

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	08
	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	17
	1.6 Private insurance schemes	19
	1.7 Differences in labour market institutions	20
	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?	33
	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	48
	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	80
4.5	The trade-off between budgetary union and flexibility	81
4.6	Costs and benefits in the long run	83
4.7	Should the UK join EMU?	87
4.8	Is Latin America an optimal currency area?	90
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 rate 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	114
5.5	Grexit: can it happen and why? Is it desirable?	118
5.6	Conclusion	125
6	How to complete a monetary union	126
	Introduction	126
6.1	The role of the central bank: lender of last resort	127
6.2	Consolidating government budget and debts	132
6.3	Coordination of budgetary and economic policies	133
6.4	The theory of optimal currency areas and political union	134
6.5	How does political integration affect the optimality of a monetary union?	136
6.6	An omitted 'deep' variable	140
6.7	Conclusion	141
7	The transition to a monetary union	142
	Introduction	142
7.1	The Maastricht Treaty	142
7.2	Why convergence requirements?	144
7.3	Technical problems during the transition: how to fix the conversion rates	150
7.4	How to organize relations between the 'ins' and the 'outs'	153
7.5	Conclusion	155

8	The European Central Bank	156
	Introduction	156
	8.1 The design of the ECB: the Maastricht Treaty	156
	8.2 Why has the German model prevailed?	157
	8.3 The ECB: a 'conservative' central bank?	160
	8.4 Independence and accountability	165
	8.5 The ECB: institutional framework	169
	8.6 The ECB as lender of last resort	173
	8.7 Did the ECB violate its statutes when it announced its government bond buying programme (OMT)?	175
	8.8 The new financial regulatory and supervisory structure in the EU: towards a banking union	176
	8.9 Conclusion	178
9	Monetary policy in the Eurozone	180
	Introduction	180
	9.1 Central banking and asymmetries of shocks	180
	9.2 The Monetary Policy Strategy of the ECB: a description	190
	9.3 The Monetary Policy Strategy of the ECB: an evaluation	191
	9.4 The instruments of monetary policy in the Eurozone	205
	9.5 <i>The Eurosystem as lender of last resort during the financial crisis</i>	210
	9.6 Conclusion	212
10	Fiscal policies in monetary unions	214
	Introduction	214
	10.1 Fiscal policies and the theory of optimum currency areas	214
	10.2 Sustainability of government budget deficits	218
	10.3 The argument for rules on government budget deficits	225
	10.4 Fiscal discipline in monetary unions	228
	10.5 Risks of default and bailout in a monetary union	232
	10.6 The Stability and Growth Pact: an evaluation	233
	10.7 A joint issue of common bonds	234
	10.8 Conclusion	236
11	The euro and financial markets	238
	Introduction	238
	11.1 EMU and financial market integration in Europe	238
	11.2 <i>Why financial market integration is important in a monetary union</i>	243
	11.3 Conditions for the euro to become an international currency	246
	11.4 Conclusion	252
	References	254
	Index	267