I. **Short Answer Questions.** (Underline the correct answer when relevant)

1. To be an optimum currency area, a monetary union like the EMU should have a high level of labor mobility to alleviate the effect of regional shocks. Is it the case for the EU? Why or why not?

X.8/9

2. The Treaty of Amsterdam imposed the *Growth and Stability Pact* on all future members of EMU. What did that pact involve?

X.4 and XI.2

3. Although the Euro bills and coins were introduced in January 2002, the Euro has been the real common currency of Euroland since January 1999. Explain.

X.5

4. What happened to the Euro between the time of its introduction and September 2000?

XI.3…

Why did the ECB in collaboration with the FED intervened in foreign exchange market on behalf of the Euro in September 2000?

XI.6

5. Which country had a dominant role in the Bretton-Woods system _US_ and which country had a dominant role in the ERM _Germany_?
6. Explain why capital controls were necessary in the 60ies and the 70ies in France? 
to avoid massive K outflows due to weakness of the Franc (high rates of inflation) 

7. The currency crises of the early 90ies were attributed to specific political upheavals in 
   Germany and the Eastern Europe that took place at the end of the 80ies: what were they? 
   German reunification IX.34 

8. In 1999, 4 out of the 15 EU countries did not join in the EMU for 2 different reasons: by 
   choice (opt-out) or because they did not meet the criteria: 
   which are the countri(es) that did not meet the criteria? Greece __________________________ 
   which are the countri(es) that opted out (or just decided not to join yet)? UK __________
   ________________________________________________
   ________________________________________________
   Denmark Sweden ____________________________________________

9. What do economists mean when they state that the single currency will enhance price 
   transparency in Euroland? 
   XI.13 

10. Can you characterize in a few words the exchange rate policy of the ECB? 
   X.16 benign neglect
II Theory – Export subsidies (small country case)

Finish the graph and carry out the welfare analysis.

\[
\begin{align*}
\text{change in CS} & \quad \text{(increase or decrease?)} & a+b \\
\text{change in PS} & \quad \text{(increase or decrease?)} & a+b+c \\
\text{cost of subsidy} & \quad \text{} & b+c+d \\
\text{deadweight loss} & \quad \text{} & b+d
\end{align*}
\]

Did domestic consumption increase decrease stay the same?
Did domestic production increase decrease stay the same?
Did exports increase decrease stay the same?

III Problem

In the sixties, the French Franc (FF), a currency participating in the Bretton-Woods arrangement, was pegged to the dollar at $.20/FF (the equivalent of 5FF per $). Between 1965 and 1970, the rate of inflation in France was twice as high as in the US (the French CPI went from 100 to 120 while the US CPI went from 100 to 110).


1965: 5 
1970: 4.58

b. What happened to the FF with respect to the dollar (in real terms)?

A **real** or nominal **appreciation** or **depreciation** of the FF.
c. So would France exports increase or decrease? and would France imports increase or decrease?

d. In conclusion did the higher French rates of inflation result in an increase in France international competitiveness or a decrease in France international competitiveness?

e. What are the resulting pressures on the FF (nominal ER)?

to appreciate or to depreciate (with respect to the $)

f. How did the Banque de France intervene to keep its parity with the $?

it buys $ or it sells $

g. What did the Fed do to help?

nothing

IV Question of readings

One article discusses the consequence for a country like Italy or Greece of leaving the Euro. These countries would want to do that because they have lost their competitiveness – basically the Euro is too strong for them. However a devaluation that would allow them to regain their competitiveness is impossible, unless they leave the Euro and readopt their own currency. However these countries have also issued long run bonds (20-30 years) denominated in Euro. Comment.

That would be a problem because their currency would depreciate but their debt will still be denominated in Euro and very hard to repay.