

Panel discussion

A New Fiscal and Monetary Framework for the EMU?

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Forence, 10 May 2018

Overview

- Commission's roadmap
- Risk sharing versus risk reduction
- Fiscal policy reform: need to consider fiscal rule reform in conjunction with central fiscal capacity (CFC)
- Reform of SGP: simplification and enhanced role for independent assessment



What the Commission is aiming for:

Strengthen **unity**

Improve **efficiency**

Enhance **democratic accountability**

What the Commission's proposals include:

The Commission is presenting a Roadmap for deepening Europe's Economic and Monetary Union, together with:

A proposal to **establish a European Monetary Fund**

A proposal to **integrate the Treaty on Stability, Coordination and Governance into the EU legal framework**

A Communication on **new budgetary instruments for a stable euro area within the Union framework**

A proposal to **strengthen the Structural Reform Support Programme** and a proposal to **mobilise EU funds in support of national reforms**

A Communication on a **European Minister of Economy and Finance**



In 2018

FINANCIAL UNION

BANKING AND CAPITAL MARKETS UNION

- ✓ Adoption of all the remaining proposals on Banking Union, including on risk reduction, the European Deposit Insurance Scheme and a common backstop for the Single Resolution Fund
- ✓ Commission proposal for an enabling framework for European Sovereign Bond-backed Securities for the euro area, following the work of the European Systemic Risk Board

ECONOMIC AND FISCAL UNION

EU MULTIANNUAL FINANCIAL FRAMEWORK

- ✓ Adoption of the proposal to reinforce the Structural Reform Support Programme
- ✓ Adoption of the targeted changes to the Common Provisions Regulation
- ✓ Commission proposals for the post-2020 Multiannual Financial Framework

DEMOCRATIC ACCOUNTABILITY AND EFFECTIVE GOVERNANCE

EUROPEAN MONETARY FUND

- ✓ Discussion on the legislative proposal

EUROPEAN MINISTER OF ECONOMY AND FINANCE

- ✓ Discussion at political level

EXTERNAL REPRESENTATION OF THE EURO AREA

- ✓ Discussion on the legislative proposal

INCORPORATION OF FISCAL COMPACT INTO EU LAW

- ✓ Discussion on the legislative proposal

DIALOGUE BETWEEN EU INSTITUTIONS

- ✓ Formalisation of practices between the European Parliament and the Commission



By mid-2019

FINANCIAL UNION

BANKING AND CAPITAL MARKETS UNION

- ✓ Fully functional backstop to the Single Resolution Fund
- ✓ Implementation of the European Deposit Insurance Scheme
- ✓ Finalising all pending legislative initiatives for Capital Markets Union

ECONOMIC AND FISCAL UNION

EU MULTIANNUAL FINANCIAL FRAMEWORK

- ✓ Adoption of the post-2020 proposals for structural reform support
- ✓ Adoption of the post-2020 proposal on a dedicated convergence facility for non-euro Member States
- ✓ Adoption of the post-2020 proposal for a stabilisation function

DEMOCRATIC ACCOUNTABILITY AND EFFECTIVE GOVERNANCE

EUROPEAN MONETARY FUND

- ✓ Adoption of the legislative proposal

EUROPEAN MINISTER OF ECONOMY AND FINANCE

- ✓ Common understanding

EXTERNAL REPRESENTATION OF THE EURO AREA

- ✓ Adoption of the legislative proposal

INCORPORATION OF FISCAL COMPACT INTO EU LAW

- ✓ Adoption of the legislative proposal



Possible further steps: end 2019-2025*

FINANCIAL UNION

- ✓ Continuous implementation of Capital Markets Union initiatives
- ✓ Move towards the issuance of a European safe asset
- ✓ Changes to the regulatory treatment of sovereign exposures

ECONOMIC AND FISCAL UNION

- ✓ Implementation of the new Multiannual Financial Framework
- ✓ Fully functional stabilisation function
- ✓ Simplification of the rules of the Stability and Growth Pact

DEMOCRATIC ACCOUNTABILITY AND EFFECTIVE GOVERNANCE

- ✓ Fully-fledged function of European Minister of Economy and Finance as chair of the Eurogroup and Vice-President of the Commission
- ✓ Fully operational European Monetary Fund
- ✓ Setting-up of a euro area Treasury

Risk sharing versus risk reduction

- Reform is stuck due to opposing views: advocates of risk reduction fear paying for policy mistakes of others, while advocates of risk sharing view themselves as victims of a moral diktat
- CEPR Policy Insight No. 91 (Bénassy-Quéré et al., 2018) argue that progress requires movement on both fronts: risk sharing and risk reduction complements, not substitutes
- European Fiscal Board (EFB) shares this view; moreover, it is also highly relevant in the area of fiscal policy reform

Fiscal policy reform

- Unfortunately, revision of fiscal rules has been postponed until 2020 or later
- This is unfortunate because enhanced fiscal risk sharing (a CFC) and risk reduction (reform of fiscal rules) need to go together – both sides need to benefit
- OCA has long ago made clear the need for risk sharing in EMU
- More financial integration conducive to private risk sharing
- However, especially in times of stress financial integration may raise volatility and public risk sharing is particularly needed

- EFB strongly in favour of a CFC
- Many design issues, such as what to target, trigger (automatic/expert judgment), symmetric/asymmetric shocks, funding
- Concern about moral hazard weighs particularly heavily
- Make access to CFC *conditional* on compliance with commonly agreed fiscal rules → strengthening the EU fiscal framework and setting up a CFC must be seen as one package

- SGP has worked imperfectly, in particular pro-cyclicality [\[pro-cyclicality\]](#) [\[more\]](#) , and has become very complex with many elements of discretion (also undermining enforcement)
- Simplification is magic word: one objective (debt), an operational rule (e.g., exp. growth) and parsimonious use of escape clauses
- Complete contract approach does not work: expert judgment unavoidable → who should exercise it?

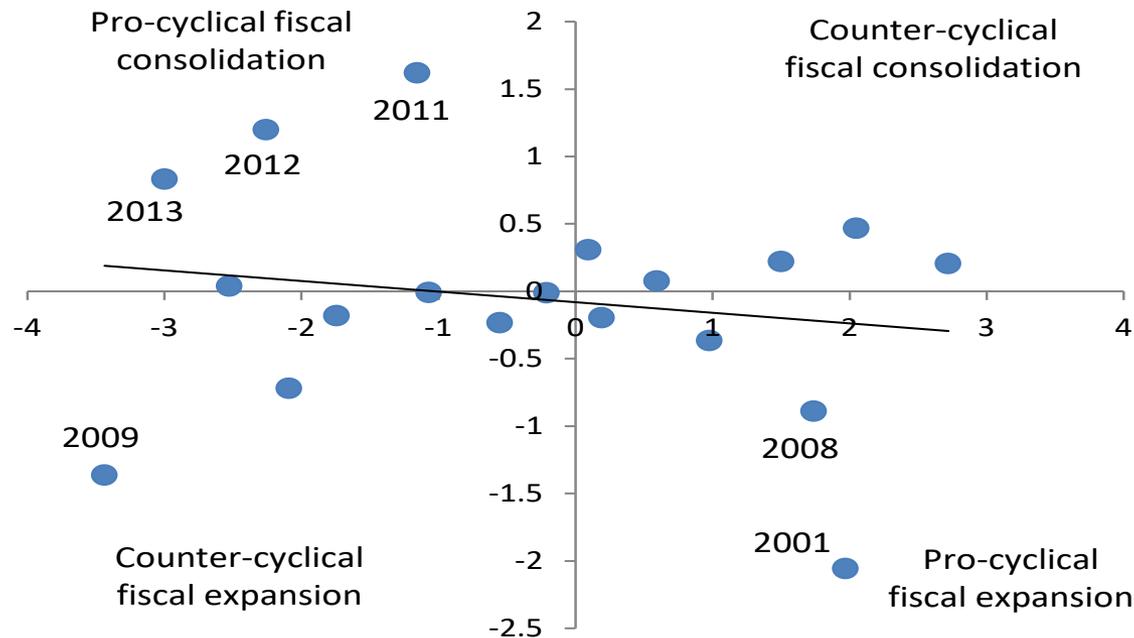
- Bénassy-Quéré et al. (2018) propose to separate assessment fiscal policy developments against common rules and political decision on further steps (prosecutor and judge)
- EFB shares idea of separating role, but “prosecutor and judge” is somewhat misleading:
 - Judge is decision maker with the necessary democratic legitimacy, while Executive moves from Guardian of the Treaty to a more conventional executive branch which takes political decisions (see, also, Marimon, 2018)
 - Independent assessment will gain in importance

- Bénassy-Quéré et al. (2018) also suggest junior bonds to finance new debt for spending above benchmark
- Junior debt may fulfill useful role to strengthen discipline, but carries also risks:
 - Judgment needed to establish that threshold has been exceeded
 - Markets may be disrupted when junior debt is placed by country that can ill afford it
 - Legal enforcement
- Alternative is budgetary charge: divert EU spending on MS to rainy-day fund for bad times (for MS itself)

Improving the SGP: more symmetric rules

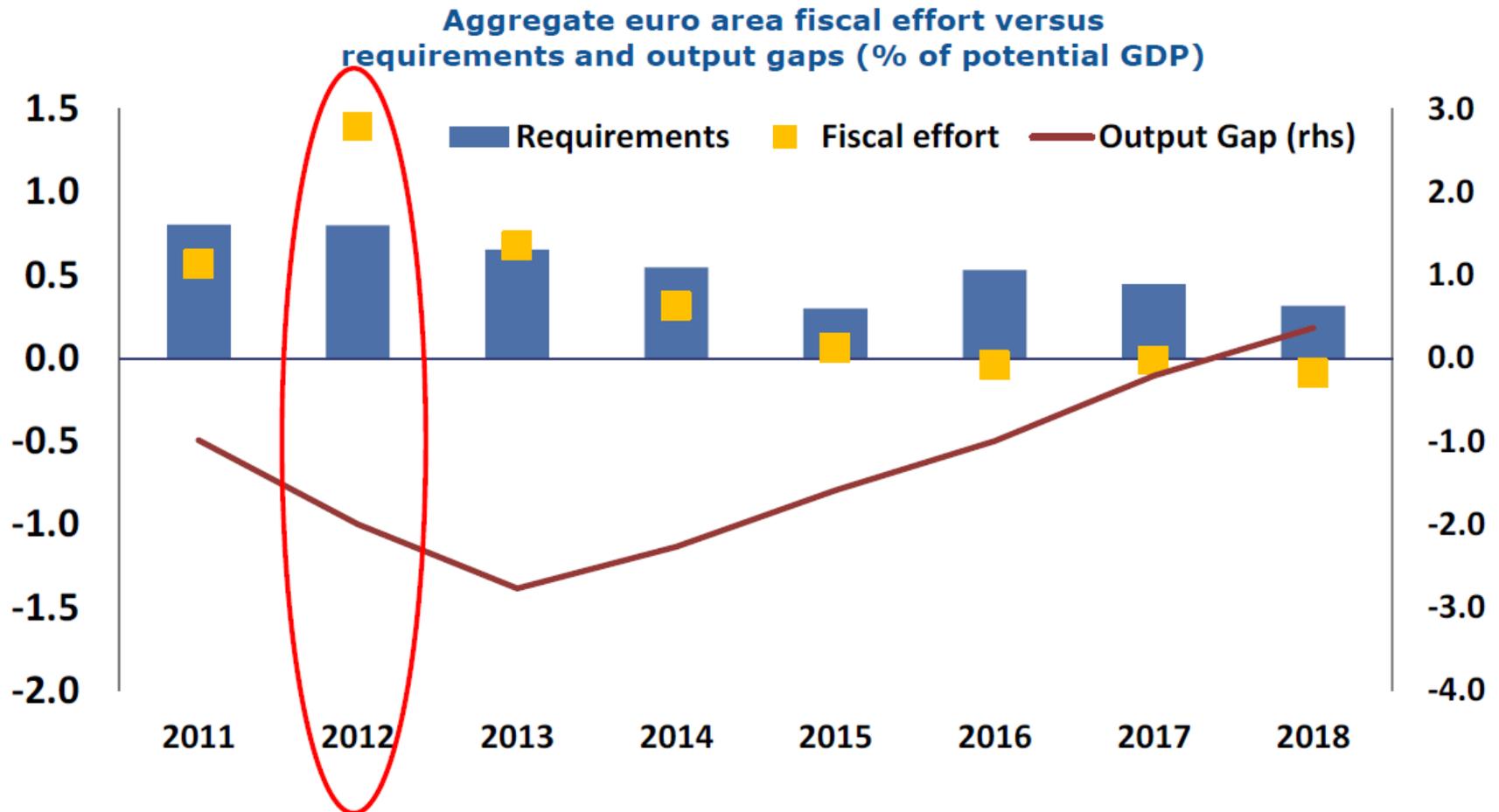
Fiscal policies tend to be pro-cyclical

Change of the cyclically adjusted primary balance (vertical axis) vs. the output gap (horizontal axis), in percent of potential GDP



Source: European Commission.

How can fiscal rules mitigate pro-cyclicality?



Source: European Commission autumn forecast 2017