

Contents

Introduction

ix

PART 1 Costs and benefits of monetary union

1	The costs of a common currency	03
	Introduction	03
1.1	Shifts in demand (Mundell)	03
1.2	Monetary independence and government budgets	07
1.3	Asymmetric shocks and debt dynamics	10
1.4	Booms and busts in a monetary union	12
1.5	Monetary union and budgetary union	16
1.6	Private insurance schemes	18
1.7	Differences in labour market institutions	19
1.8	Differences in legal systems	21
1.9	Conclusion	22
2	The theory of optimum currency areas: a critique	23
	Introduction	23
2.1	How relevant are the differences between countries?	23
2.2	How effective are national monetary policies?	34
2.3	National monetary policies, time consistency, and credibility	40
2.4	Mundell once more	47
2.5	The cost of monetary union and the openness of countries	49
2.6	Conclusion	51
3	The benefits of a common currency	53
	Introduction	53
3.1	Direct gains from the elimination of transaction costs	53
3.2	Indirect gains from the elimination of transaction costs: price transparency	55
3.3	Welfare gains from less uncertainty	57
3.4	Exchange rate uncertainty and economic growth	61
3.5	Monetary union and trade: the empirical evidence	66
3.6	Benefits of an international currency	66
3.7	Benefits of a monetary union and the openness of countries	68
3.8	Conclusion	69

4	Costs and benefits compared	70
	Introduction	70
4.1	Costs and benefits compared	70
4.2	Monetary union, price and wage rigidities, and labour mobility	73
4.3	Asymmetric shocks and labour market flexibility	74
4.4	The degree of completeness of a monetary union	79
4.5	Costs and benefits in the long run	80
4.6	The challenge of enlargement of EMU	84
4.7	Should the UK join EMU?	87
4.8	Is Latin America an optimal currency area?	91
4.9	The next monetary union in Asia?	92
4.10	Monetary unions in Africa	95
4.11	Conclusion	97

PART 2 **Monetary union**

5	The fragility of incomplete monetary unions	101
	Introduction	101
5.1	Fixed exchange rates regimes as incomplete monetary unions	102
5.2	A monetary union without a budgetary union	109
5.3	More bad news about bad equilibria: banking crises	113
5.4	More bad news about bad equilibria: automatic stabilizers	113
5.5	Conclusion	118
6	How to complete a monetary union	119
	Introduction	119
6.1	The role of the central bank: lender of last resort	120
6.2	Consolidating government budget and debts	124
6.3	Coordination of budgetary and economic policies	126
6.4	The theory of optimal currency areas and political union	127
6.5	How does political integration affect the optimality of a monetary union?	129
6.6	An omitted 'deep' variable	133
6.7	Conclusion	133
7	The transition to a monetary union	134
	Introduction	134
7.1	The Maastricht Treaty	134
7.2	Why convergence requirements?	136

7.3	Technical problems during the transition: how to fix the conversion rates	142
7.4	How to organize relations between the 'ins' and the 'outs'	146
7.5	Conclusion	147
8	The European Central Bank	148
	Introduction	148
8.1	The design of the ECB: the Maastricht Treaty	148
8.2	Why has the German model prevailed?	150
8.3	The ECB: a 'conservative' central bank?	153
8.4	Independence and accountability	156
8.5	The ECB: institutional framework	160
8.6	The ECB as lender of last resort	163
8.7	Did the ECB violate its statutes when it announced its government bond buying programme (OMT)?	165
8.8	Bank supervision and financial stability in the Eurozone	166
8.9	The new financial regulatory and supervisory structure in the EU	169
8.10	Conclusion	172
9	Monetary policy in the Eurozone	173
	Introduction	173
9.1	Central banking and asymmetries of shocks	173
9.2	The Monetary Policy Strategy of the ECB: a description	180
9.3	The Monetary Policy Strategy of the ECB: an evaluation	184
9.4	The instruments of monetary policy in the Eurozone	197
9.5	The Eurosystem as lender of last resort during the financial crisis	201
9.6	Conclusion	203
10	Fiscal policies in monetary unions	205
	Introduction	205
10.1	Fiscal policies and the theory of optimum currency areas	205
10.2	Sustainability of government budget deficits	209
10.3	The argument for rules on government budget deficits	215
10.4	Fiscal discipline in monetary unions	218
10.5	Risks of default and bailout in a monetary union	222
10.6	The Stability and Growth Pact: an evaluation	223
10.7	A joint issue of common bonds	224
10.8	Conclusion	226
11	The euro and financial markets	228
	Introduction	228

11.1	EMU and financial market integration in Europe	228
11.2	Why financial market integration is important in a monetary union	232
11.3	Conditions for the euro to become an international currency	235
11.4	Conclusion	242
	References	243
	Index	256