

Yordan Mahmudiev

“Dynamic Monetary-Fiscal Interactions in a Monetary Union”

Abstract:

When a country with an impatient fiscal government decides to join a monetary union, the degree of monetary conservatism has implications for the level of debt and, consequently, welfare. Under discretionary policy, two effects, both leading to a higher stock of debt, enhance each other.

A free-rider effect, as the union’s central bank considers total union debt, regardless from which country it originates, and an effect due to the dynamic monetary-fiscal interactions. The higher level of debt leads to negative welfare consequences.