

Money Markets and Politics

A Study of European Financial Integration
and Monetary Policy Options

Jens Forssbaeck

Lund Institute of Economic Research, Lund University, Sweden

Lars Oxelheim

*Lund Institute of Economic Research, Lund University and
the Research Institute of Industrial Economics (IUI),
Stockholm, Sweden*

Edward Elgar

Cheltenham, UK • Northampton, MA, USA

Contents

<i>Preface</i>	<i>ix</i>
1. Introduction	1
1.1 The role of short-term financial markets	2
1.2 The international aspects of money market change: a framework for analysis	6
1.3 Some conceptual clarifications: capital mobility and monetary policy autonomy	9
1.4 The case of small, open European economies	13
1.5 The scope and plan of the book	15
2. Background indicators of economic and financial development and integration	18
2.1 Indicators of economic development and economic integration/openness	18
2.2 Indicators of financial development and financial integration/openness	30
2.3 Concluding remarks	40
3. Money market formation and transformation	42
3.1 The emergence of efficient domestic money markets: facts and drivers	42
3.2 The deregulation of domestic financial sectors	64
3.3 The impact of money market development and deregulation	75
3.4 Summary observations of money market formation and transformation	85
4. Money market development and monetary policy operations	92
4.1 Interest rate management in practice: a few benchmark examples	93
4.2 Changes of central bank instruments: main drivers	97
4.3 Changes in central bank operations 1980-2000	99
4.4 Sources and effects of fluctuations in money market liquidity in the 1980s and 1990s	110

4.5	Concluding remarks on money market development and monetary policy operations	116
5.	External arrangements: exchange rate regimes and capital controls	120
5.1	Formal exchange rate regimes and nominal exchange rate developments	122
5.2	<i>De-jure</i> vs. <i>de-facto</i> exchange rate policy: variability and the problem of regime classification	132
5.3	Capital account liberalization in the focus countries	141
5.4	A summary classification of external policy regimes	152
6.	Measuring capital mobility: the degree of direct money market integration	156
6.1	International Fisher Parity	157
6.2	An extended International Fisher Parity model	163
6.3	'Weak' tests of International Fisher Parity	175
6.4	Concluding remarks on measuring capital mobility	179
7.	Monetary policy autonomy under different institutional regimes	190
7.1	Analytic framework and some practical considerations	192
7.2	Analysis of the cross-country responsiveness of policy interest rates	196
7.3	Bivariate tests of market interest rates and money growth rates	201
7.4	Multivariate tests	214
7.5	Concluding remarks on monetary policy autonomy	223
8.	Money market development and monetary policy options: concluding remarks	233
8.1	No indication that general economic indicators explain EMU membership/non-membership	235
8.2	Four sets of motives for policy-makers to promote money market development	237
8.3	No signs of a single European money market	239
8.4	Five main reasons behind changes in monetary policy operating procedures	240
8.5	Loss of clout in monetary policy is not a predictor of EMU membership	242
8.6	No evidence of large and systematic differences in nominal exchange rate volatility across exchange rate regimes	243
8.7	Increasing financial integration over time, but no sign of a collective pattern for the EMU countries	244

8.8	Exchange rate regime not a good predictor of monetary policy autonomy	246
8.9	The 'cost' of losing monetary policy autonomy cannot explain EMU membership	247
	<i>Glossary</i>	250
	<i>References</i>	258
	<i>Index</i>	275