Divergent competitiveness in the eurozone and the optimum currency area theory

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Abstract

As the euro is on its second decade, the European sovereign debt crisis and the ever more evident disparities in competitiveness among member states are prompting many to question whether monetary union is bringing more benefits than costs. The optimum currency area (OCA) theory provides a framework with several criteria for such analysis. Most literature focuses either or on OCA individual criteria or on an aggregate analysis of these criteria, using meta-properties. Differently, we start by a descriptive analysis of the first twelve euro countries under six criteria between 1999 and 2009.

We detect signs of labour geographic mobility. However, nominal wages growth largely outpaced productivity growth in some periphery countries, resulting in losses of competitiveness. Financial markets seem to be deeply integrated. Total intra-EMU trade increased, though core countries seem to have benefited more, as their relative competitiveness improved. We detect no increased homogeneity of exports structures of EMU countries. Inflation rates alternated between periods of convergence and of divergence, though prices levels consistently converged between EMU countries. Finally, budgetary indiscipline was frequent preventing several countries from having fiscal room to face asymmetrical shocks.

We conclude by estimating the impact of five OCA criteria (differences in output growth; dissimilarity of trade patterns; bilateral trade; size of the economy; differences in unit labour costs growth) on countries’ relative competitiveness, using real effective exchange rates as a proxy. Differences in the growth of unit labour costs, the dissimilarity of trade and the differences in output growth were found to be significant. With a higher confidence level, bilateral trade is significant and points towards the specialization paradigm. The size of the economy is found to be not significant. Thus, we identify some causes of the divergent competitiveness between some EMU countries that contributed to weaker economic growth in parts of the euro area.

Keywords: optimum currency area; euro area; Economic and Monetary Union (EMU); competitiveness

JEL-Codes: E42, E63, F15, F33, F41

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