Fiscal Union -Toward a Treasury for the euro area?

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Current EMU fiscal framework has major shortcomings

- EMU not well-equipped to respond to a new sovereign debt crisis
  - Debt levels remain very high and continue to increase in some countries (IT)– likelihood of crisis not negligible
  - ESM has limited lending capacity, lengthy procedure for activation and lacks proper democratic accountability
  - OMT not tested but might be politically contentious (‘hidden’ fiscal transfers) and difficult to use it after a long period of QE

Current EMU fiscal framework has major shortcomings(2)

- EMU as a whole performs badly as regards fiscal stabilisation
  - No provisions or instruments to directly manage the euro area aggregate fiscal stance
  - Aggregate fiscal stance pro-cyclical between 2011-2014, broadly neutral or slightly expansive afterwards
  - Fiscal spillovers larger in deep recessions and when monetary policy at the zero-lower bond

Current EMU fiscal framework has major shortcomings(3)

- Limited capacity to stabilise at national level
  - Heterogeneous monetary unions need mechanisms to deal with large asymmetric shocks
  - SGP does not allow counter-cyclical action in severe and long recessions
  - Financial risk-sharing a complement but not substitute for fiscal risk-sharing
    - Truly transnational banking union unlikely to emerge even in the long term in the absence of credible political commitment to keep euro

Ways to improve the status quo

- Complete BU and progress towards CMU
- ESM+
  - Generalise QMV, harmonise national parliaments' involvement, create rapid-response facility based on jointly-guaranteed debt (Enderlein et al 2016).
- Fiscal discipline
  - Develop consensual interpretation of SGP's flexibility clauses, strengthening role of EFB and coordinate with national fiscal councils
- Temporary measures to boost investment
  - Increase EFSI's lending capacity, extend investment clause to corrective arm, exclude all national co-funding of EU-supported investments from SGP calculus

Further possible reforms?– different ideas at debate

- Strengthen market discipline introducing a rules-based sovereign debt insolvency regime
- Convert ESM into a real lender-of-last resort/create ‘eurobonds’
- Equip EMU with macro-economic stability capacity
  - Unemployment insurance scheme in diff variants
  - Intergovernmental ‘rainy day’ scheme
  - Euro-area budget based on common resources/borrowing capacity
  - Euro-area treasury with exceptional powers of coordination

Four criteria when thinking on further reforms

- Consistency
- Political feasibility
- Pragmatism
- Appropriate sequencing

Three consistent views of fiscal union

	MARKET-BASED REGIME (I)	MARKET-BASED REGIME (II)	'SUI GENERIS' FISCAL FEDERALISM
Protection against sovereign debt crises &fiscal discipline	Rules-based insolvency regime, ESM confined to temporary liquidity crises Instrument to deal with debt legacy (e.g. debt redemption fund)	Rules-based insolvency regime, ESM confined to temporary liquidity crises Instrument to deal with debt legacy (e.g. debt redemption fund)	European Monetary Fund (EMF) with extensive competences to issue mutually-guaranteed debt Reinforced powers of fiscal surveillance (including the power to veto national budgets)
Macro-economic stabilisation	Rules-based fiscal risk-sharing capacity + arrangement to coordinate national fiscal policies in exceptional circumstances	Fiscal capacity in charge of over-the-cycle and cross-country stabilisation	No need for further fiscal risk-sharing, EMF used to manage intertemporal aggregate demand in exceptional circumstances
Governance	Stronger euro group (e.g full time euro group president, more use of QMV), COM in charge of managing the rules-based mechanism, accountability through national executives	Strong euro area executive (e.g. 'double-hat' euro area minister of finance) with large discretionary capacity, accountability through national&EU parliament	Strong euro area executive (e.g. 'double-hat' euro area minister of finance) with large discretionary capacity, accountability through national&EU parliament

On political feasibility….

Member States' replies to the analytical paper published in preparation of the 5 presidents' report (February 2015)

No major reform needed	Need further budgetary integration for solidarity/macro-economic stability purposes	Creation of insolvency regime
ESTONIA, FINLAND, GERMANY, IRELAND, LITHUANIA, MALTA, THE NETHERLANDS	CYPRUS, FRANCE, GREECE,ITALY, LATVIA, LUXEMBOURG, PORTUGAL, SLOVAKIA, SLOVENIA, SPAIN	

Note: lacking contributions from Austria and Belgium

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Design principles for a fiscal risk-sharing mechanism

- Only limited to exceptional circumstances
- Minimum convergence needed before introducing it
- Minimum adjustment capacity (make adoption of certain reforms a condition for access to)
- A tax-based instrument preferable
- Should not lead to permanent transfers but do not obsess with perfect neutrality

How to build a EMU stabilisation function on EFSI?

Five Presidents' Report (2015):

- In stage 2 (from June 2017 onwards), to set up a *"macroeconomic stabilisation function for the euro area"*
- *"A prospective stabilisation function could, for example, be built on the EFSI as a first step"*

How to build a EMU stabilisation function on EFSI?

- Establish a euro area investment platform co-financed by EFSI and with contributions from all euro area NPBs in proportion of their GDP
- Commitment to increase lending capacity in bad times (through increased EFSI contribution and contributions from NPBs)
- Selection of projects based on strict quality criteria, no subject to geographical pre-allocation, priority to projects having significant short-term impact on growth and employment

How to build a EMU stabilisation function on EFSI?

Advantages:

- May have significant fire power (in DE, FR and IT NPB's loans to non-financial corporates represent around 11-20% of total loans)
- Allocation to high-quality projects

Problem:

- Need to harmonise landscape of NPBs in EMU

EUR bn (2012)	KfW	CDC	BPI France Financement	Cassa Depositi e Prestiti	ICO	European Investment Bank	Total
Balance sheet total (Total Assets, 2012)	497,5	393,7	29,9	305,4	115,2	508,1	1 850,0
Total loans	118,5	155,6	15,6	100,5	88,8	293,4	772,3
Country	Germany	France		Italy	Spain	European Union 1/	
Long-term credit rating	AAA/Aaa/AAA	AA/AA1/AA+		BBB/Baa2/BBB+	BBB/Baa2/BBB+	AAA/Aaa/AAA	
Memo							
Nominal GDP (2012)	€ 2 666	€ 2 032		€ 1 567	€ 1 029	€ 12 960	
MFI Loans to NFC	€ 909	€ 876		€ 875	€ 729	€ 4 674	
Balance sheet/GDP	19%	21%		19%	11%	4%	14%
Total loans/GDP	4%	8%		6%	9%	2%	6%
Total loans/MFI Loans to NFC	13%	20%		11%	12%	6%	17%

Thank you!

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