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 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 $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. Estonia
   d. Poland
   e. Greece

8. What is a "haircut" and what does it have to do with the Eurozone crisis?

   a. An across-the-board reduction in tariffs on imports; required of Greece and Portugal on their imports from other Eurozone countries in return for assistance.
   b. A mild form of austerity; being asked of Greece instead of the more severe budget cuts that would be called "scalping".
   c. A severe form of austerity; insisted on by Germany in order to reassure German voters for the cost of bailing out Greece.
   d. A write-down in the value of a debt, so that lenders take a substantial loss; used as a way to reduce the government debt of Greece closer to its GDP.
   e. A negotiated reduction in the interest rate on government bonds; used to ease the debt burden on Greece.

Part II: Short Answer

Answer in the space provided.

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