

A BRIEF HISTORY OF THE INTEGRATING OPTIMIZED WALKING AREAS IN TRADITIONAL THEORY

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Abstract

The theory of credibility (George Tavlas) pursues a neoclassical approach, ignoring the demand side. If aggregate offer is the subject of asymmetric shocks, it can no longer be possible to assert the superiority of the fixed rule to discretion, so that giving up currency and currency independence can result as very expensive. Considering Keynesian origin, the traditional theory of optimal foreign exchange areas has focused on the demand side, ignoring the supply. As early as 1969, Kenen (P. B. Kenen) considered the technology shock to be provoked by supply, coupled with other shocks that hit demand, driven largely by changes in consumer preferences.

Key words: *optimal currency area; integration; traditional theory*

I. A BRIEF OUTLOOK ON THE EVOLUTION OF THE TRADITIONAL THEORY OF OPTIMAL CURRENCY AREAS

With regard to the various criteria proposed by the traditional theory of optimal currency areas, one can observe the lack of a general framework in which these criteria can be located (Yshiyama, 1975).

To overcome these limits, a more complex approach has been proposed to allow for the consideration of each criterion as a whole.

This requires that each criterion be assigned a certain valence, so that the conclusion reached will depend precisely on these valences related to the various criteria.

At the same time, this also implies the need to insist on the benefits derived from monetary unification, so that they can be compared to costs.

Traditional theory in fact ignores the benefits because they are considered to be of little significance from a quantitative point of view.

To support Y. Yshiyama's position, it is important to emphasize the implausibility of the hypothesis, which is only pursued by the traditional theory of optimal currency areas, namely that a country decides to move from one regime to another only because this transition is not costly. It goes without saying that such a change is accepted primarily because it has benefits.

The fact that the traditional theory of optimal foreign exchange zones only takes into account the costs, considering the benefits as irrelevant to a monetary union, is only able to establish the inappropriateness of the abandonment of monetary and foreign exchange independence, but cannot define the opportunities for accession to a monetary and currency union.

Bini-Smaghi and Silvia Vori (Bini-Smaghi, Silvia Vori) argue that the discontent offered by the traditional theory of optimal currency zones is due to the fact that there is no trust test to understand whether a geographical area is or not an optimal currency area.

In order to compare the costs and benefits (P. R. Krugman, M. Obstfeld), a curve of the loss of economic stability (decreasing, the cost based on the degree of economic integration) was established and a curve on the benefits of monetary efficiency (rising, representing the benefits derived from the union Currency or monetary union depending on the degree of economic integration). (De Grawe)

In other authors' opinion, empirical verification of the costs and benefits of a monetary union is impossible. In 1990, the European Commission estimated a reduction in transition costs of around 0.4% of Community GDP. However, the EMU allows for the elimination of uncertainty about trade, which would lead to an increase in trade as a result of GDP. And the European Commission estimated (also in 1990) that EMU benefits increased by 1% of European GDP.

The tilt of the cost curve therefore negatively depends on its sensitivity to the degree of openness of the economy, while the geographical position is standardized according to a number of factors defined by the traditional theory, that is the existence of adjustment mechanisms and the degree of diversification of the economy.

But the cost / benefit ratio does not remain immune to criticism. In order to achieve a cost-benefit comparison (G. Gandolfo), it is necessary to define a function related to social welfare, which is very difficult to achieve.

If, on the one hand, EMU benefits (Melitz, 1995) represent a continuous flow, on the other hand costs aim to verify specific shocks.

This comparison can only be possible if the costs are converted into an equivalent continuous flow, with an obvious question of whether the costs are higher than the continuous flow of benefits (in Melitz's view this would be very simple).

II. REFLECTIONS ON THE ADVANTAGES AND DISADVANTAGES OF A MORE DECENTRALIZED ALLIANCE

An integral monetary union is not the only option. Other forms of strategic alliance, less demanding and not requiring a complete delegation of monetary sovereignty, are possible.

Indeed, formal authority can be delegated to joint institutions to a greater or lesser extent to serve the interests of individual states.

Monetary powers must not be as centralized as they are in the EMU or the ECCU (Eastern Caribbean Currency Unit).

The advantage of a more decentralized alliance is that it offers a possible compromise between the pressures generated by the need to defend a non-competitive national currency and the lack of partners willing by a monetary union.

Policies can be traced in common, especially monetary growth and interest rate objectives, but can be implemented individually, depending on the local context. Similarly, the degree of rigidity of exchange rates can be negotiated.

The idea is to enhance the attractiveness of participating coins in the market, while maintaining some of the historical advantages of monetary sovereignty.

Are there states that would opt for this more limited variant? This is certainly not the case for bilateral mergers.

Smaller countries, such as Canada, New Zealand and Belarus, seeking an alliance with a stronger neighbor, may consider this option as viable.

They would have decision-making power in the alliance without losing their national currency. But they would face the same problems as those within a complete monetary union - namely the lack of a flexible partner.

For the United States, Australia or Russia, there would be minor direct benefits if they would give up even a small part of their monetary authority, dividing it with a smaller neighboring country.

Their interests would be much better served if the smaller neighboring country were to adopt the currency of the greater powers, as suggested by the Australians of their neo-Zeeland neighbors (Benjamin J. Cohen).

III. ASYMMETRIC SHOCKS ON DEMAND AND SUPPLY

Facing Europe with the US (T. Bayoumi, B. Eichengreen), it was possible not only to test the presence of asymmetric (temporary) shocks that hit demand, as the traditional theory of the optimal currency areas supports, but also the likelihood of asymmetric shocks (permanent) striking the offer, a hypothesis supported by the credibility theory (J. Frankel, A. Rose).

In both situations, the increased probability of asymmetric shocks would create a timely discretion in the disadvantage of imposing fixed rules (P.R. Masson, M.P. Taylor).

Both empirical studies of asymmetric shocks as well as real exchange rate variables can be absolutely irrelevant for assessing the optimality of a currency area as they do not take into account the dynamic and endogenous effects of monetary unification (P. De Grauwe).

In order to assess the likelihood of supply shocks, account must be taken of the productive structure of countries wishing to join a monetary or foreign exchange agreement.

An asymmetric shock of this nature will be all the more likely to be the more diverse equipping of these countries with raw materials and the need for such materials for productive purposes.

A highly segmented economy, that is, based mostly on service production rather than on goods, could be immune to supply-side shocks that hit raw materials. It is important to point out that the theory of credibility when treating the offer, and Phillips curve is hit by exogenous shocks, absolutely ignores the possibility of automatic rebalancing mechanisms.

An increased probability of supply shocks leads immediately to the conclusion that waiver of currency or monetary independence is very costly. In this context, there may be automatic adjustment mechanisms capable of bringing the economy back to balance (which is not the case in the traditional theory of optimal currency areas).

As traditional theory also argues, these mechanisms could act as substitutes for monetary discretion, the loss of which would not involve very high costs.

The fact that this possibility is ignored probably depends on how automatic mechanisms work, which could be very slow and costly.

Based on arguments argued by the traditional theory of optimal foreign exchange areas, we can ask not only whether it is possible to control a supply shock but also to what extent this shock has automatic adjustment mechanisms and if, in the absence of such mechanisms, interventions Deliberate economic policies are effective in counteracting negative effects.

In order to support the conclusions derived from the theory of credibility, we can say that an increased likelihood of asymmetric shocks from demand determines a renunciation of costly, non-optimal currency or currency independence, independent of the existence of automatic adjustment mechanisms and the effectiveness of the currency tool in absorbing shock.

IV. CONCLUSIONS

It is also important to determine the amount of costs and benefits derived from joining a currency or monetary union.

Apart from the fact that automatic adjustment mechanisms need to be considered, the degree of diversification of the economy will have to take into account the elements highlighted by the current literature, especially the major or minor probabilities that the economy will be hit by a supply shock from the potential benefit deriving from the reduction of the risk of currency instability and the dynamic and endogenous aspects that could subsequently lead to meeting the above mentioned criteria.

Historical experience, in addition to scientific theories, helps us to conclude that fixed, irrevocable exchange systems are intrinsically unstable, being the subject of the risk of speculative attacks, unjustified from the point of view of the fundamentals of the economy, leading to the abandonment of the system itself.

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