Stability of Business Cycles and Criteria for an Optimum CurrencyArea: A Kaldorian Two-country Model

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Abstract

In this study, we focus on the relationship between the stability of business cycle and the criteria of optimum currency area. We do so by investigating the effect of satisfying the criterion of the degree of an economic openness on the stability of the business cycle, using a Kaldorian two-country model with a monetary union and imperfect capital mobility. We find that an increase in capital mobility is a destabilizing factor, whereas an increase in the degree of openness of an economy and a counter-cyclical fiscal policy are a stabilizing factors. Furthermore, we obtain the result that a high degree of economic openness can adjust a shock in the monetary union regardless of whether the shock is asymmetric. The criterion of degree of economic openness serves as one of the criteria for optimum currency area, even if an asymmetric shock tends to occur by regional concentration of industry due to high degree of openness of the economy.

Keyword: Optimum currency area, Kaldorian two-country model, Stability of business cycle, Euro area

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