
Optimal Currency Areas

Some Empirical Examples

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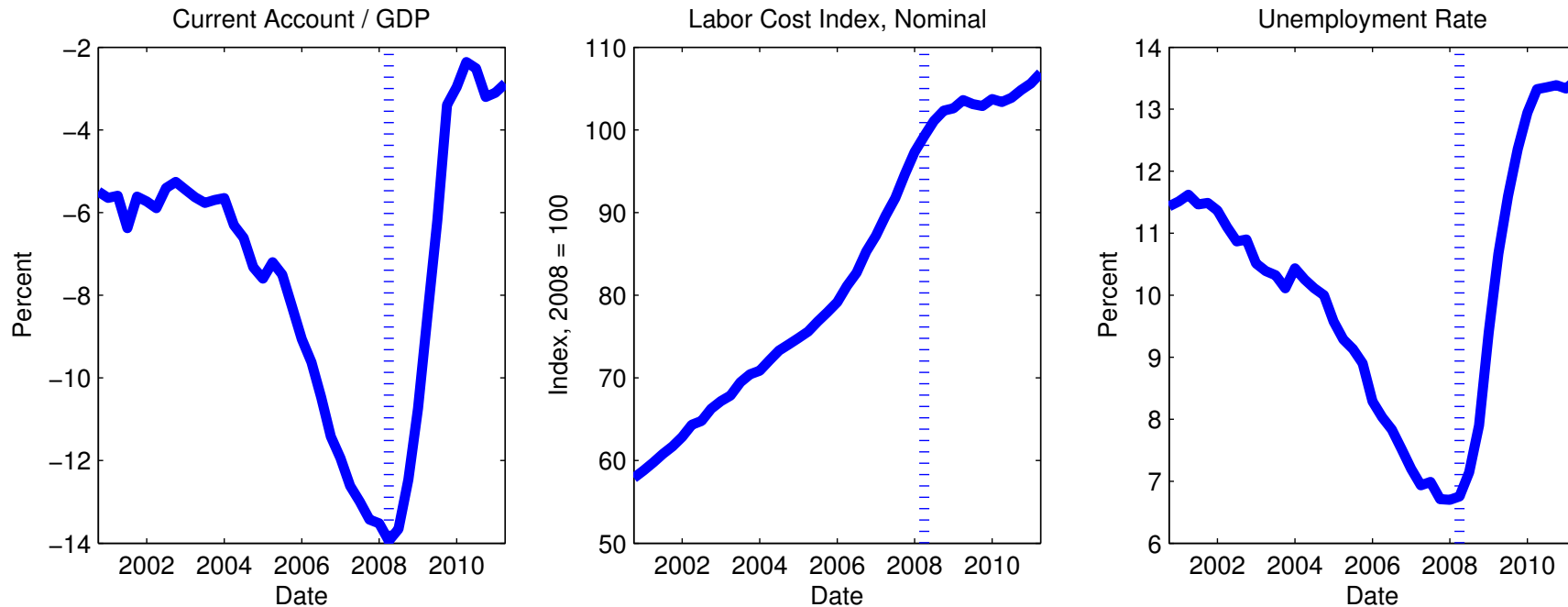
Three Types of Currency Unions

1. Currency Union Proper (e.g., the Eurozone)
2. Dollarization (e.g., Ecuador, Panama, El Salvador)
3. Currency Pegs (e.g., Argentina's peg to the dollar 1991-2001)

Proper Monetary Unions

**The Case of the Eurozone During
the Global Financial Crisis of 2008**

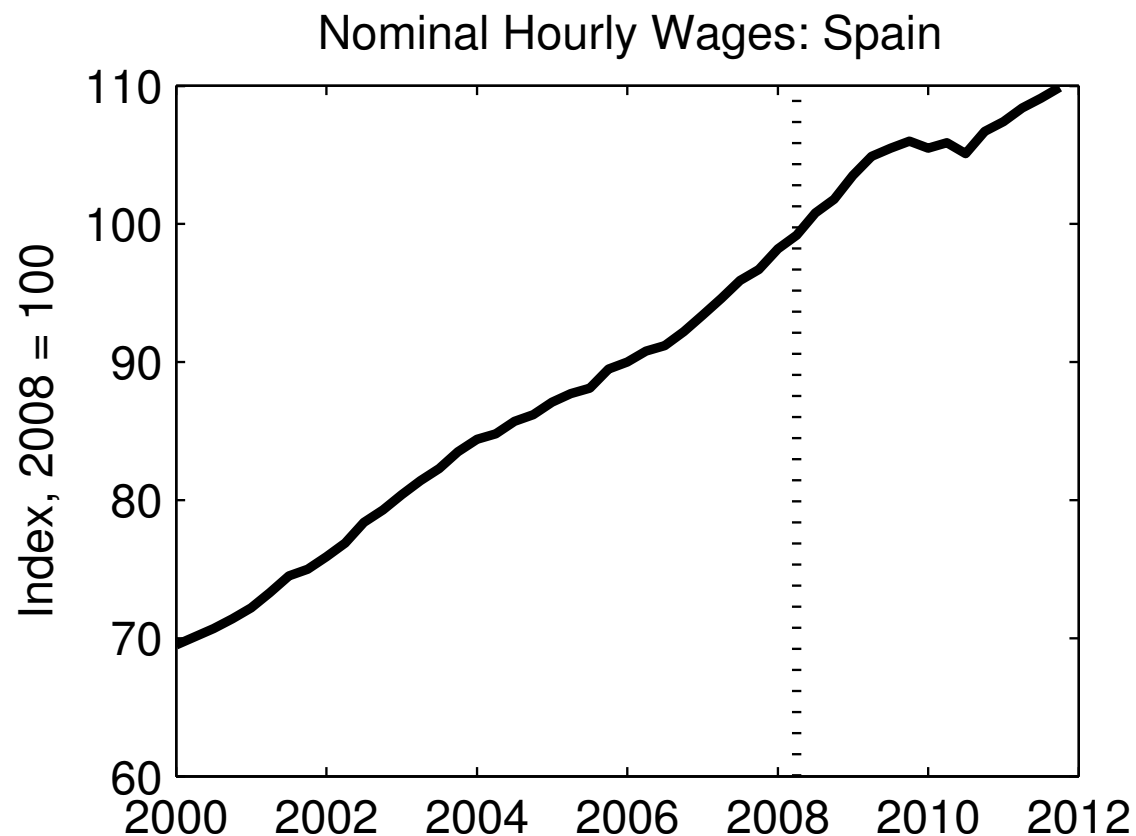
Boom-Bust Cycle in Peripheral Europe: 2000-2011



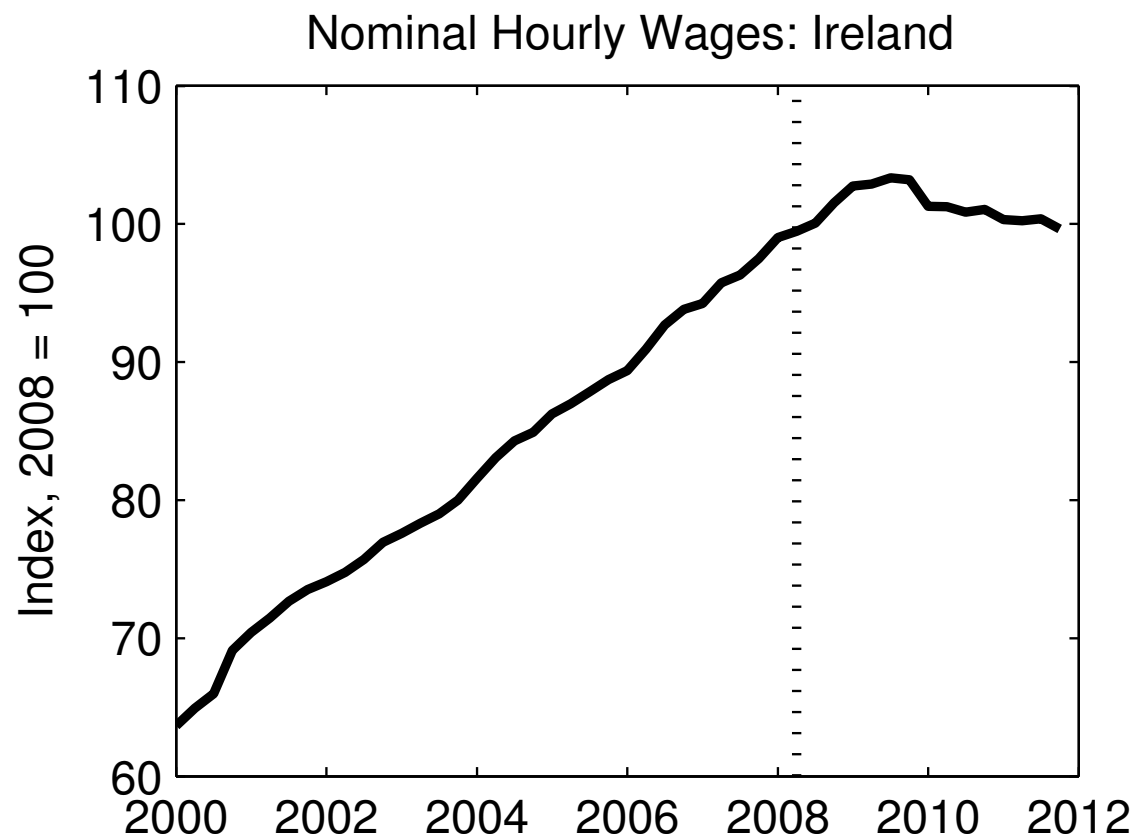
Data Source: Eurostat. Data represents arithmetic mean of Bulgaria, Cyprus, Estonia, Greece, Ireland, Lithuania, Latvia, Portugal, Spain, Slovenia, and Slovakia

⇒ Wages grew by 70 percent between 2000 and 2008!

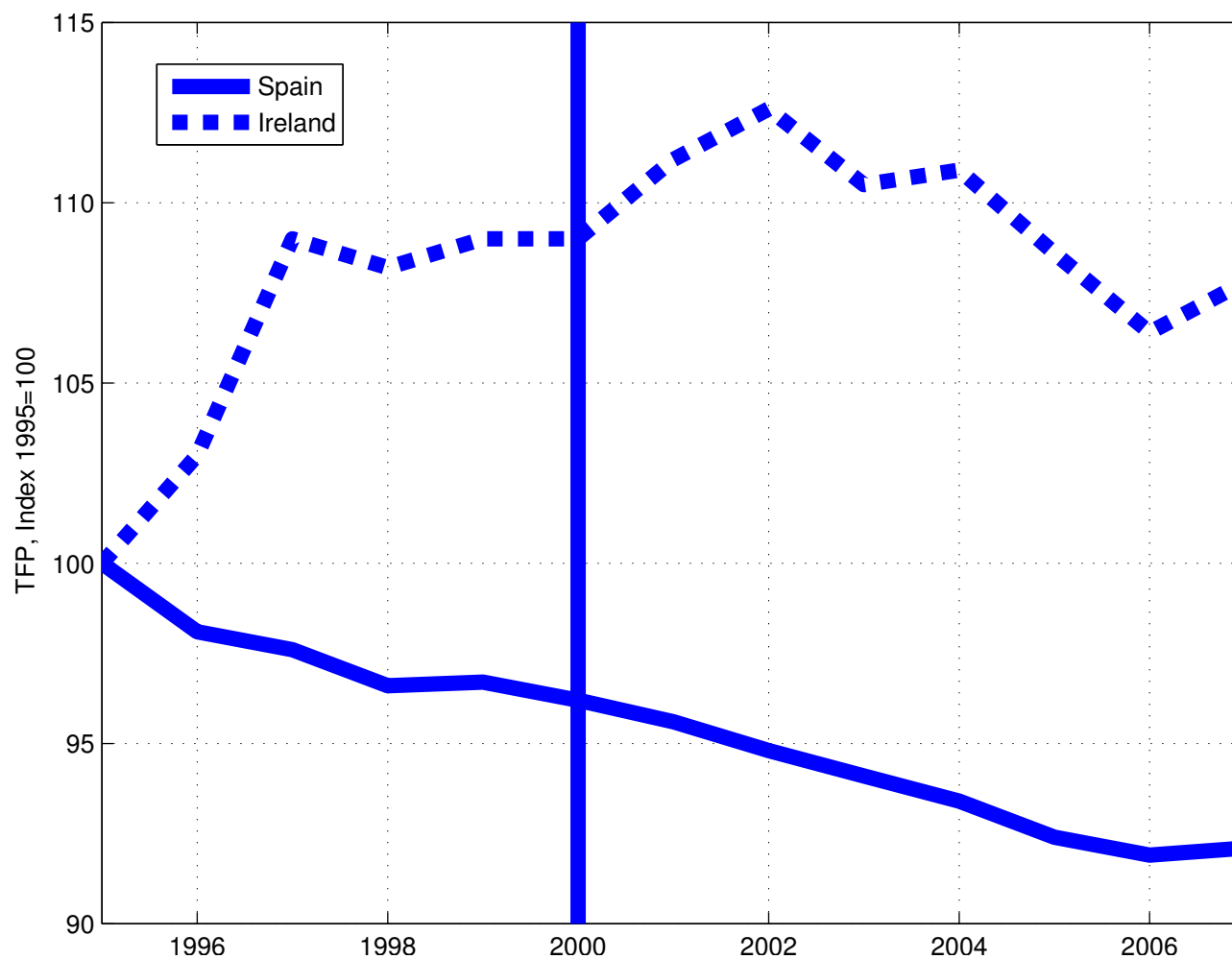
Nominal hourly wages in Spain increase by 44 percent during the 2000-2008 boom



Nominal hourly wages in Ireland increase by 57 percent during the 2000-2008 boom



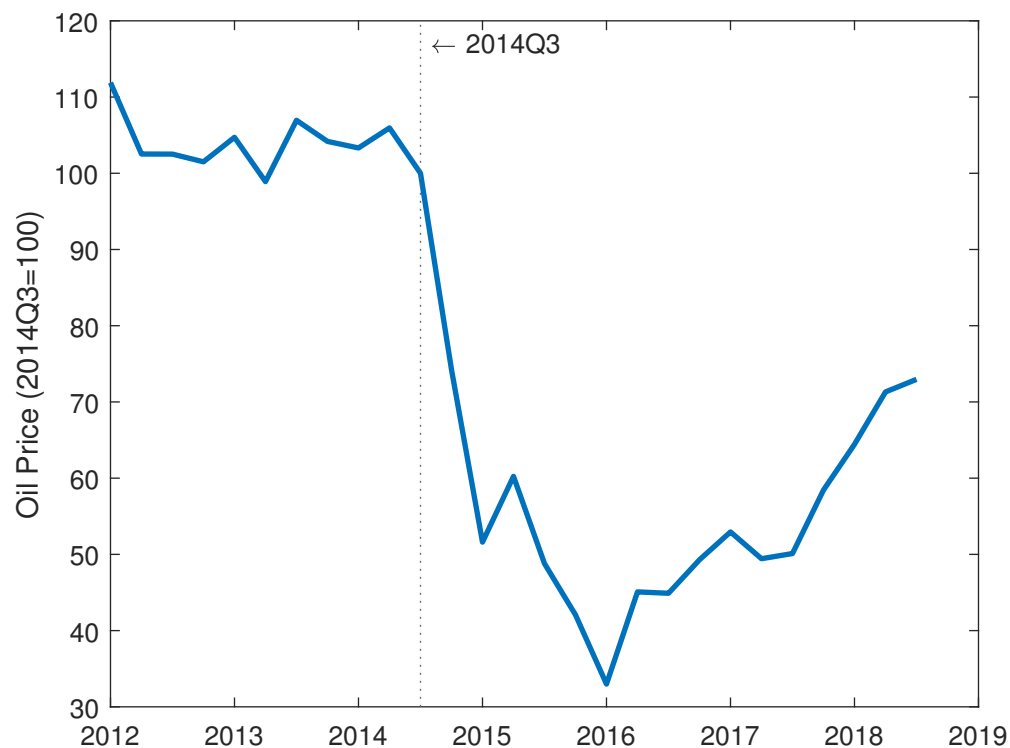
... Despite No Growth in Total Factor Productivity



Dollarization

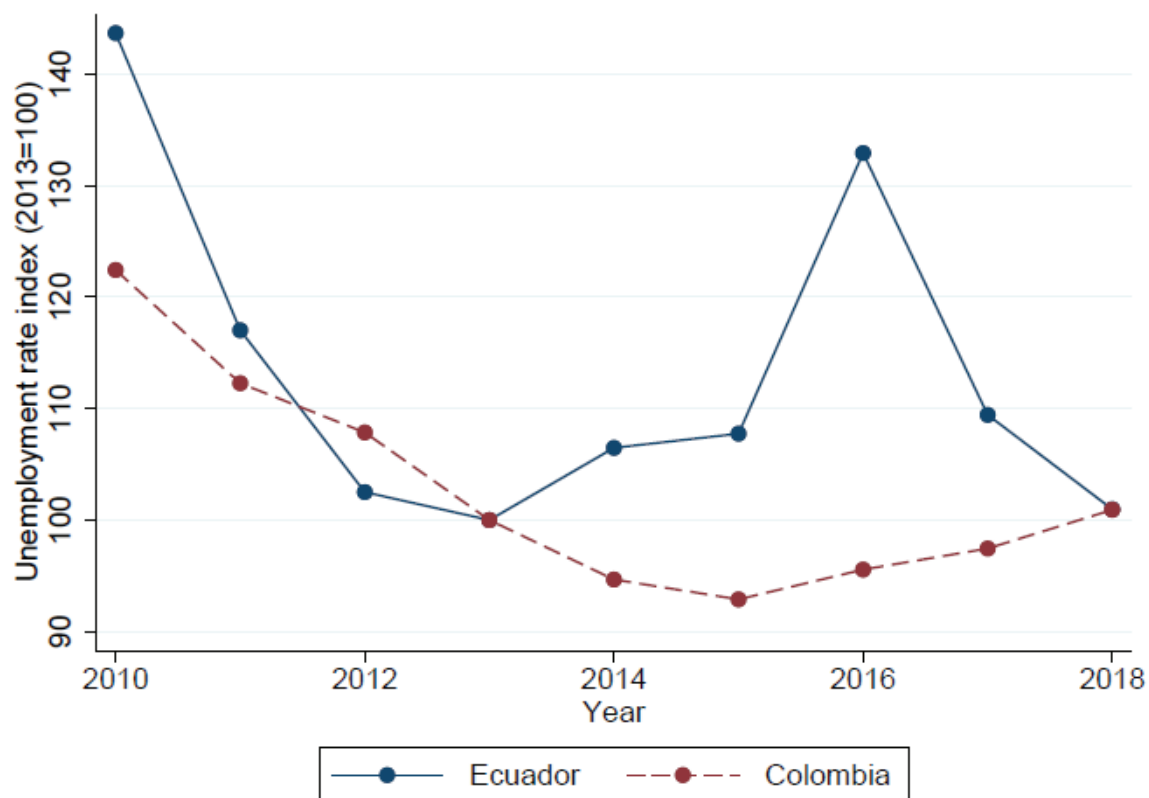
Ecuador, Colombia, and the Oil Price Collapse of 2014-2016

The Oil Price Collapse of 2014-2016



Source: Own calculations with data from FRED.

Unemployment in Colombia and Ecuador During the Oil Price Collapse

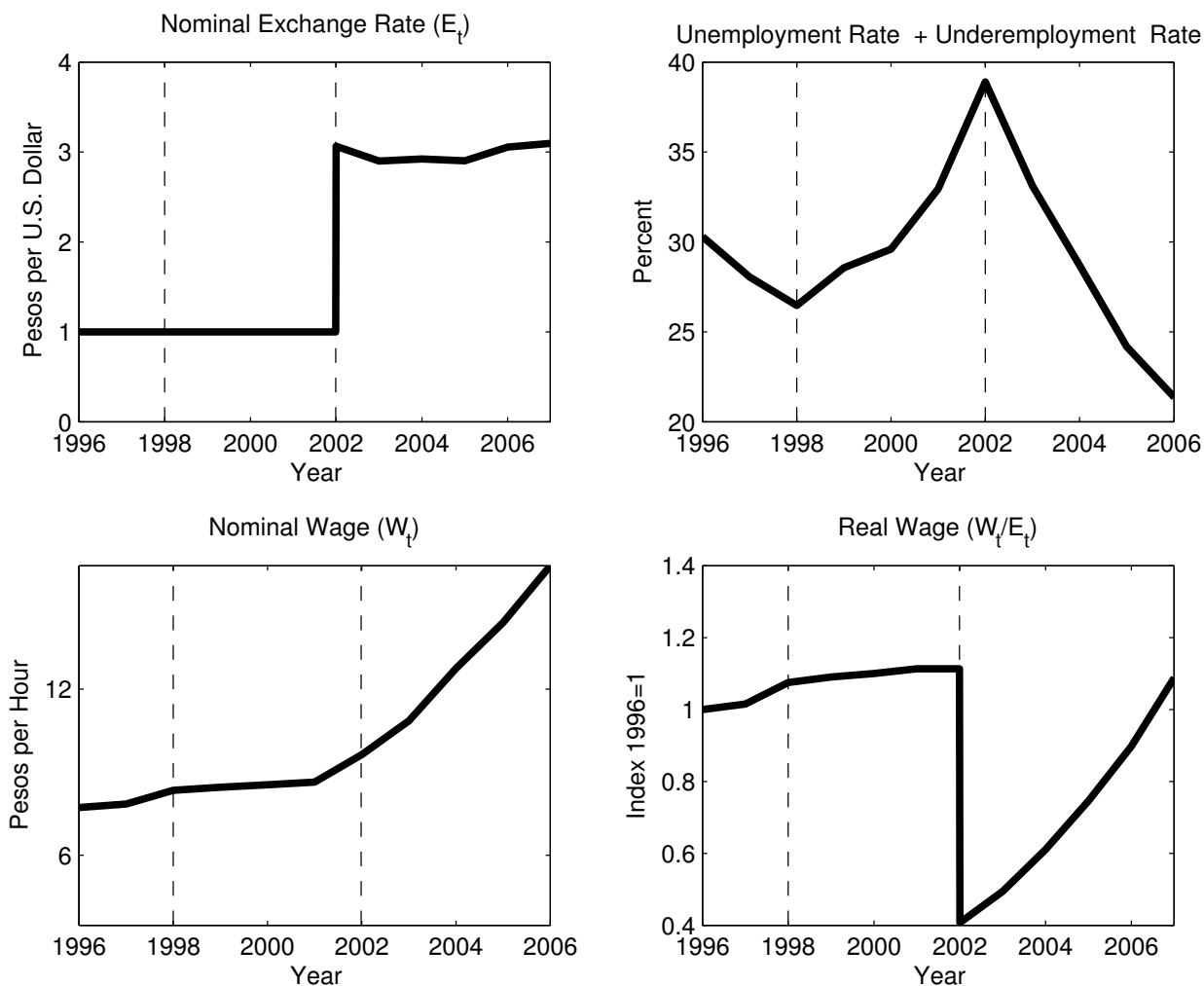


Source: Ahn, Choi, and Rivadeneyra (2024).

Currency Pegs

The Case of the Argentine Convertibility Law (1991-2001)

The Demise of Argentina's Convertibility



Vertical Line 1998, beginning of recession. Vertical Line 2002, default and devaluation.

Source: Schmitt-Grohé and Uribe (2016)

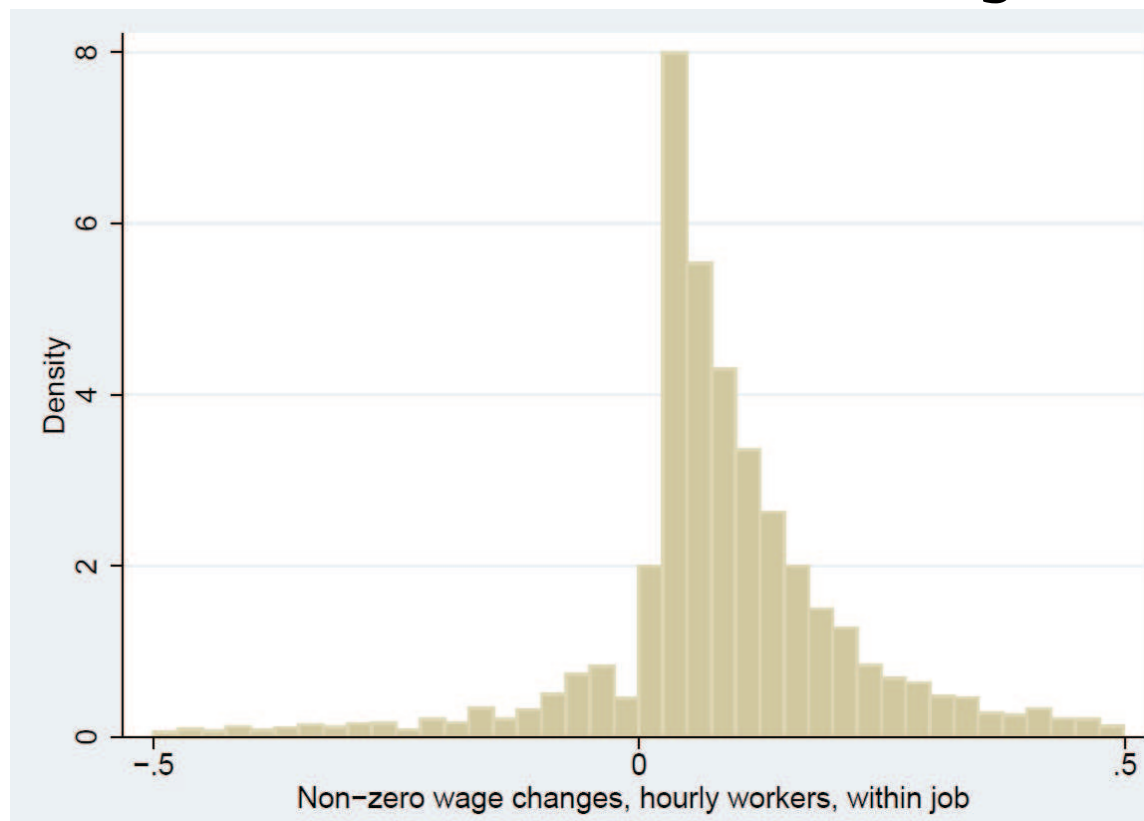
The United States is a Monetary Union

Why don't we observe balance-of-payments crises across states?

Is it because in the United States nominal wages happen to be flexible?

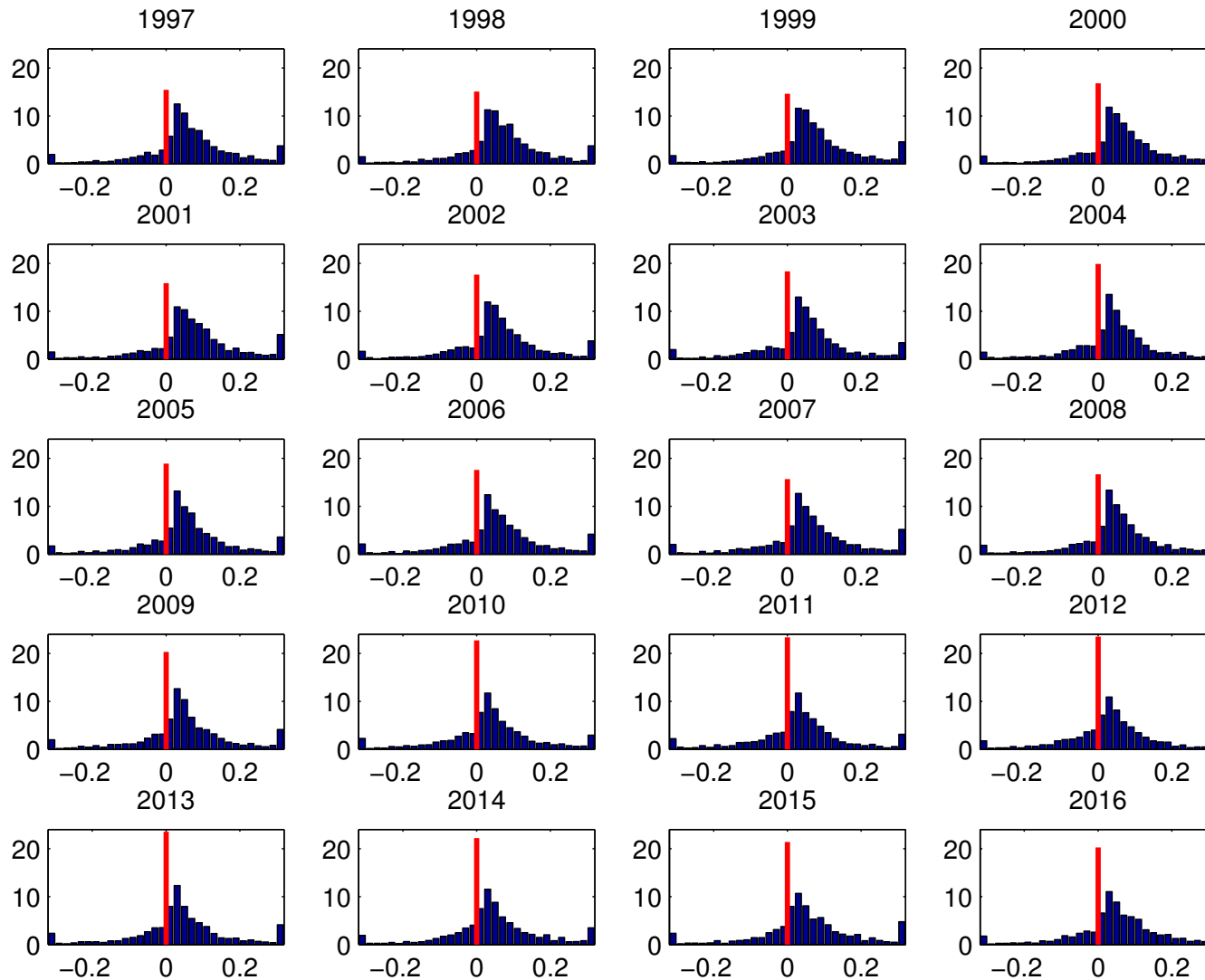
United States 1996-1999, SIPP panel data

Distribution of Non-Zero Nominal Wage Changes



Source: Barattieri, Basu, and Gottschalk (2012). SIPP panel data.

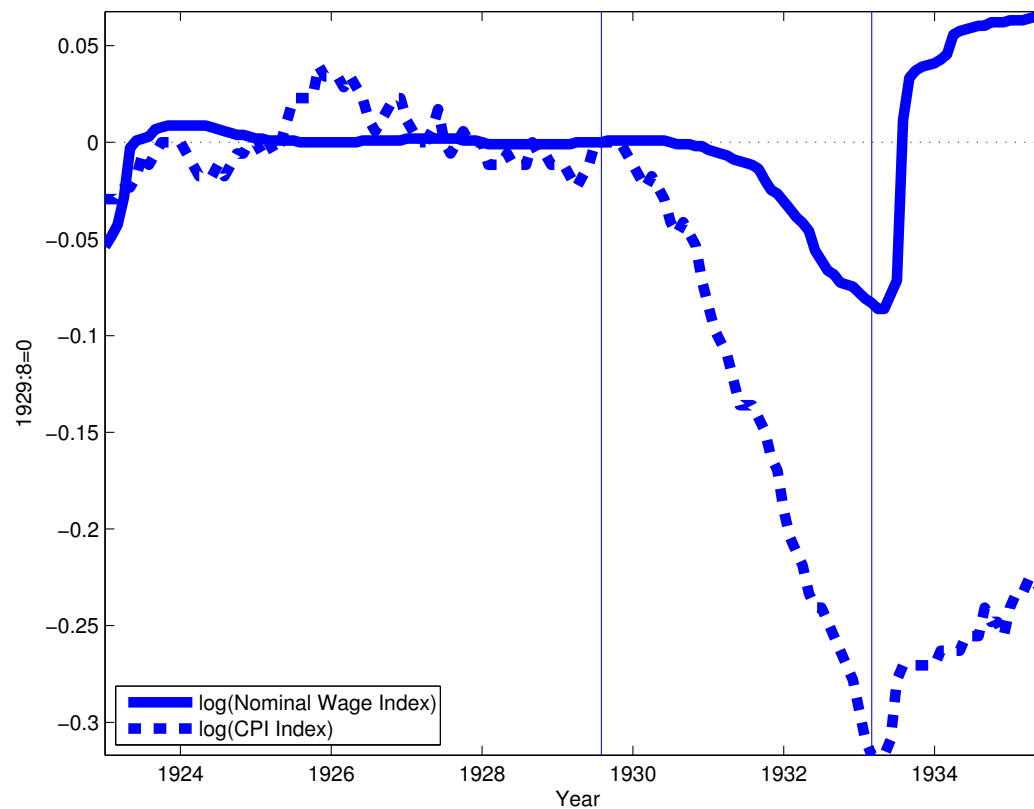
A3.) United States, 1997-2016, CPS panel data



Source: Jo, Schmitt-Grohé, and Uribe (2017).

Evidence of Wage Rigidity From the Great Depression

Nominal Wage Rate and Consumer Prices, United States 1923:1-1935:7



Solid line: natural logarithm of an index of manufacturing money wage rates. Broken line: logarithm of the consumer price index.

A More Plausible Explanation: The United States is both a monetary union and a fiscal union

Conclusion

- **Robert Mundell warned of an inherent weakness of currency unions:** the lack of country-specific central banks leave members vulnerable to asymmetric shocks.
- Evidence across time and space suggests that making sure that country members have synchronized business cycles is not a robust enough criterion for an optimal currency area.
- A better criterion appears to be to couple currency areas with other domestic or area-wide countercyclical policies.

EXTRAS

D.) Evidence From the Great Depression In Europe

