

# **“Ordinary Riches Can Be Stolen, Real Riches Cannot”**

Oscar Wilde

The Currency of Identity: Ireland 1978 to 1992

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**Dedicated to the Nurse**

## **Abstract**

*Following 10 years in operation, the European Monetary Union (EMU) has been shaken by the global financial crisis and some peripheral states have experienced significant economic shock. The pitfalls of currency unions have been well documented in the literature of International Political Economy (IPE), so the situation that these states find themselves in cannot come as a surprise to any member country. Without highly synchronised economies, some states will suffer significantly in the event of an exogenous shock. This begs the question why a country would make an "irrational" choice to join the monetary union to begin with. The predominant IPE theories on how the EMU was formed are explained using rational choice with material interests as the focus for interstate bargaining. By arguing that they really have no choice to begin with, rational choice theory renders small states impotent. Unsatisfied with this reductionist answer, this body of work explores the participation of one of the states currently in trouble by introducing a constructivist theory of economic identity politics. Exploring the historical record of Ireland in the period of 1978 and 1992, this work reveals that Ireland in fact had choices, and the "irrational" choices it made were significantly influenced by Irish identity politics. However Ireland's "irrational" motivation can only be understood by including economic identity politics into the analysis. It will reveal that the supranational institutions of the European Union can serve as economic instruments to further nationalist goals. In the process the institution can become embedded in the nation such a country like Ireland is now a hybrid - highly European monetarily while it still remains distinctively Irish. As small states now make up the majority of the European Union this thesis adds to our understanding of small state participation in its most ambitious institution thus far.*

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## Introduction

The economic crisis sweeping across four member states of the Eurozone<sup>1</sup> has earned them the inglorious acronym “PIGS”. Portugal, Ireland, Greece and Spain have found themselves in deep financial trouble following the fallout of the global economic crisis. Anti-Euro proponents have been quick to say ‘I told you so’ and Britain has been hailed as the poster child for sensible monetary policy, by retaining control over its monetary sovereignty allowing it to devalue its currency to accommodate the financial shock.<sup>2</sup> Meanwhile the “PIGS” may face years of economic contraction simply to restore their finances within European Monetary Union (EMU) guidelines.

The pitfalls of currency unions have been well documented in the literature of International Political Economy (IPE) so the situation that the “PIGS” find themselves in cannot come as a surprise to any member country. In order to meet the goals of the EMU all participating countries had to surrender their sovereign right to independent monetary policy in return for a supranational currency union. However according to economic theory there has to be a high level of synchronicity between the economies of the union, otherwise an exogenous shock can force some member states into deep recession. This is precisely what has happened in Europe, the monetary policy for the union at large does not meet the requirement of the most badly affected economies. The first question that springs to mind is why an economically rational entity would ever join such a union to begin with. To answer this question the thesis has focused on Ireland because it represented the extreme outlier in Europe; it was the least synchronised economy within the European Community on formation of the European Monetary System (EMS) in 1979; and again in 1992 when it ratified the Maastricht treaty for European Union. Therefore it stood to suffer the worst impact in the event of an exogenous economic shock. The economic argument strongly supported a decision for Ireland to remain outside the EMS and EMU yet it proved to be an enthusiastic supporter of monetary union in contradiction to rational

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<sup>1</sup> The Eurozone is the term used to describe the 16 members of the EU who also participate in the European Monetary Union.

<sup>2</sup> <http://www.telegraph.co.uk/finance/economics/7232369/Can-anyone-fix-the-euro-puzzle.html>

expectations. Through a detailed analysis of the actual political record this thesis will reveal that Ireland did not enter this arrangement temerarily, in fact its Government was fully aware of the economic choices it made. In turn it will reveal that identity politics was the driving force for Ireland's participation in the institutions of European Union.

To close the gap between expected and actual behaviour, this thesis underwent a detailed exploration of the political debates in the Irish Dáil<sup>3</sup> and the popular press in both 1978 and again in 1992. The purpose of this was to reconcile the seemingly irrational decisions made on both occasions with the public and political discourse. Was Ireland simply naïve on the economic ramification of monetary union? Was rational choice theory correct and Ireland had no choice but to join, or were other factors at play?

The thesis begins by reviewing the existing body of IPE literature on the formation of the EMS and EMU. The literature review highlights that the predominant focus of IPE literature on European institutional formation is based on rational choice theory, with monetary sovereignty as a central foundation for interstate bargaining. This body of work is largely applied to the big states of the European Union including Germany, France and the United Kingdom (UK). In the process small, weaker states are either ignored completely or pooled together under some generalisation such as 'the South'.

The literature review highlights the limited scope of the Intergovernmentalist framework when applied to small states as it is too reductionist and as such renders a very limited view of small state motivation. With its focus on power and bargaining, small states are quickly rendered impotent. Part of the problem lies in the fact that the study of IPE has tended to ignore how national preferences are formed and once made how they influence economic policy - preferences are simply "given". This thesis presents an alternative constructivist framework to provide a richer understanding of small state engagement, introducing identity politics as the driving force behind international economic policy. This framework builds on

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<sup>3</sup> Dáil is the official name for the Irish parliament.

the constructivist work of theorists such as Eric Helleiner, Andreas Pickel and Rawi Abdelal and has been labelled “economic identity politics”.<sup>4</sup>

The thesis explores the Irish record to understand how national identity directed economic policy. A detailed examination of the official record from the Dáil debates of 1978 and 1992 will reveal how Ireland’s decision to join the EMS and EMU was mainly driven by economic identity politics. Ireland was fully aware of the potential economic hardship that could result from its decisions yet it went ahead with an economically “irrational” decision in pursuit of its nationalist goals. By encompassing identity, and not just interest, this thesis will show how small states leverage supranational institutions to create their own economic identity. Further it will reveal that the positive or negative identification of these small states can affect the integrity of the institution itself, put simply, small states have power too.

Finally this thesis will show that the focus on rational choice theory in analysing political economies has proven insufficient to explain smaller state motivation for joining supranational institutions. While it may have provided a “big-bang” theory on large state motivation, rational choice theory provides little insight into how the institution will fare as more and more small states join the institution. By including economic identity politics into the framework, our understanding of how the European Monetary Union may fare in the future will be significantly improved.

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<sup>4</sup> Helleiner, Pickel and Abdelal label their constructivist framework “economic nationalism”, however this term is confusing as it conjures up Robert Gilpin’s neo-realist account of economic nationalism. Therefore the author has coined the framework “economic identity politics” to avoid any confusion.

## **The Political Economy of Monetary Union**

The following section reviews the theory of monetary unions from their economic foundations to the politics of monetary cooperation. It begins by reviewing Europe's chequered history of currency unions to demonstrate that the drive for the EMU should not be considered *sui generis*, in fact monetary unions had been pursued for millennia. The section then reviews the two major competing debates around the formation of the EMS and the EMU. The literature review will reveal that rational choice theory takes a narrow view of institution formation and fails to provide a convincing explanation for small state participation in Europe's monetary institutions.

### ***The Appeal of Currency Unions***

Far from being a recent innovation, currency unions have predated the modern nation state for millennia. The Roman Empire oversaw one of the earliest European currency unions and created a uniform currency that persisted as long as the Empire did. Early European economists such as John Stuart Mills favoured a world currency and attributed the nationalistic nature of currencies to the "vestiges of barbarism" in what were still to be "fully civilized" nations.<sup>5</sup> While the likelihood of a single world currency is unlikely any time soon, a regional currency union serves to deliver the benefits of a currency union on a more manageable scale.

Past history has shown that while currency unions remove uncertainty and volatility in trade relations, they are fragile systems subject to failure under political pressure. As trade between European countries increased dramatically during the 19<sup>th</sup> century a common currency that would make valuation and exchange more seamless became highly desirable. However while a common European currency removed the uncertainties of trade, the 19<sup>th</sup> century attempts at a currency union were politically motivated. The Latin Monetary Union established in 1865 between France, Belgium and Switzerland, favoured the imperialist political ambitions of France. Meanwhile the Scandinavian Monetary System between Sweden, Denmark and Norway

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<sup>5</sup> Robert A. Mundell, "A Theory of Optimum Currency Areas," *The American Economic Review* 51, no. 4 (1961), p. 662



served to strengthen the political solidarity between these northern states.<sup>6</sup> The currency unions only proved as strong as the degree of political commitment, cooperation and trust that sovereign states bestowed on each other and interstate trade alone was not sufficient to maintain the union. Ultimately the onset of the First World War undermined the functioning of both currency unions leading to their collapse.<sup>7</sup>

On a global scale, monetary unions did not fare any better. By the turn of the 20<sup>th</sup> century a system backed by gold had emerged as the first truly international monetary system. It provided a framework for stability that enabled international trade to flourish, and it protected the money supply from political meddling within sovereign countries, as all domestic currency had to be backed by gold reserves.<sup>8</sup> However in spite of its attraction, the Gold Standard did not fare any better than the European specific arrangements as governments were forced to trade off currency goals against domestic political priorities.<sup>9</sup> Following World War II a new international monetary arrangement based on a United States (US) dollar peg was created under the supervision of the International Monetary Fund (IMF). The new Bretton Woods system included greater domestic flexibility allowing governments some limited correction for monetary disequilibrium. But again it faced a similar demise to all prior currency unions due to severe devaluation in the US dollar caused by the political demands to fund a costly war in Vietnam. On August 15<sup>th</sup> 1971, President Nixon formally broke the US commitment to maintain convertibility of the US dollar at a peg of \$35 to an ounce of gold, effectively ending the Bretton Woods system for good.<sup>10</sup>

With the demise of Bretton Woods in the early 1970s, Europe created a regional currency union generally based on the rules of Bretton Woods, but this time built around a narrow band of fluctuation of 2.25%. The new system called “the Snake” limited exchange rate fluctuations between European

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<sup>6</sup> Kenneth Dyson, *Elusive Union: The Process of Economic and Monetary Union in Europe* (Harlow, Essex: Longman, 1994). pp. 25-27

<sup>7</sup> Ibid. pp. 28-29

<sup>8</sup> Ibid. p. 33

<sup>9</sup> B Eichengreen, *Globalizing Capital: A History of the International Monetary System* (Princeton Univ Pr, 2008). p. 29

<sup>10</sup> Public announcement by Nixon on US Television:-  
<http://www.youtube.com/watch?v=iRzr1QU6K1o>

countries, however it remained pegged to the US dollar, a further devaluation of the US dollar in 1973 dealt a fatal blow to this currency union. The consequent appreciation of the Deutschmark made it unsustainable for many of the Snake currencies to maintain parity within the system and they abandoned the union. A scaled down monetary union based on the Deutschmark continued between the Northern European countries including Germany, Belgium, Luxemburg, the Netherlands and Denmark until 1978. In the demise of the international arrangements the Deutschmark emerged as Europe's regional anti-inflationary currency peg of choice.<sup>11</sup>

The European experience in monetary unions demonstrated a number of important factors that became the foundation of the EMU: firstly, a stable currency union had facilitated ease of trading, particularly for export focused economies like Germany; secondly, political involvement in currency unions led to their demise; thirdly when the monetary arrangement lacked a single monetary authority there was nothing preventing a country from abandoning the exchange rate mechanism leading to its inevitable demise. Intent on creating its own zone of economic and monetary stability separate from the US dollar, the European Economic Community (EEC) undertook a study of monetary options to satisfy the Community needs. Published in 1970, the Werner report<sup>12</sup> outlined the requirements for a stable monetary union. It recommended a system composed of an independent supranational central bank supported by a coordinated fiscal union among member states. As such, the EMU represented the first currency union that truly blurred the line between domestic and international control. The EMU, if it ever were to materialize, would require a major shift in sovereign authority from national entities to an apolitical supranational institution independent of political meddling or national sovereign governments.

Flandreau and Maurel contend that the prior examples of European and global currency unions were mislabelled as they represented regimes based on adherence to some underlying standard of cooperation rather than a true currency union that the Eurozone represents. Lacking a common central

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<sup>11</sup> Eichengreen, *Globalizing Capital: A History of the International Monetary System*. p. 157

<sup>12</sup> The Werner Report and was produced in 1970 by the European Commission under the Chairmanship of Pierre Werner.

bank or federal monetary authority, there was nothing preventing a country from printing and circulating money within its own sovereign boundaries. Such an act would ultimately lead to exchange depreciation between the rogue country and the other currency union members resulting in de-facto exclusion from the union.<sup>13</sup> They note that to compare the Euro area to prior monetary regimes is inappropriate. The EMU represented the first democratic, multinational currency union that involved ceding monetary authority to a supranational organization while retaining political sovereignty. As such the Euro represented a major shift in sovereign authority from national entities to a supranational institution not answerable to any individual sovereign body. Therefore the surrender of monetary sovereignty has become a major focus of the political discourse around the EMS and EMU. This thesis will show how the focus on sovereignty and interstate bargaining has limited our understanding of why states participate (or not) in supranational arrangements. In particular this limited view, particularly in the field of IPE, does little to further our understanding of small state participation. This next section reviews the two leading theories that have dominated the discourse of IPE as an explanation for the evolution of Europe's monetary institutions.

### ***The Politics of European Monetary Union***

The theoretical debates on the evolution of the European Monetary Union have centred around two competing explanatory frameworks, namely Neofunctionalism and Intergovernmentalism. At the most general level, Neofunctionalists argue that European institutions frame policy choices while Intergovernmentalists argue that nation states and national preferences dominate European politics. To a degree the arguments are speaking over each other as one emphasises cause while the other addresses effect. Either way, both share a common underlying assumption that political actors act according to a rational decision making process.

The following section reviews these competing theoretical accounts of European monetary integration and critiques them from the perspective of explaining a state's participation firstly in the EMS and later the EMU. The

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<sup>13</sup> M Flandreau and M Maurel, "Monetary Union, Trade Integration, and Business Cycles in 19th Century Europe," *Open economies review* 16, no. 2 (2005). pp. 136-137

fundamental claim of this section is that the body of explanatory literature on the formation of the Europe's monetary union is biased towards large state power politics and does little to explain the participation of smaller peripheral economies of the Union. As a generalization, the major theoretical explanations work well in the context of larger states, but small state participation either goes unaddressed or is reduced to a minor role due to the power asymmetry within European community. As such the IPE literature produced around the formation of the EMS and the EMU predominately focuses on Germany, France and the UK. Ireland, which received scant mention, was on occasion lumped with "the South" for convenience, or more usually ignored completely. The literature review reveals that the Intergovernmentalist accounts of the process of European monetary integration is far richer in depth and breadth than the Neofunctionalist accounts as it provides theoretical explanations for the formation of both the EMS and EMU as well as small and large state participation. Therefore Neofunctionalism is acknowledged briefly but the bulk of the theoretical review focuses on Intergovernmentalism.

### **Neofunctionalism**

The Neofunctionalist debate on European Union has primarily centred on articulating how incremental political change occurred through a self-sustaining process of integration. Pioneered by Ernest B. Haas during the 1960s this theoretical framework was used extensively to explain the ongoing process of integration in Europe up to the 1970s. Neofunctionalists argue that the "low politics" of economic interdependence between nation states eventually leads to "high politics" of full political integration within Europe. The process begins by first focusing on non-controversial "technical" issues that solve a common problem. In time, through experience and learning the integration process "spills-over" into new areas that encompass "high politics" issues requiring supranational oversight. At this level the supranational institutions develop a self-reinforcing cycle of institution-building managed by elites and technocratic bureaucracies.<sup>14</sup> The theory stresses that ultimately

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<sup>14</sup> Andrew Hurrell, "Explaining the Resurgence of Regionalism in World Politics," *Review of International Studies* 21, no. 4 (1995), p. 348

governments are embedded in a process of integration over which they have little control; instead the system generates its own momentum. The theory fell out of favour in the 1970s as it struggled to explain the lack of progress in the European Union (EU). However it was revived by Wayne Sandholtz and John Zysman to explain the formation of the EU in 1992. They argued that the elite alliance between the European Commission, central bank technocrats and business groups furthered monetary integration as an inevitable spill-over from economic integration of the Single European Act in 1989. With the removal of all trade barriers and the elimination of all capital controls, monetary union was a natural spill-over effect to ensure economic stability.<sup>15</sup>

While Neofunctionalism has added richness to the debate on why institutions continue to persist it has been criticized for its inability to explain an institution's origins.<sup>16</sup> As such it is unable to explain the transition from self-interested actors to cooperation based on collective interests.<sup>17</sup> Secondly Neofunctionalism fails to explain the stop-start progress in institutional integration. As an example the process of monetary union took over 40 years from original concept. While Sandholtz and Zysman provide a solid account for persistence of EMU integration, the analysis lacks account of the prior events leading to the EMS. As such, Neofunctionalism failed to provide much insight into some of the critical initial steps to monetary formation and as such it proved insufficient for the scope of this thesis.

## **Intergovernmentalism and Member State Cooperation**

*"Europe can hold its own in world-wide competition with Japan and North America only if it acts as one"*

*Helmut Kohl, German Chancellor*

Within the European Community, intergovernmental bargaining was seen as "an institutionalized form of collective action among states" in response to

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<sup>15</sup> For a detailed Neofunctionalist account read Wayne Sandholtz and John Zysman, "1992: Recasting the European Bargain," *World Politics* 42, no. 1 (1989). and Wayne Sandholtz, "Choosing Union: Monetary Politics and Maastricht," *International Organization* 47, no. 1 (1993).

<sup>16</sup> PA Hall and RCR Taylor, "Political Science and the Three New Institutionalisms," *Political Studies* 44 (1996).

<sup>17</sup> Thomas Risse-kappen, "Exploring the Nature of the Beast: International Relations Theory and Comparative Policy Analysis Meet the European Union," *Journal of Common Market Studies* 34, no. 1 (1996). p. 56

perceived external threats.<sup>18</sup> Through inter-state relations countries could develop a common set of solutions to problems that arose from increased regional interdependence. Beginning in the 1970s, Europe was increasingly under attack from the economic power of Japan highlighting its growing uncompetitiveness in the world market. In addition it found itself at the mercy of US dollar depreciation which drove up the value of the Deutschmark, disrupting intra-European trade. Added to this pressure, all regions found themselves at the mercy of OPEC<sup>19</sup> induced inflation due to oil price hikes. It was widely held that individual European states had lost much of their former power over economic policy as global financial pressure had forced economies to remove tariffs and increase capital flows, or face punishment from the capital markets<sup>20</sup>. States responded to the loss of power over macroeconomic policy by opting to compete as larger economic blocks such as the European Union.<sup>21</sup> Through regional integration, states could pool their sovereignty as a means of preserving their own powers against these external threats. The EU provided a compromise solution for national governments to maintain greater control over their economies by acting as a regional competitive block instead of being exposed to the impacts of globalisation from multilateral trade and competition. The EU was unique in that it went further than the other regional blocks by pooling monetary sovereignty in return for greater regional power. Europeans could have simply integrated trade policies while maintaining flexible exchange rates, a system that NAFTA<sup>22</sup> has operated under since its inception. Yet the decision to pool monetary sovereignty became one of the major policy initiatives pursued in the process of European regional integration.

Intergovernmentalist theory views national governments as the principal agents driving European co-operation and the centrality of State

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<sup>18</sup> P Pierson, "The Path to European Integration: A Historical Institutionalist Analysis," *Comparative political studies* 29, no. 2 (1996). p. 128

<sup>19</sup> Organization of Petroleum Exporting Countries (OPEC)

<sup>20</sup> John Ravenhill, "Regionalism," in *Global Political Economy* (Oxford: Oxford University Press, 2008). p. 186

<sup>21</sup> For an overview of regionalism in Europe - James Anderson and James Goodman, "Regions, States and the European Union: Modernist Reaction or Postmodern Adaptation?," *Review of International Political Economy* 2, no. 4 (1995). and Richard Gibb and Wieslaw Michalak, "Regionalism in the World Economy," *Area* 28, no. 4 (1996).

<sup>22</sup> NAFTA stands for North American Free Trade Association, a regional block composed of the USA, Canada and Mexico.

sovereignty is one of its defining elements. Pioneered by Andrew Moravcsik, "Intergovernmentalist theory seeks to analyse the EC as the result of strategies pursued by *rational* governments acting on the basis of their preferences and power."<sup>23</sup> Based on rational choice theory, it emphasises the role of inter-state cooperation through bargaining. Central to Intergovernmentalist theory is the preference of states for the preservation of sovereignty in evaluating their options for cooperation, and monetary sovereignty was considered an essential element of state sovereignty. Robert Mundell argues that "the right to produce and control money is a clear-cut test of a country's independence and sovereignty".<sup>24</sup> It was accepted that a sovereign entity maintains the prerogative to 1) determine what constitutes money, 2) the right to determine legal tender and 3) the right to produce money.<sup>25</sup> In this light, monetary sovereignty was seen as something that solidified the Westphalian concept of a nation. Therefore relinquishing monetary sovereignty to a supranational arrangement would have to be compensated by some greater political or economic benefit that more than offset the domestic sacrifice. As such, monetary sovereignty has dominated much of the EMU Intergovernmentalist debate in terms of what it means to relinquish monetary sovereignty to an alternative monetary arrangement.

The rational argument for creating monetary unions was presented in terms of economic efficiency. Hailed as "the Godfather of the Euro" Robert Mundell's work on Optimal Currency Areas (OCAs) framed a significant amount of the debate in the lead up to the formation of the EMS and later the EMU. The fundamental question that Mundell addressed was the conditions that made it advantageous for regions to relinquish monetary sovereignty in favour of a supranational currency regime. He posited that optimal stability was valid only if it was based on economically homogenous units. These regions shared common characteristics such as economic symmetry, a high degree of intra-region trade, high labour mobility and fiscal transfers from

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<sup>23</sup> Andrew Moravcsik, "Preferences and Power in the European Community: A Liberal Intergovernmentalist Approach," *Journal of Common Market Studies* 31 (1993). p. 496 emphasis added by author

<sup>24</sup> Robert A. Mundell, "Monetary Unions and the Problem of Sovereignty," *Annals of the American Academy of Political and Social Science* 579 (2002). p. 133

<sup>25</sup> *Ibid.* p. 128

economically stronger to weaker areas. He reiterated that regions are economic entities with a high degree of homogeneity and the argument for flexible exchange rates “hinges on the closeness with which nations correspond to regions”<sup>26</sup>. However regions are typically socially constructed areas with defined territorial boundaries, which may not necessarily map to an OCA. <sup>27</sup> Mundell was unconvinced that a currency union could ever materialise given the major political hurdles that would have to be overcome in its creation:

*“What is the appropriate domain of a currency area? It might seem at first that the question is purely academic since it hardly appears within the realm of political feasibility that national currencies would ever be abandoned in favour of any other arrangement.”*<sup>28</sup>

Geoffery Garrett highlights how the European Community members shared a common goal of increasing Europe’s competitiveness in the global marketplace by developing an internal market as a means to create new forms of protectionism. Meanwhile by sharing a common currency they were able to lower internal transaction costs through a single market. However state preferences are based on the cost/benefit trade off between increased integration and loss of sovereignty. As long as the benefit of collective action outweighs the cost of remaining autonomous, states will participate in the institutional arrangement. The primary rationale put forward for a currency union was to facilitate ease of trade among participants of the union and to guarantee greater price stability through lower inflation. But to accomplish these objectives sovereign states had to relinquish a powerful weapon to manage a nation’s welfare in times of economic crisis – monetary independence. As long as Europe represented an OCA, the rational economic argument held that it was in the interest of states to cooperate as they would all benefit from the shared currency. But in fact the EMU was highly criticized by economists because it did not map to an OCA. <sup>29</sup> There

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<sup>26</sup> Mundell, "A Theory of Optimum Currency Areas." p. 664

<sup>27</sup> As an example Mundell noted how Western Canada and Western USA were more regionally synchronised than Western and Eastern USA.

<sup>28</sup> Mundell, "A Theory of Optimum Currency Areas." p. 657

<sup>29</sup> For an in dept review of Europe as an OCA read B Eichengreen, "Is Europe an Optimum Currency Area?," *NBER Working Paper* (1991). and Milton Friedman, "Why Europe Can't Afford the Euro," *The Times*, November 19, 1997.



was a significant lack of synchronicity between the core “hard” currency areas and the peripheral economies such as Ireland. However the theory of OCA was still used extensively in the official documents produced by the European Commission to convince governments that Europe did in fact constitute one.<sup>30</sup> The European Commission staunchly defended monetary union on the basis of a rational economic argument of OCAs, arguing that “on average” the EU was more synchronous than not. The accepted Intergovernmental view is that the EU institutional formation was largely political and economic logic was applied to add “after the fact” credibility to the initiative.

Lloyd Gruber is the main proponent of an Intergovernmentalist view to describe the formation of the EMS. In particular he focuses on small weak states as an explanatory basis for his “Winners and Losers”<sup>31</sup> explanation for the formation of supranational institutions. Gruber provides a pessimistic view of the regionalisation process which argues that weak peripheral states had no choice but to participate in the EMS driven by the “go-it-alone” power of the institutional beneficiaries, France and Germany. Gruber proposes that many of the purported “successful” supranational organizations such as the EMS and NAFTA are in fact composed of “winners” and “losers”, meaning that they had a pareto-improving impact on a select number of countries but the “losers” were worse off on a relative and absolute sense.<sup>32</sup> In particular he notes that the participation of losers is the result of “the absence of any better alternative” “despite their strong preference for the original, pre-cooperation status quo”.<sup>33</sup> But given the inevitability of the institutional formation, they are forced into a Hobson’s choice of participation or suffering the worse consequences of complete exclusion.<sup>34</sup> France, Germany and the Deutschmark pegged states stood to benefit from the pooled sovereignty of the OCA, while states like Britain, Italy and Ireland faced being relegated to the periphery within a “two tier” Europe. Their preference was the status quo, but that could never be regained as France and Germany had altered the

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<sup>30</sup> The EC commission report “One market, One money” became the foundation document to the EMU and extensively referenced the logic of OCAs to explain the rational for further integration.

<sup>31</sup> Lloyd Gruber, *Ruling the World: Power Politics and the Rise of Supranational Institutions* (Princeton: Princeton University Press, 2000). p. 171

<sup>32</sup> Ibid. p.4

<sup>33</sup> Ibid. p. 7

<sup>34</sup> Ibid. p.47

game. Given this analysis, Gruber argued that governments join institutional arrangements that render them worse off as the means to avoid an even more deleterious outcome. The more powerful states create a new dynamic that alters the regional status and smaller states are forced to join simply to stay in the game. As such, regionalism does not reflect a pooling or sharing of risk and reward in return for loss in sovereignty, rather the winning strategy will go ahead irrespective of what weaker do. The peripheral players are reduced to making a decision on whether to be included in the institutional arrangement or whether to suffer an even worse fate external to the institution.<sup>35</sup> Gruber specifically mentioned Ireland as an example of one of the losers camp reduced to bargaining for side-payments as symbolic face savers.<sup>36</sup> Gruber's account of institutional formation such as NAFTA and EMS leaves little room for small state preferences as they are relegated to mere survival.

Intergovernmental theorists like Moravcsik and Garret primarily focus on the 1992 formation of the EMU, which was far more encroaching on sovereign power than the EMS. According to Garrett interstate bargaining was central to explaining the particular path chosen by the European member states from the many possible economic and political alternatives that could have provided a coordinated regional response.<sup>37</sup> Garret reduced the EMU into three broad camps; the UK and Denmark were pro-deregulation but vehemently against EU level re-regulation therefore their preference was to maintain monetary sovereignty while supporting the removal of capital controls; France, Germany and Benelux countries were less supportive of deregulation but wished to see a greater level of harmonization of practices within Europe therefore the currency union appealed to their desire for monetary stability; finally the South, which included the poorer Southern European countries (and Ireland) stood to lose anyway and states simply bargained for what they could get in terms of structural funds.<sup>38</sup> Moravcsik provides a similar view of the process of European integration with state support pooled around specific preferences. Britain and Denmark preferred a

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<sup>35</sup> Ibid. p. 39

<sup>36</sup> Ibid. p.206 footnotes and p. 196 on side payments

<sup>37</sup> Geoffrey Garrett, "International Cooperation and Institutional Choice: The European Community's Internal Market," *International Organization* 46, no. 2 (1992). p. 536

<sup>38</sup> Ibid. pp. 541-545

laissez-faire trade regime while France, Germany and the Benelux countries preferred a more managed economy. The final group of Southern states knew they had no choice and resorted to bargaining for development assistance paid for by the wealthier member states.<sup>39</sup> Ultimately both analyses reduce the peripheral states down to a thin explanation of interests with no consideration for national differences.

Intergovernmentalism has been criticised for its focus on “grand bargains”. While it provides a powerful argument for major institutional formations such as the European Union, it provides little insight into the smaller bargains that cumulatively led to bigger change within the European context. In addition it reflects the neo-realist preoccupation with sovereignty as the essential element of state preferences, where the ultimate goal is relative gains while conceding as little sovereignty as possible. It assumes that groups cluster around narrowly defined interests and those preferences remain fixed during the process of interstate bargaining.<sup>40</sup> The bargaining process is limited to deals and side payments without any preference adjustment. In addition, Intergovernmentalism is focused exclusively on the instruments of state with no differentiation between state and society; therefore it fails to articulate any cultural or ideational goals that could lead to “irrational” behaviour.<sup>41</sup> As a case in point, the Danish plebiscite rejected the Maastricht treaty on the grounds of diminished monetary sovereignty – quite a rational position to take. However the Danes had long ago surrendered functional monetary sovereignty to the Deutschmark as an active participant in both the “Snake” and the EMS. At a functional level, a yes vote on Maastricht would have maintained status quo, not resulted in some huge loss of sovereignty. Yet the plebiscite rejected monetary union on the grounds of maintaining sovereignty and even today it still maintains a peg to ERM II while rejecting full monetary integration.

Finally while the “grand bargains” provide meaningful insight into large state participation, the Intergovernmentalist theory has a very limited

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<sup>39</sup> Andrew Moravcsik, "Negotiating the Single European Act: National Interests and Conventional Statecraft in the European Community," *International Organization* 45, no. 1 (1991). p. 543-545

<sup>40</sup> Risse-kappen, "Exploring the Nature of the Beast: International Relations Theory and Comparative Policy Analysis Meet the European Union." p. 56 and Hall and Taylor, "Political Science and the Three New Institutionalisms."

<sup>41</sup> Pierson and Risse-Kappen provide excellent critiques of Intergovernmentalism

explanation for small state participation. It fails to provide any more creative solution than “cap in hand” bargaining for peripheral states faced with the inevitable loss of power. The assumption that they were left no option is just too reductionist. Peter Katzenstein, one of the few writers who focused on small European states, notes that small states of Europe lacked the power to engage in meaningful intergovernmental economic bargaining therefore this level of analysis does nothing to explain their participation. According to Katzenstein, the study of European integration has been dominated by a “great-power fixation”<sup>42</sup> which renders students of International Relations (IR) ignorant of small European state politics. He argues that in a global context, the odds are stacked against small and dependant states but this does not render them helpless and without choice. Therefore what largely goes unmentioned in the body of IPE is that even though small state choices are limited, they still have *some* choices.<sup>43</sup> As the European Union expands eastwards, it is increasingly moving to a system of smaller states and the classic theoretical approach of power politics becomes less valid or informative. In particular as Europe expands eastwards with many new small members the prominent IPE theories lose relevance in exploring and analysing future membership.

### ***Critique***

This section has reviewed the two competing IPE theories on European integration, Neofunctionalism and Intergovernmentalism. Neither of the rational choice theories provides meaningful insight into small state participation in Europe’s supranational institutions. Both rely too heavily on utility maximizing actors while treating preferences exogenous to the process of integration. The path to monetary integration was presented in a highly technocratic form that presented the logic in terms of economic fact absent any cultural preferences. Both are preoccupied with large state power and largely ignore or minimize small state participation.

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<sup>42</sup> Peter J Katzenstein, *Small States in World Markets: Industrial Policy in Europe* (Cornell Univ Pr, 1985), p.37

<sup>43</sup> Ibid. p. 23

Both Eric Helleiner and Benjamin Cohen argue that the traditional concept of sovereign territorial currencies is no longer valid with the effects of new technological advancements in the globalization of capital.<sup>44</sup> Nations no longer have the power to control money in ways that were historically possible therefore the focus on monetary sovereignty almost seems anachronistic. This became patently clear during the global economic crisis when national governments were left defenceless against the global capital meltdown. Therefore the traditional view of sovereign monetary power has been significantly eroded and may not be a valid unit of analysis to begin with.

Neofunctionalist explanations for the formation of Europe's supranational institutions over-generalise the process of institution building and it is widely criticised for not providing a satisfactory account of European integration. In fact, its pioneer Ernest Haas advocated that the theory needed to be supplemented by a more general theory encompassing national preferences.<sup>45</sup>

The Intergovernmentalist model is preoccupied with monetary sovereignty as an explanatory mechanism for the inter-state bargaining process. However what happens when a state does not possess monetary sovereignty to begin with? Ireland had never possessed functional monetary sovereignty during its 56 years of existence. As a hard peg to Sterling, its monetary policy was imported from Britain. Given that Ireland essentially had no monetary sovereignty to bargain with, one would expect that its decision making would be carefully framed around the most favourable economic decisions. If economic rational was to prevail, Ireland would have evaluated the case for monetary convergence from the perspective of economic best-fit. As Table 1 demonstrates, at the time of formation of the EMS Ireland's economy was highly uncorrelated in relation to the German economy. Being pegged to the Deutschmark meant that Ireland stood to suffer significantly in the event of any economic shock. Given that the 1970s had been marked by significant oil driven shocks, this posed a real and present threat to the Irish economy. Even as late as 1992 when Ireland pursued further integration

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<sup>44</sup> Eric Helleiner, *The Making of National Money: Territorial Currencies in Historical Perspective* (Cornell Univ Pr, 2003). and BJ Cohen, *The Geography of Money* (Cornell: Cornell Univ Pr, 1998).

<sup>45</sup> Moravcsik, "Preferences and Power in the European Community: A Liberal Intergovernmentalist Approach." p. 478

towards monetary union, it still remained the worst synchronized economy within Europe with a correlation of only 0.35 between it and Germany.<sup>46</sup> On analyzing Ireland's export profile in 1978, almost 50% of its exports went to the United Kingdom alone.<sup>47</sup> Given that Ireland was already participating in an OCA with Britain, it should have maintained a currency union with its primary trading partner not joined the EMS. As noted by Gruber, there was no coercive power being ladled on the peripheral members to join the EMS, therefore Ireland did not stand to lose significantly.

Table 1: Business Cycle Symmetry in the European Community 1965-1979

Country	Correlation <sup>a</sup>	Symmetry
		Rank
Germany	-	1
Denmark	0.77	2
France	0.71	3
Netherlands	0.67	4
Belgium	0.66	5
[Greece] <sup>b</sup>	0.59	6
United Kingdom	0.58	7
[Austria]	0.56	8
[Finland]	0.53	9
[Portugal]	0.49	10
[Spain]	0.47	11
Italy	0.47	12
[Sweden]	0.29	13
Ireland	0.16	14

Source: Lloyd Gruber: *Ruling the World: Power Politics and the Rise of Supranational Institutions*<sup>48</sup>

<sup>a</sup> Correlation between annual GDP growth rates in Germany and other European Countries, the closer to 1.0 the higher the correlation

<sup>b</sup> Countries in brackets were not members of the EU in 1979

<sup>46</sup> Gruber, *Ruling the World: Power Politics and the Rise of Supranational Institutions*. p. 209 Table 8-5

<sup>47</sup> Irish Central Statistics Office. (Also presented in Chart 2 p.42 of thesis)

<sup>48</sup> Gruber, *Ruling the World: Power Politics and the Rise of Supranational Institutions*. Table 8-3, p. 202

In summarising, the literature review reveals that the prominent IPE literature covering European monetary integration provides a weak fit to explain Ireland's decision to join the EMS in 1978 and to join the EMU in 1992. On both occasions Ireland had an alternative choice and in both cases Ireland proved to be an enthusiastic supporter for the creation of the institution, yet its actions appear contrary to its material interests. Intergovernmentalism provides a strong argument for institutional formation through the balance of interstate bargaining and sovereignty preservation. However while power dynamics plays a major role for large states, it proves too reductionist for small states with little power, relegating them into the "cap-in-hand" bargaining camp. Due to the centrality of sovereignty as the basis of bargaining, it has difficulty accommodating alternative realities. For large states money was seen as an extension of state monopoly on power therefore it is fitting that the Intergovernmentalist approach works well for them. However for smaller states with no major claim on monetary sovereignty it requires an alternative framework to provide a more meaningful explanation for economic decision making that on the surface defies the rationally bounded world of traditional IPE scholarship.

## ***Economic Identity Politics as an Alternative Framework***

The following section presents an alternative framework that provides a more expansive role for institutions beyond the limited instrumentality outlined in the literature review. The predominant theories of IPE focus on government decisions that are derived from their material interests in economic structures and nationality or culture are exogenous to the process. As Rawi Abdelal notes, IPE is hostile to identity politics due to its “relativity” or “being against science”. However recent scholarship has challenged the prominence of economic rationalism in explaining state participation in the supranational institutions of Europe. Theorists such as Peter Katzenstein, Rawi Abdelal, Eric Helleiner and Colin Hay have provided greater insight into the field of IPE by encompassing identity politics to broaden the perspective on how society and political economy interrelate.

In the process of providing a constructivist view some of the authors have confusingly reclaimed the term “economic nationalism” to further their case for introducing identity politics back into IPE.<sup>49</sup> Traditionally economic nationalism (also termed neo-mercantilism) has been associated with Robert Gilpin’s seminal work on economic protectionism.<sup>50</sup> Gilpin’s profoundly neo-realist perspective is considered anachronistic as it is associated with the economic protectionist policies prominent in the interwar period through to the 1970s. However as George Crane notes, this narrow view of nationalism should be termed “statism” as it treats identity as “exogenously given, deductible from state interests, which in turn are determined by interstate systemic conditions”<sup>51</sup> This view is echoed by Helleiner and Abdelal who argue that Gilpin’s economic nationalism is merely a “masterly restatement of realist political economy” whereas nationalism is “an expression of a constructed societal identity”.<sup>52</sup> Nationality combines the indeterminacy of

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<sup>49</sup> For more on Economic Nationalism Eric Helleiner and Andreas Pickel, *Economic Nationalism in a Globalizing World* (Ithaca: Cornell University Press, 2005). and GT Crane, "Economic Nationalism: Bringing the Nation Back In," *Millennium: Journal of International Studies* 27 (1998).

<sup>50</sup> R Gilpin and JM Gilpin, *The Political Economy of International Relations* (Princeton University Press Princeton, 1987).

<sup>51</sup> Crane, "Economic Nationalism: Bringing the Nation Back In." p.55

<sup>52</sup> Rawi Abdelal, "Nationalism and International Political Economy in Eurasia," in *Economic Nationalism in a Globalizing World*, ed. E and Pickel Helleiner, A (Ithaca: Cornell University Press, 2005), p. 22



race, ethnicity, language, religion, shared historical experience, political culture and economic reality. Even more problematic, it is not necessarily territorially bounded and it is subject to change and contestation.<sup>53</sup>

However the constructivist use of the term “economic nationalism” to explain a vastly different concept has injected confusion into the field of IR. To avoid promulgating any further confusion, this thesis will use the term “economic identity politics” as a clarifying term for the reader who associates economic nationalism with traditional neo-realist literature. Economic identity politics focuses on economic policy that emanates from a shared national identity and is guided by national purpose and direction.

By making identity the locus of enquiry it helps explain how foreign economic policies can help advance nationalist goals. Economic identity politics can include the political legitimization of new state economies, the development of a national economic identity or the distancing from prior economic dependency. Economic identity politics describes how governments use national or foreign economic policies in order to enhance some particular definition of collective identity. It explains how societies are willing to endure national economic sacrifice for a higher national goal that shapes the vision of the future. Economic identity politics stresses the longer term vision for society and its government such that current sacrifice is framed in terms of future rewards. Finally it directs economic policy away from the nations “other” towards a new cultural space.<sup>54</sup> For example, Rawi Abdelal shows how Estonia oriented its foreign economic policies around the West and away from Russia, (the “other”) to legitimize its European identity. It rejected close economic ties with Russia and was willing to endure the economic cost of establishing its autonomy. It even rejected its Ruble link and pegged to the Deutschmark in 1992, linking its currency toward a new cultural space – Europe.<sup>55</sup>

Using this framework, economic identity politics provides a much richer picture of international economic policy providing explanatory power for

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<sup>53</sup> Crane, "Economic Nationalism: Bringing the Nation Back In." p. 55

<sup>54</sup> Rawi Abdelal, "National Strategy and National Money, Politics and the End of the Ruble Zone," in *Monetary Orders, Ambiguous Economics, Ubiquitous Politics*, ed. Jonathan Kirshner (Cornell: Cornell University Press, 2003).

<sup>55</sup> Ibid. p. 113-114

seemingly irrational economic decisions. It can reconcile the participation in neoliberal supranational institutions with purely national identity goals. As such economic identity politics can explain actions that are seemingly contradictory or dichotomous. The very act of pursuing a nationalist goal can lead to greater participation in a supranational entity such as monetary union.

## **Economic Identity and Monetary Sovereignty**

In the way that monetary sovereignty is overemphasised as an instrument of power politics, the theoretical literature on the EMU ignores the indeterminate aspects of monetary sovereignty as a unifying national symbol. Cohen argues that while the production of money may not be an essential attribute of the state it has been monopolized by Governments as a means to further national identity. Beginning in the 19<sup>th</sup> century, as geographically defined states acquired monopoly power over currencies, one of the benefits bestowed on governments was the political symbolism that accompanied monetary unification.<sup>56</sup> Kaelberer notes how money began to represent a collective identity which governments leveraged to enhance their nationalist goals to generate greater social cohesion. Money became an essential element in the “imagined community”<sup>57</sup> of the sovereign state. The imagery on notes and coins provided governments with a means to express their vision of the state.<sup>58</sup> Helleiner notes how France emblazoned its notes with liberty, equality and fraternity, while Kaelberer shows how post World War II German notes turned to scientists and artists rather than promoting political heroes.<sup>59</sup> Words like “strong” and “weak” are used to describe a currency and there is a sense of national pride in being associated with “strong” even if its economic impact is deleterious. While the nuances of monetary sovereignty may be beyond the average citizen, the physicality of money and what it can buy is tangible for everyone. While economic rationality might favour combining currencies, national desires to maintain monetary sovereignty can

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<sup>56</sup> Cohen, *The Geography of Money*.

<sup>57</sup> This term was coined by Benedict Anderson to articulate the social construction of the nation.

<sup>58</sup> Matthias Kaelberer, "The Euro and European Identity: Symbols, Power and the Politics of European Monetary Union," *Review of International Studies* 30, no. 02 (2004). p. 164

<sup>59</sup> Helleiner, *The Making of National Money: Territorial Currencies in Historical Perspective*. p. 103-104 and Kaelberer, "The Euro and European Identity: Symbols, Power and the Politics of European Monetary Union." p. 164

be highly influenced by the perceived loss of identity in transitioning to the sterile functionality of the Euro.

While the literature on IPE overemphasises the centrality of monetary sovereignty in foreign economic policy, it ignores the centrality of money in the formation and reinforcement of national identity. As noted by René Lévesque, the leader of the Quebec Nationalist movement, "[it] is national image which makes the franc the franc and the lire, the lire" not monetary sovereignty.<sup>60</sup> To return to an example mentioned previously, the Danes rejected the Maastricht treaty on the grounds of economic identity, even though their currency had been functionally pegged to the German mark prior to 1992 and had been associated with some form of monetary union for most of its prior existence. Similarly the British resistance to the Euro is significantly influenced by public's refusal to give up the pound which is considered a major symbol of being British. Yet economic rationalism has no means to capture this essential piece of monetary sovereignty, as identity is exogenous and sovereignty is only reflected in terms of state power.

It is important to note that the Euro had existed in all but the physical coinage for three years before it gained a public face. As an electronic currency from 1999 to 2001 it served as the main currency for all economic transactions. As Kaelberer notes, "the Euro was already there when it arrived".<sup>61</sup> From an economic perspective there was no change when the physical currency came into being in 2002, yet the transition to the physical currency created a significant identity gap within many of the individual countries that still exists today.<sup>62</sup>

In summary, this section has outlined an alternative framework for reviewing the decision making process to participate in monetary union by framing it in terms of economic identity politics. In doing so it has allowed a much richer interpretation for individual nation engagement (or not) with supranational organizations. In addition, it has provided a better

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<sup>60</sup> Cited by E Helleiner, "Why Would Nationalists Not Want a National Currency? The Case of Quebec," in *Economic Nationalism in a Globalizing World*, ed. E Helleiner and A Pickel (Ithaca: Cornell University Press, 2005). p. 178

<sup>61</sup> Kaelberer, "The Euro and European Identity: Symbols, Power and the Politics of European Monetary Union." p. 168

<sup>62</sup> The differing attitudes of states is captured in Eurobarometer, "Public Attitudes and Perceptions in the Euro Area," in *Series # 216* (Brussels: European Commission, 2008).

understanding of monetary sovereignty articulating how it can never be treated as entirely functionalist as its very roots and legitimacy are based on collective national identity. It has also shown how economic identity significantly impacts how countries view matters of economic sovereignty. Monetary identity can exist in the effective absence of functional economic monetary sovereignty; therefore it is essential to consider identity when reviewing any arrangement that involves ceding monetary power to a supranational institution. Using a framework that encompasses economic identity politics, the following section will help unravel Ireland's puzzling and economically "irrational" participation in both the EMS and EMU.

## **Experimental Union**

### ***Ireland the Outlier***

Throughout its history in the European Union, Ireland has remained an enigma for IPE theorists.<sup>63</sup> As recent as 2008, Hay et al. noted that it inhabits a unique position being an outlier both physically and economically. Geographically remote and unattached to mainland Europe, it is the only liberal “Anglo-American” style market in the Eurozone and is the most heavily dependent on trade and investment from economies external to the union. Superficially it has less to gain from Euro membership than any other economy within the Eurozone and, based on OCA theory, it stood to lose significantly should the global economic climate turn sour. Classic Intergovernmentalist literature accounts for Ireland’s participation from the perspective of side-bargains for structural funds or from a lack of alternative choices. However this thesis will demonstrate that Ireland’s positive association with EMU can be better explained from the perspective of economic identity politics. Through primary research reviewing the historical records of official government debates and the popular press in the periods of 1978 and 1992, this thesis will present an alternative discourse that shows Ireland’s economic decisions were significantly influenced by national identity goals. The institutions of the EMS and EMU created a new Irish monetary identity that was an essential part of enhancing its national identity. In the process, Ireland has developed a hybrid nationality, economically and monetarily European while still remaining distinctly “Irish”.

### ***The Formation of Ireland’s Currency***

Ireland’s path to the Euro was a multi-step process beginning with its decision to participate in the EMS in 1978, leading to its full commitment to monetary union on ratifying the Maastricht Treaty in 1992. These two events were essential decision points in Ireland’s economic identity formation. On both occasions Ireland had choices, and both times it opted for further European

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<sup>63</sup> Colin Hay et al., “Ireland: The Outlier Inside,” in *The Euro at Ten*, ed. Kenneth Dyson (Oxford: Oxford University Press, 2008). p. 182

integration, even in light of strong economic warning bells. Ireland's decision to join the EMS was significantly more complex than any other state in Europe as Ireland had to first sever its 150 year old link with Sterling to join the EMS. As a territorial subject of the British crown, the Irish currency was combined with Sterling in 1826 and the union remained in place for nearly 100 years until the formation of the Irish Free State in 1921. As noted earlier, political identity is inextricably intertwined with monetary sovereignty and it was at the forefront of the Irish Government's mind as it unwound itself from British colonial rule. Following its independence from the UK, Ireland quickly set about forming its own currency, which was considered an essential piece of promoting its new found independence. In 1926 the Irish Government appointed a Banking Commission to investigate and report on any changes that should take place in light of the formation of the Irish Free State.<sup>64</sup> To add credibility, the commission was headed by a prior director of the US Federal Reserve Board, Dr. Henry Parker-Willis. The interim report recommended that Ireland maintain a fixed peg to Sterling and set up an independent non-political organisation called the Currency Commission to manage the issuance of notes and oversee currency reserves. Following the commission's recommendation, the Irish pound<sup>65</sup> was created as part of the Currency Act of 1927. The Irish currency would be underpinned with a guarantee of total convertibility to Sterling, backed by British Government securities, Sterling and gold reserves. Such was Ireland's commitment to maintaining the hard peg with Sterling that any change or re-valuation would require an act of Parliament.<sup>66</sup> At that time the UK and Ireland represented as close as one can get to an OCA and maintaining a currency union made sound economic sense. However as Mundell noted, monetary sovereignty is composed of two distinct elements, namely policy sovereignty and legal sovereignty.<sup>67</sup> The first describes a country's ability to set or manage its

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<sup>64</sup>This section draws largely from the historical accounts documented by the John Kelly, "The Irish Pound: From Origins to Emu," *Central Bank of Ireland Quarterly Bulletin*, no. Spring 2003 (2003). At the time of the formation of the Irish Free State 98% of Ireland's exports were to the UK and Northern Ireland and over 80% of its imports.

<sup>65</sup> For the purpose of language simplification I am calling the currency the Irish Pound. It was initially called the Soarstat (Free State) pound and its name was changed to the Irish pound in 1937 after the completion of the Irish constitution.

<sup>66</sup> <http://www.irishstatutebook.ie/1927/en/act/pub/0032/sec0004.html#zza32y1927s4>

<sup>67</sup> Mundell, "Monetary Unions and the Problem of Sovereignty," p. 125

economic policy and the latter describes the legal right to maintain a sovereign currency. When Ireland entered a fixed exchange peg with Sterling it relinquished policy sovereignty to the UK and with it, lost the ability to control its inflation or interest rates. In return, it inherited the stability from being pegged to a more powerful international currency and eliminated any country-specific exchange rate risk. It maintained legal sovereignty over its currency as the sole issuer of legal tender for Ireland, which it managed through the instruments of a currency board.<sup>68</sup> As Benjamin Cohen notes, currency boards served an important role in presenting the “*illusion*” of national monetary sovereignty and it provided Irish officials with a symbolic measure of currency independence.<sup>69</sup> The appeal to Ireland’s national identity was accomplished through the physical symbolism of its own unique currency. Territorial currencies as national symbols of unification were in vogue during the 1920s and Ireland’s currency took on the role of “silent ambassadors of national taste” “to show our national identity”.<sup>70</sup> The Currency Commission under the chairmanship of the poet William Butler Yeats used allegories that represented the cultural renaissance of Ireland. The notes contained a figure of a woman, wearing a traditional Irish shawl, leaning against a harp. It represented Kathleen Ní Houlihan<sup>71</sup>, a mythical character who was an allegorical representation of Ireland during the political struggle for independence. The harp, another symbol of Irish nationalism, was chosen as the emblem on all coinage. The notes and coins were significantly leveraged to create a new Irish identity and reinforce Irish nationalism, while on a pragmatic level Ireland was still under the monetary control of the UK.

Throughout the 1960s several studies were undertaken by the Central Bank of Ireland to assess the viability of an independent Irish currency. However in all cases the analyses recommended maintaining the status quo.

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<sup>68</sup> In reality, while the Irish pound was sole legal tender, people freely traded in both Irish pounds and Sterling and both were widely accepted in retail.

<sup>69</sup> Cohen, *The Geography of Money*. p. 52 - 54

<sup>70</sup> Helleiner, *The Making of National Money: Territorial Currencies in Historical Perspective*. p. 154

<sup>71</sup> Kathleen Ní Houlihan was widely used in myth and legend to represent the struggle for Irish freedom. It was also used by the Irish Diaspora to represent their prior homeland. Her “four green fields” were the provinces of Munster, Leinster, Ulster and Connaught that were the ancestral kingdoms of Ireland.

Even on entry into the EEC in 1973, Ireland maintained its steadfast link with sterling. But while Ireland maintained its hard peg to Sterling, the Dáil records show that the Irish Government grew concerned about the inflationary affects of the currency union during the early 1970s. Britain had suffered significant inflationary shocks from the oil crisis of 1973 and a subsequent fall in value meant that Ireland suffered significant inflationary impact on imported products. Even so, a 1973 Banking Commission report emphasised that the Sterling link was necessary both on the grounds of economic efficiency and the survival of the economy.<sup>72</sup> Bradley and Whelan note that the Central Bank report explicitly invoked Mundell's theory of OCAs to justify maintaining the link with Britain. Sterling provided Irish politicians with ample reason to blame Britain for its economic woes, however no serious considerations were expressed in the Dáil records indicating a desire to terminate the relationship.<sup>73</sup>

### **The EMS Embryo – Copenhagen 1978**

While monetary integration had been discussed on and off in Brussels since the 1950s, it had been plagued with stop-start progress throughout the decades.<sup>74</sup> The Werner report published in 1970 marked the first serious attempt at reviving the goal of monetary union. It argued for a parallel development of economic and monetary integration ultimately leading to an irreversible currency union. According to Kathleen McNamara, the EMS emerged as a result of the change in international monetary order as well as changing domestic policy away from Keynesian economics to a monetarist approach to policy.<sup>75</sup> On the international arena, a continued decline in the US dollar drove up the Deutschmark, threatening Germany's export based market. For other European countries plagued with inflation, low growth and unemployment, governments began to look to a new model of "economic

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<sup>72</sup> John Bradley and Karl Whelan, "Irish Experience of Monetary Linkages with the UK," in *Economic Convergence and Monetary Union in Europe*, ed. R Barrell (London: Sage, 1992). p.125

<sup>73</sup> The official Dáil transcripts show that there were approximately 16 oral or written questions on currency related issues between 1971 and 1977. All were minor questions on the monetary link and currency valuation.

<sup>74</sup> The first plan drawn up was the Schuman plan in 1950. Cited in Kelly, "The Irish Pound: From Origins to Emu." p. 101

<sup>75</sup> KR McNamara, *The Currency of Ideas: Monetary Politics in the European Union* (Cornell Univ Pr, 1998). p. 123



liberalism" as the way forward. McNamara argued that monetary participation in the EMS was motivated by a preference to adopt the low inflation regime of Germany away from Keynesian economics. Countries like France were willing to accept an austerity program in exchange for the low-inflation policies of the German monetary regime.<sup>76</sup> The reform commitment to monetary stabilization is widely viewed as the catalyst that spurred Italy and France to participate in the EMS program. However the Irish Government of 1978 did not fit the profile of a fiscally conservative government determined to pursue economic policies through the instruments of the EU. At the time Ireland's government was a major proponent of Keynesian demand management policies to stimulate the economy,<sup>77</sup> in stark contrast to the policies being pursued in countries like France and Germany. Under the economic policies of the Fianna Fáil government, the country experienced an unprecedented period of "unbridled pro-cyclical discretionary fiscal expansion" reversing years of fiscal contraction.<sup>78</sup> Unfortunately McNamara's argument does not provide explanatory insight into Ireland's participation in the EMS as its domestic economic policies were focused in the opposite direction to Europe. The proposal for monetary co-operation was first socialized at the European Council summit meeting in Copenhagen on April 7, 1978. However the events that followed demonstrate the two-tier approach taken by European elites. There were actually two meetings held at Bremen, the first, a vague socialization of monetary union to the Community at large and the second, a very specific proposal to a select audience. At the general Council summit, Helmut Schmidt introduced the subject of greater monetary co-operation but it is obvious from the Dáil records that little substantive details were provided. The Irish government was represented by the Taoiseach<sup>79</sup> Jack Lynch and a small contingency of his Fianna Fáil Government. The Taoiseach's report back to the Dáil following the summit reveals that Schmidt's socialization was presented in terms of preliminary investigatory work to be carried out by the Commission - as noted in the following passage:

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<sup>76</sup> Ibid. p. 129-135

<sup>77</sup> Oireachtas, "European Union Treaty: Statements " Dáil Debates Vol. 420 (June 9th, 1992). p. 1941

<sup>78</sup> John Bradley, "Medium Term Analysis of Fiscal Policy in Ireland: A Macroeconomic Study of the Period 1967-80," *European Social Research Institute* (1985).

<sup>79</sup> The name given to the Prime Minister of Ireland, Prime Minister is never used in the Irish Dáil.

*"We talked of certain ideas on how the Community could make a contribution to world-wide monetary stability that would be commensurate with its importance in world trade. Further work is to be done on these ideas within the context of a common strategy which we agreed to develop over the coming three months and which, in addition to economic and monetary affairs, will cover employment, energy, trade, industrial affairs and relations with the developing world.....The Copenhagen meeting was not an occasion for final decisions on action. It concentrated rather on analysis, looking forward to decisions at the next meeting in Bremen in July and at the so-called World Economic Summit in Bonn shortly thereafter."*<sup>80</sup>

While one could simply accuse the Taoiseach of obscurantism, Lynch would have reveled in bringing back the news of a possible new European monetary arrangement to the Dáil, as his party was no friend of the Sterling peg.

The second meeting, which occurred late in the proceedings after dinner, was limited to an exclusive group of European elites including Chancellor Helmut Schmidt of Germany, President Giscard d'Estaing of France, James Callaghan the British Prime Minister and Roy Jenkins the head of the European Commission. At this private meeting the major European powers held discussions on dissolving the Snake and creating a new monetary system based on a Franco-German proposal.<sup>81</sup> News of this meeting was broken to the public by the Economist on April 15<sup>th</sup>, five days after Lynch's debrief to the Dáil.<sup>82</sup> The formation of this political splinter group was used extensively in the Intergovernmentalist account to explain the power politics of monetary union. It also supports Lloyd Gruber's view that the new currency arrangement was primarily a union of the major "winner" currencies pursuing a go-it-alone strategy to satisfy their immediate interests.

The discussion of a potential monetary union was notably absent from Jack Lynch's debrief, but notably present was the issue of Irish unification discussed with Jim Callaghan, the British Prime Minister. The question of power-sharing in Northern Ireland<sup>83</sup> and devolution dominated a significant

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<sup>80</sup> Oireachtas, "Copenhagen Meetings: Statement by Taoiseach," Dáil Debates Vol. 305 (April 11th, 1978). p. 343

<sup>81</sup> Dyson, *Elusive Union: The Process of Economic and Monetary Union in Europe*. p. 101

<sup>82</sup> Anonymous, "Emu Lives, and Its Saviour's Name Is Schmidt," *Economist*, April 15 1978.

<sup>83</sup> On formation of the Irish state, only 26 counties of the island of Ireland were included, the remaining 6 counties which had a strong protestant contingent remained under the United Kingdom.

portion of the Dáil debrief with little concern for the issues of European monetary integration. At the time in question, relations between Ireland and the United Kingdom were at a heightened level of tension due to increased sectarian violence in Northern Ireland. The Fianna Fáil party was closely linked with IRA sentimentality and ran on a platform of total independence for Ireland.<sup>84</sup> The Irish Government had previously conducted several discussions with the British Government to discuss some power sharing arrangement for Northern Ireland. However Callaghan was simultaneously implementing legislation that increased the level of Northern Ireland participation in the British Parliament in Westminster, sending a clear signal that devolution was not on the table.<sup>85</sup> The following passage underlines the tension in the meeting between the two heads of government at the Copenhagen Summit:

*"I mentioned our belief that the only basis for permanent peace and stability and a harmonious relationship between Britain and Ireland is the coming together of the people of Ireland under agreed structures. I said that we thought that progress towards this objective would be facilitated if the British Government were to declare its interest in Irish unity and join with us in working towards that end. The difference between us on this issue was clearly and frankly acknowledged."*<sup>86</sup>

Early in the Dáil record it became clear that what should be a technocratic discussion on monetary sovereignty was conflated with political discussions of Irish unification and nationalism. A Government monetary brief produced after the Copenhagen summit highlights the frustration with the perceived dependency relationship between Britain and Ireland. It noted that its inherited monetary constraints forced the Irish pound to "appreciate and depreciate willy-nilly with Sterling".<sup>87</sup> The Irish Government report was optimistic that the proposed monetary system would provide external control

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<sup>84</sup> Fianna Fáil, which means Soldiers of Destiny were the Republican Party who staunchly supported full unification of Ireland. <http://cain.ulst.ac.uk/events/crights/nicra/nicra783.htm> describes Fianna Fail as having fathered the Provisional IRA

<sup>85</sup> Legislation to increase the number of Northern Irish MPs increased from 12 to 17 was passed into law on November 28<sup>th</sup> 1978. <http://cain.ulst.ac.uk/othelem/chron/ch78.htm>

<sup>86</sup> Oireachtas, "Copenhagen Meetings: Statement by Taoiseach." p. 346

<sup>87</sup> Patrick Honohan and Gavin Murphy, "Breaking the Sterling Link: Ireland's Decision to Enter the Ems," in *XVth World Economic History Congress* (Utrecht2009), p. 8

from Europe to rein in and stabilise Sterling. At this point Ireland presumed that Britain would be part of the new monetary arrangement and it clearly had not considered an alternative situation where Ireland would have to enter alone.

### **Who Speaks For Irish Monetary Policy?**

Prior to the Bremen Summit, held on July 7<sup>th</sup> 1978, there was a dearth of dialog regarding the EMS in both the Irish newspapers and Dáil debates, even though it was being broadly discussed in Britain. The Dáil record shows that between April and July no further discussion was held on the proposal for a new European Monetary System. Instead, Ireland's crippling economy, unemployment and the escalating violence in Northern Ireland were at the forefront of Irish political debate. The lack of dialog was notable given the gravity of the potential economic impact on Ireland, but the impact would only be felt if Ireland were to enter the EMS without Britain. As long as they entered together, the currency union could be maintained and no exchange rate differential would disrupt trade between them. As such, it points to a presumption by the Irish Government that Britain was committed to monetary cooperation with its European counterparts. Irish officials participated in several meetings of ECOFIN and the Committee of Central Bankers over the following months to formulate a proposal for the European Commission. Meanwhile the "Group of Three"<sup>88</sup> was privately working on a competing plan as it wanted to keep the new system out of the hands of Central bankers and European Commission elites.<sup>89</sup> This negates any Neofunctionalist explanation of state cooperation that presents the process of institution creation as a system of "collective action". This example highlights that the German and French elites had alternative motives to derail any EU-wide negotiated institutional arrangement.

The events of the Bremen Summit were to serve as a painful reminder for Ireland that it lacked credibility within the European community, both as an independent voice for the Irish state and a relevant player in European

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<sup>88</sup> The Group of Three was the name given to the special group formed between France, Germany and Britain to develop a monetary system. Dyson, *Elusive Union: The Process of Economic and Monetary Union in Europe*.

<sup>89</sup> Ibid.

monetary politics. Immediately prior to the Summit, the proponents of the Schmidt-d'Estaing plan socialized their proposal to other EEC members but neglected to brief Ireland, giving the perception that the UK spoke for Irish monetary policy.<sup>90</sup> As the country with the most complex decision to make, it was not even afforded a place at the discussion table. The French and German governments had assumed that Britain would have engaged with Ireland and therefore neglected to update it directly. This seemingly minor oversight had a major impact on the Irish Government's response to the new monetary system.<sup>91</sup> Firstly, it highlighted the fact that Ireland was perceived to be part of Britain and secondly, Britain was seen as the authoritative voice to speak for Ireland's monetary policy. Honohan and Murphy note how Giscard d'Estaing even assumed that the UK's initial rejection of the monetary proposal was taken to assume that it represented the Irish stance too. Following this oversight it became clear to the Irish Government representatives that its status as an independent sovereign nation was in contestation. Among the European elites, Ireland suffered an identity deficit as a sovereign independent voice for economic policy. Worse still, its voice was assumed to be represented by its long term adversary, the UK. With relations between Callaghan and Lynch already strained, this seemingly minor oversight became the turning point to embolden Ireland's nationalist government, as it was clear that Europe did not attach a voice to Ireland for its monetary policy decisions. Ireland had to assert its economic independence through its monetary policy; a vote to stay with Sterling would reinforce its UK association; a vote for the EMS represented its sovereign independence to decide monetary policy.

During the Bremen meetings, President Giscard d'Estaing and Chancellor Helmut Schmidt presented their formal proposal for European Monetary Union. With the French and German Governments present, Jack Lynch "explicitly aired his grievance" at the way Ireland had been treated and asked that Ireland be afforded "the same type of consultation that other members had in a matter of this nature".<sup>92</sup> To add insult to injury, in spite of

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<sup>90</sup> Honohan and Murphy, "Breaking the Sterling Link: Ireland's Decision to Enter the Ems." p.14

<sup>91</sup> Ibid. p.14

<sup>92</sup> Ibid. p. 15

Jack Lynch's protestation at being overlooked in Bremen, Ireland was rendered the same treatment some weeks later. As further evidence of Ireland's lack of sovereign credibility within the EEC, at the Bonn Summit of Western powers, Mr Lynch was issued further embarrassment by being excluded from access to an advance briefing on the proposed currency union. As noted by one Irish official "we had to ferret the information out for ourselves" and while Mr. Lynch once again issued a soft protest against Ireland's total neglect, it was clear that he was not afforded the respect of a sovereign head of state in the negotiations.<sup>93</sup> Any doubt the Irish Government had on the validity of its status as an independent nation in Europe was cemented after its treatment at Bonn.

Honohan notes how government documents reveal that Lynch entered the Bremen Summit proceedings with a predetermined intent to act independently of Britain, even if it meant breaking the 150 year old link with Sterling. This "independence" was reflected in Ireland's initial press interview following the summit as Lynch expressed enthusiastic support for the new monetary regime even though the details and implications were barely understood. The Economist confirms that the Taoiseach had openly expressed a very positive response to the EMS.<sup>94</sup> It notes how "the most surprising supporter is Ireland. Mr Jack Lynch is quite prepared to enter the new zone even if Britain holds back, and thus cut the link between the British and Irish pounds."

From the tone of Jack Lynch's quotes in the Irish newspapers, it is clear that nationalist goals were an essential motivation for his expression of support and his message back to the Irish reinforced this. The language reiterated his economic independence to both the home audience and may well have been directed at British and European elites too: "While tied to sterling, we have always held that we have the capacity to leave the sterling club if and when it suits us".<sup>95</sup> Lynch went on to state that the new monetary scheme "made a break with sterling a practical possibility for the first time in the history of the state". Later that month the Irish Times sarcastically noted

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<sup>93</sup> John Cooney, "Ireland at the Bonn Summit - by Proxy," *Irish Times*, July 24th, 1978.

<sup>94</sup> Anonymous, "Those in Favour," *Economist*, July 15 1978.

<sup>95</sup> John Cooney and Dennis Kennedy, "Ireland Backs New Monetary Plan Despite British Doubts," *Irish Times*, July 8th 1978.

that "to judge .... by the Government's tone generally, it seems to be infatuated by a sneaking notion of grandeur - that it could be the one to go down in the history books as having given Ireland her own currency".<sup>96</sup> Given the focus of language on the break with sterling rather than implications of the new monetary system, it highlights the symbolic tension of the Sterling/Irish relationship. The record contradicts the notion that Ireland joined because it had no other choice. It was an enthusiastic proponent of the new system from its first socialization, as it provided a means to extricate Ireland from the unfinished nationalist goal of creating a truly independent nation. The link with Sterling was a sore reminder that Ireland had not yet accomplished what it set out to do in 1921 and its economic policy reinforced its dependency on the UK, as an economic marketplace and a monetary authority. Lynch's assertion of his right to speak on behalf of Ireland – by expressing positive support for the EMS – had begun the process of completing Ireland's psychological independence from Britain. It was not based on any rational calculation of economic preferences even though Ireland was well versed on the economic limitations of breaking the link with Sterling. The indignity of being treated as an appendage of the UK had invigorated a tremendous sense of nationalism within the Fianna Fáil party that emboldened it to shed Ireland's traditionally conservative stance on maintaining the Sterling link.<sup>97</sup> This rendering of the empirical evidence contradicts Lloyd Gruber's Intergovernmentalist view that Ireland found itself in a "loser" situation with no choice but to join. In fact Ireland could have let the UK be the bad guy of the negotiations and simply have ridden its coattails. Ireland was well positioned to remain with Sterling without experiencing too much EEC backlash and in fact this would have been its best near term option. As evidenced in Bremen and Bonn, the EU hardly acknowledged Ireland's presence other than an offshoot of Britain to begin with. But the price of capturing its sovereign national identity was the short term economic cost of joining the EMS. As such, the ideational goals influenced economic policy and shaped Ireland's decisions. The only loss that Ireland perceived it suffered from was being treated as an economically independent entity. If the argument that Ireland had

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<sup>96</sup> Ken O'Brien, "And Now, the Break-the-Link-with-Sterling Season," *Irish Times*, July 24 1978.

<sup>97</sup> Honohan and Murphy, "Breaking the Sterling Link: Ireland's Decision to Enter the Ems." p. 15

no choice held true then one would expect the Irish response to be caged while it held out for the best possible bargain from Europe. At this early juncture in the process, little was known about the format of the system yet Ireland had already expressed its strong support even before it was even clear the EMS would ever materialise.

### **Rational Economics vs. Irish National Identity**

Reading the transcripts from the official government debate which took place after the Dáil reconvened, it is evident that the Government's mind was all but made up and the economic logic was framed to validate the national purpose. Fianna Fáil highlighted that Ireland's economic issues were an artefact of its colonial linkage to Sterling. The government claimed that Ireland would benefit from being linked to a stronger Deutschmark, even though all the economic experts disagreed. Prior to the Dáil Debate in October, a conference of leading economists and intellectuals in Dublin questioned the Government's logic on joining the EMS. Dr. Terence Ryan a Trinity College economist noted that the recent upsurge in the Irish economy was due to its link with Sterling and the "euphoria" of the Government was questionable given the expected deflationary effect of joining the EMS. He cautioned that it was inappropriate to join the stronger currency band of the EMS at this time and his warning was echoed by Mary Robinson who argued that the Government's unqualified enthusiasm was driven by nationalist sentiment rather than economic logic.<sup>98</sup> The general economic view was that without significant fiscal transfers, the deflationary impact of the EMS currency link would cripple the economy.

At the Dáil Debate the language of the Taoiseach was framed in a way that associated the UK (and consequently Ireland) with "weakness" and the EMS and Deutschmark with "strength". The Taoiseach was pragmatic in relation to Ireland's monetary sovereignty noting that "As a small open economy, our freedom of action in currency matters is inevitably restricted"<sup>99</sup> However he quickly drew attention to the "suffering" Ireland endured under a

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<sup>98</sup> Dennis Kennedy, Paul Tansey, and Ken O'Brien, "Ems Would End Present Irish Economic Upturn - Economist," *Irish Times*, October 14 1978.

<sup>99</sup> Oireachtas, "European Monetary System: Motion," Dáil Debates Vol. 308 (October 17th, 1978). p.414



system that Ireland had been tied to since its foundation. The language projected a resolve to pursue a monetary policy independent of the UK while simultaneously appealing to national sentiment by highlighting the damage rendered to the economy from Ireland's dependency on Sterling.

While the opposition parties acknowledged that EMS entry could be a good long run goal for Ireland, both Fine Gael and Labour argued that the timing of entry could prove disastrous to the Irish economy, which was the weakest and poorest in Europe. The leader of Fine Gael, Dr. Garrett Fitzgerald led a highly technocratic debate on the economic risks to European monetary integration.<sup>100</sup> Dr. Fitzgerald accused the government of rushing in to announce their commitment to the new system "with an enthusiasm that has drastically reduced their bargaining power". Noting that Ireland's economy was "not sufficiently strong to go into the European Monetary System under the terms proposed", it would require Ireland to take serious deflationary measures in order to bring its inflation rate in line with Germany. He continued by arguing that since joining the EEC in 1973, there had been no convergence between the Irish and German economies, and in fact Ireland had diverged further. Fitzgerald noted that Ireland was "worse placed than any other country...to enter the EMS" and it would take a massive injection of aid to enable Ireland to remain within the system without very damaging economic effects.<sup>101</sup> Should the Irish pound strengthen against Sterling, as was the prevailing belief, Ireland would be overvalued against the bulk of its export market which serviced the UK and USA.<sup>102</sup> The economic debate validates the fact that the Irish government and opposition were keenly aware of the economic implications of the decision at stake.

Throughout the debate it is clear that in the eyes of the political elites, the decision was squarely in Ireland's control and there was no external pressure forcing Ireland into this economic quandary. Neither Britain nor Europe was threatening, coercing or cajoling Ireland into joining the EMS and the lack of dialog on Europe suggests that it didn't care one way or the other.

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<sup>100</sup> Dr. Garrett Fitzgerald held a PhD in Economics from University College Dublin and was highly respected as an economist

<sup>101</sup> Oireachtas, "European Monetary System: Motion (Resumed)," Dáil Debates Vol. 308 (October 18th, 1978). p. 878 - 882

<sup>102</sup> Europe accounted for only 20% of Ireland's exports

Dr. Fitzgerald also questioned the speed of passage of the proposal by President Chirac and Chancellor Schmidt, leaving little time for other countries to study the full implications of the measure. In the following section, Fitzgerald highlights that the EMS served the recent interests of France and Germany. Fitzgerald noted that the idea originated from “a meeting between two heads of State who committed themselves very strongly to the establishment of this system [EMS] without explaining very clearly what had led them to this overnight conversion from the evident skepticism they had shown throughout the previous five years”.<sup>103</sup> This account confirms the Intergovernmental assessment that the EMS was primarily in the interest of France and Germany and they planned to proceed irrespective of who else joined.

Ultimately the Dáil debate reduced to a rational economic debate against the EMS versus a nationalist debate on Ireland’s link with Sterling. It was clear to the Government that in the eyes of European elites, Ireland neither possessed monetary independence nor the voice to speak for it. Neither was Ireland considered a stakeholder in institution building in the EU. By remaining with Sterling, the Irish Government would have remained a contested economic identity within the context of Europe. In closing the debate Dr. O’Donoghue<sup>104</sup> of Fianna Fail accused the opposition parties of “weakness” by not acknowledging that an Irish Government was capable of exercising its freedom to independently decide what was best for the Irish people. Dr. O’Donoghue’s comments capture the essence of the sentiment of what was at stake for Fianna Fáil:

*“I want to pick a remark which at first struck me as incongruous and inappropriate. The Labour Party Leader, Deputy Cluskey, said that Fianna Fáil had a romantic approach to this subject [EMS entry]; we had this romantic idea of breaking the link with sterling.....on reflection he was right. We do stand convicted as romantics. .... It implies having a belief in the Irish people, a commitment to shaping our own affairs, to exercising the power that has been conferred on an independent Government, to adopting a truly*

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<sup>103</sup> Oireachtas, “European Monetary System: Motion (Resumed).” p.874

<sup>104</sup> Dr. O’Donoghue, the Minister for Economic Planning was a close advisor to the Taoiseach. Jack Lynch had “created” the position for O’Donoghue and the final decision was under the umbrella of his office.

*republican stance and saying "It is Government of the people for the people". Whether it results in mistakes or in the right conclusions the crucial thing is for the Government of the day, whoever they are, to have this romantic approach, to believe in things; above all to believe that there is a way in which Ireland can play its part among the nations of the earth and make a contribution. We do not have to suffer from a massive national inferiority complex; we do not have to spend our time tied to mother England's apron strings rather than run the risk of developing any monetary or other policies of our own."*<sup>105</sup>

This speech highlights how the Irish Government was willing to incur the painful sacrifice of economic dislocation in order to reinforce Ireland's position as a truly independent political entity within Europe. For Ireland, the EMS represented the new cultural space that enabled it to distance itself from its colonial "other" as part of the new monetary regime. With their policy preference already publicly stated, and with a 20 seat majority in power, the opposition had no chance of stopping Fianna Fáil.

The Irish Government was fully aware that it had little chance of operating an independent currency; it could either be part of Sterling or part of the Deutschmark. The question for Jack Lynch was not which currency was economically better or stronger but who got to decide Ireland's monetary policy. Ireland's economic identity was at stake in the form of independence to choose. Without a firm stance by the Government, Ireland could continue indefinitely under a power relationship that it had been trying to undo for hundreds of years - even if that power relationship made sound economic sense. As long as Ireland remained with Sterling, the UK exerted "power over" Ireland through the currency link, and shadowing the UK reinforced the power relationship in the minds of other countries too. However by choosing to go with the EMS Ireland was accorded the "power to" determine its own economic future and established its legitimacy as a sovereign state within Europe.

The review of the historical record is consistent with the Intergovernmentalist account from the perspective of how France and Germany operated in the creation of the EMS. However it also shows that the

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<sup>105</sup> Oireachtas, "European Monetary System: Motion (Resumed)," Dáil Debates Vol. 308 (October 25, 1978), p. 1139-1141

narrow field of analysis was too exclusionary to explain Ireland's participation, such that the "no-choice" option looked like the likely answer. The Irish decision highlights how the Intergovernmentalist focus on bargaining alone led to an inaccurate conclusion on Ireland's participation in the EMS. The total lack of fiscal transfers confirms that Ireland's bargaining position was negligible, and Germany or France had no interest in bargaining for Ireland's entry.<sup>106</sup> With no promise of economic respite, rational choice theory would have directed Ireland to remain with Sterling where it would have fared better, but instead it chose the EMS. Ireland was neither forced into joining due to lack of alternatives nor chose to join because of the side bargains it received. Its decision was first and foremost driven by economic identity politics which drove a nationalist vision to distance itself from Britain (the "other") towards a new national identity to be created around the EMS. In turn, the Irish government was willing to undertake the economic sacrifice to meet its national goal and when the EMS came into existence on March 13<sup>th</sup> 1993, Ireland was one of its founding members.<sup>107</sup>

## **A Decade of Economic Sacrifice**

The promise of lower inflation and interest rate through convergence towards the German economy never materialised throughout the following ten years. Independent studies confirm that Ireland suffered significant economic dislocation following the move to the EMS.<sup>108</sup> While Ireland eventually managed to reduce inflation, throughout the early 1980s inflation peaked at over 20%. Ireland experienced negative growth in the economy for the five years between 1980 and 1985. Public debt grew to over 140% of GNP and Ireland's unemployment rate climbed to 19.5% in 1988.<sup>109</sup> In addition, instead of Ireland's interest rate premium converging to the hard currencies of

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<sup>106</sup> Ultimately Ireland was offered a loan package of £45M per year in interest subsidies for 5 years. But in order to avail of this loan the Government would have to expand borrowing by £1,125M, effectively doubling the national debt in just 5 years.

<sup>107</sup> [http://europa.eu/abc/history/1970-1979/1979/index\\_en.htm](http://europa.eu/abc/history/1970-1979/1979/index_en.htm)

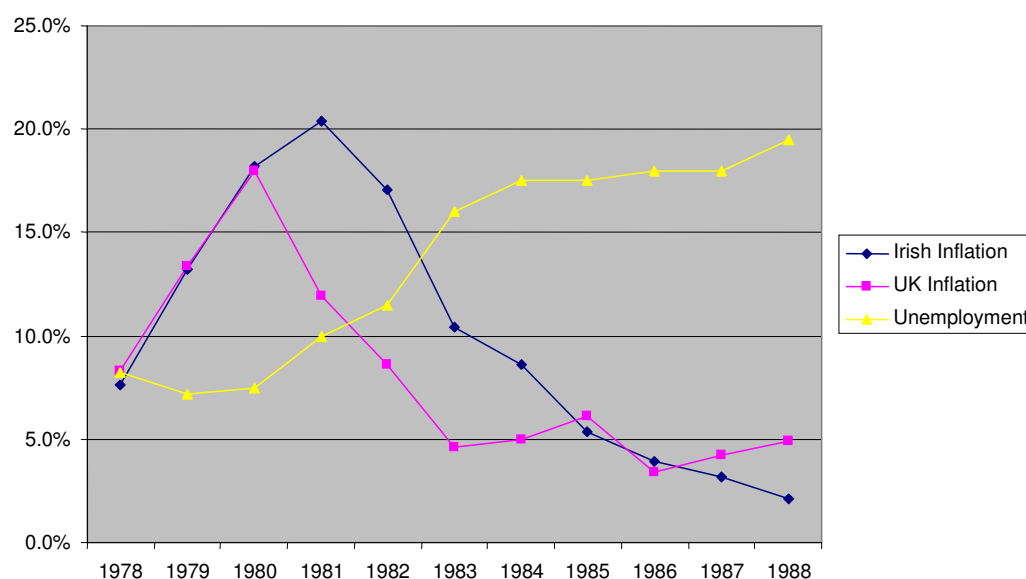
<sup>108</sup> Rudiger Dornbusch, Jean-Pierre Danthine, and Patrick Honohan, "Credibility, Debt and Unemployment: Ireland's Failed Stabilization," *Economic Policy* 4, no. 8 (1989). and P Massey, "Exchange Rate Policy in a Small Open Economy: An Examination of Irish Experience," *Journal of Statistical and Social Inquiry Society of Ireland* XXV, no. V (1988).

<sup>109</sup> Dornbusch, Danthine, and Honohan, "Credibility, Debt and Unemployment: Ireland's Failed Stabilization."

Europe it remained significantly higher than both the UK and Germany due to lack of domestic fiscal credibility.<sup>110</sup>

In describing Ireland's experience in the EMS, Central Banker Padraic O'Connor noted that the Central Bank had warned that the benefits of a strong exchange rate regime could not be enjoyed unless it was accompanied by an anti-inflationary stance in other policy areas. Without this, the country would eventually have to endure low growth and high unemployment or it would have to devalue the currency.<sup>111</sup> Ireland experienced both cases as its Keynesian fiscal policies did not match an anti-inflationary policy being adopted in Europe. O'Connor concluded that joining the EMS had made the Irish pound weaker as Irish inflation persistently converged towards the UK inflation rate between 1979 and 1985, not towards Germany, and it would have benefited from lower inflation sooner had it remained linked to sterling (see Chart 1).<sup>112</sup>

Chart 1: Irish inflation and Unemployment rates 1978-1988



Source: Irish Central Statistics Office

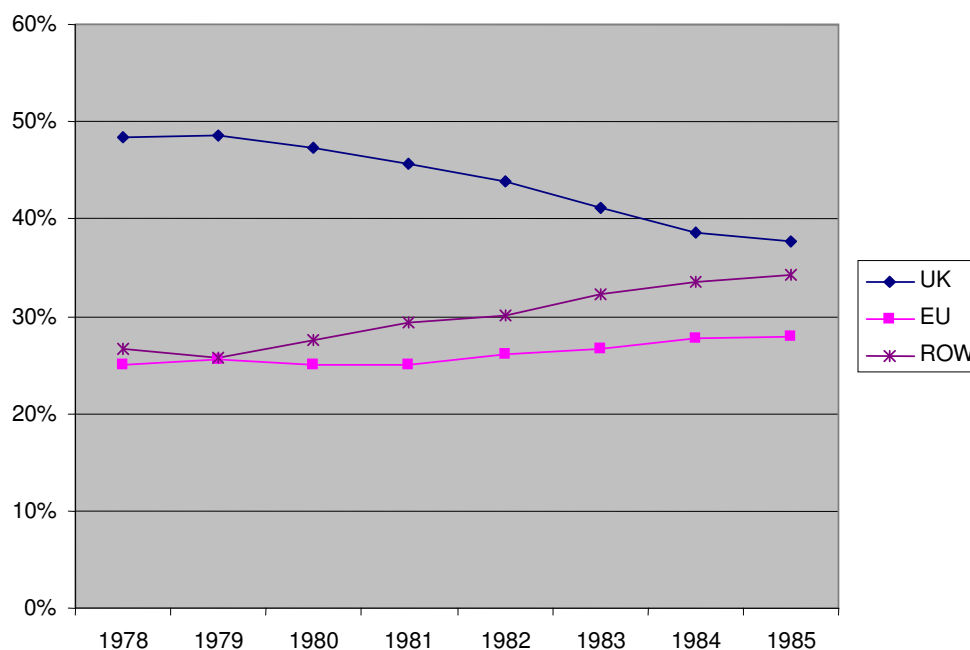
<sup>110</sup> Bradley and Whelan, "Irish Experience of Monetary Linkages with the Uk." Ireland had no prior history of monetary management and consequently suffered a credibility deficit.

<sup>111</sup> Padric O'Connor, "The Ems - Ireland's Experience and Prospects," *Journal of Statistical and Social Inquiry Society of Ireland* XXIV, no. III (1980). p.4

<sup>112</sup> Massey, "Exchange Rate Policy in a Small Open Economy: An Examination of Irish Experience."

Finally Ireland did not significantly benefit from the promised growth in European trade. While the break with Sterling hurt Irish trade with the UK over the coming years the majority of the growth came from outside of Europe, in particular the USA (See Chart 2). Ireland continued to remain a peripheral economy within the European Union and at the next major juncture in European Monetary integration in 1992, Ireland still was the least synchronised economy in Europe.

Chart 2: Distribution of Irish Trade 1978-1985



Source: Irish Central Statistics Office<sup>113</sup>

\*ROW = Rest of World

However in the process of joining the EMS, Ireland had “grown up” economically and monetarily. Ireland had no experience of major bank operations while linked to Sterling.<sup>114</sup> Although Ireland technically had a Central Bank in place when it entered the EMS, its role had been largely symbolic without the ability to set reserve requirements, manage open market operations, set discount rates or manage credit controls. In fact, Ireland did not even have the capability to print its own money as it had depended on the

<sup>113</sup> Cited by Ibid.

<sup>114</sup> Oireachtas, "European Monetary System: Motion." p.443

Royal mint and UK printers for its currency. Therefore the process of monetary independence provided a significant learning period for the Irish government. As Honohan noted, "Overall, Ireland's experience with an independent currency in the years of the EMS was not a very happy one."<sup>115</sup> The brief period of the "Punt"<sup>116</sup> left a negative identification within Ireland and he notes that it may have swayed Ireland's preference for the EMU. Ultimately the period from 1978 to 1992 solidified Ireland's economic independence, for better or worse.

Given such a negative outlook one would expect a more calculated approach to the Maastricht Treaty to ratify the European Union and EMU formation. The memory of the huge economic and social cost that Ireland experienced under the EMS was still at the forefront of Ireland's mind. One would predict that Ireland approach complete monetary integration with significantly more caution than when it entered the EMS. In contrast to rational expectation, this next section will demonstrate that Ireland's response to full monetary union was widely embraced by all sectors of Irish political life. While Ireland was no closer to being part of a Europe-wide OCA, it proved one of the most enthusiastic supporters of EMU. Contrary to the general European sentiment in 1992, Ireland was more than happy to relinquish monetary sovereignty to a supranational arrangement. In fact, while many European countries balked over the loss of identity associated with relinquishing its national currency, Ireland mocked the nationalist attachment to monetary sovereignty.

In 1992, Ireland was still the least synchronised economy within the European Union with a trade pattern that was disproportionally dependant on the UK and USA market for exports.<sup>117</sup> This asymmetry with mainland Europe would mean that Ireland's interest rate demands would not be satisfactorily met by the EMU, leaving it significantly more vulnerable to exogenous economic shocks than any prior monetary arrangement.<sup>118</sup> Hay et al. note how the Irish financial papers and leading economists had highlighted the

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<sup>115</sup> Patrick Honohan, "Using Other People's Money: Farewell to the Irish Pound," (Dublin: Trinity College). p. 4 <http://homepage.eircom.net/~phonohan/Five%20Centuries.pdf>

<sup>116</sup> The freely floated Irish Pound was called the "Punt" within the EMS

<sup>117</sup> Gruber, *Ruling the World: Power Politics and the Rise of Supranational Institutions*. As shown earlier, Ireland came last in terms of correlation with the German economy at only 0.35

<sup>118</sup> Hay et al., "Ireland: The Outlier Inside."p.188

constraints that EMU membership would place on Ireland's economic autonomy. Of particular concern, was its potential to lose competitiveness vis-à-vis the US and UK in the event of a significant rise in the value of the Euro. Yet in spite of a generally negative experience under the EMS and economic signs that argued against further integration, Irish support for further monetary integration was dramatically higher in 1992 than in 1978.

In theory the 1992 Maastricht Treaty should have proven significantly more challenging for the government as it required a full constitutional amendment that had to be ratified by the Irish plebiscite. The treaty referendum brought the decision into the forefront of national engagement in a way that was absent in 1978. With a public to convince one would have expected heated debates for and against integration, yet as the record showed, the event was marked more by the *lack* of any substantive debate. The debates contained little of the economic banter of 1978 and it appeared that monetary union was a no brainer.

### ***Ireland Support for EMU***

The 1992 decision was clear-cut from the outset as far as all the major political parties were concerned - Ireland had to join the EMU. While Jacques Delors, the European Commissioner was courting Irish politicians with a promise of further fiscal transfers, Ireland could have chosen to negotiate partial entry into the EU as Britain and Denmark did. Europe had shown that it was willing to negotiate "opt-out" terms and Ireland had already received some exclusion clauses on political neutrality. Yet Ireland proved to be an ardent supporter of the EMU. The following section highlights how economic identity politics again played a significant role in guiding Ireland's decision to pursue complete monetary integration in defiance of economic warnings. In particular three major themes emerged on reviewing the Dáil debate leading up to the Maastricht Treaty referendum; firstly, Ireland paid little homage to monetary sovereignty; secondly, the country rallied behind a vision to build an economically modern state and shed its image as the "blacks" of Europe; and finally, Ireland saw the EU as a way to regain its vision for a "United" Ireland.



## Economic Sovereignty Debunked

The most striking aspect of the Irish government debate on the Maastricht Treaty was the near complete absence of dialog about the potential negative economic impact of full monetary union. The grand bargain theories paint a picture of carefully calculated intergovernmental bargaining in return for the acquiescence of monetary sovereignty. By contrast the Dáil debate reveals that Ireland was almost blasé in its treatment of monetary sovereignty, and only a fringe group of “naysayers” addressed the potential downside impact from joining the EMU.<sup>119</sup> There was near unanimous agreement among the leading political parties, industry elites, trade unions, farmers’ organizations, women’s organizations and industry associations that Europe would significantly “enhance” Ireland’s position as a strong economy within Europe.<sup>120</sup>

In his opening speech the Fianna Fáil Taoiseach, Albert Reynolds emphasised the centrality of monetary union in the building of a “new Europe”. From the tone of the debate, Ireland seemed positively enthusiastic about monetary union in contrast to much of Europe. According to Reynolds “The kernel of the treaty is the single currency”<sup>121</sup> and for Ireland to be able to participate in the benefits of the European Union, it was seen as essential that it support the currency initiative. He referenced the ideological debate on sovereignty that had paralysed much of Europe and reiterated the importance of not becoming embroiled in a sovereignty argument as had happened in Denmark. Just days before, the Danes had rejected the Maastricht treaty largely on the grounds of sovereignty. Instead he argued that the surrender of monetary sovereignty would in fact “enhance our standing in Europe”.<sup>122</sup> In return, Reynolds noted that the European Union would provide the foundation for economic confidence and prosperity that Ireland desperately needed. The small price that Ireland had to pay for enhancing its economic standing in the world was to relinquish monetary authority. The political leaders argued that Ireland’s loss of monetary sovereignty was nominal as the EMS had left it with

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<sup>119</sup> Socialist Workers Party and Sinn Féin were considered the “naysayers” against the Treaty, Irish Times, “McGiolla Urges No on Maastricht,” *Irish Times*, May 25th 1992.

<sup>120</sup> ———, “Industrialists and Ifa Rally Behind Treaty,” *Irish Times*, June 4th 1992.

<sup>121</sup> Oireachtas, “European Union Treaty: Statements”, p. 1928

<sup>122</sup> ———, “European Union Treaty: Statements,” Dáil Debates Vol. 420 (June 3rd, 1992). p.1357

little real control over monetary policy to begin with. As one politician noted, "the loss of sovereignty...is more apparent than real....We retain nominal power but the real decisions are made elsewhere"<sup>123</sup> Mr. Alan Dukes, deputy-leader of the Fine Gael party added that the Westphalian notion of sovereignty had eroded worldwide since the Second World War and countries like Ireland had little control over the global economy:

*"We are price takers....we do not determine interest rates...we do not determine our exchange rate.....we do not determine these things because as an economic actor on the world stage we are too small to have an influence. This notion of giving up sovereignty, which is being advanced as an objection to signing the Maastricht Treaty is false, you cannot give up something which you never had".*<sup>124</sup>

Ireland did not seem to place any emphasis on sovereignty as an instrument of state power. In fact Ireland's lack of concern about the loss of sovereignty may in fact have been its greatest bargaining tool because it projected such a positive attitude to European integration and in particular the EMU. The short and chequered history of the Punt had ingrained a negative connotation in the minds of the Irish and the opportunity to be part of a new currency was seen as highly positive.

### **Long Term Economic Vision for Society**

The Government rhetoric and public debate highlights that the EMU was associated with a vision of what Ireland could become in the future. With the recent memory of economic dislocation on its mind, Ireland experienced a huge transformation in attitude to pull itself out of its economic decline. It began re-inventing its economy through a public-private social partnership, turning the external constraints of the European Union into economic opportunity.<sup>125</sup> Ireland was in the throes of developing its own economic platform by leveraging its position as the "gateway to Europe" through the attraction of Foreign Direct Investment (FDI) as the foundation of its economic base. The new European regional block spurred US and Japanese companies to look for ways to circumvent "Fortress Europe". By relocating

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<sup>123</sup> ———, "European Union Treaty: Statements ". p.1940

<sup>124</sup> Ibid. p.1986-1987

<sup>125</sup> O'Donnell Rory, "Ireland: Social Partnership and the 'Celtic Tiger' Economy," in *Where Are National Capitalisms Now?*, ed. J Perraton and B Clift (Palgrave Macmillan, 2004). pp. 50-69

within the European Union, multinationals had complete access to the European market as nationally imposed restrictions on imports were eliminated. As noted by Heinz Wehrich, peripheral countries like Ireland and Spain, with little indigenous competitive industry, were considered possible alliances for American firms wishing to locate within Europe.<sup>126</sup> As one of the most liberal OECD countries, with a well educated english speaking workforce, Ireland stood to be the major beneficiary of transnational investment within the European regional block.<sup>127</sup> With a history of reaching out to its North American Diaspora, Ireland already had established strong connections within US political and industrial circles.<sup>128</sup> Government participants in the Dáil debate noted that Ireland's success at attracting FDI was directly linked to its location within the European community and its economic strategy was dependent on capitalizing on the opportunities created by the formation of the European Union.

Ireland's new economic identity was being built on top of the institutions of the European Union (the regional trading block, the tariff free internal market and a common trading currency) and monetary sovereignty was a small price to pay for the huge benefits that Ireland envisioned through extra-regional investment. The response of the Irish Government to loss of sovereignty shows how sovereignty is to a great degree what countries believe it stands for. It does not necessarily follow the same prescription for all states that the rationalist argument of IR scholarship upholds.

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<sup>126</sup> Heinz Wehrich, "Europe 1992: What the Future May Hold," *The Executive* 4, no. 2 (1990). p. 17

<sup>127</sup> OECD, "Foreign Direct Investment Restrictions in Oecd Countries," (2002).

<http://www.oecd.org/dataoecd/24/35/2956455.pdf> p. 5

<sup>128</sup> Dáil records show that Ireland had been making trade visits to the USA since the 1960s. Oireachtas, "Taoiseach's Visit to America: Statement " Dáil Debates Vol. 307 (30 May, 1978).

## Europe as a New Cultural Identity

“Do you not get it, lads? The Irish are the blacks of Europe”<sup>129</sup>.

The Commitments, 1991

The perception of the Irish as “the blacks of Europe” was succinctly captured in the 1991 film “The Commitments” and reflects the national psyche at that time. A key element of the Dáil debate was the need for Ireland to shed its image as the backwater of Europe, and the creation of a new identity away from its prior self became a central theme in Ireland’s Maastricht debate. A major focus of government and public rhetoric was on building a vision of modern Ireland evolving to a more economically and culturally sophisticated society. Its economic strategy was seen to be an essential element in creating this new image. A “no” vote was associated with backwardness and regression while a “yes” vote was an endorsement of Ireland as a part of Europe’s new regional block. Whereas in 1978 the “other” was clearly Britain, in 1992 the “other” was “black” Ireland whose economy remained underdeveloped relative to the rest of Europe. Framing the language in terms of “idealism” and “political maturing” a yes vote was a vote for modernity and progress while a no vote was “a conscious decision to remain in an Irish backwater”.<sup>130</sup> European Union was painted as part of a long term strategic vision to provide opportunities for the youth of Ireland that the current generation never had access to. One politician noted how “to find [Ireland] excluded from any policy area designated as a core activity of the European Union would be a serious breach of a strategy first elaborated by Sean Lemass in the early 1960s and would be a disgrace, both for Ireland’s self-image and for its role in the Europe of the 21<sup>st</sup> century”<sup>131</sup>.

The theme of a “new Europe” was used throughout the debate as if it was a restart for the entire continent and Ireland was simply one of the building blocks. The European Union would allow Ireland to reincarnate itself in a “new Europe”. The alternative “no” vote framed Ireland as “isolated” and

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<sup>129</sup> Spoken by Jimmie Rabbite, From the film “The Commitments” released in 1991

<sup>130</sup> Oireachtas, “European Union Treaty: Statements ”, p.1936

<sup>131</sup> Ibid. p. 1950

an “outsider”. As Brigid Laffan notes, the exclusive language of the European Union became an integral part of the discourse on integration:

*“The term Europe has been appropriated by the EU for itself. The term ‘rejoining Europe’ or ‘returning to Europe’ highlighted the fact that since the 1950s the European Union was institutionalised in Western Europe as the dominant framework above the level of the state. Acceptance as a candidate country carried with it a powerful marker of inclusion and identification as “European” however ambitious that term remains. From the outset, the EU – through membership and non-membership, inclusion and exclusion – has exercised a powerful impact on state identity in Europe.”*<sup>132</sup>

In an impassioned editorial piece in the Irish Times, Mary Holland noted how a German journalist considered Slavs and Tartars, “not really Europeans at all”. Holland commented that “We in this country have experience of being on the receiving end of that kind of attitude. We know, too, the enormous courage it takes psychologically, as well as politically, to break free from the bonds of history and shape a new society after years, centuries even, of oppression. Our membership of Europe has helped us in this.”<sup>133</sup>

At a social level an abortion debate became intertwined with Maastricht, as traditional Catholics lobbied for a “no” vote while progressives looked to Europe as the way to divest Ireland’s theocratic, paternalistic past.<sup>134</sup> Europe was seen as a countervailing force against “traditional conservatives in Irish society”. A return to “narrow nationalism” would be a serious backward move for Ireland, the “no” vote was associated with “isolationists and fundamentalists”<sup>135</sup> who would “leave the Irish people as second-class citizens within the European Community”<sup>136</sup>. This sentiment was echoed in the general public rhetoric, as one private citizen noted: “I cannot wait to get out of our national straitjacket, with its closed minds, its

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<sup>132</sup> Brigid Laffan, “The European Union and Its Institution as ‘Identity Builders’,” in *Transnational Identities: Becoming European in the Eu*, ed. Richard K. Herrmann, Thomas Risse, and Marilyn B. Brewer (Oxford UK: Rowman and Littlefield, 2004), p. 80

<sup>133</sup> Mary Holland, “The Courage to Break from the Bonds of History,” *Irish Times*, June 18 1992.

<sup>134</sup> In the year prior to Maastricht, there was a highly controversial case where a court injunction stopped a teenager going to the UK to get an abortion even though the baby was from a rape incident. Tom Rafferty, Fine Gael, quoted in the Irish Times, June 17 1992 - “Reports of priests urging a ‘No’ vote are disturbing. Even more disturbing are the reports of priests allowing lay people to use the pulpit as a platform to call for a ‘No’ vote.”

<sup>135</sup> Quoting Mr Liam Lalor Fianna Fáil, Irish Times, “Maastricht Treaty Approved in Strasburg,” *Irish Times*, April 13 1992.

<sup>136</sup> ———, “Ifa Urges ‘Yes’ Vote in Maastricht Referendum,” *Irish Times*, April 22nd 1992.

repressed and oppressive society, its religious zealotry and bigotry and its triumphalist nationalism".<sup>137</sup>

### ***Economic Policy to Enhance National Goals***

Mirroring Fianna Fáil's message in 1978, European integration was also seen as a way to capture Ireland's long term vision for Irish Unification. The Taoiseach argued that Europe would provide a framework for peace and reconciliation and he warned that a no vote would reinforce partition with the North as the UK was expected to endorse the EU. The leader of the Fine Gael party, John Bruton, noted that the European Union allowed the North and South of Ireland to share a common platform of economic interdependence "without the supremacy of one tradition over another".<sup>138</sup> As part of "new Europe" the South and North of Ireland would be united in a neutral space that allowed mutual interdependence to flourish, leading to long term peace. The institutions of Europe allowed both societies to develop in tandem without one being subsumed to the other. European integration created an ahistorical space with no past baggage which allowed the two Irelands to redefine themselves in a new economic context. As noted by one politician, "It is a noble and exciting prospect that after 800 years of domination by our nearest neighbours...we will now participate in the building of the new Europe of free and equal citizens".<sup>139</sup> Ironically the path to Irish unification and long lasting peace could only occur through the rejection of national sovereignty and national claim on territory in return for a shared transnational entity.

Yet coincident with the message that Europe offered greater independence for Ireland, the political elites simultaneously stressed that Ireland was not being asked to surrender or undermine its own identity. Participation in the EMU was presented as a means to enhance rather than diminish the Irish national identity. As noted by one politician in a newspaper interview prior to the Maastricht vote "If we go forward we face the future with

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<sup>137</sup> ———, "Letters to the Editor," *Irish Times*, June 18 1992.

<sup>138</sup> Oireachtas, "European Union Treaty: Statements." p. 1366

<sup>139</sup> ———, "European Union Treaty: Statements ", p. 1937

pride and confidence, dedicating our talents to building a new Ireland in a new Europe, proud of being Irish in the new Europe.”<sup>140</sup>

In summary, Ireland’s second foray with monetary union demonstrates how the economic decision making was framed as an integral part of the nascence of a new national identity. This national vision was built on a self confidence that would follow from greater economic integration with the outside world and the economic benefits it would provide. By focusing on a shared economic vision it explains how Irish citizens so overwhelmingly supported an international economic policy which had imposed significant economic dislocation and could do so again in the future. This does not deny that Ireland’s elites were not concerned with maximizing their interests in terms of lobbying for structural funds. While the structural funds were mentioned, they compromised little of the Dáil or other Irish public debates. In fact, there was a hint of embarrassment that Ireland would be viewed as going to Europe with a “begging-bowl”<sup>141</sup> in hand. Instead the political elites talked about appealing to Ireland’s idealistic vision of being part of Europe. The European Union was an instrument in Ireland’s nationalist goal to advance its economy within Europe. Throughout the debate proceedings there was no indication of pressure or coercion from European elites or threats of retaliation if Ireland chose a path similar to Denmark or the UK. In fact, Ireland outright rejected the Danish decision as an example of narrow nationalism. Instead the debate was framed in terms of the power that lay within the Irish populace to transform itself. A yes vote would give Ireland the power to alter its national identity through the economic policy it pursued.

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<sup>140</sup> Irish Times, "Noonan Urges "Yes" Vote on Maastricht," *Irish Times*, June 10 1992.

<sup>141</sup> Oireachtas, "European Union Treaty: Statements ", p. 1939

## Ireland's New National Identity

Alan Milward argues that small European States have a distinct interest in European regional integration which can enhance their own sense of identity. Therefore the way that they approach supranational organizations is different from larger states.<sup>142</sup> Small states are unable to participate in intergovernmental grand-bargaining therefore their approach to Europe is more pragmatic. The decoupling of rights and identity (legal and cultural) dimensions of nationality were easy for Ireland because it had always operated within a framework of limited monetary sovereignty. Its legal sovereignty was not significantly diminished moving from a Sterling peg to the EMS or the EMU, but with each stage its national identity was enhanced. Economic identity politics provides a more meaningful framework to explain Ireland's seemingly irrational participation in supranational institutions such as the EMS and EMU because national identity, not economic instrumentality or power politics, was the driving force for the economic policies pursued. As Dyson notes, the EMU is often portrayed as "an inexorable process of dissolving national identities, undermining domestic political structures, and removing national sovereignty over economic policy".<sup>143</sup> The problem with this rational instrumentalist representation is that it views sovereignty and identity in absolutist terms such that a loss in one equates to a loss in the other, therefore a reduction in state sovereign control equates to a loss in national identity. However, Ireland's experience contradicts the rationalist view because it participated in monetary union as part of an economic policy choice to enhance its identity as a sovereign state, not because it had "no choice". If Ireland had pursued a purely rational approach to monetary policy it is likely that it would have not joined the EMS in 1978, and would have approached the Maastricht treaty with much greater caution than was shown in the government records on the lead up to the 1992 referendum.

The 1978 decision to break from Sterling and join the EMS was motivated by the political desire to assert Ireland's sovereignty within the

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<sup>142</sup> Alan Milward, G Brennan, and F Romero, *The European Rescue of the Nation-State* (London: Routledge, 2000).

<sup>143</sup> Kenneth Dyson, *European States and the Euro: Europeanization, Variation, and Convergence* (Oxford University Press, USA, 2002). p. 15



context of the EU as an independent sovereign state not as an outcrop of Britain. The events leading up to the formation of the EMS made it clear to Ireland's leaders that the European powers did not consider Ireland separate from the UK and it was not afforded the same treatment as other members of the European community. Breaking the sterling link and joining the EMS, at whatever economic cost to society, was a necessary step to establish Ireland's psychological independence both at home and in Brussels. While Ireland's decision defies rational economic choice due to the cost it leveraged on its citizens, joining the EMS established the political legitimacy of Ireland within the European community. It simultaneously served to complete Ireland's independence from Britain by distancing itself economically from its prior colonizer, forcing it to build its own economic capability. As Paul Gillespie notes, Ireland had never broken free from its post-colonial dependency following independence and the world wars. He argued that "In a sense, EC/EU membership represented the fulfilment of Irish independence"<sup>144</sup> through its participation in the sovereignty sharing institutions of Europe. The process of integrating Ireland within the EU monetary framework allowed it to tap into its American Diaspora to build an independent economic strategy. In spite of the economic hardship Ireland endured during the 1980s, the EU psychologically broke the dependency cycle that Ireland existed in, under the weight of its colonial past. Essentially, Ireland grew up economically through the EMS and learned to stand on its own shaky feet. The Irish government was well aware of the economic consequences that could - and did - result from its decision, but economic logic would not have brought Ireland the economic maturity it needed. The EMS provided Ireland an institutional framework to take the first steps on the road to economic independence from Britain.

The 1992 Maastricht Treaty, which was ratified by a 70% majority, was a necessary step in building Ireland's self confidence as a modern economically liberal player in the new European regional block. The "new Europe" being constructed around monetary integration presented Ireland with a chance to be part of the building block of Europe. Ireland's desire to

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<sup>144</sup> Paul Gillespie, "Ireland in the New World Order: Interests and Values in the Irish Government's White Paper on Foreign Policy," *Irish Studies in International Affairs* 7 (1996). p.148

modernize and progress beyond the post-colonial backwater of Europe was enhanced by identifying with the developed economies of Europe. Therefore the promise of being a part of the greater economic powerhouse of Europe outweighed any purely statist sovereign hold on monetary policy. This is not to suggest that Ireland did not engage in bargaining as the intergovernmental accounts claim, rather bargaining was not central to its decision to join the EMU to begin with. Ireland had successfully bandwagoned together with other members of the “cohesion camp” (Spain, Greece and Portugal) to demand significant fiscal transfers in return for economic and monetary integration.<sup>145</sup> But it is likely that their decision would not have been any different if fiscal transfers were not forthcoming. This is because the economic impact of FDI was expected to be orders of magnitude greater than any of the structural funds it received from Europe. As time proved, Ireland became one of the largest recipients of FDI investment the world. By 2001 over €163 Billion of FDI had been invested in Ireland, and in 2002 alone it received an additional €25Bn placing it in the top 10 countries in the world.<sup>146</sup> By comparison, that same year Ireland only received €656Million in regional development and cohesion fund, less than 3% of the FDI inflow.<sup>147</sup>

Yet while Ireland associated with “new Europe” it did so in a way that enhanced its own sense of Irishness through the institutions in Europe. Ireland was not trying to replace its Irish identity with a European one rather it was trying to build a new national identity through the instruments of economic policy. In the process, Ireland created a category to separate other citizens of Europe from Irish identification. The term “non-national” is used to identify other members (mostly poorer Eastern Europeans) of the European Union who now work or reside in Ireland. In addition, Ireland has dramatically

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<sup>145</sup> Sean Flynn, "Ec within Striking Distance of Agreement," *Irish Times*, December 6 1991. As a result, Ireland had received a high level commitment of over £2 billion in cohesion funds.

<sup>146</sup> FDI numbers from Irish Central Statistics office [http://www.eirestat.cso.ie/releasespublications/documents/economy/2002/fdi\\_2001and2002.pdf](http://www.eirestat.cso.ie/releasespublications/documents/economy/2002/fdi_2001and2002.pdf)  
Worldwide facts from UNCTAD website

<http://www.unctad.org/Templates/Webflyer.asp?docID=4461&intItemID=2807&lang=1>  
<sup>147</sup> European Regional Development fund and cohesion fund transfers from Government report provided directly to me by Irish Finance Department. Report titled “Department of Finance Budgetary and Economic Statistics, September 2009”. These numbers do not include Common Agricultural Policy as that was available to all countries

tightened its citizenship and *jus soli* laws to maintain exclusivity for the label “Irish”.

### ***Ireland the “Euro”phile***

Hay and Rosemond note that the process of adopting the economic reforms of the EMU was constructed as an issue of national pride for Ireland.<sup>148</sup> The economic discipline of meeting the Euro convergence criteria became an integral part of Ireland’s economic identity and entry was the badge of honour. In Eurobarometer<sup>149</sup> polls, the Irish consistently score the highest in terms of identification with the Euro currency. In fact the most striking aspect of the attitudinal survey was that 88% of the Irish “think” in Euros, in that they do not resort back to their former currency to calculate major purchases. It is as if the Punt has become a distant memory even though it had only been replaced by the Euro six years prior to the survey. By contrast, in the number two country, only 45% associated first with the Euro currency.<sup>150</sup> Ireland also scored highest in the survey when asked if the Euro was a good thing for Europe. By contrast the other three “PIGS” highlighted in the introduction scored lowest when asked the same question.<sup>151</sup> Ireland’s reaction to the recent economic crisis serves as a powerful example of how identity affects individual country response to European institutions. Ireland has been the most responsive of the “PIGS” in bringing its economy back into line with European requirements and has been applauded by the financial community and European Commission for its quick and decisive steps to correct its fiscal deficit, even when the results are painful.<sup>152</sup> By contrast the other three member states have met significant internal resistance to reform from their citizens and government elites alike. Ireland’s strong identification with the Euro as its national currency has made the bitter pill of reform more

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<sup>148</sup> C Hay and B Rosamond, "Globalization, European Integration and the Discursive Construction of Economic Imperatives," *Journal of European Public Policy* 9, no. 2 (2002). p. 163

<sup>149</sup> Eurobarometer is the home for all European Union surveys, both analytical and attitudinal.

<sup>150</sup> Eurobarometer, "Public Attitudes and Perceptions in the Euro Area." p.19

<sup>151</sup> When asked “Do you think that having the Euro is a good or bad thing for Europe?” Ibid. p. 9

<sup>152</sup> Stephen Collins, Mark Hennesy, and Arthur Beesley, "Budget Will Bring Down Cost of State Borrowing, Says Cowan," *Irish Times*, December 11th 2009. “The Budget measures received support from an important quarter last night when EU economic and monetary affairs commission Joaquín Almunia said the Irish people and authorities should be commended for the “considerable” steps they were taking to tackle the fiscal crisis”

acceptable. This is not to suggest that Ireland has “Europeanized”, in fact in other benchmarks Ireland remains quite distant from Europe. When asked about the major institutions of Europe – the European Parliament, the European Commission and even the European Central Bank (ECB) - Ireland reflects a relatively low trust of these institutions.<sup>153</sup> For Ireland, the ECB has no symbolic meaning in its life, it is merely a faceless institution in Europe and, while Ireland loves the Euro, only 43% trust the ECB.<sup>154</sup> The low identification with the political institutions of the EU and the high identification with the symbol of its economic institution may explain why Ireland appeared so positive towards Europe yet still voted no on the first Lisbon treaty referendum in 2008.

The reason for Ireland's high support for the Euro is that Ireland's modern economic identity has been constructed through the instruments that formed the EMU. The “Celtic Tiger” wasn't a European phenomenon, it was an Irish one. It was created out of the European Union that allowed Ireland to leverage its links to its North American Diaspora and become the “gateway to Europe”. While the Spanish and Greeks share a common currency with Ireland, they do not share in the economic identity created around the Celtic Tiger - that is exclusively Ireland's. The Euro marks part of Ireland's political maturing in Europe, and Irish society and the Euro cannot be easily separated in some utilitarian sort of way. Money is firstly a social relation and it is the Euro currency that has reinforced a positive European identity as noted in Ireland's different attitude to the Euro and ECB. The Euro has enhanced Ireland materially and in turn it has reinforced Ireland's positive identification with Europe. The Irish Government has categorised its approach to Europe as “conditionally integrationist”. According to Government documents the European Union is “an integral part of our future. We see ourselves, increasingly, as Europeans and national identity and self confidence have been bolstered not diminished by membership”.<sup>155</sup>

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<sup>153</sup> Eurobarometer, “Europeans in 2009,” in *Series # 308* (Brussels: European Commission, 2009). p. 108

<sup>154</sup> Ibid. P.104-108

<sup>155</sup> Cited in Gillespie, “Ireland in the New World Order: Interests and Values in the Irish Government's White Paper on Foreign Policy.” p. 150

## Conclusion

This thesis has shown that Ireland's 1978 and 1992 decisions to participate in the supranational institutions of the EMS and EMU were driven by economic identity politics with the vision of constructing a new national identity. By introducing identity politics into the analysis, the thesis reveals the motivation for a small, asynchronous economy to pursue seemingly "irrational" economic choices. In 1978, the nationalist goal of complete Irish independence could only be accomplished through an economic policy that separated Ireland from Britain once and for all. The Intergovernmentalist view that Ireland joined the EMS because it had no choice is inaccurate, as Ireland was neither pressured nor left choiceless in the decision. The 1992 decision was constructed around a nationalist vision for a modern nation, shedding Ireland's identity as the "blacks" of Europe. In turn, Europe represented a symbol of re-birth and its economic and monetary institutions became powerful symbols to hitch Ireland's economic vision to.

By bringing economic identity politics into the framework, our understanding of small state engagement in supranational institutions is significantly improved. While Intergovernmentalism may provide a "big-bang" theory on the EMU formation, it provides little insight into how the institution is perceived by small states. Limiting the unit of analysis to deterministic variables can lead to an incomplete or wrong conclusion on why states participate in supranational institutions. The preoccupation with monetary sovereignty as the central issue defining the economic bargaining process within Europe has resulted in a very narrow conclusion on the motivation for small state participation in its institutional arrangements. The rational argument posits that without monetary sovereignty then a state has little choice in international regimes. This has meant that small states are, at best, lumped together into survival mode or, at worst, ignored completely as a unit of analysis. But as the Irish case study elucidates, this limited analysis can lead to the wrong interpretation and conclusion. Even if small states have no monetary sovereignty to speak of they still has *some* power over their economic choices, and states are willing to make "irrational" decisions if it

further their ideational goals. However only by expanding the field of IPE to include economic identity politics can we start to uncover and interpret small state motivations in a more use way.

A shared national vision can be a powerful influencer in shaping the economic policy a state pursues by leveraging supranational entities to provide legitimacy for the preferred economic policy. In this context, rather than being viewed as surrendering power to the supranational institution, the institution is in fact empowering the nation to accomplish its vision. Economic identity politics provides an alternative view on where power lies and in the case of the EMU, it is this author's view that small states have the power to weaken or undo the monetary union just as much as large states. So, unlike the view projected by Hans Tietmeyer that monetary union is a "monetary community of destiny",<sup>156</sup> EMU integrity can be rendered more fragile through negative identification. This has become painfully obvious as the current "PIGS" crisis has caused significant devaluation in the Euro and shaken its viability as a global currency.<sup>157</sup> By including identity politics we get a better understanding of the sustainability or survivability of these institutions.

Different national constructions of how EMU shapes its economy can lead to vastly different levels of support for the institution. The analysis has shown that the Euro - the physical symbol of monetary union - can be a force for enhancing national identity, and it explains Ireland's hybrid personality of being both highly nationalistic and highly supportive of Europe. Support is reinforced by the degree that the institution has become embedded in the national identity. Therefore it explains how Greece considers the Euro bad for its country while Ireland believes it is a good thing. The corollary is that Ireland has a high identification with maintaining the integrity of the Euro while Greece is less inclined to do so.

Abdelal et al. note that "Scholars of IPE have arrived at a comfortable certainty about how the world works" based on rational choice and materialist theories.<sup>158</sup> However this thesis is a challenge to the field of IR on what

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<sup>156</sup> Cited by C Shore, *Building Europe: The Cultural Politics of European Integration* (Routledge, 2000). p. 111

<sup>157</sup> <http://www.ecb.int/stats/exchange/eurofxref/html/eurofxref-graph-usd.en.html>

<sup>158</sup> Rawi Abdelal, Mark Blythe, and Craig Parsons, *Constructing the International Economy*, ed. Draft - yet to be released (2010).

should be considered valid knowledge in the study of the international political economy. As the European Union expands eastwards, it is increasingly moving to a system of smaller states and the classic rationalist focus on large state power politics becomes less valid or informative. The predominant IPE literature on European Monetary Union has no acknowledgement of economic identity since it follows a narrow line of enquiry that cannot accommodate indeterminate variables such as nationalism or culture. As such rationalism has reduced the social to purely strategic interaction, and in turn reduced economic policy to some utility maximizing game. This phenomenon is widespread in the study of IPE as the emphasis on the rationality of economic logic cannot be easily reconciled with identity.

Ireland is an important case study because it was an economically immature state when it joined the European Union in 1973 and it had far more in common with new states like Slovenia, and candidate states like Croatia, than it had with Spain or Belgium. Therefore it provides insight into how we can expect these countries to approach Europe's monetary institutions. As has been demonstrated with Ireland, for states who traditionally considered themselves 'outside' Europe, the Euro can act as powerful physical symbol of inclusion, and in turn this reinforces the integrity of the institution. The European Union is now mostly comprised of small countries<sup>159</sup>, and their positive participation in the EMU is vital in maintaining the integrity of the institution. Given that participation in the Euro is now mandatory, the field of IPE needs to cultivate a better understanding of how states construct the Euro as this will be essential for its survival.

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<sup>159</sup> 20 of the 27 economies in the European Union have an economy worth 2% or less of the EU wide GDP, Source CIA World Factbook

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