Int Econ Econ Policy (2009) 6:83–84
DOI 10.1007/s10368-009-0139-y

EDITORIAL

Monetary Integration in Europe (and beyond)

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Published online: 4 June 2009

In this special issue of International Economics and Economic Policy, we have compiled seven papers which were given at the 9th Annual Conference of the International Network for Economic Research (INFER) in Loughborough, UK. These papers repesent only a small sample of papers, which were presented in Loughborough. However, they all fit into the special topic of that conference (Monetary Integration in Europe).

Ten years after the introduction of the Euro there are still open issues, which are subject to ongoing research. In this special issue, we address some of them. We start with a paper by Hughes Hallett and Richter that looks into the transmission mechanism of monetary policy for the two most influential Eurozone economies, for the Eurozone as a whole and the UK as an outsider. They find that transmission mechanisms were significantly different to each other, but have converged since the introduction of the Euro.

Adam Koronowski analyses divergent business cycles in the Euro area. Within his theoretical framework, the results of economic policy in a monetary union are suboptimal; the domestic product ends up below its potential level that the economy could attain at a flexible exchange rate and an individually set interest rate. This solution is an example of a Nash equilibrium, which is not Pareto optimal. It proves again that micro-optimization is not a substitute for a proper macroeconomic policy that should create the right conditions for decisions taken by individual agents. When representative agents differ among countries with respect to their inter-temporal preferences macro-policies should be "customized", one size does not fit all.

Asymmetric shocks are not only important with respect to business cycles but also in terms of current account adjustments. If the Euro–Dollar exchange rate changes then that might have asymmetric implications for the Eurozone countries, which in turn has consequences for monetary policy in Europe. Langwasser analyses

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external shocks to the euro area, which may have asymmetric effects on the euro area economies. In this paper, trade equations for individual euro area countries using a vector error correction model are estimated. The result suggest that global adjustment will affect individual euro area countries differently, complicating the response of the euro area's one-size-fits-all monetary policy.

The following three papers analyse the enlargement of the European monetary union. The first of these analyses the expansion in a theoretical framework combined with some simulations:

Plasmans, Engwerda, van Aarle and Michalak study the effects of a monetary union enlargement using the techniques and outcomes from an extensive research project on macroeconomic policy coordination in the EMU. They use a linear-quadratic differential games model to capture externalities, spillovers and strategic behaviour of (fiscal and monetary) players. They find that it is never profitable to enlarge the monetary union when there is a risk of an asymmetric shock. What is more, the potential losses from accession are so high that it can be barely possible to design a transfer system to compensate for a worse situation of some countries.

Žďárek analyses the process of nominal and real convergence in the new Member States of the European Union (NMS). The importance of nominal and real convergence is underlined in connection with a successful catching-up. The NMS economies experienced robust economic growth in recent years, which had a positive impact on the convergence process. This development allows to evaluate potential benefits and risks connected with joining the euro. The benefits connected with elimination of exchange rate risks and reduction of transaction costs can be compared with the disadvantages associated with the loss of an independent monetary policy and an adjusting exchange rate mechanism.

As Žďárek pointed out already the importance of exchange rates, the following paper analyses this issue in greater detail. Ledesma–Rodríguez, Pérez–Rodríguez and Sosvilla–Rivero attempt to identify implicit exchange rate regimes for currencies of the Central and Eastern European Countries *vis-à-vis* the Euro. They apply a sequential procedure that considers the dynamics of exchange rates to data covering the period from 1977:01 to 2006:02. Their results suggest that implicit bands have existed in many subperiods for almost all currencies under study. Once they detected *de facto* discrepancies between *de facto* and *de iure* exchange rate regimes, they develop a model in order to explain these differences. Their results suggest a positive association between the previous inflation rate and the probability of a peg with the euro, and a negative association with past unemployment rate.

Finally, we look beyond the Eurozone. The Euro is discussed as a model for introducing a common currency in Asia. Hughes Hallett and Richter look at the changing economic relationships in Asia in order to determine whether convergence in between Asian countries has taken place. They find that the links with the US have been weakening, while those based on China have strengthened. This result is not new—it has been happening since the 1980s, but has now been reversed by the surge in trade. They also show that the links with the US have been rather complex, with the US able to shape the cycles elsewhere through her control of monetary conditions, but the China zone able to control the size of their cycles. On the other hand, Japan remains linked to (and dependent on) the US.Finally they do not find evidence that pegged exchange rates encourage convergence.