

How much fiscal union? Has the answer changed since 2016?

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The views expressed are my own and not necessarily those of the Portuguese Ministry of Finance or of Nova School of Business and Economics

I. How much fiscal union?

Setting the scene

- Not starting from scratch
- Given existing externalities, market and government failures, more fiscal union better than status quo
- Much more even better
- But some action better than no action

Not starting from scratch

We have come a long way since the 1997 SGP + (non-credible) no-bailout

- **Rules-based fiscal and economic policy coordination**

Six-Pack + Two-pack + Fiscal compact + etc. → MIP, SGP+, European Semester, National Fiscal Councils, European Fiscal Board, etc. [Not credible, not delivering]

- **Crisis management**

ESM [current governance: uncertain, lengthy processes]

OMT [ECB has lender of last resort for sovereigns? Legitimacy?]

- **Banking Union**

Break sovereigns-banks nexus [Incomplete cannot fulfil its goal]

- (EU budget + EU funds: Convergence & Cohesion)

(Much) More fiscal union (1/3)

Rules that induce reforms , the building up of buffers and a coordinated fiscal stance

- **Enforcement:** sovereignty progressively transferred to center as imbalances build up? Role for EFB – Bénassy-Quéré et al (2016)
- **Symmetry:** deficit/surplus, boom/bust
- **Flexibility:** SGP – adjustment accounts? Allard et al (2013); Bénassy-Quéré et al (2016)
- **Conditionality:** CSRs - investment and reforms
- **Ownership:** NP+EP

(Much) More fiscal union (2/3)

ESM Roles

- **Crisis management:** improved conditionality (shared sovereignty), legitimacy (EP+NP) and design (speed, prioritization, sequencing and bundling)
- **Banking Union:** (reduce exposure to national sovereigns) + Common deposit insurance scheme + Common fiscal backstop
- **Risk prevention:** Fund for investments at euro area and national level (conditionality promoting reforms)
- **Stabilization** (5 Presidents Report)
 - Across regions (country-specific shocks) and time (common shocks)
 - Moral hazard → only large shocks (higher externalities; ZLB), clear rule by EFC
 - Linked to cycle – no permanent transfers (Allard et al, 2013) but is all redistribution unjustifiable? Rubio (2016)
 - Triggered by unemployment (superior to output-gap – Thirion, 2017 - but...)
 - Earmarked – unemployment expenditures, activation, public investment
 - Smoothing negative and positive shocks (Belbecque, 2013)

(Much) More fiscal union (3/3)

ESM governance

- Political responsibility at central level
- Involvement of EP + NP

ESM funding

- national contributions (“net contributors” issue, Rubio, 2016)
- own resources: common tax + bonds issuance

What about **debt legacy**? German Council of Economic Experts (2011) Debt redemption fund (>60%, strong conditionality)

II. Has the answer changed since 2016?

Myth 1: EU and EA lack support

- 7/10 EU citizens feel that they are citizens of the EU (and improving) – **record high**
- 7/10 EA citizens support the euro area (on the rise since 2013) – **record high**
- Broad support for EU policies (and rising)
 - 8/10 free movement of citizens and common defense and security policy
 - 7/10 common policy on migration
 - 6/10 digital single market and agree that public money should be used to stimulate private investment at EU level

(source: Eurobarometer 86 – latest release)

Myth 2: Populism is winning

- “Does the perception of 2016 as “the year of the populists” really fit for Europe? A closer look suggests that while populism was an omnipresent theme in public discourse, **support for populist parties in polls rather remained stable** and elections did not translate into outright populist wins.” (Böttcher and Wruuck, 2017)
- “The rise of populist parties has however been a **multi-year trend.**” → impact on politics (lengthier processes, debate style and content, scope for reform)
- **Brexit means Brexit opportunity:** rise in the share of people who would talk positively about the EU to friends since the Brexit vote (Vries and Hoffmann, 2016)

Myth 3: There is no scope for reform

- “While a majority of citizens support their country’s membership of the Union and further political and economic integration, they are **not satisfied with policy direction in the EU.**” de Vries and Hoffmann (2017).
- 3/4 of Europeans inside the euro area see a **need for reform** of the euro area (de Vries and Hoffmann, 2016) **but no consensus** on what to do.

Myth 3: There is no scope for reform

How to build support and find common ground?

- **Social dimension**
 - Tackling inequality key as it increases support for EU and for reform (Eurobarometer; de Vries and Hoffmann, 2016)
 - Unemployment considered the major issue at national level; decreased significantly since 2013 but still top concern in Eurobarometer – better policy mix
- **Ownership**
 - Information boosts support for reform (Vries and Hoffmann, 2016; Gouveia, 2017)
 - Framing matters (Dolls and Wehrhöfer, 2017; Gouveia, 2017) – Improve communication
 - 54% thinks their voice does not count, but 67% in 2013 (Eurobarometer)

Going forward

- First debate, then debate, finally SET A PLAN
- Stepwise approach (such as in Enderlein, Letta et al, 2016)
- Risk reduction no substitute for risk sharing (Gern et al, 2015)
- Single market, CMU, BU key for additional stabilization and risk sharing (labor and capital mobility, fiscal and credit markets)
- Steady (but modest) growth - complacency...

Thank you

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