



DE-RISKING THE FUTURE OF EUROPE

REFORMING THE MACROFINANCIAL ARCHITECTURE

The political economy of
monetary solidarity: where next
for the euro?

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London School of Economics
Old Building - Houghton Street, London

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Overview

The political economy of monetary solidarity
in a nutshell

What next for the euro

What next for research on the euro

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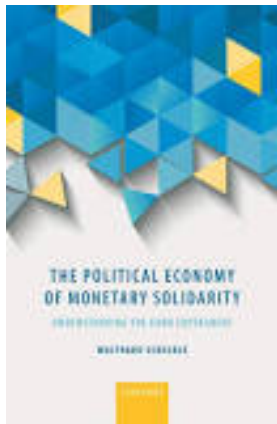


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..in a nutshell

Governing the commons of a monetary union is beset by **political market failures** (cf Keohane 1984, Keohane and Ostrom 1995)

Risk-sharing is typically a **by-product** of selective (national) incentives for cooperation (Broz 1998)

This gives rise to a **political-economic paradox of insurance in a diverse union**

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What next for the euro: the problem

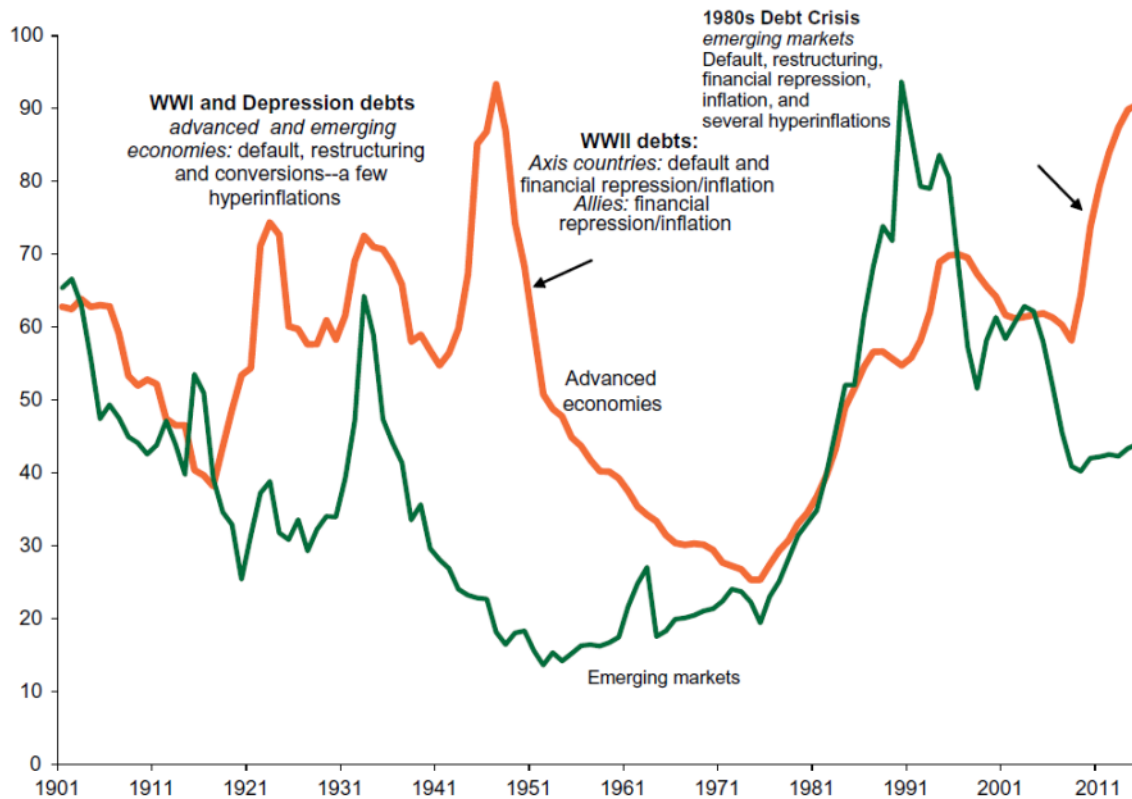


Figure 1. Surges in central government public debts and their resolution: advanced economies and emerging markets, 1900–2012

The major policy problem is public debt, so how can we re-enact financial repression? Not confined to the euro area but solutions most urgent here

What next for the euro: solutions

1. Inflation and capital controls
2. Sovereign default (Bruegel 2010):
 - a. Greece's 2nd and 3rd bailout programme
 - b. Central banks' holding of government debt
3. Debt liquidation through **financial repression redux** (Reinhart & Sbrancia 2015):
 - a. The ECB's QE with forward guidance
 - b. Macroprudential turn in prudential policies
 - c. GDP-linked bonds

What next for research on the euro

Economists have made impressive progress in macro-financial terms (Brunnermeier and Reis 2019 for a summary)


Political scientists have made some progress on the politics (eg Bermeo and Bartels 2014, Beramendi et al 2015, Manow 2018)

but political economists have still not made much progress on the question: **what are the political implications of debt and financial crises?**

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Compare sectoral decline with financial crises

| Sectoral decline (agriculture, leading industries) | Financial crisis |
|--|--|
| Confined to national sector with adverse effects on aggregate demand | Systemic and international , with adverse effects on AD and on supply side |
| Targeted social policies tend to be progressive | Financial bailouts and private deleveraging tend to be regressive |
| Structural change leaves a legacy of alienated voter-workers | Boom-bust cycles leave a legacy of public debt |
| → Democratic welfare states have come to turn this into a political resource for support | → the dilemma between functional and political imperatives seems to give rise to anti-democratic, nationalistic forces |

To sum up

- Scholars have explained why the euro area is in crisis
- ..but not how it survived the last: **under what conditions did monetary solidarity between member states emerge? Did this make the union resilient?**
- The euro's future will depend on whether public debt levels can be reduced
- My hunch is that financial repression redux becomes the next 'European rescue of the nation state' (Milward)



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THANKS!

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