

What Should Academics Tell Policy-Makers

About Monetary Union?

Discussion of Coleman and Wyplosz

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An Unusual Situation

- Usually discussants disagree with authors
 - Coleman: NZ-Australia monetary union at least arguable
 - Wyplosz: broad Asian monetary union is, should be a long way off
- Both sensible reasonable papers with which there is little deep to disagree

Generally, rare to be in company of believers in monetary union

Growing Academic Consensus for Monetary Union

- Monetary Unions (for small open low-inflation economies)

have costs and benefits

- Typical View: Poor business cycle synchronization and lack of adjustment mechanisms/risk-sharing implies that monetary union is of academic interest

But intellectual tide is turning

- Benefits of floating usually over-stated
- Benefits of monetary union usually under-stated
- Nevertheless, consensus view that substantial spread of monetary union outside Europe unlikely

Benefits of Floating lower than Perceived

- Floating typically doesn't provide insulation or additional tool of monetary policy
- In practice, just as likely to introduce volatility
- Part of problem, not solution
 - Hence “fear of floating”

Why are Floating Exchange Rates so Volatile?

- No one knows
- Still agreement that it's hard to link exchange rate fluctuations to macroeconomic fundamentals
- More importantly, fixed regimes have similar macro volatility, only more stable exchange rates
 - Exchange rate occasionally useful (Australia and Canada post-Asia), but only occasionally

Benefits of Monetary Union higher than Perceived

- Three new aspects to new literature

1. Standard Criteria often viewed as inappropriate

- Wyplosz: irrelevant in practice
- Alternatively, Lucas Critique: monetary union induces structural changes which make data from old regimes irrelevant

2.Literature more empirical

- Use data on actual currency unions
- I find strong robust effect of currency union on trade

3.Consequently, literature more positive on currency union

Example

- 1967 dollarization/decimalization of New Zealand currency



Figure 1: The Effect of the NZ Dollar on NZ-UK Trade

Currency Union Dissolution consistently Affects Trade

- Glick-Rose use 130 exits from currency union, show trade halves when currency union dissolved
- Frankel-Rose show openness has big affect on income
- Caveat: no currency unions (pre EMU) for large rich countries in modern era

Time to De-Mystify National Money

- If surrender of monetary sovereignty potentially sensible, then should be politically feasible
- Currently discussion of monetary union is hysterical (UK) and rarely democratic (Europe)
- Policymakers should start to speak the unsayable, educate public.