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Europe in transition – economic opportunities for Austria: European Union and fiscal governance

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Austria‘s place in the Europe of tomorrow
Oesterreichische Nationalbank, April 27, 2018

Europe(an Union) in transition – fiscal governance

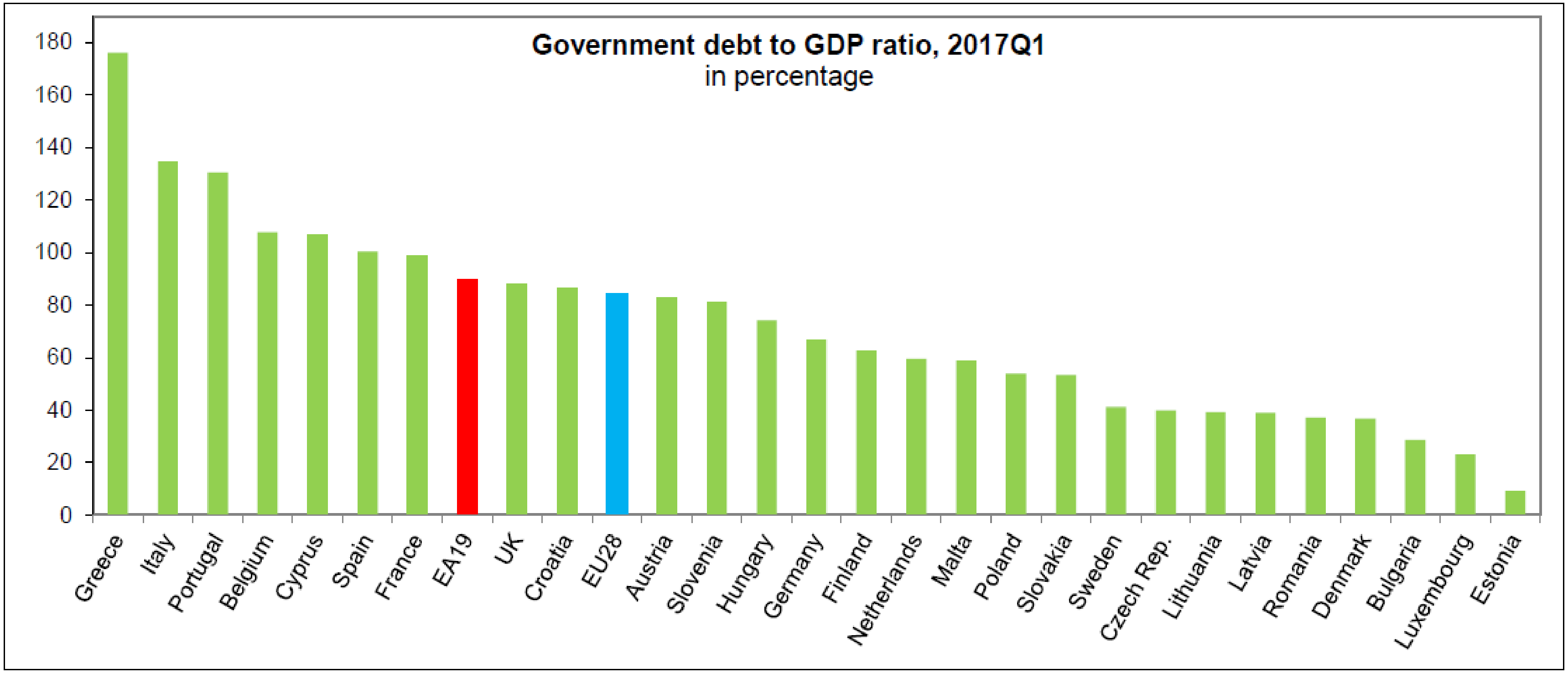
For instance:

- Fiscal governance of the Eurozone
- Financing the European Union
- Managing Brexit
- …

Fiscal governance of the Eurozone

Problems of the current setup of European Monetary Union (EMU):

- EMU policy coordination has been weak. Democratic legitimization on the national level. Symptoms: persistent deficit bias in fiscal policy, public debt growth and a reluctance to undertake structural reforms.
- Existing rules failed as substitute for explicit policy coordination.
- EMU lacks "incentive-compatibility“, lending a term from contract theory.



Ireland: GDP not available for Q1 2017

Source: eurostat

Are the underlying assumptions of Maastricht rules (60%, 3%) still valid?

Two conceptual models: Model I

Maastricht model:

- Fiscal coordination and supervision based on fiscal rules aimed at preventing crises.
- ESM as stabilizer.
- Credible insolvency procedure for sovereigns.
- European Banking Union. More ‘bail-inable’ capital on balance sheets of banks.

Two conceptual models: Model II

US model:

- Common budget would be to provide fiscal stabilization in the event of asymmetric shocks. Imply a EMEF.
- Common economic and fiscal policies.
- Insolvency procedure for sovereigns.

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Reforming Maastricht

The US model (even though more suitable from the perspective of the theory of Optimal Currency Area) seems politically infeasible.

Some reforms have already taken place in the Eurozone:

- Process of policy coordination and supervision has been reformed.
- New fiscal rules have been introduced (with the fiscal compact).
- New institutions have been created (European Fiscal Board, ESM, European Banking Union).

Reforming Maastricht I

Model for the Eurozone:

- **Rules and enforcement:** Stability and Growth Pact has been augmented and fine-tuned, but became so complex that nobody is really happy with it. De-politization versus a genuinely political topic such as fiscal policy. The way forward – European Fiscal Board? Simpler rules? More transparency? What else?
- **Completing European Banking Union:** Risk sharing (deposit insurance) as stabilizer, but requires writing down NPLs and more trust in bail-in rules that insure taxpayers against being forced to bear potential bank losses.

Reforming Maastricht II

Model for the Eurozone:

- **Insolvency regime for sovereigns:** Probably the most sensitive issue. No-bailout clause versus joint liability (would mean giving up national sovereignty over debt issuance). Do we need more rules regarding insolvency of sovereigns? Exposure of banks to individual Eurozone member states should be reduced. ESM should be reformed to reduce the risk that the ESM bails out member states in cases where debt restructuring is needed.

Reforming Maastricht III

Why the US model is probably a not suitable for the Eurozone:

- US federal government's share of overall public spending is roughly 54%, whereas public spending at the EU level is just 2%. Still stronger fiscal capacity seems desirable (see next slide).
- Issues of moral hazard, transparency, procedures in the context of fiscal sustainability are profoundly different in the US.

Reforming Maastricht IV (based on Delatte et al., 2017)

Can we combine aspects of the US model and the Maastricht model:

- Completion of European Banking Union (recapitalize banks with high NPLs, ESM as a fiscal backstop).
- Increasing credibility of No-Bailout-Clause by reducing costs of sovereign insolvencies (equity underpinning of government bond holdings, greater diversification, tightening of capital requirements for banks).
- Creating a Eurozone fiscal capacity that supports public investment and unemployment insurance in the event of strong asymmetric shocks.

Reforming Maastricht V (based on Delatte et al., 2017)

- Separating fiscal surveillance from the European semester and giving independent fiscal boards (or the ESM) the task of making countries comply with fiscal rules.
- Reforming the European Semester to integrate independent expertise at the national level to achieve recommendations that are more adjusted to specific circumstances of individual member states.
- Transparency, clear accountability of institutions (EMEF?), distinction between political institutions (Commission, Council) and watchdogs.

European Fiscal Board

European Fiscal Board mentions in its report in 2017:

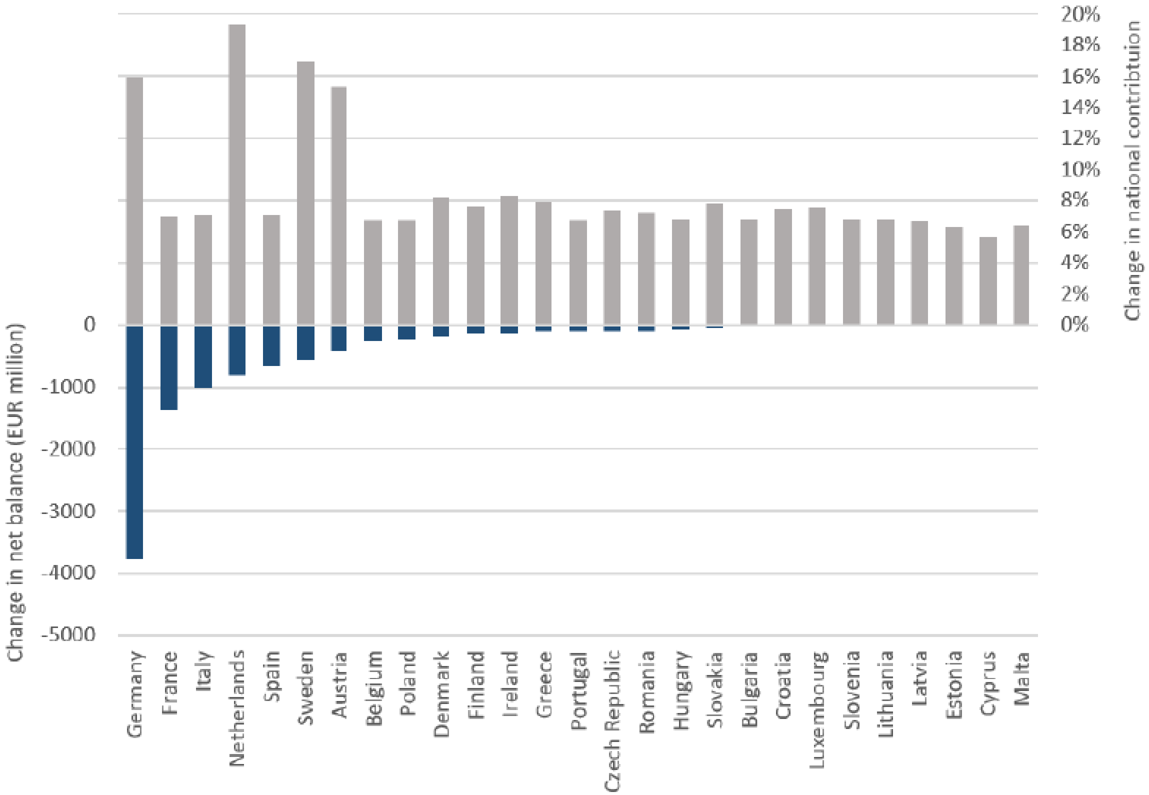
- Creating fiscal buffers for economic bad times.
- Strengthening the enforcement of fiscal rules.
- Strengthening the comply-or-explain principle in relation to advice of national fiscal councils.
- Simplifying the complex set of fiscal rules while safeguarding flexibility and a clear responsibility for surveillance.
- Strengthening economic resilience.

Austria‘s role

Forward-looking:

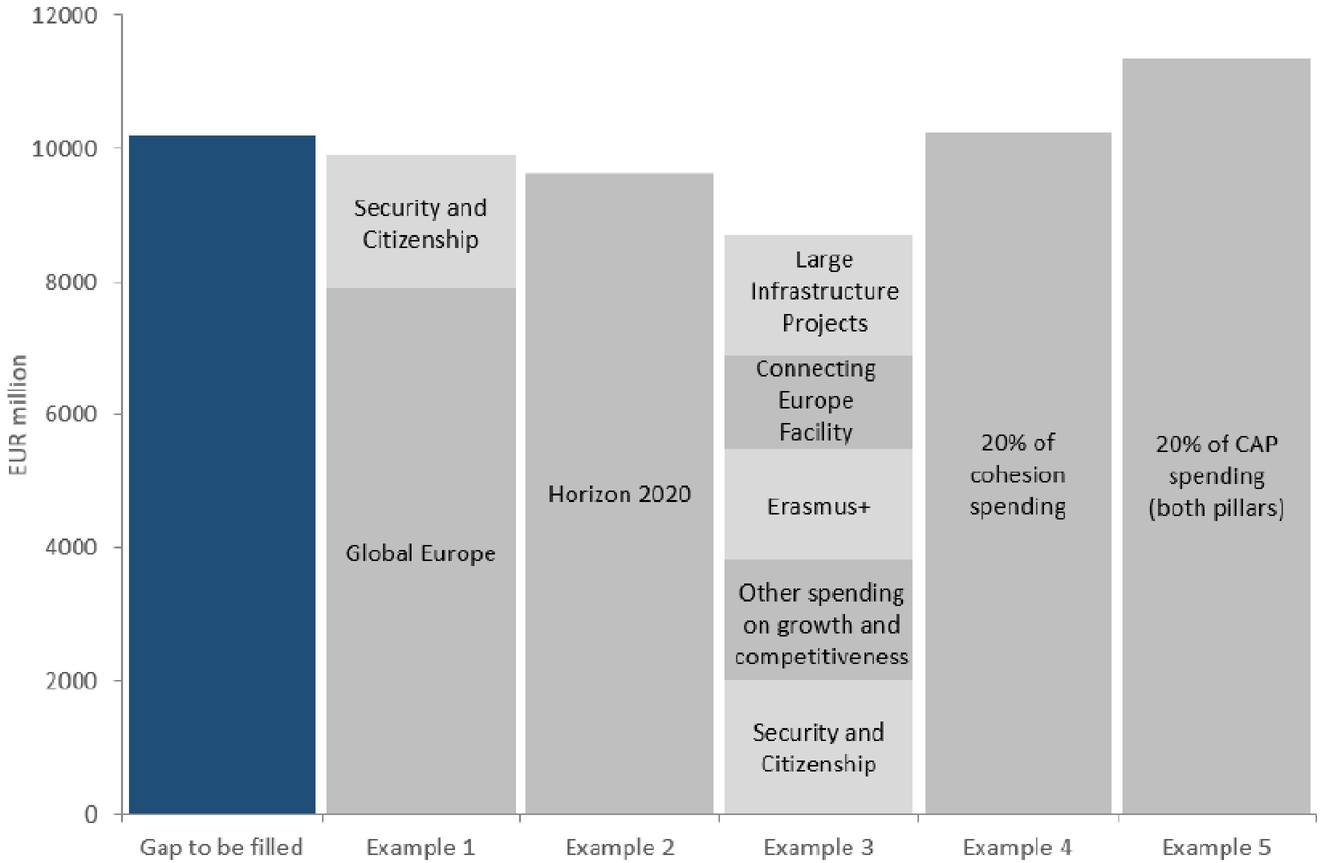
- Where to position itself in terms of the continuum between the Maastricht and the US model?
- What model to have in mind for the EMU in ten to 20 years (members of the EMU, potential changes in European contracts).
- Which public goods to be provided on the union level? What is subsidiarity (economies of scale)?
- How to deal with the short-term challenges from the Austrian EU-presidency: Eurozone reform, the EU Multi-annual Financial Framework 2020-, and Brexit – these short-term challenges are more complicated than many think.

Figure 1: The impact of a €10 billion increase in contributions on Member States' net balances.



Source: Authors' calculations based on European Commission data on expenditure and revenue by Member States (operating budgetary balances), as reported in EU Financial Reports for 2014-16.
Note: A Member State's national contribution consists of the revenue generated by the VAT- and the GNI-based Own Resource.

Figure 2: Spending cuts in comparison

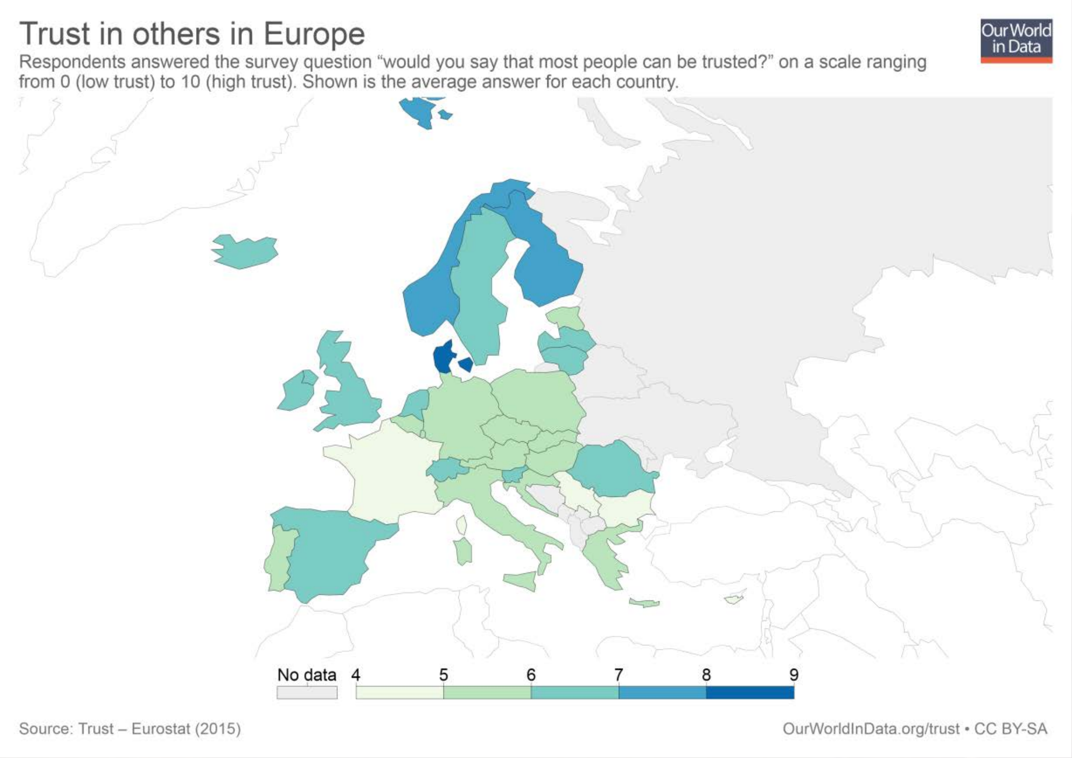


Source: Authors' representation based on European Commission data and Haas, J. and Rubio, E. (2017), Brexit and the EU budget: Threat or Opportunity, Jacques Delors Institute, Policy Paper 183.

Austria's role

The very long run:

- Building trust within Europe! As a substitute for complicated rules.



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Thanks very much!

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References

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