price stability of free-riding by the latter[27] or if other institutions are needed to complement the type of central bank that has been chosen. Beetsma, Uhlig (1999) claim that a pact of the kind of the SGP can reduce the negative spillovers arising from political distortions that can be exacerbated in a monetary union.[28] Beetsma, Uhlig (1999) give two possible justifications for constraining the action of national fiscal policy: one refers to a country, closed or open, which wants to draft a fiscal constitutional rule in order to tie the hands of its own government, based on the arguments developed in sub-section 5.1); the other lies in the existence, in a monetary union, of negative spillovers deriving from a country's budgetary policy and accumulation of debt on the common inflation rate.

The same problem, i.e. sufficiency of a committed central bank for ensuring price stability, has been investigated from another point of view. The 'unpleasant monetarist arithmetic' of Sargent, Wallace (1981) held first the view of the insufficiency of a monetary policy rule for price stability, due to rational expectations. Given this kind of expectations, bond financing of public expenditures and tight money could give rise to immediate inflation. Along similar lines Woodford (1996) applied the fiscal theory of the price level[29] to the case of the EMU and, in the absence of fiscal self-discipline of governments, found that it supported introduction of limits to public deficit and debt as a way to complement the monetary rule chosen by the common central bank – or even to set up a precondition for this bank to be charged with maintaining price stability.

A final justification for setting limits to national fiscal policy in the context of a common monetary system was suggested by Casella (1989): a country's fiscal deficit has negative spillovers on the interest rates and the bonds' prices of the area and should then be limited.

Then, in the years preceding the constitution of the EMU the rationales were laid for advocating rules setting constraints to discretionary fiscal policy. These were:

1. time inconsistency;
2. political economy considerations about the attempts of governments to force the unemployment rate below the natural one;
3. ineffectiveness of fiscal action, with possibly negative multipliers and effects of accumulated public debt on growth;

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[27] See also, more recently, CHARI and KEHOE (2007, 2008).

[28] This issue is reviewed at length in BEETSMA and GIULIODORI (2010) section 7.

[29] The theory had been developed by LEEPER (1991), SIMS (1994). For a critique see BUITER (2002).