Policy implications for sutainable finances

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European Stability Mechanism
DSA Seminar
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Why do we talk about DSA,

when we are talking of SGP?

Why do we talk about DSA,

when we are talking of SGP?

then and now?

then

Policy: EU and EMU design & 21st Century crises

2000 - 2008. The euro stable childhood: A EU & EA without resilience (EU single market & EA monetary union; domestic fiscal + SGP; no bail-out and no EU debt)

Economic and Monetary Union: before the financial & euro crises

Monetary Union

EUROPEAN CENTRAL BANK
EUROSYSTEM

Economic & Fiscal Union

Stability and Growth Pact

then

bad MS fiscal policies
threatening
joint monetary stability

then

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joint monetary
without joint risk-sharing

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2008 - 2009. Financial crisis: the need for financial resilience (begins development of the banking and capital European unions)

2010 - 2012. Euro-Debt crisis: the need for sovereign debt resilience (first EU partial default and EA bail-out; EFSF & creation European Stability Mechanism)

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A failure of the SGP?
Greece, Spain, Ireland,...

Economic and Monetary Union after the financial & euro crises

Monetary Union

Economic & Fiscal Union

Stability and Growth Pact II

European Stability Mechanism

esm

Financial Union

Banking Union
SSM & SRM

Capital Markets Union

EU and EMU design & 21st Century crises

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2019 - 2021. COVID-19 crisis: EU $\approx$ EA & the need for resilience to aggregate shocks (Post Brexit NGEU, with risk-sharing (SURE), EU support for heath security and green & digital transitions, and first large EU eurobonds emission with EC 'Treasury')

and now

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2022 - 2023: Russian invasion of Ukraine & first EA inflation: the need for a EU & EA with resilience, for a geopolitical EU of 30+ (+ defence and energy, migration, cost of debt overhang (old and NGEU), and other long-term EU financial commitments: Ukraine reconstruction + enlargement transfers)

Economic and Monetary Union after the COVID-19 crisis *et al.*

Monetary Union

Economic & Fiscal Union

Stability and Growth Pact III?

EC Temporary Treasury (RRF)

European Stability Mechanism

esm

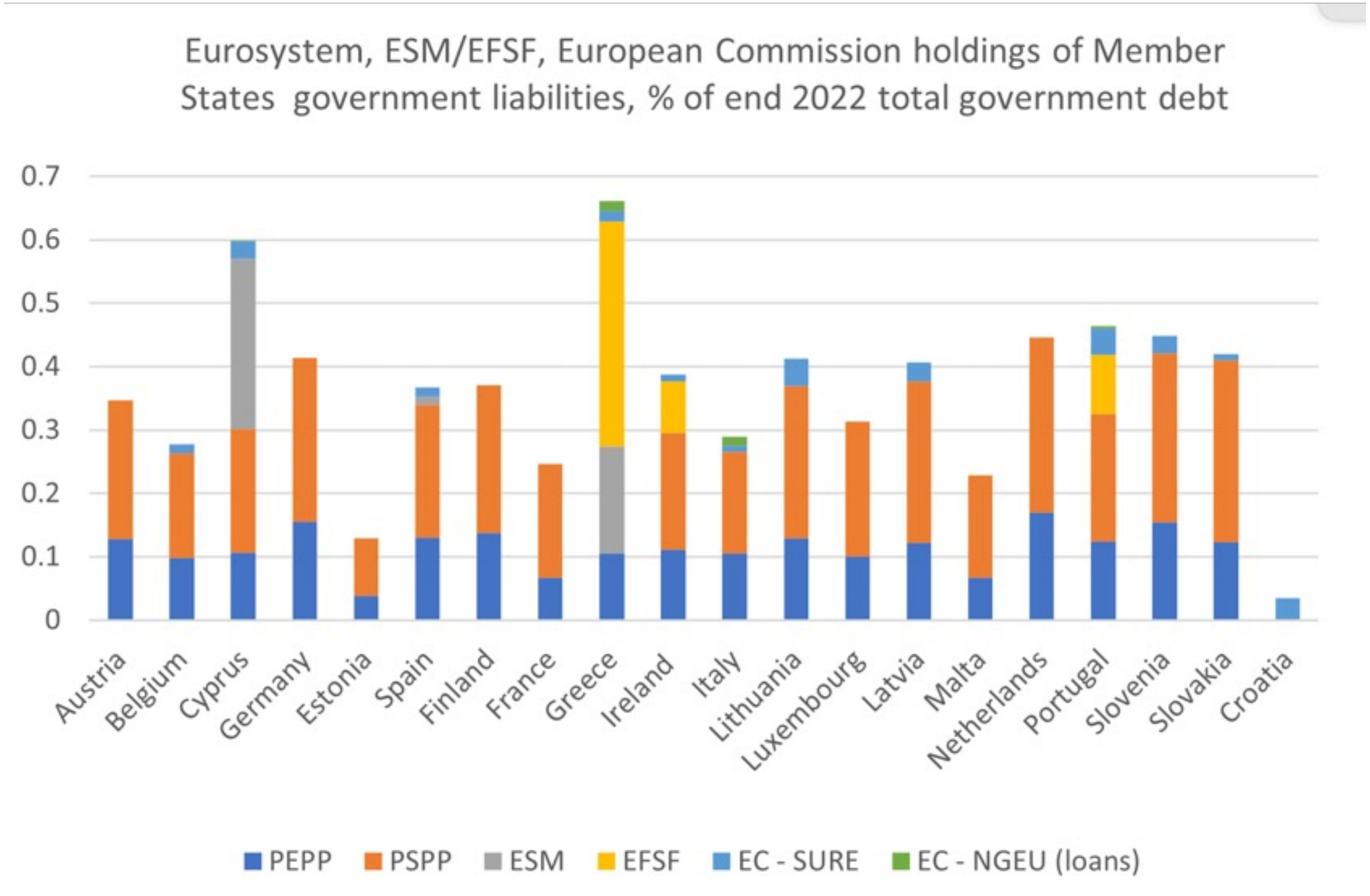
Financial Union

Banking Union SSM & SRM

Capital Markets Union

- + Facing common risks and challenges
- + Long-term commitments on EU public goods
- + EU debt and EU-MS debts in EU institutions

With 1/3 of the EA debt liab. in EU instiutions



and now

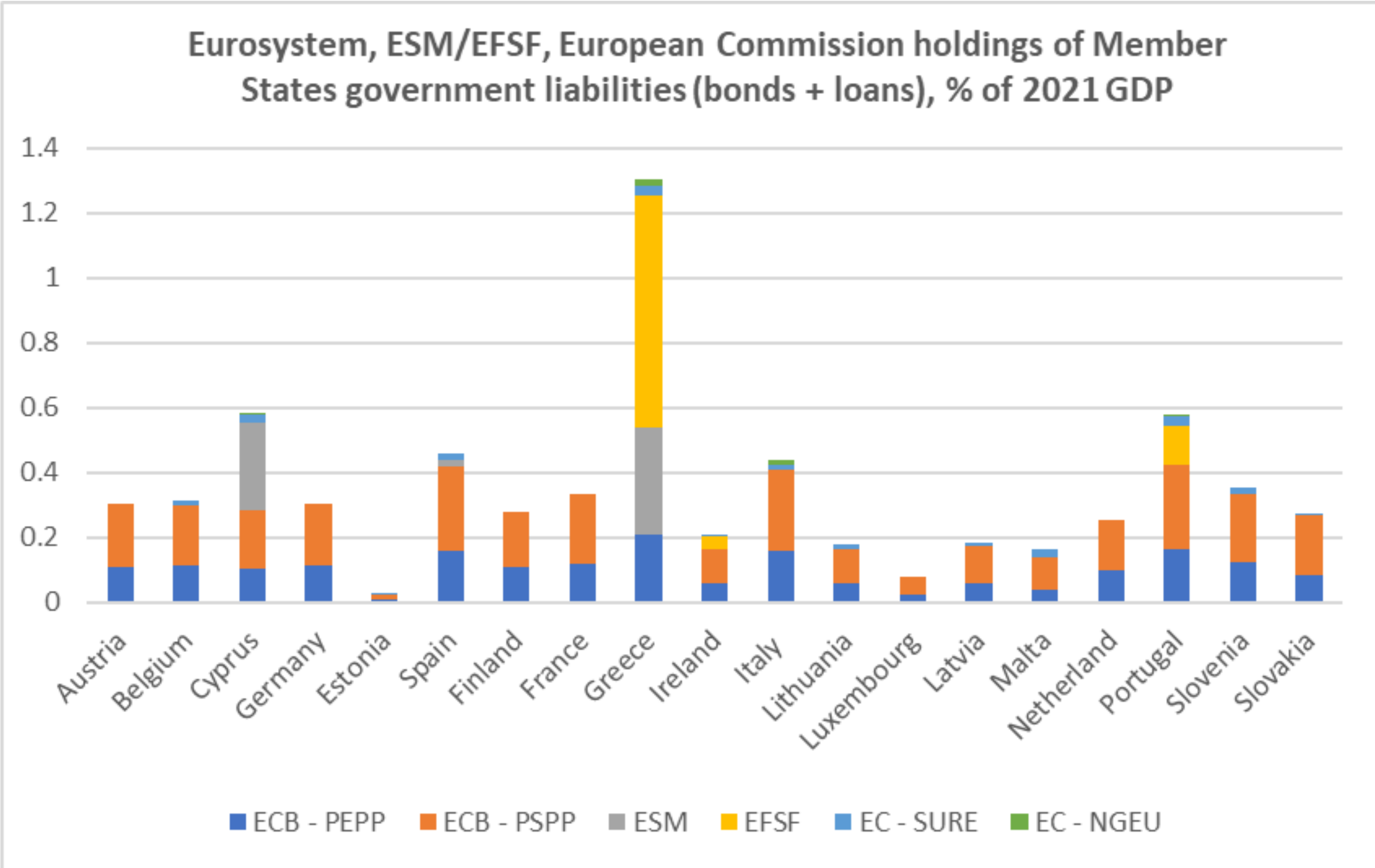
bad MS fiscal policies

threatening

joint fiscal commitments

(& joint monetary stability)

With 2+% EA debt/GDP liab. in EU instiutions



and now

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joint monetary

supporting EU debts!

DSA = DC&WA

Debt – Sustainability =
Capacity & Willigness to repay
- the Debt

Capacity = with future primary surpluses

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Capacity = with future primary surpluses

not easy to assess…

Three reasons not to talk of SGP when we talk of D**S**A

1. 60% Debt/GDP is too tight, particularly if
   - The EU financial market is integrated and eurobonds are safe and/or there is “debt revenue” (Reis 2020)
   - There are no unwritten liabilities in the DSA that can threaten its **S**.

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2. Debt + needed to deal with DSA unwritten liabilities (e.g. PAYG system in Spain, last year ESM sem.)
3. **S** is fundamentally state-contingent

(& a well-designed *Fund contract* accounts for it…)

A well-designed Fund contract takes into account:

- Willigness to repay (no default)
- Capacity (never expected losses for the Fund)
- State-contingencies (risk-sharing)
- Minimum intervention in the private sovereign debt market

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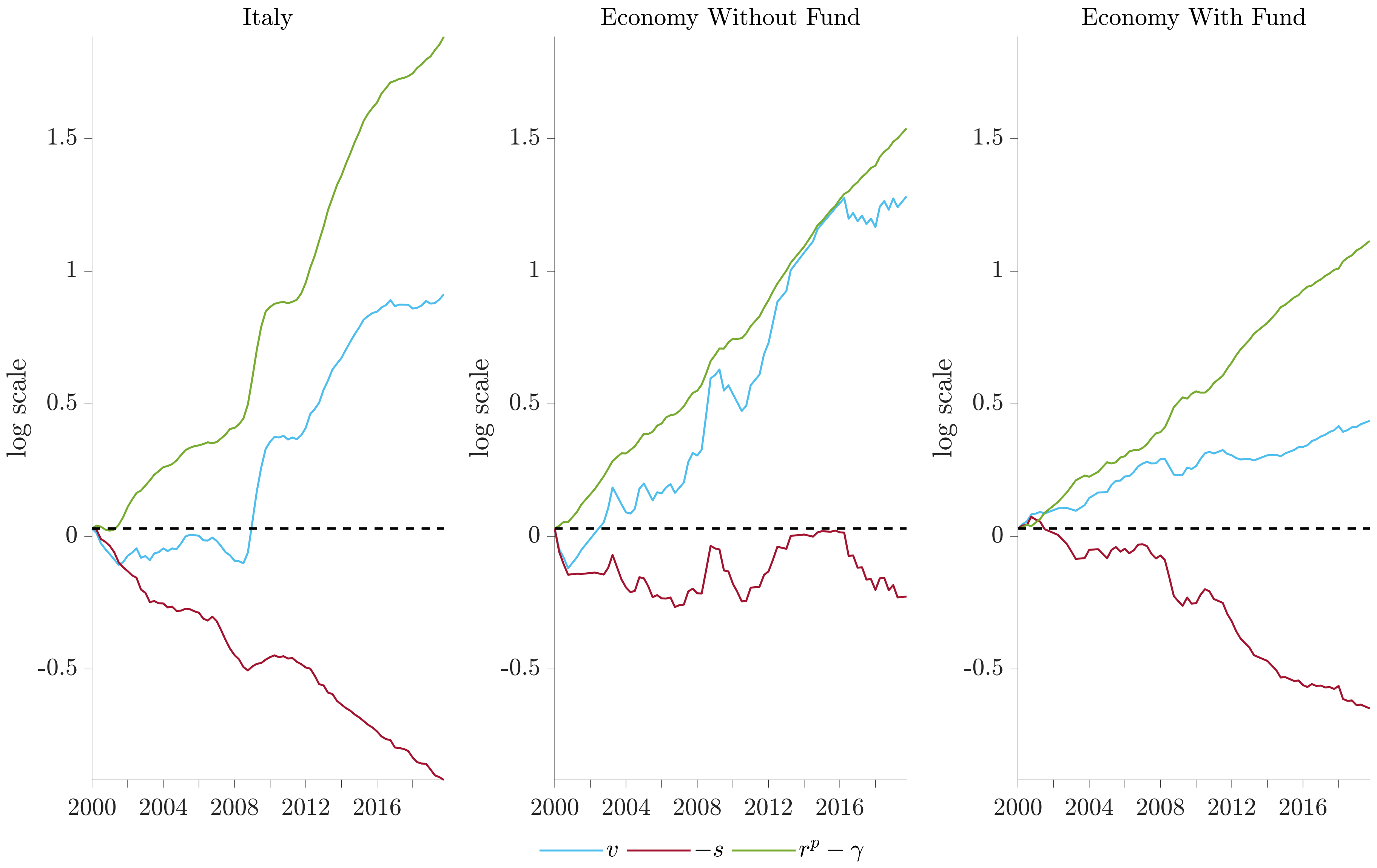
and sovereign debt becomes safe

Decomposing the evolution of Italy's sovereign debt

(past & cntfct.: value debt/GDP = real cost- primary surplus = *r-g* –*s*



Y. Liu, R. Marimon & A. Wicht (*JIE 2024*)

Let's talk: Surveillance, *DSA - LSA & IFIs*

EU has an unparallel surveillance system

(EU semester, EC DSA, ESM, etc.)

Yet, it can do better:

- *DSA* of common reference
- *Liability Sustainability Analysis*, based on homogeneous Public Sector Balance Sheets
- Empowering *IFIs*; in particular the *EFB*
- Politics out of *DSA*
- *DSA* with current policies, but also counterfactual *DSA*s with alternative policies or reforms.

Let's talk: NGEU-style programmes

The EC, EIB or MS can have their policy oriented debt programmes (e.g. digital, green, defence)…

The DSA must account for all the debts of MS, including their share of EU debts

(if policy oriented programmes have

expected fiscal returns

count them too as part of ***S***)

Let’s talk: sticks & carrots in the New SGP?

Peer pressure has worked

but it may be less effective in the future

(populism on the rise 😱)

similarly, fines may be even less credible

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for countries at risk

for other countries to benefit

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well-designed Fund contracts

for countries at risk

for other countries to benefit

and can be designed with SGP constraints 🤷‍♂️


esf

Thanks

Thanks

let’s talk!