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Themed Issue: The Limits of EUrope: Identities, Spaces, Values

BOOK REVIEW

A technical fix to the euro's original sin? Review of Ashoka Mody's *EuroTragedy: A drama in nine acts*

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Twenty years after the introduction of the euro and ten years after the start of the global financial crisis, so many books have been written on the euro crisis by academics, journalists and policy makers that one would think nothing more is to be said. Ashoka Mody proves this assumption wrong in his *EuroTragedy: a drama in nine acts*. In this *tour de force* of a book, the author discusses the entire history of European monetary integration from the Schuman Declaration in 1950 until the most recent standoff between Italy and the rest of the eurozone, which he predicts with striking precision. Mody, an economist who spent most of his career with the International Monetary Fund and was in that capacity involved in the bail-out of Ireland, succeeds in combining cool-blooded economic analysis with a passionate critique of the many mistakes that were made throughout the history of the euro; errors that impoverished millions of citizens and estranged them from the ideals of European integration.

As the title of the book reveals, Mody has chosen to present his analysis of the euro crisis as a tragedy, discussing its origins, dynamics and responses chronologically while focusing on the role of individual protagonists. Helmut Kohl, the German Chancellor during a long and key period (1982–1998) of the euro's genesis, plays the central role in this drama. Mody depicts him as the tragic hero, who has been critical in twisting the arms of sceptics of monetary union in Germany and other member states. Mody rightly contradicts the conventional wisdom that Kohl accepted the euro as a *quid pro quo* for German reunification. Rather, in his quest to make the history books as not only a central figure in German but also in European unification, Kohl became a staunch proponent of the euro, willing and able to override concerns within and outside Germany.

While telling the history of the euro chronologically and focusing on historical figures, Mody's theoretical analysis of how the incomplete monetary union came into existence appears throughout the book. The central concept, which he borrows from social psychology, is that of 'groupthink' (Janis, 1972). Mody argues that politicians were willing to neglect warnings by economists about the limited advantages of monetary union and about the necessary but politically unattainable framework conditions to make a single currency viable, because they wanted to preserve a pro-European consensus at any cost. Politics trumped economics. Those contemporary politicians that realised that the conditions for a monetary union were not met believed in the 'falling forward thesis', the idea that in Europe crises always lead to further integration (see Jones et al, 2016). With regard to the euro, this means that they were convinced that the essential, but for the time being lacking, fiscal underpinnings would eventually result from future economic turbulence.

Mody ends the book with two possible future scenarios. In the first, 'more of the same', groupthink continues and eurozone leaders proceed with cheap talk about a fiscal union, which they all understand differently, and hence cannot really put into practice. Eventually, new shocks happen, most likely in Italy, and become fatal for the euro. In the second scenario, European leaders finally recognise that more Europe does not work and return full fiscal responsibility to national governments. They agree to forgive Greek debt, introduce automatic restructuring clauses in future debt and dismantle the fiscal rules. In Shakespearian fashion, Mody stages Angela Merkel as the saviour who ends the euro tragedy by delivering a speech in which she calls for these measures. Merkel, who infamously dethroned Kohl at the helm of the German centre-right party CDU in 2000, in this way rectifies her predecessor's great mistake. After this reversal, Mody believes that Europe can flourish again as a 'Republic of letters' where desirable competition between member states leads them to create egalitarian education systems. As a consequence, Europe is able to win again in the global competitive race and European citizens can engage in high-minded dialogue based on a mix of national cultural identities and open-society values.

The book offers an excellent read, both for those who are new to literature on the euro and its crisis, who get the full history introduced in an accessible, even novel-like style, as well as for more seasoned observers, who get insights in key decisions made before and during the crisis as if they were a fly on the wall in those historic episodes. Nonetheless, there are two key issues with the book with which I disagree.

Beyond groupthink

I believe that Mody's explanation for the launch of an incomplete monetary union as the result of groupthink among contemporary politicians and the decisive role played by Helmut Kohl, while supported by archival research and interesting quotes, is not entirely convincing. This argument leaves a number of questions unanswered. First, it is not clear why politicians in other member states than Germany sheepishly followed Kohl in his fixation to introduce the euro to secure his European legacy. Second, this perspective does not explain why Kohl succeeded to override opposition within

Germany against introducing the euro, while he was at the same time constrained by their resistance against giving the monetary union the necessary fiscal capacities.

Throughout the book, Mody juxtaposes (irrational) politics against (rational) economics. This ignores political economy explanations of the euro. These would argue that the monetary union as it has been constructed promotes a certain (German, ordoliberal) vision on desirable macroeconomic policies, and serves the interests of certain economic operators and member states quite well. Rather than groupthink among a small circle of European leaders around the time of the Maastricht negotiations, a larger consensus existed then about the overriding need of stable inflation, the futility of monetary sovereignty and the benefits of tying politicians, always prone to 'deficit bias', to supranational fiscal rules (see McNamara, 1998). The introduction of the euro was not an *idée fixe* of Kohl and a handful of other politicians blinded by their Europhilia, forced through against a more clear-thinking rest of society. The euro was also supported by organisations representing big European firms, and the European Commission acted as a policy entrepreneur for the introduction of the common currency, as it would also boost its prestige and competencies (see Jabko, 1999).

Beyond the market

I am also not convinced by Mody's solution to end the euro tragedy, which also disregards political economy explanations of the euro's vulnerabilities. Similar to what Martin Sandbu, in his book on the euro crisis *Europe's Orphan* (2015), has proposed (he is of the opinion that the euro crisis is the result of behavioural – policy mistakes – rather than structural problems of the common currency), Mody argues that a combination of automatic debt restructuring and handing back fiscal sovereignty to the member states will make the euro sustainable. This will lead financial markets to scrutinise member states' fiscal policies more seriously, to differentiation in interest rates and reduced risk of the development of fiscal imbalances. If such imbalances do arise, debt is automatically restructured so that taxpayers in other member states do not have to pick up the bill, thereby avoiding reciprocal acrimony between euro area populations.

Although such reforms would be helpful to lower the risk of future crises and would distribute the costs of responding to a crisis more fairly, I do not think that they are sufficient to make the euro area sustainable, let alone flourish. Abolishing the fiscal rules gives euro area member states *ostensibly* the ability to use the budget counter-cyclically. But, without automatic stabilisers at the union level, a state that has to borrow in a currency that it does not control will always be forced to apply austerity more than monetary sovereign nations do (see De Grauwe and Ji, 2013). In this constellation, internal devaluation by lowering labour costs remains the sole instrument for member states to restore competitiveness. This has redistributive consequences, as the burden is carried by workers and those dependent on benefits, and will in that way keep reinforcing euroscepticism among the losers of this asymmetrical adjustment process.

Mody's recipes also do not change the fact that the euro area is composed of heterogeneous national political economies, some of which have domestic institutions that facilitate maintaining competitiveness within a monetary union while others lack these. Member states like Germany with responsible wage-bargaining institutions and vocational training regimes that support incremental innovation and diversified quality production can handle the loss of the exchange rate instrument to maintain competitiveness more easily (see Hall, 2014; Johnston and Regan, 2016; De Ville and Vermeiren, 2016). The presence within the euro area of member states with low-inflation, export-led economies that tend to accumulate current account surpluses structurally pushes the euro's exchange rate upwards, making it even more difficult for other member states lacking such institutions to remain competitive. While Mody's proposal limits the risk of fiscal imbalances and makes remedying these less painful, the accumulation of competitiveness and current account imbalances remain likely, and will still be reinforced by the ECB's *one-size-fits-none* interest rate. The idea that better education systems will magically solve all these remaining problems *and* will end the current identity wars within and between member states frankly seems wishful thinking.

If Mody truly believes that automatic debt restructuring and restoring national fiscal sovereignty is sufficient, he should be quite optimistic about the current state of the euro and the direction of its further reform. Bailing in creditors in case of bank defaults has been established in the context of banking union, and automatic sovereign debt restructuring has now been agreed in the euro reform package of December 2018. The EU's capital market union is anticipated to strengthen financial market integration, increase creditors' supervision of member states' fiscal policies, and will ensure that, in case of private or sovereign insolvencies, costs are spread out throughout the union automatically. Braun and Hübner (2018) have aptly called this 'a financial fix to [the euro area's] structural – above all: fiscal – fault'. Supporters of these ideas, including the governments of the Hanseatic League of northern member states (see Heijdra et al, 2018), see them as a viable alternative for a fiscal union, making the acceptance of the latter less likely. Over the past few years, the European Commission has also taken a more flexible stance *vis-à-vis* member states' fiscal policies.

But I wonder if Mody really believes that this path of fiscal responsibility, scrutinised by capital markets who pay the price when things go wrong, instead of solidarity will be sufficient to make the euro area flourish. It is very much in line with the 'stability ideology' that he criticises in the rest of the book, and is not incidentally supported by this ideology's adherents in Germany and the Hanseatic League of small, northern euro area member states.

Mody's true preference?

In the final paragraph of the book, Mody hints at 'the ultimate disengagement' whereby on a Monday morning 'world financial markets open [and] the deutschmark trades against the dollar and the euro. The euro depreciates against the other major currencies' (p 457). The dismantling of the euro, or at the very least the exit of Germany from the euro, seems to be Mody's real preference. However, it appears that he did not want to go as far as proposing the break-up of the euro as the only logical conclusion from his devastating analysis that the single currency brings few benefits and needs fiscal stabilisers to be sustainable, which have been and always will be politically unattainable. Maybe, exhausted at the end of his impressive effort of writing this book, the author fell prey to groupthink in believing that 'a new pro-Europeanism', consisting of a technical fix to the euro's structural problems and better education of citizens, will turn the euro tragedy into paradise.

Conflict of interest

The author declares that there is no conflict of interest.

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