The EURO:
Maintaining an Optimum Currency Area

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ABSTRACT
This manuscript is presented in Research Brief format and for a research presentation at the annual meeting of the American Society of Business and Behavioral Sciences and publication in the ASBBS Proceedings. The purpose of the Research Brief and ASBBS conference presentation is to receive comments and suggestions for going forward with the research and ultimate publication in a scholarly journal. The author acknowledges the ASBBS for allowing his research to be presented at its conference in research brief format.

INTRODUCTION
The paragraphs below likely will be the opening paragraphs in on-going research for a scholarly manuscript examining whether the euro currency area is as an optimum currency area. These opening paragraphs are presented in this Research Brief in order for the author to receive comments and suggestions for going forward with the research and ultimate publication in a scholarly journal.

Some fifty-two years ago, a time seeming long ago in the scope of international economic affairs, the concept of an optimum currency area (Mundell, 1961) was introduced. That concept, introduced in a high-profile journal, the *American Economic Review*, established a framework and way forward for countries seeking to integrate economically and/or monetarily in what now is known as regional economic integration. Without the concept of an optimum currency area, regional economic integration, typified, for example, by the European Union's integrative agreement, arguably may not have occurred, particularly not in its current form.

The concept of an optimum currency area, its implementation, and a current case example of an optimum currency area are explored in this paper. First, an optimum currency area concept is elucidated below. Then, in a later scholarly manuscript, its implementation will be examined through the example of the convergence criteria established for the euro area currency. Finally, the euro area will be critically analyzed as a current case example of success or lack thereof of an optimum currency area.

AN OPTIMUM CURRENCY AREA
A preliminary review of the literature finds that Mundell (1961) conceptualized an optimal currency area as "a domain within which exchange rates are fixed." McKinnon (1963) refined the concept as "a single area within which monetary-fiscal policy and flexible external exchange rates can be used to give the best resolution of three objectives: the maintenance of full employment, the maintenance of balanced international payments, and the maintenance of internal average price level." Kehoe and Whitten (2000) defined an optimal currency area "as a geographic area in which nations have or will develop similar economies through convergence criteria, similar fiscal and monetary policies, and have, as in the case of the euro, fixed national currency conversion rates irrevocably in the process of introducing a new currency as legal tender alongside national currencies, with an intention of eventually phasing out all national currencies for the new currency."

Simply put, an optimum currency area is a group of countries whose economies are similar enough economically that a single currency might be utilized across the national borders of a group of countries. That is, the countries elect to abandon their national currencies and pledge irrevocably to utilize a single currency. Of course, such abandonment of a national currency and adoption of a single currency does not occur easily or quickly. Rather, national parliaments and policy makers, in addition to a country's citizens (generally through a referendum), must agree to join a currency union.

CONCEPT OF ECONOMIC SIMILARITY

In seeking agreement among countries to establish an optimum currency area, first the countries must be similar economically. But, what does similar economically mean and who is to decide on the degree of economic similarity? These questions were considered by European finance ministers in contemplating whether as well as how to establish an optimum European currency area. Daunting questions about inflation rates of potential member countries; government debt per a country's GDP; budget deficit as a percent of countries' GDP; a country's long-term interest rates and parity with other countries; the stability of a country's economy; and the independence of a country's economic affairs from changing political leadership, perhaps demonstrated by the presence of an independent central bank in a country, are among questions to be considered. These questions are among candidates for discussion in considering whether a group of countries are similar enough economically to justify adopting a single currency across all the countries in a currency agreement.

EUROPE AS A CASE EXAMPLE

In the 1980s and early 1990, Europe appeared ready to consider the concept of an optimum currency area (Warner, 1998). The notion of readiness sometimes is an easy notion. One either is ready or not ready for something. Shakespeare (1564-1616a) wrote in Hamlet that "the readiness is all." If one is ready, a way forward should be easy, or so it seems. But, readiness sometimes is not an easy concept. It requires precursors, sometimes developed over decades.

In Europe, the precursors were the decades of work toward implementation of the European Common Market, what arguably may be considered as being Stage Three regional economic integration. Along the way, the European countries moved through a Stage One free trade area type of regional economic integration typified by the early attempts to organize a European Iron and Steel Community (EISC, 2014) as a European trading area. Some countries experienced a Stage Two custom union type of integration, typified by the present day Benelux customs union of Belgium, The Netherlands, and Luxembourg. Then, some European countries moved to a Stage Three regional economic integration in establishing the European Common Market, followed by the present day Stage Four integration of the European Union (European Central Bank, 2014). A remaining question is whether there ever will be a Stage Five integration of Europe, a so-called United States of Europe?

CONVERGENCE CRITERIA

Bringing Europe toward the concept of an optimum currency area required agreement among the European Countries about how they were to approach determining the extent of similarity in their economies. Such similarity is the bedrock of an optimum currency area and arguably must be present for an optimum currency area to develop.

A test of economic similarity was established in the development and use of convergence criteria as accepted in the Treaty on European Union enacted in Maastricht, The Netherlands in December 1991 (European Parliament, 1998). The Maastricht Treaty, as it is known, required euro-member countries to achieve stringent goals for inflation rates, size of budget deficits, exchange rate fluctuations, government indebtedness levels and presence of a national central bank in each country as conditions for admittance to the euro currency. (In a research manuscript that is being developed as part of this Research Brief, the euro convergence criteria will be analyzed in detail.)

The treaty of the European Union, enacted in 1991, paved the way with convergence criteria for a 1999 launch of the euro currency. Today, some twenty-five years after its launch, eighteen member states of the twenty-eight nation European Union use the euro as currency (ECB, 2014) - Austria, Belgium, Cyprus, Estonia, Finland, France, Germany, Greece, Ireland, Italy, Latvia (as of 1/1/2014), Luxembourg, Malta, The Netherlands, Portugal, Slovenia, Slovakia, and Spain. Another ten European countries - Bulgaria, Croatia, Czech Republic, Denmark, Lithuania, Hungary, Poland, Romania, Sweden and the United Kingdom - are member states of the European Union but currently have not adopted the euro (ECB, 2014).

SUCCESS OR LACK THEREOF

Given the launch of the euro currency some twenty-five years ago, a key aspect of ongoing research on the euro currency area involves a critical examination of its success or lack thereof. Is Europe and the countries represented in the euro currency area a successful or an unsuccessful optimum currency area. How is success judged? What are viable metrics for use in judging an optimum currency area's progress? How should world economic conditions be considered in an analysis of the euro currency zone? How are the original eleven member states of the then fifteen-member European Union who launched the euro currency - Austria, Belgium, Finland, France, Germany, Ireland, Italy, Luxembourg, Holland, Portugal, and Spain - doing today? What is the condition of the other European countries that later joined the euro currency, how well did they match to convergence criteria, and how are their national economies performing since joining the euro currency? And, is the so-called falling star metaphor of the euro currency presented by *The Economist* magazine several years ago an accurate depiction or is the euro currency a brightly shining star as opposed to being a falling star (*The Economist*, 2011a and 2011b).

The star metaphor cover page is one of a series of euro-related cover pages that *The Economist* magazine has published, with most of the covers attempting to illustrate difficulties in the euro currency area. These difficulties will be explored in this research as the success or lack thereof of the euro currency area is examined. For a reader interested in how *The Economis*t is covering the euro area situation, a collection of cover pages is available at Euro Cover Pages (2011) at: http://www.economist.com/blogs/newsbook/2011/11/euro

BENEFITS AND WEAKNESSES

As this research unfolds, benefits and weakness of the euro will be examined as a part of understanding the success of failure thereof of the euro currency. Benefits will be posited at both microeconomic and macroeconomic levels. Among microeconomic benefits to be examined are:

- The euro facilitates price transparency across the European markets.
- The euro eliminates waste in currency exchanges.
- The euro facilitates cross-border financial transactions.
- The euro enhances trade and comity among the European nations.
- The euro enables easier travel throughout Europe.

In addition to its significant microeconomic benefits, significant macroeconomic benefits are posited to include:

- The euro eliminates exchange rate risk in the euro area.

- The euro encourages investment in the euro area.
- The euro encourages development of the single European market.
- The euro promotes the convergence of the national European economies.

An analysis of weaknesses of the euro currency area is expected to be examined from at least two perspectives. First will be a critical examination of reasons why certain European countries not as yet are members of the euro currency. It is expected that a host of reason will be found, many of which may involve nationalism or a desire by a country's parliament not to yield a country's sovereignty by joining the euro currency. Other reason may be inertia of the part of national governments or that a country has not as yet met the euro's convergence criteria. A second perspective will involve an examination of policies both of the European Central Bank and the European Parliament in regards to the euro currency. An a priori research query will be whether there policies of the ECB and the European Parliament that discourage euro currency membership? It is anticipated that this examination may produce guidelines for European policy makers to encourage euro currency participation so that Europe operates as a true optimum currency area.

CONCLUSION

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In summary, this research is concerned with developing an understanding of the past, present, and possible future of the euro currency area. Is it an optimum currency area? What metrics are appropriate for evaluating the euro currency's success or lack thereof? Is the euro currency area thriving or is the end of the euro as a currency in use at hand? As an optimum currency area, is there anything in Europe good or bad? Or, as noted by Shakespeare (1564-1616b) many years ago, "There is nothing either good or bad, but thinking makes it so." This research, and the thinking underpinning it, seeks to understand both the bad as well as the good of Europe as an optimum currency area.

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File: Euro: Maintaining an Optimum Currency Area -A Research Brief