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Crises in a Globalised World

Policy Instruments for a Crisis-Proof European Union

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Policy Instruments for a Crisis-Proof European Union

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Although numerous euro area reforms have been carried out in the last decade, fostering economic crisis resilience and convergence among Member States remains high on the agenda. This policy brief draws on results of several studies analysing specific reform proposals and preferences. We cover the proposals for a "European Finance Minister", a reform support programme, and a European unemployment re-insurance scheme. Moreover, we survey economists of Central and Eastern Europe on their preferences of euro area reform. We find that further euro area reforms should include both elements of fiscal discipline and fiscal solidarity. A European unemployment re-insurance scheme might serve as such a solidarity tool. A reform support programme could successfully incentivise necessary reforms, while a European Finance Minister would not lead to any value added for the euro area.

1 Introduction

Euro area reform remains a pressing topic, even though substantial reforms have been undertaken in the last decade: The Stability and Growth Pact (SGP) has been strengthened alongside with other fiscal and macroeconomic governance rules. Moreover, the European Stability Mechanism (ESM) has been introduced to support countries with liquidity constraints. The mere instalment of Outright Monetary Transaction (OMT) has restored trust in the markets for sovereign euro bonds. The newly established banking union includes so far the Single Supervisory Mechanism and Single Resolution Mechanism.

Despite all these achievements, the debate on further reforms of the Economic and Monetary Union (EMU) is high on the agenda of politicians and academics. There is a wide consensus that the institutional set-up of the euro still lacks resiliency to cope with another major crisis that could hit the euro area from outside or, equally likely, from inside.

In this policy brief, we summarise insights on different dimensions of this EMU reform debate from research that has been undertaken in the context of the Leibniz Research Alliance "Crises in a Globalised World". We cover three of the recent prominent reform proposals: first, the possible installation of a "European Finance Minister", second, a fiscal instrument to incentivise reforms, and third, a European unemployment re-insurance scheme. Moreover, we explore the political constraints for any such reform that relate to the euro reform preferences of veto players. Here, we focus on the particular perspective from Central and Eastern Europe. Although the EU Member States from the east are not very visible in the ongoing reform debate, their consent is nevertheless indispensable if the euro shall one day reach its objective to become be the currency of all EU Member States.

2 A European Minister of Economy and Finance[1]

In its "Roadmap for deepening Europe's Economic and Monetary Union", the European Commission proposed to instate a "European Minister of Economy and Finance" (EMEF). The purpose of this Minister should be to reduce complex decision-making within the EMU by centralising numerous tasks into one institution. The Commission's proposal includes several responsibilities for the EMEF: The minister should take a strong representing role of the euro area within the EU and outside Europe. Moreover, the EMEF should coordinate reforms and the enforcement of the SGP. The institution should also be in charge of the management of European budgetary instruments. The EMEF would serve as Vice-President of the Commission and President of the Eurogroup.

Would such a minister be beneficial for the setup of a European Fiscal Union (EFU)? We answer this question by analysing four different EFU dimensions: fiscal sustainability, macroeconomic shocks, incentives of structural reforms, and the optimum provision of European public goods.

The general underlying problem with safeguarding fiscal sustainability is that the current rules within the SGP are very complex, thus leaving much room for interpretation and politicisation. As the EMEF would serve as Vice-President of the Commission, she might not be able to depoliticise the enforcement of rules but further increase disorderly political negotiations.

Stabilising the EMU against asymmetric shocks is a difficult task, as countries do not build enough fiscal buffers in good times, fiscal policies are not coordinated enough among Member States during crises, and the implementation of common shock absorbers might lead to moral hazard issues. We evaluate that an EMEF could play a supporting role in coordinating national fiscal policies based on appropriate euro-wide fiscal stance and national fiscal space.

Policymakers might be reluctant to carry out structural reforms, as costs are high and outcomes uncertain. Moreover, there might be positive cross-border externalities when successful reforms in one country increase the resilience of the union as a whole. In addition, learning from neighbouring countries' policy experimentation is another reason for a potential low-reform equilibrium. For this dimension, the inauguration of an EMEF might be beneficial as she can improve policy coordination and communication among Member States.

Finally, common pool disincentives lead to an underprovision of European public goods, even if they would be beneficial in the case of large cross-border spillovers and economies of scale. This would be true for areas like defence, migration or development aid. An EMEF would be confronted with heterogeneous spending preferences and would be, again, not well suited for this highly politicised area.

The positive roles an EMEF could play in the stabilisation against macroeconomic shocks and structural reforms is not as big as the negative impact the institution could have in the two other dimensions. Besides, the bundling of tasks could further raise conflicts for the EMEF institution. Therefore, we do not regard an EMEF as a key progress for the functioning of the euro area.

3 A Blueprint for the European Commission's Reform Support Programme[2]

Aiming to reduce reform fatigue among EU Member States, as well as to foster convergence, the European Commission has proposed a reform support programme as a key pillar of the "Roadmap for deepening Europe's Economic and Monetary Union". As part of the 2021-2027

[1] This section presents the key results of Asatryan et al. (2018).
[2] This section summarizes the key findings of Dolls et al. (2019).

multi-annual financial framework, the reform support programme is planned to be endowed with funds of EUR 25 billion. With a budget of EUR 22 billion, the bulk of funds are intended for the `reform delivery tool', which aims to support reforms destined to strengthen economic resilience, while also leading to positive spill-overs on other Member States. In addition, the reform support programme encompasses a technical support instrument as well as a convergence facility intended to support structural reforms in non-euro area Member States.

Within the scope of the reform delivery tool, Member States can apply for funding for structural reforms that have been identified in the context of the European Semester. This requires committing to a comprehensive set of reform targets and intermediate milestones. Available funds are proportional to population size and paid out in one instalment once the agreed reform package is fully implemented.

In our view, the proposal includes several provisions that constitute an improvement to the current top-down approach of the European Semester. For once, the reform delivery tool encourages national ownership of reforms by enabling Member States to submit their own reform proposals and by making participation voluntary. Also, requiring milestones and a timetable for completion should increase commitment in pursuing reforms. In addition, a peer-review process enables Member States to learn from other Member States' successful reforms.

However, some provisions are likely to limit the success of the programme, notably regarding the allocation and disbursement of funds. In particular, allocating funding in proportion to population size may lead to large Member States receiving substantial funds for reforms with a relatively small scope and comparatively low effectiveness. We hence propose `convergence roadmaps' as an alternative framework that accounts for such deficiencies. First, we are in favour of restricting the target indicators to a small number of structural outcomes such as per capita income and the unemployment rate. Member States should themselves suggest reforms that they consider conducive for reaching these targets. In addition to enabling better policy targeting, this increases flexibility in how to reach targets and thereby strengthens national ownership of the reform. As opposed to the Commission proposal, financial support should not be paid in a single instalment, but should be structured as several tranches that consider the potential for positive spill-overs, continuous reform implementation and the achievement of convergence targets. Also, programme eligibility should be limited to Member States with below average per capita income in order to channel funds to Member States with the highest need to catch up, rather than to Member States with the largest population size. Unused funds within the scope of the European Structural and Investment Funds should be used for this purpose, rather than generating additional expenditures.

4 An Unemployment Re-Insurance Scheme for the Eurozone?[3]

The introduction of a supranational fiscal capacity at the Eurozone level has been a topic of debate in economic policy discussions. It has been argued that a supranational fiscal risk sharing mechanism, for example in form of an unemployment re-insurance scheme, could strengthen national automatic stabilisers. Critics have emphasized that macroeconomic shocks can be sufficiently dealt with at the Member State level and that national automatic stabilisers in the euro area Member States play a more important rule in cushioning macroeconomic shocks than in the US, for example. Moreover, there is a concern that a fiscal stabilisation instrument at the Eurozone level would lead to misguided incentives and a "transfer union through the back door".

[3] This section draws on results presented in Dolls (2019).

Dolls (2019) provides an ex-ante evaluation study of an unemployment re-insurance, which would provide assistance only in major crises. His results suggest that the analysed reinsurance would have cushioned major labour market shocks and the associated loss of income for employees by an average of 15-25% since the introduction of the euro. The stabilisation effects would have been achieved by the interregional smoothing potential of the re-insurance. For comparison: the intertemporal stabilization potential of an average national unemployment insurance system is about 16-26% in the period under consideration. The study further shows that the average annual payments by Member States into the re-insurance scheme would have been less than 0.1% of GDP. Throughout the simulation period, some countries would have been in a net contributor position and others in a net recipient position, but no Member State would have made (received) permanent contributions (transfers).

In our view, a fiscal stabilisation instrument at Eurozone level should be just one element of a larger reform package in which complementary market discipline, risk reduction and risk sharing are strengthened (Bénassy-Quéré et al. 2018). An orderly procedure to restructure the debt of an insolvent Member State and a fiscal insurance mechanism for large shocks should be two central pillars of this reform package (Dolls et al. 2016).

5 EMU Reform Preferences in Central and Eastern Europe[4]

So far, EMU reform debates are largely dominated by Western European academics and politicians. In particular, there is high visibility of French-German contributions. In order to advance to a broader based reform debate we study interests and preferences of Central and Eastern European (CEE) Member States, as these countries are often neglected in the reform debate.

Economic indicators provide evidence that the convergence process of the eastern Member States is more stable than often perceived. Some of the CEE countries are even about to overtake several old EU Member States in GDP per capita or have already done so. However, they are still net beneficiaries from the EU budget through cohesion and agricultural policy. Moreover, during the last decade, Eastern European countries experienced a higher GDP volatility than the Western European countries and high unemployment rates, which have not yet always returned to pre-crisis levels. Debt-to-GDP ratios are below the 60% Maastricht criterion for most CEE countries and they also breached the 3% deficit criterion less often than the old Member States in the last decade. Effective corporate tax rates are much lower in the east than in the west.

Studies analysing policy positions of Eastern European countries show that they more frequently align with Northern countries emphasising the importance of fiscal discipline. They also rather reject a European budget and the collectivisation of debt. The common currency has become less popular among the population of CEE countries outside of the Eurozone over time.

We conducted a survey among economists in all CEE countries as well as many economists in Germany, France and Italy as old Member States benchmarks. 1,800 experts responded to the questions on general economic policy orientation, support for the euro, attitudes towards new possible EU competencies, and opinions regarding several EMU reform issues.

The most important results from the survey are the following: Support for the euro among CEE experts is high, even though a bit smaller in non-euro countries compared to euro

[4] This section outlines key findings of Blesse et al. (2019).

members. CEE economists rather do not wish to delegate more competencies to the EU regarding defence, immigration, and qualified majority voting on tax issues as opposed to their colleagues in western Member States. Economists from poorer countries are more in favour of cross-country redistribution, a relaxation of the SGP rules, and Eurobonds than those from more advanced countries. Germany is aligned with the richer CEE countries in these questions, while Italy rather aligns with the poorer countries. Furthermore, expert communities in CEE countries align with their German peers on the importance of sovereign debt restructuring mechanisms. Finally, eastern economists are in favour of both the EDIS and the ECB's asset purchase programme.

We conclude from the survey results that euro area enlargement is conditional on the perceived costs and benefits of the euro membership. Given the advancing economic convergence and favourable fiscal situation in many CEE countries, unbalanced reforms with a large weight on fiscal solidarity will not be popular among CEE countries. Moreover, future reform decisions could be decisive for euro area enlargement. Attractive reform packages should include a credible sovereign insolvency procedure, a strengthening of fiscal rules without the threat to lose access to cohesion funds, and new stabilisation tools against GDP and unemployment volatility without triggering permanent transfers. Finally, tax policy should stay in the responsibility of Member States.

6 Conclusion

In this policy brief, we discussed several reform proposals for the Economic and Monetary Union. A survey among economists from Central and Eastern Europe as well as from France, Italy and Germany shows that reforms should come in a package that includes both stabilisation tools with potential elements of solidarity and instruments that strengthen fiscal discipline.

A potential stabilisation tool could be a European unemployment re-insurance scheme. It could complement national automatic stabilisers by providing support in severe recessions. A key challenge would be to design the scheme such that incentives for sound economic and fiscal policies are preserved. This could be achieved, for example, by imposing ex-ante conditionality with respect to compliance with fiscal rules and country-specific recommendations. Moreover, contribution payments to the re-insurance could be experience-rated to account for country-specific risk profiles.

A reform support programme could be another tool to increase resilience of Member States. The Commission's proposal of such a programme is already a good baseline, as Member States are encouraged to develop their own reform proposals, but should be refined concerning some elements: Support size should not be proportional to population size and payment should be carried out in several tranches.

A European Minister of Economy and Finance, as proposed by the Commission, should bundle several responsibilities to facilitate complex decision-making. We draw the conclusion that this institution would not be a significant value-added in the reform process and might even create further political conflicts.

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