1. Introduction

In 2006, as what would come to be known as the subprime mortgage crisis took effect, few could have imagined the economic and political ramifications it would eventually have in Europe. By 2008, US and European governments intervened in financial sectors in ways that seemed unprecedented, in order to prevent banks' losses from negatively affecting credit provision, and leading to larger economic crises at home. By 2010, several European governments that had guaranteed the assets of those banks were embroiled in the eurozone crisis, which stemmed from the sovereign debt crises in which they found themselves. In 2016, the after-effects of these crises are still apparent, in diminished lending, slow economic growth, and high unemployment. How did Europe reach the point of crisis in 2008 that would lay the foundations for the eurozone crisis of 2010 and onward?

Financial liberalization throughout Europe in the last quarter of the twentieth century, and the acceleration of that process are the keys to understanding that process. The circumstances in which Western European countries liberalized their financial sectors, the financial markets that were deregulated, and the resulting changes in Europe's financial landscape all laid the groundwork for Europe's exposure to financial risk, the resulting crisis, and the subsequent aftermath of the eurozone crisis. These processes, in particular the negotiation dynamics, are also important for understanding why some European countries emerged in 2016 less notably affected by the financial and economic dynamics that occurred between 2007 and 2016, while others bear lasting economic scars. Understanding the root causes and consequences of these changes provides a roadmap for avoiding similar economic outcomes in the future, particularly in the context of renewed worries about financial stability and systemic risk in the eurozone.

Why add another book to the growing literature about Europe's crisis? Conventional narratives about Europe's crises have focused on factors ranging from Europe's welfare states, to lack of productivity in the eurozone's crisis states, to the monetary policies that assumed the same risk for peripheral European states' bonds as for core states. While these arguments may have some value in explaining the European sovereign debt crisis, this line of thought and policy absolves the Economic and Monetary

Union (EMU)'s financial sectors from their role in the creation of this crisis by promoting and requiring financial liberalization, deregulation, and privatization from states that wished to join the EMU. It also excuses the European banks that fueled housing and credit bubbles in different European nations and the states that oversaw those financial activities. I argue that without this deregulation, and these capital flows, European states might not have accrued the current and capital account imbalances they did following the onset of the global financial crisis, and that the eurozone crisis would not have been as severe as it was.

Another reason to ask these questions relates to the emerging power dynamics within Europe and the EMU, in which countries that lent to nations in the midst of bubbles appear to be shifting the costs of the crisis to those countries whose bubbles have burst through the provision of bailouts with high interest rates and required austerity policies. The uneven enforcement of paying for financial mistakes undermines smaller countries' ability to recover from their crises, and exempts lenders in more powerful countries from the costs of their irresponsible lending. Understanding how the required financial policies of the EMU contributed to the current crisis can illustrate ways for the EMU to reform itself to avoid crisis (and experience growth) in the future, and may illustrate social inequities in the region's response.

Orthodox neoclassical literature seems to largely conclude that liberalized (and privatized) finance begets economic growth. On a theoretical level, these proponents of financial liberalization rely on efficient market theory, which has many problems. Empirical literature about the effects of financial liberalization on growth are more mixed. Ross Levine, Frederic Mishkin, and others argue and conclude that financial liberalization has positive effects on economic growth (Mishkin, 2007; Levine, 2009). Other economists from the neoclassical to the New Keynesian – Jagdish Bhagwati, Joseph Stiglitz, and others – conclude that financial liberalization is likely to negatively impact economic growth (Bhagwati, 1998; Stiglitz and Charlton, 2004). Theorists and empiricists across the economic and political spectrum seem to agree that financial liberalization is positively correlated with financial crisis; they also tend to argue that countries must have the 'right' kinds of financial regulations and governmental institutions to guard against such potential negative outcomes. (Though many argue that financially open economies recover from financial crises more quickly – see Prasad et al., 2007b.) Another trend in the empirical literature about financial liberalization and growth is the conclusion that, for developing countries, financial liberalization is not unequivocally positively related with economic growth. The conclusions these authors come to is often that institutional quality makes the difference in protecting economies from crisis following financial liberalization (Beckaert et al., 2001; Prasad et al., 2007b; Eichengreen et al., 2011), though they differ on the recovery prospects that remain for those countries that experience financial crisis.

Economic experiences in the USA and Western Europe since 2007 give lie to the notion that first world institutions are better able to prevent financial crises, and that financial development automatically translates into improved economic growth. By analyzing the institutional history of European financial liberalization, as well as the empirical changes in intra-European borrowing and lending, both descriptively as well as econometrically, I show how that liberalization is connected to an increased incidence of financial crisis. By demonstrating that European members of the Organisation for Economic Co-operation and Development (OECD) are not immune to the destabilizing and negative growth effects of financial crisis, and that financial development is not implicitly linked with economic growth, I augment the arguments that financial deregulation and liberalization can have destructive economic effects even in states with presumably sophisticated institutions. This illustrates the need to restructure financial sectors in a way to better foster real economic growth, and to reform European Union (EU) and EMU institutions in a way to protect members from the wide-reaching consequences of financial crisis.

There is a high likelihood of future crisis in Europe if there is no significant re-regulation of its financial architecture. If banks continue to lend and securitize as they have in the past decades, then there will be risks of future crisis. In 2013, Angela Merkel won a second re-election as Chancellor, as German citizens rewarded her pro-austerity stance in European economic policy. Meanwhile, divergent and extremist political movements seem to gain ground in European states like Greece experiencing prolonged economic crisis, and in the midst of large influxes of refugees into Southern European countries worst affected by the eurozone crisis. Without an attempt to understand the full extent of the causes of the crisis, particularly located in liberalized finance, Europe's core will continue to set the economic and financial terms for the EMU periphery, while those in the EMU periphery will assume greater economic and social costs as the consequences of austerity. Indeed, the 2016 UK Brexit vote narrowly in favor of leaving the EU indicates that the status quo may not hold for much longer.

This book is organized around several hypotheses. First, privatization and deregulation of different European countries' financial sectors increased European financial fragility and instability, and created the conditions for financial crisis and subsequent sovereign debt crisis. Second, the formation of the EMU facilitated lending and borrowing from one bank to another, accelerated the effects of this deregulation, and exacerbated the effects of the ongoing financial crisis. The design of EMU financial policy promoted the rapid and unlimited transfer of capital between EMU nation states' banks, and required would-be members to liberalize their financial sectors enough to bring about that financial state. This rapid transit of capital fostered real estate bubbles in Spain, Ireland, and Eastern Europe, as well as rapid currency appreciation in Iceland, with little real sector (non-financial or real estate) economic development in those regions. Once those bubbles burst, as Charles Kindleberger's theory and histories of manias, panics, and crashes would predict, these countries have faced tremendous pressure from different lenders and states to bail out banks (on the threat of economic collapse) or to recompense foreign lenders (Kindleberger and Aliber, 2005). The leaders of the countries in crisis have then had the "choice" between the costs of not accepting bailouts to deal with the costs of their crises, or the imposition of austerity measures in order to qualify for bailouts and improve their future debt ratings, leading to further and greater economic downturns as their countries' aggregate demand declines.

Other financial components of the EMU structure facilitated and exacerbated the current economic decline in Europe. The intent to shift towards a market-based financial sector on the grounds of the UK's and the USA's financial experience ignored the failings of that system in those countries and exposed countries with little experience with equity and bond markets to a host of new financial risks (Lewis, 2011a). Many European financial markets bought financial innovations developed during the subprime mortgage boom, particularly synthetic collateralized debt obligations based on subprime mortgages, and intermediaries ranging from large investment banks, publicly owned regional banks, and pension funds have lost value as a result (Evans, 2007; Morgenson and Story, 2009; Lewis, 2011a). Banks and pension funds across Europe have been affected, and the pressure that UK, Dutch, German, and French political and economic actors have placed on Greek, Icelandic, Irish, Italian, Portuguese, and Spanish banks and governments to pay back what the stronger countries have lost illustrates two phenomena: powerful countries' attempts to recap losses in the bond market, and powerful countries' bankers' impunity from making poorly researched loans in the first place (Johnson, 2010). Power asymmetries that allow banks to transfer the costs of their mistakes to those more immediately in crisis enable future bubbles and crises – without significant reforms to restructure European finance, we are likely to continue to see such crises with the attendant economic costs.

Political shifts to the right, rising inequality, and shifts from fraternal to fratricidal competition within the finance sector across Western Europe also contributed to the demand in Europe for increasing financial deregulation, and may be likely to continue if there is not some major shift in financial policy inside and outside the EMU. Finally, re-regulation and socialization or nationalization of European financial sectors should present a first step toward improving financial stability and inequality measures, but these policies should also be paired with active fiscal policies if we want finance to contribute to growth, employment, and productivity improvements.

The organization of the rest of the book is as follows. Chapter 2 presents a brief history of financial liberalization, country by country, in Western Europe. It explores patterns and anomalies in liberalization and privatization of these countries' financial systems. It also examines how joining Europe's Economic and Monetary Union affected this liberalization process. Many of Europe's largest, or core, economies had already substantially liberalized their financial systems by the creation of the Maastricht Treaty in 1992. Europe's smaller economies by and large needed to rapidly liberalize their financial systems in order to qualify for EMU membership – I argue that this had negative implications for financial and economic stability throughout Europe down the line.

Chapter 3 maps the quantitative effects of European financial liberalization across various metrics. It demonstrates increases in cross-border financial flows, increasing competition within domestic banking sectors, and rising financial and macroeconomic instability as countries began to liberalize their financial sectors and engage in more international transactions. It also explores interest rate, housing price, and foreign direct investment dynamics, and offers an abbreviated description of the costs of the subprime mortgage crisis and the global financial crisis.

Chapter 4 presents an econometric analysis of the connection between financial liberalization measured in several ways and the onset of financial crisis in the sample of Western European countries considered in Chapter 3 between 1983 and 2011. It finds that there is a statistically significant correlation between various measures of financial liberalization and the onset of financial crisis, and that this connection is robust to several model specifications.

Chapter 5 uses a political economy framework to analyze how different interest groups influenced European countries decision to join the EMU, and to accept the financial terms of joining. Key interest groups included financial actors and institutions, core European economies likely to gain from a trade and monetary union with no barriers to capital flows, and academics that subscribed to neoclassical and neoliberal theories of the benefits of financial globalization. It briefly considers the consequences of doing so.

Chapters 6 and 7 are case studies. Chapter 6 examines the causes and consequences of financial liberalization and financial crisis in a core European country, Germany. It also expands upon the circumstances and consequences of domestic financial liberalization in Germany from the 1970s onward, the supranational consequences of European financial liberalization for Germany, and Germany's responses to the global financial crisis and the European debt crises. Chapter 7 contrasts the experiences of Iceland and Ireland, two peripheral European economies that rapidly liberalized financial sectors in the late twentieth century, received large capital inflows from elsewhere in Europe, and experienced outsize financial and economic crises given the size of their respective economies. It explores the different experiences of a small European country that belongs to the EMU with that of a country that declined to join the European Union. It shows that two apparently developed economies were prone to the same kind of financial vulnerability and crisis that many conventional economists believed were the sole terrain of developing economies, that finance-led growth is unsustainable, and that national connections with European economic powers outside the EMU matter for recovery options. Chapter 8, the conclusion, concludes and presents policy considerations moving forward.