# Response to Ritschl and Wolf's Endogeneity of Currency Areas and Trade Blocs: Evidence from the Inter-War Period Andrew K. Rose, UC Berkeley CEPR and NBER

Ritschl and Wolf (2003) rely on an unusual variable for currency unions in their empirical analysis. In particular, their data set indicates that all the country-pairs listed below were considered to be in currency unions in the interwar period. Thus, according to Ritschl and Wolf, Austria and Bulgaria were in a currency union. Indeed, Austria was also in currency union with Czechoslovakia, Denmark, Finland, Germany, Greece, Hungary, Italy, the Netherlands, Norway, Roman, Spain, Sweden, Turkey, and Yugoslavia. And don't forget the monetary union between New Zealand and Germany! There are 267 pairings listed in all by them.

This seems odd; I've never heard anyone argue that these currency unions existed. Ritschl and Wolf probably mean "fixed exchange rates" instead of "currency unions." But the two are radically different! A currency union is simply not the same as a fix; ask any Dane! Hong Kong is fixed to the dollar, but they're certainly not in a currency union. As I concluded in my original *Economic Policy* paper,

"...Two countries which use the same currency trade much more than comparable countries with their own currencies; my point estimate is over three times as much. The impact of a common currency is an order of magnitude larger than the effect of reducing moderate exchange rate volatility to zero but retaining separate currencies..."

Indeed the whole point of the original paper was to say that my results (of the currency union effect on trade) were consistent with those of the literature (which had, to that point, focused on countries with different currencies), since previously a currency union had been conceptually equated to a fix with zero exchange rate volatility. In practice though, a currency union turns out to be quite different. (Why remains unclear ... but that's a different issue).

Just for the record, a standard definition of a currency union is in my *European Economic Review* paper with Glick:

"... By "currency union" we mean essentially that money was interchangeable between the two countries at a 1:1 par for an extended period of time, so that there was no need to convert prices when trading between a pair of countries."

So I don't think the evidence of Ritschl and Wolf bears strongly on the issue of currency unions and trade one way or another. It seems to be about exchange rate fixes and trade, not currency union and trade.

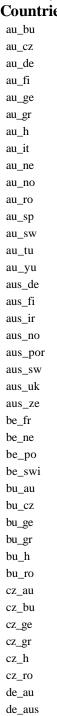
### Country Pairs For which CU\_IN=1 meaning, according to Ritschl-Wolf (2003) "Both Countries in Same Currency Arrangement"

#### **Country Mnemonic Guide**

USSR Soviet Union CA Canada US **United States** ARG Argentina JA Japan ΑU Austria BE Belgium CZCzechoslovakia FR France GE Germany IT Italy NE Netherlands SW Sweden SWI Switzerland BUBulgaria DE Denmark FΙ Finland GR Greece Η Hungary NO Norway PO Poland POR Portugal RO Romania SP Spain TU Turkey YU Yugoslavia IR Ireland UK United Kingdom AUS Australia ZE New Zealand

#### **Example:**

## Country Pairs For which CU\_IN=1 meaning, according to Ritschl-Wolf (2003) "Both Countries in Same Currency Arrangement"



de\_fi de\_ge de\_h de\_ir de\_it de\_ne

de\_no

de\_por

de\_ro

de\_sp

 $de\_sw$ 

de\_tu

de\_uk

de\_yu

de\_ze

fi\_au

fi\_aus

fi\_de

fi\_ge

fi\_h

fi\_ir

fi\_it

fi\_ne

fi\_no

fi\_por

fi\_ro

fi\_sp

fi\_sw

fi\_tu

fi\_uk

fi\_yu

fi\_ze

fr\_be

fr\_ne

fr\_po

fr\_swi

ge\_au

ge\_aus

ge\_bu

ge\_cz ge\_de

ge\_fi ge\_gr

ge\_h

ge\_it

ge\_ne

ge\_no

ge\_ro

ge\_sp

ge\_sw

ge\_tu

ge\_yu

gr\_au

gr\_bu

gr\_cz

gr\_ge

gr\_h

gr\_ro

h\_au

h\_bu

h\_cz

h\_de

h\_fi

h\_ge

h\_gr

h\_it

h\_ne

h\_no

h\_ro

h\_sp

h\_sw

h\_tu

h\_yu

ir\_aus

ir\_de

ir\_fi

ir\_no

ir\_por ir\_sw

ir\_uk

ir\_ze

it\_au

it\_de

it\_fi

it\_ge

it\_h

it\_ne

it\_no

it\_ro

it\_sp

it\_sw

it\_tu

it\_yu

ne\_au

ne\_be

ne\_de

ne\_fi

ne\_fr

ne\_ge ne\_h

ne\_it

ne\_no

ne\_po

ne\_ro

ne\_sp

ne\_sw

ne\_swi

ne\_tu

ne\_yu

no\_au

no\_aus

no\_de

no\_fi

no\_ge

no\_h

no\_ir

no\_it

no\_ne

no\_por

no\_ro

no\_sp

no\_sw

no\_tu

no\_uk

no\_yu

no\_ze

po\_be

po\_fr

po\_ne

po\_swi

por\_aus

por\_de

por\_fi

por\_ir

por\_no

por\_sw

por\_uk

por\_ze

ro\_au

ro\_bu

ro\_cz

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ro\_fi

ro\_ge

ro\_gr

ro\_h ro\_it

ro\_ne

ro\_no

ro\_sp

ro\_sw

ro\_tu

ro\_yu

sp\_au

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sp\_fi

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sp\_it

sp\_ne

sp\_no

sp\_ro

sp\_sw

sp\_tu

sp\_yu

sw\_au

sw\_aus sw\_de

sw\_fi

sw\_ge

sw\_h

 $sw\_ir$ 

 $sw\_it$ 

sw\_ne

sw\_no

sw\_por

sw\_ro

sw\_sp

sw\_tu

sw\_uk

sw\_yu

sw\_ze

swi\_be

 $swi\_fr$ 

swi\_ne

swi\_po

tu\_au

tu\_de

tu\_fi

tu\_ge

tu\_h

tu\_it

tu\_ne

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uk\_ze yu\_au yu\_de yu\_fi yu\_ge yu\_h yu\_it yu\_ne yu\_no yu\_ro yu\_sp yu\_sw yu\_tu ze\_aus ze\_de ze\_fi ze\_ir ze\_no ze\_por ze\_sw ze\_uk

Taken from: http://www.wiwi.hu-berlin.de/wg/ritschl/ritschl\_wolf\_exceldata.zip In particular, the two files of relevance are "series\_names.xls" and especially "ritsch\_wolf\_data1.xls" (CU\_IN is column "W")