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

  o 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

  o 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.