Macroeconomic policy and policy coordination in EMU remain controversial issues. This is not surprising in light of the fundamental policy asymmetry built into EMU: power over monetary policy is delegated to the ECB, thereby centralised in the hands of a highly independent supranational institution. Other economic policies, by contrast, remain a matter for national governments, though subject to the rules of the internal market and the SGP. As noted above, the euro is a ‘currency without a state’ and as such lacks historical precedent. This adds to the pertinence of the basic questions: is this asymmetric policy configuration problematic, perhaps even unsustainable, or is it a matter of little concern, perhaps even desirable? What is the appropriate relation between economic policy decisions of member states and of the euro area as a whole? How should we define the aims and boundaries of policy autonomy, policy discipline and policy coordination?

One view of EMU is that it will function well (only) if markets are flexible, if domestic prices and wages adjust as required by country-specific shocks, and if disciplined budgetary policies maintain sound public finances while leaving ample room for automatic stabilisers to operate. The government of each member state should concentrate on ‘putting its house in order’. Policy coordination, if any, should amount to establishing a set of common rules and monitoring that they are respected, otherwise leaving member states free to pursue their policies independently.

A different view is that EMU, as set out in the treaty and as we know it today, needs to be complemented by a political edifice in the form of a ‘Euro council’ or an ‘economic government’ with important decision-making powers, capable of discretionary coordination of economic policies. EMU should also be associated with more power at the
Community level over, *inter alia*, taxes and social policies. Crudely (but only somewhat misleadingly), the contrast is between a ‘technocratic’ EMU with a liberal flavour and a ‘political’ (more activist or interventionist) EMU. The issues involved are of great significance for economic policies and also for how the institutional framework of Community decision-making should be designed. The differences of view are not easily resolved; they are not a matter of analysis only but also of vision or *Weltanschauung*.

Building on the analysis introduced above, this chapter makes a number of points on cross-border policy effects in a monetary union and on the case for macroeconomic policy coordination. In particular, it examines the cross-border effects of shocks and policies under different assumptions about the monetary policy strategy (section 1), the case for fiscal policy coordination (section 2), the role of relative price changes in the adjustment process (section 3), the potential usefulness of a ‘stabilisation fund’ at Community level for helping member states hit by asymmetric shocks (section 4), and the role of the SGP in ensuring stable public debt dynamics (section 5). Finally, the chapter makes an appraisal of the ‘EMU policy assignment’, which de-emphasises discretionary policy coordination and gives priority to a clear assignment of roles and responsibilities between the different policy authorities (section 6). A formal analysis of some of the points is to be found in the Annex.

### 6.1 Cross-border effects in a monetary union

The key feature of the institutional design of EMU, from the point of view of economic policy, is that a single currency (the euro), a single central bank (the ECB) and a single monetary policy coexist with multiple national governments that are, by and large, free to decide on their budgets and fiscal policies. The question addressed in this chapter is how this asymmetry between centralisation of monetary policy and decentralisation of fiscal policy affects overall policies.

The framework used is essentially the simple model of Chapter 5 applied for the case of a two-country monetary union (the model is set out in the Annex to this chapter). A key assumption to be retained is that Monetary Union itself is small in global terms; that is, world income and the level of the global interest rate as well as foreign prices are treated as given. This allows the focus to be on the interaction between the member states of the Monetary Union. It is first assumed that both countries are characterised by the MF relations set out in