DOWNLOAD PDF MONETARY UNIONS, EXTERNAL SHOCKS AND ECONOMIC PERFORMANCE

Chapter 1 : EconPapers: Monetary unions, external shocks and economic performance: A Latin American

During the last few years there has been a renewed analysis in currency unions as a form of monetary arrangement. This new interest has been largely triggered by the Euro experience. Scholars and policy makers have asked about the optimal number of currencies in the world economy. They have analyzed.

The framework of rules for entry into the Eurozone was laid down in the Maastricht Treaty in This treaty also created the rules for membership of the European Union EU in general. The euro-system The euro-system has two elements - the European Central Bank ECB , which is responsible for all monetary policy in the eurozone euro area , and the National Central Banks CBs of the 19 member countries. Other European countries are free to join the euro area if they meet the criteria laid down in various treaties. The two most important criteria for entry are that the applicant country has demonstrated price stability, and that its public finances are well managed. Co-ordination of macro-economic policies Co-ordination of policy was designed to enable the original 12 economies of the euro-area to converge. A key feature of this was the Stability Pact, which involved members agreeing to keep their economies stable, and keeping their budget deficits under control. This restriction was designed to prevent any unnecessary fiscal stimulus which might de-stabilise the economy, even in the face of high unemployment. However, several countries, including Germany, France, and most notably, Greece, have broken this rule, and this has cast serious doubts about the ability of the euro area to maintain this rule. The European Financial Stability Facility The EFSF was formed to help stabilise the European economies after the financial crisis, recession and sovereign debt crisis, and now forms a key element of the reformulated euro-system. The fiscal compact In attempt to prevent EU countries from running up further debts, the majority of the EU states signed a fiscal compact which opened up their domestic budgets to collective scrutiny. It remains to be see how successful this measure will be, and whether its leads to a full fiscal union. The advantages of the Euro There are several significant benefits of having a single currency area. These are primarily derived from the benefits of fixed exchange rates, and include the following: Transparency Producers and tourists can more easily compare the prices of international goods, services and resources. Lower transaction costs Transaction costs are reduced because there are no commission payments to financial intermediaries. Certainty and investment The Euro creates certainty because firms can predict the cost of imported raw materials and can set the price of their exports, which means they can plan, and are more likely to invest. Trade creation Trade between members of a single currency area is likely to increase because of the benefits of sharing a currency. Job creation Increased trade is likely to generate jobs in those industries that experience increased exports. Discipline against inflation Members cannot take the easy option devaluation to get out of economic difficulty. The disadvantages of the Euro Loss of economic sovereignty Once a country become a member of the euro area, National Central Banks, including the Bank of England, lose their ability to use interest rate policy to achieve independent macro-economic objectives. Following the financial crisis and global recession, recession-hit countries like Greece were not able to reduce interest rates unilaterally. Difficulty of conversion Many European countries, including the UK, may never be able to converge fully with the euro area. In addition, the UK labour market is highly flexible in comparison with France, Germany, and Spain and this also makes convergence difficult. One cap does not fit all Having only one interest rate is not sensible when dealing with a diverse range of economies and economic circumstances. Even within a single currency area, great diversity can exist, suggesting that a common economic policy might be unproductive. Dealing with asymmetric shocks Asymmetric shocks are external shocks that have an unequal impact on an economy or, in this case, the EU area. The following recent shocks did not have an equal effect across Europe: The growing imbalance between the more affluent northern euro members, including Germany, and the increasingly indebted southern ones, including Greece, Italy and Portugal, has also raised the issue of the inadequaces of having a single monetary policy. In these types of circumstance it is argued that a single interest rate will not be appropriate. A member experiencing a negative perhaps domestically originating shock would require lower interest rates and looser monetary policy in comparison with those members less affected. The weakness of an asymmetrical monetary target Having an asymmetrical inflation target means that the ECB must only intervene if the rate is exceeded, and not if inflation falls below the target rate. Critics argue that, as a result, there is a built-in deflationary bias. The euro area has certainly experienced deflationary pressures in recent years. Membership tests In the UK government laid down five conditions for the UK to join the euro area. Economic convergence The trade cycles of the UK and euro area should be in alignment. Flexibility Joining should not harm the highly flexible product and labour markets of the UK. Investment Joining should not discourage domestic investment and FDI. Financial services The City the financial centre should not suffer as a result of membership of the euro area. Growth and jobs Membership should be good for growth and job creation. Given the strength of the case against joining the euro area, even before Brexit, it was increasingly doubtful whether the UK would every scrap the pound. Indeed, the financial crisis re-opened a wider debate about the benefits of enlarging the euro-area. Brexit impact This debate has, clearly, been overshadowed Brexit. With the future of the EU itself now uncertain, there is the increased risk that some members of the euro-area, notably Greece and italy, might wish to revert back to their previous currencies. The single currency does not appear to have led to any great reduction in price differences across Europe. It was thought that price transparency would have brought prices much closer together, but, without perfectly free trade and tax harmonisation, price differences are still likely. For example, considerable price differences in many basic products, such as cigarettes, chocolate, and water, still persist, as indicated below:

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Chapter 3 : Economic and Monetary Union: past and present

And, (b) the effects of different shocks on economic growth, under alternative exchange rate and monetary regimes, including currency unions. In this section I deal with the first set of questions, while in "Section 4 " I address the second set of issues.

Chapter 4 : Monetary Unions, External Shocks and Economic Performance

Monetary unions, external shocks and economic performance: A Latin American perspective The rest of the paper is organized as follows: In "Section 2" I review the literature on currency unions in Latin America.

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