

**Comments on**  
**“The Financial Accelerator and International Business Cycles**  
**under Alternative Monetary Regimes”**

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**by Simon Gilchrist, Jean-Olivier Hairault and Hubert Kempf**

In this very interesting paper, Gilchrist, Hairault and Kempf study the consequences of introducing a financial accelerator à la Bernanke, Gertler and Gilchrist (1999) in a two country dynamic general equilibrium model of monetary union. Within this framework the authors analyse the impact of supply shocks under four different regimes: with and without monetary union, and with and without financial accelerator. From this they conclude that financial frictions may significantly amplify the cyclical dynamics and affect the international spillovers. Moving from a multi-currency flexible exchange rate setting to a monetary union triggers changes in the dynamics of responses to shocks, where the foreign country reacts in the opposite way compared to the flexible exchange rate case. The financial accelerator further augments the cyclical differences between countries in a monetary union. Finally, as expected asymmetries in financial frictions across countries lead to different country responses to a common shock.

The paper starts in Section 2 by documenting some eye-catching features of financial structure in the euro area, and by drawing comparisons with the US and the UK. The authors argue that in the euro area bank credit is a major source of finance relative to securities, and that differences in financial structures are likely to be a major cause of asymmetries in the transmission of monetary policy. Therefore, the advent of a common currency and monetary policy may create a problem, as these asymmetries can no longer be mitigated by adjustment of the exchange rate. This background provides the main motivation to develop a two-country model for exploring the implications of a monetary union, which accommodates the existence of different national financial structures (by introducing asymmetries in financial frictions). Clearly, the issues involved are not only interesting but also topical.

My comments follow up on the authors' own assessment that their results are “clearly preliminary and need to be confirmed by means of other empirical observations”. Indeed, the model used should be seen mainly as a starting point for further research. Taken literally, the two-country model setting suggests that two large countries are forming a global monetary union. This is clearly not what has been achieved with the advent of EMU, which makes the connection between Section 2 and the theoretical analysis pursued in the remainder of the paper a bit hazy. So, one way to proceed would be to strengthen the EMU perspective of the model.

The authors focus entirely on the potential role of the financial accelerator operating on investment as an amplifying transmission mechanism, which may be different in different countries<sup>1</sup>. Although recent empirical evidence supports the view that capital market imperfections do play a role in many of the euro area countries (Angeloni, Kashyap, Mojon and Terlizzate, 2002), the reader may wish to be informed on the extent to which the model is able to replicate observed stylised facts. No such attempt is presented, making the analysis an almost purely theoretical exercise. Closer inspection of the model properties documented in the paper points to aspects that seem at odds with empirical evidence. The impulse responses to the supply shock, for instance, show very little persistence in exchange rate behaviour. After one quarter the (real) exchange rate almost fully adjusts to its equilibrium level. Furthermore, there is also very little persistence in inflation effects. Introducing fiscal and monetary feedback rules, allowing for different types of shocks as well as for asymmetries in the functioning of goods and labour markets<sup>2</sup> would make it possible to confront the model's properties with observed stylised facts along various dimensions. Endogenous national fiscal policies might mitigate the asymmetries in the propagation of shocks. All in all, strengthening the EMU perspective requires a richer model. By developing such a model it would also be possible to get a feel for the robustness of the current results, notably of the main finding that monetary union leads to a sign reversal in the response of the foreign country relative to the flexible exchange rate case.

Apart from this, a more fundamental issue concerns the scope of the concept of monetary union. In the Gilchrist-Hairault-Kempf paper the move from flexible exchange rates to monetary union means two things: 1) a move from two currencies to one common currency, implying the loss of the exchange rate as an adjustment mechanism; and 2) the introduction of a common monetary policy. As such the model may

be used as a tool for analysing the implications of moving to a monetary union viewed from the perspective of macroeconomic stabilisation policy. However, there is more to a monetary union. Here one should refer to the heated debates on the benefits of currency unions, where some have argued that national moneys act as a barrier to international trade (e.g. Rose and Van Wincoop, 2001). Following this line of reasoning the disappearance of exchange rate uncertainty and increased levels of price transparency, which attend the advent of a currency union, are important factors driving international trade and may thus have major consequences for the behaviour of private agents and policy makers. For a balanced assessment of the implications of moving to a monetary union these factors should be taken into account.

Peter van Els<sup>3</sup>  
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<sup>1</sup> De Bondt (2000) provides evidence for the financial accelerator being relevant for consumption as well.

<sup>2</sup> Recent evidence of institutional features other than financial structure playing a potentially important role in explaining differences in responses to shocks is provided by OECD (1999) and Van Els, Locarno, Morgan and Villette (2001).

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