views, although they are too polite to point out just how badly wrong many economists were when they attempted to forecast the prospects of Economic and Monetary Union.

It would seem important to attempt to understand why so many fine scholars were so often mistaken. I profess a special interest, and perhaps an unusual position here, along two dimensions. First, I am a political scientist, not an economist, although Jonung and Drea have very generously included work of mine in their survey. Second, it is probably fair, if immodest, to say that my own analyses and expectations were somewhat less skeptical than those of the average economist. I observe this not to excuse my mistakes, but by way of introducing my own interpretation of what was lacking in much of the economic analysis.

Most economic analyses of European monetary integration focused almost entirely on the *economics* of the matter. Many economists, to be sure, remarked frequently (sometimes disapprovingly) on the political factors driving monetary union. However, even when scholars attempted to incorporate political considerations, they did so quite unsystematically, typically to invoke vague geopolitical, or Europeanist, or ideological factors. The result was a literature that

1. Professor of Government and Acting Director, Weatherhead Center for International Affairs, Harvard University, Cambridge, MA 02138.

was often lopsided: sophisticated economic analyses were melded with simple-minded political observations that rarely went beyond the level of political journalism.

Most economic analyses ignored two central tenets of political economy. The first is that governments are not benevolent social planners. The optimum currency area literature, which dominated most economic analyses, is extremely useful as a baseline, but it is not very useful as a predictor of what governments are likely to do. Governments rarely adopt policies simply because economic analysis identifies them as socially optimal; policymakers have to take into account the preferences of their constituents, weighted by features of national social and political institutions. So it should surprise nobody that the optimum currency area findings are not a good explanation of policy. If our goal is to *explain* government actions rather than to advise governments on a preferred course, we need a careful analysis of the electoral, partisan, special-interest, and other pressures on governments—all of which tend to push governments in directions orthogonal to what would be expected from a naive view of policymaking as an exercise in maximizing the utility of the representative agent. This is not to say that governments are venal or corrupt, but that their actions are constrained by their political environment. To explain, and anticipate, government policies, we need a systematic analysis of both the economic and the political constraints and opportunities that policymakers face.

The second principle of political economy that would have provided more accurate assessments of the state of European monetary integration is that policies made jointly by a number of governments are strongly affected by bargaining among states. Just as there is no authoritative planner to aggregate a social welfare function at the national level, there is no supranational authority to aggregate the welfare impact of policies jointly adopted by several national states. European governments bargained their way to the eventual EMU outcome, making deals at every step of the way. Some of these deals were on the purely macroeconomic front, such as linking fiscal improvement to membership in the currency union; others were on less directly macroeconomic, or perhaps even noneconomic, dimensions. Some European governments may have settled for their second or third choices on EMU, in return for more desirable outcomes on other policies.

There is nothing particularly novel about attempting to integrate political and economic analysis, and most good economists know that explanations of government policy require consideration of both economic and non-economic influences on policy. However, it is striking how many of the projections about the future of a single European currency relied on purely economic analyses. This was a sure-fire formula for inaccurate predictions. Going forward, analyses of the future course of EMU—whether with regard to potential new adherents to the euro, or with regard to the European Central Bank's policies—similarly need a broader, political economy, approach to the matter.

References

Jonung, Lars, and Eoin Drea. 2010. It Can't Happen, It's a Bad Idea, It Won't Last: U.S. Economists on the EMU and the Euro, 1989-2002. *Econ Journal Watch* 7(1):4-52. **Link**

About the Author

Jeffry Frieden is Professor of Government at Harvard University and Acting Director of the university's Weatherhead Center for International Affairs. He is also a member of the Advisory Council of the Federal Reserve Bank of Atlanta's Americas Center. He has written extensively on the politics of currencies, especially in Europe and Latin America. His most recent books are *World Politics: Interests, Interactions, and Institutions* (with David Lake and Kenneth Schultz, 2009) and *Global Capitalism: Its Fall and Rise in the Twentieth Century* (2006).

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