A stabilisation function for the EMU

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Does the EMU need a stabilisation function?

1) Responding to large negative shocks:
   • Automatic stabilisers insufficient to ensure proper stabilisation and coordination of national fiscal policies has proven to be difficult
   • Overburdened monetary policy
   • Escape clauses cannot replace a proper stabilisation capacity

2) Complementing private risk sharing:
   • Central stabilisation can foster private risk-sharing (cross-border ownership of assets) by reducing country specific macro-risks

3) Fostering good behaviour in good times:
   • More rigorous build-up of buffers in better times
   • Strengthen the commitment to the irreversibility of the euro
A counterfactual: benefits of a central stabilisation capacity in 2012-2013

- Fiscal adjustment (change in the structural balance)
- Amount of unused capacity in the economy (output gap)

Very bad economic times

Normal economic times

2011

2012

2013

2014

2015

2016

2017

COM AF2017
Features of design

• Eligibility
  ➢ Avoid moral hazard
  ➢ Maximize the positive incentives to comply with fiscal rules

• Activation
  ➢ Automatic, unemployment trigger (double condition on level/change)
  ➢ Visible, simple, few revisions, fine to capture large shocks

• Destination
  ➢ Protect investments in the event of large shocks
Thank you
Further detailed slides
6 December "EMU package"

- Transformation of the ESM into a European Monetary Fund
- Integration of the substance of the TSCG into EU law
- Creation of a dedicated euro area budget line in the EU budget
  - Stabilisation function
  - Structural reform assistance
  - Convergence instrument for euro pre-ins
  - Backstop for the Banking Union

- European Minister of Economy and Finance
Does the EMU need a stabilisation function?

Lack of instruments in case of large shocks:

- Automatic stabilisers insufficient to ensure proper stabilisation in the presence of large shocks (especially in small open economies)

Disparities in amplitude of cyclical variations across member states (output gap, in % of GDP)
A European stabilisation function in support of investment

- Loans
- Insurance mechanism

**EU BUDGET**
- Back-to-back loans without conditionality

**EUROPEAN MONETARY FUND**
- Grants
- Loans and/or precautionary credit line

**INSURANCE MECHANISM**
- Member States’ contributions and/or dedicated resources

**STABILISATION FUNCTION**
- Dedicated vehicle managed by the Commission
- Mixed support of loans and grants
- Loans reimbursement

**NATIONAL PLATFORM FOR INVESTMENT**
Two compartments

- **Compartment 1: loans**
  - Union back-to-back loans (comparable to EFSM)
  - Possibly loans from the ESM/EMF

- **Compartment 2: insurance mechanism**
  - Annual contributions from MS
  - (significant) pay-outs in the event of large shocks
  - Contributions match pay-outs on average but borrowing may be needed
The insurance mechanism

Markets

Borrowing and saving

Stabilisation Function: Insurance compartment

EU budget guarantee

EU budget

Contributions $C_t$

Member States

Payouts $P_t$
Trigger: Double condition

Country A
High and increasing unemployment

Country B
Neither condition applies

Country C
Low and falling unemployment

- **High U** = higher than past 15 years average. **Low U** = the opposite
- **Increasing U** = higher than previous year. **Falling U** = the opposite