Study Questions

Lecture 17
European Monetary Unification and the Euro

Part 1: Multiple Choice

Select the best answer of those given.

1. The Euro is
   a. The common currency that the members of the European Union adopted when they established the Exchange Rate Mechanism in 1979.
   b. The unit by which all new financial transactions in member countries of the Economic and Monetary Union were denominated as of January 1, 1999.
   c. Equal to one deutsche mark.
   d. A tunnel connecting France and England.
   e. Backed by gold.

2. Which of the following countries did not become a member of the Economic and Monetary Union as of January 1, 1999?
   a. Britain
   b. France
   c. Germany
   d. Italy
   e. Spain

3. When it came into existence on Jan 1, 1999, the euro was worth $1.18 because
   a. Europeans sought purchasing power parity with the U.S. dollar.
   b. This happened to be the value of the Deutsche Mark at the time.
   c. This was the market value of the basket of currencies in one ECU.
   d. This made the after-tax value of one euro equal to one dollar.
   e. The number was chosen to commemorate the year of the end of World War I.
4. Among the benefits that European monetary unification was expected to provide were the following:

   a. Greater sovereignty for member governments to pursue independent policies.
   b. Freedom for individual countries to stimulate their national economies.
   c. It ties together all current members of the European Union into a single unit.
   d. It satisfies the popular demand by Europeans for a single currency.
   e. Greater competition across national borders.

5. Since the euro came into existence on January 1, 1999, its value relative to the U.S. dollar has

   a. Started at $1 and remained there.
   b. Rose steadily from a little less than $1 to just under $1.20 in the last few weeks.
   c. Started at more than $1, fell to less than $1, then rose to more than $1 later.
   d. Moved by amounts very similar to the U.S. stock market.
   e. Been rigidly controlled by unsterilized exchange market intervention.

6. Which of the following is not a reason why the countries of the euro zone may be expected to have difficulty adjusting to asymmetric shocks to their economies?

   a. Labor is very mobile among the countries of Europe and will quickly abandon any country that experiences a negative shock.
   b. Europe does not have a mechanism for fiscal transfers that would permit countries doing well to assist those who are in trouble.
   c. If one European country has more inflation than another, it cannot depreciate its currency in order to keep its goods competitive.
   d. Governments are constrained by their agreement from large uses of deficit spending to stimulate their economies.
   e. The labor market policies of European countries make it difficult for wages to adjust up and down in response to changes in demand.

7. Which country first adopted the euro in 2011?

   a. Bulgaria
   b. East Germany
   c. Poland
   d. Estonia
   e. Greece
Part II: Short Answer

1. Explain the meaning of the acronyms BAFFLING PIGS and DUKS.

2. For each of the following, indicate whether it would be expected to gain or lose from European monetary unification, and write one sentence indicating why.

   a. A large company that manufactures household products in France for sale throughout Europe.
      
      Gain / Lose
      
      Why?

   b. The owners of a small family-run restaurant in a village of Italy
      
      Gain / Lose
      
      Why?
c. A large commercial bank in Berlin

Gain / Lose

Why?

3. True or False: Denmark and the U.K. chose to “opt out” of the adoption of the euro, even though they ratified the Maastricht Treaty.

Explain:

True or False: An optimal currency area is the geographic region within a country where the currency issued by local government primarily circulates

Explain:

4. What do the following acronyms represent, and what do they actually mean?

ECU

EMU

EMS

ERM