Which Fiscal Union?

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Questions

- Goals and priorities for common fiscal policy?

- Principles on which to build fiscal capacity for Eurozone ?

Caveats:

  - Not politically feasible now
  - Minimalist criteria, since size of national govts already too large

Two Priorities

1. Tool for aggregate demand mngmt
   – Zero lower bound on interest rates
   – FP coordination not enough
   – Loss of national CB => national FP more constrained

2. Common fiscal resources for mngmt of large financial crisis
   – Risk of sudden stop + exit
   – Very large financial sectors
   – ESM is a step forward but not enough

NOT a priority: direct risk sharing with individuals (eg. U insurance)

- Moral hazard and harmonization of labor mkt institutions
- Member states can cope, if they don’t lose mkt access

Main idea

CEPR 2015, Ubide 2015, Paris-Wyplosz 2014

- EU is a *super-national* institution

- Has more commitment capacity than national legislatures
  - Can impose costs if renege binding intntl agreements

- Exploit commitment to build borrowing capacity, pledging little govt revenues but far into future

Stability Bonds

Ubide 2015, Tabellini 2016

- Member states agree to yearly transfers to Eurozone, up to x% of GDP for N years, *if asked*

- Backed by this, Eurozone (EZ) can issue own debt

  D/Y = 25%, average cost of D = 4% => debt service = 1% of Y

- Initial EZ debt replaces national debt, to achieve liquidity

- Then, EZ debt used for stabilization policy or crisis mngmt

Governance

Sapir-Wolf 2015, Tabellini 2016

- ESM morphs into European Fiscal Institute (EFI)
  - Exec Committee + Governing Council (Eurogroup)
  - Policy decisions by majority rule
  - Accountable to European Parliament, who has to approve main decisions

- EFI also supervises national budgets, with veto rights if national debt is not on sustainable path

- In the long run, own tax capacity also to pay for common public goods, administered by Eurozone Treasury

A safe asset?

How to insure high rating? Two options

- Convertibility in Euros at maturity (i.e. joint liability of ECB and Eurozone member states)
  - Could give ECB veto right on monetary bail out

- Eurozone tax capacity sufficiently large

  D/Y = 25%, average maturity of 7 years => maximum tax capacity of 3.5% of GDP

  Special procedures, joint liability of all member states?

Tradeoff: ECB credibility vs transfer of tax capacity

Main benefits

Not the creation of a safe asset (ESB)

But the creation of a new policy tool for the Eurozone (intertemporal fiscal policy):

- To stabilize aggregate demand at i=0
- To manage large financial crises

(Most) member states cannot achieve this, because:

- They don't have credibility / commitment capacity to raise *future* surpluses when running *current* deficits

- They cannot cope with large debt / banking crises

Difficulties

- Need a very long run commitment
  – But…..Euro should be irreversible

- Asymmetric benefits
  – But …. loss of sovereignty also asymmetric