Paul Wallace. *The Euro Experiment.* Cambridge: Cambridge University Press, 2015. 353 pp. $39.99, cloth, ISBN 978-1-107-10489-1.

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The Euro Experiment written by Paul Wallace, the European economics editor of *The Economist*, is the latest to tackle the question of the sources of the euro crisis and the best way to move forward. Witty and readable, with references ranging from Johann Wolfgang Goethe to *The Godfather* movies, the book provides a rich analysis that encompasses economic and political factors, noting how the latter can have an important impact on how the former is perceived and interpreted. Indeed, "a recurring pattern throughout was a failure ... to grasp and to respond to the multidimensional nature of the crisis" (p. 7).

The first chapter, "A Question of Survival," establishes the central argument that the euro crisis concerned six major issues: sovereign debt, banking, private debt, macroeconomic imbalances, economic governance, and the "interplay of national and European politics," specifically the presence of "rescue fatigue" in creditor countries and "austerity fatigue" in debtor countries (p. 10). Other works have also pointed to the multifaceted nature of what has been called the "euro crisis" and the "sovereign debt crisis," with the latter implying that the root cause was limited to a single source. Early work, such as that done by Jay C. Shambaugh, had identified three crises (sovereign debt, banking, and growth), and explanations quickly expanded, with academics and journalists offering a myriad of reasons.[1] The main point of agreement was that the so-called sovereign debt crisis was about much more than sovereign debt.

One of the critical differences between these explanations is the extent to which the authors contend that the euro area's design is at fault. Martin Sandbu has persuasively made the case that although the design of euro area governance was not optimal, the inadequate policy response of the euro area governments is to blame for the ongoing crisis. This has important policy implications regarding the most effective reforms for euro area governance and its long-term sustainability. Wallace's book asks whether the crisis could have been handled better, citing European Central Bank (ECB) President Mario Draghi's contention in 2014 that the policy measures undertaken by the euro area had not been sequenced properly, leading to a weaker economic performance than what occurred in the United States. The book also considers other counterfactuals but nevertheless concludes that the euro itself had contributed to the onset of the financial crisis and to the weakness of its recovery afterward.

The book's major strength is that it is comprehensive, perhaps a natural outgrowth of the choice to identify so many causes of the crisis. This can mean that the book at times covers territory that is very familiar to most readers who have already studied the subject. For example, chapter 2 argues that the architects of the euro ignored economic theory (specifically optimum currency area theory) and historical precedents that had monetary union coming after political union. While well done, this material does not differ substantially from other treatments of the same topic. Some recent scholarship, including Kathleen R. McNamara's essay "Forgotten Embeddedness: History Lessons for the Euro," has questioned the utility of optimum currency area theory for explaining the euro's troubles.[2] Additionally the political economy perspective of the book could have been strengthened by giving more consideration to challenges of the conventional wisdom. While academics and researchers would enjoy the thorough analysis of the crisis, *The Euro Experiment* would be of particular benefit to students, policymakers, and those with a more general interest in the crisis. The pacing of the book is brisk and it does not get too bogged down in theoretical debates. Even without a prior knowledge of the economics or politics behind the crisis, readers should be able to follow the major arguments and understand the progression of the crisis.

Rather than devoting a chapter to the six causes of the crisis, the book takes a more linear narrative, explaining first the construction of the euro and its inherent weaknesses (chapter 2) and its relatively successful first decade (chapter 3) before analyzing the crisis evolution in Greece (chapter 4) and the famous "vicious circle" between banks and their sovereigns that plagued euro area economies in the periphery (chapter 5). In doing so, Wallace covers much of the ground implied by his original argument in the first chapter, but the analysis does not occur systematically. Reflecting the complicated nature of the crisis, the analysis weaves its arguments with a compelling empirical narrative that leaves the reader convinced that all of these factors played a role but without a strong sense of hierarchy or priorities for reform. And while *The Euro Experiment* considers other academic and policy-oriented analyses of the crisis, it does not attempt to refute works that would disagree with its own central arguments.

In addition to its narrative of the evolution of crisis, the book offers its own take on some of the important issues regarding the future of euro area governance. The participation of the International Monetary Fund (IMF) in the troika of bailout creditors has long been controversial for reasons ranging from its democratic accountability to the quality of its policy recommendations. An internal IMF report criticized the handling of the Greek crisis, depicting an IMF that bowed to political pressure to change its internal lending criteria to allow for the Greek bailout.[3] IMF Managing Director Christine Lagarde defended the IMF after the release of the report, saying "'I do not accept the premise of the recommendation, which the IEO [Internal Evaluation Office] failed to establish in its report, and thus do not see the need to develop new procedures.'"[4] Wallace, however, cites a *Wall Street Journal* article in which Lagarde is more cognizant that "we violated all the rules" and argues that this resulted in a euro area rescue that was "'flimsy as well as insufficient'" (pp. 95, 96).

Another important player of the sovereign debt crisis is the ECB. While it became a much more prominent institution during the crisis as its formal powers expanded (it became a member of the troika as well as the banking supervisor for the euro area), the ECB's actions during the crisis can be understood better in the longer-term context of its development. Wallace provides a useful explanation of how the emphasis on such indicators as price stability and public finances masked weaknesses in banking supervision and the credit boom in the periphery. He argues that the ECB was hampered both by its "standard monetarist thinking" and its lack of supervisory authority that would have allowed it to sanction banks (p. 121). As the crisis evolved, the ECB emerged from its initial "reactive and hesitant" responses to the euro area's troubles to become the euro's savior (p. 175). Given the potential conflict between remaining true to its mandate to gear monetary policy toward price stability and the need to rescue the euro, the ECB's initial response to the crisis under the Securities Market Programme (SMP) was inadequate for both tasks. For the purposes of monetary policy, SMP was "tortuous" (p. 179), and speculation continued as the euro area periphery became vulnerable to sudden stops of capital flows. The ECB continued to raise the stakes through its long-term refinancing operations (LTROs) and finally through the Outright Monetary Transactions (OMT). With the support of German Chancellor Angela Merkel, Draghi successfully isolated the German Bundesbank's objections to OMT. This has deep political implications, as the Bundesbank wanted to allow for the possibility of governments and citizens to decide that the euro is reversible while the ECB used all of its policy tools to maintain its integrity.

Wallace's conclusions regarding the future of the euro are not optimistic (the final chapter is titled "Debtors' Prison"). History provides limited guidance for policymakers searching for a way to avoid a potential euro area breakup that could dwarf the impact of the global financial crisis, as earlier examples of monetary unions (and their breakups) differ from the euro area. He also refers to the "half-hearted" banking union in which "the original three pillars became one-and-a-half" (p. 138). Given that banking union is the cornerstone of the euro area's governance reforms and has been identified by numerous analysts as the key to its ultimate success, such skepticism (though warranted) is deeply unsettling. Similarly, the book notes the modest result of structural reforms thus far. These reforms have been politically divisive and can take up to a decade to show results, which does not bode well for policymakers trying to appease national electorates and European partners simultaneously.

In summary, *The Euro Experiment* provides an excellent overview of the causes and handling of the sovereign debt crisis. It grounds its analysis well in recent history and contextualizes the problems that arose both economically and politically. It deftly switches between academic theories and policy-oriented plans for resolving the euro crisis. While it is theoretically informed and ably cites relevant economic theories, the book itself does not contribute to the development of these theories. It is focused narrowly on the euro crisis and does not do a lot to extrapolate from more generalizable lessons that could be gleaned about crises in general.

Notes

[1]. Jay C. Shambaugh, "The Euro's Three Crises," ***Brookings Papers on Economic Activity*** 44, no. 1 (Spring 2012): 157-231; Richard Baldwin and Francesco Giavazzi, eds., ***How to Fix the Eurozone: Views of Leading Economists*** (London: Centre for Economic Policy Research, 2016); Michele Chang and Patrick Leblond, "All In: Market Expectations of Eurozone Integrity in the Sovereign Debt Crisis," ***Review of International Political Economy*** 22, no. 3 (2015): 626-655; James A. Caporaso and Martin Rhodes, eds., ***Political and Economic Dynamics of the Eurozone Crisis*** (Oxford: Oxford University Press, 2016); Martin Sandbu, ***Europe's Orphan: The Future of the Euro and the Politics of Debt*** (Princeton, NJ: Princeton University Press, 2015); and Joseph E. Stiglitz, ***The Euro:***

And Its Threat to the Future of Europe (London: Allen Lane, 2016).

[2]. Kathleen R. McNamara, "Forgotten Embeddedness: History Lessons for the Euro," in *The Future of the Euro*, ed. Matthias Matthijs and Mark Blyth (Oxford: Oxford University Press, 2015), 21-43.

[3]. Independent Evaluation Office of the International Monetary Fund, "The IMF and the Crises in Greece, Ireland, and Portugal," July 8, 2016, http://www.ieo-imf.org/ieo/pages/CompletedEvaluation267.aspx.

[4]. Arthur Beesley, "IMF Swayed by Politics during Eurozone Crisis, Say Inspectors," *Financial Times*, July 28, 2016.