

Chapter 30 European Monetary Union

Question 30.4

Locate the ECB working paper no. 138 called “New views on the optimum currency area theory: what is EMU telling us?”. The paper offers a broad literature overview on optimal currency areas (OCAs).

30.4A Which OCA properties were discussed in the early literature and are not mentioned in section 30.2? How do they work?

30.4B Which two problems were identified with the early literature?

30.4C Which new “meta-property” was discussed in the “reconciliation phase”? Explain.

30.4D Why does the long run ineffectiveness of monetary policy increase the attractiveness of forming a monetary union? Explain.

30.4E Which two properties are considered to be the key determinants for the desirability of a monetary union?

30.4F Which two paradigms are associated with these characteristics? Explain.

Question 30.5

Locate the paper by Martin Feldstein called “The euro and the stability pact”, NBER working paper 11249. In this paper, the author discusses the inherent conflict between a monetary union and independent fiscal policies.

30.5A What is this conflict and how does it work out? Explain.

30.5B Why does Feldstein believe that there is a greater need for discretionary fiscal policies in Europe than in the United States and how does this relate to the problem described in A?

30.5C What solution did the designers of the EMU have for the problem described in A?

30.5D Which correction mechanism was envisaged for countries that violate the stability pact? Do you think this is an effective measure?

30.5E Which other disciplinary measures are left for the European central bank and EMU member states to stimulate fiscal discipline after the effective termination of the stability pact?

Question 30.6

The EMU has provided an enormous impetus for research into optimal currency areas. Moreover, it challenged many European countries to reconsider their exchange rate policies in light of the euro introduction. One such country is Iceland, which has its own currency, but which sees itself

confronted with the creation of a large euro block, as its most important trading partner. Working paper no.10 of the central bank of Iceland, called “Is Iceland an optimal currency area?”, (by Willem Buiter) investigates the benefits and drawbacks for Iceland to join the euro area.

30.6A What is the distinction between a symmetric and an asymmetric monetary union? Explain.

30.6B From a microeconomic efficiency point of view, would it be optimal for Iceland to join the euro? Explain.

30.6C What is seignorage and how does it relate to the discussion about a common currency area? Explain.

30.6D What financial stability considerations does a monetary authority face when it considers joining a currency area?

30.6E Willem Buiter is very critical of the theory of optimum currency areas. Can you explain why?

30.6F How does Iceland score in terms of openness and asymmetric shocks? What does this imply for the attractiveness of euro adoption? Explain.

30.6G What does Buiter believe to be the significance of factor mobility for optimal currency areas?

30.6H What is the track record of monetary unions if you look at the historical evidence?