Structural heterogeneity and partial budgetary cooperation in a monetary union

The underlying paper investigates the question whether structural heterogeneous countries in a monetary union would benefit from a budgetary cooperation. In general, this is a very interesting topic and of a high relevance for the current political discussion. I am therefore pleased to see that this issue is analyzed in a formal model.

However, I do struggle with the way the model is written up and the way the paper is written in general. The paper defines supply and demand functions and some loss function for the monetary authority and the fiscal authorities. Here, I am not convinced that the set-up of the model would allow to answer the questions at hand. It is assumed that it takes more time for monetary policy to affect inflation and real activity than budgetary policy. This assumption seems odd, given the long time lags we currently observe until fiscal policy changes can be implemented. I would prefer to see the outcome of a model with a single monetary policy that follows a simple standard rule than the very general rule that is now presented in equation (5). It is not clear here how that rule is derived.

On page 7, the author defines “symmetric” and “asymmetric” shocks. I do not have an intuition why the sum of the country-specific shocks is a “symmetric” shock whereas the difference between the two is an “asymmetric” shock. Please clarify.

Why would the fiscal authority want to stabilize supply shocks? Wouldn’t it be more informative about the current discussion to introduce a common bond market and in addition national fiscal policies as a form of coordination? The outcome now is that in the case of symmetric shocks (both demand and supply), cooperation would often be beneficial, whereas it is detrimental with asymmetric shocks. What does that outcome tell us? What should the figures show? The text does not even refer to them.

Overall, I think the paper would benefit a lot from re-writing, clearly outlining the assumptions and equations and using a standard policy rule or introducing a common euro bond instead of the model that is written up here. It is not clear why we would need these long equations that are in the paper and in the Appendix. A lot of variables are carried around that do not seem to be necessary for analysing the question at hand.