

Comment on H. Robert Heller's "Exchange Rate Flexibility and Currency Areas"

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Robert Heller's paper "Exchange Rate Flexibility and Currency Areas" is extremely useful in highlighting the formal analogy between factors that are relevant for the choice among alternative exchange rate systems and those that are relevant for the determination of optimal currency areas. More importantly, *Heller* faces up to the difficult challenge of devising an empirical framework that is useful for evaluation of countries' actual choice among alternative exchange rate systems. My remarks are divided into three parts. The first elaborates on some theoretical considerations concerning the determinants of optimal currency areas. The second deals with the empirical framework and the third provides a sketch of an alternative approach to the analysis of the optimal degree of exchange rate flexibility.

I. Optimal Currency Areas: Theoretical Considerations

The Second Amendment to the Articles of Agreement of the International Monetary Fund practically permits each country to choose an exchange rate system that is most appropriate for its needs. *Heller* recognizes, and this is his major theoretical insight, that the existing literature on the determinants of optimal currency areas may be relevant for analyzing the determinants of countries' choice among alternative exchange rate systems. This insight is then followed by a useful survey of the major factors that have been mentioned in the literature on optimal currency areas. These factors are: (i) the degree of openness, (ii) the size of the economy, (iii) the degree of commodity diversification, (iv) the degree of capital market integration, and (v) the degree of similarity of inflation rates. *Heller* then describes the empirical proxies for these factors which are then used in his empirical study. In what follows I will elaborate on these measures and outline some of their limitations. It should be emphasized at the outset that these limitations should not be viewed as a criticism of *Heller's* con-

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