

Introduction

1. Subject and Approach

This book studies the interactions between monetary and wage policies in the euro area. It carefully discusses the process of policy competition and the structure of policy cooperation. With respect to policy competition, the focus is on competition between the European central bank, the American central bank, the German labour union, and the French labour union. Similarly, with respect to policy cooperation, the focus is on cooperation between the European central bank, the American central bank, the German labour union, and the French labour union. Further topics are:

- sequential decisions: cold-turkey policies
- simultaneous decisions: cold-turkey policies
- simultaneous decisions: gradualist policies
- fast monetary competition, slow wage competition
- monetary cooperation between Europe and America,
wage competition between Germany and France
- monetary cooperation between Europe and America,
wage cooperation between Germany and France
- policy cooperation within Europe,
policy competition between Europe and America.

The targets of the European central bank are price stability and full employment in Europe. The targets of the American central bank are price stability and full employment in America. Monetary policy in one of the regions has a large external effect on the other region. For instance, an increase in European money supply lowers American output. The target of the German labour union is full employment in Germany. And the target of the French labour union is full employment in France. Wage policy in one of the countries has a large external effect on the other countries. For instance, an increase in German nominal wages lowers French output and raises American output.

The key questions are:

- Does the process of policy competition lead to full employment and price stability?
- Can policy cooperation achieve full employment and price stability?
- Is policy cooperation superior to policy competition?

This book takes new approaches that are firmly grounded on modern macroeconomics. The framework of analysis is as follows. The world consists of two monetary regions, say Europe and America. The exchange rate between Europe and America is flexible. Europe in turn consists of two countries, say Germany and France. So Germany and France form a monetary union. There is international trade and capital mobility between Germany, France and America. Special features of this book are numerical simulations of policy competition and numerical solutions to policy cooperation. To illustrate all of this there are lots of tables.

This book consists of six major parts:

- Basic Models of a Monetary Union
- Monetary Interactions between Europe and America
- Wage Interactions between Germany and France
- Monetary and Wage Interactions: Intermediate Models
- Monetary and Wage Interactions: Advanced Models
- Rational Policy Expectations.

Now the approach will be presented in greater detail.

2. Monetary Competition between Europe and America

1) The static model. The world consists of two monetary regions, say Europe and America. The exchange rate between Europe and America is flexible. Europe