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Mody's 'Euro tragedy': the counter story

Miguel Otero-Iglesias

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Miguel Otero-Iglesias | Senior Analyst at the Elcano Royal Institute, and Professor at the IE School of Global and Public Affair | @ miotei

Index

Abstract[1]

This is a long and dissenting review, in nine acts, of Ashoka Mody's book *EuroTragedy: A Drama in Nine Acts*. It is based on a political economy approach, generally absent in the book. Mody's work can be added to 'The euro: it can't happen, it's a bad idea, it won't last' literature. It presents some fair criticism of the single currency and how the Eurozone authorities have (mis)handled the past crisis, but overall it is too one-sided in its dramatisation of the euro's history, overlooking key events and the developments that first prompted the introduction of the euro and then made the euro stronger over the years. While Mody thinks the euro is economically illogical and therefore should be discarded, with Germany being the first country to leave, there is a strong consensus among political and business elites –and economists and political scientists on the continent– to retain it. Furthermore, after 20 years public support for the single currency is at its highest ever. There is no attempt by Mody to explain this, which is a pity because overall Mody makes the valid point that for the euro to survive it needs a legitimate political authority to sustain it. The problem is that he thinks that Europe cannot move forward, so he wants it to go backward.

[1] I would like to thank Nicolas Véron for reading the whole text and providing valuable comments and suggestions.

Preamble

I was at first reluctant to read Ashoka Mody's *EuroTragedy*. I knew his opinions on the European single currency from following him on Twitter, and I was not sure I wanted to read yet more 'euro-bashing' from a scholar based across the Atlantic. I still remembered the pain of reading Joseph Stiglitz's *The Euro: How a Common Currency Threatens the Future of Europe*. But as a scholar of the euro you need to read everything that is relevant to the subject and Mody's credentials cannot be doubted. He is currently Charles and Marie Robertson Professor in International Economic Policy at the Woodrow Wilson School at Princeton University and was previously Deputy Director at the IMF's Research and European Departments, being responsible, among other things, for the design of the Irish financial rescue package of 2010-11. Thus, in principle, he is certainly knowledgeable about the workings of European monetary union.

The book also received many positive reviews. *Foreign Affairs*, *The Economist* and the *Financial Times* (publications that are often on my screen) considered it one of the best books of 2018, and as we are now celebrating (or lamenting, depending on where one stands) the 20th anniversary of the single currency, I thought it would be good to drop my prejudices and engage with Mody's nine-act tragedy. Since the book is organised as if it were a play, I decided to follow suit and treat it like drama. Hence, the review is necessarily long, but aims to give the reader the chance to follow my train of thought as I soak in Mody's story, which is intense and therefore very rich in detail and consequently deserves in-depth dissection. I believe this review can be useful not only for Eurozone scholars, experts and policymakers who have already read the book (quite likely since it is over a year old) but also for those who intend to read it. I think such a structure is also useful for students of European monetary integration. I will certainly ask the students at my courses on the subject to read the book (or at least certain passages) and then give them this working paper review so that they can see that it is possible to have two very different, and sometimes opposing, analyses of the same socio-economic and political phenomenon.

Introduction

While reading the introduction, I discovered early on that this would be another tome in the long list of works written by US (or US-based or educated) scholars and pundits that consider the euro's creation economically irrational. Lars Jonung and Eoin Drea put it magnificently in a 2009 paper titled 'The euro: it can't happen, it's a bad idea, it won't last. US economists on EMU, 1989-2002'. Interestingly, 30 years on (1989-2019), the list keeps growing, and Mody's book is the latest addition to the 'euro-doom' tower of scholarly work.

Another striking aspect is the missing parts. There is no engagement whatsoever with key concepts of the international political economy literature that has studied international monetary affairs for over 40 years, such as 'international monetary power' and the 'dollar weapon', also known in the economic literature as the 'dollar shock' (see my work on this). According to Mody, the creation of the euro was strictly an endogenous affair, without considering important, for some decisive, exogenous factors such as US dollar hegemony. As Randall Henning has wonderfully explained in his essential 'Systemic conflict and regional monetary integration: the case of Europe', the creation of the euro is above all a defensive move by the Europeans against the monetary power (including the dollar weapon) of the US. There is a strong consensus in the international political economy literature on the subject, with Benjamin J. Cohen –who has done the most to develop the concept of international monetary power over the years– in the lead. But even non-IPE scholars, who have chronicled the evolution of European monetary integration over the past decades, like David Marsh, include the US factor. It is striking that Mody does not.

Mody argues that there were no good economic or political reasons to create the euro and dismisses oft-cited arguments such as the common agriculture policy (CAP). He writes that this was not the reason for creating the euro because it was not written in any official documents. But this is misleading. With the erosion of the Bretton Woods system in the late 1960s, and the ultimate repudiation of it by the US in the 1970s, exchange rate volatility became the norm, so what the CAP needed was to have stable exchange rates. This explains the European obsession with the snake in the tunnel and the European Monetary System and the Exchange Rate Mechanism (ERM). Mody also says that the (irrational) fear of competitive devaluations could not be a reason, because that was not written in any of the documents either. However, one wonders whether the memory of the drama of the devaluations in the 1920s and 1930s was still so strong in the 1960s and 1970s that policymakers did not have to make a written reference to acknowledge its negative consequences. As Barry Eichengreen, perhaps the most renowned monetary historian of our times, has pointed out:

> 'Europe, not the United States or Japan, was where floating currencies had been associated with hyperinflation in the 1920s. Europe was where the devaluations of the 1930s had most corroded good economic relations' (p. 150).

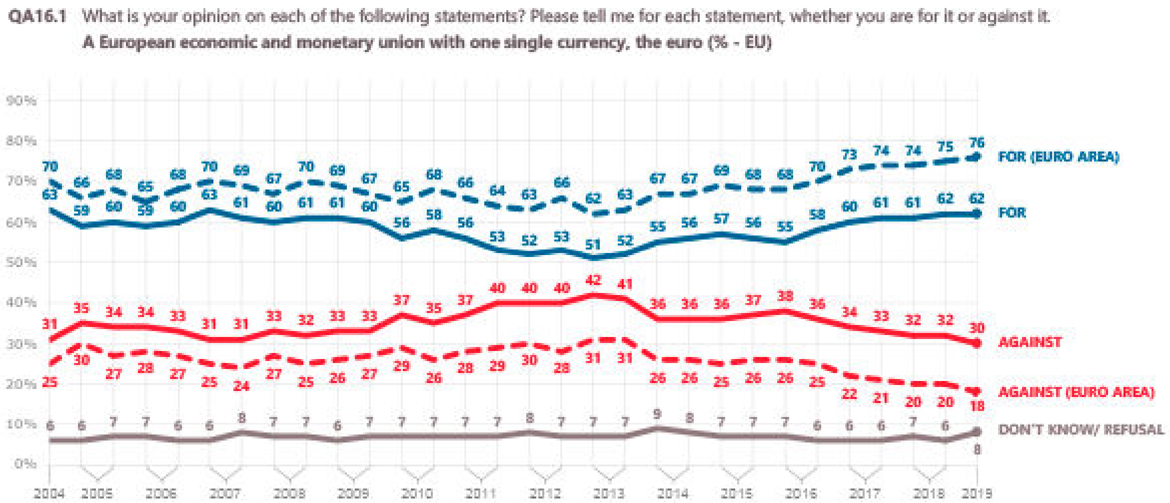
In describing the reasons for further monetary cooperation in Europe, apart from, of course, pointing to instabilities from the dollar area, Eichengreen also highlights that 'the desire to avoid jeopardizing the CAP, whose administration would be complicated by frequent and sizable exchange rate movements, was a source of support for the Werner Report' (p. 151).

In finding logical reasons behind the creation of the euro, Mody also overlooks the desire of many peripheral countries, even France, to buy Germany's price stability culture. Here the essential book is Kathleen McNamara's *The Currency of Ideas*, which explains how in the 1980s and 1990s there was an emerging consensus among central bankers that the Bundesbank model was the one to follow and that it therefore made sense to regain part of the monetary sovereignty by creating a supranational central bank, thus having a seat at the table. Marsh (2011) refers to this as the way to overcome the 'tyranny of the Mark'. In the same vein, there was also a strong desire in Europe, especially in France, to restrain or tame German power. This, again, is well explained not only in Marsh's account but also in other works by well-known political economists and experts in EMU like Amy Verdun, and especially Kenneth Dyson and Kevin Featherstone in their fascinating *Road to Maastricht*. Helmut Kohl himself agreed with this taming strategy, as explained more recently by Thomas Klau.

At this point, when I had not even reached the first act, I was realising that Mody had overlooked most of the political economy literature that had been written on the euro in the past 20 years. I went straight to the bibliography and discovered that Henning and Marsh and Dyson and Featherstone were there but after checking the passages quoted I realised most of their references were marginal to Mody's story. I also discovered that there was no mention of Erik Jones, Mathias Matthijs and Mark Blyth, Waltraud Schelkle, Nicolas Jabko, Manuela Moschella or Michele Chang. One could say: 'it's not fair, Mody is an economist so he doesn't need to know the political economy literature on the euro'. That may be true, but then I checked for well-known economists, experts in EMU, and they were also absent from the bibliography. Big names like Guntram Wolff, Daniel Gros, Stefano Micossi, Isabel Schnabel, Sebastian Dullien, Nicolas Véron and Paul de Grauwe –for me the leading scholar on the subject, with a textbook on the Economics of Monetary Union that is in its 12th edition– were missing. Neither were there citations of important books on the euro written in recent years, like Pisani-Ferry's *The Euro Crisis and its Aftermath*, Martin Sandbu's *Europe's Orphan* and Markus Brunnermeier *et al.*'s *The Euro and the Battle of Ideas*. Even giants in the field like Tommaso Padoa-Schioppa is only cited once, and certainly not on account of his most important work on the euro. It is certainly striking.

What was also surprising in the introduction was to see that there was no mention of the popular support for the euro that, according to Eurobarometer, is currently at historic highs, as it was already when Mody was writing the book (see Figure 1). There was also no mention in the introduction of some of the most important institutional innovations in the architecture of the EMU since the euro crisis of 2009-10. Incredibly, the European Stability Mechanism (ESM), the European equivalent of the IMF, and the banking union were absent in the short summary of the book's key messages. It appeared that Mody was only focusing on the bad and not the good. Hence, having finished reading the introduction, I knew I was in for an 'interesting' play.

Figure 1. What is your opinion on each of the following statements? Please tell me for each statement whether you are for or against it. A European economic and monetary union with one single currency, the euro (% – EU)



Source: Eurobarometer, nr 91, Spring 2019.

Act 1: three leaps in the dark

The first act covers the history of European (monetary) integration from 1950 to 1982 and is mostly informative, and in the interest of space, and given that the most important acts are yet to come, it is better to move on quickly. However, two points need to be made. One is that Mody focuses much more on Franco-German (structural) tensions, overlooking their cooperation initiatives, and the other that he misses some of the key endogenous and exogenous factors that led to the euro, as explained above.

Act 2: Kohl's euro

Even though, as mentioned above, Mody misses out completely on US monetary power as a factor in creating the euro, this is a very interesting act on Kohl's decisive role in designing European Monetary Union. There are certain parts with which I agree completely. For example, when Mody criticises French and Italian devaluations in the 1970s and 1980s to keep up with German competitiveness, citing 'Milton Friedman's 1968 theorem that macroeconomic policy, especially monetary policy, cannot solve a country's fundamental economic ills' (p. 68). This is equally valid today and goes against those who have argued that Greece and Portugal should have left EMU to devalue their currencies.

Where I disagree with Mody is in his contention that the euro has not increased the interdependence of EMU member states. While the trade numbers are less impressive than many thought before the creation of the single currency, this is not the only interdependence that needs to be analysed. As I have explained at length elsewhere, it was the credit/debt interdependence that made the core of the eurozone put together the biggest financial rescue (Greece's) in modern history. Not only that, but I have also explained somewhere else that money functions as a language: it brings people together in many different ways and acts like a social bond. This partly explains why despite the pain in the south and the anger in the north, three quarters of Eurozone citizens support the single currency (see Figure 1 above).

I also disagree with the assumption that having multiple currencies in the single market would not be such a big deal because businesses can just buy insurance against possible exchange-rate risks. This might be true for bigger firms, but SME's do not usually have the know-how or even the resources to undertake financial hedging. There is also, of course, the power of being able to invoice contracts outside the eurozone in one's own currency. This is the benefit companies from the peripheral states now enjoy and that they would not have recourse to if they had their own national currencies. This would be true for Spain, for instance.

Then there is the controversial claim by Mody that there was never a quid pro quo between German unification and the creation of the EMU. In other words, when we tell this to our students in class, we are factually wrong. It is a fascinating issue, because it is possible that a myth has been created around this interpretation, despite the historic evidence pointing in another direction. I remember a few years ago at a European Union Studies Association (EUSA) conference that Andrew Moravcsik (also a strong critic of the euro) took a very similar line. He told me that the common view that Mitterrand had used the historic window of German unification to tie Germany to European monetary union was simply a lie.

So, in order to get the historic record straight I went back to my home library to look at the works of David Marsh (2011) and Kenneth Dyson and Kevin Featherstone (2003), who I knew had explored this historic moment in depth, and this is what I found. According to Marsh:

> 'There was never a formal bargain under which Germany gave up the D-Mark in return for unification. Mitterrand, by far the most powerful and resourceful politician among Germany's neighbours, knew by autumn 1989 that German unity was unstoppable; his aim was to manage it, not to hold it up. However, fusing of the two Germanys, and the birth of the single currency, are intimately intertwined. If unification had not happened, it is highly unlikely that France would have been able to persuade Kohl to agree the EMU timetable to replace the D-Mark by the Euro' (p. 133).

In a similar vein, Dyson and Featherstone write that when Mitterrand convened a special informal meeting of EC heads of state and government on 18 November 1989 (hence just nine days after the Fall of the Berlin Wall), his…

> '… intention was not only to placate domestic criticism of French activism [vis-à-vis the possibility of a powerful united Germany] but also to subject Kohl to pressure, to soften him up so that he would be more susceptible to French influence. There was no explicit discussion of German unification or any linkage to EMU. But the atmosphere was, from a French point of view, suitably uncomfortable for Kohl: and linkage was in the minds of Mitterrand and Dumas [then French foreign minister]' (p. 196, brackets added).

Further on, these same authors write that:

> 'Mitterrand viewed EMU as following the single European market and preceding political union [a longstanding demand by the Germans]. His strategic preoccupation was to establish parallelism between EMU and German unification… Right up to the Strasbourg meeting [when a concrete timetable for EMU needed to be agreed] he kept up the pressure, telling Kohl on the telephone that too great a preoccupation with inner-German relations at the expense of priority to European unification could lead to Germany's isolation. Three days before the meeting Guigou received from Bitterlich [both aides of President and Chancellor, respectively] the message that Kohl had no problem with fixing a date for the IGC at Strasbourg but that he would press for a delay of one year in order to clear the next German federal elections out of the way first. Though Mitterrand would have preferred an earlier date, he was prepared to respect Kohl´s domestic difficulties in order to ensure that the EMU negotiations were not later derailed. He had attained his prime strategic objectives – to bind Germany into EMU by setting a clear date for the IGC and to prevent conditionality of EMU progress with political union' (p. 198, brackets added).

Indeed, sometimes you need not to make an objective explicit in order to attain it. Mitterrand used German unification to achieve EMU without a political union first, and this latter point is very important and again overlooked by Mody. He is very harsh –and rightly so– on the German insistence on an orthodox framework for EMU based on 'sound money' and the full independence of the ECB, without acknowledging, as Geoffrey Ingham does in his analysis of the euro, that this orthodox construct was necessary to give credibility to a currency that would not have a political union behind it, because the French resisted such a move. The blame in this case should go to the French rather than the Germans. In any case, the stability culture was not just a German notion. It was the period's zeitgeist, as McNamara (1999) has documented.

Interestingly, Mody does not take into consideration that France had long lost its monetary sovereignty to the Bundesbank and the City of London. This is a story well told by Nicolas Jabko. It was this understanding and the reluctance to submit to a political union, that convinced the French elites to accept the 'sound money' ideology from Germany.

I also disagree with Mody's idealised view that the 'no bail-out' provisions for regional states in the US went smoothly after the 1840s balance-budget amendments and that this should be the model adopted by the Eurozone. As indicated by researchers at the Peterson Institute for International Economics, US history actually shows that financial instability was pervasive in the free banking period of the second half of the 19th century and it only stabilised with the creation of a central bank, a banking union and a large federal budget to overcome asymmetric shocks and function as a macroeconomic stabiliser in the 20th century.

What is interesting from Mody's account is his focus on the French referendum on the Maastricht Treaty in September 1992. As is well known, 'yes' won by a very small margin. He shows that the disaffection with the system has many parallels with the discontent of today. Back then high unemployment pushed the lower classes to use their anger against Europe to punish their elites. Here, Brexit comes to mind.

Finally, Mody finishes this act by claiming that 'when it came down to it, a small group of European leaders had decided that Europe should proceed with such an "incomplete monetary union"' (p. 92). This gives the impression that the project was the obsession of a small group of politicians. However, as Dyson and Featherstone and especially Verdun and McNamara have shown, there were many officials involved and business associations and even trade unions were also actively in favour. The same goes for the IMF, which as an external –supposedly neutral– and technically-equipped actor should have known whether the euro was the folly Mody believes it is, European influence in this institution notwithstanding.

Act 3: Schröder asserts Germany's national interest

There was much in this act that I liked, starting by the acknowledgment (and the deserved criticism perhaps) that for too much time the EU, and previously the European Economic Community (EEC), was too lenient with Greece and provided consistent financial assistance to the tune of between 3% and 5% of Greek GDP in the 1980s. Thus, 'instead of acting as an anchor, Europe, in effect, licensed irresponsible behaviour' (p. 132). But here again, geopolitics always played a role. In the midst of the Cold War, and even now, no-one in Brussels –and certainly not in Paris, which has a much more geostrategic mind-set than Berlin– wants Greece to drift east towards Russia and China.

In any case, Mody's critique of the widespread corruption in certain countries such as Greece and Italy is totally justified and an issue that points more to domestic problems rather than to the euro per se. What is also interesting is how many (bad) old habits are repeated. In fact, in the recession of 2000/1, the response to the crisis was also austerity in Europe, and this time it was Germany that was doing it at home. Back in 2001, as occurred ten years later in 2011, austerity generated even greater public deficits in 2002. Here too France resorted to fiscal stimulus and the US used an aggressive fiscal and monetary policy: a mirror image of what happened in the aftermath of the global financial crisis. Mody reminds us how 'the whole idea of punishing a country in distress was absurd', and in an interview with the French newspaper *Le Monde* on 18 October, Prodi stated the obvious: 'I know very well that the Stability Pact is stupid, as are all rigid decisions'. Prodi added that the 'SGP needed to be intelligent and flexible' (p. 146). Here I must agree with Prodi, and Mody.

Ironically, at that time it was the Germans (in cooperation with the French) who had realised that more flexibility was needed and that the rules of the game needed to be changed. This passage of Mody's is worth reproducing.

> 'On November 17 [2003], Eichel [the then Finance Minister of Germany] made one final plea for economic good sense. A senior European leader has never since made a clearer and more cogent public statement on the fundamental problem with the SGP. In an opinion piece for the *Financial Times*, Eichel explained that the German authorities had made every effort to rein in their fiscal deficit. Despite those efforts, the deficit had continued to widen because the economy was stuck in extended recessionary conditions. Eichel rightly insisted that more austerity would be counterproductive' (p. 150).

This reminds me of the plea of many Italian politicians over the past few years. What was valid then for Germany should be valid for Italy now too.

Another interesting (and for me new) aspect of this act is Mody's critique of Schröder's nationalism in respect of protecting Volkswagen from possible foreign take-overs. By doing so he 'legimitized the idea that countries would protect their "national champions" from the discipline of financial markets' (p 154). Yet again, this is another example of how German fetishism in market discipline can be selective. It works on others, but when it comes to German interests, there can be exceptions.

Act 4: irrational exuberance

The fourth act starts with a critique of Tommaso Padoa-Schioppa, because in 2004 –during the years of euphoria– he praised the ECB and said that the European banking system was sound. This is harsh on someone who devoted his life to European (monetary) integration and had one of the sharpest European minds in understanding the flaws of the US dollar-led international monetary system and, therefore, why a single European currency was necessary to overcome dollar shocks. See, for instance, one of his latest contributions before he died. Of course, Padoa-Schioppa was a staunch defender of the euro (see here) and perhaps that is the reason why Mody does not engage with his work.

Overall, in this act it becomes obvious that Mody is a clear advocate of what the varieties of capitalism literature would call the liberal market economy (LME) model without considering the positive parts of another quite successful model: the coordinated market economies. It is striking that Mody presents the US economic model as a role model, when it was the epicentre of the crisis. There is much critique of the size of the European banks in the first years of the new century, but finally it was the US financial system that collapsed first. Generally, the CME model based on cooperation between the different economic agents, the insistence on a stakeholder rather than a shareholder culture and the emphasis on dual vocational training and so on seems to be a better socioeconomic system, as even many economists and pundits in the US acknowledge. In hindsight it is really not that obvious that the response to the crisis was much better in the US (or the UK for that matter) than in the Eurozone. The key was rather that the latter did not have the institutional governance structures in place to deal with a crisis of such calibre. Donald Trump and Boris Johnson are not simply an accident, but rather a reflection of deep structural problems in the flagship LME economies. The big difference is that they cannot blame the euro for their ills.

Arguably, the median European has a better standard of living than the median American (and this is even valid for so-called peripheral countries such as Italy and Spain) so the insistence by some that the Eurozone needs to follow the US model is certainly striking.

Talking about Spain, Mody does not even mention the counter-cyclical provisions imposed by the Bank of Spain, which were a frontrunner for today's macroprudential regulation. See the book by Jesús Saurina and Carlos Trucharte. Neither does he remember that in February 2005 Spain voted in a referendum overwhelmingly in favour of the European Constitution. But, again, this would not fit his overall argument that the euro and the dream of a more federalised union is something that only the elites want. Here Paul De Grauwe is mentioned (his name is not in the bibliography) but only to say that he found out that after the French and Dutch 'noes' to the Constitution, the political integration needed to make EMU work would be more difficult. This is a minor reference to someone whose work has been ground-breaking in EMU studies. Of course, how the French and Dutch referendums were intoxicated and misled by the 'no' camps lying about the 'very likely' entry of Turkey in the club is also overlooked.

Act 5: after the bust

I do not have many notes on this act as I imagine I enjoyed and agreed with most of it. The criticism of the ECB's rate hike in July 2008 is certainly well deserved. Mody also does a good job at explaining Greece's internal problems before the crisis hit in 2009/10.

Act 6: delays and half measures

Where I disagree on many points is in this act. Here we are entering the depths of the euro crisis and Mody makes a number of sweeping statements. This is the first: 'The euro would unify Europeans, its proponents had promised. Instead, the euro was creating bruising divisions between the German and Greek people' (p. 244). While, of course, there was much animosity at the peak of the crisis, Mody overlooks the fact that the Greek rescue was the biggest in the history of modern finance. He also oversimplifies the complexity of the matter as there were stark divisions within Germany and Greece, which are not monolithic societies. There were many people that were in favour of greater solidarity for Greece in Germany, and there were also many Greeks that understood and even encouraged a tough approach from other European leaders vis-à-vis Greece's, especially when Syriza rose to power.

What is also striking about Mody's account of the Greek crisis in 2010 is that most of it derives from US newspapers like the *New York Times* and the *Wall Street Journal* and US (and British-American) experts like Barry Eichengreen and Simon Johnson. There is no doubt that these are highly respectable sources, but one wonders whether it would not have been better to also look at European newspapers (lack of linguistic skills can no longer be an excuse since the most prestigious –*Der Spiegel*, *Le Monde*, *Il Corriere della Sera* and *El País*– have English-language editions) and European-based experts like those cited in the introduction to this paper to understand the complexities on the ground. Throughout the book the feeling is that the euro project is best understood from Washington, New York and London and that is puzzling.

Mody brings in important European voices, such as Joschka Fischer's, who in this period was very critical about Angela Merkel's hard-love attitude and encouraged her to help Greece for the common good. But, again, Mody is categorical. In his words:

> 'Fischer's vision of a progression to European federation was a fairy tale. European leaders had rejected the possibility of a European federation immediately after French Foreign Minister Robert Schuman had first proposed it in May 1950. Since then, every brave proponent's latest plan for a European federation had been spurned quickly' (p. 248).

The assertion that the Europeans do not want a federal state is common among Anglo-Saxon (and even some European) commentators but as I have argued elsewhere the evidence is not conclusive. It is difficult to know what Europe's citizens really want. Depending on the survey and the questions asked, the results can lead to different conclusions, and in many areas it seems clear that they want the EU to take on more competences, as explained by Silvia Merler *et al*. What is clear is that in Spain in particular, the support for a federal union is consistently strong, both amongst the elites and the people in most of the surveys conducted by the Elcano Royal Institute. Nevertheless, Spain may well be an outlier.

All along, while explaining the Greek crisis Mody defends the notion that Greece should have restructured its debt from the beginning and he insists that the fear of contagion was unwarranted. To back up his point he reminds us that in the midst of the chaos 'At an FOMC [Federal Open Market Committee] meeting in Washington, Nathan Sheets told anxious committee members that there was no evidence of "wake up call" contagion from Greece. Greece's problems were not causing investors to "tune in" to the debt problems of a large number of eurozone governments. Irish and Portuguese troubles were homegrown; Spain and Italy remained insulated' (p. 252) Again, it is fascinating to see how Mody again relies on US analysis and is very selective with his sources. I followed events very closely on the ground because I was engaged at the time in my PhD on the euro and my recollection of events is very different. As a matter of fact, as Nicolas Véron has pointed out to me, even American policymakers like Tim Geithner warned about contagion.

The political economy of the time is completely absent in Mody's account. The bankruptcy of Lehman Brothers and its spill-over effects had been an authentic trauma in Europe and many key policymakers and experts would point to that experience when discussing a possible Greek default. And then there was a widespread fear that if Greece were to benefit from a debt cancellation, Ireland, Portugal and Spain would request the same, with Italy then following suit. The fear was not exaggerated, as Mody would like us to believe. The Spanish left (which later became Podemos) wanted it and Grillo, leader of the Five Star Movement, wanted it too. I remember attending many meetings where people (of which I was one) asked for a Hamilton moment of debt mutualisation. This scared many key business players, especially the banks, which had a large volume of the debt on their balance sheets and, of course, policymakers from the continent's north who feared they had to foot the bill.

It is almost unbelievable that throughout his explanation of the Greek crisis, Mody does not write a single line on the spread of contagion to other Eurozone countries. This is just distorting the facts. He believes that the following words by the US executive director Meg Lundsager, when justifying the extraordinary IMF support for Greece, were just an exaggeration: 'The potential for even more damaging spillover to other European economies and financial sectors is clear and demands a swift and decisive response'. But they were not: in Spain we all remember how already in May 2010 the Spanish Prime Minister, José Luis Rodríguez Zapatero, had to effect a U-turn in his left-leaning social programme and start cutting expenditure because of the pressure of the markets and of his European peers. Of course, this very important moment in one of the biggest countries in the Eurozone is overlooked by Mody. So are the tensions that Italy was experiencing during that time, not to mention those in Ireland, the next country to fall.

Mody's obsession is to point out that the euro had created more division than unity, as shown in another extract: 'The Greek crisis and the way it was handled aroused unrestrained public aversion. Antagonism between horrified Germans and Greeks steadily increased. For Germans, Greeks were lazy and incompetent; for Greeks, Germans were bullies. The sense of European identity and common destiny eroded' (p. 264). The deep scars it left is a line that many commentators repeat, but the fact is that the euro crisis showed that the Eurozone has become like a family. Families do not get along well all the time. On the contrary, they fight, and they even stop talking to each other. Many Germans were not bothered when some of their money had to be spent in Hungary or Ukraine (they were considered simply 'neighbours'). But they were angry when the same had to be done with Greece because they saw the latter as a member of the family, and it is always hard to hand money out all the time to a family relation: it shows that he cannot stand on his own two feet and that you are partly responsible for the dramatic situation.

Taking the family metaphor further, it is also easier to understand why not only German but also other northern European countries' policymakers demanded that Greece impose austerity and reform programmes. Again, here Mody mentions that the Slovaks were particularly tough, but most of his criticism is directed towards Germany, when we now know that the Dutch and the Baltics were just as harsh, as were the Finns, who demanded extra collateral for their financial help. Hence, this is certainly not just a story of the Germans against the Greeks. Many other cousins in the family told the Greeks off.

But eventually there was solidarity. Yes, Germany agreed to rescue Greece because it was the way to rescue the German and French banks that had massively lent to Greece, but historically speaking the aspect to highlight is that with the creation of the European Financial Stability Facility (EFSF) and later with the permanent European Stability Mechanism (ESM), Germany crossed its Rubicon. For the first time it agreed to pool common resources. This is completely ignored by Mody.

Another controversial assumption by Mody is that the Deauville agreement to automatically restructure debt in case of a bail-out did not spook the markets. He writes: 'On the ninth day after the Deauville decision, Greek bond yields were back to where they were nine days before the decision, Irish bond yields moved in a narrow range during this time window, and Portuguese yields actually fell. Spanish and Italian yields barely moved. Put simply, Deauville did not spark panic or contagion' (p. 277). This is true of the first few weeks, although due to the fact that the headlines of that October 2010 summit were concentrating on how Germany had given in to France (again an angle missed by Mody) by not imposing automatic sanctions for countries that would not follow the Growth and Stability Pact and by agreeing to have a permanent ESM. The effects of Deauville were noticed later, or at least that is what I heard from many French bankers and treasury officials from Spain and Italy at numerous meetings. See also the book by George Papaconstantinou, the former Greek finance Minister, on this. It must be borne in mind that Greece's debt restructuring, based on the Deauville spirit, came only in 2012. It is also important to highlight that the effect on the bond markets was limited after Deauville because the ECB was intervening with its Securities Market Programme (SMP).

Where Mody is right is in pointing out that over the period 'austerity' had become part of the Eurozone's identity and this was highly problematic because, as Mark Blyth has well explained, the Eurozone fell into the fallacy of composition of all countries cutting down on expenditure at once. Nonetheless, it needs to be said that over the period this was not only imposed by the north on the south, as many commentators have repeated ad nauseam. At the end of 2011, in Spain, the conservative Popular Party (PP) gained an absolute majority on a programme based on putting the 'public accounts in order' and being an 'austere government'. Democracy sometimes holds these surprises.

Act 7: policy wounds leave scar tissue

Of course, the Spanish case is interesting because it certainly did not cut public expenditure as deeply as countries like Greece and Portugal, and this is presumably why it did not have an equivalent fall in GDP. As Mody, citing Olivier Blanchard, points out: 'The historical record for public debt reduction suggests that a gradual, sustained approach supported by structural changes offers the best chance for success within today's constraints' (p. 288). It could be argued that this is exactly what Spain did.

Mody is also more than justified in criticising the two ECB rate hikes in 2011. They were perhaps the ECB's biggest mistake in its crisis management. However, in this section it is surprising that Mody does not mention even once the debate on the effects of the quantitative easing policy adopted by the Fed. It is important to understand the mentality and psyche, the zeitgeist, of the moment, and in 2010 and 2011 there was much criticism against QE not only from German conservatives such as Wolfgang Schäuble but also from policymakers in the BRICS. This led the Brazilian Finance Minister Guido Mantega to denounce that we were in a currency war. Mody does not include any of this in his analysis, despite the debate being crucial. In Europe the view was that the Fed's unorthodox policy was reckless and for years the ECB was reluctant to try to devalue the euro because it did not want to further fuel the currency wars between the US and China. As explained elsewhere, during the period the Europeans were trying to play by the rules.

Mody also omits the tough battles that Jean-Claude Trichet had to fight within the ECB. Many commentators tended to criticise Trichet for being too orthodox and German during his mandate, but one needs to understand the opposition that he faced with people like Axel Weber, the President of the Bundesbank, and especially Jürgen Stark, the German executive member and chief economist at the ECB. Only once these two hawks were pushed aside (and I am sure Trichet helped in this endeavour) was the ECB ideationally and institutionally capable of undertaking the bold measures that came with Draghi in 2012.

Furthermore, throughout his analysis of the ECB's policy during this time, Mody overlooks the 'game of chicken' that the ECB was playing with the member states. The ECB, especially with Draghi, had become a strategic player, as explained by Randall Henning, following a specific sequencing order. It would only help if the member states would take further steps in pooling sovereignty at the centre of the union. SMP, as stated by the letters to Rodríguez Zapatero and Berlusconi, would only be activated if Italy and Spain implemented the required reforms, the LTRO programme only came once the member states agreed on the Fiscal Compact and later Draghi's 'whatever it takes' speech and OMT only came once the member states agreed to form a banking union, see for example Herman Van Rompuy's account of these dramatic moments. Of course, such a blackmail-tainted tactic can be criticised as illegitimate, and Mody is justified in doing so, but the truth is that the ECB was the only federalising agent in town.

What is certainly extraordinary is that Mody does not even mention the June 2012 summit that brought about the banking union. At this point of his EuroTragedy it did not come as a complete surprise. It had become obvious that Mody was overlooking some of the key institutional changes that make the euro a more robust project, but not mentioning arguably the most important political decision to keep the euro alive is certainly telling. I remember that until that decision came, I was considering transferring my savings and those of my parents out of Spain (the outflow of deposits from the south to the north of the Union was already considerable by then) but I stopped doing so immediately after that summit. That is how important the agreement was.

No doubt, the other big moment was Draghi's 'whatever it takes speech', but that was one month after the leaders had agreed on creating the banking union. Mody says that Draghi almost improvised the speech but, again, here I would disagree. He might have decided on the particular wording by himself but as Peter Spiegel has reconstructed, Draghi's charm offensive with Merkel was long in the making. Where I completely agree with Mody, and this is a point that needs to be underlined, is in emphasising that it was really Merkel –by supporting Draghi's OMT programme– who saved the single currency, not only the Italian's words and actions. I also agree with Mody when he argues that 'OMTs created a fiscal union by the backdoor. More precisely, they created a fait accompli under which some member countries could be forced to contribute fiscal resources if another member state was in financial distress' (p. 313). This has enormous distributive and legitimacy issues that Mody rightly stresses.

On the other hand, I need to disagree when Mody says that 'between 2011 and 2013, ECB policy worked mainly for Germany and other northern countries' (p. 320). This is factually wrong. The ECB policies helped the south enormously. As a matter of fact, most informed people in the Union's south see Draghi as a hero and think there should be statues of him on many city squares.

At this point of the play, Mody announced that so far he had only focused on the economics and that he would subsequently analyse the politics of the euro crisis. I became excited. It was obvious that in his dramatisation he had omitted the political economy. Perhaps this would change now. But not really. The first thing that Mody does is to strongly criticise the role of Angela Merkel throughout the crisis. He believes she lacked solidarity and empathy with the southern countries. This is deserved to a certain extent. But Mody overlooks the fact that in many surveys over the years Merkel was quite popular in places such as France and Spain, even during the crisis. Furthermore, even in this part of his political analysis Mody does not mention Merkel's two biggest concessions over the years: the establishment of the permanent EMS and the creation of the banking union, usually two German red lines.

Generally, Mody also overstates the anti-euro sentiment in Germany. The AfD started as an anti-euro party, but very soon it realised that being anti-euro would not get it too far and progressed to being anti-Islam and anti-immigration. The euro remains very popular in Germany, as the Eurobarometer shows. I am also unconvinced about Mody's interpretation of German President Joachim Gauck's February 2013 speech. Drawing on Mark Mazover from Columbia University (again a US-based scholar), Mody believes that Gauck had presented Europe with a stark choice: 'give up the euro; or keep it and see the political crisis spin out of control' (p. 337). I think this is a distortion of Gauk´s words (see here the speech). I repeat, no-one with real power in Germany, and certainly not after Brexit, not even the AfD, is calling for the end of the euro.

Act 8: the ECB hesitates

In this act the focus is on Italy and in many ways I agree with Mody's analysis about the country's problems, but again he is wrong in thinking that the situation would be better for Italy outside the single currency. The first thing that needs to be said is that Italy entered the euro not because of Germany's insistence. On the contrary, it was (apart from Italy itself of course) France, who felt that Italy would become a tough competitor outside the currency union, that was very keen to have the Italians on board. Later, in explaining the crisis, Mody insists that 'Italy's problem was the direct result of it being in the eurozone' (p. 342) and that 'while Germany was doing fine even at the elevated exchange rate, the euro was unbearably strong for Italy. For Italy to grow its exports, the euro's exchange value needed to be close to $1.00'. This might be true, but the fact is that Italy continues to be an export country with a current-account surplus, so there is more to the story than what Mody reflects in his play. Leaving the euro is certainly not the solution. Ironically, Mody quotes Luigi Zingales a lot when analysing Italy's problems, but Zingales himself wants Italy to stay in the euro.

On the broader discussion about whether the ECB should have a double mandate like the Fed, and that it waited too long to activate QE, Mody's arguments are certainly valid, but yet again he presents only one side of the story. The ECBs dovish rhetoric in 2014 was bringing the euro exchange rate down already, and this was helpful, not only for the north, but also for Spain and Portugal, which had embarked on an export-led growth recovery.

In general, in this act there is a contradiction between Mody's quite accurate analysis of Italy's structural problems and his criticism of European officials' obsession with structural reforms. One can debate which structural reforms are particularly necessary. Mody is correct when he writes that 'well-established international evidence showed that companies made little effort to train workers whom they could easily fire' (p. 366) Hence, making hiring and firing cheaper might not be the solution. But liberalising labour markets has also been the IMF's mantra for years, so the Washington based recipes are to blame, not the single currency.

Mody is right in the following:

> 'Especially in southern Europe, politicians have remained unwilling or unable to invest sufficient energy in setting up the infrastructure and establishing the incentives to expand educational and skill-development options commensurate with evolving international standards' (p. 368).

This is spot on but, again, Mody should not blame the euro. The same goes for the banking problems in countries such as Spain and Italy. Yet again, there are many problems with Mody's analysis. Here for the first time he mentions the banking union, but only to criticise it. Yet again there is a sweeping statement:

> 'The so-called "banking union" was not a "union". Each member state was still responsible for the costs incurred when closing down a troubled bank or merging it with another bank. No eurozone government was willing to finance cleaning up another member state's banking systems' (p. 371).

There are many problems with the banking union, the lack of a European Deposit Insurance Scheme (EDIS) being one of them, but Spain for instance received support to clean up its banking system and its restructuring programme ended smoothly. This is again overlooked by Mody.

Mody is right in castigating the European Banking Authority and its stress tests over the years, although a lot of the blame needs to fall upon the national supervisors too. He is also accurate in drawing parallels with Japan and the zombie banks. As analysed elsewhere, Italy essentially procrastinated even more, as Spain did for years, but again perhaps it would have been better to obtain a loan from the ESM, like Spain did.

Mody is also right in pointing out the risks that come with unorthodox monetary policies that were needed because of the lack of a fiscal union. As he emphasises, 'the ECB's bond purchases reached seven times governments' net bond issuance. In other words, for every euro of net new bonds issued by eurozone governments, the ECB bought €7 worth of bonds'. This is significant because 'If the Italian government defaulted on its bonds, the Banca d'Italia would need to draw on its capital and reserves to absorb 92 percent of the loss; all member states would share the other 8 percent of the losses' (p. 385). Ultimately, although the story is more complex than presented and progress has been made in achieving a more robust eurozone, I must agree with Mody on the following:

> 'The original conundrum remains. A single monetary policy for diverse countries cannot operate effectively without a mechanism to share risks in crisis conditions. Eurozone leaders cannot agree to a risk- sharing mechanism based on a democratically legitimate political contract. Under pressure during the crisis years, they agreed on technical arrangements to share risks. These arrangements can be undone politically at an inopportune moment' (p. 385).

Having said this, usually European leaders tend to deepen EMU in crisis moments, so the last sentence could also be interpreted in a positive way. I must thank Nicolas Véron here again for pointing this out to me.

Act 9: the final act

This is the final act of Mody's euro misery story, and he does not pull any punches. Again, while in some instances he is correct, in others he is wrong. He states, for instance, that 'since the onset of the global crisis in 2007, no eurozone economy has performed better than Japan did in its "lost decade"' (p. 391). This might be true nominally speaking, but the levels of well-being in countries like the Netherlands, Germany, Finland and Austria are extremely high even today. Mody might be right that Europe is falling behind Asia in growth, R&D and innovation, but would the break-up of the euro really change this dynamic? I do not think so.

It is certainly fascinating to read that Mody believes that maintaining the euro goes against any economic logic, especially for countries on the periphery like Spain, but the entire mainstream of Spanish economists thinks otherwise. One wonders again who is right and who is wrong. If most experts and most Eurozone citizens want to retain the single currency, there must be a reason. Mody makes no effort to understand why.

Mody is, of course right when he argues that 'the deeper causes of the southern eurozone's low productivity growth lay in endemic institutional deficiencies'; he is also right that countries like Spain have seen their institutional governance fall in the last two decades, at least according to the World Bank Worldwide Governance Indicators (WGI), which is deeply troubling, but again the reason for this is not the euro. Mody recognises this by pointing out that 'the French who voted against Europe in the referendums and held their votes back from Macron were not necessarily anti-European; they were mainly trying to redirect the attention of French leaders back to the many domestic problems that Europe could not solve' (p. 405). One should not blame the EU and the euro for domestic problems, as it is something that populists like Matteo Salvini do.

Where I do agree with Mody is in insisting that labour market liberalisation and cheaper hiring and firing practices cannot be the only solution to our problems. As he puts it, 'creating job insecurity is easy, but compensating workers for heightened insecurity is always hard' (p. 407). In many ways this has happened in Spain. As Mody warns, 'the reforms also reduced employers' incentives to invest in their workers and, thus, increased the risk that Spain's productivity growth will remain low' (p. 411). Indeed, it would have been much better to compensate the necessary flexibilisation of the labour market with more investment in education and R&D and strive for a high-productivity and high-wages growth model. But, overall, Mody does not recognise the positive aspects of Portugal and Spain's recovery. He overlooks, for instance, the fact that the share of exports in Spain rose from 25% of GDP in 2007 to 34% in 2017. This is a massive structural change. Mody also overlooks the positive transformations in the Baltic economies. For instance, GDP per capita has grown in Estonia from US$14,000 in 2008 to almost US$20,000 in 2018.

Another important discussion that Mody tackles in this final act is the spread in the Target 2 accounts. Mody, like many other commentators, points to the fact that in 2017 and 2018 we again reached a record number in imbalances and this should be a cause for alarm. As is well known, the ECB has explained that these recent imbalances should not be confused with those of the 2008-12 period, which were due to capital flight. The recent period is dominated by the ECB's asset-purchase programme and the fact that many national central banks need to buy assets outside their domestic markets, and therefore there is a mechanical outflow of funds and an increase in Target 2 liabilities. See, for example, the letter that Mario Draghi wrote to the MEP Marco Zanni in May 2017. A deeper analysis by Karl Whelan in November 2017 for the ECON Committee of the European Parliament suggests that the ECB explanation is only true for Portugal, since Italy and Spain effectively had capital outflows.

However, he concludes that 'there is little reason to be concerned at these developments' (p. 5) because they show that Italian and Spanish creditors, especially banks, feel that they do not have to support their sovereigns as in the crisis years. This passage by Whelan is worth reproducing at length:

> 'The diversification of Italian and Spanish banks and investor portfolios away from their high concentration on domestic sovereign bonds is to be welcomed. Purchasing sovereign bonds of your own country is a poor hedge against risk for banks, households and firms: If your country suffers a crisis that could lead to you losing income or making losses on assets, then also being invested in the debt issued by the same country leaves you further exposed to the same idiosyncratic source of risk. So, the pattern of diversification observed over the past two years should, on balance, be viewed as a positive thing' (p. 19).

This is, indeed, a very different assessment than Mody's. It is also worth noting that during the period Spain has improved its net international investment position (NIIP) from -99.6% of liabilities in 2014 to -77% in 2019, and Italy from -24.6% to -2.6% over the same period. That is good news.

Mody is also very critical with the ECB's handling of the Grexit crisis in 2015. He denounces that 'on February 4, the ECB decided Greece's fate. In an aggressive move that took everyone by surprise, the ECB cut off funding to Greek banks, pre-emptively immobilizing the Greek government before it could begin negotiations with its creditors' (p. 416). Again, this is debatable, and it is certainly only one side of the story. Mody omits the radical stand by Varoufakis the week after Siriza won the elections on 25 January, and during the whole campaign before winning. The ECB took such a drastic decision for a reason. The Syriza government came to power with an agenda that would break with everything negotiated by the previous government.

One can argue that Syriza had a democratic mandate for that, and I was sympathetic at the time with some of the proposals put forward by Varoufakis, such as the GDP growth-linked bonds and I was certainly against kicking Greece out of the club, but there were another 18 democracies that needed to be respected, and their representatives were starting to get fed up. One cannot forget that Varoufakis threatened many times with defaulting and with debt cancellation for the whole south with the support of political forces like Podemos. People in many capitals and in the markets were frightened by this 'radical' scenario in the first half of 2015, and this led to a tough stand not only by the northern countries but also by southern governments like the Spanish one led by Mariano Rajoy. The political economy of all of this is completely overlooked by Mody.

Mody is also wrong in indicating that the Italian and the French governments sided with Varoufakis. This is not what happened. Varoufakis was alone in the Eurogroup. The French and the Italians were just the 'good cops' and the Germans and Spaniards the 'bad cops' in the pressure strategy. While is true that French officials tried to help the Greek government, they sided with the moderate Tsipras, not with the radical Varoufakis. The same goes for Juncker or Obama. They advocated a solution and argued strongly against a Grexit scenario, but fans of Syriza's tactics they certainly were not. There was much anger in Brussels and in many European capitals, and even in Washington, against Syriza at the time. As the IMF's Poul Thomsen, cited by Mody, said, 'If we were in the same situation, with the same information at that time, we would probably do the same again' (p. 420). This is something I heard from many European officials that negotiated Grexit over that time.

Not surprisingly, Mody ends his final act with a gloomy outlook: 'since it is almost certain that, over the next few decades, eurozone economies will grow at a slower pace than high-performing economies elsewhere, the share of trade with eurozone economies will decline and public willingness to support the eurozone financially will diminish' (p. 424). This will mean that 'any German leader will find it incredibly hard from now on to justify sacrifices for Europe' (p. 427). I would be cautious about claiming that German leaders will not fight, alongside France and other partners, for 'more Europe' and greater 'German leadership' and 'ambition' in steering the European integration project further. My analysis of the German political system tells me that in a world of great-power rivalry, the German political establishment and the German public know that having a stable neighbourhood and keeping the economic scale that comes with a single market of hundreds of millions of Europeans is quintessential to the survival of the German nation.

Scenarios and concluding remarks

Mody's book ends with possible scenarios. His favourite is to drop the federal obsession and go for 'A new European Republic of Letters, forged as part of a renewed commitment to competitive decentralization' (p. 462). The idea is to 'dismantle the economically counterproductive and politically corrosive system of administratively supervised fiscal rules and instead rely increasingly on financial markets to enforce fiscal discipline' (p. 437). By doing so the Eurozone member states would 'create egalitarian access to education that matches and exceeds the best in the world' because education 'is not just a source of economic growth, but it is also the great equalizer. It is the only consistent and reliable path for children to have a better life than their parents did' (p. 453).

Education is certainly the great equaliser, and I fully agree with Mody on its importance, but I doubt that the 'Maastricht 2.0', no bail-out on steroids solution that Mody proposes will do the trick. In the US, states can default because there is a large 'federal' budget to 'equalise' and keep the 'education' and 'unemployment and the Medicare and Medicaid subsidies' funding going. If we want to emulate this arrangement, the Eurozone would need to have a federal budget.

Like many others before, Mody also proposes that Germany (which according to him is the ultimate problem) should leave the eurozone. He even adds that 'global financial disruption from a German exit will be minor' (p. 448). Here Mody shows that he lacks a clear and in-depth understanding of the political project that the euro involves. Were Germany to leave the Eurozone and re-introduce the Deutschemark the tensions between Germany and France (and other neighbours) could easily resurface. No-one in the old continent wants to see this. The euro was introduced to embed Germany in the European integration project. It is better if it stays that way. That is why we moved from a monetary union to a banking union, and the next big step might be to move forwards in a defence union that will necessarily require a fiscal union. Mody thinks such a thing impossible. But people also thought that having a monetary union in Europe was impossible.

Two final remarks. At the end of the book, in the list of key characters that participate in Mody's Eurotragedy, there is not a single Spaniard. This is sad. It shows that Spain as a country is underrepresented in European affairs. It is to be hoped that this will change in the future. Spain is a strong pro-Europe country that is heavily against the Maastricht 2.0 intergovernmental scenario advocated by Mody. As I have argued elsewhere, one cannot have an intergovernmental governance structure for a monetary union that is inherently, due to the nature of money, a supranational social phenomenon.

Finally, in the list of key dates of the drama, the June 2012 European Council that agreed the creation of the banking union is missing. This must have been intentional (as it does not match the 'doom and gloom' account presented here), proving that the story of the single currency is not as tragic as Mody wants us to believe. I hope this counter story will help to get a more balanced final assessment.

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