the trade agreement. For example, it has been argued that Canada made implicit side payments to the U.S. as part of the Canada-U.S. FTA by agreeing to changes in domestic policy toward energy, foreign investment and pharmaceuticals that were desired by the U.S.

The remaining essays evaluate the success of the U.S. policy of encouraging PTAs in Asia and the Americas. In Chapter 2, Paul Wonnacott points out that the existence of overlapping preferential agreements in the Americas creates difficulties for the objective of creating a single hemispheric trade agreement. In a free trade area (FTA) such as NAFTA, each country maintains its own external tariff. The differences in tariff rates between countries create arbitrage opportunities, so agreements must contain rules of origin that outline conditions required for duty free access to the partner country market. A customs union (CU) avoids this problem by adopting a common external tariff for all countries, but is impractical in the western hemisphere because the U.S. would be unwilling to give up control of its external tariff. Wonnacott proposes an agreement that would be a hybrid of a CU and a FTA.

In Chapter 3, Gary Saxonhouse reports the history of U.S. efforts to turn the Asian Pacific Economic Cooperation (APEC) into a PTA, and notes that despite U.S. efforts the Asian members seem more interested in an agreement that commits the member countries to unilateral liberalizations. His conclusion is that U.S. efforts toward regionalism may primarily have the effect of expediting multilateral agreements. A concluding chapter by Claude Barfield argues that U.S. interests are best served by multilateral negotiations.

Overall, this book provides an excellent and readable survey of the welfare analysis of PTAs, as well as an account of recent U.S. trade policy regarding them. The welfare analysis is almost exclusively diagrammatic, so the book will be accessible to a wide audience. As such, it may help to correct the popular misconception that free trade and FTAs are synonymous.

The reader should be aware, though, that the authors have focused primarily on the potential costs of PTAs. However, multilateralism may have weaknesses as well. For example, further cuts in tariffs on manufactured goods without reductions on agricultural goods also is a second best exercise that has the potential to be welfare reducing. Could liberalization through PTAs be desirable if it results in tariff reductions on a wider range of goods, service, and factor flows than is possible under multilateral negotiations? In fact, the authors note in the preface that an exception to their critique of PTAs arises in the case of deep integration, as in the European Union and its single market. Because the European Union has the same potential to be trade diverting as other PTAs, this exception must arise out of its success in expanding market integration and policy coordination to include other dimensions beyond trade. If regional agreements such as NAFTA and Mercosur have the potential to be stepping stones to such deep integration, then one's view of them might be less pessimistic.

ERIC W. BOND
Pennsylvania State University

Globalizing capital: A history of the international monetary system. By BARRY EICHENGREEN. Princeton: Princeton University Press, 1996. Pp. viii, 223. $24.95. ISBN 0-691-02880-X.

JEL 97-0886

This book offers a timely reminder that contemporary discussion of international monetary reform raises issues that are far from new. As the author traces the evolution of the international monetary system from the advent of the classical gold standard in 1870 to the present day, one is struck by how fresh these issues seem. Be it with the Mexican peso crisis of 1994 or the EMS crises of 1992–93, the historical episodes resonate. Although developing and centrally planned economies are mentioned in passing, the focus of this book is monetary arrangements among the western industrialized economies, with Europe in the forefront.

The book is divided into four main chapters, bracketed by a short introduction and conclusion. Each chapter describes an international monetary regime: the classical gold standard of 1870–1913; the chaotic inter-war monetary arrangements; the Bretton Woods

This content downloaded from 206.253.207.235 on Thu, 17 Oct 2019 20:18:39 UTC
All use subject to https://about.jstor.org/terms

era of fixed rates and capital controls; and, the system of floating rates in operation since 1973. For each regime, the author draws on his excellent and extensive research. Yet the book is much more than a survey of earlier work. A number of threads link the various chapters together. At each transition, the author asks what lessons were drawn from the demise of the previous regime, and on several occasions concludes that the wrong prescription for the future was adopted. Furthermore, three main themes run throughout the book, linking the material together. Domestic politics, changing perceptions of the effectiveness of monetary policy in determining real outcomes, and the evolution and increasing sophistication of international capital markets all help to explain the transition from one monetary regime to another.

But this volume is more than either a history or an economic treatise. Above all, it is an exercise in institutional analysis in the broadest and richest sense. Students of open economy macroeconomics will be familiar with the "inconsistent quartet." It is impossible for a country to simultaneously peg its exchange rate, allow unfettered movement of international capital and pursue free trade, while retaining any autonomy over its monetary policy. *Globalizing Capital* puts institutional flesh and blood on the bare bones of this abstract, theoretical construct. More than simply describing how each regime dealt with the constraints imposed by the inconsistent quartet, it explores the reasons behind the outcomes that emerged.

Economists are familiar with the concept of path dependence that results from the network externalities implicit in any monetary convention. However, they often appear to be at a loss when deciding how to deal with such dependence. This book draws on the richness of other disciplines to investigate the political, social, and historical context that drives economic outcomes when path dependence matters. As such, it offers a worthy model for other economic research. For example, the author criticizes the view that the credibility of an exchange rate peg is grounded in the length of time during which the parity has been maintained. The belief that a durable commitment to a specific peg builds the credibility of that peg was an important reason for the delay in adjusting parities in Mexico, Europe, and South East Asia. But Eichengreen argues compellingly that credibility is born out of the deeper political and institutional context, rather than simply the duration of the existing peg. The credibility of gold standard parities resulted from the narrowness of the electoral franchise and the lack of a perceived role for activist monetary policy, rather than the durability of the parities themselves. (Indeed, either these parities or convertibility had been suspended during crisis periods.) Credibility is often an important element of formal models of the exchange rate, not least in the recent voluminous target zones literature, but is usually determined outside the model. Some idea of where it comes from is therefore necessary as the formal research agenda in exchange rate economics proceeds. This book offers some interesting guideposts for this research. Moreover, it has profound implications for the design of exchange rate systems and for policy makers' responses to exchange rate crises.

Reflecting its origin in a series of lectures given in 1994, the book is relatively pessimistic about the prospects for greater monetary integration in Europe, as intra-European capital mobility increases. Subsequent events have served to moderate such pessimism and the earlier chapters offer some reasons why. The author characterizes the widening of EMS fluctuation bands to ±15 percent in 1993 as an inevitable move towards floating given the constraints imposed by the inconsistent quartet. However, if one examines the fluctuations of the deutsche mark/French franc exchange rate since 1993, it has remained remarkably stable despite the greater permitted fluctuation. Perhaps the institutional changes introduced in August 1993 simply represent a return to the tactics pursued by central banks under the gold standard: suspension of the parity during crisis periods, followed by restoration of historical parities when calm and order return to the exchange markets. While disagreeing with one of the book's conclusions, one can still admire and exploit the power of the analysis contained therein.

This content downloaded from 206.253.207.235 on Thu, 17 Oct 2019 20:18:39 UTC
All use subject to https://about.jstor.org/terms

This is an excellent book. Researchers in open economy macroeconomics will benefit from the richness of the institutional analysis that complements other, more formal economic approaches. Aside from enjoying a well-written treatise on a compelling and important subject, economists from outside the field will find this work of value. It illustrates how the approaches adopted by other disciplines can be combined with economic analysis to mutual benefit.

HUW PILL
Harvard University

International financial integration: A study of interest differentials between the major industrial countries. By RICHARD C. MARSTON. Japan–U.S. Center Sanwa Monographs on International Financial Markets. Cambridge; New York and Melbourne: Cambridge University Press, 1995. Pp. xii, 197. $39.95. ISBN 0–521–47100–1. *JEL 96–1394*

This book examines the twin processes contributing to financial market integration: deregulation of national capital markets and liberalization of international capital flows. It argues that these processes are interrelated and that competitive pressures from international markets have often spurred domestic deregulation. Professor Marston provides a useful description of the progress made in five countries (Britain, France, Germany, Japan, and the United States) toward deregulating domestic markets and liberalizing restrictions on international capital flows, but his main focus is on the consequences of those changes for firms and investors rather than on the changes themselves.

As one indication of the breathtaking changes in international financial markets over the past generation, Professor Marston notes that cross-border transactions in bonds and equities involving U.S. residents grew from 2.8 percent of GDP in 1970 to 92.5 percent of GDP in 1990. But his focus in the book is on returns, especially interest rate differentials, rather than on the volume of cross-border flows or on the stock of cross-border liabilities. This choice is the right one given his interest is analyzing changes since the early 1970s and the availability of data.

Do borrowing costs differ systematically across countries? Have the differences declined over time? Professor Marston answers these questions by providing evidence on four sources of potential systematic differences: domestic regulations or conventions in less than perfectly competitive markets that lead to large differentials between domestic money market and domestic loan rates, capital controls that lead to differentials between domestic money market and offshore (Eurocurrency) rates, deviations from uncovered interest parity that lead to differentials in Eurocurrency rates adjusted for expected exchange rate changes, and expected changes in real exchange rates that lead to differences in borrowing costs even if all of the other sources are absent.

Of course not all of these differences would be eliminated in an integrated financial market. Competitive pressures should reduce gaps between money market and loan rates in deregulated markets and no significant gap between domestic money market and Eurocurrency rates should persist once capital controls are removed. But differences in nominal interest rates adjusted for expected exchange rate changes can persist, for example, because of risk premia and expected changes in real exchange rates would not be eliminated. Borrowing costs in integrated markets should, however, differ only by currency and not by location.

Most of the book is devoted to examining the empirical evidence on each of the four sources of potential differences in borrowing costs. A chapter is devoted to each of the sources except uncovered interest parity, which gets two chapters (one focusing solely on the European Monetary System). On the basis of this empirical evidence, the author concludes that integration of the financial markets of the five countries he examines has progressed to the point that markets are separated by currency and not by regulations and controls that were formerly important.

The two chapters on the deregulation of domestic markets and the liberalization of capital movements document the changes that have occurred in the major industrial countries since the early 1970s. Deregulation has followed a different path in each country

This content downloaded from 206.253.207.235 on Thu, 17 Oct 2019 20:18:39 UTC
All use subject to https://about.jstor.org/terms