

for a successful monetary union, political differences among these three countries make it difficult to imagine an economic integration.

In the final chapter, "National Currency: When Do Monetary Unions Fall Apart?", Volker Nitsch analyzes previous monetary unions. He uses large panel data to find that political breakups and large inflation differences were the major reasons of monetary union dissolution of the period from 1948 to 1997.

A group of authors in the book attempted to answer primary macroeconomic questions regarding the monetary union in Europe (EMU). In addition, other authors analyzed possibilities and benefits of potential monetary unions in other regions in the future. This book gives numerous excellent insights in the field. However, readers will notice that because much more remains unknown, many other researchers will be attracted to study these issues.

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***Structural Unemployment in Western Europe: Reasons and Remedies.*** MARTIN WERDING (editor). Cambridge, MA: The MIT Press, 2006. Pp. ix, 350. \$45.00.

The book is a collection of papers that originated from a conference in Munich in December 2002. Two introductory chapters summarizing the labor markets in Europe are followed by ten chapters relating to individual countries, written by researchers in those countries. The idea is to provide a diversity of experiences and public policies in dealing with problems of structural unemployment. This approach works because, despite how we tend to treat the subject in introductory economics courses, there is no monolithic European labor market with relatively high and persistent unemployment rates. There is enough

variation among the ten countries surveyed, and within each country over time, to perhaps tease out several factors causing the high structural unemployment rates of some countries. There are also differences in how each country has dealt with unemployment, so that public policies dealing with the problem can be recommended.

In the introductory chapter, Stephen Nickell presents a model of equilibrium unemployment. He uses the model along with descriptive statistics to provide an overall picture of European unemployment rates. His purpose is to distinguish the role of shocks from the role of institutions in causing deviations from equilibrium. He concludes from a simple but interesting analysis that institutional factors such as unemployment benefits, labor unions, employment protection, and labor taxes explain much of the differences in unemployment rates across countries, and the changes in unemployment rates within countries since the early 1980s.

Edmund Phelps follows with a chapter outlining some of his newer ideas about why unemployment differs among countries (some of this analysis appears in his Nobel lecture, Phelps (2007)). The main causal factor in this new approach is what he calls “economic dynamism”, which directly affects economic performance, and in turn, unemployment. Dynamic economies have greater rates of innovation and are also better at directing the innovations toward efficient outcomes. Because entrepreneurs play the key role in this process, institutions that provide incentives for entrepreneurs and provide them with access to markets are very important. In comparing the relatively high unemployment rates of Western Europe to the lower rates of the United States and United Kingdom, Phelps argues that Western Europe has more of a corporatist market system which erects barriers to entrepreneurship, social policies that attempt to protect individuals from the harsh nature of competition, and cultural attitudes that look down on ambition, initiative, and self-help.

Even though the theory is admittedly incomplete, Phelps offers some empirical support. Investment booms are a crude measure of the dynamism in his model. He notes that institutions in countries where there was an investment boom in the 1990s were markedly different from those where a boom did not occur. Specifically, countries that had a strong general investment boom tended also to have higher fixed investment rates, higher real exchange rates, higher labor’s share in national income, greater stock market capitalization, less red tape and

union influence, and more university graduates as a percentage of the labor force.

With these two chapters in hand, the reader is then taken on a whirlwind tour of ten European economies. The differences in the operation of the economies and the macroeconomic experiences since 1970 are quite striking. Sweden (described in a chapter by Bertil Holmlund) has been largely successful in recovering from the international recession of the early 1990s, primarily through policy changes that have contributed to a decline in the non-accelerating inflation rate of unemployment (NAIRU). What comes as somewhat a surprise is the extremely high (and pro-cyclical) absenteeism in Sweden. In 1990, absenteeism rates averaged close to 18 percent. One wonders how an organization can operate when almost a fifth of its employees are absent on any given day. The Netherlands (authored by Jan C. van Ours) also brought down unemployment rates from the high levels of the 1990s but it experienced lower labor force participation rates due to generous disability benefits. Finland (Erkki Koskela and Roope Uusitalo) is a case study of poor fiscal policy response, and how aggregate shocks can interact with institutions in determining the unemployment rate. Ireland (Brendan Walsh) has been hugely successful in increasing economic growth and bringing down very high unemployment rates partly through broadening the centralized wage bargaining process to include objectives such as “bringing about a fairer and more inclusive Ireland” and “promoting an entrepreneurial culture”. The chapter also has an interesting discussion of how emigration determined in part the Irish equilibrium unemployment rate. The key to Britain’s success (Christopher A. Pissarides) was a combination of monetary policy reform and a decline of trade union power. Pissarides also has an interesting discussion of how monetary policy can actually be considered an institutional constraint.

The book then turns to the economies that have not been quite so successful in lowering unemployment rates. Jean Pisani-Ferry describes how in France the universal minimum income program of 1988 created extremely perverse incentives: marginal tax rates in some instances were over 100%. It is disappointing that the chapter does not contain much about the impact of the 35 hour work week. Germany (Norbert Berthold and Rainer Fehn) seems to be doing everything wrong. Very high real wages, wage rigidities, a lack of wage differentiation and high reservation wages have created the prime

example of the hysteresis model. The apprenticeship programs that worked so well in the 1970s are not appropriate in modern economies with technological changes that lead to the creative destruction necessary for the greater returns and opportunities for entrepreneurial success. In Italy (Giuseppe Bertola and Pietro Garibaldi), much of the unemployment problem is restricted to the southern regions, largely as a result of 1970s legislation that limited wage differentials across geographic regions. Combined with legislation that prevented firms from dismissing redundant employees, aggregate shocks have led to large increases in unemployment, especially among youth. Finally, for Spain (Samuel Bentolila and Juan F. Jimeno) it is easy to forget how recent its transition from dictatorship to democracy has been. The end of the Franco regime and the sharp recession of the 1970s led to excessively protective labor institutions that are now difficult to change.

The book is accessible to anyone with a principles-level understanding of macroeconomics. There are few equations, and no esoteric econometric techniques, but a full understanding of the issues would require familiarity with the work of Olivier Blanchard and Justin Wolfers (2000) and panel estimation. But for someone looking for good examples of how institutions can affect economic performance, there are plentiful anecdotes in this book. There is no summary chapter at the end of the individual country chapters; perhaps the summary is in the title of the introductory chapter (by Martin Werding): “Still More Questions Than Answers”.

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