Chapter 3 examines neoclassical models of both the old and new variety. Hein associates the former with Robert Solow's work and the latter with that of Paul Romer and Robert Lucas. On the one hand, he argues that useful additions have been made through this evolution. In particular, he finds the new growth theory superior in that it makes endogenous what is clearly an absolutely key variable in any such model—the rate of technological progress. However, at the end of the day, Hein still believes that neither is of much use when both view the world through the "neoclassical lenses of scarcity" (Hein, p. 51). A model that assumes continuous full employment is not going to shed much light on the financial crisis. We are again disappointed.

Chapter 4 seems more hopeful, as we are introduced to models that attempt to more directly apply the principles of Keynes's work to growth and distribution. However, after outlining the work of Joan Robinson, Luigi Pasinetti, Anthony Thirlwall, and Nicholas Kaldor, Hein again laments the fact that critical aspects of the real-world economy are ignored. While it is true that these approaches move away from short-term full employment and general equilibrium and they view investment as a key factor both in terms of short-term employment and long-run productivity, they are nevertheless set in a flexible-price world where full employment (or something similar) is assumed over the long run.

Finally, in chapter 5, Hein introduces a growth theory that he says fits the bill, that of Kalecki. His work, thought to have anticipated Keynes's in several respects, never assumes full employment over any time horizon, is set in historical time, and treats investment as key in both the short and long run. In addition, as Kalecki tended to think more in terms of classes (workers and capitalists) than expenditure types (investment and consumption), it is ideal for questions of income distribution. On the assumption that this model finally has the potential to explain growth and development, Hein spends most of the rest of the book adding features such as technical progress and a financial market that includes the effects of financialization. In the end, Hein believes that he has shown how such a model can "provide rich, applicable, and empirically relevant models of distribution and growth for modern capitalism" (Hein, p. 477).

This book will be of interest to scholars hoping to shed light on the relationships between growth and income distribution in a model that does not require us to assume away essential features of the real-world economy. Eckhard Hein shows that it is possible to develop a useful theory without having to pretend that the world is marked by full employment, perfectly flexible wages and prices, and a Walrasian auctioneer.

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F International Economics

Currency Politics: The Political Economy of Exchange Rate Policy. By Jeffry A. Frieden. Princeton and Oxford: Princeton University Press, 2015. Pp. x, 301. $39.95. ISBN 978–0–691–16415–1. *JEL 2015–0409*

Jeffry Frieden, professor of government at Harvard, is a rare political scientist who has managed to gain the respect of economists. A specialist in international political economy (IPE), he is best known for his work on the politics of exchange rates, going back to a seminal article published in 1991 (Frieden 1991). In *Currency Politics*, a quarter century of scholarly rumination has been distilled in one definitive treatment.

International political economy—a field of study integrating international economics and international politics—is a remarkably diverse discipline, with many variants to be found around the world. For Frieden, as for most mainstream American political scientists, IPE is best understood in terms of a theoretical paradigm that has come to be labeled "open economy politics" (OEP), echoing the economics profession's notion of open economy macroeconomics. Whatever the issue facing governments, OEP decomposes the policy process into three distinct phases: a first stage where preferences are derived; a second stage where interests are aggregated and mediated through domestic political institutions; and a third stage of international bargaining as states seek to influence one another's behavior, explicitly or implicitly.

In *Currency Politics*, Frieden directs attention almost exclusively to the first stage. When he speaks of the political economy of exchange-rate policy, he means the identification of distributionally motivated currency policy preferences. "My main focus," he writes, "is on the relationship between currency policy and *distributional* (rather than political-institutional) features of national political economies" (p. 11, emphasis in the original). He acknowledges that this is a "limited goal" (p. 20) but insists that an understanding of the policy preferences of domestic socioeconomic groups is a "necessary first step" (p. 20). The task of exploring the nitty-gritty of domestic politics or international bargaining is largely left to others.

After laying out his theory of preferences in chapter 1, Frieden devotes most of *Currency Politics* to empirical applications in three distinct historical settings—nineteenth-century United States (chapters 2–3), the European march to monetary union (chapter 4), and Latin America since the 1970s (chapters 5–6). His attention to detail is remarkable, and wherever the data permit, he backs his qualitative discussion with solid quantitative analysis, relying mostly on logistic regressions. Readers unfamiliar with any of these episodes will find the treatment enlightening, even fascinating.

Frieden's theory of preferences focuses on two related dimensions of exchange-rate policy choice: the regime (fixed or floating) and the level (appreciated or depreciated). With regard to the former, his basic contention is that actors who rely heavily on international trade, investment, or financial ties will prefer a stable exchange rate in order to reduce currency risk. With regard to the latter, he argues, tradable-goods producers will prefer a depreciated exchange rate in order to gain competitive advantage. From these starting points, and relying heavily on such familiar economic tropes as the Mundell–Fleming trilemma and exchange-rate pass-through, he distills a complex web of "expectations" about who will prefer what—described as the essential "building blocks of national currency policies" (p. 21). For instance, while a depreciated exchange rate is expected to be favored by tradables producers, it will be opposed, Frieden suggests, by firms with large net foreign-currency liabilities.

In principle, none of Frieden's expectations can be said to be especially controversial. All are solidly grounded in widely accepted economic theory. But as a practical matter, they present a serious tactical problem: how to convert the abstract categories of economic theory into real, live human beings. Decades ago, John Maynard Keynes's Cambridge colleague Joan Robinson made a similar complaint about the theory of comparative advantage. Yes, she reportedly said, it could say something about how the benefits of trade are divided up among factors of production. But it could tell us little about how the gains were divided up among the "chaps." Frieden faces the same problem. Socioeconomic groups may be torn by conflicting distributional implications. What if a firm produces largely tradable goods but also has large net foreign liabilities? Which way will the "chaps" jump?

The problem keeps coming up in Frieden's empirical applications, where repeatedly he is forced to set aside the subtleties of his own theory in order to fit the available data. In his discussion of Europe's debates over monetary integration, for instance, he finds it necessary to reduce his analysis to just two groups: manufacturers with significant intra-European export interests and tradables producers facing significant import and export competition. To his credit, Frieden acknowledges that these two proxies for private interests "are not particularly close to what we want to measure" (p. 157). But on what basis, then, can he claim that "the results are in line with my expectations" (p. 172)?

Overall, *Currency Politics* provides a considerable amount of insight into the political economy of exchange rates, but regrettably, it is a partial picture at best. Clearly, interests matter. They are indeed a necessary first step. But so too do other considerations matter, as the omitted second and third phases of the OEP paradigm suggest. Nor can we ignore the powerful role of ideas—the dream of European unity, for example, which may well have had more to do with the birth of the euro than any collection of diverse particularist interests. Economists can learn much from this work of a political scientist, but it is not the whole story.

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H Public Economics

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I. Background

The global financial crisis that erupted in the United States instantaneously swept across Europe. Like the United States, the European Monetary Union (EMU) was ripe for a crash. It had its own real estate bubble (specifically in Ireland and Spain), had indulged in excessive deficit spending, had become financially deregulated, and had rapidly expanded credit (partly through derivatives). Policy responses and recovery patterns for key EU members such as Germany, France (within the Eurozone), and the United Kingdom (outside the Eurozone) were similar. However, after the bubble burst and the crisis began unfolding, it became clear that the Eurozone plight differed from America's in one fundamental respect: There was no exact counterpart of the Eurozone GIIPS (Greece, Ireland, Italy, Portugal, and Spain) in the United States. Some American states had overborrowed, but the sovereign debt crisis didn't place individual states at deflationary risk or threaten the viability of the federal union. Not so for some members within the Eurozone. During the U.S. savings and loan crisis in the 1980s, the southwestern American states received a transfer from the rest of the U.S. states equal to almost 20 percent of the southwestern states' gross domestic products combined. But such a transfer has not been politically feasible among members of the EMU. The American experience therefore demonstrates that Europe's problem is not purely an economically failing single-currency area; the failure is political in an institutional sense. Politicians on both sides of the Atlantic can be uncooperative, but interstate disputes are more easily finessed under the American federal system than under the Eurozone's weakly politically integrated system. The global financial crisis involving the Eurozone periphery is mainly a balance of payments crisis of the type akin to "sudden stop" in capital inflows (see Calvo 1998) cum liquidity trap (Krugman 1998). The cumulative current account deficits in the wake of the crisis are large for the Eurozone countries that plunged into the crisis. The crisis from sudden stop of capital inflows triggered, in turn, the sovereign debt crisis. The key mechanism behind the panic-based sovereign debt crisis was the belief among investors that the European Central Bank (ECB) would not behave as a lender of last resort. The belief was indeed confirmed in the initial phase of the crisis. In 2013, the ECB adopted the "whatever it takes" policy of (limited) sovereign bonds purchase. Recall that sovereign debt, for a member of the Eurozone, is in effect denominated in "foreign currency"; that is, a national central bank cannot independently bail out the governments through purchasing their debt by printing its own currency—a point made forcefully by De Grauwe and Ji (2013). In contrast to the strong correlation between external deficits and crises in the Eurozone, there is weak correlation between sovereign debt to output ratio and crises. Sovereign debt to GDP ratio in the wake of the crisis was not larger, on average, for the GIIPS countries (except Greece) than for other Eurozone countries (such as Belgium). The disparity is easily traced to the European Union and Eurozone's special form of governance called supranationality (a partially sovereign transnational organization), which has largely been ignored in economic treatises about the costs and benefits of customs unions, economic communities, and monetary unions. Until now, it has tacitly been assumed that supranational governance was as good or better than national economic mechanisms—that any policy regime accessible to nation-states could be replicated without dysfunction by supranational communities.[1]

[1] See Razin (2015), Razin and Rosefielde (2012).