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## Book Review

# The future of the euro

Matthias Matthijs and Mark Blyth (eds.)

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If you only want to read one book on the euro crises that started after 2008, this is the one to read. Matthijs and Blyth have assembled an excellent set of authors to produce an edited volume with significantly more coherence than the usual collection. The authors' central point is a simple but important one. Both the initial analyses of the politics of economic and monetary union (EMU) and the political forces pressing for EMU assumed everything that was important for its success. The academic analyses assumed that introduction of the euro was inevitable because it promised to reduce transaction costs. The social groups pressing for the euro – northern European financial firms looking for new markets but also southern European labour unions and other actors hoping to constrain their own politicians and states – were also happy to overlook any potential long-term problems in favour of probable short-term gains.

The authors do not start with the more familiar point that the Eurozone did not constitute an optimum currency area (OCA) with free mobility of capital, labour and goods, and thus was vulnerable to asymmetric shocks. Rather, the authors elaborate the concept of an embedded currency area (ECA). OCAs have to be embedded in a set of political and social compromises or understandings that make it acceptable to bail out regions damaged by an asymmetric shock. The Eurozone lacked all the essential political and social conditions that actually make an OCA work. There was no prior political solidarity or robust common identity that might legitimate sharing the costs of adjustment to a regional shock, no mutualization of risk via a common Eurozone bond market and no central authority both charged with and experienced at restoring market confidence.

The book is organized in three broad sections. The first discusses the ECA and provides a deep historical background not only of the origins of the euro but also of previous – and equally fragile – monetary unions in Europe. The second investigates the politics of crisis response in Germany, France, Italy and Spain, who collectively constitute 75 per cent of Eurozone GDP, and who thus must be at the centre of any solution. The third is more forward looking, providing the international context for



the euro, some prognostication on Germany's probable policy choices, and the view from the European Union level.

The chapters collectively present pointillist accounts that resolve into three main themes. First, the European responses to the euro crises replicated the classic Japanese CRIC – crisis, response, improvement, complacency – cycle from the 1990s, but with considerably more willingness on the part of the ECB and Germany to bring things to the brink of failure in pursuit of changes in the political economy of the south. In other words, creditor regions and institutions sought to forge an ECA via coercion to solve crises caused by the absence of an organic ECA. Unsurprisingly, this has triggered anti-EU and anti-austerity sentiment sufficient to propel a substantial share of the electorate towards a variety of anti-system, anti-EU political parties. Second, creditors succeeded in defining the crisis as one of southern public sector profligacy, rather than Germany's (and some smaller north European countries') export of their deflationary, demand suppressing domestic policy in the form of trade surpluses. This is a short-term success that makes it harder for creditors to actually recover their money over the long term. The south feels rightly put upon, and a second decade of austerity politics surely will result in anti-EU political majorities. Third, political consensus and by extension the creation of an ECA requires finding common ground or fusing two not entirely compatible visions of the state and market, namely German ordoliberalism and French *gouvernement économique*. One fetishizes numbers and rules while the other focuses on outcomes and the business cycle. One deters unproductive rent-seeking while the other encourages insider politics.

Two small features weaken the book. The first is an omission. The most important trigger for the first euro crisis was the collapse of the US housing bubble. Northern European banks were the main conduit for recycling north European trade surpluses back to the trade deficit southern countries. Northern banks in search of yield unwisely sought extra profits in the United States, borrowing dollars short term to on-lend long term as mortgages or purchases of mortgage-backed securities. When the US housing bubble burst, these banks were *de facto* bankrupt, and thus unable to continue lending to the south. Given that the financial sector was a major society side proponent for EMU, and the major beneficiary of the bailouts, their role in triggering the euro crises deserves greater scrutiny.

The second flaw is an implicit but somewhat incorrect comparison with the United States that is pervasive in the literature on the euro and EU. This comparison assumes that the United States similarly started out with a fiscally weak central government and weakly integrated national economy and thus constituted neither an OCA nor an ECA. This overstates the case. The US federal government controlled both customs revenue and land sale revenue from 1789 forward. It set the terms by which local governments outside the south raised and disbursed revenues for their core activity, education. It set the terms by which land settlement westward occurred. By doing so it induced/forced state (that is, provincial) governments to raise revenue via



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pro-development policies. This is far from a fiscally weak central state. Similarly, the integration of Midwestern food production and northeastern financial and mercantile activity with southern cotton export production was almost total, given the technical capacities of the time. Consistent with the authors' larger point, the United States also had something closer to an ECA by virtue of the Revolution and two subsequent wars, with slavery being the only major issue dividing national elites. These quibbles aside, this is a comprehensive and insightful collection.

Herman Mark Schwartz<sup>a,b</sup>

<sup>a</sup>Hedmark University College, Hedmark, Norway

<sup>b</sup>University of Virginia, Charlottesville, USA