

# Currency area

[Economics](#), [Currency](#)



Name Course Date Currency Area Krugman, Paul. “Revenge of the Optimum Currency Area.” The New York Times. June 24 2012. Web. 10 October 2012.

The writer uses his expertise in economic issues to analyze the ongoing economic crisis that is threatening the stability of European nations. This article seeks to explain the current economic crisis in Europe, an Optimal Currency Area. Optimal Currency Area refers to a geographic region whereby a single currency is used for purposes of creating the greatest economic advantage. The writer sites the crisis to be caused by ignorance of the theory of Optimal Currency Area at the onset of the integration of the European Union and adoption of the Euro as a common currency. He also shows the advantages that countries have with such an economic arrangement.

It highlights the major factors affecting the Euro Zone and the problems that are experienced such as high rates of inflation. Krugman also indicates some of the major causes of the crisis for instance asymmetric shocks. He also offers sustainable solutions that can help the European Governments deal with the critical situation and consequently avert another crisis. Krugman explains the advantages of a single currency are costly, and a balance should be weighed between the benefits and the potential cost it might have. A common unit of currency is applicable if the regions involved are characterized by high levels of mutual mobility of labor. However, it is argued that a currency area may not be the most productive economic method. This has been seen with European countries that have also undergone problems for instance the Greek debt crisis, which is threatening the stability of the state.

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He applies the works of Mundell in his explanation of the theory of the optimal currency area. The theory of optimal currency area set grave and dire consequences for the economic integration of the European Union. The theory sets the benefits accrued from the currency area such as a reduction in the cost of transaction, competition because of price comparison mechanisms and eradication of currency risk. The theory also comprises two key components the mobility of labor and fiscal integration. However, the failure of flexibility of a single currency is a shortcoming because there will be little or no mechanism to do adjustments. According to Krugman, adjustments are necessary in situations of asymmetric shocks a condition where some sections of the currency area are experiencing growth while others are having an economic crisis.

He shows this with what happened when there was a colossal movement of capital from countries like Germany and Netherlands to the periphery leading to a boost in their economy. Consequently, there were higher rates of inflation in countries like Greece and Spain as compared to Germany. Reduction of monetary flexibility is also a disadvantage of common currency.

Krugman refers to these as the leading causes of the Euro crisis. Regions like Greece are experiencing an enormous debt crisis with factors like labor mobility and lack of monetary flexibility playing a key role. The Gross Domestic Product of the country is gradually on the decline. The article cautions that this crisis threatens the whole region politically, as it can lead to the rise of some political extremists, as was the case with violent protests and chaos in Greece and economic progress is curtailed. The economic

pressures are also threatening the process of European economic integration. The writer offers his knowledge on some of the most suitable and applicable solutions.

He states that the European governments should inject capital and receive equity stakes in return. This is an alternative to loans in the provision of capital injection. The European Central Bank should be installed as the lender of last resort to help countries in crisis. The region should also set a higher inflation target to ease the burden of adjustment. The countries should take into consideration the principles of the theory of optimal currency area as it is viewed to be taking its revenge on the region.

These recommendations can be applied to reduce and eliminate the current crisis. Work Cited Krugman, Paul. “Revenge of the Optimum Currency Area.” The New York Times. June 24 2012.

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