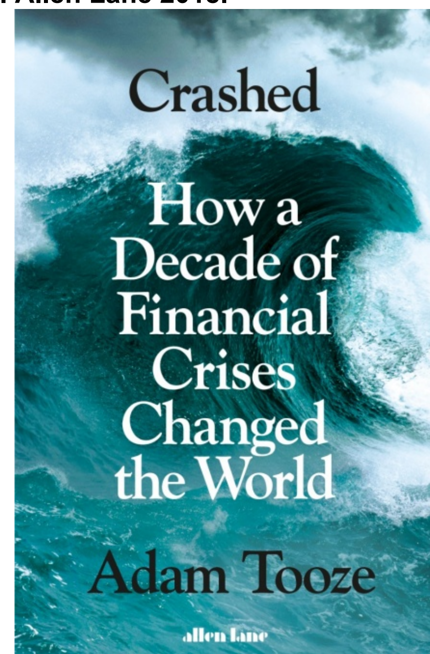
Book Review: Crashed: How a decade of financial crises changed the world by Adam Tooze (Part 2)

*In Crashed: How a decade of financial crises changed the world, author Adam Tooze proposes a remarkably consistent narrative of the 2008 financial crisis and its political, geopolitical consequences — one that attempts a coherent interpretation of the global and European crises. In part two of his review of this seminal work, **Shahin Vallée** examines Tooze's take on the crisis of transatlantic finance and the existential crisis for Europe that ensued.*

Crashed: How a decade of financial crises changed the world. Adam Tooze. Allen Lane 2018.



Tooze's personal and educational background—from a childhood in Germany to studies in the UK, and teaching in the US—offers a rich and rare perspective that is especially useful to understanding the way in which this crisis affects Europe. Tooze's central argument is that it is a crisis of the transatlantic finance that emerged after the fall of Bretton Woods, but one that ought to leave more profound scars on Europe than in the rest of the world, in large part because of Europe's inadequate policy response.

Indeed, a central feature of the crisis response in the United States has been the speed with which the Federal Reserve delivered dollar liquidity to US financial system and to the rest of the world, the way in which it helped rescue and buttress its financial system, and the fiscal stimulus it provided to its economy. This stands in sharp contrast to the European approach, which objected to fiscal expansion, was slow in backstopping financial markets, and opted for protracted bail-outs with no clean-up of the banking system rather than rapid recapitalization.

But this economic divergence rested on the inadequate nature of Europe's government as well as on pre-existing tensions of a geopolitical nature. Tooze argues convincingly that since the invasion of Iraq in 2003, Europe was in the midst of an identity crisis split between the Old and the New Europe that raised questions about Europe's boundaries in the East as well as the Southeast (with Turkey) and questioned the underlying support of the United States to the EU and NATO. It is very common to believe today that the transatlantic tension started with Trump's election; but in reality, it has spanned four American presidential terms and three presidents. Indeed, the Bush administration planted the seed of this division with the invasion of Iraq. This early rift was soon tested and exploited by Russia with the invasion of Georgia (2008). The rift was further deepened by Obama's decision to renege on intervention in Libya (2011), a move that effectively left France holding the bag alone when a US and British coalition had first been contemplated and finally in Syria (2013). This brought Russia back onto the world stage. The global financial crisis, as well as the debilitating effect of the euro crisis, may have played an important role in empowering Russia to undertake the occupation of Ukraine-Crimea (2014), which despite united US and European sanctions left Europe uncertain about the effectiveness and future of the US security guarantee.

The eastern front

Given this geopolitical backdrop, it is quite critical to analyse the way in which the EU responded to the crisis in Central-Eastern Europe, which started in the fall of 2008 immediately as Lehman Brothers collapsed. Tooze argues convincingly that "*When added to the incomplete project of the eurozone, and the missing frame for the transatlantic financial system, the unresolved geopolitics of Europe's Eastern question completed a trifecta of unanswered political questions that hung over Europe in the summer of 2008* (p.139).

Date originally posted: 2018-10-24

Permalink: http://blogs.lse.ac.uk/brexit/2018/10/24/book-review-crashed-how-a-decade-of-financial-crises-changed-the-world-by-adam-tooze-part-2/

Blog homepage: http://blogs.lse.ac.uk/brexit/

While I share the view, and had been writing myself, about the neglect with which the ECB treated Central-Eastern European countries during the crisis by refusing to extend bilateral swap lines that would have helped to limit capital flight, shore up their banking systems, I am less critical of the European Commission and not entirely convinced that this was the turning point that explains the turn towards Orban and the rebirth of Christian identity politics in Hungary and more broadly in the EU, as suggested by Tooze in the London Review of Books podcast.

Indeed, my recollection is that in October of 2008 when Hungary asked for an IMF programme, there had been no request nor even a warning to the European Commission, which created some commotion in Brussels. People like me sitting in at BNP Paribas and officials at the Commission were preparing for the use of the Balance of Payment Assistance facility, a facility used by the EU to support countries experiencing balance of payment distress and last used in Italy in the 1990s and were somewhat sidestepped by the Hungarian request to the IMF. The EU was then very quick to ensure that the IMF would not be dealing with an EU member state on its own. I therefore do not fully share the view that the EU shunned Hungary and pushed it towards a humiliating IMF programme. This was also true later on when Latvia would follow suit and come under and EU/IMF financial assistance programme. It was the European Commission which pleaded for Latvia to be able to maintain its peg to the euro, while the IMF's wanted a more drastic and rapid adjustment by way of a currency devaluation.

I agree nonetheless that at a later stage, in the beginning of 2009 when the crisis was engulfing all of Central-Eastern Europe and that IMF programmes were proving insufficient to stabilize the situation, several proposals from the Visegrad Four (Poland, Hungary, Slovakia and the Czech Republic) to offer a systemic solution were rejected by Germany and the EU. It is at this moment that a combination of public and private sector liquidity support was most needed. Indeed, countries heavily indebted in foreign (mostly euro but also Swiss Franc) currency would have greatly benefited from a more active European Central Bank and it is quite incomprehensible that while the ECB was engaged in bilateral swap lines with Sweden, the Swiss National Bank or the United Kingdom, it would refuse to offer the same to Latvia, Poland, and Hungary, countries which, after all, were in the process of accession to the single currency. The decision was driven by a certain perception of credit risk, but probably more importantly, in the eye of Jean Claude Trichet, these countries, didn't quite deserve the same treatment AS "core" European countries.

A second element of Europe's agony over Central-Eastern Europe relates to the way the European banking system managed a severe collective action problem. Here, Tooze probably doesn't give enough importance to the Vienna Initiative, a public-private sector coordination exercise led by a handful of policy entrepreneurs without a real mandate from their institutions that eventually became critical. Piroska Nagy, a Hungarian economist formerly from the IMF and Erik Berglof, the Chief Economist of the European Bank for Reconstruction and Development (EBRD) played a vital role in organizing a collective response by the European banking sector and to create financial incentivizes through a form of public private partnership that would offer multilateral financial support by way of a World Bank, EBRD and European Investment Bank commitments. As a young economist specialized in emerging Europe, I was deeply involved in these debates. Although the Etat Major (senior management) of BNP Paribas worried of the potential "stigma" of participating in such a collective effort alongside other European banks that were heavily exposed to Central-Eastern and in mortal danger, I nonetheless took part in several meetings of the Vienna Initiative held in London. My modest presence allowed the organizers to show some interest from the largest bank in Europe, even though it was never to make a formal commitment alongside the other banks. This constructive ambiguity proved also very useful to BNP Paribas, which had a very large exposure to Ukraine and which would benefit indirectly and substantially from a collective solution found for the rest of Central-Eastern Europe.

Europe and the single currency

On the question of Europe, Tooze provides a forensic and scary account of how rapidly the EU, led by Germany (but immediately followed by then-French President Nicolas Sarkozy) demanded fiscal consolidation not only in Europe but across the world (in particular in China and the US). And how dysfunctional the governance of the euro area was (and remains). He finds the root of these two evils (a) in Germany's demand for fiscal rectitude, which had been elevated with the introduction of debt brake "schuldenbremse" in 2009 to a constitutional priority and which became an object of such constitutional patriotism that German leaders (and voters) felt it had to be exported to the rest of Europe but also to the rest of the world; and (b) in the German Constitutional Court ruling on the Lisbon treaty, which given the failure of the constitutional treaty of 2005 took a very conservative view towards transfers of sovereignty and fiscal resources. These two pillars would remain a central feature of Germany's attitude through the crisis and to this day. Yet these explanations do not entirely square with the fact that, despite its dismal governance and ordoliberal bias, the EU was still able to pass as early November 2008 a more than 200 billion euro fiscal stimulus, equal to 1 percent of EU's GDP. While this is proved too small especially because most of the subsequent 10 years were spent undoing this first policy impulse, it speaks to the ability for Europe, despite the European treaties constraining/constitutionalizing a large portion of economic policy, to do the right thing, and not only after it has exhausted all other possible options.

Perhaps is it on the issue of the extent of the architectural deficiencies of the single currency that Tooze leaves the reader with more questions than answers. He seems to side with the FT columnist Martin Sandbu on the view that a federal budget and a genuine fiscal union is secondary. And yet he argues convincingly that a crisis of this scale "required a very capable state indeed". It is hard to reconcile both views and argue that the single currency could adopt the sort of radical banking system repair policies adopted in the United States in the absence of a federal government of sorts relying instead only on the sum of national responses or even on the sort of incomplete and poorly designed banking union the EU has today. If that were the case, then there would be no relationship between fiscal union and the creation of a State apparatus, which defies the history of the American federation for example. Tooze's account of this failure rests on the supposed fundamentally inter-governmental nature of the Lisbon Treaty, which I take some issue with. It is not that the letter of the Lisbon Treaty that was intergovernmental in nature, even it surely didn't go far enough in endowing the euro area with a distinct executive power controlled democratically. It is rather the fact that the Lisbon Treaty was hijacked by the European Council during the crisis that corrupted the spirit of the Treaty. Here, while I would agree with Tooze that Germany played a central role in this inter-governmental turn, its behaviour can also be largely explained by France's failure to ratify the constitutional treaty in 2005, which was rightly or wrongly understood to mean that pooling of sovereignty and the build out of a transnational democracy a la Habermas was no longer possible.

But the more important point might be about the future of European politics, which could face more severe challenges than the ones visible in Trump's America. Like the United States, Europe has been profoundly marked by the emergence of insurgent political forces caused by the economic hardship and the inadequate policy response to the crisis and the perception of a runaway economic and political elite best epitomized —but not limited to— large bank bail-outs.

But it has also exposed the weakness of its form of government (lack of executive authority) and its democratic deficit (lack accountability and control) that went to the point that one could hear in Germany after the removal of Berlusconi from office and the taming of SYRIZA in Greece, that "*Europe does regime change better than the US*" (p. 412). This political settlement, which is perceived by most Europeans as both ineffective in dealing with financial, economic, geopolitical crises and as profoundly undemocratic leaves Europe more profoundly scarred than the US or the rest of the world from the aftershock of the Lehman collapse 10 years ago.

This idea that the political order can be corrupted by what Merkel called "codetermination with the imperatives of the markets" or that it can be entirely replaced by what Jean-Claude Trichet has called federalism by exception (in practice the entire subordination of national democracy by European institutions in times of crisis) leave the continent most confident about its democratic superiority in the midst of an existential crisis.

Indeed, we are marking the tenth anniversary of Lehman's failure and the ensuing financial crises with a stabilized world economic system while political systems from the United States to Europe continue to suffer from acute PTSD.

This post gives the views of the author, and not the position of the LSE Brexit blog, or of the London School of Economics. Image by Jeremy Weate, (CC BY 2.0).

Shahin Vallée is a PhD candidate at the LSE's European Institute.