Session 1 – Internal market and EMU

Discussion of

C. Guillemineau: Endogeneities of optimal currency areas

And

L. Fontagne: Empirical evidence of EU intra-industry trade

By

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Short summary of results:

C. Guillemineau:

EMU has 1) increased intra industry trade

2) reduced differences in government deficits

L. Fontagne

Increase in intra industry trade in the EU (both vertical and horizontal nature)

Discussion of C. Guillemineau

I basically agree with the result that cyclical convergence has increased.

This has occurred despite some assymetric shocks which can be related to the creation of EMU such as:

1) Large (negative) shocks to exchange risk premia (ES, PO, IR)
2) Liberalisation of financial markets.

Therefore I would expect even more convergence of business cycles in the future.

But, we have also seen more divergence of trend growth in EMU.

Do shocks have a longer impact in EMU?

Increased synchronisation has occurred despite the fact that (assymmetric) demand and supply shocks do not generally lead to positive spillovers (more synchronised cycles)

3 examples:

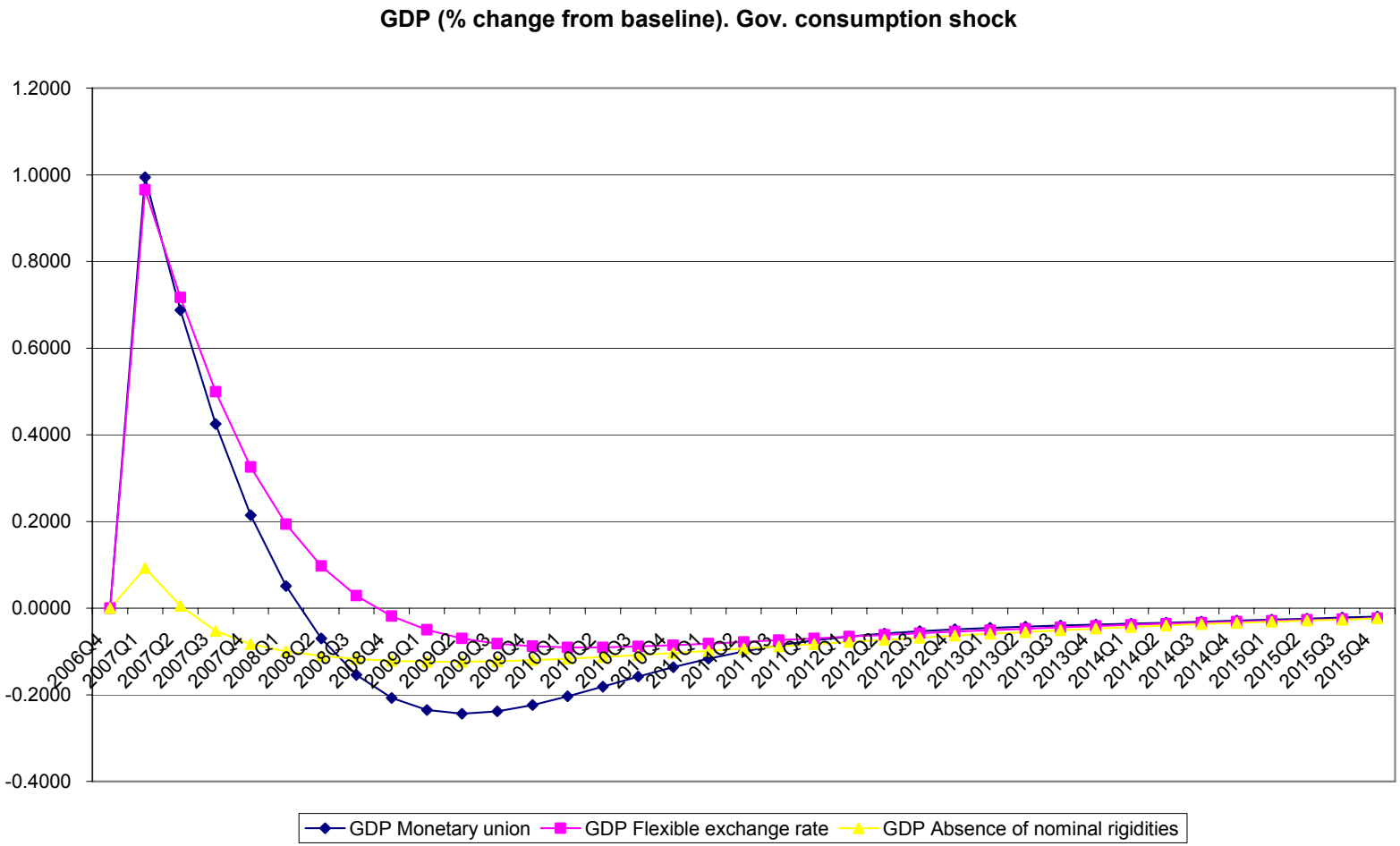
Government demand shock

Tradable TFP shock

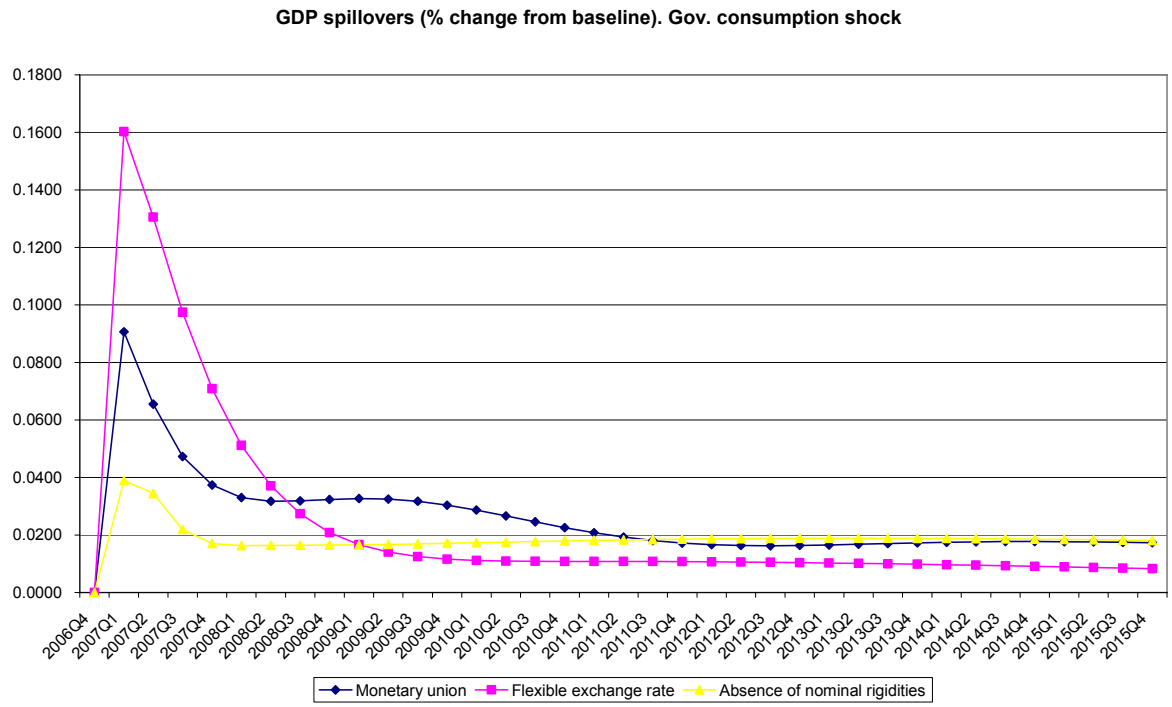
Non tradable TFP shock

Figure 1. Market spillovers: Government consumption shock. Benchmark scenarios

1.a



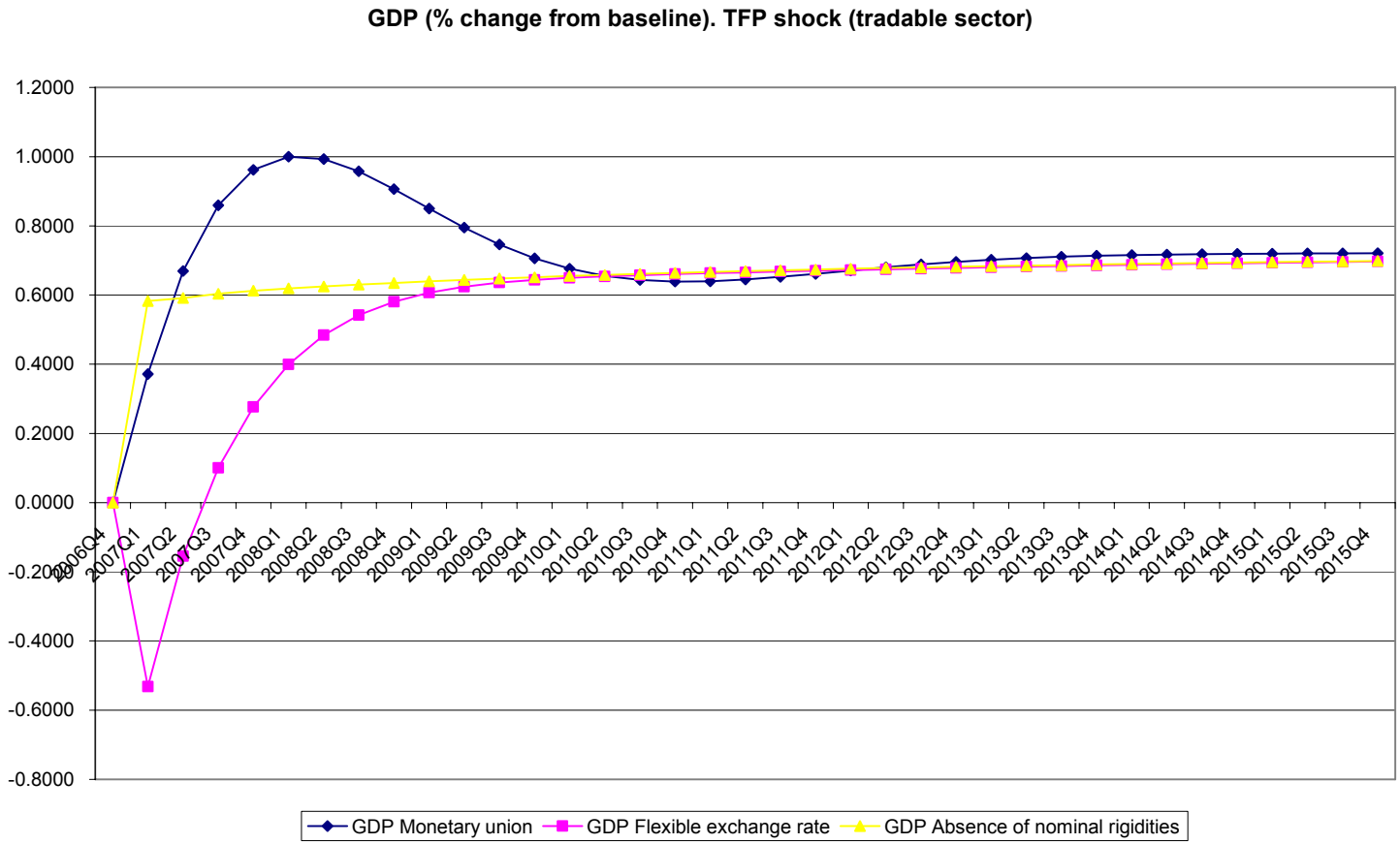
1.d.



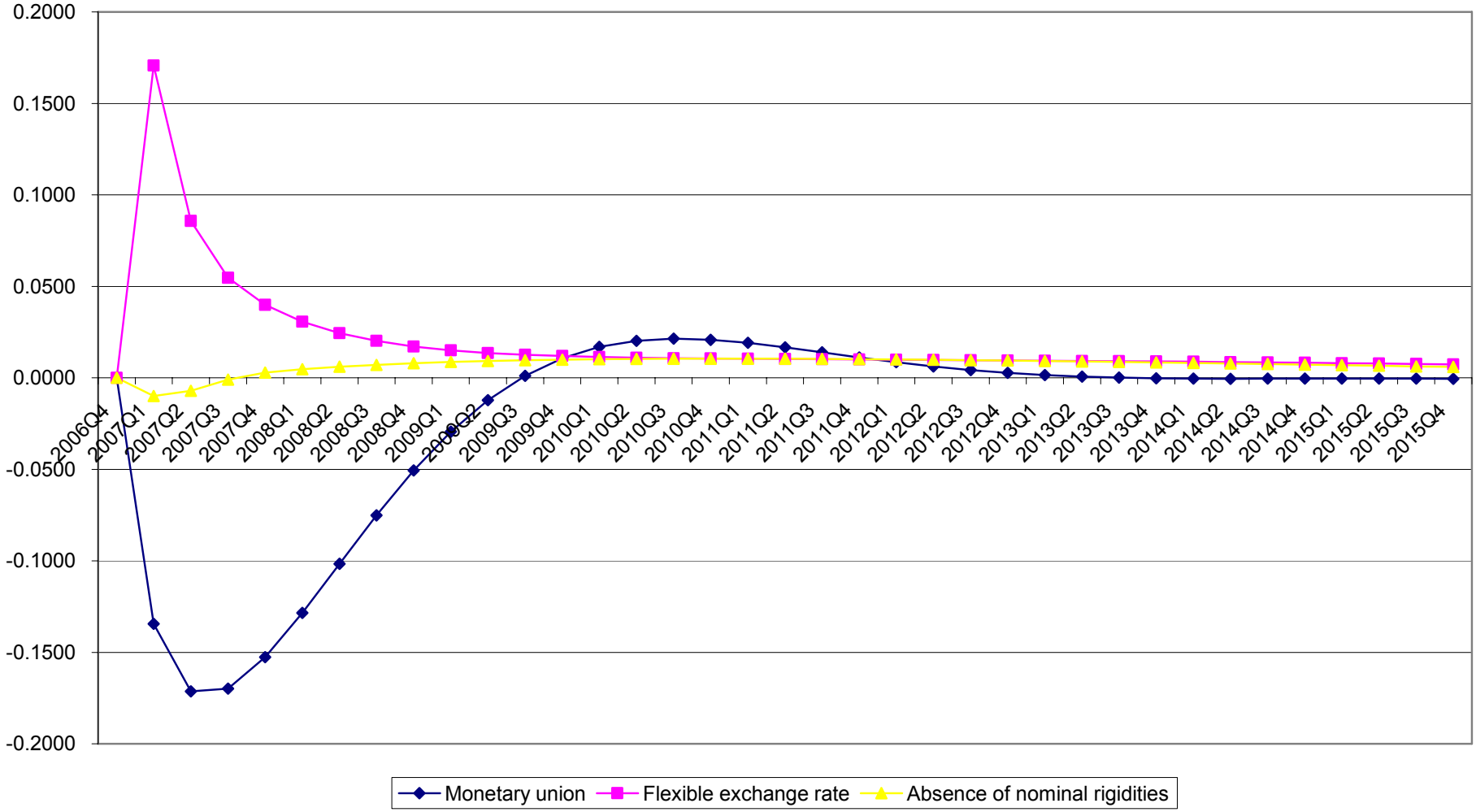
More synchronisation under FlexE

Figure 3. Market spillovers: TFP shock (tradable sector). Benchmark scenarios

3.a.



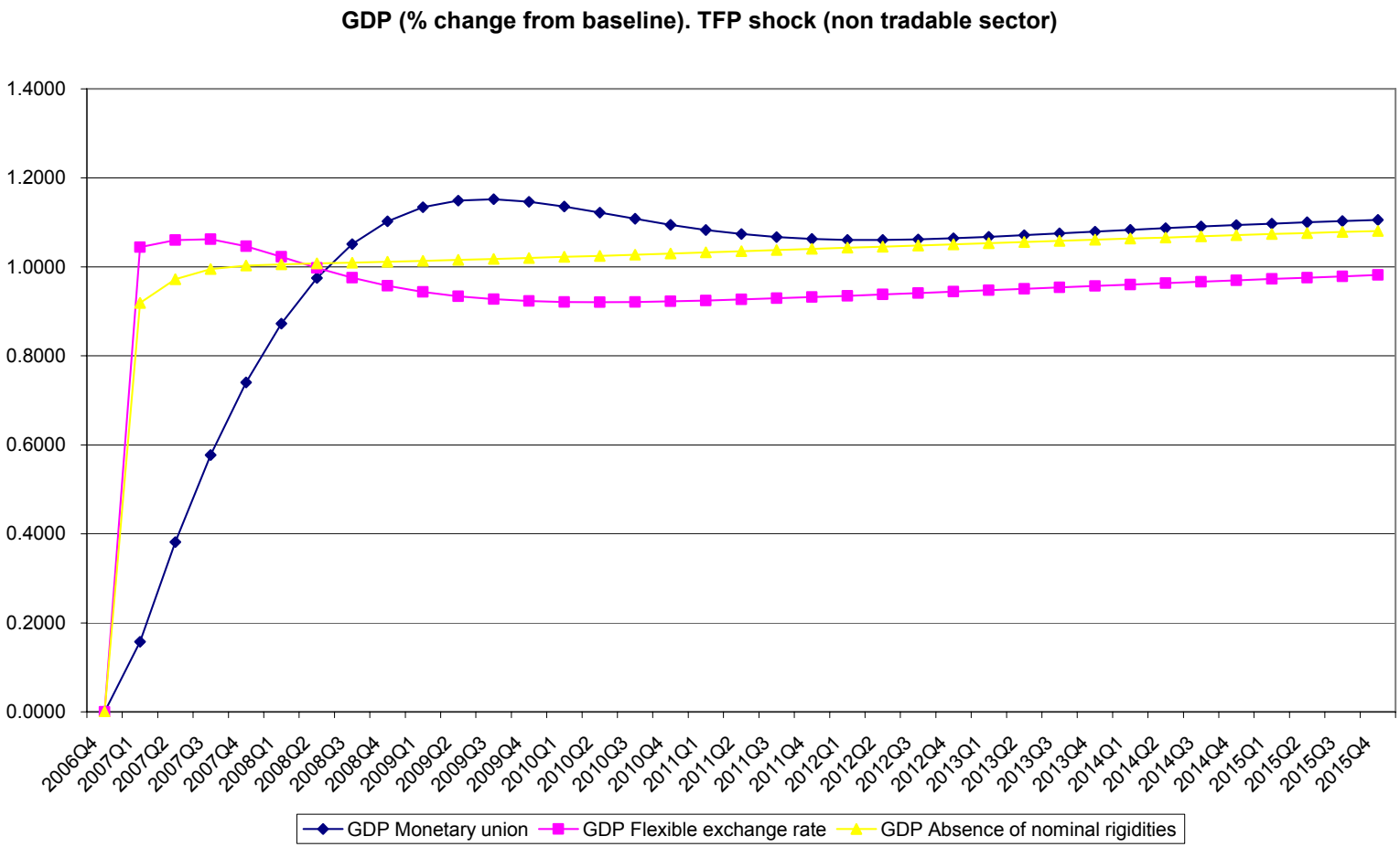
GDP spillovers (% change from baseline). TFP shock (tradable sector)



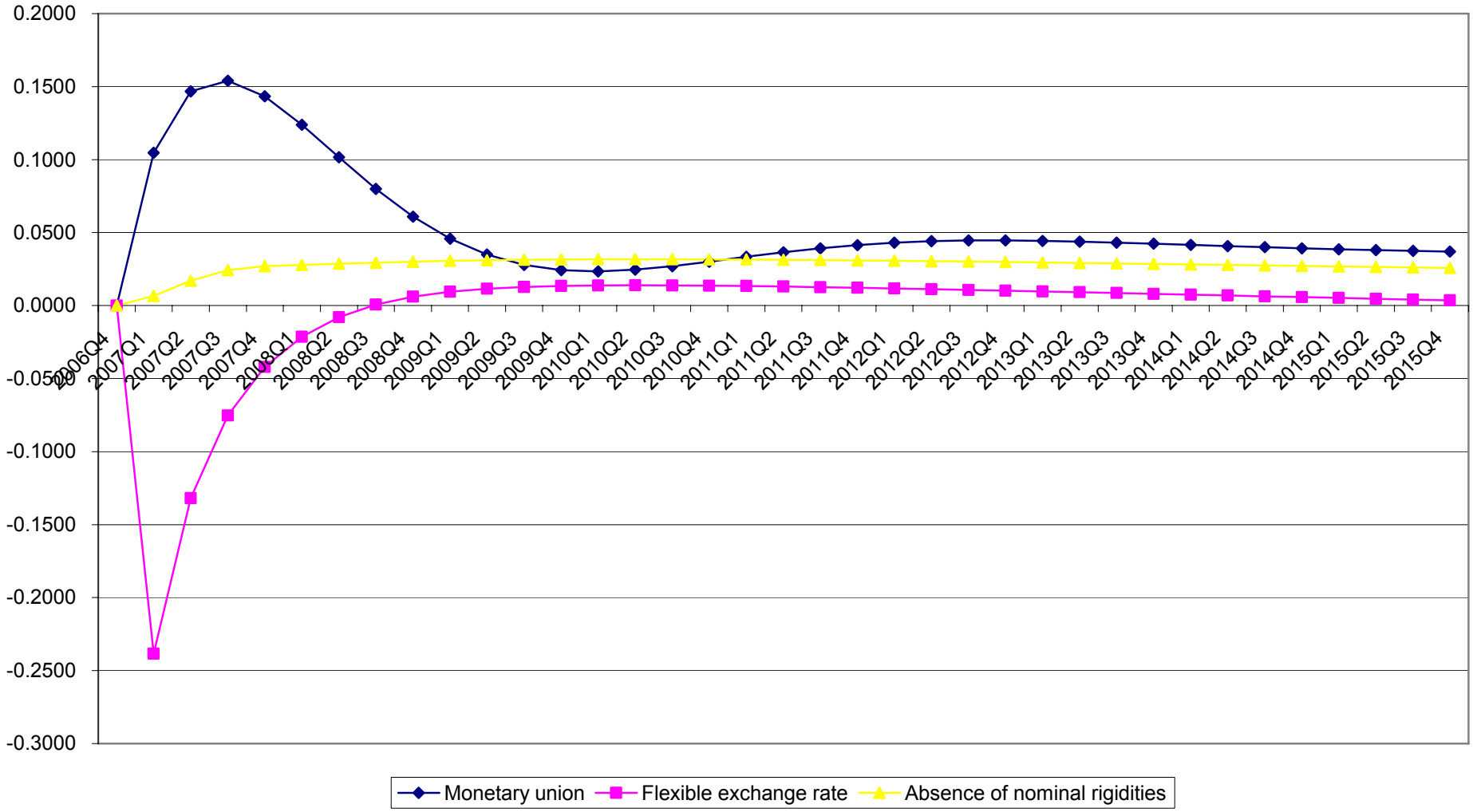
More synchronisation under flexE

Figure 4. Market spillovers: TFP in the non-tradable sector shock. Benchmark scenarios

4.a.



GDP spillovers (% change from baseline). TFP shock (non tradable sector)



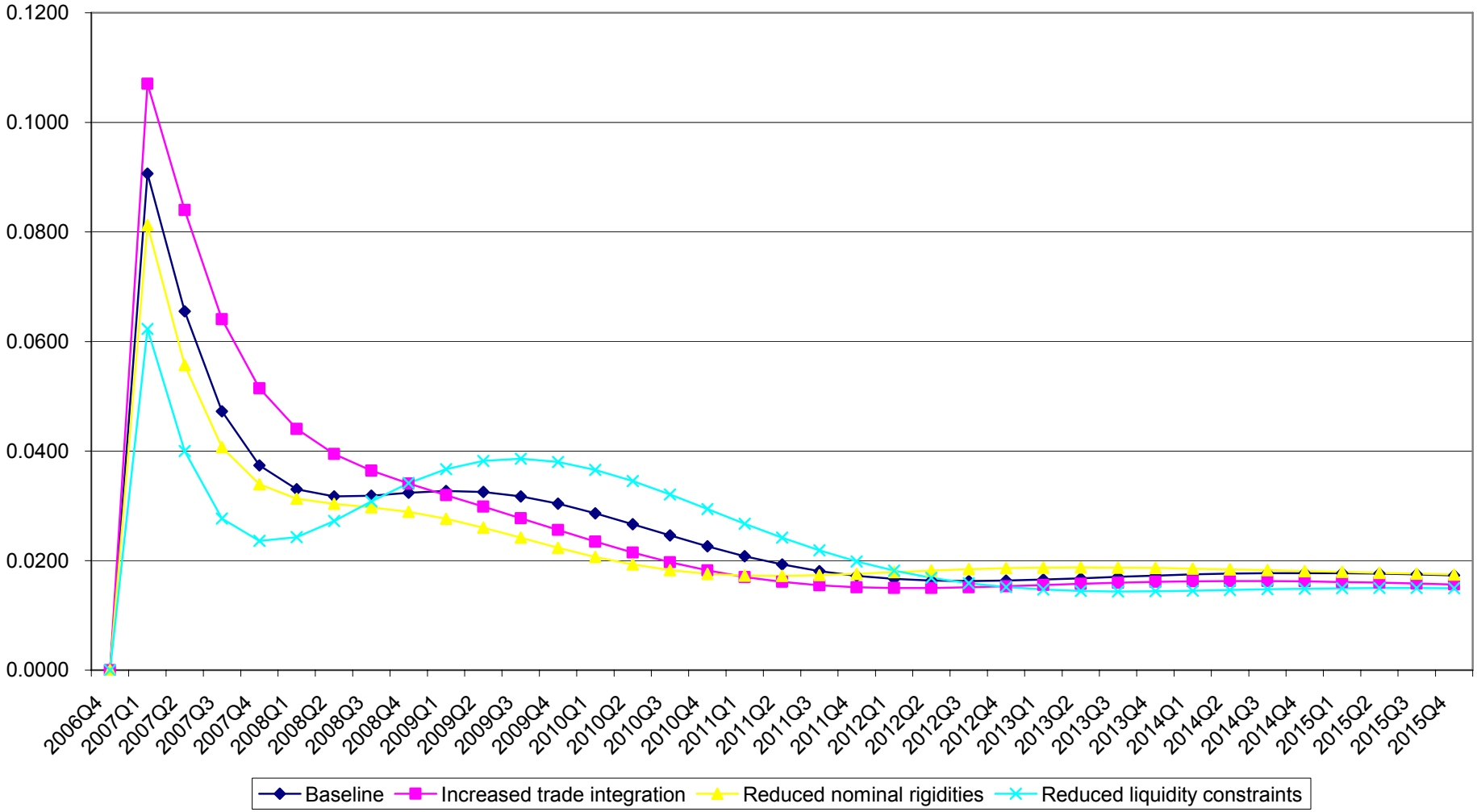
More synchronisation under fixE

Increased trade integration does not always lead to more synchronisation.

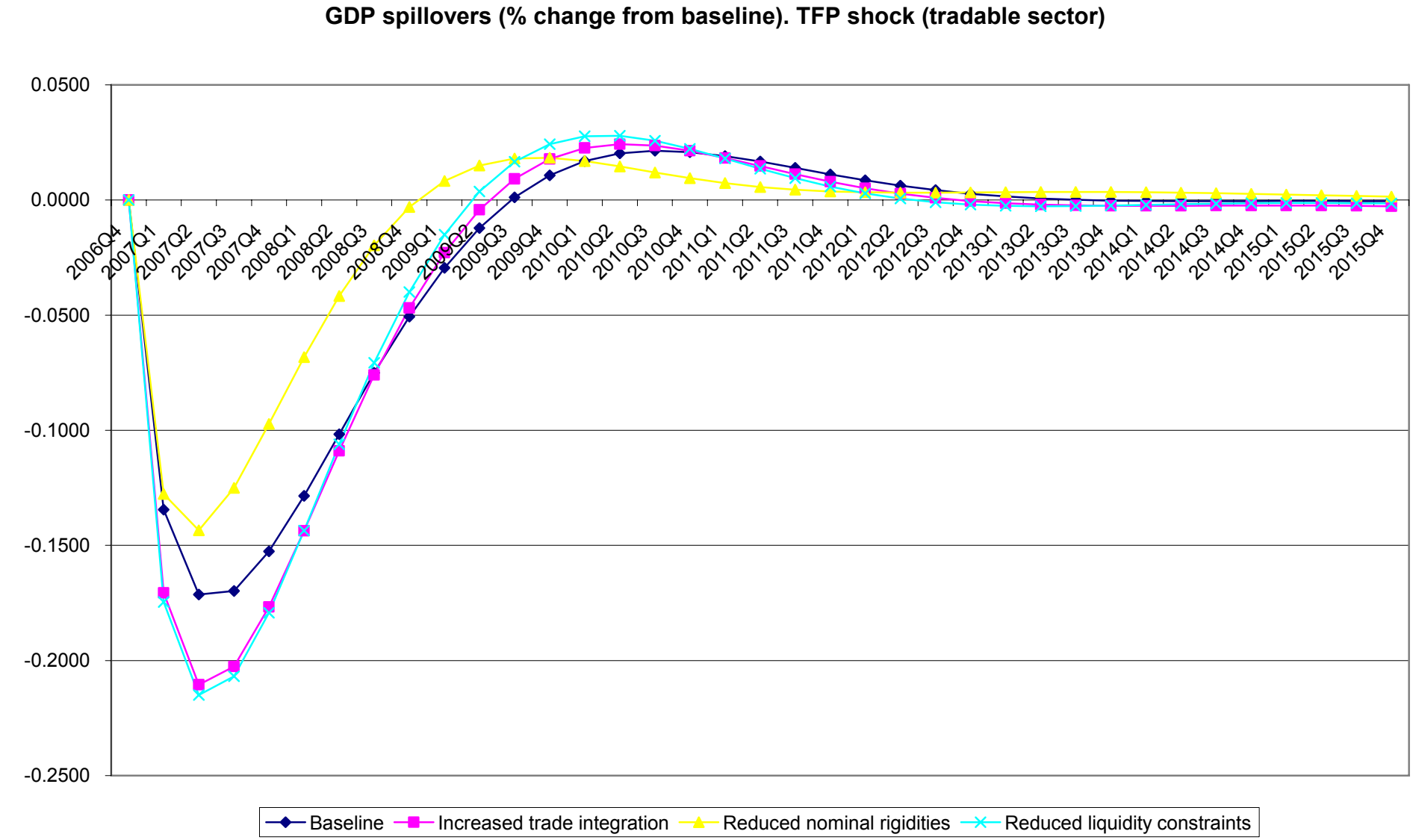
Notice: trade integration here is defined as increasing the EOS between goods and services traded in EMU. (i. e. traded goods become more similar)

The 3 examples again.

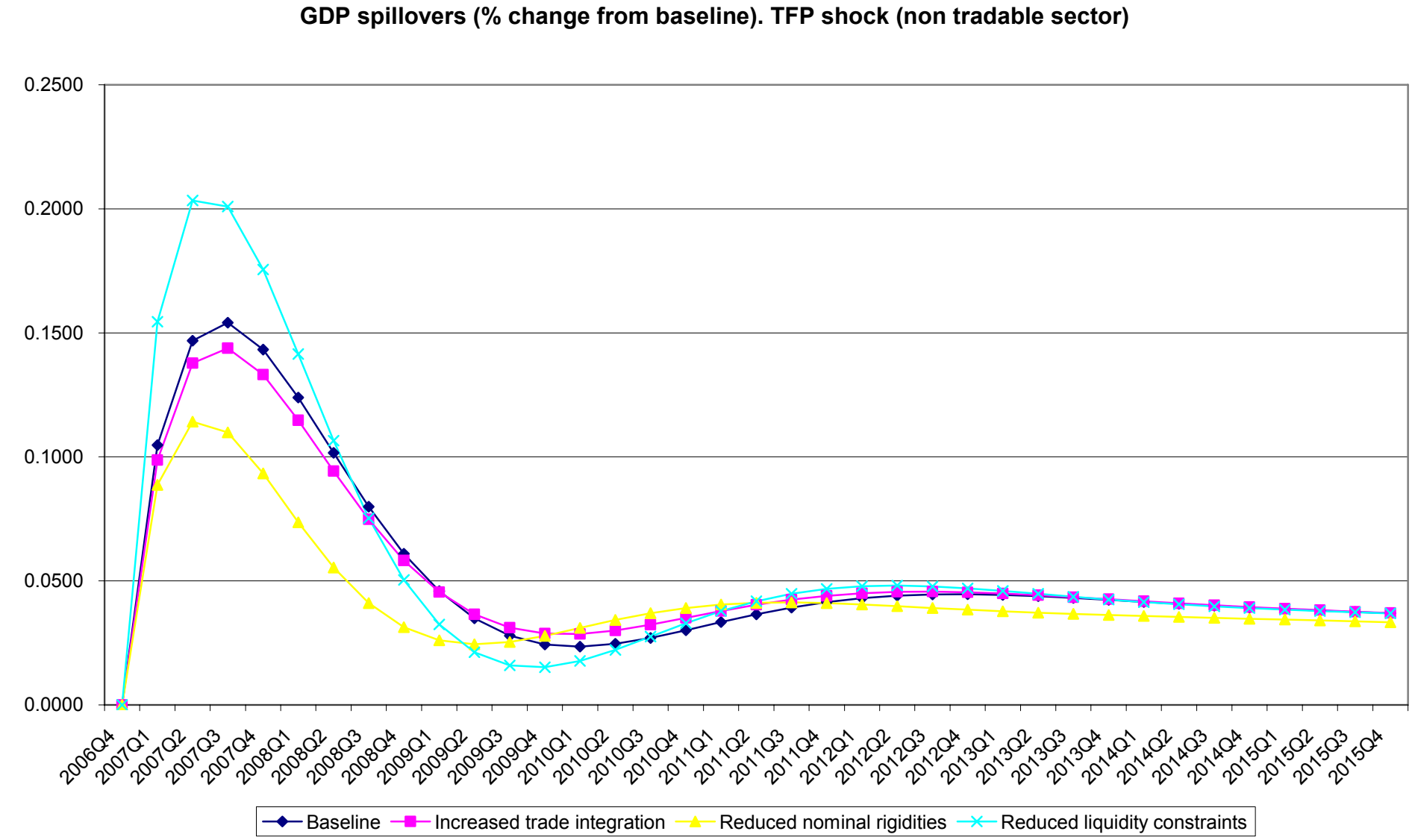
GDP spillovers (% change from baseline). Gov. consumption shock



Trade integration leads to higher synchronisation, because imports respond more strongly to price increases in the dom. economy.



Shocks in the tradable sector become more negatively transmitted, because the competitiveness effect increases. (notice, this goes counter to the argument that less specialisation leads to more synchronisation, since this argument implies that with less specialisation shocks become more similar.



Slightly more synchronisation

Under fixed exchange rates, there is not necessarily more synchronisation.

Especially assymmetric tradable TFP shocks lead to negative spillovers.

These shocks are likely to be important.

Why do we not see more assymmetry?

Shocks are common across countries, i. e. largely sector specific?

Maybe they have less cyclical but growth implications and could potentially increased growth divergencies in EMU?

The link between trade integration and synchronisation is not straightforward.

If production structures become more similar this could either mean

More synchronisation because shocks are becoming more similar across countries

But it could also mean

More asymmetry if there are country specific shocks.

This raises an interesting political economy issue:

Does EMU increase the incentive for governments to make their export sector more competitive.

And, if spillovers are negative will this raise the reform effort in EMU in general?