In recounting the litany of his villains' misdeeds, Blinder makes clear his penchant for more government oversight and less freedom for market participants. Although he has no practical experience in the financial markets, he is quick to chastise professional participants for becoming unduly enamored of rising prices, leverage, and complexity. To be fair, he is not the only academic economist to display some naiveté about the profit-seeking behavior of business people forced to cope with unusual market conditions. (It is noteworthy how many journalists, regulators, academics, and other observers have written about the crisis and how few direct participants and decision makers have chosen to offer their "here is why we did what we did" perspective.)

Blinder's chronological narrative of events throughout 2007 and 2008 is useful. His writing is clear, and his tone is both educational and conversational. His straightforward recounting of responses by the U.S. Federal Reserve Board, the U.S. Congress, the Bush administration, and the Obama administration to the nearly fatal economic meltdown of late 2008 and 2009 is also well done. A former Fed vice chairman, Blinder does not hesitate to criticize certain governmental actions he believes were ill advised. Even more refreshingly, he states quite forcefully that communications by "officialdom" to the general public regarding its actions set new lows for ineffectiveness and probably made it more difficult to take the necessary remedial steps.

If *After the Music Stopped* had stopped there, it might have joined the list of classic accounts of economic calamities. Clearly, however, "the work ahead" was an important priority for the author. Blinder devotes a large portion of the book to critiquing the processes by which the authorities decided which steps to take to resolve the financial crisis. Along the way, he promotes a dozen reforms aimed at preventing—or dealing more effectively with—the next one. Moreover, taking full advantage of his platform, Blinder revisits historical policy disputes, laments the involvement of parties whose political interests overwhelmed their economic judgment, and digresses into superfluous commentaries on quantitative easing and the European debt crisis. (It would be churlish to suggest he felt a need to justify his one-year leave of absence from Princeton University by including as many elements as possible in this tome.)

Throughout this long and multifaceted work, Professor Blinder demonstrates that he is the rare academic economist who writes clearly about a complicated topic. This former (and future?) policymaker/adviser also shows how one's worldview inevitably colors even a good-faith effort to tell the complete story of the recent financial crisis.

It is easy to appreciate this narrative's usefulness in clarifying complex issues for readers who remain confused about what happened. It is more difficult to accept the author's prescriptions for dealing with this recent period of financial and economic distress and with possible future problems.

—M.A.M.

***Europe's Unfinished Currency: The Political Economics of the Euro*. 2012. By Thomas Mayer, CFA. Anthem Press, www.anthempress.com. 218 pages, $26.95.**

Reviewed by Mark K. Bhasin, CFA

In *Europe's Unfinished Currency: The Political Economics of the Euro*, Thomas Mayer, a senior fellow at the Center for Financial Studies at Goethe University Frankfurt and a senior adviser to Deutsche Bank, argues that European monetary integration can work but only if policymakers repair its faulty original architecture in the correct way. He argues that a new framework for the euro must be based on two elementary principles:

1. The euro must be a nonpolitical currency, shielded from any form of fiscal dominance by member states of the Economic and Monetary Union (EMU).
2. Sovereignty and liability in essential fiscal policy matters must be firmly aligned at the national level.

Mayer posits that launching the EMU and creating the euro without some form of political union were risky undertakings because no monetary union has ever survived without some form of political union of its member states. Previous monetary unions failed because of a lack of fiscal and monetary discipline. Against this historical background, the architecture of the EMU seemed untenable.

In the euro's successful first decade, the majority of eurozone countries exhibited fairly healthy growth. But the near default of Greece in April 2010, brought about by the financial crisis of 2007–2008, exposed the EMU's fragile framework. Cheap credit was the glue that held the EMU together, and so when the credit bubble burst, the EMU unraveled.

The EMU eventually fell into a crisis of legitimacy as critics accused governments of having violated, among other things, the no-bailout clause of the Maastricht Treaty by monetizing the debt of insolvent banks and governments. In addition to the legitimacy crisis, the euro area experienced a balance-of-payments crisis. External

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current-account and internal government budget deficits could no longer be smoothly funded in the markets, and cautious investors fled countries with weak financial fundamentals.

Mayer argues—correctly, in this reviewer's opinion—that fiscal and political union is unlikely because it is unrealistic to expect such a union to have a politically and fiscally dominant federal government. He believes that the only realistic option is to return to the original design of the EMU, whereby each country is responsible for its own government finances and the European Central Bank (ECB) aims for price stability within the union.

The historical model that comes closest to the fiscal policy requirements of the EMU is that of the United States in the 19th century. The individual states were both sovereign in their budget decisions and fully responsible for their finances and were thus left to default on their debt whenever they overborrowed. Pressure for fiscal policy discipline had to come from the market because the political influence of the federal government was limited by its relatively small size. Mayer persuasively argues that there must be a lender of last resort that has access to central bank credit during a financial crisis, when capital markets are closed to virtually all borrowers.

According to Mayer, the EMU needs to be based on politically neutral money and national fiscal sovereignty, coupled with national liability. Mayer's proposed new EMU architecture is based on five building blocks:

1. EMU governments are held fully liable for their financial decisions.
2. The central bank ensures price stability and provides funds of last resort to all systemically important debtors.
3. The central bank lends funds of last resort in close cooperation with the European Systemic Risk Board and the European Monetary Fund (EMF).
4. The EMF monitors national economic policies, provides adjustment funding to illiquid governments, and conducts orderly debt restructurings for insolvent governments and banks.
5. The European System of Financial Supervisors ensures an appropriate financial architecture in which public sector debt is considered subject to default risk, cooperates with the EMF in restructuring or resolving insolvent banks, and manages a common deposit insurance scheme.

Because not all present and future EMU member countries can be expected to remain "fit" for the EMU, leaving the EMU without also leaving the EU should be allowed as a last resort to stabilize the economy.

Without a new architecture, Mayer asserts, the long-term survival of the EMU in its present form appears to be at risk. He envisages two possible future mutations.

In the first mutation, the ECB would be dragged into monetizing the deficits and debt of insolvent governments and banks. Over time, this action would lead to the formation of a new "hard currency" union centered on Germany, with the existing EMU continuing as a "soft currency" union. The hard union could exist within the soft union, with cash shared by all members but with the new hard money adopted only by the financially strong members, which would include AAA rated countries and EMU member countries with solid government finances.

In the second mutation, the EMU would be reduced to a hard currency union by the exit of all countries unable to operate under a hard budget constraint. These countries would return to their national currencies. Owing to the economic pain that an EMU exit would inflict on weak countries, the first mutation would seem to be more likely than the second.

In *Europe's Unfinished Currency*, Mayer cogently argues that the European Economic and Monetary Union could work, provided the member states embrace a new EMU architecture. Even though all monetary unions of sovereign states have failed in the past, Mayer remains hopeful that the EMU can develop a more robust framework and contribute to the historical work of European unification.

—M.K.B.

***Misunderstanding Financial Crises: Why We Don't See Them Coming*. 2012. By Gary B. Gorton. Oxford University Press, www.oup.com. 296 pages, $29.95.**

Reviewed by Martin S. Fridson, CFA

Eugene Fama, whom many regard as the father of modern finance, was asked in a May 2012 interview what he thought was the cause of the 2007–08 financial crisis. Fama replied,

> I think the global crisis was first a problem of political pressure to encourage the financing of subprime mortgages. Then, a huge recession came along and the house of cards came tumbling down.[1]

This not-unconventional assessment is precisely what Yale economist Gary B. Gorton seeks to refute in *Misunderstanding Financial Crises*. He

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