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Financial Repression to Ease Fiscal Stress: Turning Back the Clock in the Eurozone?

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Abstract

Policy-makers are addressing the euro area sovereign debt crisis in various ways. History suggests that they may also attempt to revive two age-old tactics of financial repression: curtailing financial markets and relying on the central bank to ease fiscal stress. Several euro area governments have indeed applied various repressive techniques directed at domestic financial institutions, savers and investors in order to secure debt financing, induce lower funding costs, fill budget holes or resolve a public debt overhang. European legislators have stepped up their control over the financial system to correct market and regulatory failures. Some of their interventions, however, also established government privileges which unduly restrain market discipline. The European Central Bank has been actively engaged in restoring financial stability and preserving the euro. Although governments just as others benefited from its extraordinary monetary policy actions, the ECB pursued its mandate in an independent manner and with a credible focus on maintaining medium-term price stability while creating incentives for policy-makers to underpin the stability of the eurozone.

Keywords: Financial Repression, Financial Crisis, Fiscal Stress, Monetary Policy, Central Bank Independence

JEL Classification: E44, E58, E63, F36, G18, G28, H63

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