Essays on the Macroeconomics of Monetary Union

Chapter 2 studies the impact of the formation of a monetary union on equilibrium unemployment in the presence of large labor unions. A strategic interaction between the labor unions and the central bank emerges so that the way monetary policy is conducted will affect labor union behavior. It is shown that the formation of a monetary union will lower equilibrium unemployment, provided that central bank conservatism is high enough. If conservatism is low, equilibrium unemployment will increase. The main results of the model are independent of the existence of the inflation bias in monetary policy.

Chapter 3 studies the determination of labor market flexibility in a monetary union, where the governments of the member countries decide on the flexibility. Insiders of the labor unions have considerable power in wage setting. Labor market flexibility is not in the interests of the insiders. When the government sets flexibility optimally, it faces a tradeoff between macroeconomic stability and political popularity. It is shown that labor market policy coordination will affect the chosen level of flexibility, provided that a stabilization bias of monetary policy exists. The governments internalize the stabilization bias problem under coordination, and to reduce the bias, they choose more flexible markets than under independent policy making.

Chapter 4 studies expectations formation and the impact of expectations on the macroeconomic equilibrium. The formation of a monetary union is a major regime shift in economic policy. The standard hypothesis of rational expectations applied in economic theory is a particularly strong assumption in this kind of situation. The agents should know all the factors affecting the economy in the new regime. In this study the assumption of rational expectations is abandoned, and it is assumed that the agents try to learn the true parameter values. It is shown that the multiple equilibria problem in the monetary union model of Chapter 3 disappears, when the agents form their expectations adaptively by using the least-squares method to update their parameter estimates.