## **Contents**

$\boldsymbol{A}$	ist of Tables and Figures cronyms reface	xi xiii xv	
1	Principles and Issues of European Monetary Unification		
	<ul><li>1.1 Theoretical Issues and Competing Hypotheses, 2</li><li>1.2 Structure and Main Findings of the Book, 5</li><li>Notes, 10</li></ul>		
2	A Description of the European Monetary System	11	
	<ul> <li>2.1 The Long Road to Monetary Union, 11</li> <li>2.2 The EMS: Institutions and Policymaking, 19</li> <li>2.3 The Economic Record of the EMS, 26</li> <li>2.4 Conclusions, 37</li> <li>Notes, 38</li> </ul>	••	
	Appendix 2A: The ECU, Central Parities, and the Indicator of Divergence, 40		
3	Cooperation or Discipline: The Political Economy of the EMS	43	
	<ul> <li>3.1 The Cooperative Interpretation of the EMS, 44</li> <li>3.2 The Disciplinary View of the EMS, 48</li> <li>3.3 A Model of Monetary Policy Making in the EMS, 53</li> <li>Notes, 57</li> </ul>		
4	The EMS and Central Bank Credibility	59	
	<ul><li>4.1 Theoretical Considerations, 59</li><li>4.2 Evidence from Inflation Rates, 68</li><li>Notes, 72</li></ul>		

			٠	
7)	1	1	1	

5	Ge	rman Dominance in the EMS: The Empirical Evidence	<i>7</i> 5		
	5.1 5.2	and and them of GDII.			
	5.3	Evidence from Monetary Base Growth, 78 The Short-Run View of GDH: Evidence from Interest Rates, 84			
	5.4				
	5.5				
	5.6	Conclusions, 94			
	Not	tes, 97			
6	The EMS and Central Bank Cooperation				
	6.1	Central Bank Cooperation: Theoretical Foundations, 99			
	6.2	The EMS as a Surrogate for Cooperation, 103			
	6.3				
	6.4	Exercise, 108			
	6.5	Policy Coordination in the EMS and the Process of European Integration, 118			
	6.6	Empirical Evidence of EMS Coordination, 128			
	6.7	Conclusions, 129			
	Not	es, 130			
7	Exchange-Rate and Inflation Uncertainty in the EMS				
	<b>7.</b> 1	Modeling Exchange-Rate and Inflation Uncertainty, 134			
	7.2	Nominal and Real Exchange-Rate Uncertainty in the EMS, 136			
	7.3	Realignment Uncertainty in the EMS, 146			
	7.4	Inflation Uncertainty in the EMS, 153			
	7.5	Conclusions, 155			
	/ Not	es, 158			
8	European Monetary Union				
	8.1	The Costs and Benefits of European  Monetary Union, 161			
	8.2	Central Bankers: Collusion Versus Competition, 163			
	8.3	Exchange-Rate Union or Currency Union? 174			
	8.4	The Role of Fiscal Policy in a Monetary Union (176)			
	8.5	Institutional Requirements for a Low-Inflation EMU, 185			
	8.6	Conclusions (187)			
	Note	es, 188			

X	9 On the Road to Economic and Monetary Union				
		9.1	The Delors Report: A Strategy for Monetary Union, 191		
		9.2	Alternative Strategies to Achieve EEMU, 194		
		9.3	A Public Choice Interpretation of the Delors Proposal, 200		
		9.4	Choosing a Strategy for EEMU, 203		
		9.5	Adjustment to Central Bank Dominance, 210		
		9.6	How Long Should the Transition Period Be? 215		
		9.7	Conclusions, 218		
	Notes, 219				
	10 Conclusions: A Strategy for the Transition to EMU				
		Note	es, 225		
	Bibl	liogra	ohy	227	
			Book and Authors	241	
	Inde	ex		243	

## Tables and Figures

7	a	h	1.	00

2.1	The European currency unit	21
2.2	Exchange-rate realignments within the EMS	22
2.3	Cumulative bilateral inflation differential	27
2.4	Cumulative percentage change in bilateral	
	real exchange rates	29
2.5	Variability of the annual growth of the effective	
	exchange rate	30
2.6	Real interest rates	33
2.1A	EMS bilateral central rates and intervention points	41
2.171	Livis bilateral central rates and	
3.1	A model of policymaking in the EMS	55
	, , , ,	
4.1	A simplified model	61
4.2	CPI inflation rates, EMS and non-EMS countries	69
5.1	Model characteristics	80
5.2	Hypothesis tests for German dominance	81
5.3	Hypothesis tests for dominance of the DM area	83
5.4	Summary of estimates	86
5.5	Testing strong German dominance	87
5.6	Testing weak German dominance	88
5.7	Responses to unit interest rate innovations	93
5.8	Decomposition of interest rate changes	95
6.1	The simplified model	100
6.2	Parameter values for the symmetric baseline model	110
6.3	Baseline simulations of shocks	113
7.1	Conditional variances of weekly DM	
	nominal exchange rates	138
7.2	Conditional covariances of weekly DM	
- ·-	nominal exchange rates	139
7.3	Relative changes in conditional variances of weekly	
0	DM exchange rates	141
	: : :: :: :: : : : : : : : : : :	

xii

7.4 Condition	al variances of monthly DM	
real exc	change rates	144
7.5 Condition	al covariances of monthly DM	
real exc	change rates	145
7.6 Relative ch	hanges in conditional variances of	
real exc	change rates	146
7.7 Weekly ch	langes of the one-month expected DM	
exchange		148
7.8 Transfer fu	unctions for weekly changes of one-month	
expecte	ed exchange rate	149
7.9 Four-week	forecast error of exchange-rate changes	151
7.10 Transfer fu	unctions for the forecast error of	
exchange	ge-rate changes	152
7.11 Conditiona 7.12 Relative sh	al variances and covariances of inflation rates	154
7.12 Relative sn	nares of EMS exports	15 <i>7</i>
8.1 Taxes, mor	netary base, debt, and inflation rates	169
8.2 Fiscal restr	raints and fiscal performance of states	109
in the U	Inited States	180
9.1 Alternative	e paths to EEMU	195
9.2 Required p	primary deficit to stabilize the debt ratio	175
at 1990 v	values	214
9.3 Required p	orimary deficit to stabilize the debt ratio	
in absen	nce of risk premium	216
Figures		
2.1 EMS and n	on-EMS inflation rates	31
	s non-EMS money base growth	32
2.3 EMS minus	s non-EMS unemployment rates	34
2.4 EMS minus	s non-EMS real GDP growth	35
2.5 Net debt-to	o-GDP ratio, EMS versus non-EMS	37
6.1 MARs with	n rising import expenditure shares	116
6.2 MARs with	rising interest elasticity money demand	119
6.3 MARSPs w	rith rising import expenditure shares	123
6.4 MARSPs w	rith rising interest elasticity money demand	125
9.1 Real debt g	rowth minus money growth	213