

Athanasios Orphanides (Massachusetts Institute of Technology - Sloan School of Management)

The Fiscal-Monetary Policy Mix in the Euro Area: Challenges at the Zero Lower Bound

Abstract

This paper explores the reasons for the suboptimal fiscal-monetary policy mix in the euro area in the aftermath of the global financial crisis and ways in which the status quo can be improved. A comparison of fiscal and monetary policies and of economic outcomes in the euro area and the United States suggests that both fiscal and monetary policy in the euro area have been overly tight. Fiscal policy has been hampered by the institutional framework which constrains individual states and lacks instruments to secure an appropriate aggregate stance. ECB monetary policy has been hampered by the distributional effects of balance sheet policies which needed to be adopted at the zero lower bound, and by discretionary decisions taken before the crisis such as the reliance on credit rating agencies for determining collateral eligibility for monetary operations. The compromising of the “safe asset” status of euro area sovereign debt during the crisis complicated fiscal and monetary policy. Changes in the discretionary decisions governing the implementation of monetary policy in the euro area can potentially reduce the distributional effects of policy and improve the fiscal-policy mix and longer-term prospects for the euro area.