

REGULAR REVIEWS

Waltraude Schelkle: *The Political Economy of Monetary Solidarity: Understanding the Euro Experiment*.
Oxford 2017: Oxford University Press, 387 pp.

In this remarkable book, Waltraud Schelkle provides a novel account of the core concern in the debate on European monetary integration: the issue of diversity. Conventional economic theory and comparative political economy approaches argue, each in their own way, that structural diversity among the interdependent eurozone's members poses a fundamental problem to the currency union's functioning. In contrast, Schelkle takes an insurance-based perspective which suggests a more complicated interpretation, called the 'paradox of diversity'. In this view, more diversity means greater gains, because the costs of risks are better spread among a larger pool of insuring members. Especially when economic cycles are not synchronous, there will be a continuous rotation between the 'lucky and unlucky', who compensate each other (p. 6). However, diversity also involves greater political impediments to further risk-pooling. Mistrust and misperception as well as the range of interests, preferences, and state power are seen to increase with greater membership. Taking up this paradox, Schelkle attempts to explain why the Economic and Monetary Union (EMU) came about but remains a rather minimalist arrangement. She maintains that monetary solidarity, defined as the 'deliberate or at least consciously tolerated risk-sharing' among the members (p. 1), is certainly present in the eurozone, but it is insufficiently exploited. Reforms appear mostly to result from crises, with solidarity materialising as ex post acceptance. Following this reading, Schelkle makes several policy recommen-

dations to address the eurozone's present institutional shortcomings.

The starting point of the book is a theoretical elaboration of the insurance view of monetary solidarity (Chapters 1 and 2). Schelkle creatively connects a rational choice IR approach with the 'by-product theory of collective action'. The argument is that even states with heterogeneous interests, preferences, and power relations may initially start to cooperate out of sheer self-interest, but that creating a common resource like a shared currency means having an exhaustive public good. Monetary integration, understood as financial risk-sharing, requires continuous mutual monitoring in order to prevent moral hazard or, in other words, a 'tragedy of the commons'. This, however, involves coordination problems and unintended consequences. Thus, a common currency is a politically contested resource in incessant need of institutional revision, particularly in the face of crises. After having outlined various forms of these 'political market failures' to put additional analytical flesh on her theory, Schelkle complements her monetary solidarity approach with established economics literature on the forms and effects of macroeconomic risk-sharing (Chapter 3). This discussion supports Schelkle's idea that there exist 'multiple interfaces of risk-sharing' between monetary, fiscal, and financial prudential functions (p. 79). These institutions, so the argument goes, need to be in place simultaneously, at least to a certain extent, in order to allow the common currency to function properly.

With this original perspective in place, Schelkle formulates a new empirical take on the mechanisms of macroeconomic integration by analysing the American and European histories of monetary solidarity (Chapters 4 and 5). Through a laborious

empirical exercise, Schelkle exposes key problems associated with many of the often-heard interpretations of these cases. Schelkle first argues that the American case cannot be relied upon by those claiming that political union should precede monetary union, or inversely. In the United States, monetary integration was imposed on the South during the Civil War, hence no political union existed at the time, and subsequent developments substantially altered original arrangements. Even in this federal context, political contestation as well as (financial) crises caused frequent alterations to or even reversals of the monetary, fiscal, and supervisory institutional structures. The eurozone's history reveals, according to Schelkle, a substantially different trajectory of monetary solidarity. Europe's route is marked by the political objective to establish a single currency that provides both low interest rates and inflation. This dual objective foremost required stability-oriented monetary policy and prudent fiscal policy in order not to deplete the common resource. Therefore, Schelkle argues, the eurozone's unfinished pre-crisis institutional design is best explained by the perceived need, above all, to prevent moral hazard. It is not, as often maintained, the ideological hegemony of ordo- or neo-liberalism that explains the fixation of the eurozone's designers with fiscal consolidation, but rather their desire to prevent a tragedy of the commons. Subsequently, however, the eurozone crisis uncovered that there was actually a dire need for the financial and fiscal risk-sharing structures that were lacking, particularly in the context of deep financial integration. Analysing the crisis reforms (Chapter 7), Schelkle argues that, indeed, the supervisory and resolution functions of the Banking Union and some forms of fiscal integration (e.g. the fiscal backing of the European Stability Mechanisms or the European Central Bank's emergency liquidity programmes) were intended to address some of these previously

neglected areas. Nevertheless, several key ex ante risk-sharing institutions with combined institutional functionalities, such as the collective deposit insurance scheme to secure customer savings and prevent capital flight, regrettably remain absent.

This reinterpretation of the American and European cases is novel and thought-provoking. But, as indicated at the outset, Schelkle's contribution goes much further. To me, *The Political Economy of Monetary Solidarity* is particularly valuable because it is an ambitious attempt to expose several major flaws in established theory. As such, Schelkle challenges our understanding of the single currency's evolution and our judgement about its present (mal)functioning. Her main targets are optimum currency area (OCA) and growth model theory. These are responsible for the predominant diagnoses stressing economic diversity as the principal cause of the eurozone's structural ills. It is beyond the scope of this book review to do full justice to the complexity of these theories and Schelkle's empirically rich analysis. Nevertheless, let us focus on Schelkle's main contributions in regard of these two theories. Basically, OCA argues that interdependent countries with different export profiles and their own currency would respond to an 'asymmetric shock', for example a sudden price increase in the main export good, with exchange rate manipulation to restore competitiveness. In a shared currency area, this option is relinquished. Other means of adjustment, such as labour migration or fiscal policy, are needed to address such an asymmetric shock. However, because the eurozone does not have sufficient interstate labour mobility or a shared fiscal framework, it cannot persist. Schelkle's second target, growth model theory, maintains that the eurozone is divided between the export-led growth regimes of northern creditors and southern consumption-led debtors. The trade surpluses generated in the more competitive North are dependent on the debt-

financed consumptive imports of the South, which the euro primarily enables by lowering the costs of borrowing primarily by issuing bonds denominated in euros rather than liras or escudos. Previously, the consumption countries could devalue their national currencies in order to maintain competitiveness vis-à-vis their northern trading partners. But without this option and lacking the wage-bargaining institutions to secure low inflation, the consumption-led countries can only restore competitiveness by means of the practically impossible policy of wage decreases. Therefore, stagnation will continue and, ultimately, the common currency will become untenable.

So, what are Schelkle's key claims I find particularly valuable? First, she maintains that OCA wrongly focuses on the concept of asymmetric shocks between supposedly too different economies (Chapter 6). In fact, Schelkle argues that OCA, by neglecting the financial sector, does not allow for understanding what happens when an incomplete monetary union faces a *common* economic shock like the European banking crisis. Rather than arguing that the South was a logical prey due to its low growth and high debt levels, Schelkle perceives them as the unlucky few who were targeted by the financial sector as its main victims in a moment of speculation and herd behaviour. It is the lack of *financial* risk-sharing mechanisms, not a supposedly necessary option of national monetary policy or flexible labour markets as means of adjustment. Second, Schelkle argues that growth model theory also misses the point and thus leads to wrong conclusions. It overemphasises the wage-bargaining effects of both export-led and consumption-led varieties on inflation rates as well as the alleged incompatibility of the northern and southern economies sharing a single currency. Schelkle provides evidence that the mutual dependency between these regimes only works unidirectionally. The South is indeed dependent on the North

for financing its trade deficits, but northern growth results much more from trade with rising economies such as China. Third, Schelkle reveals two more analytical problems (Chapter 8). OCA sees interregional labour mobility as a key alternative adjustment mechanism and maintains that, for reasons such as language, the eurozone countries cannot have the same stabilisation as occurs in the United States. However, Schelkle provides convincing evidence that even in the United States labour mobility never functioned as a stabilisation mechanism during a regional downturn. Rather, migration responds to inequality, not idiosyncratic changes in employment following a regional shock. In fact, migration seems not even a proper adjustment mechanism. While it can be good for the individual, migration is not favourable to regions of origin because, primarily, of brain drain effects. Schelkle shows that the welfare state can ameliorate this problem, because the incentive to leave is smaller when benefits substantially compensate. In the more generous welfare states of the eurozone or the EMU, therefore, conditions actually seem somewhat better than in the United States.

Despite these great contributions to our understanding of currency unions and the eurozone's problems in particular, Schelkle's book contains several shortcomings. In my view, two main problems stand out. First, the critique offered to growth model theory may be valid, but it does not refute the permanent divergence between the North and South. This has a substantial implication for the insurance-based perspective and, therefore, the potential for more monetary solidarity of the deliberate kind. By this I mean that even if export-led growth in the North may not be as dependent on imports from the South, there remains a major structural discrepancy in regional competitiveness, resulting from both costs and innovation potential, and, subsequently, socioeconomic development. This

divergence is likely to be permanent, if no other measures are taken (see my second point). This constitutes a fundamental problem for Schelkle's insurance-based perspective because it is founded upon the assumption that states voluntarily join a shared currency regime as a financial risk-sharing mechanism on the basis of reciprocal self-interest. Insurance is only beneficial to all, however, if today's winners could be tomorrow's losers. If southern members face structural growth problems while the North does not, the presumed reciprocity will in practice not materialise. Risk-sharing through fiscal measures, even indirect or limited, would then constitute a permanent, one-sided fiscal transfer. In that case, if a more extensive fiscal integration policy is pursued, the explanatory variable would not be reciprocal self-interest, but something else such as *political* solidarity.

Second, Schelkle's policy recommendations reflect a limited and technocratic perspective on eurozone politics. By emphasising financial risk-containment, her policy recommendations are largely confined to ex ante safeguards against volatile financial markets and moral hazard. Problematically, however, Schelkle does not address the major political risks causing instability. She argues, according to the paradox of diversity, that fiscal integration should not go too far as it would risk a political backlash from citizens in creditor countries. But fiscal transfers are of utmost necessity given the worsening structural divide between the North and South. The absence of substantial investment in presently uncompetitive economies with limited innovation capabilities perpetuates welfare stagnation and import/debt dependency. Accordingly, Schelkle's limited policy recommendations regarding Cohesion Funds and monetary stimulus are insufficient to resolve this fundamental issue. Instead, high structural investment through pooled fiscal resources (beyond the Juncker Plan), potentially accompanied with Community-level

democratic accountability mechanisms, are needed. These redistributive transfers are indeed controversial, but not attempting to diminish structural disadvantages could dissolve the already battered belief in eurozone membership. Doing too little may, potentially, foster disruptive politicisation even more.

Jasper P. Simons
European University Institute
Jasper.Simons@eui.eu

Ivan Krastev: *After Europe*

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In this eloquent, witty, and provocative essay, Ivan Krastev, a political scientist with admirable intellectual skill and a penchant for grand historical visions, reflects on the future, and possible lack thereof, of the European Union. Krastev departs from more common diagnoses of the Union's crisis as resulting from fundamental institutional flaws (e.g. the introduction of a common currency in the absence of shared fiscal policy), or from the Union's democratic deficit. Instead, he focuses on Europe's so-called migration crisis. The comparatively large numbers of migrants arriving in the EU, and the reactions following, have dramatically changed the nature of politics at the national level, politics that are not merely 'a populist riot against the establishment but a voter's rebellion against the meritocratic elites' (p. 14). As a result, key values and principles of the EU have come under serious challenge. This crisis, Krastev thinks, has the potential to become a critical juncture and the starting point of European disintegration.

In the first part of the book, Krastev shows how the migration crisis has exposed, and likely also reinforced, disagreements surrounding European integration. To begin with, the migration crisis has brought to the fore the more general crisis