

“Enhanced Fiscal Integration in the EMU?” - Speech by Rolf Strauch

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Speeches

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Ladies and gentlemen,

Welcome to this workshop on enhancing fiscal integration in the monetary union. In this room, we are all experts, and we know the topic intimately. This means we can look forward to a valuable discussion at a well-informed and technical level. And I expect that we may actually make progress today in finding answers to some of the issues all of us have been working on for years. Before I start, let me, on behalf of the ESM, thank the two co-organisers: the European Commission, and the German Council of Economic Experts.

The *causa finalis* why we are here is that the euro area still needs to improve the functioning of its economy. Some deficiencies remain in place, despite the progress in strengthening Europe’s institutional architecture over the crisis. This is inherent to the fact that euro area is a monetary union consisting of 19 different countries. Integration always means some reallocation of responsibilities between levels of government, and is by necessity a stepwise process. It needs to be in tune with the political and economic realities of Member States.

Europe has already taken profound steps in economic integration through the

establishment of the single market and the euro in the past half century, which is showing clear benefits. It has taken another landmark step in the last decade through the creation of Banking Union. Now it is time to address remaining vulnerabilities.

The timing of this conference, right after the State of the Union speech of Commission President Juncker last week, is good. I'd like to refer also to the Commission's recent reflection paper on deepening of the Economic and Monetary Union, which addresses these remaining problems that I mentioned, and proposes ways to solve them. Among other things, it suggests improving the fiscal policy framework and advancing fiscal integration. We are not being asked to invent a magic potion. But doing so in a sensible manner may well contribute to making Europe's economy more resilient.

Let me also remind you that the odds of making real progress in integrating the euro area further have rarely been more favourable. The pro-European outcome elections in France and the Netherlands have shown that. The popularity of the euro is at its highest level since 2004. This gives policymakers such as us a window of opportunity to make the euro more robust and protect the many benefits that it brings to Europe's citizens.

Today's programme consists of two topics that the political debate has centered on in recent months. First, the fiscal rules and how they have been applied. We will hopefully be able to simplify them in the near future, to make them easier to understand and apply. The second topic concerns the establishment of a fiscal capacity to support countries that are hit by an asymmetric shock, and other ways to promote fiscal stabilisation and risk-sharing in the monetary union. Let me focus on this second issue.

Establishing a euro area fiscal capacity is an important task and I hope we will be able to do so in the future. So the aim of this workshop is to come up with ideas that are not just academically rigorous, but also practical. We need something that works. Another requirement is that we don't want to double our efforts, replicating something that already happens elsewhere. So let's have an open exchange of views today. We should assess the benefits and shortcomings of the various proposals on fiscal risk-sharing and economic stabilization functions that are on the table so far, and at the same time explore new ideas.

As a first guide to this dialogue, I suggest that we first ask ourselves what deficiencies there are in the current fiscal policy framework. Secondly, we need to establish how any new functions would fit in the overall architecture and where we can benefit from additional elements. And thirdly, we should try to achieve as much as we can without pooling more resources than needed.

It is equally important to keep in mind that permanent fiscal transfers and debt mutualisation are impossibilities at the moment, mostly because we have not yet been able to overcome sufficiently structural disparities between national economies. Relatedly, avoiding moral hazard is an important consideration. On all these points, I believe we will hear some good ideas today.

Let me sketch out some of the fiscal instruments we currently have at the supranational level and look at the elements that need to be reinforced. Countries already benefit from the EU budget, especially through regional policy funds which ensure convergence among regions. Net transfers can amount to 4 percent of GDP, which is a considerable amount of money. Secondly, the European Investment Bank, which is in charge of implementing the Juncker plan, promote investment. Finally the ESM provides a firewall against a loss of market access. It disburses cash only in return for strict economic reform programmes, and its function can therefore be applied during a crisis only if all else fails. The Commission's Balance-of-Payment assistance plays a similar role outside the euro area.

With this list, it is clear that a function that would address countries' vulnerability to severe asymmetric shocks is a remaining critical gap, in particular in the euro area where countries are facing a common monetary policy. Such a stabilisation function could provide funding to increase fiscal space in bad times. It would thus allow for full operation of automatic stabilizers and some discretionary stimulus at the national level. With this it would help better smooth severe asymmetric shocks. Thus, it would safeguard overall euro area macroeconomic stability.

Different options have been floated for such a function by academics, politicians, European institutions and think tanks. These ideas range from common European unemployment insurance, or reinsurance scheme, to proposals for a macroeconomic stabilisation fund. On these options, there are different ideas as to whether the stabilisation function should address only large shocks, or smooth all cyclical variation. Other open questions are whether the transfers should be triggered

automatically following a rule or be subject to a discretionary decision, what the trigger variable should be, and whether the trigger rules should be specified in absolute terms, or relative to the euro area average. There are also different ideas as to how the size of the transfers or payments is determined, and what conditions should be put in place to guarantee efficient use of the funds and avoid moral hazard. We also need to explore whether we can combine our ideas with the U.S. experience with rainy day funds and unemployment insurance, although these need to be adapted to the needs and the structural settings that are specific to the EMU.

Some may object by saying that establishing a new institution in the monetary union is nearly impossible. But let me take the ESM, my own institution, as an example that need not be true. The period after the global financial crisis hit Europe in 2007, when the euro debt crisis hit this region, provided sufficient momentum for euro area countries to establish the ESM, a lender of last resort for sovereigns. This function that did not exist before in the monetary union and many would have not imagined beforehand. Its stated goal was to prevent the euro from breaking up, by helping countries regain their footing after they had lost market access. This is a goal that the ESM very successfully achieved. Member States have put enormous trust in the ESM and its role has evolved over time. But the ESM does not operate in an institutional vacuum. From its inception, it has been deeply embedded in the institutions of the monetary union through its connections with the Eurogroup, the Commission and the ECB, and through its links to the macro-economic governance framework and Banking Union. It shows how new institutions or functions can be introduced in the European framework in a complementary way.

Ladies and gentlemen, I've tried to give you some ideas on what we can discuss today. Hopefully, when our deliberations appear in print not too long from now, the reader will find that we have made some valuable additions. Let me underscore the importance of this workshop again. We are discussing very practical issues on how to continue to build Europe, to make monetary union more robust and the economy more resilient.

Thank you for your attention.

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