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The Domestic Sources of Multilateral Preferences: Varieties of Capitalism in the European Community

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6.1 Introduction

The Treaty on European Union (TEU) of December 1991 is considered by many as causing the most extensive abdication of national sovereignty in modern times. Popularly known as the Maastricht Treaty, it created the European Union (EU) by adding two new 'pillars' to the existing architecture in the form of a common foreign and security policy and greater cooperation in justice and home affairs. However, the decision to include these areas formally as part of a European Union did less in terms of adding competencies than 'formaliz[ing] the *status quo ante*, since . . . the two new pillars built on established circles of intergovernmental cooperation' (Wallace 1996: 56). Instead, it was agreements affecting the organization's economic architecture—formally labeled the European Community and known as 'Pillar 1' after Maastricht—that placed limits upon the economic autonomy of member-states and that signaled a new era of economic cooperation. This gave some observers the impetus to declare that the Treaty had 'the potential to change the EC beyond recognition by the end of the century,' and to call the new organization a 'superstate.'[1] These characterizations of unity, however, mask crucial and consequential differences in member-states' interests in the Treaty,

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[1] This chapter focuses on events leading up to the Maastricht agreement and emphasizes the first pillar of the European Union and thus primarily uses the designation 'European Community.' It employs the label EU when discussing the organization in general and for events after November 1993 when the EU formally began to operate. The quotations are from the *Journal of Commerce*, 12 Dec. 1991: 1A, and the *Houston Chronicle*, 11 Dec. 1991: 21.

differences that were articulated in the extensive and acrimonious negotiations preceding the agreement.

Explaining why—rather than how—individual member-states agreed to the TEU, particularly their preferences over the shape of the first pillar concerning economic cooperation, takes us away from the traditional emphasis on intergovernmental bargaining in studies of European integration and leads us to consider more seriously the domestic bases for a member's decisions. The EU is an organization where bargaining among members tends to be positive-sum, frequent, and regularized, and where time-horizons often are long, information extensive, sanctions possible, and decision-rules set. In such an organization, the nature of states' 'national preferences' thus becomes a key determinant in defining the shape of common multilateral institutions (Moravcsik 1998). This chapter argues that with the help of the varieties of capitalism framework developed in this volume, two matters of importance to current scholarship in International Relations (IR) can be explicated: first, why two countries may have different preferences over the structure of the same policy area in a multilateral organization; and second, why individual member-states may adopt divergent preferences across issue areas in that organization.

In studying national preferences we must avoid two common problems in the literatures of IR and European integration. We must resist taking national preferences as given, because, as Robert Jervis reminds us, 'by taking preferences as given we beg what may be the most important question of how they were formed . . . [and draw] attention away from areas that may contain much of the explanatory "action" in which we are interested' (1988: 324–5). Moreover, we must avoid being overly general in our definition of preferences. In studies of the EU, assessments of states' positions are often confined to broad dichotomies, such as for or against deeper integration. For example, while Germany is often identified as a vigorous champion of greater cooperation (Bulmer and Patterson 1987), Britain is typically characterized as a reluctant supporter of European integration (George 1990). However, such general statements not only conceal the fact that the positions of the two countries are reversed in some cases, but also mask the reality that countries individually prefer different degrees of integration across issue areas. A theory of national preference formation should not only explain how preferences are formed, but also be able to account for cross-national variations, as well as why varying preferences across issue areas are internally consistent in the case of individual countries. Section 6.2 briefly examines alternative IR explanations of state preferences.

The central proposition advanced in this chapter may be stated simply: the shape of multilateralism that an EC member espouses depends primarily upon the potential or actual implications of the form of multilateralism on the ability of that country to sustain the comparative institutional advantages provided by its specific variety of capitalism. If this proposition holds, then we should observe patterns of national preferences that differ across market economies. Additionally, we should observe that the variation in states' preferences across issue areas is consistent with the internal logic of individual market economies. This chapter tests that proposition by examining the variation in British and German multilateral preferences during the Maastricht negotiations in core economic areas. The two countries represent, respectively, a liberal and a coordinated market economy and are described in section 6.3.

Sections 6.4 and 6.5 review the Treaty on European Union and discuss the potential implications that multilateral institutions have for national regulatory frameworks. Particular attention is given to how the structures of the British and German market economies shape their national preferences over the structure of the TEU's provisions for common European monetary, social, and industrial policies. The chapter concludes with a discussion of a set of contemporary research topics at the intersection of comparative and international political economy.

6.2 Explanations of National Preferences

'[E]xplicit attention to preferences helps illuminate enduring issues in international relations, both at the theoretical level and in empirical applications,' writes Jeffrey A. Frieden (1999: 41). Moreover, Andrew Moravcsik adds that 'The first stage in explaining the outcome of an international negotiation is to account for national preferences' (1998: 24). However, despite the pivotal importance of accounting for the shape of states' preferences, there is little consensus among scholars on what determines national preferences over multilateral institutions. As a preamble to how the varieties of capitalism framework can be used to explain the structure of states' multilateral preferences, a brief review follows of two alternative approaches that privilege either the international or the domestic environment as the key determinant.

6.2.1 Realism and Institutionalism

Realism and institutionalism—two dominant IR theories—both treat states as unitary actors and explain national preferences as a function of the anarchic nature of the international environment. While realism privileges the balance of power among states in explaining why one point on the Pareto frontier—i.e. the universe of possible outcomes—triumphs (Krasner 1991), institutionalism emphasizes the conditions under which states reach the frontier itself.

Realism explains states' support for European integration as a function of their efforts to improve security and to enhance their *relative* position vis-à-vis competitors in other economic regions such as East Asia and North America. More specifically, it accounts for the timing of the Maastricht Treaty in terms of western Europe's efforts to boost its security as the Cold War was coming to an unexpected end, and it explains the shape of the Treaty with reference to the balance of power within the EC (Grieco 1995). According to this perspective, the content of the Treaty reflected a compromise between the three most powerful member-states—Germany, France, and Britain—with some side-payments made to smaller states for their support of the Treaty (XXX). However, this account of the TEU is not fully persuasive, since both the fact and content of the Treaty had been planned before the Cold War's sudden demise. More importantly, realism cannot explain why the preferences of the core member-states—whose relative power within the EC is very similar—varied significantly. The emphasis on states as unitary actors also makes it difficult for realism to spell out why individual states' preferences diverge across issue areas and why they favor different points on the Pareto frontier.

While institutionalism—often termed functional regime theory—shares realism's ontological core, it maintains that international institutions can mitigate the effects of international anarchy and allow states to focus on the absolute gains from multilateralism (see Baldwin 1993). Institutionalism has paid particular attention to the importance of shared and converging preferences among states in fostering cooperation.[2] The process of preference convergence is intensified by higher levels of economic interdependence and by membership in international regimes like the EC which constitute a set of 'principles, norms, rules, and decision-making procedures around which actor expectations converge in a give issue-area' (Krasner 1983*a*: 1). For institutionalism, then, the timing and shape of the Maastricht Treaty was not so much a function of the end of the Cold War, but a consequence of converging state preferences caused by long-term membership in the same multilateral organization

[2] The renaissance of European integration in the 1980s has been studied in such terms (Keohane and Hoffmann 1991; Moravcsik 1991).

and by higher levels of international economic exchange. However, like realism, institutionalism's emphasis on the unitary nature of states and the exogenous environment as the source of their preferences makes it difficult to explain why states that are structurally similar and are faced with cognate constraints adopt diverse preferences. For example, institutionalism cannot explain why, as the Maastricht negotiations demonstrated, the empirical record of the EC suggests a continuation—and in some cases an intensification—in the *divergence* of member-states' preferences over the structure, scope, and degree of European integration. Thus, while institutionalism may account for *how* the Pareto frontier was constructed (i.e. which alternatives were possible), it can neither explain the *shape* of that frontier (Moravcsik 1997: 543) nor *why* member-states prefer some points along it more than others.

Institutionalism, then, like realism, cannot explain why a member-state prefers a particular institutional make-up at the European level. The emphasis on the fact rather than the form of multilateralism in these theories is problematic considering that negotiations within the EC take place exactly because member-states vary in their preferences over the structure of common institutions. Thus, without a better understanding of the process that determines national preferences, we are unlikely to provide the 'explanatory action' that Jervis advises us to search for.

6.2.2 Domestic Explanations of National Preferences

In order to address the shortcomings of the systemic realist and institutionalist accounts of international cooperation and to give greater clarity to why states adopt particular economic policies and support international cooperation, scholars in recent years have created a renaissance in the study of the domestic sources of international relations (e.g. Milner 1997; Moravcsik 1998). These theories have ascribed causal significance to national political and economic variables in the analysis of inter-state relations, and these theories have been deemed particularly important in establishing the source of states' policy preferences and choices (e.g. Keohane and Milner 1996; Gourevitch 1996). The focus on the process that leads states to adopt specific preferences is both appropriate and important since it 'is analytically prior to both realism and institutionalism because it defines the conditions under which their assumptions hold' (Moravcsik 1997: 516, emphasis omitted). It is exactly because the prospects of successful multilateralism rest on the credibility of national commitments to those institutions (Ruggie 1993; Cowhey 1993) that the sources of national preferences deserve analytical emphasis.

Among the more sophisticated versions of the domestic approach to IR is the so-called societal school that has developed strong microfoundations for explaining why interest groups (usually firms) have distinct policy preferences and how governments aggregate these preferences to arrive at a specific policy choice. The societal school operates with a broadly pluralist model and suggests that 'the national interest will be the sum of the preferences of different interest groups as weighted by their access to policy-making institutions' (Milner 1992: 494). Consequently, it has focused much of its research agenda on determining what variables shape the preferences of interest groups. Particular emphasis has been given to relative factor endowments (Rogowski 1989; Shafer 1994), and other material elements such as asset specificity (Frieden 1991) and export orientation (Milner 1988) in deriving actors' preferences. Changes in actors' preferences are explained with reference to alterations in exogenous economic conditions.

Because of its methodological rigor, theoretical parsimony, and ability to bridge international and comparative political economy, the societal school has become one of the dominant approaches in studies of economic policy-making. However, it has difficulties accounting for some crucial variations across countries. Although recent contributions in this tradition have given greater weight to how domestic political institutions shape the interaction between governments and interest groups (Milner 1997), the approach has not devoted much attention to how national economic institutions shape the *institutional* preferences of actors. Thus, why actors of the same category (say firms with the same type of relative factor endowments) in different countries have divergent policy or institutional preferences is not easily accounted for by this approach. Rather, the societal approach assumes that economic agents like firms that are, *ceteris paribus*, embedded in different national contexts will adopt the *same* preferences. Hence, like the study of the firm in neoclassical economics, this approach assumes that firms do not have 'discretionary powers' or 'autonomous qualities,' and therefore, this approach 'militates against paying attention to firm differences as an important variable affecting economic performance' (Nelson 1991: 197–9). The claim that actors' preferences are exogenously determined also presents a problem for the societal approach's claim of how interests are aggregated. As Geoffrey Garrett and Peter Lange note, 'it is assumed that the effects of internationally generated changes in the constellation of domestic economic preferences will be quickly and faithfully reflected in changes in policies and institutional arrangements within countries' (1996: 49). Consequently, the societal approach cannot fully explain why two countries with similar material profiles and interest groups that share their general policy preferences—such as, for or against monetary cooperation—advocate very different institutional structures in, and across, policy domains.

This chapter suggests that we can fruitfully supplement the societal school with insights from the varieties of capitalism research agenda outlined in this volume as a way of understanding how differences in national economic institutions shape actors' preferences and political outcomes in distinct, divergent, and predictable ways across countries. It further suggests that by building on the strengths of the societal school and by supplementing it with a more dynamic theory of what defines economic actors' preferences from the varieties of capitalism literature, we are in a stronger position than are the two approaches individually when coming to terms with how domestic and international politics are interlinked, as well as why governments promote specific institutional configurations in multilateral settings.

6.3 Varieties of European Capitalism

The varieties of capitalism approach that informs this volume starts from the premiss that countries exhibit distinct, historically determined, national institutional equilibria that tie together a number of building blocks (such as the industrial relations, financial, corporate governance, and vocational training systems) in a coherent fashion that defines particular and differentiated market economies (see also Zysman 1994; Crouch and Streeck 1997*b*; Hollingsworth and Boyer 1997). It suggests that institutional complementarities prevail between the constituent units of a market economy—that is, the efficiency and returns on some building blocks depend upon, and frequently increase with, the presence of others (Richardson 1990; Milgrom and Roberts 1992: 108–13). The sum of the building blocks is thus greater than its parts, and shapes the behavior of economic agents in ways that transcend the limits and possibilities of an economy's constituent units. Since the manner in which the institutional building blocks are integrated differs across countries, agents have access to divergent comparative institutional advantages and, therefore, their core capacities and product market strategies often vary (Hall and Soskice, this volume; cf. Porter 1990).

Based on this holistic and relational understanding of advanced capitalism, the varieties approach makes important claims. For example, it suggests that existing institutions significantly shape policy and institutional preferences of economic actors, and that similar types of firms embedded in different market economies are likely to support divergent policies and institutions. As such, and in contrast to the theoretical traditions reviewed earlier, the varieties approach endogenizes agents' preferences.

This has important consequences for how we study processes of institutional change and continuity. For example, the varieties approach suggests that because the transformation of one market economy to another is a very costly, long, and uncertain process (due to the difficulties of achieving a new and stable institutional equilibrium) economic agents have strong stakes in protecting existing structures. Some studies have demonstrated that even in times of rapidly changing external economic circumstances, economic agents do not seek to transform the existing institutional equilibrium, but prefer to engage in marginal institutional reform for the purposes of *adapting* the existing market economy to new circumstances (e.g. Hancké and Soskice 1996; Muller 1997; Fioretos 1998; Thelen 2000). The varieties approach expects economic agents' institutional preferences to be relatively inelastic, and institutional change to be incremental and in accordance with the logic of the existing institutional make-up (cf. Hall 1986; North 1990; Steinmo et al. 1992). A comparison of the structure and development of Britain's and Germany's economic institutions bears these points out.

6.3.1 Britain and Germany

The manner in which economic coordination is structured differs significantly in Britain and Germany, a fact that has important implications for how economic agents in the two countries respond to changes in their economic and institutional environments. Britain's liberal market economy (LME) is characterized by low levels of business coordination and state intervention, and deregulated markets serve as the primary coordinating mechanism for economic activity. As a consequence, firms are often unable to resolve collective action problems and are rarely in a position jointly to provide basic supply-side goods that sustain vocational training, R&D, and long-term finance. In contrast, Germany's coordinated market economy (CME) is distinguished by extensive coordination among firms that is facilitated by encompassing and overlapping business associations. Whereas membership in business associations in Britain is below 50 per cent in most sectors (Edwards et al. 1992: 21), 95 per cent of German firms belong to the Federation of German Industry (von Alemann 1989: 76). These associations have allowed German firms to overcome collective action problems and to secure long-term vocational training, R&D, finance, and technology diffusion.

This fundamental difference, sustained by disparities in the legal architectures of the two countries, that mandates and provides incentives for non-market coordination in Germany, has produced different institutional equilibria with far-ranging consequences. For example, Britain has struggled with a low-skill, low-wage equilibrium because a deregulated labor market has produced an industrial-relations system that discourages producers from making long-term investments in their employees (Finegold and Soskice 1988). In contrast, Germany has relatively inflexible labor markets that have produced a high-skill, high-wage equilibrium, where there are institutional incentives for employers to invest in their employees' skills acquisition (Soskice 1994*b*). Extensive deregulation throughout the economy allows and sometimes forces firms in LMEs to adjust rapidly and cut their operational costs. The relatively extensive social and economic regulations in CMEs, on the other hand, encourage firms to adjust in incremental ways and to overcome short-term costs by emphasizing the long-term benefits of gradual product development. As a consequence, producers in LMEs tend to be more sensitive to relative costs than firms in CMEs who stress the importance of increasing the quality of their products.

Because of the structural disparities in the two countries, producers are provided with different institutional advantages that bias them toward adopting distinct product market strategies. The conventional picture of Germany as a country with strengths in advanced medium-tech manufacturing, and Britain as one with a concentration in basic manufacturing, is accurate (Matraves 1997). Unlike in Germany, where the industrial-relations and financial systems emphasize long-term product development and productivity growth (Streeck 1991), British producers have predominantly emphasized short-term profits because of a financial system that promotes rapid turnover and an industrial relations system that encourages employers to adopt cost-cutting practices (Rubery 1994).

While the institutional infrastructure of the German economy presents competitive advantages in areas that benefit advanced manufacturing (so-called specialized supplier and scale-intensive industries in Fig. 6.1) and are characterized by incremental innovation patterns, differences in the financial and innovation systems have allowed Britain to outpace Germany in high-tech areas characterized by radical innovation patterns (Soskice 1997). Not only did the British science-based sector show a

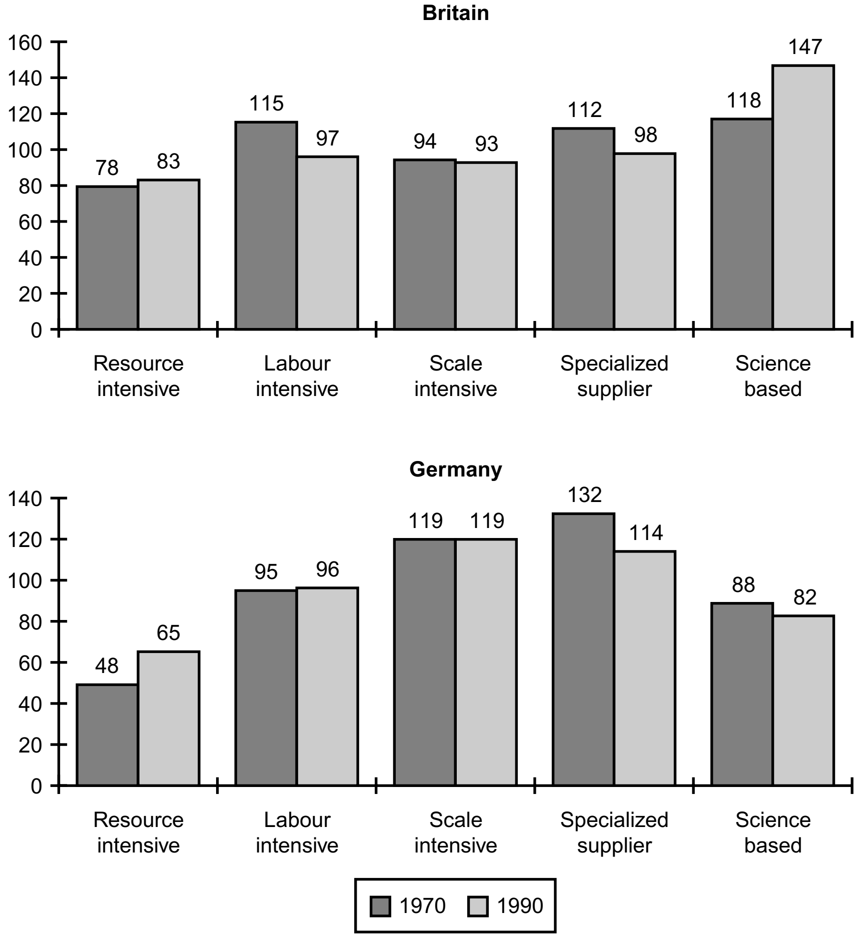

FIG. 6.1 The revealed comparative advantage of British and German manufacturing industry

Note: Revealed comparative advantage 'for a particular industry (or industry grouping) is defined as the ratio of the share of the country's exports in that industry in its total manufacturing exports to the share of total exports by that industry (or industry grouping) in OECD manufacturing exports.'

The industry classification is based on core factors that determine competitiveness, and are divided into: resource-intensive (food, beverages, tobacco, leather, wood, paper products, petroleum-refining, cement, and clay); labour-intensive (textiles, apparel, footwear, furniture, non-ferrous and fabricated metals, other manufacturing); scale-intensive (printing, industrial chemicals, rubber and plastics, pottery and glass, iron and steel, shipbuilding, railroad equipment, cars, and other transport); specialized supplier (non-electrical machinery excluding computers, electrical machinery excluding telecommunications and semiconductors); and science-based (pharmaceuticals, computers, telecommunications and semiconductors, aircraft, scientific instruments, and other chemicals).

Source: OECD (1992: 158–9).

strong and growing competitive advantage in the 1970–90 period (Fig. 6.1), but it was twice the size of its German equivalent and grew much faster.[3] While there has been great continuity in the British and German industrial profile, changes in the external institutional environment of the two countries due to deeper European integration challenge firms' abilities to exploit the comparative institutional advantages of the respective national models.

6.4 National Institutions and European Integration

How can the varieties approach, which is primarily designed to address issues of economic performance and institutional change at the national level, be used to give greater clarity to a state's preferences over the structure of multilateral institutions? The following pages suggest that attention to how common European regulatory frameworks affect the institutional equilibrium of national market economies allows us to uncover why interest groups and governments prefer particular forms of European multilateralism.

Common regulatory frameworks on the European level present a challenge to member-states because EC regulations can both consolidate and undermine national institutions through intergovernmental agreements (Moravcsik 1998) or through spontaneous processes of up- and downward regulation (Vogel 1995; Scharpf 1997*b*). Thus, for example, while European agreements on low social standards may protect British interests in this area, it is often feared that it would undercut Germany's ability to maintain higher standards. Because the potential benefits or costs of institutional change at the national level as a result of EC agreements may be high, domestic interest groups and governments pay strong attention and invest great resources in influencing and anticipating the direction of common European regulations (Andersen and Eliassen 1993). However, interest groups or governments are not necessarily relegated to passive 'takers' in this environment, but have extensive opportunities to voice their preferences.

From the vantage point of member-states, EC institutions can generate three general effects on national regulatory structures. First, multilateral institutions can lock in national regulatory regimes at the multilateral level. The Single European Market (SEM) and Single European Act

[3] In 1990, the science-based sector in Britain made up 9.12% of industrial production, while the figure in Germany was 4.67%. In Britain the sector grew by 78.3% between 1976 and 1990, and in Germany by 39.4%. Calculations based on figures reported in OECD (1997*b*).

(SEA), for instance, have served to strengthen the liberal free-trade policies of EC member-states. Similarly, common minimum regulations in the social and environmental areas prevent processes of competitive deregulation from undermining core features of national frameworks. Second, multilateral institutions may facilitate new institutional growth trajectories at the domestic level that a country might have difficulties achieving on its own. Many governments and business groups, for example, support European-wide research programs in areas where existing national institutions are unable to facilitate rapid advances in the high-tech sector. I call this positive institution-building because the basic purpose of supporting the multilateral institution is to supplement national institutions with a common European-level institutional structure for the purposes of achieving goals that member-states are unable to achieve on their own. Third, multilateral institutions may undermine specific domestic institutional constructs that governments or producers are dissatisfied with. Efforts by producers in some countries (e.g. large firms in Germany) to undermine national antitrust and merger laws that are more restrictive than those of the EU are an example of this scenario. I call this negative institution-building since the objective is to undo and reduce certain national institutional frameworks that are deemed detrimental to achieving the desired policy outcome.

In brief, the EC should not only be seen as an institutional constraint on member-states, but also as an organization that presents opportunities for institutional reform that may be difficult to achieve on a purely national scale. In that sense, joining national with European institutions presents member-states with an opportunity to explore and achieve novel institutional complementarities.

While many of the chapters in this volume demonstrate that significant complementarities exist between the building blocks of national market economies, this chapter focuses on national political processes that lead member-states to adopt specific preferences over the structure of the EC in order to achieve complementarities between their national institutions and those at the European level. The rationale for this focus is simple: since the form of European multilateralism may have long-term implications for the structure of national economic institutions, member-states should hold specific preferences over those EC structures that may affect the institutional landscape at home. ‘Selecting institutions’, as George Tsebelis notes, ‘is the sophisticated equivalent of selecting policies or selecting outcomes’ (1990: 118).

As noted in the earlier discussion of alternative approaches to studying preferences, the formation of a national preference—that is, the position that a country's government will promote at the EC level—is a process that requires us to address a set of issues. Key political actors and their preferences in applicable policy areas must be determined.[4] How their often diverse preferences are aggregated into a 'national preference' is the next step, and for that purpose I use the structure of state–society relations to ascertain the domestic balance of power (Katzenstein 1978*b*). Since the likelihood of realizing the national preference in the EC depends on the distribution of preferences among other member-states and the environment in which EC institutions are negotiated—in particular the nature of voting rules in the relevant issue area—attention must also be given to the strategic environment that faces member-states (Moravcsik 1998; Pollack 1996). Following a brief overview of the Maastricht Treaty, I examine how these three factors shaped the British and German institutional preferences in crucial policy areas of the Treaty.

6.4.1 The Maastricht Treaty

The Maastricht Treaty consisted of seven titles divided into nineteen articles that partly amended previous treaties and partly added new competencies to the organization. Additionally, seventeen 'Protocols' were appended that added and expanded aspects of the Treaty, including among other things, special 'opt-outs' for some member-states (most notably for Britain and Denmark), protocols on social policy (No. 14), economic and social cohesion (No. 15), the structure of the European Central Bank (No. 3), and a timetable (No. 10) and criteria (No. 6) for an economic and monetary union (EMU).[5] Here, the focus falls on three core policy areas that were subject to negotiations at Maastricht, namely, the structure of EC monetary, social, and industrial policies.

Monetary Policy

Perhaps the most remarkable aspect of the Maastricht Treaty was the decision to set a timetable, define the criteria, and establish the structure for an EMU to begin in January 1999. If EMU was the most remarkable achievement in Maastricht, it has also proven to be its most controversial aspect. The Treaty provided for the introduction of a single currency and the transfer of monetary authority from national branches to the

[4] In the following, I make an assumption that interest groups and governments largely share a commitment to maximizing the comparative institutional advantages of their respective market economy. Elsewhere I explore the conditions under which such a situation does not hold (Fioretos 2000).

[5] For detailed accounts of the Maastricht Treaty, see Church and Phinnemore (1994).

European Central Bank (ECB). As such, it provided a blueprint for the relinquishment of national policy autonomy in this area and the introduction of a new supranational policy domain. The Treaty stipulated that member-states consider their economic policies a matter of common concern and that they meet strict economic requirements to qualify for EMU.

EMU had remained an elusive goal to the member-states since the 1970s, and the text adopted in Maastricht was preceded by many alternative designs and proposals (Ungerer 1997). Despite the agreement in Maastricht to form EMU, many of the twelve member-states were reluctant to support it. While Germany and France were strong advocates, others like Britain and Denmark were given opt-out (or better, opt-in) clauses which allowed them to defer the decision on whether to join EMU.

Social Policy

In the 1957 Treaty of Rome there was a small section devoted to employment and working conditions. However, it was not until after the SEA was adopted in 1987 that a more extensive discussion about the competence of the EC in this area took place and that the Community was given explicit authority to work for the advancement of a dialogue between management and labor and for the improvement of health and safety in the workplace. With the enactment of the SEM the discussion continued and was generally couched in terms that some member-states might undermine the internal market by engaging in 'social dumping' by maintaining low social standards. As a consequence, attempts were made to introduce a 'social dimension' to the economic dimension that was quickly emerging. The Social Charter of 1989 entailed provisions concerning social security benefits, freedom of association, fair compensation, and the dialogue between the labor market parties. The Charter was accepted in December 1989 by all member-states except Britain. Eventually, most of the Social Charter was appended to the Maastricht agreement and was called the Social Protocol (rather than Chapter) because of Britain's opt-out. Although this protocol does not entail any far-reaching provisions that will seriously undermine national authority in this domain—in fact, the Protocol states that 'the Community and the Member States shall implement measures which take account of the diverse forms of national practices' (Art. I)—it was subject to divisive negotiations and was only signed by eleven of the twelve member-states at the time.

Industrial Policy

If EMU and the Social Protocol have proven to be the most debated, celebrated, and to some extent most controversial issues in the aftermath of the Maastricht meeting, then the provision for a common industrial policy is an area that has received much less attention since the agreement. Before the Maastricht Treaty, the EC's industrial policy had primarily been designed for market liberalization and the abolishment of discriminatory subsidies (P. Nicolaides 1993), and nowhere could one find a statement suggesting that the Community have an activist and interventionist industrial policy. However, the debate surrounding Article 130 of the Treaty, which was interpreted as potentially giving the EC the authority to pursue an industrial policy, was very heated. The Article establishes that '[t]he Community and the Member States shall ensure that the conditions necessary for the competitiveness of the Community's industry exist'; that '[t]he Commission may take any useful initiative to promote . . . coordination [between Member States and the Commission]'; and that the Council may design 'specific measures in support of action taken in the Member States.' The Article was largely the result of the demands by some member-states (France and Italy) and industry groups for a more proactive European Commission with the authority to initiate and sustain programs that would enhance the competitiveness of European industry. This was primarily to be done through programs that facilitated inter-company collaboration and large-scale industrial projects on a precompetitive basis so that European producers would be better positioned to meet the competition from non-European manufacturers.

Although vague statements were made to the coordinating function of the Commission, Article 130 is in fact very much of the same essence as previous EC policies and has not been used to justify interventionist practices in the spirit of national industrial policies that were common during the 1970s or 1980s. Instead, the Article's general message—that the pursuit of competitiveness should take place 'in accordance with a system of open and competitive markets'—and its emphasis on creating a favorable environment for business cooperation and development remains the guiding principle of the EC's industrial policy. Nevertheless, the heated debate prior to and during the Maastricht meeting clearly revealed the great diversity in member-states' attitudes in this area. While France espoused an interventionist form of industrial policy reminiscent of its *dirigiste* tradition, Britain advocated a minimalist version and at times objected to the idea of the Article, and Germany adopted a middle-of-the road position that corresponded relatively closely with the final outcome. How do we explain the variation in these policy positions, and the fact that Britain and Germany not only advocated different forms of industrial policy, but also different designs for EC's social and monetary components?

6.5 Unmasking Britain and Germany at Maastricht

The central hypothesis in this chapter states that the underlying determinant of a country's preferences over the structure of multilateralism is the composition of its market economy. If this is correct, then we should observe that individual countries' preferences constitute a coherent and internally consistent strategy across areas, and that there are distinct differences between countries' multilateral choices if their market economies differ. This section examines this proposition in the British and German cases in the context of the Maastricht agreement.

6.5.1 Britain

The common perception that Britain, under the Conservative governments of Margaret Thatcher and John Major, was persistently opposed to increased European integration is a great exaggeration. A closer examination of British policy positions in various issue areas reveals that the logic of its engagement in the EU does not reflect a general antipathy to the EU, but rather a calculated policy informed by the economic and institutional rationale of its national market economy. During the 1980s Britain supported many institutional programs that could only be characterized as entailing more integration and less national autonomy, including a strong commitment to the full implementation of the SEM and a highly centralized competition policy. While less interested in deeper integration during the Maastricht negotiations, it is clear that Britain's institutional preferences during those negotiations also reflected its attempts to promote and protect key features of its liberal market economy.

The structure of state–society relations in Britain gives the government a relatively high degree of autonomy from societal pressures in formulating its policy due to the considerable centralization in policy-making and the low organizational capacity of interest groups (Katzenstein 1978*b*). During the Maastricht negotiations, Prime Minister Major's domestic battles were therefore less with economic interest groups and more directed at appeasing the disparate interests of domestic federalists, Euroskeptics (especially in his own party), and an electorate which was bound to treat him harshly in the 1992 election if he was perceived to have given up key national interests. While the demands of these political constituencies constrained the availability of policy options to the Conservative government, they did not compromise—but rather reinforced—the government's objective of ensuring that the institutions of the EC would serve a complementary function to its economic policy program at home.

Originating in the Thatcher government's commitment to market deregulation and neo-liberalism, the Major government formulated a policy which aimed at making Britain the 'Enterprise Center of Europe' by offering a business environment with highly deregulated labor and financial markets (see HMSO 1996*a*). This setting, it was argued, would provide the appropriate institutional infrastructure for British companies to flourish in global markets and to attract foreign companies to Britain. The SEM played a key role in achieving this objective. However, the Maastricht Treaty was seen as a potential threat to the competitive advantages offered by Britain's market economy because the structure and development in key areas were to be determined by qualified majority voting (QMV) and thus could potentially force Britain to implement EC regulations that would undermine the institutional logic of its LME (HMSO 1996*b*: 25). The Major government's strategy at Maastricht was therefore primarily concerned with ensuring an EC that would not undermine mechanisms that sustained and reinforced market coordination in Britain.

Monetary Policy

While Britain has cooperated on and off with the other member-states in monetary affairs, it was adamant not to sign on to the criteria and timetable for EMU during the Maastricht negotiations. After lengthy negotiations, Britain managed to secure an opt-out from EMU, which effectively gave it full autonomy in deciding if and when it wishes to join the single currency area. While the Tory government's reluctance to sign on to EMU to some extent was a function of its fear of antagonizing Euroskeptics within its own ranks, the decision also reflects a larger institutional rationale associated with the LME.

The British market economy provides an institutional framework that gives a competitive advantage to firms emphasizing relatively low-cost production, and has therefore made British producers particularly concerned with the potential effects of a fixed exchange-rate system. Currency devaluation becomes a particularly important mechanism to restoring competitiveness in Britain since its LME lacks a coordinated wage-determination system that can control labor costs (cf. Soskice 1996*c*), and provides a quick solution to restoring cost-competitiveness should prices rise too quickly at home. Accordingly, the British were more reluctant to give up national autonomy over the exchange rate than countries that had alternative means for controlling wages or that depended less on low labor costs for their competitive advantage. The reluctance to commit to 'irrevocably' fixing its exchange rate within a monetary union was expressed in its insistence on receiving an opt-out from the three-stage plan to construct EMU. For similar reasons, if Britain were to enter, it was concerned with entering with an exchange rate that was competitive vis-à-vis its partners. This reasoning urged a delayed decision as to when to enter the currency area.

Social Policy

The dependence of British manufacturers on a low-cost and deregulated business environment gave the British government a strong incentive to ensure that EC-level agreements did not impose high social regulations that would undermine the rationale of its 'Enterprise Centre of Europe' strategy. Economic coordination in Britain's LME is secured primarily via the market mechanism and it is generally by maintaining that mechanism—and the discipline it enforces on individual actors in a deregulated setting—that superior levels of coordination are achieved. Accordingly, the British were adamant in their opposition to EC regulations that would erode the market incentives on which the competitive advantage of the economy to a large extent is constructed. This logic extended itself most pointedly to social policy. Extensive social regulations were perceived to undercut the market incentives facing the workforce since higher levels of social benefits tend to raise the reservation wage, thereby raising labor costs for firms that, in many cases, depended on relatively low labor costs for their competitive edge. During the Maastricht negotiations, the Major government thus demanded a singular opt-out from the Treaty's Social Protocol. Upon securing the opt-out, Prime Minister Major summarized the rationale for its strong opposition to European-level legislation in this area: 'Europe can have the social chapter. We shall have employment . . . Jacques Delors accuses us of creating a paradise for foreign investors; I am happy to plead guilty' (quoted in Leibfried and Pierson 1995: 49). The opt-out allowed the government to retain a cost-competitive business environment at home, as well as full access to EC's other programs without committing, as John Major put it, 'a betrayal of our national interests' (quoted in *Daily*

Telegraph, 19 Dec. 1991). While the importance Britain has paid to its opt-out from the Social Chapter is only one example of its relationship to the EC, it signifies the importance the country attaches to structuring that relationship in a way that is consistent with its market economy. The Social Protocol, explained one government official, 'is absolutely anathema to freeing up labor markets . . . [and] it makes absolutely no sense to import European-level labor market regulations to Britain.'[6]

'Today, the UK has the best of two worlds: free access to 370 million consumers and low social costs,' were the words used by another official when summarizing the rationale for the British position.[7] Without membership in the EC, the government reasoned, its ability to attract foreign investment or even maintain domestic investments would have been seriously jeopardized. However, membership in the EC had to be on terms that did not erode the comparative institutional advantages of Britain's market economy. The strategy thus became one of encouraging foreign direct investment by maintaining a cost-competitive business environment and being a member of the internal market. Opting out of the Social Chapter was part of that strategy on both a rhetorical and practical level. This arrangement, as the government officials suggested, has allowed Britain to deregulate its economy, attract the largest share of incoming foreign direct investments in Europe, and exploit the consistency of this policy in an effort to secure the comparative institutional advantages of the LME.

Industrial Policy

Industrial policy arose as an issue during the Maastricht negotiations primarily with regard to whether the European Commission should have the authority to orchestrate an interventionist industrial policy. While the French championed such a solution, Britain was strongly opposed to this initiative. The varieties of capitalism framework suggest why it would. Since the British economy secured superior performance largely by enhancing the market mechanism, Commission-directed interventions that provided firms with alternative market incentives were seen as a source of likely distortions to economic coordination in the British economy. Instead, in the general area of industrial policy, Britain wanted to implement a more rigorous competition policy which in part would contribute to undermining the multiple forms of cooperation found else-

[6] Author's interview with Peter Bunn, director of EU Internal, Trade Policy, and Europe Directorates, Department of Trade and Industry, London, United Kingdom (19 June 1996).

[7] Author's interview with Stephen Lillie, head of Section, European Union Internal, Foreign and Commonwealth Office, London, United Kingdom (25 June 1996).

where in Europe (in particular in CMEs) often described as cartels. Thus, the primary concern for the British was to extend the economic area regulated by the EC in a fashion that would enhance the market mechanism and provide British firms with an environment they were accustomed to and that would ensure their competitive edge.[8]

At the center of the discussion concerning a European industrial policy was how the EC could contribute to industrial competitiveness by supporting large-scale European R&D programs. Although Britain would be a net monetary beneficiary of some of these programs (George 1990: 199), the government paradoxically opposed most of these programs and insisted that this area of Community activity be governed by unanimity voting to ensure that Britain could influence the size and structure of future R&D programs. Again, the varieties framework suggests an answer to the government's and business community's reluctance to give the Commission greater resources and authority in this area. The institutional infrastructure for technology diffusion that exists in CMEs does not exist in Britain, and as a consequence the results of these programs were questioned (Buxton et al. 1994). Moreover, since British companies were already doing comparatively well in the high-tech sector (Fig. 6.1) that a common European industrial policy was to target, they might potentially have been relative losers from these programs within the EU.

There was a strong logical coherence to Britain's preferences over the structure of the Maastricht Treaty premissed on how common European regulations would impact its LME. It was reluctant to support common European monetary, social, and industrial policies for fear that they would undermine the institutional foundation of the British market economy and the basis of its strategy to attract investments and promote economic recovery. Its position at Maastricht was primarily an attempt to prevent the introduction of negative institutional growth trajectories at home, which could have eroded the basis of the LME's comparative institutional advantages.[9] 'Mr. Major can . . . claim that the "Thatcher

[8] The British government also objected to a common EU industrial policy because it maintained that member-states would have greater recourse to engage in competitive bidding for advanced and high-tech manufacturing (so-called "subsidy auctions") by enticing investors with direct monetary contributions. Since the government was committed to minimizing public expenditures (most EU programs must be matched by national funds), and since it did not have the administrative apparatus to implement such programs in the early 1990s, the government feared that a common industrial policy within the EU would jeopardize Britain's attraction for foreign investors who had chosen Britain over other countries because of its competitive business environment (HMSO 1994: 84–6).

[9] It should be noted that the support for multilateral institutions during the Maastricht negotiations that would prevent negative institution-building at home has not been a

Revolution" is safe from the encroachment of Brussels,' were the words used by one observer when describing the British 'success' (Jenkins 1991: 1). The intensity of its preferences were not in doubt. Faced with the potential reality that it would be outvoted under the Community's rules of QMV, it insisted, in an unprecedented move and at considerable political costs, on receiving opt-outs from participation in the Social Chapter and EMU to ensure that the LME remained intact. For similar reasons, Britain refused to accept QMV in the industrial policy area and insisted on, and won approval for, unanimity voting in matters relating to common R&D programs. This outcome gave John Major cause to claim 'Game, set, match for Britain' (*Independent*, 15 Dec. 1991: 14) and ensured a strong endorsement in the House of Commons. The support of the business community for his achievements was also unequivocal: 'The prime minister and his colleagues have achieved exactly what business needs—an agreement on economic and monetary union which has left the way open for UK participation in a single European currency, steps to secure more even enforcement of Community legislation, and no extension of Community powers that could threaten international competitiveness,' concluded the director general of the Confederation of British Industry (*Financial Times*, 12 Dec. 1991: 4).

6.5.2 Germany

In strong contrast to the common perception of Britain as a diffident member of the EU, Germany is often described as its *Musterknabe* and a firm supporter of extensive economic integration (Bulmer and Patterson 1987). However, if the view of Britain as always reluctant to increased European integration is an exaggeration, then the claim that Germany is always a champion of integration is no less an overstatement. While EU's structure—including the emphasis on federalism and subsidiarity—is more similar to the German system than to the British, this does not necessarily mean that Germany is always supportive of deeper integration. Like Britain, Germany's institutional preferences within the EU are closely linked to the implications of deeper integration for the structure of its national market economy (cf. Anderson 1997).

The manner in which a German government ensures national support

persistent pattern in British policy. During the 1980s, Britain strongly espoused multilateral institutions that would lock in a liberal trade and extensive competition policy through the construction of new institutions. In both instances Britain's EU policy reflects the liberal bias that has existed for decades in its economic policy and its precise multilateral institutional preferences have depended on how common European regulatory programs affect the workings of its LME at home.

for its policies differs in crucial respects from that of its British counterpart. Because of high levels of party discipline in the Bundestag, German governments have generally little reason to worry about ratifying an international agreement in parliament. Instead, because of the decentralized nature of the German state and the high organizational capacity of economic interest groups, German governments must more actively consider the input of key societal interests and ensure their support for the implementation of policies (Katzenstein 1978*b*). As a consequence, Chancellor Helmut Kohl worried less about partisan political differences than his British counterpart during the Maastricht negotiations. Instead, his attention was directed towards guaranteeing the endorsement of the Bundesbank, and raising support from the national business and labor communities (Moravcsik 1998: ch. 6). However, these domestic constituencies posed relatively few constraints on the Kohl government during the Maastricht negotiations since their general interests were also broadly directed at ensuring that the Treaty did not erode key institutional domains of the German economy.[10]

The Kohl government, with strong support from the national business community, used the SEM and SEA as vehicles to secure the country's dependence on the European market and to dampen the effects of price competition from East Asia. These were important concerns because the strength of national labor unions made it difficult to reformulate Germany's industrial strategy to one that would focus on lowering costs. The internal market also cut transaction costs in Europe and was met with optimism because German firms' superior productivity was seen as a sure way to enhance market shares in Europe. However, as the SEM was being implemented, concerns grew regarding the potential effects the internal market could have in Germany if a stronger European social dimension and greater monetary cooperation were not achieved. The potentially negative effects on the German political and economic landscapes of an EU without stronger protection of the country's social regulations and its monetary regime—both core components of Germany's social market economy—became defining features of the Kohl government's approach to the Maastricht negotiations. A closer examination of Germany's policy and institutional preferences during the negotiations illustrates nicely not only the differences between Britain and Germany, but also the logical coherence to the Germany policy and

[10] If anything, the political opposition and the Bundesbank wanted the Kohl government to insist on more detailed regulations on social and monetary policy. The general direction and content of Kohl's policy, though, were not disputed (Beuter 1994).

the crucial role institutional considerations played in the formulation of its institutional preferences.

Monetary Policy

Germany's CME is centered around structures that maintain a great deal of non-market coordination, and it has contributed to the development of competitive advantages based on the capacity to sustain high quality control, customization of products, and incremental innovation in products and production processes. Fig. 6.1 showed the extent to which this structure has made Germany particularly strong in specialized supplier and scale-intensive goods which characterize advanced manufacturing. However, sustaining this kind of production system also comes at a price; in particular, German products tend to be relatively costly to manufacture. While cooperative arrangements at home make it unlikely that producers are undercut in terms of the price of goods, they are vulnerable to foreign competitors who may produce goods of similar quality at lower cost. German producers, unions, and politicians were particularly wary of the ability of other advanced European economies to devalue their currencies and price German products out of competition in the SEM. The risks that other members of the EC would use devaluations to strengthen their competitiveness was, therefore, of particular concern to Germany since it does not have recourse to the same option because of constitutional and political constraints (protected in large part by a fiercely independent Bundesbank). For this reason, EMU was particularly attractive to Germany—especially to manufactures who dominate the economy—because it would impose limits on the ability of other European countries to undercut German competitiveness. Moreover, by fixing exchange rates within EMU, German producers calculated that they would be able to rely on their relatively superior productivity and the flexibility of their industrial-relations system to increase the quality and competitiveness of their products and thus enlarge their market shares.[11] The government also reasoned that with institutional provisions guaranteeing price and currency stability through EMU, Germany would be able to maintain a domestic environment that encouraged private investments and limited public spending (Waigel 1993).

While geopolitical concerns also played a role in the minds of Europe's political leaders during the Maastricht negotiations, the varieties approach aids in explaining both why Germany preferred a particular

[11] Author's interview with Hans-Joachim Haß, head of section, General Trade and Industry, Federation of German Industry (BDI), Bonn, Germany (25 April 1996).

shape to EMU and why it could pursue this policy confident of strong domestic support. Germany's interest in EMU should not simply be seen as a consequence of its historical commitment to a tight monetary policy. Rather, it must be seen within a context that pays attention to the implications of European multilateralism for the institutional structure that underpins its market economy. Key domestic political and economic forces feared that this structure would be undermined in the absence of a multilateral monetary arrangement like that agreed upon at Maastricht.[12]

Social Policy

Germany is one of the strongest supporters of a 'social dimension' to European economic integration. It is frequently thought that because Germany has relatively high social standards and extensive labor market regulations, it promotes upward harmonization of the Community's social policy and that its support for the social dimension is premissed on this logic. However, this is a misrepresentation of the German government's objectives, as well as of the preferences of the business and labor communities. There was a political logic behind the government's efforts to broaden EC's social dimension during the Maastricht negotiations because of the potential political costs that organized labor and the electorate could impose on the government if it gave up the coveted social program at home. The content of Germany's policy was premissed on how an integrated Europe would affect Germany's CME. More specifically, Germany supported the establishment of common minimum social regulations (as opposed to harmonization). This preference was a function of a set of interrelated considerations.

The major German concern was to prevent the introduction of processes of competitive deregulation in Europe because of their poten-

[12] Events following the Maastricht meeting also show the extent to which Germany's position on EMU is shaped by the implications of non-EMU on its national market economy and product markets. Despite enormous social costs of meeting the Maastricht convergence criteria, Germany insisted throughout the 1990s that even a mini-EMU be implemented with the countries that qualify. This at first sight is puzzling since we would expect Germany to want as many countries as possible to be part of the arrangement. However, since the countries that qualified (or nearly qualified) were countries that produce in similar product markets to those of German companies, Germany was particularly keen that EMU be implemented (author's interview with Eberhard Meller, head of Brussels Bureau, Federation of German Industry, Brussels, Belgium (27 June 1996)). The fact that many member-states who did not seem to qualify for EMU produce in markets where German companies are weak was not a major concern for Germany since they do not pose a significant threat to German producers if their currencies depreciate.

tial threat to the regulatory coherence of the German economy. Because of the political difficulties of lowering social regulations at home, it was feared that 'social dumping' might place German producers at a distinct cost disadvantage. Under such circumstances it was argued that Germany would have to abandon key regulatory structures that underpin its economy and thus undermine the foundation of the CME, which receives a large part of its comparative institutional advantage from the 'productive constraints' imposed by relatively strict social regulations (Streeck 1991; Vitols 1997). In contrast, common minimum regulations would ensure that there was a floor under which no country would allow its social regulation to fall, while at the same time giving Germany the flexibility to exceed common standards as it saw politically and economically fit. Agreeing on minimum standards also had the benefit of increasing Germany's chances of finding support for its policy under QMV rules governing this area; in contrast, insisting on applying German standards across the Union would have ensured the opposition of many member-states and thus presented the possibility of minimal European social regulations.

An associated reason Germany did not support upward harmonization was because such an arrangement would lock in common regulatory arrangement and would limit the future flexibility of producers and instead establish high social costs across the EU. If that were the case, German producers argued, industry in most of the Union would be unable to produce competitive products and demand increased economic support from the wealthy countries, which would translate into higher taxes for German producers.[13] By the same token, high common social regulations would make changes to existing structures in times of external economic changes subject to the political will of a qualified majority of the EC, which would impose a slow, burdensome, and uncertain process of regulatory change.

Industrial Policy

On the issue of a European industrial policy, the outcome at Maastricht and the language in Article 130 corresponded closely to the German national preference—roughly between the British minimalist and the French maximalist positions. Unlike Britain, Germany was favorably disposed to including an article that would commit the Community to a horizontal industrial policy that encouraged large-scale cooperative

[13] This point is stressed both by the business community (author's interview with Haß 1996) and in government publications (Deregulierungskommission 1991:187).

research projects within the EU and that would entail provisions to employ the kind of framework regulations that characterize Germany's regulatory architecture. Unlike the French, however, Germany was opposed to giving the Commission increased powers which could be used to direct the disbursements of collective funds towards specific industrial projects in particular sectors or firms. The rationale behind the German position rests on regulatory principles that are consonant with the principles of the CME, and the calculation that a limited EC industrial policy may have beneficial effects for German producers in areas (especially high-tech) where the German market economy has been relatively weak (cf. Grewlich 1984).

In a CME like Germany, the effectiveness of industrial policy and the provision of supply-side goods depends on the ability of the government to make credible commitments to the national business community that it will support firms' objectives without direct intervention. These commitments are a combination of explicit and often implicit contracts between the government and business, where the former provides important resources—frequently based on regulatory mandates—that are administered by business associations and para-public institutions (Katzenstein 1987; Streeck 1983). Such agreements are used to enhance the non-market coordination of the economy and improve the capacity of business to coordinate the provision of, among other things, vocational training, R&D, and technology diffusion. Aware of the benefits of this system to both the government and firms, the German government and the business community supported a similar type of arrangement at the EC level. A highly interventionist national or European industrial policy would be detrimental to this kind of arrangement since it assumes that public officials have the requisite private information that business possesses and would instead increase the power of the Commission to act in an arbitrary fashion.

Germany's position on an EC industrial policy was in practical terms also associated with attempts to provide German producers in the high-tech sector with the opportunity to cooperate with firms in other member-states. The German high-tech sector was relatively weak and showed little growth in the 1980s (Gerstenberger 1992). A common European industrial policy that encouraged cross-European inter-firm relations was very attractive to the German government and industry since it would supplement an area in which its national market economy was comparatively weak. Moreover, since the German form of industrial policy emphasizes the diffusion of technology (Ziegler 1997), a European industrial policy that follows that tradition as well as provides new opportunities in the high-tech area would allow German producers to make use of the comparative institutional advantages of the CME in technology transfer and diffusion while improving its innovation potential in high-tech industry. Thus, in this context, the EC actually served the purpose of facilitating a positive institutional growth trajectory which Germany, only with great difficulty and costs, would be able to achieve alone. In other words, Germany's preference in this area was shaped also by efforts to acquire expertise that its CME had difficulties providing and not, like Britain, by efforts to limit the involvement of the EU.

Like the British Prime Minister, the German Chancellor also claimed success at Maastricht stating that the outcomes 'fully reflect German conditions and interests' (quoted in *UPI*, 11 Dec. 1991). However, while Britain sought to preserve essential components of its domestic market economy by opting out from common arrangements, Germany approached Maastricht as an opportunity to lock in features of its CME by participating in EC-wide regulations. Although the Kohl government was not greeted with the same ringing endorsement at home as Major was, there was general consensus that its ability to push through the Social Protocol and EMU despite British and Danish opt-outs was a major achievement (Beuter 1994). In particular the principles embodied in EMU that were broadly consonant with those of the Bundesbank, and the emphasis on framework regulations akin to the principles of Germany's *Ordnungspolitik*, were hailed as crucial milestones in ensuring a European Community congruent with Germany's economic system.

6.6 Conclusion

A global economy and EC membership has heightened the tension between national and European institutions in recent decades, and it has become more important for countries to ensure that national and international institutions function in a complementary fashion. This chapter has suggested one way of understanding the underlying political and economic motivations that shape a country's preferences over how national and European institutions should be integrated. More specifically, I have suggested that a country's preferences over the structure of multilateralism are primarily a function of how international cooperation will affect the workings of its national market economy, and how the preferences of actors with a stake in that process are aggregated into a national position. The case studies of the British and German positions on the structure of the Maastricht Treaty support this claim. The cases also showed that common generalizations in the academic literature on

European integration and in the media that use stark dichotomies to portray member-states' interests in the EU mask crucial differences within and between states. Thus they often distort the source of states' support for specific forms of international cooperation. This chapter has sought to provide a framework for a more nuanced understanding of why states espouse particular institutional preferences and why these vary across countries and issue areas.

In grounding the analysis of the process of institutional preference formation within the varieties of capitalism literature, this chapter reaches different conclusions than prevailing IR theories. It disputes many of the traditional arguments in IR that rely on the relative distribution of power among states as the primary determinant of a state's international bargaining position, as well as those that expect long-term international cooperation to produce similar policy preferences across countries. Instead, this chapter has employed the varieties literature as a way of supplementing existing societal theories of IR in order to address how domestic actors are affected by the institutional architecture of differentiated market economies and how existing institutions shape their multilateral preferences. As such, the chapter provides additional theoretical depth and empirical breadth to societal theories of international relations by explaining why countries with similar compositions of interest groups support different institutional programs in the EU.

One of the strengths of the varieties of capitalism approach is that, unlike many theories in IR, it endogenizes actors' preferences and does not assume that actors have static preferences over time or issue areas. Rather, this framework emphasizes how institutional preferences vary across areas depending on how changes in one domain of the market economy will affect the institutional infrastructure of the economy as a whole and the complementarities it furnishes. As such, it provides a more empirically nuanced account of events, as well as a theoretically more precise approach to understanding the domestic sources of multilateralism. At the same time, by illustrating the importance that economic actors attach to achieving an institutional match between domestic and European institutions, this chapter provides a theoretical and empirical extension of the varieties of capitalism research program, which has limited itself primarily to events at the national level.

A competing explanation that has not been addressed thus far concerns the explanatory value of partisan differences. In short, could a model premissed on the notion that the ideology of the political party in office determines national preferences explain the variation in British and German approaches at Maastricht? This chapter suggests that such an explanation has serious limitations on both empirical and theoretical grounds. During the negotiations, right-of-center parties were in power in both countries, and yet their institutional preferences during the negotiations differed greatly. A partisan explanation would suggest greater similarities. More importantly, there has been a great deal of continuity in the two countries' policies vis-à-vis European integration despite recent changes in governments. Though beyond the limited scope of this chapter, events following the Maastricht negotiations are illustrations of this effect. In Britain, the Labour Party's electoral victory in 1997 did not fundamentally change that country's multilateral preferences within the EC. Despite Prime Minister Tony Blair's emphatic promise to improve his country's somewhat tarnished reputation within the EU, his government 'broadly followed the path taken by the Conservatives' (Driver and Martell 1998: 145; cf. Holmes 1991). While signing on to the Social Protocol, the Blair government claimed that the Protocol 'will not impose the so-called German or European model of social and employment costs,' and promised to oppose such movements 'if necessary by veto' (*Financial Times*, 11 Mar. 1997). Instead, Blair pledged that there would be no fundamental change in Britain's market economy or its attraction to foreign investors by promising that there would be a minimum of new social regulations (*Financial Times*, 11 Mar. 1997: 8). In fact, Blair's slogan of 'a nation of entrepreneurs' sounded surprisingly similar to Major's 'enterprise centre of Europe' strategy.[14]

The 1998 victory of Gerhard Schröder in Germany illustrated a similar path of continuity. His party's electoral manifesto echoed the policy of the Kohl government and stressed the importance of 'renewing the social market-economy,' using the European Union for the purposes of maintaining key framework regulations and common social minimum regulations, as well as utilizing the EU to improve the German high-tech sector, and employing EMU in order to prevent 'currency-dumping' from undercutting Germany's competitiveness (SPD 1998: 6, 9, 54–6). Finally, the manner in which Blair and, in particular, Schröder back tracked from their joint July 1999 statement of a 'third way' for Europe was indicative of the practical limitations of fashioning an economic architecture in the European Union that would meet the goals of both national constituencies.[15]

[14] Another instance of remarkable continuity in British policy is its lasting reluctance to commit to EMU. This is in part due to concerns with the potentially negative consequences that a fixed exchange rate and the limited recourse to currency depreciation would pose for producers in Britain (cf. *Financial Times*, 21 Nov. 1997: p. vii).

[15] The text of the joint statement, as well as other details on the Schröder government's *Neue Mitte*, are found in Hombach (2000).

The varieties framework suggests why there is such strong continuity in the institutional preferences of the two countries. It considers the political and economic calculations that policy-makers and interest groups make when evaluating the consequences of institutional change. The framework suggests that institutional continuity and adaptation are often a shared interest among these actors because a transformation of the existing institutional environment is seen as costly, uncertain, and time-consuming. Under such circumstances, European integration is approached, usually without regard to political partisanship, as a process that must be managed with the general economic and institutional interests of the national market economy as a whole in mind. Deeper European integration under appropriate terms helps both governments and interest groups to achieve their joint goals in strengthening the structural competitiveness of the economy in which they are embedded. This framework, then, suggests that there are parameters within which the preferences of policy-makers will be shaped and that these are defined by the extent to which national and European institutions will function in a complementary fashion, and not significantly by changes in the ideological make-up of governments.

No doubt the subject of how national and international institutions interact deserves more scholarly attention in the future as their interactions intensify. This chapter has suggested one way of approaching this issue, and in doing so it offers a set of implications for related topics of interest. For example, on both empirical and theoretical grounds it disputes the claim that economic globalization and long-term membership in international organizations like the EC necessarily lead to policy convergence or institutional isomorphism among states. Instead, the chapter shows that economic actors process external economic signals in a manner consistent with existing institutions and that because of the costs associated with moving from one institutional equilibrium to another—that is, with replacing one market economy with another—states seek to promote existing comparative institutional advantages. Therefore, we expect a continuation in varieties of market economies and, as a consequence, also continued differences in states' multilateral preferences.

Some scholars of the EC assert, however, that institutional convergence is a prerequisite for the successful achievement of important economic gains (Heylen and van Poeck 1995). While it is beyond the scope of this chapter to address the solutions that the EU has devised to resolve institutional differences and conflicting demands among member-states, this chapter questions institutionalism's claim that states' preferences will converge over time if they are members of the same organization. Thus, if diverse forms of advanced capitalism continue to coexist within the EU, the analytical emphasis in the future should not be on how convergence can be promoted, but rather on how divergence can be accommodated. Under these circumstances, it becomes increasingly important to uncover the source of members-states' institutional preferences in order to understand the basis of their negotiating positions, as well as under what circumstances members are willing to compromise. This chapter suggests that the varieties of capitalism literature can serve as a domestic theory of international relations in order to address these issues.

A second implication of this chapter concerns the terms on which states engage in international cooperation. It has been asserted that states' primary goal in international organizations is to transfer the structure of their national regulatory regimes to the international level in order to minimize the costs associated with institutional change or to maximize their advantages over competitors (e.g. Kahler 1995: 2). This chapter provides a more nuanced picture of states' terms of engagement at the multilateral level. It shows that states do not necessarily seek to replicate their national regulatory systems at the multilateral level, but that they also use multilateral cooperation to reach objectives which they are unable or have great difficulties achieving on their own. Thus, for example, the German case demonstrated attempts at positive institution-building when Germany sought to acquire greater strength in the high-tech sector through common EC programs. Conversely, knowing that it would not be able to replicate its LME within the EU, Britain sought to lock in significant parts of its comparative institutional advantages by opting out of some areas of European cooperation like parts of its social and monetary spheres.

This volume as a whole discusses significant issues relating to institutional change among advanced capitalist countries, and this chapter has addressed more specifically the interaction of national and European institutions. It shows that in an integrated Europe, institutional change at the national level happens neither spontaneously or independently of the institutional environment that the European Community embodies, nor is the direction of institutional change independent of existing constructs at home. Rather, existing national institutions shape the institutional preferences of economic agents in distinct ways, and European institutions provide opportunities to solidify desired outcomes. Using the intellectual framework of the societal approach to international relations and adding an institutional lens with the help of the varieties of capitalism literature, this chapter has argued that the nature of a country's market economy fundamentally shapes its multilateral preferences. As such, it demonstrates the importance of examining institutional change and national preference formation in Europe with a nuanced perspective that pays attention to the interaction between domestic and European-level institutions. In this context, it employs the varieties of capitalism literature as a domestic theory of international relations and potentially opens up a new avenue of research for scholars interested in narrowing the gap between comparative and international political economy as a means to acquire a fuller understanding of the contemporary political economy of Europe.