Contents

Introduction		ix			
Part	i Co	sts and benefits of monetary union			
1	Th	e costs of a common currency	3		
		Introduction	3		
	1.1	Shifts in demand (Mundell)	3		
	1.2	Monetary independence and government budgets	8		
	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	The theory of optimum currency areas: a critique			
		Introduction	24		
	2.1	How relevant are the differences between countries?	24		
	2.2	How effective are national monetary policies?	- 35		
	2.3	National monetary policies, time consistency, and credibility	41		
	2.4	Mundell once more	49		
	2.5	The cost of monetary union and the openness of countries	50		
	2.6	Conclusion	52		
3	The	benefits of a common currency	55		
		Introduction	55		
	3.1	Direct gains from the elimination of transaction costs	55		
	3.2	Indirect gains from the elimination of transaction costs: price transparency	56		
	3.3	Welfare gains from less uncertainty	59		
	3.4	Exchange rate uncertainty and economic growth	63		
	3.5	Monetary union and trade: the empirical evidence	68		
	3.6	Benefits of an international currency	69		
	3.7	Benefits of a monetary union and the openness of countries	70		
	3.8	Conclusion	71		

CONTENTS

4	Costs and benefits compared		
		Introduction	73
	4.1	Costs and benefits compared	73
	4.2	Monetary union, price and wage rigidities, and labour mobility	76
	4.3	Asymmetric shocks and labour market flexibility	77
	4.4	The degree of completeness of a monetary union	83
	4.5	The trade-off between budgetary union and flexibility	84
	4.6	Costs and benefits in the long run	88
	4.7	ls Latin America an optimal currency area?	92
	4.8	The next monetary union in Asia?	94
	4.9	Monetary unions in Africa	97
	4.10	Conclusion	99

Part 2 Monetary union

• • • • •		· · · · · · · · · · · · · · · · · · ·	• • • • • • • • • • • • • • • •
5	The	e fragility of incomplete monetary unions	103
		Introduction	103
	5.1	Fixed exchange rate regimes as incomplete monetary unions	104
	5.2	A monetary union without a budgetary union	111
	5.3	More bad news about bad equilibria: banking crises	115
	5.4	More bad news about bad equilibria: automatic stabilizers	116
	5.5	Conclusion	120
6	The	e transition to a monetary union	122
		Introduction	122
	6.1	The Maastricht Treaty	122
	6.2	Why convergence requirements?	123
	6.3	How to organize relations between the 'ins' and the 'outs'	130
	6.4	Conclusion	131
7	How to complete a monetary union		
		Introduction	132
	7.1	The role of the central bank: lender of last resort	133
	7.2	Consolidating government budget and debts	138
	7.3	Coordination of budgetary and economic policies	143
	7.4	An omitted 'deep' variable	147
	7.5	Conclusion	148
8	Pol	itical economy of deconstructing the Eurozone	149
		Introduction	149
	8.1	Case study: Greece	151

CONTENTS

	8.2	Case study: Italy unfit for the Eurozone?	155
	8.3	Towards deconstructing the Eurozone?	159
	8.4	The costs of deconstruction	160
	8.5	Will the rest of the Eurozone be better off?	161
	8.6	Conclusion	163
9	The	European Central Bank	165
		Introduction	165
	9.1	The design of the ECB: the Maastricht Treaty	165
	9.2	Why has the German model prevailed?	166
	9.3	The ECB: a 'conservative' central bank?	169
	9.4	Independence and accountability	174
	9.5	The ECB: institutional framework	178
	9.6	The ECB as lender of last resort	182
	9.7	Did the ECB violate its statutes when it announced its government bond-buying programme (OMT)?	184
	9.8	The new financial regulatory and supervisory structure in the EU: towards a banking union	185
	9.9	Conclusion	188
10		netary policy in the Eurozone	189
10	MU	Introduction	189
	101	Central banking and asymmetries of shocks	189
		The Monetary Policy Strategy of the ECB: a description	195
		The Monetary Policy Strategy of the ECB: an evaluation	197
		The instruments of monetary policy in the Eurozone	209
		The Eurosystem as lender of last resort during the financial crisis	214
		Conclusion	216
11	Fisc	al policies in monetary unions	218
		Introduction	218
	11.1	Fiscal policies and the theory of optimum currency areas	218
	11.2	Sustainability of government budget deficits	222
	11.3	The argument for rules on government budget deficits	229
	11.4	Fiscal discipline in monetary unions	232
	11.5	Risks of default and bailout in a monetary union	237
	11.6	The Stability and Growth Pact: an evaluation	237
		A joint issue of common bonds	240
		Conclusion	242
12	The	euro and financial markets	244
		Introduction	244
	12.1	EMU and financial market integration in Europe	244

vii

CONTENTS

••

Why financial market integration is important in a monetary union	250
Conditions for the euro to become an international currency	252
Conclusion	259
References	
	277
	Conditions for the euro to become an international currency