"Who Benefits from Capital Market Integration in a Monetary Union?

Abstract

I study how capital market integration redistributes risk and welfare in a monetary union hit by asymmetric shocks. Using microdata on household portfolios and macro-data on cross-border holdings, I document large disparities in financial participation within countries and persistent asymmetries in portfolio diversification between them. To assess the distributional consequences of limited integration, I develop a two-country monetary-union model with heterogeneity in participation and country-specific portfolio structures. Integration operates through two channels: a diversification channel that insures Savers by stabilizing financial income, and a reallocation channel that shifts capital toward higher returns, lowering real wages and amplifying consumption losses for Non-Savers where negative shocks occur. These mechanisms overturn the representative-agent prediction that deeper integration unambiguously enhances risk sharing. Calibrated to 2010 euro area data, the model shows that integration stabilizes aggregates but redistributes welfare unevenly across and within countries. Allowing for endogenous participation amplifies domestic asymmetries, weakens cross-country spillovers, and concentrates exposure to shocks among financially constrained households.