
A fiscal capacity for the euro area?

Options for reforms to counter
asymmetric shocks



IN-DEPTH ANALYSIS

EPRS | European Parliamentary Research Service

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Members' Research Service

September 2016 — PE 589.774

EN

This publication provides an overview of the debate on a possible fiscal capacity, especially the role of automatic stabilisers, for the European Economic and Monetary Union (EMU). It presents the issue and its theoretical underpinnings, as well as the main reform options that have been proposed.

Building on previous EPRS publications, this in-depth analysis was produced upon request for a member of the Committee of the Regions, in the framework of the Cooperation Agreement between the European Parliament and the Committee.

PE 589.774

ISBN 978-92-846-0027-4

doi:10.2861/87358

QA-02-16-981-EN-N.

Original manuscript, in English, completed in September 2016.

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EXECUTIVE SUMMARY

Beginning in 2010, the sovereign debt crisis exposed weaknesses in the economic and monetary union (EMU), the integration process that brought about the creation of the euro. Member States and EU institutions have taken a number of measures to tackle these shortcomings, including stricter rules on economic governance and setting up the European Stability Mechanism. Ideas to further strengthen EMU include the creation of a specific 'fiscal capacity' for the countries that have adopted the single currency. In the longer term, this could lead to the establishment of a dedicated euro-area budget.

In 2012, policy documents from EU institutions envisaged steps towards fiscal union, coupling budgetary discipline with solidarity tools. Two main functions are identified for an EMU fiscal capacity: 1) promoting structural reforms; 2) mitigating macro-economic shocks which affect only some euro area countries.

During 2013, the debate focused on the creation of a 'convergence and competitiveness instrument' (CCI) that would aim to promote structural reforms. A CCI would have encompassed both contractual arrangements, through which Member States commit themselves to key structural reforms, and financial incentives to facilitate the implementation of those reforms. Already in late 2013, after the immediate threat of failing financial markets had decreased, the political will to pursue work on CCIs faded, while the discussion on an all-encompassing EMU reform resumed after the European elections in May 2014.

While overall real GDP growth in the euro area remains sluggish (-0.3% in 2013, 0.9% in 2014 and 1.1% in 2015), divergence between Member States in the monetary union has grown recently. Against the backdrop of crises in Cyprus (2013) and Greece (2014, 2015), the European Council assumed a more important role discussing EMU reform, involving all major European institutions. Building upon earlier work in 2012, the Five Presidents' Report of June 2015 spelled out specific steps and institutional elements on how to 'complete' the monetary union. Several policy options are currently under discussion, some including automatic stabilisation instruments (such as European unemployment insurance), and some containing more room for political discretion (such as a public investment strategy).

The European Parliament's Committee on Budgets (BUDG) and Committee on Economic and Monetary Affairs (ECON) are jointly preparing a report on a budgetary capacity for the euro area. In May 2016, the two rapporteurs presented a draft report on a budgetary capacity for the euro area, combining three different pillars: an instrument to incentivise structural reforms, a pillar to counter asymmetric shocks in individual Member States, and a third pillar to mitigate the effects of symmetric shocks for the euro area as a whole.

Proper democratic scrutiny of EMU economic governance, with new measures in this area possibly having implications for the European Parliament, and the question of political feasibility, are also central components of this debate.

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Glossary

Asymmetric shocks: Macroeconomic shocks that affect only some of the states belonging to an area or hit them differently.

Automatic stabilisers: Economic policies and programmes that are designed to offset fluctuations in a country's economic activity without intervention by the government or policymakers. Examples are corporate and personal taxes, and transfer systems such as unemployment insurance and welfare. 'Automatic' because they act to stabilise economic cycles and are automatically triggered without explicit government intervention.

CCI: Convergence and competitiveness instrument. In 2013, the Commission proposed options for contractual arrangements for Member States to undertake specific reforms and financial support to help Member States implement these reforms.

Counter-cyclical fiscal policy: A fiscal policy that reduces fluctuations in a country's economic activity (i.e. a fiscal policy that is expansionary in a recession and contractionary in an economic upturn).

European Stability Mechanism: Entering into force on 27 September 2012, the ESM is an intergovernmental treaty among those EU Member States whose currency is the euro. The ESM issues debt instruments in order to finance loans and other forms of financial assistance to euro-area Member States, and is their main instrument for providing financial assistance.

Economic business cycle: The period over which an economy undergoes different levels of activity, including one expansion and one contraction.

'Fiscal capacity': In EU policy documents,¹ a set of common budgetary instruments which could include mechanisms to counter adverse economic shocks.

Optimum currency area (OCA): According to its first proponent, Robert Mundell, the case for separate currency areas clearly holds good only if the impact of a shock varies between areas: i.e. is asymmetric. If the impact were to be the same for all, the exchange-rate changes needed for adjustment would be the same for all, in which case separate currencies would serve no purpose. Thus, OCA theory implies that any two countries generally experiencing symmetric shocks, and trading significant proportions of their GDP bilaterally, should fix their exchange rates. The approach indicates a series of characteristics that a currency area (and its members) should have in order to function properly and to be resilient to asymmetric shocks. They include: labour mobility; openness to trade; fiscal, economic and political integration.

Output gap: An economic measure of the difference between the actual output of an economy and its potential output. Potential output is the maximum amount of goods and services an economy can turn out when it is most efficient – that is, at full capacity. Potential output is often referred to as the production capacity of the economy.

Pro-cyclical fiscal policy: A fiscal policy that accentuates fluctuations in a country's economic activity (i.e. a fiscal policy that is expansionary in an economic upturn and contractionary in a recession).

¹ Herman Van Rompuy, [Towards a Genuine Economic and Monetary Union](#), European Council, 26 June 2012.

1. Context

A common currency implies benefits such as lower transaction costs, better price transparency and absence of foreign-exchange risk.² If strong enough, it can reduce the exposure of the area to international monetary policy developments.³ On the other hand, a common currency reduces policy options for countering *asymmetric shocks*. A common central bank means countries have a single monetary policy, adjustment mechanisms such as exchange rate fluctuations no longer exist.

Inspired by the *optimum currency area* (OCA) theory,⁴ the euro ran smoothly for around ten years after its creation in 1999,⁵ and soon became a major international currency (second only to the US dollar). Interest rates on sovereign debt and inflation were low, with growth in most countries. However, when the global financial and economic crisis triggered a sovereign debt crisis, the euro area (formed by the EU countries that had adopted the single currency)⁶ displayed its vulnerability to asymmetric shocks.

According to many economists,⁷ there were shortcomings in the design of the currency area in respect of elements that the OCA theory considers important for its functioning, including the level of economic, fiscal and political integration. Other weaknesses were identified, such as the lack of a lender of last resort.⁸

Member States and EU institutions have taken many measures to strengthen the economic and monetary union (EMU), the integration process that created the euro. The main areas of action include:

- *Increased coordination of Member States' budgetary and economic policies, with stronger surveillance at EU level.* Building on the existing stability and growth pact (SGP), several changes in this area have been introduced, with new legal obligations,⁹ such as those contained in the 'six pack' (for all Member States) and 'two pack' (applying to euro-area countries only). A working method for policy planning (known as the European Semester)¹⁰ ensures ex-ante coordination on a regular calendar. Additional measures were taken by groups of Member States through an intergovernmental approach (e.g. the Treaty on Stability, Coordination and

² Chris Mulhearn and Howard R Vane, [The euro. Its origins, development and prospects](#), Cheltenham: Edward Elgar, 2008.

³ Thomas Mayer, *Europe's unfinished currency. The political economics of the euro*, London: Anthem Press, 2012, ch. 10.

⁴ Initiated by Robert Mundell's seminal article in 1961: A theory of Optimum Currency Areas, in: *American Economic Review*, Vol. 51, No. 4, pp. 657-665. Several other economists, such as Ronald McKinnon and Peter B. Kenen later elaborated on it. For an early overview on its relevance for EMU see Francesco P Mongelli, ['New' views on the optimum currency area theory: what is EMU telling us?](#), European Central Bank, Working Paper No 138, April 2002.

⁵ Mayer, op. cit., ch. 4, 'The euro's happy childhood and its abrupt end'.

⁶ Currently, the euro is the currency of 19 EU countries. 'Opt-out' clauses in the Treaty allow Denmark and the United Kingdom not to adopt it.

⁷ See for example Paul Krugman, [Revenge of the Optimum Currency Area](#), in: *The New York Times*, 24 June 2012.

⁸ Paul De Grauwe, [Managing a fragile Eurozone](#), in: Vox.eu, 10 May 2011.

⁹ See European Commission pages on the [Stability and Growth Pact](#) and [EU economic governance](#).

¹⁰ See European Commission, [Making it happen: the European Semester](#), Andrej Stuchlik, [European Semester. 'Revamping' and 2016 priorities](#), EPRS, February 2016, and Angelos Delivorias, [European Economic Governance. State of play and reform proposals](#), EPRS, November 2015.

Governance (TSCG),¹¹ signed by all then Member States except for the Czech Republic and the United Kingdom).

- *Establishment of tools to provide support to Member States confronted with liquidity crises.*¹² For example, euro-area countries created the European Stability Mechanism (ESM)¹³ by means of an intergovernmental treaty. In 2012, the European Central Bank (ECB) presented its bond-buying programme (outright monetary transactions, or OMT).¹⁴
- *Revision of rules governing the financial sector.* Steps towards creating a Banking Union,¹⁵ including single supervisory and resolution mechanisms for banks as of 2014.

In mid-2012, policy documents began to outline visions for the completion of EMU. One idea on the table is the creation of a *fiscal capacity* for the currency area, sometimes including references to a dedicated 'euro-area budget'. The latter would imply at least a partial delegation of budgetary competences to the EU level.¹⁶ Unlike the ESM, which was created to manage severe crises close to economic default, such a tool should create adjustment mechanisms that increase the resilience of the area to asymmetric shocks.

During 2013, the debate focused on the creation of a *convergence and competitiveness instrument* (CCI). A CCI would have encompassed both contractual arrangements through which Member States commit themselves to key structural reforms, and financial incentives to facilitate the implementation of those reforms. However, in late 2013, after the immediate threat of failing financial markets had decreased, the political will to pursue the debate on CCIs faded, while the discussion on an all-encompassing EMU reform resumed after the European elections in May 2014.

In the wake of the crises in Cyprus (2013) and Greece (2014, 2015), the European Council assumed a more important role in discussing a more encompassing EMU reform, involving all major European institutions. Building upon the earlier work, published in June and December 2012, the Five Presidents' report of June 2015 spelled out specific steps and institutional elements on how to 'complete' monetary union (see section 4.1.2). Several policy options are currently under discussion, some including automatic stabilisation instruments (such as European unemployment insurance, see section 3.2), some containing more room for political discretion (such as a public investment strategy).

The economic rationale for a common fiscal policy focuses on two aspects:

- **Interdependence:** While overall real GDP growth in the euro area remains sluggish (-0.3% in 2013, 0.9% in 2014 and 1.1% in 2015), divergence between Member States within monetary union has grown recently. Individual Member States remain responsible for their fiscal policy. However, the euro area's interdependence creates

¹¹ Signed on 2 March 2012, the intergovernmental [Treaty on Stability, Coordination and Governance in the Economic and Monetary Union](#) entered into force on 1 January 2013.

¹² See European Commission, DG ECFIN on [intergovernmental support mechanisms](#).

¹³ Set up in December 2010, the [Treaty](#) on the [European Stability Mechanism](#) was signed on 2 February 2012. The first ESM pay-out occurred in November 2012, supporting Spanish banks.

¹⁴ See European Central Bank, [Technical features of Outright Monetary Transactions](#), press release, 6 September 2012.

¹⁵ See [European Commission](#) banking union webpages; and Andrej Stuchlik, [Banking Union – 2015 Annual Report](#), EPRS, 3 March 2016.

¹⁶ European Parliament, [Working Document on a Budgetary capacity for the Eurozone](#), Committee on Budgets, Committee on Economic and Monetary Union, 19 February 2016, p. 7.

concerns regarding the aggregate fiscal stance.¹⁷ During economic downturns, national efforts alone may prove to be insufficient and growing divergence only exacerbates this threat.

- **Size of shock absorption:** The euro area's overall resilience against asymmetric macroeconomic shocks is comparatively low. Compared to the US, the European capacity to mitigate and smooth out such output shocks, both through financial and labour market incomes generated across borders and through cross-border fiscal transfers, is only one third that of the US.¹⁸ A fiscal capacity would help to increase this resilience through increased risk-sharing.¹⁹

2. Strengthening fiscal stabilisation in the euro area

2.1. Asymmetric shocks – economic theory

In the context of the *optimum currency area* theory, Kenen²⁰ showed the role that fiscal integration can play in reducing the impact of asymmetric shocks. A central fiscal system that transfers funds to members adversely affected by asymmetric shocks, allows for smoother adaptation to such events. As early as 1977, the MacDougall report²¹ for the Commission argued that any plan for monetary integration needed a common fiscal stabilisation policy. However, this function remained mainly at national level under EMU.²²

According to Paul Krugman,²³ the lack of fiscal integration – together with banking issues – was a key factor explaining the magnitude of the crisis in some euro-area countries. He suggests that Florida was less severely hit by its housing bubble due to the USA's much higher fiscal integration: Florida received significant *de facto* transfers from the centre, thanks to the tax system and a range of federal programmes. In addition, its banks benefit from federal financial backing. In a 2012 article, Krugman deemed full integration

¹⁷ 'It matters for monetary policy whether fiscal policy is steering aggregate demand in the same direction, and how strongly.' Mario Draghi, [On the importance of policy alignment to fulfil our economic potential](#), 5th Annual Tommaso Padoa-Schioppa Lecture, Brussels Economic Forum, 9 June 2016. See also Agnès Bénassy-Quéré, [Euro-area fiscal stance: definition, implementation and democratic legitimacy](#), Study for the European Parliament, DG IPOL, Brussels, July 2016.

¹⁸ European Commission, DG ECFIN, [Quarterly Report on the Euro Area](#), Vol. 15, No 2, 2016, p. 5.

¹⁹ Buti et al. argue however, that completing the financial (and banking) union will generate an even bigger stabilisation effect. See Marco Buti, José Leandro, Plamen Nikolov, [Smoothing economic shocks in the Eurozone: The untapped potential of the financial union](#), in: Vox.eu, 25 August 2016. In a similar vein, Matthes and Lara argue that improving financial integration through targeted reforms would be sufficient to stabilise EMU, and make further fiscal integration unnecessary: Jürgen Matthes and Anna Lara, [On the Future of EMU: Targeted reforms instead of more fiscal integration](#), Cologne Institute for Economic Research, 21 June 2016.

²⁰ Peter B Kenen, 'The Theory of Optimum Currency Areas: An Eclectic View', in: Robert A Mundell and Alexander K Swoboda (eds.), *Monetary Problems of the International Economy*, Chicago/London: Chicago University Press, 1969, pp. 41-60.

²¹ Donald MacDougall et al., Report of the Study Group on the Role of Public Finance in European Integration, Commission of the European Communities, April 1977.

²² Generally, the EU budget, which applies to all Member States, is not considered to be able to tackle asymmetric shocks due to its size and inflexibility in the context of Multiannual financial framework planning. See e.g. Giacomo Benedetto and Simona Milio (eds.), [European Union Budget Reform](#), Basingstoke: Palgrave Macmillan, 2012.

²³ Paul Krugman, [Kenen, Mundell, and Europe](#), in: *The New York Times*, 14 January 2011; Krugman, 2012, op. cit.

of the EU – involving at least fiscal transfers – to be one answer to the crisis. Considering it politically unlikely, he suggested focusing on banking issues first. In a similar vein, Rogoff²⁴ argued that the euro needed a long-term vision aiming at much deeper political and fiscal integration.

A different vision²⁵ claims that proper implementation of new rules for economic governance, in addition to the banking union and ESM, would be sufficient to ensure stability. Along these lines, some analysts argue that risk reduction would render the introduction of a shock-absorber with a stabilisation function at euro-area level pointless.²⁶ Others object that this is at best a long-term vision, adding that the impossibility of eliminating the risk of serious financial and economic crises creates the need for proper stabilisation mechanisms.²⁷

An influential study by Allard et al. in September 2013²⁸ explores the role that deeper fiscal integration can play in correcting the weaknesses in the system's architecture, reducing the incidence and severity of future crises and lending long-term credibility to the crisis measures undertaken.

A 2016 paper published by the French Council of Economic Analysis²⁹ justifies, at euro-area level, a fiscal policy with a stabilisation function to mitigate fluctuations in the economic cycle. The authors find that aggregate fiscal policy in the euro area often tends to be pro-cyclical,³⁰ and attribute this feature mainly to the discretionary component, i.e. the political influence of fiscal policy as opposed to automatic stabilisers. Deeming that the creation of a proper euro-area budget with a macroeconomic stabilisation function is unlikely in the medium term, the authors suggest a series of measures to improve the coordination of national fiscal policies in the euro area and increase their ability to play a stabilisation function.³¹ In addition, they recommend steps towards the introduction of automatic stabilisers to counter large shocks in the form of a European unemployment (re)insurance scheme,³² which would require a certain degree of labour market convergence.

²⁴ Kenneth Rogoff, [A Centerless Euro Cannot Hold](#), in: Project Syndicate, 4 April 2012.

²⁵ Quoted in Stefan Vetter, [Do all roads lead to fiscal union?](#), DB Research, 11 April 2013, p. 3.

²⁶ Klaus-Jürgen Gern, Nils Jannsen, Stefan Kooths, [Economic Policy Coordination in the euro area under the European Semester](#), November 2015 (external analysis carried out for the European Parliament's Economic and Monetary Affairs Committee).

²⁷ Agnès Bénassy-Quéré, Xavier Ragot, Guntram B Wolff, [Which Fiscal Union for the Euro Area?](#), Les notes du conseil d'analyse économique, No 29, Paris, February 2016.

²⁸ Céline Allard et al., [Toward a Fiscal Union for the Euro Area](#), IMF Staff Discussion Note, September 2013.

²⁹ A Bénassy-Quéré et al., February 2016, op. cit.

³⁰ For the 2008-2015 period, aggregate fiscal policy was clearly counter-cyclical only in 2009 and 2011.

³¹ Contrary to 'counter-cyclical', 'pro-cyclical' fiscal policy means to increase spending (to lower taxes) in booms and reduce spending (to raise taxes) in recessions. This behaviour is suboptimal, as it is potentially damaging for welfare by raising macroeconomic volatility, depressing investment in real and human capital, and hampering growth (see glossary). In this regard, the authors expect the newly created European Fiscal Board advising the European Commission to 'explicitly distinguish between normal times and exceptional times at the euro area level' (p. 9). See also [Commission Decision \(EU\) 2015/1937 of 21 October 2015 establishing an independent advisory European Fiscal Board](#), OJ L 282, 28 October 2015.

³² The authors do not make a recommendation for a particular unemployment scheme at EU level.

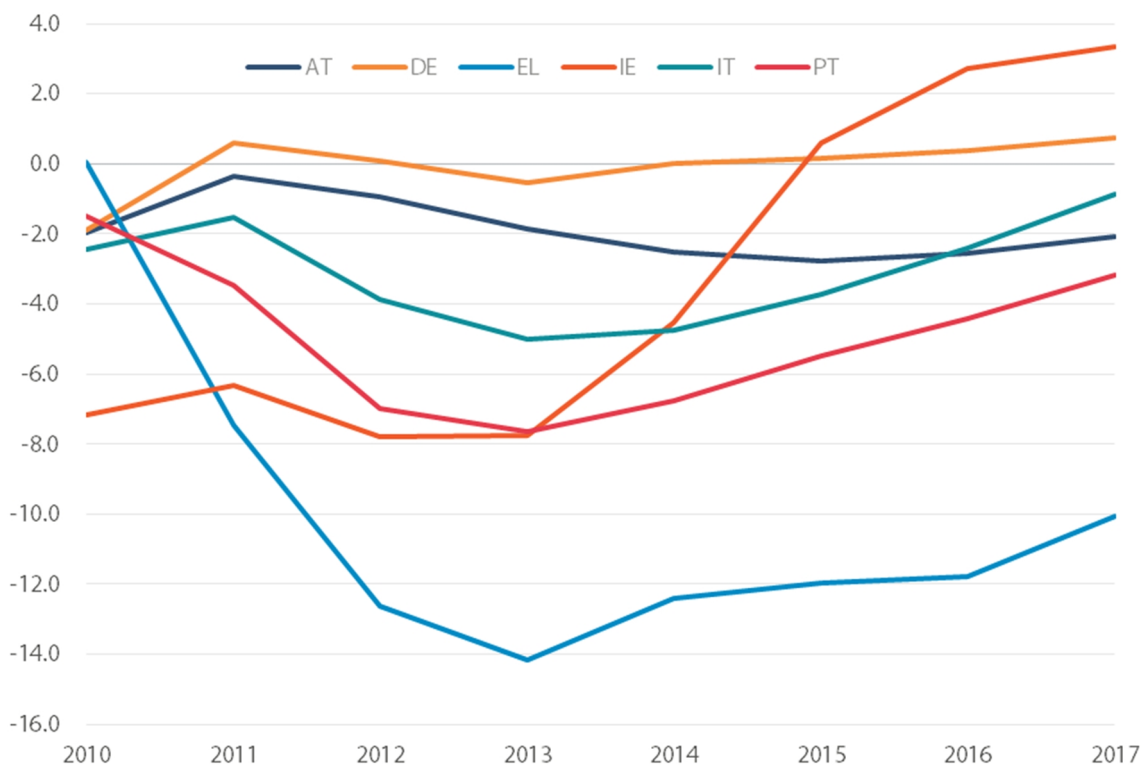
2.2. Heterogeneity in the euro area – stylised data

The concept of economic convergence and divergence within and across Member States is at the heart of the debate on fiscal stabilisation instruments for the monetary union.³³ The section briefly looks at two economic indicators for Austria, Germany, Greece, Ireland, Italy, and Portugal.

Figure 1 displays the different patterns of how the GDP *output gap* developed in six euro area Member States since 2010.³⁴ While Germany remained relatively stable after the peak of the sovereign debt crisis in Europe, Austria, Italy, Portugal, and Greece produced goods and services far below their potential GDP estimates, albeit to a differing degree.

In 2012, the output gap in Austria was -0.94% but -3.89% in Italy, -6.99% in Portugal and -12.6% in Greece. The development in Ireland illustrates the same downward trend up until 2013, but a more rapid recovery thereafter.

Figure 1 – GDP output gap in %, 2010-2016, selected euro-area Member States



Data source: [OECD Economic Outlook No 99](#), June 2016. Output gap: measured as deviation of actual GDP from potential GDP as % of potential GDP, authors' calculation.

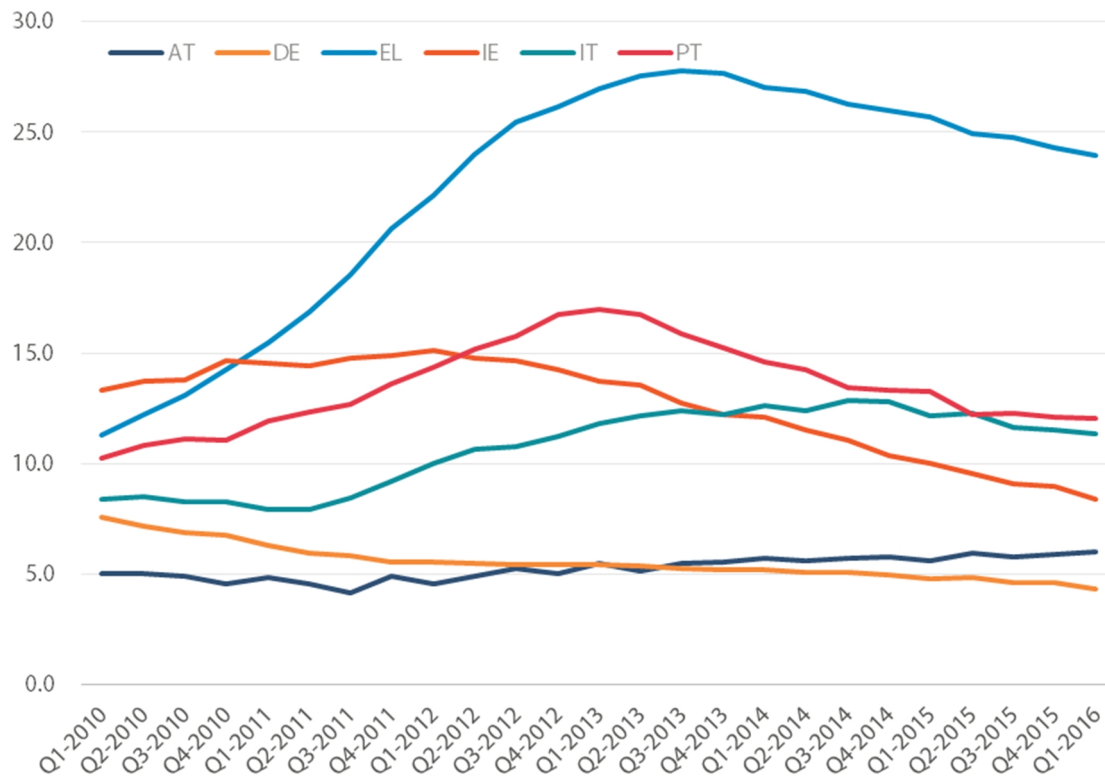
Unemployment figures similarly reveal various paths after the crisis within the euro area (see Figure 2). Of the selected group of countries, only Germany and Ireland managed to reduce unemployment to pre-crisis levels. Demertzis and Wolff warn that 'if differences are too large, it may not be sustainable politically'. However, they also find the dispersion

³³ For a sceptical view, and warning of upcoming distributional conflicts between payer and recipient countries, see Wolfgang Streeck and Lea Elsässer, [Monetary disunion: the domestic politics of euroland](#), in: *Journal of European Public Policy*, Vol. 23, No 1, 2016, pp. 1-24.

³⁴ For the euro area as a whole, the ECB estimates an output gap of 6% for 2014 and 2015. See Marek Jarocinski and Michele Lenza, [How large is the output gap in the euro area](#), European Central Bank, Research Bulletin, July 2016.

of unemployment rates in the euro area comparable to US states, thus 'potentially allowing for a form of partial unemployment insurance'.³⁵

Figure 2 – Unemployment rate in %, 2010-2016, selected euro-area Member States



Data source: [OECD Economic Outlook No 99](#), June 2016. Short-term unemployment rate, Age 15 and over, all persons, quarterly data in %, authors' calculation.

3. Major reform options for a fiscal capacity

The debate on a possible fiscal capacity for the euro area has seen a number of contributions, not necessarily limited to a full-fledged budget. In essence, much of the debate follows two quite different rationales.

One line of reasoning mostly focuses on the *economic* task of how to contain harmful spill-over of idiosyncratic shocks from one Member State to another, or just 'to contain the contagion'. At the same time, it aims to mitigate the negative downturn in a country hit by an asymmetric shock. Proponents of this 'economic' view consider for instance (mostly automatic) stabilisation instruments such as European unemployment insurance, or some emergency funding (e.g. a 'rainy day fund') at EU or euro-area level (see section 3.1). Finding appropriate rules to de-politicise fiscal policy coordination is the main concern.

However, another strand of the discussion leans more towards the *political* dimension of the issue: how to reduce governance complexity and enhance compliance (also of existing provisions such as the Fiscal Compact).³⁶ Some experts also include references

³⁵ Maria Demertzis and Guntram B Wolff, [What are the prerequisites for a euro-area fiscal capacity?](#), background paper, informal ECOFIN meeting, Bratislava, 9 September 2016, p. 8ff.

³⁶ Stanislas de Finance analyses the relatively poor level of compliance with the Treaty on Stability, Coordination and Governance in the Economic and Monetary Union (TSCG). See [Fiscal Compact Treaty: Scorecard for 2015](#), EPRS, 26 June 2016.

to fiscal support for the banking union, which should prevent contagion from crisis-stricken banks spreading to sovereign debts. Key proposals adopting this political focus contain, for instance, the creation of an EU treasury or a dedicated budget for the euro area (e.g. with a focus on supporting structural reforms).

This 'dichotomy', associated with notions of fiscal/budgetary capacity for the euro area, also becomes visible in the first policy documents from EU institutions from 2012, which envisaged steps towards a fiscal union, and coupled budgetary discipline with solidarity tools. Two main functions are identified for an EMU fiscal capacity: (i) promoting structural reforms; (ii) mitigating macro-economic shocks, which affect only some euro-area countries.

These two approaches are, of course, not mutually exclusive, but the two working documents³⁷ of the European Parliament's lead committees on the matter reveal not only the variety of suggestions for how to set up a fiscal capacity but also their underlying assumptions and intended goals. In the run-up to the draft report, the two documents outlined an overview of the debate and summarised a first round of expert hearings.

Table 1 provides a general overview of five different concepts of fiscal capacity for the euro area. They differ according to their rationale and the scope of stabilisation intended, as well as to whether pay-outs should be triggered automatically, or result from political decision-making. Finally, sources of funding also differ. The most-cited reform options are use of **insurance to absorb cyclical shocks** (measured as output gap of GDP, see section 3.1), and two versions to mitigate large swings in unemployment in the monetary union. A **genuine European unemployment insurance** (section 3.2) could top up and continuously support national budgets in economic downturns, while an **unemployment re-insurance fund** (section 3.3.) would only kick in during extraordinary economic crises. Less 'technocratic' options seek to create means that would not only allow mitigation of major macroeconomic shocks, but also support structural reforms in Member States, enhance public investment, and increase domestic demand. Such a **public investment strategy** could build upon the existing EFSI (European Fund for Strategic Investments) framework and eventually become subordinated to a dedicated borrowing-lending institution, such as the ESM (European Stability Mechanism). The two EP committees' draft report suggests eventually transforming the ESM into a European Monetary Fund (see section 4.3.2).³⁸ Finally, a dedicated **euro-area budget**, including some delegated competences for own resources, is advocated by those who consider it would become the nucleus for a genuine euro-area treasury.

The first column, the scope of stabilisation, shows the different major functions implied with the chosen instrument. An absorption fund to counter cyclical shocks (see 3.1.) for instance, predominantly aims for macroeconomic stabilisation. By contrast, supporters of European unemployment insurance (see 3.2) often evoke social policy aims as well. To set up any minimum provision regarding unemployment protection at EU level would

³⁷ European Parliament, [Working Document on a Budgetary capacity for the Eurozone](#), February 2016, op. cit. and [Working Document 2 on a Budgetary capacity for the Eurozone](#), Committee on Budgets, Committee on Economic and Monetary Union, 17 March 2016. See section 4.3.2.

³⁸ European Parliament, [Draft report on a Budgetary capacity for the Eurozone](#), Committee on Budgets, Committee on Economic and Monetary Union, 4 May 2016, Pts 20 & 41.

necessarily imply some form of harmonised labour law, while at the same time it might foster the convergence of European labour markets.³⁹

Table 1 – Overview of proposals discussed

		Stabilisation scope	Payment trigger	Sources of funding
Absorbing cyclical shocks/'rainy day fund'		Macroeconomic	Automatic	Member States' contributions
Unemployment scheme	European Unemployment Insurance	Macroeconomic and social	Automatic	Member States' contributions, or individual contributions
	(Unemployment) Re-insurance fund	Macroeconomic	(semi-)Automatic	Member States' contributions
Public investment strategy (European Monetary Fund)		Macro- and microeconomic	Discretionary	Member States' contributions, 'own resources', capital markets
Euro-area budget (EU treasury)		Macro- and microeconomic	Discretionary	Member States' contributions, 'own resources', borrowing

Source: Authors' compilation. A recent IMF paper⁴⁰ explores options for a 'central fiscal capacity' and applies a similar classification according to the level of political interference (automatic vs discretionary): 1) A so called 'tax-transfer scheme' that could take the form of targeting output gap or unemployment; 2) A 'borrowing-lending scheme' which would entail a central entity, similar to a multilateral bank, and mirrors the proposal of a public investment strategy in table 1; 3) Finally, a 'small euro area budget' which would receive revenues in the form of contributions of Member States.

3.1. Absorbing cyclical shocks (output gap)

Labelled as a 'rainy day fund', 'emergency fund', 'cyclical shock insurance' and similar, this policy proposal is based on the idea of setting up a capacity 'that should accumulate financing through all countries in good times'. According to IMF simulations, such an arrangement, with annual contributions of about 1.5% to 2.5% of GDP, could have substantially increased the overall level of stabilisation, had it existed prior to the outbreak of the euro-area crisis.⁴¹

An article in November 2012⁴² from Notre Europe, a Paris based think-tank, argues that different objectives for EMU fiscal capacity require different budgetary instruments. A budget financed by own resources could support the promotion of structural reforms. However, it would risk overlap with the Cohesion and Structural Funds. Financial support for a banking union would require borrowing or taxation capacity. According to the article, the goal of mitigating asymmetric shocks would be better served by an insurance scheme relying on national contributions.

To this end, a Notre Europe paper⁴³ from 2013 proposes an insurance fund aimed at increasing the convergence of the economic cycles of euro-area Member States. Based on differences in output gaps, this fund would be balanced every year. The authors

³⁹ See e.g. European Parliament, [Draft report on a Budgetary capacity for the Eurozone](#), Committee on Budgets, Committee on Economic and Monetary Union, 4 May 2016, Pt 31.

⁴⁰ International Monetary Fund, [Euro area policies, selected issues](#), IMF Country Report No. 16/220, Washington DC, July 2016, p. 43ff.

⁴¹ Quoted in: European Parliament, March 2016, op. cit., p. 4. However, substantial annual contributions of 1.5% to 2.5% of GDP would likely intensify the debate about avoiding permanent fiscal transfers from booming countries to those experiencing recessions.

⁴² Eulalia Rubio, [Eurozone budget: 3 functions, 3 instruments](#), Tribune, Notre Europe – Jacques Delors Institute, 15 November 2012.

⁴³ Henrik Enderlein, Lucas Guttenberg, Jann Spiess, [Making one size fit all. Designing a cyclical adjustment insurance fund for the eurozone](#), Policy Paper No 61, Notre Europe – Jacques Delors Institute, 23 January 2013.

present a simulation suggesting that net transfers for countries would be close to zero over the long run. Created as an insurance mechanism to prevent the building up of harmful divergences, the authors claim that 'smoothing effects would have been the strongest in times where differences had become the starkest, namely in the run-up to the crisis in 2005-2007, and in the last two years. Almost all EMU founding members would have been close to a net-zero financial position at the end of the simulation period.'

According to analysis by Bruegel,⁴⁴ a think-tank, monetary union requires a central fiscal capacity to ensure stabilisation policies and financial stability, together with the necessary fiscal consolidation. The resources needed to counter asymmetric shocks are estimated at 1% of the area's gross domestic product. The author concludes that, despite some shortcomings, payments based on gaps between output and potential are likely to be the best solution. The system would be neutral over the economic cycle, avoiding permanent transfers. It could include tools promoting the implementation of structural reforms. A borrowing capacity is proposed to counter shocks simultaneously hitting the entire area and provide a fiscal backstop for the banking union. Another 1% of the area's GDP could be needed for these functions.

This approach, to insure against cyclical shock, only aims at the stabilisation of cyclical divergences. It is based on the output gap concept,⁴⁵ which already plays a role in fiscal consolidation policies in the context of the European Semester, but is not uncontroversial. Some consider the output gap to be an imprecise indicator:

'Sensitive payments between countries should not be tied to it. However, the narrow understanding of the economic problem makes it an option based on lean requirements: an administration would only have to oversee the collection and distribution of funds between countries. Legally, it could be imagined within existing treaties and hence within a legislative period As the technical set-up indicates, outcomes are deliberately only in the macroeconomic realm. The question of cross-country redistribution depends on how economies behave towards the average; the mechanism would avoid unidirectional payments only if economies develop similarly in the long-term'.⁴⁶

3.2. European unemployment insurance

Following earlier studies by Dullien in 2007 and 2012,⁴⁷ the European Commission's Directorate-General for Employment, Social Affairs and Inclusion initiated consultative

⁴⁴ Guntram B Wolff, [A budget for Europe's monetary union](#), Bruegel Policy Contribution, 3 December 2012.

⁴⁵ Zsolt Darvas, [Mind the gap \(and its revision\)!](#), Bruegel, 20 May 2015. The methodology used to calculate the output gap has an impact on its estimate, as shown for example by the differences in the estimates produced by the European Commission and the OECD. The Commission estimates play a role in policy-making, since they are used to assess the fiscal adjustment needed in a given year.

⁴⁶ Nathalie J Spath, [Automatic stabilizers for the euro area: What is on the table?](#), Jacques Delors Institut Berlin, Policy Paper No 166, Berlin, 30 June 2016, p. 20.

⁴⁷ Sebastian Dullien, [Improving Economic Stability in Europe. What the Euro Area Can Learn from the United States' Unemployment Insurance](#), Working Paper FG 1, German Institute for International and Security Affairs (SWP), Berlin, 2007. Dullien, [A European Unemployment Insurance as a Stabilization Device –Selected Issues](#), paper prepared for brainstorming workshop at the DG EMPL, Brussels, 2 July 2012. See [DG Employment](#) on the topic.

work on the technical provisions for a European unemployment insurance (EUI).⁴⁸ While there are many different conceivable options, most proposals exclusively focus on short-term unemployment, which mostly reflects cyclical developments. EUI would not deal with structural unemployment related to skills obsolescence or poorly functioning labour market institutions. In a similar vein, most competences regarding the management and design of national unemployment benefit systems would remain with national authorities, while the financing of the 'core part' of unemployment insurance would be shared between euro area countries. In 2015, the Directorate-General for Employment, Social Affairs and Inclusion commissioned a major feasibility study from the Centre for European Policy Studies (CEPS). Their comprehensive overview of the literature finds that:

'When assessing the stabilisation effect of the [European Unemployment Benefit Scheme] EUBS, it is important to look at both the 'average-country' marginal stabilisation effect (the average effect across all member countries during a recession) and the 'true' marginal stabilisation effect (the effect during a recession in the most severely hit countries). Most studies in the literature estimate the stabilisation effect for each country as a ratio between the net balance of payments of the country vis-à-vis the EUBS and the change in aggregate income within that country (for example, deviation of current GDP from its trend). However, it might be advisable to produce an alternative estimate of the stabilisation effect by multiplying the numerator by a fiscal multiplier. Typically, the reviewed studies estimate the average-country marginal stabilisation effect to be between 10% and 30%. The 'true' marginal stabilisation effect is likely to be above 20%.⁴⁹

The EUI is the 'big bang' solution, based on a holistic understanding of macroeconomic stabilisation. A full-scale EUI implies substantial requirements. The indicator of short-term unemployment links absolute numbers to each other, hence introducing a structural element that may not be politically desirable. In administrative terms, it would be necessary to collect and distribute funds all the way to the individual.⁵⁰ The EUI requires at least a minimum harmonisation of labour markets, which is a difficult undertaking, but is a way in itself to provide for more stabilisation in the euro area. However, the main obstacle is the likely requirement for treaty changes – which may make the project one for the coming decades. Cross-country redistributions would have to be weighed against desired stabilisation. The far-reaching set-up of the EUI would lead not only to macroeconomic stabilisation but also provide a clear vision of the political and social integration of the EU.⁵¹ In this regard, some views link this instrument more to social policy aspects than to macroeconomic stability alone.⁵² Fichtner argues that 'such a system is socially and politically desirable, since it would set a minimum standard

⁴⁸ An informative European Commission Q&A can be found [here](#). See also László Andor, [Basic European Unemployment Insurance – The Best Way Forward in Strengthening the EMU's Resilience and Europe's Recovery](#), in: *Intereconomics*, Vol. 49, July/August 2014, pp. 184-189.

⁴⁹ Miroslav Beblavý, Gabriele Marconi, Ilaria Maselli, [A European Unemployment Benefit Scheme. The rationale and the challenges ahead](#), Centre for European Policy (CEPS), Brussels, August 2015, p. 20.

⁵⁰ For an overview of different unemployment systems see e.g. Florence Lefresne, [Unemployment benefit systems in Europe and North America: reforms and crisis](#), European Trade Union Institute (ETUI), Brussels, 2010.

⁵¹ Spath, 2016, op. cit.

⁵² This is made explicit in the EPRS Cost of Non-Europe report on European unemployment insurance, a report, commissioned by Parliament's Committee on Employment and Social Affairs. Micaela Del Monte, Thomas Zandstra, [Common unemployment insurance scheme for the euro area](#), Cost of Non-Europe Report, EPRS, September 2014.

for the level of social protection in the participating countries without necessarily enforcing harmonisation of unemployment insurance schemes across Europe^{1,53}

3.3. (Unemployment) Re-insurance fund

In January 2015, Beblavý et al.⁵⁴ made the case for a re-insurance mechanism and showed that such a system delivers, for a small average contribution, large shock-absorption capacities. Unlike the reform option in section 3.2, such a re-insurance system would only set in during an extraordinary economic downturn. According to the authors, 'due to a threshold issue, it is not suitable for EU-level absorption of small national shocks. It is rather meant to deliver a large punch once activated, which should occur only in case of major events for the labour market. Had such a scheme been in place in the EU during the period 2000-2012, it would have been triggered 40 times'.⁵⁵

A re-insurance fund 'would offer assistance only in the case of severe crisis, a very understandable approach with a clear selling point. It involves labour markets only indirectly', with the standard deviation of a country's short-term unemployment rate as the indicator. Requirements for labour market harmonisation would be low – unlike in the case of a genuine insurance model above (3.2). Here a body would have to be created that decides when the threshold for payments is met. Such a construct is not only difficult politically but requires appropriate democratic control, with additional questions surrounding the legal design. It remains unclear whether treaty changes would be necessary. Cross-country redistribution would have to be weighed against desired stabilisation. Outcomes of the mechanism are mainly macroeconomic.⁵⁶

3.4. Pros and cons of automatic stabilisers

In a 2016 paper, Spath analyses the pros and cons of the three major reform options sketched out earlier. Table 2 summarises the findings: Red cells indicate the major flaws of the proposals and obstacles, yellow cells indicate difficulties that can be overcome, and green cells are used when no flaws or major problems are identified. Grey cells are used where a judgement is not possible, or inappropriate. Instruments based on output gap estimates suffer from the imprecision of the indicator. On the other hand, such an instrument would not interfere with national labour markets and its implementation would not require Treaty change. A genuine European unemployment insurance on the other hand appears to be more demanding in legal terms. The biggest challenge for a re-insurance approach remains in finding an adequate threshold for when to trigger payouts. In other terms, how to determine as of what magnitude a euro-area wide system should deliver its stabilisation capacity.

⁵³ Ferdinand Fichtner, Euro area-wide unemployment insurance: useless, desirable, or indispensable?, in: David Natali (ed.), [Social developments in the European Union 2013](#), European Trade Union Institute (ETUI), Brussels, 2014, pp. 127; 129.

⁵⁴ Miroslav Beblavý, Daniel Gros, Ilaria Maselli, [Reinsurance of National Unemployment Benefit Schemes](#), Centre for European Policy (CEPS), Brussels, January 2015.

⁵⁵ The scheme is triggered when the actual short-term unemployment exceeds the sum of the 10 year average and a multiple of the standard deviation of the short-term unemployment rate. An 'extraordinary economic downturn' is defined as unemployment shock with a standard deviation equal to 2, Beblavý et al., p. 13.

⁵⁶ Spath, 2016, op. cit., p. 20.

Table 2 – Assessment of proposals

	Absorbing cyclical shocks (output gap)	European unemployment insurance	(unemployment) re-insurance fund
Rationale	Cyclical divergence only	Overall stability	Large shocks only
Indicator	Output gap, imprecise	Absolute values of short-term unemployment carry structural component	Standard deviation of short-term unemployment
Administrative requirements	Collection and distribution of funds at country level	Collection and distribution of funds at individual level	Decision when threshold for payments is met
Labour market harmonisation	Labour markets not involved	To insure similar risks, minimum harmonisation necessary	Labour markets not directly involved
Legal requirements	Implementation within primary law (four years)	Implementation with treaty changes (10 years)	Implementation within primary law not clear
Moral hazard	ex ante, ex post	Especially ex ante, ex post	ex ante, ex post
Output (payments)	Cross-country distribution avoided if similar long-term development	Trade-off between degree of cross-country redistribution and automatic stabilisation effects	
Outcome	Mainly macroeconomic	Macroeconomic and social	Mainly macroeconomic

Source: Spath, 2016, p. 19.

3.5. Policy challenges

In this section we retain the structure of the European Parliament's second working document⁵⁷ on budgetary capacity for the euro area.

3.5.1. Size

The working document mentions the challenge of the proportional decrease in political feasibility to set up a fiscal capacity relative to its size. However, 'if the capacity was solely dedicated to macroeconomic stabilisation it has been shown by several studies that a small budget could produce significant temporary transfers. This was especially the case if it should concentrate on big shocks and would be balanced over the whole cycle. A facility with a size of approximately 1.5% to 3% of euro-area GDP could make major contributions to stabilisation'.⁵⁸

An opinion paper from the CEPS think-tank⁵⁹ argues that the stability of the euro area depends on completing the banking union, rather than on the creation of a fiscal capacity in the form of a common budget. When comparing the US state of Nevada with Ireland, the author says that the former was hit less severely by its housing bubble because its banks' losses were mainly taken up by federal institutions. Such support brought a significant transfer from the centre to the local level.

3.5.2. Convergence

The experts' hearing accompanying the European Parliament draft report revealed a major concern: whether the lack of convergence creates the risk of permanent transfers.⁶⁰ The greater the heterogeneity of the monetary union and the longer differences persist, the greater the probability that shock-absorbing instruments will contain such permanent transfers. Growing economic divergence threatens the validity of instruments which can be conceived to be budgetary neutral over the economic

⁵⁷ European Parliament, March 2016, op. cit.

⁵⁸ Ibid., p. 5.

⁵⁹ Daniel Gros, [The False Promise of a Eurozone Budget](#), Centre for European Policy Studies (CEPS), 7 December 2012.

⁶⁰ European Parliament, March 2016, op. cit., p. 6.

cycle.⁶¹ While the indicator output gap remains contested, both the genuine unemployment insurance as well as its re-insurance variant's efficiency are dependent on some convergence in the euro-area labour market.

3.5.3. Moral hazard

Similar to any other policy instrument in insurance form, the risk of moral hazard needs to be acknowledged and mitigated. While it is impossible (and useless) to design a system which would entail zero redistribution on an annual basis, any fund-based instrument should be able to transfer temporarily (across time or geographically), to achieve fiscal neutrality in the long run. After presenting four options for fiscal capacity (common budget, insurance-type tool against output gaps, unemployment insurance scheme, equalisation of interest burden on government bonds), a Deutsche Bank Research paper⁶² notes that use of stabilisation tools may be in the interest of all euro area countries. It underlines the need for strong mechanisms to counter moral hazard.

4. Discussions at EU level

4.1. Interinstitutional initiatives

4.1.1. Report of the four Presidents

In 2012, the then European Council President, Herman Van Rompuy, worked on a roadmap for a genuine EMU, in cooperation with the Presidents of the European Commission, the ECB and the Eurogroup. To consolidate EMU over the next decade, the June 2012 **Van Rompuy report**⁶³ identified four building blocks, including an integrated budgetary framework. Under this heading, possible steps towards a fiscal union are envisaged by coupling budgetary discipline with solidarity tools. In addition to the possible creation of a treasury office for the euro area, the document underlines the need to define the appropriate role and functions of a central budget.

The December 2012 report of the **four Presidents**⁶⁴ further explored these ideas. While reaffirming that sound national budgetary policies are the cornerstone of EMU, the text notes that all other currency unions have a central fiscal capacity. Imagining the gradual creation of a fiscal capacity for the euro area, the report identified two complementary functions for this fiscal capacity: 1) promoting structural reforms (2013-2014); and 2) mitigating asymmetric shocks (post 2014). The fiscal capacity would be kept separate from the EU's multiannual financial framework (MFF), which does not cover these objectives. Financing could be ensured through 'own resources', national contributions, or a combination of both. The possibility to provide the scheme with the ability to borrow would be investigated in the longer term. As regards the shock absorption function, the text outlined a series of principles, suggesting that the scheme could work as an insurance-type system between euro-area Member States. Each country would in turn contribute to and benefit from the scheme on the basis of its position over the economic

⁶¹ Enderlein et al. simulate the effects of a cyclical adjustment insurance fund, based on an output gap indicator, for Germany: 'The overall net balance of Germany between 1999 and 2014 would have been balanced at 0.01% of GDP, with peaks of transfers reaching around 0.8% in both directions.' Enderlein et al., 2013, op. cit., p. 7.

⁶² Vetter, 2013, op. cit.

⁶³ Herman Van Rompuy, 26 June 2012, op. cit.

⁶⁴ Herman Van Rompuy et al., [Towards a Genuine Economic and Monetary Union](#), European Council, European Commission, Eurogroup, European Central Bank, 5 December 2012.

cycle. Unidirectional or permanent transfers should be explicitly avoided. Appropriate mechanisms should be established so as to limit moral hazard.

In December 2012, EU leaders discussed the report of the four Presidents. As regards fiscal capacity, their conclusions⁶⁵ only referred to contracts for competitiveness and growth that could be coupled with solidarity mechanisms. According to press sources,⁶⁶ the push for more integration lost political momentum in 2013 due to the decreased pressure from financial markets following the presentation of the ECB's bond-buying programme (OMT).

4.1.2. Five Presidents' Report

In 2014, new terms of office began for the European Parliament (following the European elections in May), the European Commission (following Parliament's approval of the new college of Commissioners led by President-elect Jean-Claude Juncker in October), and the European Council (with Donald Tusk replacing Van Rompuy as President that year). This contributed to reviving the debate on strengthening EMU. The Commission President worked on a new interinstitutional report on the completion of EMU in cooperation with the Presidents of the European Council, the Eurogroup, the ECB and the European Parliament.

Published in June 2015, the **Five Presidents' Report**⁶⁷ builds on the report of the four Presidents, as well as on a number of Commission documents. The text identifies four building blocks to complete EMU: 1) towards economic union (convergence, prosperity and social cohesion); 2) towards financial union (integrated finance for an integrated economy); 3) towards fiscal union (an integrated framework for sound and integrated fiscal policies)⁶⁸; and 4) democratic accountability, legitimacy and institutional strengthening. According to the related roadmap, EMU should be completed at the latest in ten years' time, by means of three subsequent stages: 1) immediate steps (July 2015-June 2017); 2) completing the EMU architecture (for a period of up to seven to eight years); and 3) final stage (by 2025).

As for the fiscal stabilisation function, the report says that, in the first stage, efforts should rather focus on strengthening the current governance framework through the establishment of an advisory European Fiscal Board. This new board should contribute to 'better compliance with the common fiscal rules, a more informed public debate, and stronger coordination of national fiscal policies.' However, noting that all mature currency unions have established a common macroeconomic stabilisation function, the text adds that this process of convergence and further pooling of decision-making on national budgets should result in the creation of euro-area stabilisers during stage two.

⁶⁵ [European Council conclusions on completing EMU](#), 14 December 2012.

⁶⁶ Peter Spiegel, [Fiscal union: Integration put on back burner](#), *Financial Times*, 8 May 2013.

⁶⁷ Jean-Claude Juncker, Donald Tusk, Jeroen Dijsselbloem, Mario Draghi, Martin Schulz, [Completing Europe's Economic and Monetary Union](#) ('Five Presidents' Report'), 22 June 2015.

⁶⁸ The House of Lords' European Union Committee was critical that "'Fiscal Union" is not defined in the Five Presidents' Report. Perhaps this was deliberate but we are alarmed that such a key component of that report remains such a nebulous concept and was interpreted in so many different ways by our witnesses.' However, the Committee acknowledges that 'some form of stabilisation function would be necessary and this would entail transfers between Member States'. House of Lords, UK Parliament, ['Whatever it takes': the Five Presidents' Report on completing the Economic and Monetary Union](#), European Union Committee, 13th Report of Session 2015-16, HL Paper 143, London, 12 May 2016, Pts 176, 177.

While indicating that the design of such stabilisers requires additional research, the report outlines their guiding principles, which recall and further develop those given in the four Presidents' report: stabilisers should not lead to permanent transfers; they should be closely linked to compliance with the broad EU governance framework, with a view to preventing moral hazard; and they should be established within the EU framework, being open and transparent vis-à-vis all EU Member States. In addition, stabilisers should not be used as a tool to manage crises (since the ESM already plays this role), but to mitigate large macroeconomic fluctuations (thus making use of the ESM less likely). The text gives the European Fund for Strategic Investments (EFSI) as an example of an existing tool on which a fiscal stabilisation function could be built.

A number of commentators considered⁶⁹ that the document was the prudent result of many compromises. Other analysts said⁷⁰ that the Five Presidents' Report was less ambitious than the Commission's 2012 'blueprint', but also less controversial and more realistic as regards its possible implementation.

A study for the High-Level Group on Own Resources

The interinstitutional High-Level Group on Own Resources (HLGOR),⁷¹ chaired by former Italian Prime Minister, Mario Monti, is currently examining possible reform options for financing the EU. While the HLGOR focuses on the EU budget, a study⁷² commissioned for its work devotes one section to the topic of a possible euro-area budget. This section says that the appropriate financing resources would depend on the function pursued through such a tool. If the chosen objective was the common management of at least a fraction of public debts, financing resources should have stable and reliable yield. On the contrary, volatile resources (such as a portion of a corporate income tax or of value added tax) that are sensitive to economic fluctuations in the country hit by the crisis, would better suit a macroeconomic stabilisation function.

4.2. European Commission

4.2.1. Barroso Commission

The Commission's contribution to the report of the four Presidents, 'A blueprint for a deep and genuine EMU',⁷³ envisaged three phases:

Short term (2013-2014): the creation, within the EU budget (but outside the MFF), of a 'convergence and competitiveness instrument' (CCI), to provide financial support to structural reforms in Member States.

Medium term (2014-2017): building on the CCI, the creation of a dedicated fiscal capacity for the euro area, using only own resources.

Long term (post 2017): the creation of a euro-area budget with stabilisation objectives by developing a fiscal capacity.

⁶⁹ Beda Romano, [Eurozona, riforma in tre tappe. Ma per i federalisti è una delusione](#), in: *Il Sole 24 Ore*, 21 June 2015.

⁷⁰ Marek Dabrowski, [Written evidence to the House of Lords' EU Financial Affairs Sub-Committee](#), London, 13 January 2015.

⁷¹ The interinstitutional [High-Level Group on Own Resources \(HLGOR\)](#) was established in February 2014 and is composed of Members designated by the EP, the Council, and the Commission.

⁷² Jorge Núñez Ferrer, Jacques Le Cacheux, Giacomo Benedetto, Mathieu Saunier, [Study on the potentials and limitations of reforming the financing of the EU budget](#), Expertise commissioned by the European Commission on behalf of the High-Level Group on Own Resources, 3 June 2016.

⁷³ European Commission, [A blueprint for a deep and genuine economic and monetary union. Launching a European Debate](#), COM(2012) 777 final/2, 30 November 2012.

The Commission indicated that medium- and long-term actions may require treaty changes, such as provisions for a dedicated budgetary and own resources procedure. If the fiscal capacity were to be able to borrow or to raise taxes, amendments would also be needed as this is currently forbidden (Articles 310 and 311 TFEU).

In March 2013, the Commission published a communication⁷⁴ outlining the possible features of a CCI, the instrument that was envisaged in its blueprint as a first step in the creation of a fiscal capacity for the euro area. On the one hand, the CCI would encompass 'contractual arrangements' through which Member States commit themselves to structural reforms deemed to address key weaknesses in their economies. On the other hand, it would imply conditional financial incentives that should help Member States implement those reforms. Either national contributions or new specific financial resources could ensure financing. The Commission suggested including the instrument in the EU budget outside the MFF ceilings⁷⁵ and financing it with external assigned revenue.⁷⁶ Its financial resources would be limited in the beginning, but could be increased at a later stage if the CCI proves to be effective. A concrete proposal was originally expected by the end of 2013 following discussions with Parliament and Council, but did not appear. In December 2013, the European Council concluded⁷⁷ that further work would be devoted to possible contractual arrangements and associated solidarity mechanisms, including the exact nature, the institutional form and volume of support of the latter.

The Commission carried out a number of activities to further investigate options for automatic stabilisers, as shown by 2013 and 2014⁷⁸ conferences on a possible European unemployment benefit scheme organised in cooperation with the Bertelsmann Stiftung.

4.2.2. Juncker Commission

In his July 2014 'political guidelines' for the next Commission, Jean-Claude Juncker identified ten priorities, including one on delivering a deeper and fairer EMU.⁷⁹ To this end, President Juncker expressed his intention to launch both legislative and non-legislative initiatives to strengthen EMU, including proposals to promote further structural reforms, to be coupled, if needed, with additional financial incentives and a targeted fiscal capacity for the euro area.

⁷⁴ European Commission, [Towards a Deep and Genuine Economic and Monetary Union. The introduction of a Convergence and Competitiveness Instrument](#), COM(2013) 165 final, 20 March 2013.

⁷⁵ For each major category of EU expenditure, the MFF details the maximum annual amount ('ceiling') that the EU can commit. In addition, the MFF sets an annual ceiling for overall payments.

⁷⁶ The general principles governing the EU budget include that of universality, in line with which budget revenue is to be used without distinction to finance all items of expenditure. Article 21 of the EU's Financial Regulation ([Regulation \(EU, EURATOM\) No 966/2012](#) of the European Parliament and of the Council) allows for exceptions to the principle of universality, indicating the cases in which a given revenue finances specific items of expenditure (assigned revenue).

⁷⁷ European Council [Conclusions](#), 19/20 December 2013.

⁷⁸ European Commission; Bertelsmann Stiftung, '[Automatic stabilizers for the Eurozone: pros and cons of a European Unemployment Benefit Scheme](#)', conference, Brussels, 11 October 2013. European Commission; Bertelsmann Stiftung, '[Economic shock absorbers for the Eurozone. Deepening the debate on automatic stabilizers](#)', conference, Brussels, 20 June 2014.

⁷⁹ Jean-Claude Juncker, [A New Start for Europe: My Agenda for Jobs, Growth, Fairness and Democratic Change. Political Guidelines for the next European Commission](#), 15 July 2014. For details on progress on the priorities, see Étienne Bassot and Wolfgang Hiller, [The Juncker Commission's ten priorities: State of play in mid 2016](#), EPRS, May 2016.

On 24 October 2014, the Euro Summit called⁸⁰ for work to continue, in close cooperation with the European Commission, on the development of concrete tools for stronger economic policy coordination, convergence and solidarity. This was confirmed by the December 2014 European Council, which tasked⁸¹ the Commission President with analysing closer coordination of economic policies for the smooth functioning of EMU in close cooperation with the Presidents of the Euro Summit, the Eurogroup and the ECB. The mandate resulted first in an analytical note in February 2015⁸² and subsequently in the Five Presidents' Report of June 2015 (see above). The February 2015 note said that both the Four Presidents' Report and the Commission's 2012 blueprint remained valid, reaffirming the need for the development of a long-term perspective on EMU and for the identification of its components requiring stronger common governance.

On 21 October 2015, the European Commission established an independent advisory European Fiscal Board⁸³ in line with the ideas outlined in the Five Presidents' Report for the immediate steps (July 2015-June 2017) on the road towards fiscal union. This was part of a broader package of measures⁸⁴ meant to start the concrete implementation of the Five Presidents' Report (stage 1).

In November 2015, the European Commission tabled a proposal⁸⁵ to establish a Structural Reform Support Programme and to endow it with €142.8 million for the 2017-2020 period by transferring resources allocated to technical assistance under the European Structural and Investment Funds. The objective of the proposal is to provide, upon request of a Member State, support for the implementation of structural reforms (e.g. related to Country Specific Recommendations issued in the context of the European Semester or linked to economic adjustment programmes for Member States receiving Union financial assistance).⁸⁶

In March 2016, the Commission presented a first outline of the European Pillar of Social Rights,⁸⁷ with a view to creating a reference framework to promote more convergence in the fields of employment and social performance within the euro area. In July 2016, the Centre for European Policy Studies (CEPS) think-tank organised a conference on a possible European unemployment insurance scheme to stabilise EMU. In a keynote speech, the European Commissioner for Employment, Social Affairs, Skills and Labour

⁸⁰ [Euro Summit statement](#), Brussels, 24 October 2014.

⁸¹ European Council [Conclusions](#), 18 December 2014.

⁸² Jean-Claude Juncker, [Analytical note, Preparing for Next Steps on Better Economic Governance in the Euro Area](#), European Commission, 12 February 2015.

⁸³ European Commission, [Decision establishing an independent advisory European Fiscal Board](#), (EU) 2015/1937, Brussels, 21 October 2015, OJ L 282, 28 October 2015. See also Alice Zoppè and Lorenzo Donatelli, [The advisory European Fiscal Board](#), European Parliament, Economic Governance Support Unit, 24 February 2016.

⁸⁴ European Commission, [Completing Europe's Economic and Monetary Union: Commission takes concrete steps to strengthen EMU](#), press release IP/15/5874, 21 October 2015.

⁸⁵ European Commission, Proposal for a Regulation of the European Parliament and of the Council on the establishment of the Structural Reform Support Programme for the period 2017 to 2020, [COM\(2015\) 701 final](#). See European Parliament, Legislative observatory [2015/0263\(COD\)](#).

⁸⁶ Agnieszka Widuto, [Structural reform support programme 2017-2020](#), EPRS, July 2016. The Committee of the Regions (Opinion [CDR1214/2016](#)) supported the proposal, stressing that it should be considered a pilot programme and that the suggested way of financing it can only be a temporary solution.

⁸⁷ European Commission, [Commissioner Thyssen presents Commission's Social Package: First outline of the European Pillar of Social Rights and reform of the Posting of Workers Directive](#), Speech 16/682, Brussels, 8 March 2016.

Mobility, Marianne Thyssen, noted⁸⁸ that national unemployment insurance schemes and labour market policies should be reformed to allow a euro-area unemployment benefit scheme to achieve its objectives.

In the debate on the future of the EU that followed the result of the UK referendum in June 2016, Pierre Moscovici, European Commissioner for Economic and Financial Affairs, Taxation and Customs, strongly supported the idea of a dedicated budget and finance minister for the euro area.⁸⁹

4.3. European Parliament

The European Parliament (EP) actively participates in the debate on EMU governance, including the possible introduction of economic stabilisers for the euro area. For example, in a 2010 resolution⁹⁰ the EP urged the EU to better equip itself with countercyclical tools for fiscal policy. Two years later, the EP adopted a resolution⁹¹ on the future of EMU, while considering it democratically unacceptable that its President had not been involved in the drafting of the report of the four Presidents. According to the EP, the acknowledgment that the smooth functioning of EMU requires a move towards a fiscal union was an important step forward. The resolution included a series of recommendations to this end. As regards budgetary aspects, the EP was of the opinion that a well-functioning EMU requires an increased capacity within the framework of the EU budget. This should be achieved through genuine and specific own resources.⁹² In addition, the EP called for the democratic legitimacy and accountability of EMU governance to be strengthened.

4.3.1. Scrutiny of economic governance

In the wake of the crisis, the architecture of EMU appears increasingly complex. Crisis-resolution measures were adopted through different methods, which can involve varying groups of countries. This poses a series of challenges, including from an institutional standpoint. Decisions taken outside the EU framework have generally seen only limited European Parliament involvement. In some cases, the response to the crisis raised questions about the democratic control and legitimacy of anti-crisis decision-making.⁹³ In a series of resolutions, the EP has stressed the need for proper scrutiny and accountability. The level at which this should occur is debated.

⁸⁸ Marianne Thyssen, [Speech at High-Level Conference on European Unemployment Insurance](#), CEPS 'Stabilising the EMU through European unemployment insurance: Final conference, Brussels, 11 July 2016.

⁸⁹ e.g.: Un budget pour la zone euro et plus d'investissements pour surmonter le Brexit, in: *Libération*, 3 July 2016. According to an academic view, upcoming 'Brexit' negotiations might even offer 'a window of opportunity for a broader constitutional reform of the EU'. Federico Fabbrini, [How Brexit Opens a Window of Opportunity for Treaty Reform in the EU](#), Bertelsmann Stiftung, spotlight Europe, No 1, 2016.

⁹⁰ European Parliament, [Financial, economic and social crisis: Recommendations concerning the measures and initiatives to be taken \(mid-term report\) \(2009/2182\(INI\)\)](#), Strasbourg, 20 October 2010.

⁹¹ European Parliament, [Towards a genuine Economic and Monetary Union \(2012/2151\(INL\)\)](#), 20 November 2012.

⁹² Alessandro D'Alfonso, [How the EU budget is financed: The 'own resources system' and the debate on its reform](#), EPRS, June 2014.

⁹³ Eva-Maria Poptcheva, [Parliament's role in anti-crisis decision-making](#), European Parliament Library Briefing, 17 December 2012.

Both the report of the four Presidents⁹⁴ and the Commission's blueprint⁹⁵ say that any further strengthening of EMU requires strong mechanisms for accountability and democratic legitimacy. These should occur at the level where decisions are made. The EP is indicated as the best-placed institution to take the common interests of the EU into account and to carry out these functions for decisions made at EU level. The role of national parliaments in economic governance is also noted.

As regards fiscal capacity, the report of the four Presidents says that its creation should include arrangements ensuring full democratic legitimacy and accountability. 'The details of such arrangements would largely depend on [the fiscal capacity's] specific features, including its funding sources, its decision-making processes and the scope of its activities.'

The Notre Europe analysis⁹⁶ says that the EP would be better placed to exercise control over a budget endowed with own resources to promote structural reforms. On the contrary, a fiscal capacity functioning as an insurance scheme funded by national contributions should be controlled by the parliaments of the participating countries.

According to the Commission's blueprint, national parliaments will always have a crucial role in ensuring the legitimacy of Member States' actions (national budgetary and economic policies as well as action in the European Council and in the Council), independent of the final design of EMU. The document adds that democratic legitimacy for EU decisions cannot be ensured by means of interparliamentary cooperation, but requires a representative assembly in which votes can be taken, with the EP providing that assembly for the EU and for the euro. Along the same lines, a report⁹⁷ by the European Parliament's Secretary-General on the future of the EP considers that, should a euro area budget be created, only the EP would have the necessary pan-European structure and perspective to provide it with legitimacy.

In 2012, Parliament's President, Martin Schulz, proposed⁹⁸ that a specific committee be set up within the EP in charge of democratic scrutiny of EMU issues. The committee should be composed of Members of the European Parliament from participating Member States. Opponents of the idea argued that, as representative of EU citizens, the EP is institutionally indivisible along national lines. A number of policy contributions, such as the 2013 Franco-German paper on the future of EMU, envisaged specific structures for the euro area within the EP. However, discussions on the topic currently appear to be in deadlock, and no specific committee or subcommittee for the euro area has been established within the Parliament to date.

Examining the legal options available for an additional EMU fiscal capacity, a European Parliament Policy Department study,⁹⁹ requested by the Committee on Constitutional Affairs, concludes that this could be created under the existing Treaties if it is designed

⁹⁴ Herman Van Rompuy et al., 5 December 2012, op. cit.

⁹⁵ European Commission, 30 November 2012, op. cit.

⁹⁶ Rubio, 2012, op. cit.

⁹⁷ Cabinet of the Secretary-General, [Preparing for complexity. European Parliament in 2025](#), EP 2025 Long-term trends team, European Parliament, January 2013.

⁹⁸ Quoted in: European Parliament, [Conference of Presidents – Minutes](#), 6 December 2012 and [Conference of Presidents – Minutes](#), 7 March 2013. The President's reflection note (EP Document no. PE502.355/CPG) is not publicly available.

⁹⁹ René Repasi, [Legal options for an additional EMU fiscal capacity](#), European Parliament, Policy Department C, 2013.

as an enforcement mechanism with assigned revenue promoting structural reforms. In this case, the EP should play a supervisory role for the fiscal capacity on the basis of EU budgetary law. As regards 'contractual arrangements', the EP would be involved in their implementation, but not in their negotiation and conclusion. On the other hand, only parts of an insurance-type tool to mitigate asymmetric shocks could be created under current EU law. Some issues, notably those of democratic accountability, would require treaty changes.¹⁰⁰

From a different perspective involving significant reforms, another EP Policy Department study¹⁰¹ suggests the creation of a new European political space. EP elections would become a competition to form the government of Europe. An increased EU budget funded by real own resources would play the fiscal stabilisation role in this context. A paper¹⁰² by the European Policy Centre think-tank also envisages a reformed EU budget with some degree of fiscal sovereignty to include a shock absorption function.

In a May 2013 resolution¹⁰³ on future EMU legislative proposals, the EP reaffirmed the need for proper democratic scrutiny of economic governance, while stressing that full implementation of the new governance framework (Six- and two-pack provisions), then recently agreed, should have priority over any further proposals. For a possible convergence and competitiveness instrument (CCI), Parliament formulated a series of recommendations. The instrument should be based on conditionality, solidarity and convergence and avoid overlapping with cohesion policies. It should be adopted through the ordinary legislative procedure, providing conditional support for structural reforms enhancing competitiveness, growth and social cohesion.¹⁰⁴ As such, it could represent a step towards a true fiscal capacity. It should apply to the euro area, but also be open to other Member States. In a December 2013 resolution,¹⁰⁵ the EP again stressed the need to ensure the democratic legitimacy of any further strengthening of EMU (including steps towards a fiscal union), by appropriately involving the EP, the only directly elected EU institution.

4.3.2. Some relevant activities during the 2014-2019 term of office

Contrary to the previous 2012 interinstitutional report, the EP President took part in the drafting of the 2015 Five Presidents' Report. In addition, the EP closely monitors progress on the ten priorities of the Juncker Commission, including that focused on delivering a

¹⁰⁰ See for a similar assessment, the Committee on Constitutional Affairs (AFCO) [opinion](#) on budgetary capacity for the Eurozone, European Parliament, 14 September 2016, Pt 9: 'if a budgetary capacity were to aim at providing incentives for structural reforms, it could be established on the basis of the current Treaties, if need be, through enhanced cooperation; notes that Articles 121(6) and 136 TFEU would provide the appropriate legal basis for such a mechanism; notes, however, that if the objectives of the fiscal capacity were broader and more ambitious, then it would be necessary to make use of Article 352 TFEU.'

¹⁰¹ Miguel Poiaras Maduro, [A new governance for the European Union and the euro: Democracy and Justice](#), European Parliament, Policy Department C, 2012.

¹⁰² Francesco Nicoli, [Pathways to achieve a Genuine Fiscal Union](#), European Policy Centre, 3 June 2013.

¹⁰³ European Parliament, [Resolution on future legislative proposals on EMU: response to the Commission communications, 2013/2609\(RSP\)](#), 23 May 2013.

¹⁰⁴ On structural reforms and social policy see Jan Arpe, Simona Milio, Andrej Stuchlik (eds.), [Social Policy Reforms in the EU: A Cross-national Comparison. SIM-Reform Barometer](#), Bertelsmann Stiftung, Gütersloh, October 2015.

¹⁰⁵ European Parliament, Constitutional problems of a multitier governance in the EU ([P7_TA\(2013\)0598](#)), 12 December 2013.

deeper and fairer EMU. The EP also plays an active role in the debate on the future of EMU.

With a view to providing Parliament's contribution to the white paper planned by the Commission for 2017, the EP's Committee on Budgets (BUDG) and Committee on Economic and Monetary Affairs (ECON) are jointly preparing an own initiative report on a budgetary capacity for the euro area. The draft report (rapporteurs: Reimer Böge, EPP, Germany; and Pervenche Berès, S&D, France) was presented in May 2016.¹⁰⁶

The text identifies a number of general principles; noting the importance of preventing permanent transfers and moral hazard by means of convergence, good governance and conditionality, enforced by institutions democratically accountable at euro area and national level. In addition, fiscal capacity should be established within the EU legal framework, be in addition to existing EU funding instruments, and be endowed with sufficient resources to effectively carry out its economic stabilisation role for the euro area. The document identifies three complementary functions for such a fiscal capacity: 1) promoting convergence and the implementation of structural reforms; 2) absorbing asymmetric shocks; and 3) absorbing symmetric shocks. In particular, as regards the absorption of asymmetric shocks, the establishment of a tool to address such shocks at euro-area level is deemed crucial for the stability of the currency area. Reference is made to the alternative models of a 'rainy day fund' and of a European unemployment benefit scheme, considering that a **European Monetary Fund (EMF)** built on the current European Stability Mechanism (ESM) should finance either of these. With over 800 amendments to the draft report tabled,¹⁰⁷ the tentative calendar for the procedure currently schedules possible adoption of the report by the joint committee in October 2016, with a vote in plenary at the end of the following month.

In July 2016, Members of the two committees presented differing views¹⁰⁸ when participating in a debate on a possible euro-area budget together with eight finance ministers from the currency area.

The EP's Committee on Constitutional Affairs (AFCO) is currently preparing two own-initiative reports,¹⁰⁹ which are relevant to the debate on the future of EMU, including the possible introduction of a fiscal capacity for the euro area. The January 2016 draft report on improving the functioning of the EU, building on the potential of the Lisbon Treaty (rapporteurs: Mercedes Bresso, S&D, Italy; and Elmar Brok, EPP, Germany) calls for the establishment of a fiscal capacity for the euro area – within the EU budget, but outside the ceilings of the multiannual financial framework (MFF). Funded with real own resources, the fiscal capacity would be an instrument to support the implementation of agreed structural reforms in Member States, through a system of incentives and conditions. This tool is seen as a step towards the establishment of a European Treasury, which would be accountable to the European Parliament. The July 2016 draft report on possible developments of and adjustments to the current EU institutional set-up (rapporteur: Guy Verhofstadt, ALDE, Belgium) calls for a fiscal capacity for the euro area

¹⁰⁶ European Parliament, Draft report on a Budgetary capacity for the Eurozone, 4 May 2016, op. cit.

¹⁰⁷ For details on the legislative procedure see the legislative observatory of the EP, [2015/2344\(INI\)](#).

¹⁰⁸ European Parliament, [MEPs and Euro group ministers debate path to a Euro zone budget](#), press release, 11 July 2016.

¹⁰⁹ European Parliament, [Draft report on Improving the functioning of the European Union building on the potential of the Lisbon Treaty](#) (PE 573.146), 20 January 2016; [Draft report on Possible evolutions and adjustments of the current institutional set up of the European Union](#) (PE 585.741), 5 July 2016.

based on genuine own resources and a proper treasury facility, with a view to increasing financial stability, mitigating cross-border asymmetric shocks and reducing the effects of recession. According to the document, the treasury facility should be allowed to borrow. The text envisages a treasury function located at the European Commission and accountable to the European Parliament and the Council, which would ensure democratic scrutiny.

4.4. Advisory Committees

4.4.1. European Economic and Social Committee (EESC)

The European Economic and Social Committee (EESC) has repeatedly called for measures to strengthen EMU, including by means of a fiscal capacity for the euro area. In its contribution to the Commission's 2017 work programme,¹¹⁰ the EESC said that a specific fiscal capacity for the euro area should be introduced with a view to enhancing the growth potential of the area as well as its ability to tackle asymmetric shocks and promote economic and social convergence. The EESC expects European institutions to start the second stage of EMU completion outlined in the Five Presidents' Report in 2017. In previous years, EESC opinions already supported steps towards the introduction of a euro-area budget with a shock absorption function, envisaging conditionality linked to reforms and possible ways of financing the instrument (e.g. a financial transaction tax for the entire area, a carbon tax, and a temporary levy on balance of payments surpluses exceeding 6%).¹¹¹

4.4.2. Committee of the Regions (CoR)

The advisory committee has closely followed the debate on completing the monetary union, including proposals for dedicated budgetary instruments to support the euro area. In 2013, the Committee contributed¹¹² to the debate on convergence and competitiveness instruments and requested local and regional authorities be involved when contractual agreements were developed, highlighting the importance of these authorities while engaging in structural reforms. In its Resolution on the European Commission's Annual Growth Survey 2016,¹¹³ the CoR considers

'that the AGS 2016 provides strong arguments for the Commission to look at proposing a fiscal capacity for the European Union as a whole to implement anti-cyclical policies and accelerate the recovery. Such a fiscal capacity would have to respect the subsidiarity principle and make sure that enough flexibility is provided for implementing policies that are appropriate to local needs by involving local and regional authorities in the design of policies' (Pt 9).

¹¹⁰ European Economic and Social Committee, [Contribution to the European Commission's 2017 work programme](#), 14 July 2016.

¹¹¹ Opinion on Completing EMU -The proposals of the European Economic and Social Committee for the next European legislature of 9 July 2014 ([OJ C 451, 16.12.2014, p. 10](#)); and Opinion of the European Economic and Social Committee on Improving the functioning of the European Union building on the potential of the Lisbon Treaty and on Possible evolutions and adjustments of the current institutional set-up of the European Union of 16 September 2015 ([OJ C 13, 15.1.2016, p. 183](#)).

¹¹² Committee of the Regions, [Resolution on deepening the Economic and Monetary Union](#), RESOL-V-007, 3 July 2013, p. 3.

¹¹³ Committee of the Regions, [Resolution on the European Commission's Annual Growth Survey 2016](#), RESOL-VI/008, 10 February 2016.

In April 2016, the CoR opinion on the Five Presidents' Report (rapporteur Paul Lindquist, EPP, Sweden)¹¹⁴ corroborated this position. The text 'reiterates its belief that fiscal capacity is necessary to equip EMU with a temporary shock absorption mechanism' (Pt 35).

At present, rapporteur Carl Fredrik Graf (EPP, Sweden) is preparing an own-initiative opinion on a Fiscal Capacity and Automatic stabilisers in the European Monetary Union.

5. Discussions in Member States

In order to deepen the debate and to address objections regarding political feasibility,¹¹⁵ the involvement of **France** and **Germany** remains crucial.¹¹⁶ In May 2013, French President François Hollande called¹¹⁷ for deeper integration, including an economic government for the euro area and a dedicated budget, with the possibility to borrow. At that time, press sources reported prudent reactions in Germany.¹¹⁸

Subsequently, France and Germany jointly published a proposal¹¹⁹ laying out their contribution to the June European Council that year. It set out the steps to be taken within the following two years to further strengthen EMU. It mentioned the need to better define the concept of 'contractual arrangements for growth and competitiveness', engaging all euro-area Member States, and to create solidarity tools in this context. To this end, a specific fund for the euro area was envisaged. It would provide limited and conditional financial incentives. In addition, on economic governance and democratic control, the text suggested creating specific structures for the euro area within the European Parliament after the 2014 elections.

In July 2014, under the Italian Presidency, employment and social affairs ministers officially discussed the creation of a euro-area budget for the first time, with a European unemployment benefit scheme at its core.¹²⁰

In June 2015, German Vice-Chancellor Sigmar Gabriel and the then French Economy Minister, Emmanuel Macron, called for closer integration of the euro area, with a stronger focus on fiscal policy. The ideas tabled included the establishment of a fiscal capacity for the euro area over and above national budgets, with a view to improving the ability to provide automatic stabilisation. According to the article, the fiscal capacity would have its own revenue (e.g. a common financial transaction tax and a small portion of a harmonised corporate tax), and would provide for borrowing. The article adds that

¹¹⁴ Committee of the Regions, Opinion. [Follow-up to the Five Presidents' Report: Completing Europe's Economic and Monetary Union](#), CDR 5112/2015, 7 April 2016.

¹¹⁵ Fichtner reminds us that the notion of 'fiscal capacity' was coined in order to avoid using 'fiscal transfer', Fichtner, 2014, op. cit., p. 116.

¹¹⁶ See Regula Hess and László Andor, [Automatic Fiscal Stabiliser: Make it happen](#), European Policy Centre, Brussels, 2 May 2016.

¹¹⁷ Hugh Carnegy and James Fontanella-Khan, [François Hollande goes on 'offensive' over stalled EU economy](#), *Financial Times*, 16 May 2013.

¹¹⁸ See e.g. [Europe : L'Allemagne prudente sur les propositions de Hollande](#), *Le Nouvel Observateur*, 17 May 2013.

¹¹⁹ Présidence de la République and Bundesregierung, [France and Germany – Together for a stronger Europe of Stability and Growth](#), Paris, 29 May 2013.

¹²⁰ Craig Willy, [Ministers debate EU unemployment scheme for first time](#), *dpa news*, 21 July 2014.

the capacity should not deteriorate fiscal discipline at the national level, which to the contrary would be encompassed in a strengthened framework.¹²¹

On a number of occasions, **Italy's** Finance Minister and former chief economist of the OECD, Pier Carlo Padoan, has stressed the need for EMU to be strengthened, proposing several measures for consideration. Examples of the ideas tabled are: setting up a common budget for the euro area and the creation of an unemployment insurance scheme, as well as the establishment of a finance minister and of an elected parliament for the euro area.¹²² According to a 2016 document by the **Italian** Finance Ministry,¹²³ a common instrument at euro-area level to tackle cyclical unemployment could contribute to enhancing sustainable growth and the social dimension of the euro area.

In February 2016, the Governor of the Banque de France, François Villeroy de Galhau, and the President of the Bundesbank, Jens Weidmann, jointly published an article,¹²⁴ calling for the strengthening of EMU. They state that, while monetary policy has already done a lot for the euro area, it alone cannot ensure the sustainable growth of the euro-area economy.¹²⁵ On this basis, they support a number of ideas to reinforce the economic dimension of EMU, including an ambitious financing and investment union alongside resolute national structural reform programmes and improved economic governance of the area. In an interview in August 2016,¹²⁶ the President of the Bundesbank said that further integration of the euro area, for example by means of a common budget, would imply some transfer of sovereignty to the central level, for which he did not see support in the Member States. He argued that the alternative solution would be a stronger separation between bank systems and public finances, coupled with the introduction of orderly default procedures in the case of financial problems at national level.

After the UK referendum, the debate on the future of the EU has also covered the possible strengthening of the euro area, including the creation of a dedicated budget or fiscal capacity. A number of ministers from different Member States have called for steps to be taken in this direction, including **France's** (then) Economy Minister, Emmanuel Macron and **Belgium's** Deputy Prime Minister and Minister of Foreign and European Affairs, Didier Reynders. The press reports a prudent stance from others, such as **German** Federal Minister of Finance, Wolfgang Schäuble.¹²⁷ **Eurogroup** President and **Dutch** Finance Minister, Jeroen Dijsselbloem, appears to consider¹²⁸ that steps should be taken on economic convergence first.

¹²¹ Emmanuel Macron and Sigmar Gabriel, [Europe cannot wait any longer: France and Germany must drive ahead](#), *The Guardian*, 3 June 2016.

¹²² See for example: James Politi, [Italy's Pier Carlo Padoan calls for 'political union' to save euro](#), *Financial Times*, 26 July 2015; and Politi, [Italy pushes for eurozone jobless insurance scheme](#), *Financial Times*, 5 October 2015.

¹²³ Ministero dell'Economia e delle Finanze, [Una strategia europea condivisa per crescita, lavoro e stabilità](#), February 2016.

¹²⁴ François Villeroy de Galhau and Jens Weidmann, [Europa braucht mehr Investitionen](#), *Le Monde* and *Süddeutsche Zeitung*, 8 February 2016.

¹²⁵ In line with arguments made on a number of occasions by the ECB, including its President, Mario Draghi.

¹²⁶ [L'unione monetaria è a un bivio: o si cede più sovranità a Bruxelles o si accettano le procedure di default](#), in: *Corriere della Sera*, 4 August 2016.

¹²⁷ See for example *Libération*, 3 July 2016, op. cit.

¹²⁸ European Parliament, [MEPs and Euro group ministers debate path to a Euro zone budget](#), press release, 11 July 2016.

6. Outlook

In line with the priorities of the Slovak Presidency, EU finance ministers held an informal ECOFIN meeting in Bratislava in September 2016 to discuss the introduction of a 'fiscal pillar ... , a fiscal instrument to absorb macroeconomic shocks at the central level'.¹²⁹ Reportedly,¹³⁰ such a fund would increase overall stability and reduce the 'pressure on the central bank to engage in non-conventional monetary policy'. The Commission's representative cautioned that 'it may not be the time to launch new instruments', and stressed the need for 'further reflection'.¹³¹

Voting on the European Parliament draft report on budgetary capacity is scheduled for October 2016, with a vote in the EP plenary expected in late November. On 16-18 October 2016, the Slovak Presidency will host the Article 13¹³² Interparliamentary Conference on Stability, Economic Coordination and Governance in the EU¹³³ in Bratislava.

The Monti High-Level Group on Own Resources (HLGOR) is expected to deliver its final recommendations by December 2016. While the report is expected to focus predominantly on the EU budget, euro-area aspects, and the provision of public goods, were also examined by the group. The Commission will then assess whether new legislative initiatives to amend the own-resources system are appropriate.

Given that economic recovery in most Member States using the single currency is only piecemeal, the discussion on a fiscal capacity for the euro area necessarily needs also to incorporate more general aspects of EMU. While some argue that introducing a fiscal capacity has become necessary, considering the monetary union still has structural problems,¹³⁴ others maintain a more cautious position.¹³⁵

Scheduled for spring 2017, the European Commission has announced its decision to produce a white paper on EMU governance in consultation with the Presidents of the other EU institutions. Taking into account the outcome of a public consultation and the input from a high-level expert group to be set up in September 2016, the document will report on progress towards the completion of EMU, and outline the next steps in the process. The white paper will also include the legal measures required to proceed with stage two of the roadmap identified by the Five Presidents' Report.

¹²⁹ Slovak Presidency of the Council of the European Union, [Notice: Informal meeting of ministers for economic and financial affairs \(Informal ECOFIN Council\)](#), Bratislava, 5 September 2016.

¹³⁰ See Jan Strupczewski, [EU finance ministers, central bankers will consider a euro zone crisis fund](#), Reuters, 6 September 2016.

¹³¹ European Commission, [Remarks by VP Dombrovskis at the informal ECOFIN press conference: fiscal stabilisation function](#), press release, 9 September 2016.

¹³² See Article 13 of the Treaty on Stability, Coordination and Governance in the Economic and Monetary Union. According to 2.1 of the [Rules of procedure](#), these conferences provide 'a framework for debate and exchange of information and best practices in implementing the provisions of the Treaty in order to strengthen cooperation between national Parliaments and the European Parliament and contribute to ensuring democratic accountability in the area of economic governance and budgetary policy in the EU, particularly in the EMU'.

¹³³ Conference details can be found [here](#).

¹³⁴ Olivier Blanchard warns against overly high expectations of any kind of fiscal capacity, because of the deep structural problems that still beset monetary union. Mehreen Khan, [Fiscal union will never fix a dysfunctional eurozone, warns ex-IMF chief Blanchard](#), *The Daily Telegraph*, 10 October 2015.

¹³⁵ See Gern et al. op. cit. and Buti et al. op. cit.

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The idea to create a 'fiscal capacity' for the euro area was launched in the wake of the sovereign debt crisis, with the recognition that weaknesses in the Economic and Monetary Union (EMU) had worsened the crisis. Although the debate has lost some momentum as euro-area countries have stepped back from the acute phase of the crisis, the EU institutions continue to work on designing a framework to bolster EMU, looking in particular at automatic stabilisers. The European Parliament's Committees on Budgets and Economic and Monetary Affairs are currently preparing a report on a budgetary capacity for the euro area.

This is a publication of the
Members' Research Service

Directorate-General for Parliamentary Research Services, European Parliament



PE 589.774
ISBN 978-92-846-0027-4
doi:10.2861/87358

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