

Dynamic Formation of Currency Unions

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ABSTRACT

I study the dynamic formation of currency unions in an infinitely repeated multilateral bargaining game with forward-looking players, where agreements can be renegotiated. I find that optimal currency unions will form eventually (and can form immediately), when countries experience sufficiently symmetric shocks. With asymmetric shocks however, inefficient currency union structures is possible even in the long run. Depending on the nature of the asymmetry, too much and too little union formation is possible in equilibrium.