

BOOK REVIEW

*Europe's Orphan:
The Future of the Euro and the Politics
of Debt*

by Martin Sandbu

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During the Eurozone crisis, the message from European policymakers was abundantly clear: that the euro fostered many of the recent problems, or at least was a strong contributor to the high budget deficits at the heart of the crisis, and that there were no alternatives to the bailout packages. Successive large transfers of credit from Germany to the debtor countries were therefore justified along these lines, in exchange for harsh austerity, overly tight monetary policy, and structural reforms.

In *Europe's Orphan: The Future of the Euro and the Politics of Debt*,¹ Martin Sandbu (of the *Financial Times*' 'Free Lunch' fame) perceptively argues that this accepted orthodoxy is in fact at odds with history and the evidence from this period. Nothing is wrong with the euro itself, he suggests. It is rather the policies of the governments of the Eurozone and the European Central Bank that were and remain wrong.

If true, what implication does this have for our understanding of the wider economy and the implementation of policy initiatives? Further, what can we expect in the short to medium term, given the costly spillover effects from developing emerging markets, subsequent drops in commodity prices, and revived fears of an upcoming correction in advanced economies? Sandbu is to be

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¹ Martin Sandbu, *Europe's Orphan: The Future of the Euro and the Politics of Debt* (Princeton University Press 2015).

commended for allowing readers to dig beyond the accepted orthodox explanations for the Eurozone crisis and offer a more considered, evidence based approach that cuts through the dogma of ideology that seems to have informed so much of the commentary on this subject in the 1990s and in the brave new world we currently find ourselves in our post-referendum and pre-Brexit Britain.

Sandbu lucidly puts forward the case for the euro, not by examining the merits of a single currency model, but focusing instead on the failure of European macroeconomic policy—and in particular the inflexibility of the European Central Bank, European Commission, and Member State Governments—in not allowing for the restructuring of private, and later sovereign, debt. Many analyses of the crisis blamed an unholy trinity of weak financial regulation, ineffective supervision, and profligate spending on the periphery. Sandbu provides an important alternative theory and dispels some of the post-crisis myths by pointing out, for example, that profligacy was not at the core of the problem. With the exception of Greece, the economies that had to resort to bailouts were not those with the highest debt-to-GDP ratios.

This along with other configurations of evidence allows Sandbu to convincingly make a nuanced case for the euro being more of a scapegoat than catalyst in this matter. If there was a smoking gun in the run up to the crisis then, Sandbu argues, it was not the euro but a ‘sudden stop’ in the transfers of capital between States. He goes further, stating that the sovereign debt crisis would have likely occurred without the single currency due to proliferation of cheap credit available in the region, even to fringe European nations—who although were not yet Member States themselves were able to tap up debt markets at similar rates or on par with Member States—resulting in the pushing of capital uphill. This was in part caused by the flight for yield of capital originating in inveterate creditor nations (largely in Asia), made to inveterate debtor nations (such as the UK) in response to global trade imbalances; for more read Dooley, Folkerts-Landau, and Garber’s work on the Bretton Woods II system.²

² Michael Dooley, David Folkerts-Landau and Peter Garber, ‘Bretton Woods II Still Defines the International Monetary System’ (2009) 14 Pac Econ Rev 297.

If there was one ‘take away’ from the book, it is that the euro may not have caused the crisis but the main actors, in dealing with the crisis, compounded the severity of events. In what Martin Wolf described as the ‘liquidationist’ alternative,³ Sandbu makes the case for the restructuring of debt and a softer landing, albeit with the localised pain of haircuts for bond holders. This was a point of view supported by Lord King, Governor of the Bank of England through the period, in his recent book *The End of Alchemy*.⁴ Lord King supports Sandbu’s call for a restructuring of Greek debt as the only way out of a Depression that he could not fathom getting so out of hand in the post-war period, let alone in the twenty-first century.

Whilst sceptical of the utility of European fiscal and political union, Sandbu does identify efforts made in establishing Eurozone equity markets as conducive to heading off some of the risk of a similar debt crisis in the region going forward. Similarly, although Sandbu is critical of the EU’s response to the crisis, he sees it as a learning opportunity and a chance for the balance of power to shift of paradigms from that of centralisation to more autonomy or national policy—something he identifies as crucial to spurring regional aggregate demand and avoiding the mish mash of neighbouring states importing lower demand levels from their austerity focussed neighbours.

Sandbu’s focus is not just out of historical interest, and his analysis is paired throughout with policy prescriptions under satisfyingly appropriate headings, ‘Killing Democracy in its Cradle’, ‘Germany: The Reluctance of the Hegemon’, ‘The Difficulty of Putting Your Money Where Your Mouth Is’, and ‘A Stroll through Counterfactual History’ among others. The last heading I chose to quote seems more appropriate now than ever, reading this book in the context of quite an uncertain future for both Britain and the EU. Indeed, some of Sandbu’s recommendations regarding the UK’s place

³ Martin Wolf, ‘Best books of 2015: Economics’ (*Financial Times*, 27 November 2015) <<https://www.ft.com/content/9e1ac550-940b-11e5-b190-291e94b77c8f>> accessed 31 August 2018.

⁴ Mervyn King, *The End of Alchemy: Money, Banking and the Future of the Global Economy* (Abacus 2017).

in Europe can be read as quaint musings from a bygone era. In other ways, Sandbu's analysis is strikingly prescient:

That makes it increasingly likely that a decade or so from now, euro non-membership will leave the United Kingdom's financial industry at the mercy of rules set predominantly by a group with little reason to care about its interests and which the Westminster government is ever less able to influence.⁵

The rhyme of history is all too apparent and if I had changed 'euro non-membership' to 'membership of the EU', I could have lifted that sentence from one of today's papers. However, this particular sentence is found at the end of a chapter, again satisfyingly titled 'Great Britain or Little England?', which makes the counterfactual argument that had the UK joined the euro the crisis would have been 'pulled in *the right direction*'.⁶

Halfway through another year where the Eurozone finds itself facing existential threats, it is hard to read *Europe's Orphan* without drawing the parallels between the euro and the EU project—and supra-nationalism more generally. The value of this book lies not only in its novel analysis of past events but also in the normative elements of the analysis and interestingly in how those conclusions for future paths have been reached.

Martin Sandbu's timely analysis is carefully defined, clearly presented, and one that serves as an important contribution to the current debate. *Europe's Orphan* should be required reading for anyone seeking to understand the European financial crises and the EU project more generally, and is a sophisticated and accessible insight on an otherwise too commonly obfuscated and misrepresented topic.

⁵ Sandbu (n 2) 264.

⁶ *ibid* 245.