

Sebastian Edwards and I. Igal Magendzo,
A Currency of One's Own?
An Empirical Investigation on Dollarization
and Independent Currency Unions

Discussion by
 Lars E.O. Svensson
 www.princeton.edu/~svensson

1

- Effect of a common currency on
 - GDP/capita growth
 - inflation
 - growth volatility
- Common currency
 - Dollarization (SDs)
 - Independent currency union (ICUs)
- Data 1970–1998
 - 20 SDs
 - 34 ICUs

2

- Treatment model

$$y_{jt} = x'_{jt}\beta + \gamma\delta_j + \mu_{jt}$$

$$\delta_{jt} = \begin{cases} 1 & (\delta_{jt}^* > 0) \\ 0 & (\delta_{jt}^* \leq 0) \end{cases}$$

$$\delta_{jt}^* = w'_{jt}\alpha + \varepsilon_{jt}$$

- Estimation

- 2-step
- ML

3

- Results

- GDP/capita growth higher w/ common currency (for ICUs)
- Inflation lower w/ common currency
- Growth volatility (def?) higher w/ common currency (more so for ICUs)

4

- Comments

- Reduced-form results: Mechanisms?
- What monetary policy?
 - * SDs
 - * ICUs
 - * Flexible exchange rates ambiguous
- Advantages of flexible exchange rates
 - * TOT and real exchange rate adjustment easier
 - Only if sticky domestic prices. Data?
 - * Independent monetary policy
 - Only if good monetary policy. Data?
 - Good monetary policy recent phenomenon (since 90–95)

5

- Conclusions for enlargement of EMU?
 - * Many SDs and ICUs in data quite different from potential new EMU members
 - * Alternatives to EMU entry?
 - * Other aspects than macroeconomic performance
 - Politics
 - Transfers

6