Risk sharing in EMU

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1. While risk sharing is essential for the resilience of a monetary union, it remains limited in the euro area

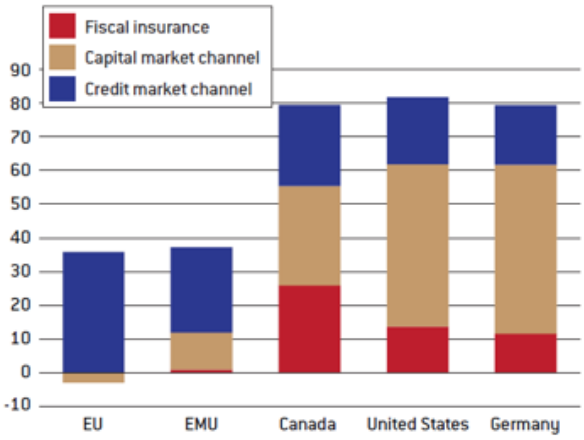
1.1. Risk sharing remains limited in the euro area

The Chair welcomed and introduced the panel and reminded them that the degree of risk sharing in the monetary union is less than half of that in the United States or within large economies like Germany or France. The reasons are clear: financial markets are fragmented in Europe along national borders, therefore there is not much private risk sharing. In Europe there is not a common tax system or a common social security system that leads automatically to fiscal risk sharing as in the US, but also within France or each Member State.

It is instructive to look at the following chart. The higher risk sharing in the United States has the result that the regions stay together. There can be different business cycles in different regions, but the common tax and social security systems help to keep it together, and there is obviously one unified capital market. The argument is not to become like the United States but to develop mechanisms that provide more risk sharing.

Today it is more difficult to deal with asymmetric shocks in the Euro area, and when business cycles in some countries in Europe deviate from cycles in other countries, markets and fiscal channels do not help much to align these cycles. Therefore, more public and private risk sharing would be useful taking into account that the more private risk-sharing is achieved via markets, the less public risk sharing is needed via fiscal channels.

Risk Sharing (% of shock smoothed by different channels)



Source: IMF (2013), Bruegel (2015)

1.2. Risk sharing is essential in a monetary union...

A minister stressed that risk sharing in a monetary union is unavoidable. The main lesson from the EU sovereign debt crisis is that everyone is in the same boat and risk is shared amongst themselves.

According to another minister, there is no doubt, in any case, that risk sharing is a very important element. It creates confidence, not only for the government and the public, but also for potential investors, and the euro area should go forward.

1.3. ...Even if comparaison n'est pas raison

A minister noted that European monetary union is compared with national countries. Obviously, comparaison n'est pas raison. More solidarity is wanted.

It can be called stabilisation or whatever people want. Luxembourg is ready for more solidarity. However, it would be difficult at any time to achieve the same kind of solidarity that you have in a country that is united and has one system, but ambition to deepen the EMU is required.

It is crucial to remember that the common currency is a true European success story and public support for the euro is at a record high. The Economic and Monetary Union (EMU) has worked extremely well over the last 10 years. The Banking Union does not exist anywhere else in the world. Their first EU meeting was in December 2013, when it was agreed to create the Banking Union. The next day the newspapers and media were not positive, in the sense that they said it would never be delivered on. It has been delivered, for the most part. It has gone further in the last couple of years. It has now been agreed to give a bigger role to the European Stability Mechanism and a common budgetary instrument for convergence and competitiveness is under discussion. Much progress has been made. But if the starting point is the maximum, saying what the United States does and what Japan does in its own country, and it is compared it to what the EU does together, that comparison is a little bit biased.

1.4. Going beyond the sterile "risk reduction – risk sharing discussion"

A minister stated that the discussions at the eurozone level should go beyond the debate on "risk reduction – risk sharing". This kind of discussion has been extremely divisive. When discussing the completion of the Banking Union or a fiscal instrument, it is risk reduction that is actually being discussed, along with stabilisation within the monetary union, and reducing the depth and the price of crisis. Addressing the fragmented financing sector or a fiscal capacity would make the monetary union more robust.

2. A macroeconomic stabilization function would make the euro area stronger

A minister noted that there are several proposals for a macroeconomic function on the table. Implementing in all parts of the EU domestic structural reforms is the right starting point to deepen the Economic and Monetary Union (EMU). A euro area budget with permanent transfers is not necessarily needed. Indeed, a reinsurance of national unemployment systems or an investment stabilisation fund are possible and adequate ways forward. An effective Banking Union which notably requires the implementation of a European deposit insurance scheme (EDIS) would also certainly be a stabilising element for monetary union and would reduce risks in the euro area.

2.1. There are several proposals on the table for a macroeconomic function

The Chair noted that there are several proposals on the table to better deal with asymmetric shocks hitting one country or synchronize national business cycles in the euro area. One is a reinsurance of national unemployment systems, which is also found in the US and which is supported by the German and Spanish finance ministers. If it is designed correctly, it will not lead to permanent transfers. There are other proposals from the Commission, like a stabilisation instrument for investment. There is also a rainy-day fund, which is something the International Monetary Fund (IMF) proposed; or shorter term European Stability Mechanism (ESM) facilities. All of these are possible without additional permanent transfers. They sound like very different schemes, but they all have the same economic objective of helping a country in monetary union that is exposed to an asymmetric shock. Furthermore, the financial sector through an effective Banking and Capital Market Union would be a stabilising element and would reduce risks in the euro area.

The EU budget is not the appropriate instrument for an effective macro- economic stabilization function

The Chair felt that the EU budget is often not given the right weight. The EU budget is important for convergence, but that does not mean macroeconomic stabilisation; that would require a new instrument, such as the instruments just mentioned. There is not an overlap there. The amount of money that is channelled through the EU budget should not be forgotten. But this is a seven-year budget plan, which already indicates it cannot react very quickly to new asymmetric shocks or deviations in the cycle.

2.2. Implementing in all parts of the EU domestic structural reforms is the right starting point

A minister explained that the elephant in the room is that it is not a problem about risk sharing. The biggest problem is that there are different levels of risk. Of course, in an economic and monetary union there is a mixture of fiscal and monetary policies. There is a homogenous monetary policy, and it requires more flexibility from national fiscal policies. This is not an easy task, because governments, presidents, and parliaments have different views on taxation and expenditure. The sustainability of public finances is crucial for the sustainability of the euro area. It is vital therefore that the Stability and Growth Pact rules should be respected.

At the end of the day, the best insurance policy is to proceed with structural reforms inside member states. These reforms cannot be done from the outside (or from Brussels). It is a question of national ownership. Therefore, politicians should also do their jobs at home, and then it is far easier to find a consensus on possible ways forward to deepen the EMU.

Another minister noted that, looking forward, it is essential to continue efforts to foster the combination of structural reforms, sound fiscal policies and quality investments, which build the foundation for a more resilient and competitive EMU. This is all the more important given the softening economic momentum and such a targeted focus will be more conducive to the long-term success of economies than yet another academic discussion on the perceived institutional deficiencies of the European construction.

Given the current economic outlook, raising potential growth needs to be at the top of the agenda. Targeted structural measures will be key to ensuring higher productivity and to improve the competitiveness of the European economy. It will be crucial to step up efforts by concentrating on areas with high potential such as digitalization and knowledge-intensive sectors.

The Chair noted that the panel agrees on national policies. Appropriate domestic fiscal policies and structural reforms are the basis. Having fiscal buffers at the national level is the starting point, but it is right to think about what can be added from the European dimension.

2.3. A budget with a federal tax system is not realistic and the macroeconomic stabilization function should be designed so that there are no permanent transfers

A minister noted that a federal tax system as in the US is not realistic. However, making progress on taxation will be one of the key elements of the agenda of the next Commission, because the differences are so wide, and it inhibits free movement of capital and free movement of services. Cracks are starting to be noticed in the system with the digital giants. More of this will be seen in the coming years, but it is not exactly a monetary union issue; it is also an EU issue, but even more so for the monetary union.

Progress is needed on the fiscal stabilisation side. This is a very political issue, but the question is how it can be calculated. The system should be designed so there are no permanent transfers. Ça va de soi but that cannot really be written down, because the cycle is going to be so heterogeneous in the different countries.

2.4. Risk sharing, through a reinsurance for national unemployment systems, is one way forward

A minister stated that, in the case in Spain, what has been put forward is a reinsurance mechanism for unemployment – as exists in the US – which would be a very powerful tool at the eurozone level in order to reinforce national automatic stabilisers. This kind of fiscal system is not about risk sharing but, again, risk reduction, because if national crises or downturns can be made milder, it will make a more stable monetary union.

Another minister stressed that insurance is a great invention in the area of finance; if there are contributions to the pool of resources and something happens, disbursements will follow. Of course, it depends on the risk profile. The insurance premium depends on actions; for example, if a driver does not care about traffic lights or speed limits then it is very clear that the insurance premium will be very high, and the driver will think twice before even buying a car.

A minister noted that people understand such a reinsurance for national unemployment systems. People cannot understand the precautionary instruments of the ESM or the backstop to the Single Resolution Fund (SRF). There is no way to explain this to a normal citizen. However, when talking about deposit insurance or unemployment insurance people understand what Europe is about. Backstops need to be built for the people so that they understand what benefit they can get from being in a monetary union.

A minister stated that, on unemployment insurance, there is a new proposal that should be soon proposed by the Commission. The Commission has not yet put it on the table, and it has not been worked on, so it should be expected that in three months' time it will be delivered, but it should not be given up on

2.5. Defining an appropriate scheme to foster productive investment in Europe would also be an encouraging way forward

A minister emphasised the need to foster investment and productive investment in Europe. If a system or a mechanism can be devised, such as a budgetary instrument or a fund to do so, Luxembourg would support that 100%. Over the last couple of years investment has been less than prior to 2008. It is less than in the United States.

Looking at it from that angle, there would be more support in the economic and monetary union (EMU) – the 19 countries and eventually the 27 – than looking at it from an angle telling people of the need to share a risk and solidarity. It is better to say, 'Let us invest more altogether. Let us give ourselves means.'

Promoting and sustaining quality investment in key areas, such as education, skills, infrastructure and innovation, would support the growth potential of EU economies. The aim should be to encourage higher levels of private and public investment, which nurtures a sustainable economic model and long-term well-being, without compromising resources for future generations

On sustainable finance, Europe is ahead of the others in this area. Two out of the three issues that were at stake were solved in this Commission. The taxonomy needs to be finalised. On unemployment, in all fairness and also thinking of the public view, if we are telling our people at home that they have to have solidarity with the unemployment in another country, it is difficult. Even if it is emphasised that it is not permanent, it is on a transitional basis, and it is for economic cycles that are not the same, politically it is very difficult to explain. The investment side, though, is easier to explain.

On the ESM, it may be difficult to explain, but it is extraordinary what has been done and what is going to be done with it. It is the task of politicians and also journalists to explain what it is good for. It might be complicated, but this is a safety net built together, and to explain it in a precautionary manner is probably the wisest thing to do.

The Chair stated that the Spanish Government has been arguing for a reinsurance of national unemployment systems. Another government prefers thinking about investment stabilisation. These are different concepts, but they have the same economic goal.

Another minister noted that, regarding investment stabilisation, there is a proposal on the table. It is quite mature. There is a very wide consensus that this would make sense. Therefore, this should be worked on. It has been proposed to put together elements of the reform delivery tool and the investment stabilisation mechanism, and to start building on that basis a budgetary instrument. Again, it can be explained to citizens as an investment stabilisation fund, a system to ensure through the cycle, for a seven-year period, that investments will be protected. It is another very important cyclical dimension of fiscal policy. The first thing that a government cuts, whenever there is a crisis, is investment. There are a broad variety of options, and they are optimistic that progress can be made in the coming months. They should not fool citizens by saying they are addressing a problem when they are not.

The minister agreed on the need to be ambitious, but also realistic and pragmatic. That is the right approach, and it is the one being taken, with some red lines.

Let us recognize that the Budget Instrument for convergence and competitiveness currently discussed is not a fiscal capacity for stabilization

A minister noted that, on red lines, honesty is required. Nobody will believe it if this is called a fiscal capacity. Governments need to be true to their citizens and be honest in saying that it is a nametag. An instrument cannot be taken which says, 'Reform support programme', and be called a fiscal instrument on the pretence that nobody will notice it. A real stabilisation tool is needed; an instrument that can allow investment stabilisation. The European Commission had proposed it. In any case, the worst that can be done is to give people a false sense of safety, saying that it is solved and there is a tool, and then the tool does not work when the worst comes to the worst.

In any case, with a basic budgetary instrument this reinsurance mechanism for national unemployment systems, would be very powerful from two points of view. One would be to ensure that the most important fiscal stabiliser is reinforced and that a deep recession is not entered because of that. That would be a very powerful tool because it has a very strong and stabilising effect.

2.6. EDIS is a necessity to improve private risk sharing

2.6.1. EDIS is a necessity

A minister stated that deposit insurance on the Banking Union side has been discussed for a long time and makes a lot of sense. Nobody is interested in having a run on a bank, and everyone sees what happens when there is panic in financial markets: everybody suffers. There is no upside to this. Everyone should be interested in a system which ensures that the whole financial system is more resilient. A number of options and alternatives have been proposed so as to have a common deposit insurance mechanism, and also to avoid permanent transfers. This would be basic common sense. Everybody agrees it should be done. Politically it is difficult, but this would be the most mature thing to do as it has been discussed for so long, and it is one of the pillars of the Banking Union. In principle, it has been already agreed at the leaders' level since 2012 but it is proving to be difficult to deliver.

Another minister agreed that talking about EDIS is a still missing element of the Banking Union that the public understands. It is easy to explain the need for it, and even if the level of risk is different in this respect, of course the solidarity aspect should be remembered. Even for those countries which have a very low level of risk, they also benefit from that, because nobody wants a panic in the society.

EDIS will be setup one day. This would be a final nail in the coffin of instability and fragmentation of the banking sector. Political difficulties in risk sharing are understood when the risks are not evenly distributed. However, a mutually agreeable balance could be found notably because the progress on risk reduction is evident. As a result, there is some reason to be optimistic regarding the eventual adoption and implementation of EDIS. In the long term, every member of the EMU will benefit from stability, resilience and confidence that a fully-fledged Banking Union will bring. It is important to remember that the EMU is not a zero sum game. One member's gain is not offset by another's loss, despite the fact that it may sometimes seem so in the short term. The EMU is a positive sum game.

2.6.2. EDIS should be done

A minister stressed that EDIS should be done. It is the third pillar of banking union that has not been delivered yet. Last, but not least, there should be a more positive talk about whatever is done in Europe, be it in the monetary union or any of the things that Europe does. When the Juncker plan was launched four or five years ago there were two criticisms. One was that it was a drop of water. The other was that it would not work and would not be delivered. It has been delivered. Again, institutions like the European Investment Bank should be trusted, which is doing a wonderful job and will do a wonderful job also in green finance. There are already quite a few instruments, but people tend to linger on what would be the ideal that they do not have yet. The instruments that are there should be leveraged.

Another minister noted that a number of options have been proposed on deposit insurance and also on the unemployment insurance, so that the system does not lead to permanent transfers or structural transfers and allowing a clear roadmap. On EDIS, first of all there is a very wide consensus, so a way forward should be able to be found. Finally, turning to private risk sharing, another minister stressed that increasing equity investment in the financing structure is the key issue where the EU should do its job.

The Chair summarised that everyone should remember all the progress that has occurred since the previous crisis and the ESM has been created as a permanent institution. The monetary union is much better prepared for future crises today than it was 10 years ago. Also, there are other areas, such as the work of the EIB and the so-called Juncker plan. Everybody is confident that EDIS, or common deposit insurance, will be achieved one day, though maybe not as quickly as some would like. A great deal of work has been done on what is called the Budgetary Instrument for Convergence and Competitiveness (BICC), but it takes longer to make progress with stabilisation. The Chair thanked the panellists and the audience. ■