

Fiscal Rules in the European Monetary Union: A No-Entry Clause

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Abstract

The paper examines the possible motivations behind the plea for fiscal rules in the Delors Report. We argue that coordination problems arising from aggregate demand spillovers cannot be solved by means of budget rules and that in any case they are not important in Europe. We then discuss the notion of structural fiscal imbalances and show that potential solvency is a problem for some European countries, probably made more severe by EMU. Membership of countries with unsustainable positions may represent a risk for the stability of the union because of financial spillovers. Neither monetary discipline enforced by a 'conservative' European Central Bank nor market discipline will by themselves prevent fiscal indiscipline or insulate the union from its consequences. Specific sanctions are needed to affect political choices by creating a trade-off between debt and monetary stability. The most effective sanction in our view would be a no-entry clause, such that membership is made contingent upon specifically defined changes in the fiscal positions of the countries concerned.

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