

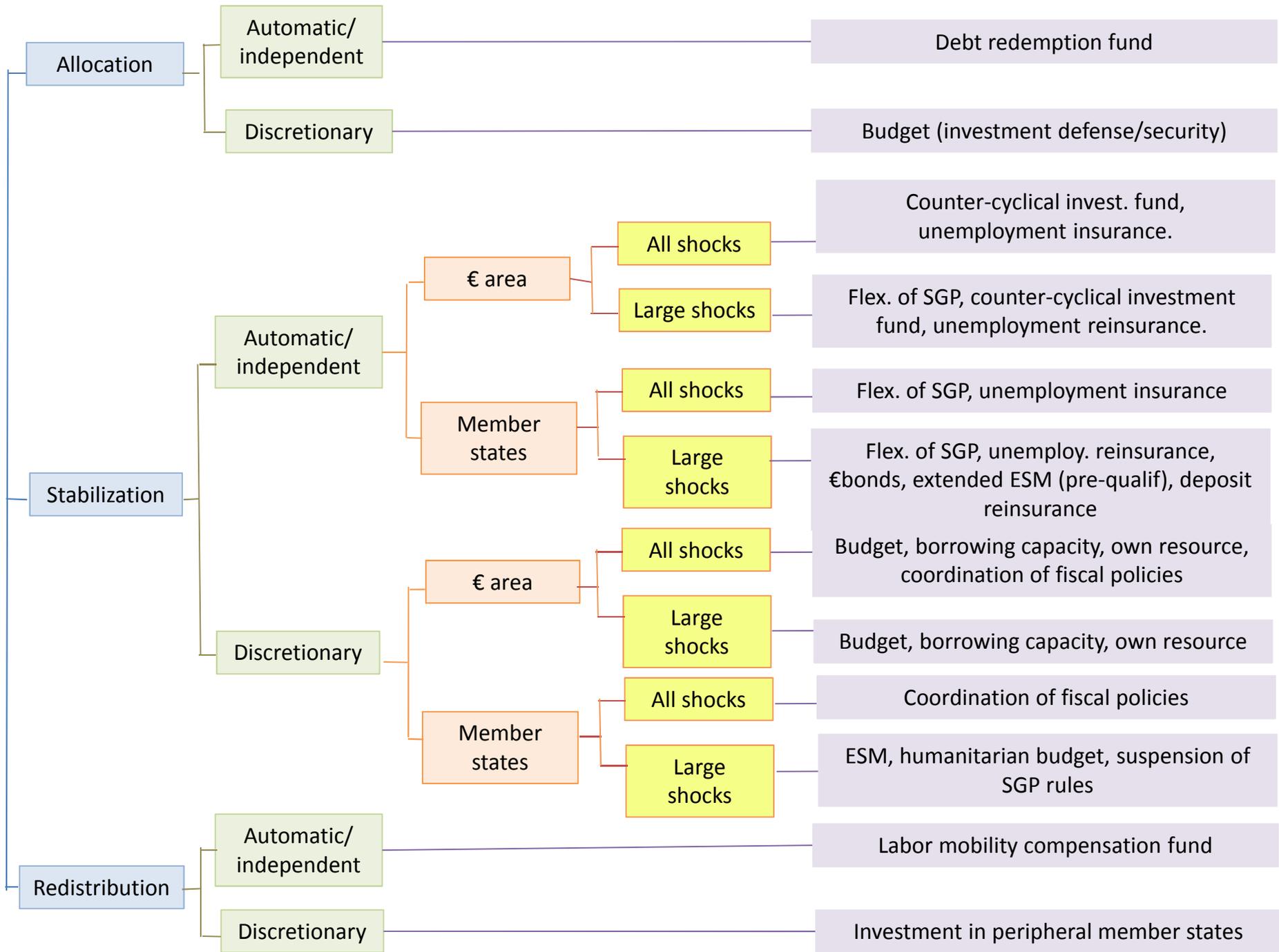
Making sense of the fiscal union: a budget for the Eurozone?

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Allocation and Redistribution: really nonstarters?

Allocation: EU or euro area?

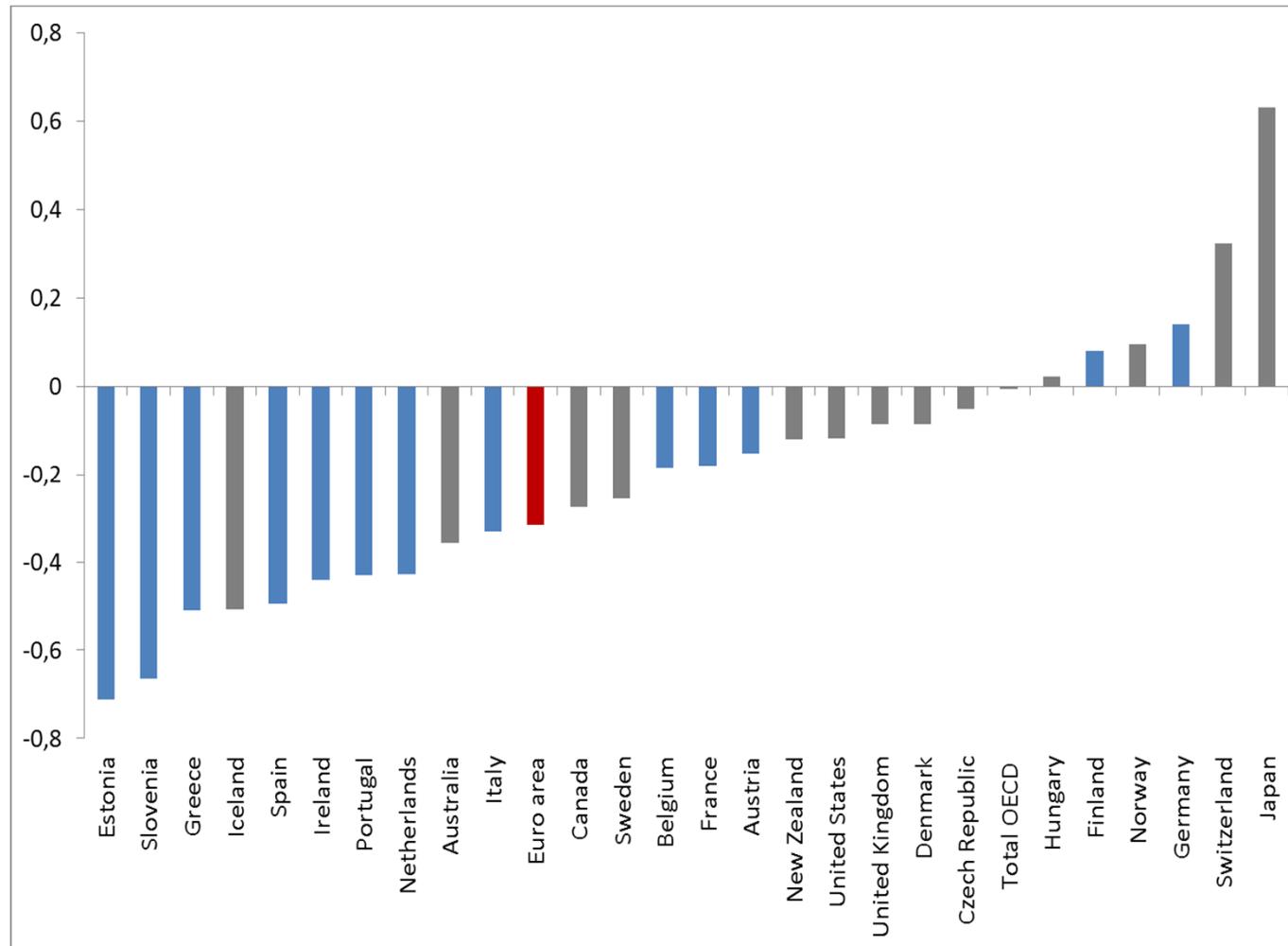
- Larger spillovers within the monetary union. Key variable: debt/GDP
- Different preferences: EU vs euro area

Redistribution:

- “It [the Union] shall promote economic, social and territorial cohesion, and solidarity among Member States” (TEU, Art. 2).
- Transfer union already there
 - Dany et al. (2015): German federal government saved more than EUR 100 bn in interest expenses between 2010 and mid-2015 in relation to the Greek crisis;
 - From 2010 to 2014, cumulated *net* immigration in Germany from other euro area countries \approx 400 000 (0 or <0 before crisis). Assuming \approx EUR 50,000 public expenditure per emigrant \rightarrow EUR 20 bn transfer
- Growth strategy based on agglomeration economies
 - Implies transfers from core to periphery

Discretionary fiscal policy in the euro area

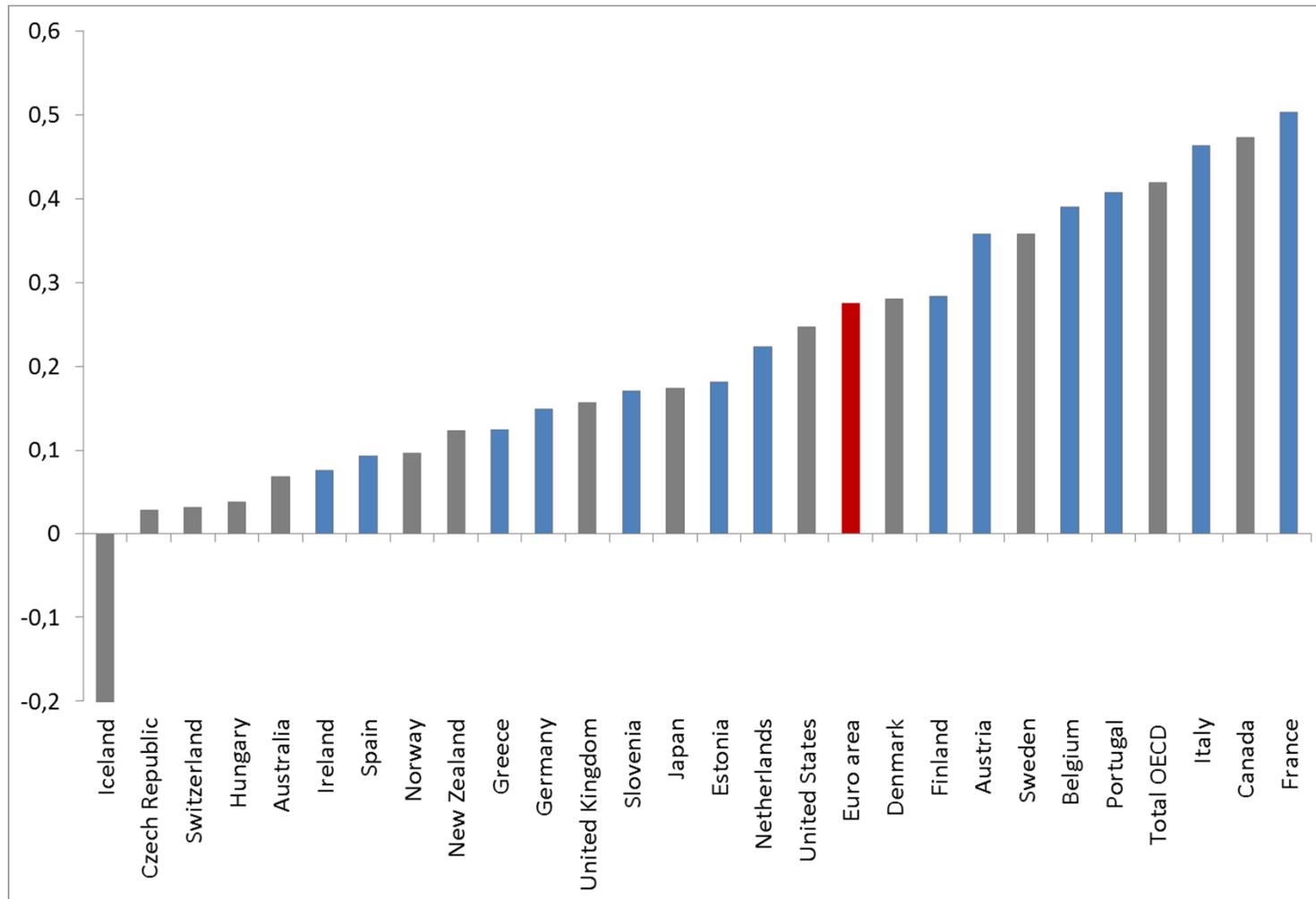
Correlation between fiscal stance and the output gap
1995-2014



Source: author's calculations, based on OECD Economic Outlook database.

Automatic stabilizers in the euro area

Correlation between the cyclical impulse and the output gap,
1995-2014



Source: author's calculations, based on OECD Economic Outlook database.

The fiscal policy framework

An asymmetric SGP

- Non-cooperative concept of discipline: country by country, rest of the world given.
- Only deficit countries are constrained → deflationary bias
 - Max deficit, no max surplus/ min deficit
 - Min adjustment speed, no max

Toothless coordination

- TFEU, Article 121.1: “Member States shall regard their economic policies as a matter of common concern and shall coordinate them within the Council” → BEPGs → European semester, MIP
- MIP relatively weak: too broad, 6 layers, limited ownership
- Still high ambition: 2015 specific recommendation to the euro area:
 - “Coordinate fiscal policies to ensure that the aggregate euro area fiscal stance is in line with sustainability risks and cyclical conditions.”
 - But no instrument.

Options for the future 1

Improve national policy framework

Reassess the notion of discipline

- Fiscal discipline insufficient (e.g. Ireland, Spain).
- Symmetrically, a fiscal surplus may be excessive (or the deficit insufficient) in a country displaying excess aggregate supply
- **Connect SGP and MIP**

Allow for some discretion

- In some circumstances, it may be appropriate to deviate from the fiscal rules (downwards or upwards), for a limited period of time. SGP flexibility insufficient.
- **Independent European Fiscal Board could be tasked with suggesting temporary floors and caps on fiscal adjustment, or even a suspension of SGP rules, in extraordinary good or bad times**

Options for the future 2

Strengthen the ESM

ESM reduces the scope of pro-cyclicality, but

- Reluctance of national government to accept a programme
- Stigma effect

Introduce more automaticity

- **Automatically extend precautionary credit lines to the ESM to all countries not in the corrective arm of the SGP.**
- **These credit lines could be activated at any time without further conditionality, albeit for a limited period of time.**
- **Beyond this period, they would automatically morph into fully-fledged programmes.**

Options for the future 3

Design a federal instrument

How to get macro stabilization with a 2% budget?

- Concentrate on counter-cyclical expenditures:
 - A counter-cyclical investment fund
 - A unemployment reinsurance fund
- Use the budget to back other stabilization mechanism
 - Banking union
 - Labor mobility
- A fully-fledged budget to complement national policies when necessary
 - *Juste retour* problem
 - Will MPs refrain from spending in good times?

A “fiscal capacity”: what for?

- **Dedicated funds for stabilization.**
- **Fully-fledged budget for allocation/redistribution**