Paul De Grauwe and Jacques Melitz, *Prospects for Monetary Unions After the Euro,* Cambridge, Mass.: MIT Press, 2005, pp.ix, 358, $45.

Europe's move to monetary union was and even now remains a bold (some would say a reckless) experiment. The European Central Bank has performed well in achieving the price stability that is its central mandate. Europe has avoided episodes of financial turbulence like those through which it suffered in the early 1990s. And the elimination of currency risk within the euro area has strongly stimulated the growth of European securities markets. All these are positive effects.

At the same time the euro area's one-size-fits-all monetary policy has proved uncomfortable for some of the participants. Countries like Portugal and Italy with high labor costs and inadequate competitiveness, no longer able to devalue their way out of their difficulties, now face years of high unemployment and grinding deflation. Eliminating the devaluation option has not magically rendered European labor markets more flexible. Nor has it resulted in an improvement in fiscal discipline.

Clearly, more time will have to pass before analysts can say with confidence whether or not the experiment is a success. But this is of little help to European countries outside the euro area now confronted with the decision of whether to join and for countries in other parts of the world considering whether to emulate Europe's example. This book, edited by two of the deans of European monetary integration studies, suggests ways of thinking about these issues. The central chapters consider the eastward expansion of the euro area to encompass the accession economies (the new members of the European Union admitted in 2004). In practice, of course, it is not only the accession economies that face this dilemma; thus, another contribution addresses the implications for the United Kingdom of staying out. A second set of chapters then analyzes the prospects for monetary unification in Asia and Latin America and, in the Latin case, whether dollarization is an attractive option.

A first question the reader would like to be able to answer with the help of this book is: how quickly and how far is the euro's domain likely to expand? Jarko Fidrmuc offers an upbeat assessment on the grounds of extensive economic linkages, especially intra-industry trade, between the euro area and the new EU members; this bodes well for the harmonization of business cycles, which should in turn ease life with a single currency. Ansgar Belke and Ralph Setzer suggest that the elimination of exchange rate variability vis-à-vis the euro area may also encourage investment and employment growth. But Michele Ca'Zorzi and Robert De Santis warn that both macroeconomic disturbances and monetary policy transmission will continue to differ between Western and Eastern Europe; they observe that the single monetary policy is likely to be adapted to economic conditions in the much larger west, meaning that the costs will be borne by the accession economies. Carsten Hefeker argues that adopting the euro offers the accession economies a guarantee of price stability but may weaken the incentive to reform (in a model where the existence of product and labor market distortions gives the monetary authorities an incentive to inflate and agents an additional reason, namely the promise of lower inflation, to invest in structural reform, but only when there exists a national central bank). Alejandro Micco, Guillermo Ordonez and Ernesto Stein, in their analysis of the benefits for the UK, are similarly cautious; they put the impact of adopting the euro on the country's trade toward the lower end of the range of published estimates.

It is not surprising that these papers settle for providing ways of thinking about the issue of euro area enlargement without providing definitive answers to the questions of how far and how fast. It is hard to imagine a single model capable of incorporating these varied aspects of the problem such as would be needed for a definitive cost-benefit analysis. In any case, the decision of whether to join is likely to be heavily influenced by political factors, which figure hardly at all in this book. Many people in the accession economies see adopting the euro as a way of becoming first-class Europeans. But many Britons harbor reservations about the European project, and sterling remains a powerful symbol of national sovereignty and of the country's global ambitions. Political factors like these suggest that the euro area will expand eastward before it expands to the northwest.

A second question the reader would like to be able to answer is: what is the likelihood of other regions following Europe's example? For Latin America the prospect seems far-fetched. Intra-regional trade is limited, and, as Felipe Larrain and Jose Tavares show in their chapter, differences in the structure of trade and production create a need for uncomfortably large intra-regional real exchange rate fluctuations. Simon Bolivar and Hugo Chavez notwithstanding, Latin America lags behind Europe in its aspirations of political integration and hence in its readiness to invest in building regional institutions. In the absence of these prerequisites for monetary unification, the alternative for Latin American countries that are very small, very open, or very prone to monetary instability is to unilaterally adopt the dollar.

The situation in East Asia is less clear cut. Intra-regional trade and investment, already high by the standards of other regions, are expanding strongly. There is considerable synchronization of business cycles. The idea that the liberalization of capital flows implies a need for exchange rates to move more freely has an awkward feel for Asian countries wedded to a model of export- and foreign-investment-led growth. These observations have given rise to a proliferation of studies, like that of Yin-Wong Cheung and Jude Yuen here, analyzing the symmetry of disturbances, the speed of adjustment, and other factors pointed to by the theory of optimum currency areas as a way of gauging what countries are the most plausible candidates for forming a monetary union.

It is hard to avoid feeling that these exercises miss the point. In Europe, monetary unification was part of a larger political bargain. To be sure, Asian countries have sought to develop deeper economic and financial cooperation in recent years. But every time a Japanese prime minister visits the Yasukuni Shrine, we are reminded of the limits of political cooperation in the region and hence of the obstacles to establishing an Asian Central Bank. For this if for no other reason, Europe's monetary union is likely to remain one of a kind for the foreseeable future.

Barry Eichengreen
University of California, Berkeley