

FISCAL AND CURRENCY UNION WITH DEFAULT AND EXIT

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WHAT IS THE PAPER ABOUT?

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- ▶ The paper embeds two main features about marriage.
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- ▶ **This discussion**
 - ▶ Are fiscal and currency unions really a marriage?

MARRIAGE

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 - 1) **Insurance:** partners pool their incomes to smooth consumption.
 - 2) **Exclusivity:** partners can only have dinner with each other.
There are no restaurants. Dinner alone is not that much fun.
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 - ▶ **Alimony** (or a one time payment): **it must be enough to “maintain the life standard” previous to divorce.**
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- ▶ “Common” dinner is a **friction**, e.g. changing tastes.
- ▶ **After divorce everyone is free to optimally choose who to dine with.**

MAPPING TO THE UNION

- ▶ While in the union:
 - ▶ Insurance = Fiscal Union.
 - ▶ Exclusivity \Rightarrow Common dinner = Currency Union.
 - ▶ Friction \Rightarrow **Unmatched taste = Labor Wedge.**
- ▶ Reasons to leave:
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- ▶ Exiting the Union:
 - ▶ Alimony \Rightarrow Present value of promised transfers = **Exiter debt.**
 - ▶ Optimal dinner at each t = Independent monetary policy

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- ▶ How to deal with the friction?
- ▶ In marriages sometimes there are implicit or explicit agreements that make them non-exclusive \Rightarrow “**modern marriage**”?
- ▶ But cultural and moral issues prevent non-exclusive marriages.
- ▶ Monetary policy is not the only way to eliminate the labor wedge.
 - ▶ Use taxes and subsidies on labor, tradables and non-tradables.
- ▶ It is argued that is hard to use these instruments. Why?
Is it as hard as agreeing on a modern marriage?
- ▶ Shouldn't we be thinking about the frictions that prevent the optimal use of other instruments?

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- ▶ Having a break-up cost different from default cost may help with quantitative exercise.

INSURANCE VS REDISTRIBUTION

- ▶ **Redistribution:** long lasting differences \Rightarrow high ρ and low σ_y .
- ▶ **Insurance:** short lived cyclicalities \Rightarrow low ρ and high σ_y .
 - \Rightarrow in the paper both go hand in hand.
 - $\Rightarrow C^N(s)$ proportional to $C^T(s) \Rightarrow$ risk-sharing miracle.
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 - $\Rightarrow C^N(s)$ proportional to $C^T(s) \Rightarrow$ risk-sharing miracle.
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- ▶ **Additional shock** with different ρ and σ may help to better **pin down the relative relevance of the friction.**
 - \Rightarrow Easy to do in the current structure. **Shock to non-tradable?**
 - \Rightarrow or tradable shock with “permanent” and transitory components?
 - \Rightarrow Expand the Markovian process to include more possibilities.
- ▶ Should a growing Germany subsidize Greece in recession?

FINAL THOUGHTS

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- ▶ Very nice paper!
- ▶ Perfect setting to study a topical and important issue.
- ▶ Maybe too much of a marriage model, which makes it hard to relate to actual fiscal and monetary unions.
 - ▶ Is the model really capturing the relevance of the friction?
 - ▶ Does alimony make sense for countries?