EMU Choices Workshop #6

Macro-Economic Stabilisation of the Euro Area

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European Research Centre for Economic and Financial Governance

euro-cefg.eu

Legal Feasibility of a Macro-Economic Stability Mechanism for the Euro Area

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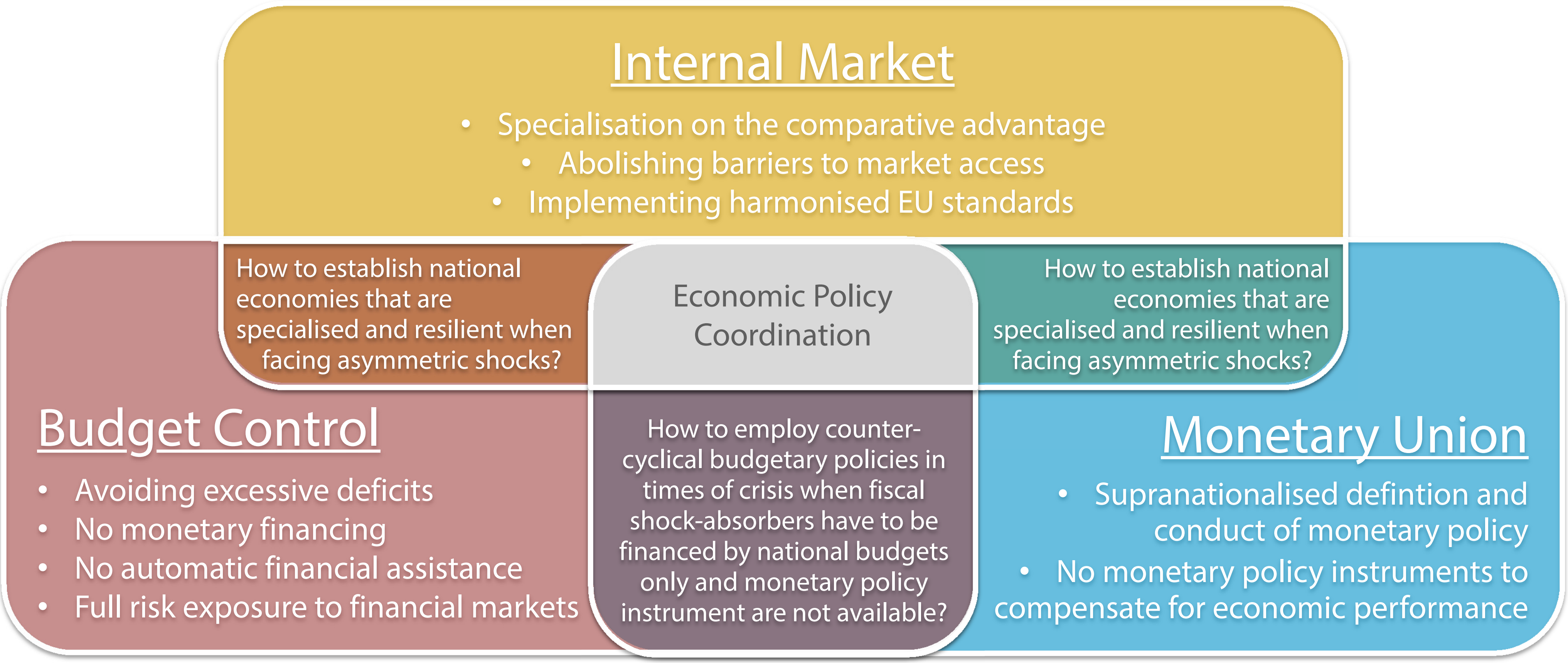
Introduction

- Rationale for a macro-economic stabilisation mechanism
- Legal Framework for an EMU macro-economic stabilisation mechanism
- Proposals presented by the European Commission

Rationale of a macro-economic stabilisation mechanism for the Euro Area

Rationale of a macro-economic stabilisation mechanism

- The triple EMU dilemma



Rationale of a macro-economic stabilisation mechanism

- Incapacity of EMU to balance conflicting demands of EU law
  - **Specialising** on the comparative advantage (internal market) <u>but</u> having **resilient national economies** in a situation of an asymmetric shock (affecting one economic sector) (monetary union/budgetary control)
  - **Procyclical** budgetary policies (budget control) <u>but</u> establishing **shock-absorbers** financed by national budgets to be activated in crisis times (monetary union)
  - **Refinancing** of public budgets on private financial markets (budget control) <u>but</u> no monetary policy instruments (monetary union) and not capital controls (internal market) in order to react to **market failure** and to the closure of market access

Rationale of a macro-economic stabilisation mechanism

- The triple EMU dilemma

Internal Market

- Specialisation on the comparative advantage
- Abolishing barriers to market access
- Implementing harmonised EU standards

How to establish national economies that are specialised and resilient when facing asymmetric shocks?

Economic Policy Coordination

How to establish national economies that are specialised and resilient when facing asymmetric shocks?

Budget Control

- Avoiding excessive deficits
- No monetary financing
- No automatic financial assistance
- Full risk exposure to financial markets

How to employ counter-cyclical budgetary policies in times of crisis when fiscal shock-absorbers have to be financed by national budgets only and monetary policy instrument are not available?

Monetary Union

- Supranationalised defintion and conduct of monetary policy
- No monetary policy instruments to compensate for economic performance

Rationale of a macro-economic stabilisation mechanism

- Cushioning of asymmetric macroeconomic shocks
  - In a Currency Union, macroeconomic shocks cannot be compensated by nominal devaluation but only by real devaluation
    - Prices and wages have to decrease (but are inflexible downwards)
    - in order to avoid harmful short-term damages, there has to be a cushioning of exceptional expenses (e.g. short-term unemployment benefits)
  - Smoothing out shocks is traditionally the role for fiscal policy and Unemployment Benefits Schemes
    - At which level is the responsibility the best allocated? Member State/EA/EU?
- Promoting social/economic cohesion

Legal Framework for an EMU Macro-Economic Stabilisation Mechanism

Legal Questions

- Payment side I: Is there is legal base?
- Payment side II: Limitations for transfer of funding set by Article 125(1) TFEU (the so-called 'No Bailout' clause)
- Financing side I: Does EU budget law allow for additional funding earmarked for the use by a Macro-Economic Stabilisation Mechanism?
- Financing side II: Does EU budget law allow for a differentiated integration?

Legal Framework for an EMU Macro-Economic Stabilisation Mechanism

Act 1

Payment side

Defining the conditions for payment

Act 2

Minimum requirements

Defining the conditions to prevent 'moral hazard'

Act 3

Financing side

Definition of the revenue

- Contributions by Member States
- Own EU tax

Earmarking of the expenditure

Payment side

Payment side: Is there a legal base?

- What is the aim that is predominantely pursued?
  - Reinforcing multilateral surveillance?
    - Article 121(6) TFEU
  - Macroeconomic stabilisation in crisis times?
    - Article 122(2) TFEU (used for the EFSM)
    - Only when 'exceptional occurences'
    - Only 'under certain conditions', no automatization
  - Reducing economic/social disparities?
    - Article 175(3) TFEU (used for the EGF)
  - Fallback option: Article 352(1) TFEU

Payment side: Limitations set by Article 125

- Issue of Article 125(1) TFEU ('no bail-out' clause)
  - General principle that EU does not finance MS
    - EU may only transfer funding to MS if there is an explicit legal base (such as e.g. in the case of cohesion policy)
    - Otherwise, Article 125(1) TFEU sets the limits for any other transfer
      - CJEU, Case C-370/12, Pringle

        'Article 125(1) TFEU does not prohibit the granting of financial assistance […] provided that the conditions attached to such assistance are such as to prompt that Member State to implement sound budgetary policies'
  - Issue of conditionality
    - Not required by the wording of Article 125(1) TFEU
    - *Pringle* 'only' confirmed the legality of ESM, which is built on conditionality
    - <u>Core:</u> **Sound budgetary policies**

Payment side: Limitations set by Article 125

- Understanding Article 125(1) TFEU
  - **EU/MS** shall not be **liable** for or assume commitments of other MS
  - **MS** are solely responsible for **sound budgetary policies**
    - Sound budgetary policies of the participating countries as a precondition for financial stability in a currency area
    - Sound budgetary policies mean that **state budgets** may not be used to finance the **consequences of unsound economic policies**
  - Financial assistance is acceptable under Article 125(1) TFEU if it does not diminish a MS's incentive to conduct sound budgetary policies
    - <u>Maastricht principle:</u> Market pressure prompts Member States to conduct sound economic policies since the financial consequences of unsound economic policies will be costly to refinance on the private financial markets
    - Applying to financial assistance: As long as it can be ensured that unsound budgetary policies can be avoided through mechanisms prompting sound economic policies, financial assistance is acceptable
    - Not by definition: Conditionality

Financing side

Financing side

- Two ways of designing the financing side
  - (1) Within the EU budget
    - Earmarking revenue for the exclusive use of the EMU Macro-Economic Stabilisation Mechanism (⇒ External assigned revenue, Article 21(2)(d) of Regulation (EU) No 966/2012)
    - External assigned revenue is excluded from MFF ceilings
    - External assigned revenue is considered to be 'other revenue' in terms of Article 311 TFEU (⇒ no change of Own Resources Decision) (cf. Article 62(1)(a) of the EBA-Regulation)
    - Legal base: Article 352(1) TFEU
  - (2) Dedicated fund outside EU budget
    - Establishment of an agency with an own distinct budget
    - Control by budgetary authorities (EP/Council) comparable to EU budget law in order not to circumvent institutional balance
    - Legal base: Article 352(1) TFEU or IGA

Financing side

- Is a Euro area budget possible?
  - Revenue
    - Article 332 TFEU: Expenditure shall be borne by the participating MS
    - Example: 'High Flux Reactor' (Council Decision 2012/709/Euratom)
  - Expenditure
    - Principle: The revenue shall be used without distinction to finance all expenditure entered in the general budget of the European Union
    - Exception: Earmarking
      - Certain revenue is assigned by the basic legal act on the creation of the revenue to a certain budget line
      - Example: Article 10 of Regulation (EU) No 1173/2013 on the enforcement of budgetary surveillance in the Euro area:

        "The interest earned by the Commission […] shall constitute other revenue as referred to in Article 311 TFEU and shall be assigned to the EFSF."

Financing side

- Possibility to raise debt
  - Principle: EU is not allowed to raise debt in order to finance the general budget of the Union
  - Precedents: e.g. EFSM may raise debt (Article 6(3) of Regulation (EU) No 407/2010)
  - EU is allowed to enter into borrowing-and-lending operations for a specific and predefined purpose, which may not lead to an indirect financing of the general budget
  - Legal base: Legal base of the legal act establishing the EMU Macro-Economic Stabilisation Mechanism

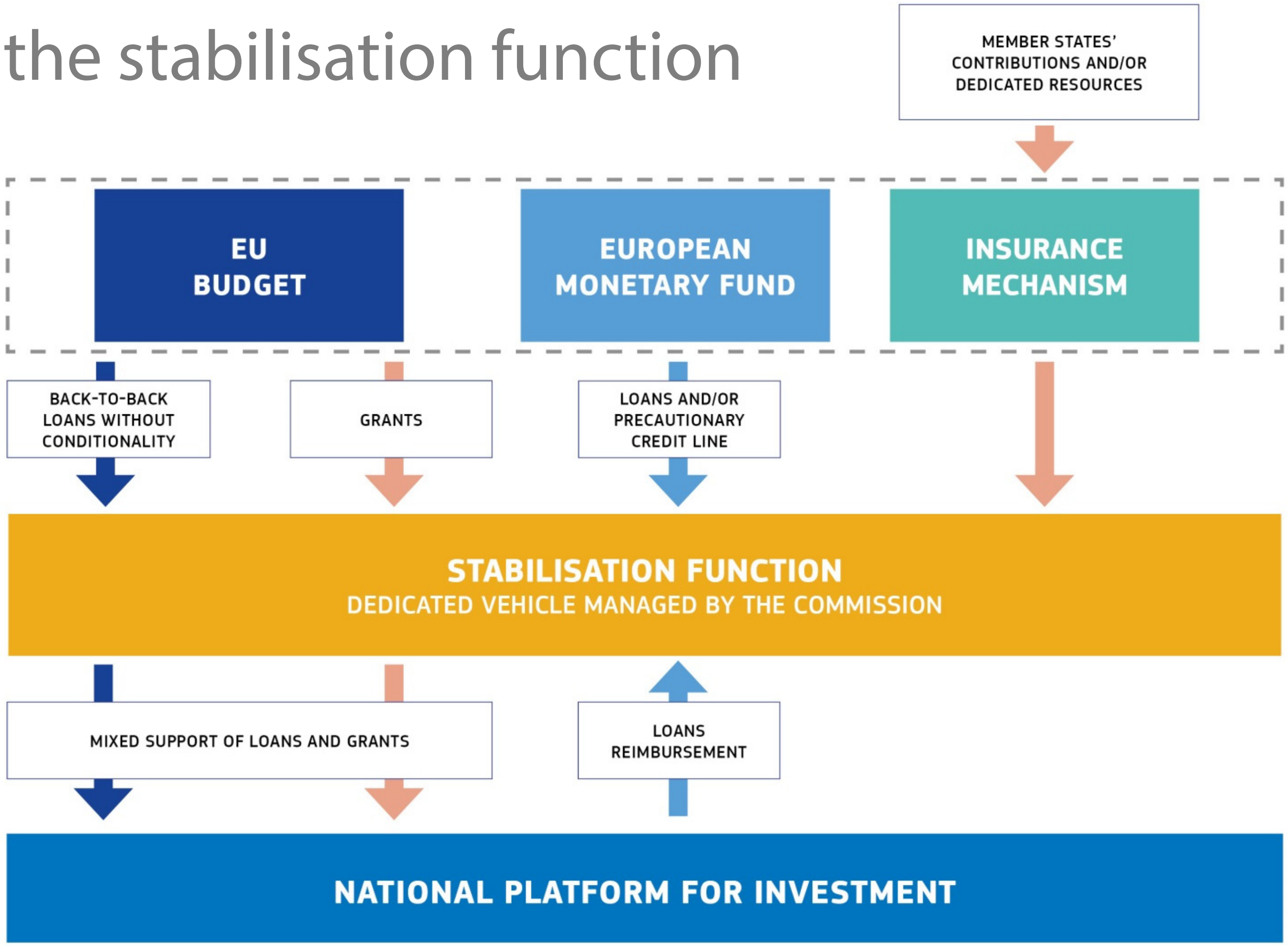
Proposals presented by the European Commission

Commission Proposals: COM(2017) 822 final

- European Investment Protection Scheme
  – Support for public investment in the event of a severe economic downturn
- European Unemployment Reinsurance Scheme
  – Earmarked automatic direct payments to national unemployment benefit schemes
- Rainy Day Fund
  – Automatic payments to national budgets after activation of a pre-defined trigger

Commission Proposals: COM(2017) 822 final

- Financing of the stabilisation function



Concluding Remarks

Thank you for your attention

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