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English summaries

Er Ísland hagkvæmt myntsvæði?

Is Iceland an optimal currency area?

Willem H. Buiter

The paper considers the pros and cons for Iceland adopting the euro as legal tender. The current Icelandic monetary arrangements are contrasted both with a unilateral adoption of the euro and with a full membership in the EMU. Microeconomic transactions costs savings argue in favour of either form of monetary union. Loss of seigniorage revenues does not seem to be an economic obstacle to either form of euroisation for Iceland. Loss of the lender of last resort is, however, a powerful argument against unilateral monetary union. The optimal currency area arguments (which concern the macroeconomic stabilization aspects of a permanently fixed exchange rate) are unfavourable to a unilateral monetary union, but the case against a full membership in the EMU is more balanced. The extraneous instability and excess volatility inherent in a market-determined exchange rate dominate the shock absorber properties of a flexible exchange rate when financial markets are highly integrated. On balance, the economic arguments favour a membership in the EMU, but not the unilateral adoption of the euro. Because Iceland is not a member of the EU, the political arguments against any form of monetary union are overwhelming. Without a EU membership, the transfer of national sovereignty to the ECB would lack political legitimacy. The lack of institutions for ensuring the political accountability of the ECB in Iceland means that euroisation of Iceland is unlikely to happen, except as part of Icelandic membership in the EU. Euroisation without a membership in the EU is simply unlikely to survive.

Keywords: Icelandic exchange rate regime, optimal currency area, seigniorage, lender of last resort, central bank accountability.

JEL: E42, E44, E52, E58, F33, F36, F41, G15, H77.

Val á hagkvæmustu gengisstefnu fyrir Ísland

Optimal exchange rate policy: The case of Iceland

Már Guðmundsson, Þórarinn G. Pétursson og Arnór Sighvatsson

This paper analysis the appropriate exchange rate arrangement for Iceland, given its structural characteristics, on the one hand, and the need for a credible nominal anchor for monetary policy, on the other. It also discusses the success of the framework of a currency peg, that was prevailed until recently, and how the apparent conflict between the exchange rate arrangement suggested by the structural characteristics of the economy and the arrangement actually chosen, was resolved. Finally, the paper provides an assessment of alternative future exchange rate regimes. The paper argues that at this point of time the recently adopted formal inflation target with a flexible exchange rate is the best available option. This does not, however, preclude membership in a monetary union at a later date.

Keywords: Exchange rate arrangement, optimal currency area, Iceland.

JEL: E52

Á gengi að vera fast eða fljóta?

Fix or flex?

Þorvaldur Gylfason

This paper discusses the pros and cons of fixed versus flexible exchange rate regimes under perfect capital mobility from a European perspective. Special attention is given to the exchange rate policy problems of Iceland and Norway and to the linkages between their dependence on natural resources and their choice of exchange rate regime. The relevance of the advent of a common currency in Europe for the Western Hemisphere is also discussed.

Keywords: Exchange rate regimes, economic policy.

JEL: F31, F33, F36.

Er verðlagsmarkmið skynsamlegra en verðbólguþáttmarkmið?

Price level target or an inflation target?

Jón Steinsson

The article discusses theoretical features of price level targets that are more appealing than the corresponding features of inflation targets. When a central bank targets the price level an unanticipated inflationary shock leads to a downward adjustment of inflationary expectations. This adjustment makes it easier for such a central bank to dampen oscillations in inflation. While it seems likely that other features of inflation targets make such a policy more appealing over all, it is argued that an inflation targeting central bank should emulate the behaviour of a price level targeting central bank to as great an extent as possible without violating the inflation target.

Keywords: Inflation target, price level target, commitment, discretion.

JEL: E52, E58.