form or its modern economic-environment form. These are absolutely central issues that need discussion for economists interested in moral assessment.

The third problem is that Vickers mislocates the source of the problem he is concerned with. He is absolutely right that economics is not value free in its practice. But no human activity is. Individual practitioners will, as Vickers recognizes, be influenced by their moral and other values in choosing the problems they pursue and the solutions that they find adequate. Indeed, economics as a profession—like any other profession—is committed to various sorts of values (e.g., clarity or testability). It is important to recognize that such values play a role in the practice of economics, but it tells us little of relevance about the role of moral considerations in economics.

The main relevant question, I think, is not *whether* economists in their professional role should make prescriptive judgments about economic policy, but rather *how and when* this should be done. A natural and common view is that the bulk of economists should focus on empirical or conceptual work, and that the normative questions are best reserved for economists and moral philosophers specializing in those questions. Applied normative economists will issue prescriptions based on clearly identified assumptions (if you want to promote these values in these ways, then you should . . .). Theoretical normative economists will also mathematically investigate the implications of various normative properties and theories (e.g., utilitarianism, maximin, envy-freeness). Indeed, work in the theory of social choice over the last 40 years (e.g., that of Sen and of Roemer) has greatly advanced our understanding of the core moral issues involved. Of course, this view of normative economics may be controversial, but given the important work in recent normative economics Vickers should have discussed it in much more detail.

In short, Vickers is right that value judgments and ethical judgments in particular are inevitably present in economic policy recommendations. He is wrong, however, to hold that we can't adequately separate the empirical from the normative questions. We can, and normative economics—primarily in the form of the modern theory of social choice—systematically investigates the core normative assumptions and their implications for policy. None of this, however, undermines Vickers claim that continued, and perhaps increased, interaction between economics and moral philosophy is important for an adequate understanding of the issues involved.

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F International Economics

Financial Markets and European Monetary Cooperation: The Lessons of the 1992–93 Exchange Rate Mechanism Crisis. By Willem H. Buiter, Giancarlo Corsetti, and Paolo A. Pesenti. New York: Cambridge University Press, 1998. $49.95. ISBN 0–521–49547–4.
JEL 98–0932

The causes of the European currency crises of 1992–93 continue to be hotly debated. On one side, "fundamentalists" argue that conventional macroeconomic variables, notably Germany's tight monetary stance after reunification, can rationalize the near collapse of the European Monetary System (EMS) in 1993. But this account fails to explain the timing, severity, or direction of speculative attacks on European currencies. Unfortunately, the alternative "self-fulfilling crisis" interpretation, based on an arbitrary selection among multiple equilibria by fickle financial markets, can only rationalize these attacks—it cannot truly explain them. Self-fulfilling models are consistent with the empirical evidence (from interest rate differentials and option prices), suggesting the crises were not fully anticipated in the financial markets, but they do not explain why the shift between different equilibria occurred.

In this book, some of the heat of this debate is replaced with the light of elucidation. By developing a typology of speculative attacks, the authors can carefully articulate where the important issues and distinctions lie. They develop a game theoretic model that provides a "fundamental" explanation for shifts between various equilibria in a conventional model of an open macroeconomy. This helps to reconcile the two existing views of the European currency crises, producing an amalgam that is more empirically appealing than fundamentalist explanations, yet offers an insight beyond that of the "self-fulfilling speculative attack" literature.

After outlining the book in chapter 1, the authors devote chapters 2 and 3 to a detailed narrative of the evolution of the Maastricht route to European Monetary Union (EMU), culminating in the EMS crises of 1992–93. While this material has been covered extensively elsewhere, the detailed reconstruction of the late August and early September 1992 prologue to crisis proves illuminating in light of the subsequent analysis. Chapters 4 and 5 review the voluminous empirical and theoretical economic literature on the crises, respectively.

The analytical heart of this book lies in chapters 6 through 8. Existing explanations of the European currency crises have viewed the EMS as a set of independent bilateral pegs, rather than as a holistic, interconnected system. The authors argue this has been their decisive flaw. Using a standard macroeconomic model, they employ a game theoretic approach to investigate the strategic interactions among members of the EMS. This analysis is based on three key assumptions. First, the "center" country (Germany) will not cooperate with the periphery. Instead, it unwaveringly pursues solely domestic objectives, primarily price stability. Second, peripheral countries (non-German EMS members) suffer a cost when they devalue against the Deutsch Mark (DM); this is the "commitment technology" that helps them overcome the time consistency problem that has led to an inflationary bias in the past. Although not developed explicitly, both of these assumptions are plausible in the light of the conventional "tying one's own hands" rationalization of the EMS, whereby inflation-prone central banks in the European periphery peg their DM exchange rate to inherit the monetary credibility of the Bundesbank.

The third assumption is the most novel and important. Political reality imposes a "national horizontal equity" constraint. When the peripheral countries cooperate, their relative welfare must be unaffected by cooperative actions. If side payments are ruled out, identical peripheral countries must behave identically in a cooperative equilibrium. In essence, the framework dissolves into a two currency noncooperative game between the center and a seamless periphery.

Similarly to the self-fulfilling crisis literature, multiple equilibria can emerge in this model. But they can be distinguished by the nature of cooperation among periphery countries—a political fundamental. When a positive demand shock hits the center country (German reunification), two equilibria are possible. The periphery can cooperate: all peripheral countries will either choose to maintain their DM pegs or to devalue modestly against the DM (a DM revaluation). Alternatively, cooperation in the periphery can break down, in which case a small number of peripheral countries will devalue aggressively, while the remainder maintain their DM pegs.

As shown in chapter 9, this is a successful positive economic model. If one believes that cooperation in the periphery broke down in early September 1992—as the discussion in chapter 3 suggests—then the speculative attacks on "weak" peripheral currencies such as the lira, peseta, and sterling are explicable. However, some puzzles remain. The model suggests that the threat to peripheral countries which maintain their DM pegs should diminish as other countries devalue. But it seems that the speculative attacks on the Franc intensified after the initial crisis, perhaps pointing to a greater role for the self-fulfilling approach than this model allows.

While the model is successful in positive terms, its normative aspects (discussed in chapter 10) are not fully developed. This is disappointing. The model seems to have important welfare implications. For example, it has been widely argued that Britain's departure from the gold standard in 1931 should not be characterized as competitive devaluation, based on a "beggar-thy-neighbor" rationale. Rather, sterling devaluation benefited the system as a whole by relaxing worldwide monetary conditions. Since (given the horizontal equity constraint) the noncooperative solution may welfare dominate the cooperative solution, the model developed in this book provides some justification for this analysis of the interwar gold standard. A similar description could be applied to the 1992–93 devaluations in Europe. But if this is the case, should we really think about the events of 1992–93 as a crisis at all? Perhaps Europe as a whole benefited from the currency crises and the consequent monetary relaxation. Paradoxically, the breakdown of cooperation in the periphery in September 1992 may have been the foundation for the recovery and renewed cooperation that restored the momentum to European monetary integration by mid decade. Echoing the famous words of British Prime Minister James Callaghan, with the benefit of hindsight, one might comment: "Crisis? What Crisis?"

Although the absence of this discussion is a missed opportunity, this book is nevertheless an important addition to the literature on European monetary integration. While self-fulfilling speculative attack models are intellectually satisfying and theoretically elegant, they run the risk of "thinking economists out of a job": if the psychology of financial markets is the key explanatory variable in currency crises, shouldn't central banks employ psychiatrists rather than economists? This book offers a commonsense response to this provocative view. The authors develop a model that accords an important and necessary role to multiple equilibria and financial market expectations, while still allowing fundamentals—albeit of a political rather than economic nature—to be central. Economic analysis—rather than the whims of financial markets—is at center stage in this richer environment. When economists broaden their horizons beyond a narrow definition of their discipline, this book demonstrates that they can find something useful and important to say.

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H Public Economics

Government for the Future: Unification, Fragmentation and Regionalism. Edited by Å. E. Andersson, B. Hårsman and J. M. Quigley. Contributions to Economic Analysis Series, No. 238. Amsterdam: North Holland, Elsevier Science B.V., 1997. Pp. 313. $140.75. ISBN 0–444–82767–6. *JEL 98–0158*

This book consists of a number of papers presented at various international conferences sponsored by the Institute for Futures Studies in Stockholm. Initial chapters provide a theoretical background to the fiscal functions of the public sector and the assignment of those functions among levels of government, followed by wide-ranging case studies of public finances in six countries. Attention is given to changes in the relative size of the public sector in the economy, the changing composition of expenditure patterns, and, perhaps most interestingly, the restructuring of fiscal responsibilities by levels of government.

Chapters 1 and 3 contain standard theoretical material on the fiscal functions of government and the theory of social goods along with a novel taxonomy that differs from the traditional Distribution, Allocation, and Stabilization (DAS) functions. Distribution, Risk reduction and sharing, and Infrastructure (DRI) are offered as better reflecting changing priorities and expenditure patterns, in particular the burgeoning category of social insurance.

Chapter 4 turns to a theoretical discussion of fiscal federalism and the trend toward greater decentralization in the course of economic development. Federal countries tend to have lower government expenditures-to-GNP ratios than do centralized countries, which is thought to reflect greater efficiency at lower levels, an observation deserving further research. The authors suggest that decentralized provision is called for in the case of private-type goods with differing demands, and of congested club goods with similar demands, but there is no discussion of nonrival (public) goods with spatial characteristics.

As may be inevitable in a collection of essays of this kind, the volume is somewhat diffuse and the theoretical sections are not closely integrated with the case studies. Moreover, most of the empirical/institutional material ends in 1990, stopping short of events (such as devolution of budgetary choices in the United Kingdom) that point to future changes. Nevertheless, the case studies contain much interesting material.

Belgium (chapter 6) offers a fascinating