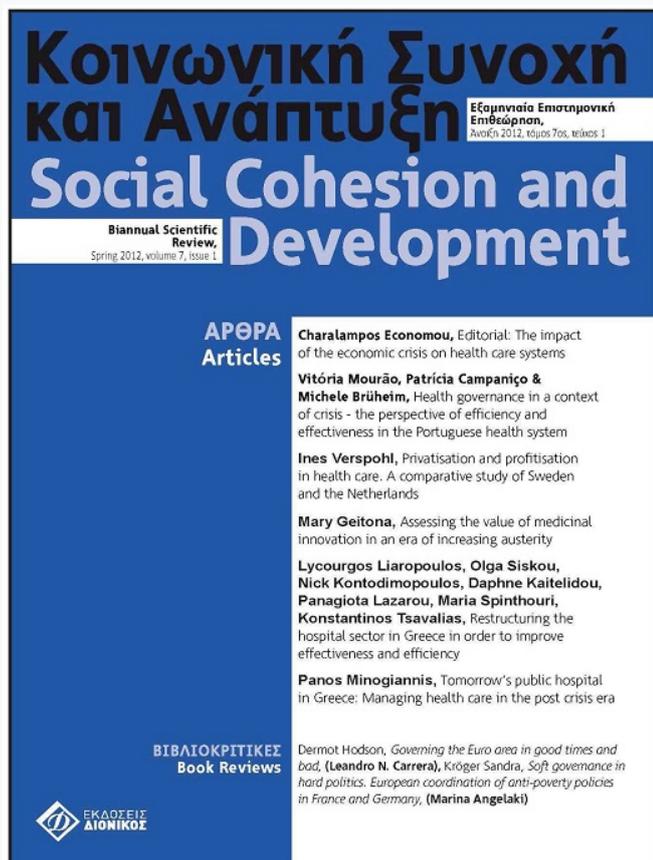


## Social Cohesion and Development

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Governing the Euro area in good times and bad, Oxford University Press , Oxford 2011.

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**Dermot Hodson,**  
*Governing the Euro area in good times and bad,*  
Oxford University Press , Oxford 2011

Since the onset of the sovereign debt crisis in Europe, some observers and policy makers alike have argued that the solution to the current crisis may be to deepen economic policy coordination in order to save the euro while other observers are much more negative and they argue that the euro is doom to fail. This book sheds some light to this debate by assessing the governance of the Economic and Monetary Union (EMU) from the launch of the Euro in 1999 until the emergence of the sovereign debt crisis in 2010.

The author starts by reminding readers that EMU represents a significant departure point from the traditional EU decision making process, the Community method, in which the Commission makes a proposal and the Council and the European Parliament debate on it. Under EMU, monetary policy is delegated to a newly created supranational institution, the European Central Bank (ECB), which has the first and final say over the definition and implementation of monetary policy. By contrast, economic policy relies on a decentralized approach in which Member states are ultimately responsible for implementing their own economic policies. Member state must, however, follow the broad economic policy guidelines (BEPG) set out by the Commission and the Stability and Growth Pact (SGP). However, countries that breach these goals face no more than non-binding recommendations for the most part, although financial penalties and fines can be employed in extremis.

The book aims to answer three specific questions surrounding the current debates about the governance of the euro area in particular and the EU in general: Is the single currency sustainable in the absence of a more centralized approach to economic policy? What conclusions can be drawn from EMU about the search for alternatives to the Community method? What lessons can be learned from the euro area's external relations for the EU's ambitions to be a global actor in its own right? To answer these questions the book starts by first focusing on the role of the ECB and the Eurogroup. It then analyzes the role of the Stability and Growth Pact and the BEPG. Finally, it looks at the external impact of EMU in the G20 and IMF decisions and in EU bilateral dialogues on macroeconomic policy with emerging economies.

Regarding the ECB the author finds that, contrary to some rational choice literature that argues that EU institutions are "competence maximizers" and thus would prefer more Community method in policy making, the ECB has proved to be reluctant do so. The reason for this, it is argued, is that the Bank's preference for "more Europe" is contingent on its overriding commitment to price stability. The author justifies these findings by looking at the cases of anti-fraud policy, the ECB views on the debates for establishing a Constitution for Europe between 2002 and 2003 and the role of the bank towards financial supervision and further economic policy coordination. Regarding the latter, one of the most interesting findings is that ECB officials appear to be against further economic governance where this is perceived to be a threat to price stability. This is consistent with the author's findings regarding the other institution tailor-made for the euro-area, the Eurogroup, composed of euro area finance ministers. In this case, the ECB has been systematically against providing this group with more oversight on economic policy coordination because of fear that this would threaten price stability.

While the findings regarding the ECB and the Eurogroup are interesting, the author does not clearly explain his selection of the cases used to illustrate the findings. This may lend itself to some questions regarding the applicability of the findings.

The chapters dedicated to the Stability and Growth Pact and the Broad Economic Policy Guidelines are one of the most interesting in the book as the author challenges some well-established institutional analyses that claim there is a specific link between electoral regimes and budget outcomes. Specifically, analysing the Stability and Growth Pact, the author finds that while political institutions affect budget institutions, it is not always true that member states electing single-party majorities that tend to “delegate” control of the budgetary process to powerful finance ministers have a harder time to comply with fiscal discipline than countries that elect broad coalition governments and that must rely on numerical rules or other types of “contracts” to enforce fiscal discipline.

While the author agrees that, in general “contract” states fare better in respecting the rules of the Stability and Growth pact, as he shows in the case of the countries that triggered an Ecofin recommendation to end excessive budget deficit, he argues that some cases do not fit nicely in this picture. He illustrates this point by highlighting the cases of Spain, Ireland and Austria, typical “delegation” states that achieved a remarkable degree of compliance with the Stability and Growth Pact rules from the late 1990s until the onset of the current financial crisis in 2007. The author argues that a possible explanation to this “puzzle” is that “delegation” states that had more stringent fiscal rules had a better time to comply with the Stability and Growth Pact. Using data from the Commission’s index of fiscal rules he finds some support for his claim as the data shows an increase in the scores for the three countries since the late 1990s, especially in the case of Spain.

One insight from this chapter, and that the author forgets to mention, is that there could be room for further econometric analyses, which could better test his assumption that domestic stringent fiscal rules may have an impact on member state compliance with the EU fiscal rules. This would provide further evidence and insight for the growing literature on domestic institutions and budget outcomes.

The chapter on the Broad Economic Policy Guidelines (BEPG) is equally significant regarding the insight that it provides. The author finds that such economic guidelines, which are overarching objectives for the economic policies of member states adopted by the Economic and Financial Affairs Council (Ecofin) upon recommendation from the European Commission, suffer from serious structural shortcomings. First, they lack a credible sanctioning institution. While the treaty article regulating the BEPG stipulate that member states should exercise “peer pressure” and make non-binding recommendations to other members who breach the BEPG, in practice policy makers have not wanted to issue such recommendations for fear of triggering a political backlash. Similarly, there is quite a lot of uncertainty regarding the specific content of such non-binding recommendations. Finally, BEPG sanctions may have little currency in domestic political arenas unless the Government’s opposition forces support such sanctions.

The author illustrates his findings by using the case of Ireland in 2001, when the Ecofin criticized the Irish budget for pushing tax cuts and capital expenditure increases that were seen as not necessary given the benign economic environment. This move generated a political backlash in Ireland with the finance minister criticising the move and receiving strong popular support. Equally, the Commission’s reprimand of Greece for breaching the BEPG in February 2010, unleashed a significant wave of strikes and protests. However, in this latter case, it is not completely clear whether the wave of strikes and protests were generated by the Greek Government’s decision to freeze wages or by the Commission’s actions.

Notwithstanding some shortcomings, the main insight of this chapter is that other “peer pressure” mechanisms, most notably the Open Method of Coordination, lack from the same problems regarding sanctioning criteria and lack of participation by key stakeholders for fear of generating a political backlash. This may point towards the need for more comparative research that illustrates on cases in which the BEPG and the OMC have been used.

The last two chapters analyse the role of the EMU at the international level. The main issue here is that the treaties that led to EMU are unclear in specifying who is in charge for EMU’s external representation. The main finding of the chapters is therefore that in cases in which there is agreement among member states in international forums, EU members states have been successful in forging an international consensus on policy responses to the current financial crisis, such as in the meetings of the G20. By contrast, the case of Greece since 2010 illustrates that deep disagreement among euro-area members made necessary to call the International Monetary Fund (IMF) to rely on its “expertise” in dealing with countries’ fiscal crises. While the author is right in pointing out that euro-area members, especially France and Germany, have had a significant degree of influence in the package of measures negotiated since 2010 with Greece, this case also marks the limits of EMU influence at the international level.

The author is perhaps too quick to conclude that EMU’s decentralised approach to economic policy coordination is here to stay. In this sense, it may be interesting to discuss further the European Commission’s proposals on EU economic governance drafted in 2010. While this is still a subject of negotiation, the author is right in pointing out that the proposals do not alter the EMU’s decentralised approach to economic policy since member states will still be in charge of implementing economic policies. The main difference is that the proposals set out more stringent budget requirements than in the SGP. In addition, they even contemplate some pecuniary sanctions against non-complying member-states. However, given the recent failure of some member states to comply with the SGP and the reluctance to use peer pressure mechanisms such as those contemplated in the BEPG and the OMC, as illustrated in the book, how likely is that the new set of rules for economic policy coordination will work? More broadly, how likely is EMU to weather successfully the current financial crisis that has affected some of its members and put them on the verge of exiting the Euro?

Overall, this book is well structured and the chapters seem to address well the research questions set out at the beginning. The author relies on a significant amount of well selected primary and secondary sources and the book is a good contribution to the academic literature on the functioning of the EMU since the launch of the Euro. As such, it will be of interest to academics and practitioners interested in the role of EMU institutions and economic policy coordination in euro-area countries.

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