



Euro Symposium

Understanding the Euro Requires Political Economy, Not Just Economics

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ABSTRACT

Once upon a time our academic subject went under the title Political Economy. But in (an unavailing) pursuit of scientific purity, the more political aspects were discarded, leaving a focus on the purely economic. The main failing in this respect of academic U.S. economists was to look at the European monetary experiment almost entirely through the prism of a narrowly economic model, the optimum currency area theory—a model which has been wholly insufficient to explain relevant facts about the life, and death, of currencies—rather than via wider political economy factors.

That failing continues. The current financial crisis has caused many of those who initially doubted the single currency's successful introduction now to forecast its imminent dissolution. But just as its original introduction was a matter of political will, rather than the result of an economic cost-benefit exercise, so any dissolution would follow from a conscious political act of separation, not from purely economic strains.

Of course, really severe economic strains could alter political perceptions of the eurozone, but there is little sign of that happening. Rather, the reverse is happening: countries in Europe under extreme strain, e.g., Ireland, Iceland, and

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the Baltics, have found the potential embrace of the eurozone to be supportive. And, while it remains possible that persistent and intensifying adjustment strains could lead to a (political) campaign in some country, or countries, to exit the euro, any cool-headed assessment of the huge costs and meager benefits of doing so should deter all but the most hot-headed or accident-prone politicians from such a course.

The choice and combination of currency regimes is a political economy issue. The failure of most U.S. academics to give due weight to political factors has made their analysis unbalanced.

References

Jonung, Lars, and Eoin Drea. 2010. It Can't Happen, It's a Bad Idea, It Won't Last: U.S. Economists on the EMU and the Euro, 1989-2002. *Econ Journal Watch* 7(1):4-52. [Link](#)

About the Author



Charles Goodhart, Commander of the Order of the British Empire, Fellow of the British Academy, is a member of the Financial Markets Group at the London School of Economics. From 1985 until retiring in 2002, he was the Norman Sosnow Professor of Banking and Finance at the London School of Economics. Before then, he had worked at the Bank of England for 17 years as a monetary adviser, becoming a chief adviser in 1980. He was an outside independent member of the Bank of England's new Monetary Policy Committee from 1997 to 2000 and advisor to the Governor of the Bank on financial stability from 2002 to 2004. His publications include more than 20 books, among them *The Evolution of Central Banks* (1988) and *The Regulatory Response to the Financial Crisis* (2009). In his spare time he is a sheep farmer (loss-making).

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