Editorial

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In the aftermath of the recent financial crisis and the slow recovery of the global economy, questions regarding the European Union (EU) and its viability as an optimum currency area have generated much discussion among both academics and policymakers. This symposium provides a forum to share different perspectives on the issue of the EU as an optimum currency area and hopefully generate further research and informed policy discussions.

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The symposium begins with the study by Rossi and Dafflon and their descriptive analysis of the sovereign debt crisis affecting the euro area as a result of the Greek debt situation. Rossi and Dafflon argue that the centralisation of monetary policy through the European Monetary Union (EMU) and currency unification with fiscal policy under the purview of national governments are contributing factors to the financial crisis within Europe. Such an institutional framework between monetary and fiscal policy raises questions as to the effectiveness of policy coordination in terms of addressing economic and financial shocks. To remedy the sovereign debt crisis in the short-run, Rossi and Dafflon propose an institutional package of debt restructuring, and in some cases, debt cancellation. Furthermore, Rossi and Dafflon also suggest the creation of a European political union, consisting of a federation of states with a federal budget and taxation powers of its own, along with financial equalisation transfer mechanisms to prevent the bailout of insolvent states ex post.

In another descriptive study, Sklias and Maris evaluate the criteria for an optimal currency area as set forth by Mundell-McKinnon. Sklias and Maris argue that political priorities have dominated economic and fiscal principles in the formation and function of the EMU. Specifically, Sklias and Maris provide several observations. First, the system of political and economic governance within the structure of the EU cannot assist member countries in addressing asymmetric shocks. Second, the presence of rigidities in the mobility of factors of production and wages attenuates the impact of asymmetric shocks on the weaker peripheral countries within the EU. Third, European Central Bank (ECB) monetary policy cannot adequately address problems encountered by the peripheral countries. Moreover, the Stability and Growth Pact does not serve as an adequate mechanism to foster growth across all countries in the EU.

Next, Karras employs the Mankiw-Weinzierl general equilibrium model of optimal stabilisation policy to examine the extent to which macroeconomic outcomes are affected by membership in a monetary union. The results indicate that the effects of shocks vary depending on the response of the common central bank and the degree to which domestic shocks are correlated with the rest of the economies in the union. For instance, a negative spending shock will have a greater impact if the shock is confined to the domestic economy. However, if the negative shock is spread across all economies in the union, there is less of an impact and may even be expansionary if the shock is restricted to the rest of the union.

In the estimation of Taylor-type reaction functions, Klose investigates whether a common central bank for the EU can address the substantial differences in the economies of member countries. Klose estimates modified Taylor reaction functions for member countries and the EU as a whole (excluding Slovenia, Cyprus, Malta, Slovakia, and Estonia) using monthly data. Specifically, the reaction functions focus on the real rather than the nominal interest rate before the start of the current sovereign debt crisis. The results indicate differences in the reaction functions of the euro area countries, raising questions regarding the euro area as an optimum currency area. Out of sample forecasts for the period of the sovereign debt crisis show that the ECB kept interest rates too low. Furthermore, the implicit inflation targets vary widely among member countries and the asymmetric responses to output and stock price growth shocks resulted in fiscal deficits increasing for credit constrained countries, as in the case of Greece, Ireland, Portugal, and Spain. Klose concludes that perhaps these countries should be excluded from the euro area for the maintenance of an optimum currency area.

Bista, Maskay, and Saunoris utilise monthly data from 2003 to 2010 to examine interest rate pass-through within a spatial framework from the ECB rate to retail lending rates in 11 European countries. Their results indicate that retail lending rates are positive and spatially correlated among countries, implying that countries set lending rates strategically. In addition, the pass-through of the ECB rate is conditional on the lending rate set by neighbouring countries. Bista, Maskay, and Saunoris conclude that the EU should continue to maintain an environment conducive to competition in order to increase the pass-through of monetary policy.

Caporale and Spagnolo estimate a bivariate VAR-GARCH model to investigate the impact of the EU accession on the relationship between the stock market and economic growth for the Czech Republic, Hungary, and Poland. Their results show unidirectional causality from stock markets to growth in levels, with the relationship becoming stronger after EU accession. The same results hold regarding volatility spillovers as well. In addition to the respective countries' stock market returns and economic growth, Caporale and Spagnolo include stock market returns and economic growth in Germany alongside the domestic 90-day Treasury Bill rate as control variables. The results indicate that the stock market returns and economic growth in Germany have a positive and significant impact for all three countries. Furthermore, a restrictive monetary policy stance has a negative and significant impact on both the stock market and economic growth for all three countries.

Bahmani-Oskooee and Hosny examine the J-curve phenomenon through a bilateral trade model with respect to Egypt and the EU. According to the J-Curve effect, if a country's trade balance is deteriorating, the implementation of a currency devaluation (or depreciation) may not have an immediate impact on reversing the deterioration of the trade balance due to adjustment lags, but in time, the trade balance should improve. Recognising the short-run and long-run response of the trade balance due to currency devaluation (or depreciation), Bahmani-Oskooee and Hosny employ the ARDL bounds testing procedure in the construction of an error correction model of the Egypt-EU trade balance for 59 industries over the period 1994 : 1 to 2007 : 4. Of the 59 industries investigated, Bahmani-Oskooee and Hosny find that in 24 industries, the trade balance deteriorates in the short-run while improving in the long-run.

Finally, Apergis, Gabrielson, Payne, and Zagaglia explore the convergence properties of Tier 1 capital ratios, which serve as the core measure of a banking institution's financial strength, within the European banking sector. Using annual data from 1990 to 2010 and the Phillips-Sul convergence and clustering algorithm, the results reveal heterogeneity in the convergence of the Tier 1 capital ratio for the sample of 251 banks. Specifically, the null hypothesis of full convergence is rejected; however, one observes five convergence clusters encompassing only 50 banking institutions, with the remaining 201 banks exhibiting non-convergence properties.

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