In his recent response to our paper on his website, Andrew Rose seems to acknowledge our finding of endogeneity, but wrongly claims we equate fixed exchange rate regimes with currency unions.

Here is our response to the response:

Nice try, but misses the point, we think. We examine currency arrangements which are definitely not currency unions. They don't have to be.

Within the gravity model, these inter-war currency areas do exactly what Rose's post-war currency unions do: they have breathtakingly high coefficients on the area dummy.

Taken by itself, this is already bad enough news: it doesn't take a currency union to get these super-high coefficients. Far weaker forms of currency arrangements apparently play the trick. This alone would considerably weaken the case for currency unions as engines of trade.

What is worse, we find robust evidence that these coefficients are spurious. Identifying the treatment effects both over time and against control groups within our sample, we obtain coefficients that almost disappear and become insignificant. That is what we do.

If currency unions are indeed creating a whole lot of trade, they need to behave very differently than our currency areas. High trade creation coefficients prove nothing. It needs to be shown that in a sufficiently rich panel with lots of pre- and post treatment observations, 1. there are no anticipation effects contaminating the data, 2. the step from pre-treatment to treatment boosts the trade coefficient, 3. countries are selected into the currency unions at random, and the trade coefficient survives against a control group.