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Fiscal stance and public debt: three easy pieces

The European Commission proposed in November the introduction of rules and instruments to manage the economy at the Euro Area level and a more supportive fiscal stance to strengthen growth and resilience of the Area. In fact, the sum of the recommendations on the individual countries budgets can result in the appropriate fiscal stance for the whole area only coincidentally. Yet, given the opposition of the Council, the EC resigns to the paradox: those who do not have fiscal space want to use it; those who have fiscal space do not want to use it.

Instead, the OECD reckons the increased fiscal space due to the effects of monetary policy for all OECD countries, including the Euro Area. Thus, a moderate expansion of fiscal policy, with the right mix of expenditures/taxes, can now increase production in the short and the long period and allow Europe to avoid the trap of low inflation and low growth experienced by Japan in last twenty years. However, growing populist threats in the political arena put pressure on the stock of public debt in countries more exposed, like Italy. Time to break the diabolical loop created by the link between banks and sovereign debt, along the lines of a proposal put forward by the European Systemic Risk Board, in order to avoid a new crisis in the Euro Area.