. Bernhard and Leblang, Democratic Institutions and Exchange Rates

The choice of exchange-rate arrangements has relatively predictable consequences for an economy. Bernhard and Leblang argue that differences in domestic political systems can help account for variations in the choice of those arrangements. Politicians and parties face political and electoral incentives that condition their choice of exchange-rate arrangement. These political incentives reflect the configuration of domestic political institutions.

Majoritarian electoral systems are so volatile that one can expect politicians to retain the ability to manipulate monetary policy: “Politicians in a majoritarian system will prefer to let the currency float” (76). In contrast, proportional representation systems may favor fixed exchange rates of one sort or another, as it they can actually help in coalition bargaining and monitoring of the party the holds the ministry of finance. The costs of serving in the opposition will have to be considered as well.

Bernhard and Leblang analyze the exchange-rate regime of twenty industrial democracies from 1974 through 1995. The multinomial logit estimates show that proportional systems with high opposition influence are the most likely to fix their exchange rate, whereas majoritarian systems with low opposition influence are the least likely to do so. In fact, politicians in a majoritarian-low oppostion influence seem to be 82 percent more likely to adopt a floating exchange rate than their counterparts.

The results cast doubt on other explanations, such as arguments based on policy capabilities and credible commitments. “Our argument has implications for recent scholarship on the interaction between the international economy and domestic politics. … Our analysis highlights the fact that politicians have interests and incentives independent of economic and societal forces. … Focusing on politicians and their incentives is a necessary complement to explanations centering solely on economic conditions” (93-94).