

Asatryan, Zareh et al.

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Which Role for a European Minister of Economy and Finance in a European Fiscal Union?

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*Zareh Asatryan, Xavier Debrun, Annika Havlik, Friedrich Heinemann, Martin Kocher
and Roberto Tamborini*

headed by



INSTITUT FÜR HÖHERE STUDIEN
INSTITUTE FOR ADVANCED STUDIES
Vienna



Toulouse
School
of Economics



UNIVERSITY
OF TRENTO



VALTION TALOUDELLINEN TUTKIMUSKESKUS
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Which Role for a European Minister of Economy and Finance in a European Fiscal Union?

*Zareh Asatryan (ZEW), Xavier Debrun (IMF), Annika Havlik (ZEW),
Friedrich Heinemann (ZEW), Martin G. Kocher (IHS Vienna), Roberto Tamborini (U Trento)*¹

Abstract:

The European Commission has proposed to inaugurate a European Minister of Economy and Finance with the broad purpose of streamlining the complex and fragmented decision-making processes within the European Monetary Union. The Minister would jointly serve as Vice-President of the Commission and President of the Eurogroup, and have the tasks of coordinating budgetary instruments and structural reforms, designing and implementing adequate fiscal policies for the euro area, coordinating the enforcement of the Stability and Growth Pact, among others. This policy report discusses the potential role the Minister could play in the development of the European Fiscal Union. The report lays out the main challenges along the current institutional solutions facing several dimensions of the Fiscal Union, in particular related to fiscal sustainability, macroeconomic shocks, incentives of structural reforms, and the optimum provision of European public goods. The report then discusses whether and to what degree the new European Minister of Economy and Finance can provide appropriate solutions to these challenges for the Fiscal Union.

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Disclaimer: The views expressed here are those of the authors and do not necessarily represent the views of the institutions they present.

Correspondence: Zareh Asatryan; asatryan@zew.de; (0049)6211235392; L7 1, Mannheim, DE-68161.

1 Introduction

Following President Juncker's statement on a possible "European Minister of Economy and Finance" (EMEF) in his 2017 State of the Union address, this idea has started gaining momentum. As part of the Commission's "Roadmap for deepening Europe's Economic and Monetary Union" in December 2017 (European Commission 2017a), the Commission has further elaborated on the creation of this new institution.

This contribution focuses on this proposition by the Commission. It should be noted, however, that this proposal is not an isolated initiative. It is rather embedded in the long-lived debate about the necessity of reform of the Economic and Monetary Union (EMU) prompted by the mismanagement of the crisis and carried on by a number of scholars (e.g. Kuenzel and Ruscher 2013, Baldwin and Giavazzi 2015). The debate precipitated the plea to "complete the Union" with the Banking Union, the Capital Markets Union, the Fiscal Union, and the Political Union ('Five Presidents Report' 2015).

According to the Commission's plan, creating the position of an EMEF should compensate for some of the Economic and Monetary Union's (EMU) shortcomings by centralising responsibilities and roles from other institutions. The EMEF's goal would be to streamline the complex and fragmented decision-making processes within the EMU, which is currently a product of multitudes of institutions involved in economic policy making.

To increase the EMU's governance and democratic accountability, the EMEF should therefore take on several responsibilities. The Commission has established a catalogue of the following possible responsibilities:

External representation: While the euro has established itself as a leading global currency, the euro area representation within international institutions like the International Monetary Fund remains in national hands, despite formal coordination among the different representatives. These institutions assign various roles to the Commission, the ECB, the President of the Eurogroup and the EU Council Presidency in international forums. To strengthen the representation within the EU and at the global level, the EMEF should promote the general interests of the economy of the European Union and the Eurozone, while also assuming the function of external representation of the euro (European Commission 2017a, p. 3).

Coordination of reforms: Structural reforms and economic policies are national competences and, hence, are not sufficiently coordinated on the EU level. While some progress on the coordination of economic policies has been made with the introduction of the European Semester, the EMEF should further strengthen these steps by promoting greater coordination among Member States for policy reforms (p. 3-4).

Stabilisation and fiscal sustainability: From the Commission's view, the EMEF could take on major responsibilities to identify and pursue an adequate fiscal policy for the euro area as a whole (p. 4). "Adequate fiscal policy" refers to stabilisation policies, along with "the broader goals of fiscal sustainability and redistribution" (p. 4). On stabilisation, the Commission communication stresses its growing interest for an aggregate fiscal stance for the euro area. The Commission envisages that the EMEF would coordinate Member State surveillance in applying the Stability and Growth Pact (SGP). Moreover, the EMEF should also promote the functioning of national fiscal frameworks building on the views of the European Fiscal Board (EFB) (p. 4).

European budgetary instruments: The Commission communication envisions that the EMEF also coordinates "relevant EU and euro area budgetary instruments" with the aim to "maximise their impact in support of shared priorities" (p. 5). In particular, the communication outlines the Investment Plan for Europe, and the relations between the Commission and the European Investment Bank.

Institutional setup: The Commission also proposes a possible institutional framework for the EMEF that should result in more efficient governance (p. 5-8): The EMEF would be a Vice-President of the Commission. This minister could be also elected as the President of the Eurogroup, possibly for the whole duration of the Commission's mandate. Moreover, the EMEF would chair the European Stability Mechanism (ESM) and, once established, the European Monetary Fund (EMF). In fact, the EMEF could already be appointed as Vice-President of the Commission as early as November 2019. She would represent the Commission in the meetings of the ECB's Governing Council, be responsible for EU-level social dialogue and interact with important stakeholders. Ultimately, the EMEF would be held accountable to the European Parliament.

To better understand the EMEF's potential, it is essential to clarify the minister's role in context of the ongoing reform debate on the new European Fiscal Union (EFU). We believe that the value created from the EMEF crucially depends on two aspects: the specific fiscal policy problem being addressed and the EU's more general plans for the future EFU. To assess the value of the EMEF, we pose the following interrelated questions:

- First, would an EMEF provide a well-targeted solution to the specific EFU challenge?
- Second, in which areas would an EMEF be not helpful or even counterproductive?
- Third, are there more optimal institutional arrangements than the EMEF for tackling EFU's goals?

In order to answer these questions, it should be noted that the EFU proposals are numerous and are still under considerable debate (see e.g. Delatte et al. 2017). The content of proposals differs according to the dimensions they take into account and how much (de)centralisation the proposals envisage for each dimension. At least two of the main approaches are ones known as the "Maastricht 2.0 model" and the "US (or better, Confederal) model". The former starts from the premise that the EMU regulatory framework has proved to be too weak and unable to constrain

elected policymakers properly. Therefore, reforms should strengthen the original rule-based conception of the EMU embedded in the Treaties. Further fiscal sovereignty devolution is preferably towards independent, non-political agencies as guardians of the rules. The latter view is critical of a number of flaws that are present in the original regulatory framework, in the eyes of its proponents, and have played a role in the mismanagement of the crisis. These flaws are as follows: (i) neglect of interdependencies across countries, (ii) insufficient coordination of national fiscal policies, and in the aggregate with the common monetary policy, (iii) lack of common instruments of macro-stabilisation. Among others, examples for the various models are found by the Tommaso Padoa-Schioppa Group (2012), Sapir and Wolff (2015) and Bénassy-Quéré et al. (2016), whose concepts are illustrated in Figure 1 of the Appendix. For each dimension, a higher score is associated with more centralisation.

This paper does not take a position on which elements should be part of a promising EFU package. Instead, we concentrate on the following four EFU dimensions which show up most prominently among various EFU proposals, namely:

- Safeguarding fiscal sustainability of Member States in line with the objectives of the existing fiscal rules,
- Stabilising EMU against asymmetric shocks,
- Designing stronger incentives for structural reforms,
- Finding the optimum provision of European public goods through the EU budget.

Hence, this contribution disregards some other EFU dimensions where an EMEF might play a role like public debt restructuring mechanisms, her potential role for a new EMF evolving from the ESM and possible responsibility for an (EMF-based) lender of last resort. Furthermore, we note that the specific template on the EMEF proposed by the Commission, which is the sole focus of our contribution, is part of a much richer spectrum of models in the literature with at least three different variations of a possible design of an EMEF: (i) a single figure similar to a “High Representative” (which is in essence the Commission’s view that will be discussed below), (ii) a President of an independent board, (iii) a Chairperson of a political body (or a “Eurogroup 2.0”). Model (ii) (see e.g. Villeory de Galhau and Weidmann 2016) is more focused on the aim of monitoring and controlling national policies in compliance with the commitments to fiscal discipline. This design is in line with the Maastricht 2.0 model of EMU reform. A more consistent design with the confederal model of reform would be given larger consideration to issues related to legitimacy, competency and normative powers. A natural solution is that the EMEF serves as the elected chairperson of a council of national ministers (i.e., the “Eurogroup 2.0”). This idea has been circulated under various shapes: the European Fiscal Institute (Tabellini 2016), the Eurosystem of Fiscal Policy (Sapir and Wolff 2015), the European Federal Institute (Guiso and Morelli 2014), and it is also present in the latest reform proposal by Bénassy-Quéré et al. (2018). Tabellini (2016) proposes that (major) decisions, approved by majority voting, are then resubmitted to the EU Parliament. Obviously, conclusions driven here based on the specific proposal by the Commission do not necessarily hold for these alternative EMEF templates.

2 Safeguarding fiscal sustainability

2.1 Underlying general problem

The question as to whether or not the growth of public debt is on a sustainable path is a central consideration in any macroeconomic assessment of fiscal policy. Governments that ignore the solvency constraint are bound to cause great harm as default and high inflation have similar end-points: a massive destruction of wealth, foregone income, and misery for those who cannot insure against such risks, especially the less affluent in society.

This explains why debt sustainability, along with price stability, is one of the two generally accepted properties of any desirable macroeconomic equilibrium, and therefore, key objectives for any finance minister including that of the EMEF. To get there, the traditional policy assignment is that monetary policy must actively pursue price stability by keeping national income close to its long-term trend (or potential). On the other hand, fiscal policy must be designed to avoid explosive public debt trajectories (Leeper 1991).

The institutional DNA of the EMU reflects a conscious effort by its founders to translate the traditional policy assignment in the particular context of a currency union where one central bank interacts with multiple treasuries. In this setting, monetary policy is in the hands of an independent central bank with an overarching objective to ensure price stability on the level of the euro area. So too must national fiscal policies comply with common standards of fiscal discipline that are deemed consistent with debt sustainability, and which are enshrined in rules meant to be enforced if needed.

Compared to a single country issuing its own currency, the monetary-fiscal assignment problem is inherently different and more complex in a currency union. First, incentives to run active fiscal policies that stabilise national income – and therefore deliberately influence inflation dynamics – are greater because national budgets are the only national macroeconomic shock absorber left to confront country-specific disturbances. Moreover, with the EU's monetary policy rates being close to their effective lower bound (ELB), the effectiveness of monetary and fiscal instruments are increasingly difficult to distinguish.

Second, the interaction between one central bank and “N” national treasuries makes the union vulnerable to the fiscal situation of its weakest member (see Bergin 2000 for theoretical considerations). In practice, this means that any currency union can face existential threats when debt sustainability is not uniformly guaranteed across all of its members because of spillover effects. Cheikbossian (2001) provides historical examples. The recent sovereign debt crisis in the euro area is another vivid illustration of this fact.

Third, because the currency union effectively insures Member States against the cost of fiscal irresponsibility at least to some degree (in the form of de-anchoring of inflation expectations for example) the threat of moral hazard arises. This is the most significant explanation as to why governments borrow beyond what a fully-informed and perfectly benevolent social planner would do. Beyond the moral hazard issue, other explanations arise due to unresolved common pool problems (i.e., a difficulty to prioritise competing demands on the budget), policies driven by short-term electoral considerations and a lack of public awareness of the corrosive effects of persistently high fiscal deficits. Evidence of excessive deficits is pervasive and has motivated efforts to contain incentives for profligacy through a mix of fiscal rules (Debrun et al. 2008, Asatryan et al. 2016) and, more recently, independent fiscal institutions (Debrun et al. 2009).

Ensuring public debt sustainability everywhere in the currency union was a key motivation behind the Delors Report (1989) calling for supranational fiscal rules formulated as caps on deficits and debts. Subsequently, the report led to the Maastricht convergence criteria which have since morphed into various incarnations of the SGP – the first element of the Maastricht model. The second element of the Maastricht model is centred on the no-bail-out clause and the idea of market discipline.

2.2 Current institutional shortcomings

Market discipline has clearly not been effective in the first decade after the euro's introduction. When government bond yield spreads started to react to creditworthiness they did so in an abrupt and discontinuous way leading to contagion and self-enforcing bad equilibria. One possible lesson from this experience is to increase incentives for sound public finance by more predictable solutions for insolvent countries through well-defined sovereign debt restructuring mechanisms, accompanied by limits on sovereign bank exposure through concentration limits and sovereign risk weights. The main counter-argument is, of course, that the perspective of debt restructuring as a realistic possibility for large euro area countries could in itself be destabilising.

Designing and implementing governance mechanisms that consist of fiscal rules, a set of monitoring measures, and a set of potential sanctions applied to non-compliers was bound to be difficult from the outset. It took only a mild downturn in the early 2000s, when France and Germany breached the 3% deficit-to-GDP ceiling and they had the Commission's Excessive Debt Procedure (EDP) rejected by the majority of finance ministers, to reveal the weaknesses of the SGP, namely too lax in good times and too tight in bad times. By 2005, the SGP had been made “smarter” (essentially meaning that it was less likely to bind in bad times), thanks to explicit considerations given to cyclical conditions and more lenient escape clauses. Without surprise, the next – and this time major – crisis in 2008 led to another round of major revisions to the SGP.

Today, EMU's fiscal governance is a complex web of rules and benchmarks (Heinemann 2018) covering the levels and first-differences of almost all relevant macro-fiscal indicators: public debt, nominal deficit, structural deficit, and expenditure corrected for revenue measures. These

rules are written in countless pages of explanations that frustrate even the most dedicated civil servants of national treasuries. While it would be unfair to conclude that the dire fiscal situation in some of euro area Member States is solely a reflection of the EU fiscal governance failure, the lingering legacies of the global economic financial crisis and the even greater reliance on fiscal policy as a stabiliser and tool to promote long-term growth has further weakened their incentives to comply with the basic numerical rules. They have now been encouraged to pursue a maximalist interpretation of flexibility as embedded in the SGP.

Besides its complexity, enforcement mechanisms have not improved dramatically (Asatryan et al. 2015). The greater and disproportionate weight given to the Commission (relative to the Council) in enforcing SGP in 2010 cannot serve its original purpose of reducing the politicisation of the process if this means opaque, disorderly and “weighted” bilateral negotiations. In the EU, where politics remain a local matter, voters have grown suspicious of uneven implementation of the SGP by the Commission. They believe that larger countries have been enjoying a quasi-impunity that have been denied to smaller ones.

In this context, the establishment of an EU-wide independent watchdog – the EFB – which is explicitly mandated to judge the even-handedness of the Commission in implementing the SGP was certainly welcomed. However, as some of us argued in an earlier policy brief (Asatryan et al. 2017b), the EFB comes across as a relatively weak body that has arguably grown too close for comfort to the Commission. At this stage, it is worth looking into whether the establishment of an EMEF and her role in fiscal policy coordination and surveillance is an improvement to the institutional setup.

2.3 Merits of an EMEF

The European Commission (2017a, p. 4) states that: “the Minister would coordinate the surveillance of Member States’ fiscal policies, ensuring fiscal sustainability and applying the Stability and Growth Pact with the economic reading that the rules foresee.” One fundamental issue with the current EU fiscal governance is the “politicised” implementation of the SGP in a disguised fashion, as argued above. Thus, we need to ask first whether the new role envisaged for the EMEF is likely to lead to more or to less political meddling.

According to the Commission, the EMEF would simultaneously serve as Vice-President of the Commission and chair of the Eurogroup. This would be equivalent to the US Treasury Secretary (an executive appointment) chairing a senate committee on States’ economic affairs. Needless to say that such an EMEF would probably be at the core of all political games in Brussels. It would also undermine the essence of the 2010 reform of SGP enforcement calling for a reverse majority voting rule to overrule the Commission. If the views of the Council (reflecting the web of national political considerations) make it straight to the Commission through one of its Vice-Presidents, it would be difficult to understand the value created from that reform.

The Commission press release nevertheless justifies its creation, stating that “by bringing together existing responsibilities and available expertise, this new position would strengthen the coherence, efficiency, transparency and democratic accountability of economic policy-making for the EU and the euro area, in full respect of national competences” (European Commission 2017b). In terms of monitoring and evidence in connection with the fiscal situation of Member States, the European Semester includes several instruments on a fine-grained scale of analysis, for instance the Debt Sustainability Monitor or the procedures arising from the Maastricht Treaty and the SGP. An EMEF could perhaps make this set of procedures and analyses more coherent, transparent and democratically accountable, but it is a priori unclear whether they would be made more efficient.

On balance, as far as the Commission’s EMEF model is concerned, we find it hard to argue that any efficiency gain stemming from greater coherence would outweigh the risks arising from more disguised and potentially disorderly politicisation.

Given the emphasis on a “full respect of national competences” in the Commission proposal, it seems clear that the Commission’s EMEF would not exert significant additional competencies. Hence, we have to evaluate the effectiveness of the proposal in terms of fiscal sustainability, assuming the current set of rules and governance mechanisms, centralised at an EMEF. Would the mere existence of an EMEF lead to positive effects on fiscal sustainability on top of effects already present in the existing regime?

Given the restriction to the current set of rules, the answer can hardly be affirmative. While it is conceivable that an EMEF could bring about more visibility and transparency to the existing procedures – which in turn invites greater external scrutiny – it is hard to imagine that enforcement and governance would change dramatically in the short and medium term. And even if they do, the far-reaching concept of creating an organic link between the Commission and the Council could plausibly lead to additional opaque political bargains.

One can imagine, however, that the introduction of an EMEF, closer to the “Eurogroup 2.0” model, could have long-run effects conducive to fiscal sustainability.² First, she could influence the debate over the long-run fiscal sustainability challenges coming from future expenditures, for instance, in the pension systems of the Member States. Second, creating the position of the EMEF could be only a first step in establishing new rules and governance mechanisms that are more effective than the existing ones. Given that there is room for improvement in terms of the incentive mechanisms, a stronger focus on reforms of the rules that would be personalised in the form of an EMEF could be helpful.

² Andreozzi and Tamborini (2017) show theoretically that a policy coordination body that aggregates symmetrically national preferences can achieve Pareto-improving policy assignments to governments with respect to non-cooperative policies. If national preferences are distant they can be aggregated asymmetrically with more weight given to the country which bears the larger marginal loss (generally the one which is less averse to the optimal policy).

That being said, it is not too difficult to think of improvements to the design of EU fiscal governance in ways that make it less vulnerable to an increased risk of politicisation. In broad terms, we would recommend prioritising the following measures:

- Simplify inconsistent and overlapping rules that make the SGP effectively unreadable (Heinemann 2018). The main value of fiscal rules is to make fiscal behaviour more predictable and provide clear direction to policymakers in the longer run. A number of sensible proposals have been made elsewhere and they deserve serious considerations. The EFB – or a reformed, more independent and better resourced variant of it – could play a useful role in initiating such a proposal. The EFB already has skin in the surveillance game and an institutional incentive to get it right from an EU-wide perspective.
- Create a clear hierarchy of rules and institutions (see e.g. Ódor 2017). Especially for the EU, it is essential to clarify the roles of national rules, supranational rules and independent fiscal institutions (IFI). To create an effective hierarchy, the following question should be addressed: should EU rules be binding only when national rules do not appear to offer sufficient guarantees against unmanageable profligacy? Any reform in that direction again begs the need for a strengthened and fully independent EFB playing an expanded monitoring function of SGP implementation, equivalent to what national IFIs do at the country level. Should the EMEF proposal be implemented as currently envisaged, good balance would at a minimum suggest to loosen any link between the EFB and the Commission and to subject the EMEF to a comply-or-explain clause as regards EFB's assessments.

2.4 Conclusion EMEF and fiscal sustainability

Ensuring public debt sustainability in all members of a currency union is critical for the viability of the union. This is achieved through a complex web of rules and institutions aimed at establishing common standards of fiscal responsibility. While the view that putting the EMEF in charge of implementing the SGP for the purpose of efficiency has its merits in efficiency terms, we still see a risk that such gains could be offset by greater politicisation. Priorities in the reform of EU fiscal governance are arguable found elsewhere. They include a significant simplification of the current maze of rules and independent institutions, including a clear hierarchy between national and supranational arrangements, and simpler supranational rules. Should the idea of an EMEF be implemented as originally planned, risks could be mitigated by reforming the EFB. Asatryan et al. (2017b) outlines effective reforms, including designating the EFB as an independent arm and expanding its ability to play a genuine monitoring function of SGP implementation.

3 Stabilising EMU against macroeconomic shocks

3.1 Underlying general problem

Establishing macroeconomic stabilisation in the EMU is puzzling. Since the 1990's, the general academic consensus has been that demand fluctuations are larger and more frequent than those on the supply side, and that a number of “frictions” require active stabilisation policies in order to smooth major slumps and restore welfare. In this perspective, the stabilisation capacity of the EMU apparatus, with a single centralised monetary policy vis-à-vis constrained national fiscal policies, has raised scepticism from the very beginning, and indeed it has proved to be largely inadequate in the face of the crisis (De Grauwe and Ji 2013b, Manasse 2015, Corsetti et al. 2017, Fragetta and Tamborini 2017).³ Therefore, enhancing stabilisation capacity ranks high in the agenda of EMU reforms (Baldwin and Giavazzi 2016, Part 3; Bénassy-Quéré et al. 2018).

From the institutional point of view, creating new common stabilisation tools is less demanding in comparison to other more ambitious steps towards further integration (De Grauwe and Ji 2013a, Gros 2017). Concerns that stabilisation tools could be abused for transfers between Member States generate political resistance. This legitimate concern may be mitigated stressing that the primary end of the EMEF is stabilisation of symmetric shocks, i.e., aggregate disruptive events that by and large affect the whole area, and which may possibly exhaust the ECB stabilisation capacity. Had the EU taken concrete innovations for fiscal insurance in due time, the effects of the crisis would probably have been less dramatic, not least for the credibility of the EMU in the eyes of the citizens. Stabilisation tools generally include fiscal policy coordination and the aggregate fiscal stance, as well as the so-called “shock absorbers”, the main instances of which are countercyclical public investments and unemployment insurance schemes. These tools could complement, but should not crowd out, the necessary capacity of each country for self-insurance and resilience to shocks.

3.2 Current institutional shortcomings

Fiscal policy coordination: International relations theory suggests that countries with reciprocal (negative) externalities can enjoy welfare gains if they coordinate policies with others instead of pursuing independent policies (Alesina et al. 2005b, 2017, Andreozzi and Tamborini 2017). These gains can be even larger when the union-wide monetary policy is constrained by the effective lower bound (ELB) on interest rates. The advantages of cooperation explain why the aggregate fiscal stance is important to resolving the current account imbalances within the EMU. Whereas the relevance of intra-EMU imbalances is questionable, it is clear that the overall monetary/fiscal

³ Not least because the magnitude and extensions of “frictions” has turned out to be far more disruptive than conceived in the mainstream stabilisation policy blueprint. “It was tempting for macroeconomists and policymakers alike to take much of the credit for the steady decrease in cyclical fluctuations from the early 1980s on and to conclude that we knew how to conduct macroeconomic policy. We did not resist temptation. The crisis clearly forces us to question our earlier assessment.” (Blanchard et al. 2010, p. 1)

stance is a key determinant of the external current account of the EMU as a whole, which is in turn relevant to the evolution of the euro exchange rate. The fallacy of composition of national policies may be the unpleasant result. We see the symptoms of a dysfunctional macro-policy with the appreciation of the euro before the ECB quantitative easing and the emergence of a sizeable external surplus of the Eurozone which went hand in hand with a contraction of economic activity locally and around the world.

Formal policy coordination devices were not contemplated in the Treaties for two reasons. The first was the lack of sufficient political agreement among member countries. The second was the theoretical recommendation to safeguard the autonomy of monetary policy according to the then dominant doctrine known as “monetary dominance” vs. “fiscal dominance”.

The SGP can be regarded as an implicit coordination device respecting fiscal sovereignty formally while simultaneously granting “monetary dominance”. Whatever the overall assessment of the SGP is given its history, there are two major problems: First, the SGP was too weak to guarantee that Member States build sufficient fiscal buffers in good times. Excessive spending in boom times severely limited the fiscal space in numerous countries on the eve of the crisis period (Andrle et al. 2015). Second, a lack of coordination of fiscal policies during the crisis, e.g. between countries with less and more fiscal space, has been detrimental for each country and the EMU as a whole (as predicted by models of policy coordination failures; in’t Veld 2013, Berti et al. 2013, European Commission 2014, Alcidi et al. 2015). Improvements on this ground require a formal institution devoted to fiscal policy coordination as a complement to the rule-based mechanisms. The necessary steps, however, may just be incremental with respect to the existing EMU architecture.

Potential for self-insurance: The debate on new stabilisation mechanisms often underestimates the potential of self-insurance for countries with sound fiscal policies. Hence, the current demand for new stabilisation tools is also related to the fact that some euro countries have effectively lost their fiscal manoeuvrability due to high levels of debt accumulated during good times. From this perspective, a strategy of debt reduction is also conducive to regain own scope for anticyclical national policies. In this sense, adherence to the long-run sustainability of the SGP should also be seen as strategy to improve the stabilisation capacities of the euro area. One advantage of better coordinated macro-policies is that it encourages the states to build up buffers during good times. Because coordinated stabilisation is based on each country's fiscal space, and hence each of their capacities to issue and sustain new debt, Member States have incentives to pursue buffers. Countries with low buffers are allowed to have less fiscal stimulus in bad times. In a coordinated equilibrium, each country creates a larger buffer than in a non-cooperative equilibrium or in a rule-based system with penalty (Andreozzi and Tamborini 2017). From this view, coordination and self-insurance may be mutually reinforcing.

Common shock absorbers: Countries hit by adverse shocks and with initially little fiscal space tend to cut public investments first. This is unfortunate because public investments sustain employment and aggregate demand in the short run and may foster potential output in the long run. A first attempt in this direction has been made with the so-called Juncker Plan (Buti 2014). As to targeted shock absorbers, such as unemployment insurance schemes, the notorious hurdle, as in all insurance mechanisms, is moral hazard. In the EMU context, this means that the mechanism could hide permanent transfers to “weak” members. This argument presumes the inability to distinguish between a shock and a permanent state. While this distinction is difficult to make, the EU has adopted the Fiscal Compact based on that distinction. Substantial progress has been made on the technical grounds and a variety of proposals are available (more recent products include Brandolini et al. 2016, Beblavý and Lenaerts 2017, Dullien and Pérez del Prado 2018). However, numerous EMU reform contributions argue that the mutation of a stabilisation into a transfer system can only be credibly excluded with a yet non-existent debt restructuring mechanism (Bénassy-Quéré et al. 2018, Fuest and Heinemann 2017, Fuest et al. 2016).

3.3 Merits of an EMEF

An EMEF would likely be responsible for stabilisation policies as, indeed, she could take decisions from a euro area perspective. Hence, she has a potential to mitigate the problem that decentralised stabilisation policies will only provide a suboptimal dose of anti-cyclical measures. For this purpose, the EMEF could serve two functions: First, she would coordinate the appropriate aggregate euro area fiscal stance and directs Member States on their appropriate contribution. And second, she would be responsible for any new euro area stabilisation instruments.

While the first competency would already have potential today, the second hinges on the outcome of current reform debates (euro area budget, European Investment Fund, new EMU financing tools). The more these new instruments materialise, the larger the potential responsibilities of an EMEF. In line with our argumentation in section 2, we do not think that an EMEF would properly act as an SGP watchdog including decisions on SGP escape clauses. Instead, this task would be best left to independent fiscal institutions. Hence, the EMEF’s coordination role of national fiscal policy would lie within constraints as defined by the SGP. Given that three waves of SGP reform have considerably increased its flexibility, this should not be a detrimental constraint.

Coordination of fiscal stance: The EMEF could provide guidance to the Member States on using fiscal space (available within the limits of the SGP) to create an appropriate European fiscal stance in the aggregate. The centralisation of these mechanisms to an EMEF may offer more uniformity, predictability, transparency and peer monitoring. This becomes particularly important, when conventional monetary policy loses grip on the liquidity markets and interest rates fall to zero, coordination with aggregate fiscal policy becomes a necessity (Corsetti et al. 2017).

Steering of new euro area stabilisation tools: Common shock absorbers may take various forms, but they share two characteristics that distinguish them from the EMU stabilisation discussed above. First, they may be designed as automatic devices, so that they entail less political discretion on the shoulders of the EMEF. Second, these shock absorbers require a common pool of resources, i.e., they presuppose the existence of an EMU budget, and this requires an additional, uneasy, step towards integration. The creation of a common budget is eminently a political choice that we cannot discuss here. It can be said that the advantage of financing shock absorbers with common resources is that the national budgets become lighter and more flexible, granting Member States more fiscal space and preventing major tensions between fiscal stabilisation and national budget constraints. Moreover, if the shock is symmetric, the absorbers are triggered simultaneously and provide automatic coordination. Even though the automatism of shock absorbers would avoid significant discretion, the EMEF would still be mandated to steer and/or coordinate the new tools with a comprehensive euro area perspective.

3.4 Conclusion EMEF and stabilisation

The EMEF's success depends on the outcome of the ongoing EMU reform debate. In case of a new central stabilisation tool, economies of scale (e.g. Ricardian effects are much smaller at the higher level than at the lower level) and positive externalities (through supply chains and aggregate demand spillovers) can arise and might be even larger when the ELB is met. Without any upcoming breakthroughs on the new central stabilisation tool, the EMEF's role on stabilisation policy would be confined to the coordination of national fiscal policies, with the objective to realise an appropriate euro area fiscal stance.

Of course, the idea to encourage additional spending (and higher deficits) in countries with fiscal space for the sake of an "appropriate euro area fiscal stance" will be met with resistance both in countries with larger fiscal space but which do not want to erode it and in countries with little fiscal space willing to spend more. Moreover, these proposals would step out of bounds of the Maastricht contract which only had announced fiscal constraints for Member States with excessive debt and deficits. The question is whether an EMEF could convince Member States to take on fiscal constraints for the purpose of EMU-wide coordination.

Furthermore, another important role emerges with new stabilisation tools like a euro area budget or an outright shock absorbing stabilisation tool. Here the EMEF would have a natural role to oversee and coordinate these new instruments.

4 Stronger incentives for structural reforms

4.1 Underlying general problem

Delayed structural reforms can harm potential growth and resilience to idiosyncratic shocks, which in turn damages the entire union. Even though Member States are aware of the needed reforms, changes have often been implemented slowly and piecemeal, reducing their overall impact. Often, they were implemented under the pressure of events, when the policy space that could buffer some of the inherent costs (either aggregate or distributive) is stretched thin (Pitlik and Wirth 2003). Researchers have discussed what makes European countries special in their approach to reform (see, e.g., Heinemann and Grigoriadis 2016). For our purposes, we hold that Member States' high aversion to risk—as the individual effects of reforms are highly uncertain—and their appetite for equity that makes it easier for the losers in the reform process to gain political support (see e.g. Debrun and Pisani-Ferry 2006).

The economic case for structural policy coordination remains a priori unclear (Tabellini and Wyplosz 2004). First, spillovers from supply-side policies can be negative, as reformers likely improve their competitive edge over laggards. In that context, policy competition (non-cooperation) may yield more reforms than coordination. Second, collaboration among states may in fact hinder the process of tailoring solutions to country-specific structural gaps and political economy constraints.

On the other hand, the lack of coordination within the currency union can lead to inefficiencies when policies entail cross-border externalities. First, better functioning labour and product markets increase the overall resilience of national economies and foster real convergence, facilitating the conduct of monetary policy by the ECB. Second, coordination could offset reduced incentives for members of a currency union to enact reforms because of the lower risk of currency crisis and runaway inflation. Third, higher output growth associated with such reforms is contagious and enhances fiscal sustainability through dynamic revenue collection in the entire union.

Beyond the positive externalities associated with cooperation, coordination may be beneficial because of economies of scale. This takes place when one country learns from neighbouring countries' policy experimentation (Gassebner et al. 2011, Asatryan et al. 2017a). Political leaders of Member States realise that poor decision making will entail a reputational cost to them and have incentive to coordinate. To facilitate the diffusion of political information, Vertical Assistance Program can be further promoted (Asatryan et al. 2017a).

At the current juncture, there are added benefits to mandating an EMEF that cheers for national success and shames poor policymaking. Structural reforms implemented during the crisis—hence at higher costs and lower return—combined with the return of more benign growth condi-

tions and the fading memory of existential threats to the euro may give rise to widespread complacency. “Fixing the roof when the sun is shining” is the kind of conventional wisdom that flies in the face of short-term political motivations. Because an EMEF is less constrained by local politics and better aware of the union-wide benefits of more resilient national economies, she could play a key role in fostering the coordination needed to offset reform complacency.

4.2 Current institutional shortcomings

The EU does have influence over financial, and to a lesser extent, product market reforms. Many critical areas of structural reforms, most notably labour and fiscal reforms, remain in national hands. While interdependencies exist to bridge the Member-State-EU gap, e.g. product and labour market reforms complement each other, existing coordination procedures are too weak to be useful. Moreover, expectation that policymakers may seek to exploit such complementarities could magnify opposition to reforms. The fact that resistance to the so-called services directive in the early 2000s was motivated by its alleged labour market implications is a case in point (Debrun and Pisani-Ferry 2006).

Currently, the two potential central levers to foster reforms operate through both the European Semester and the implementation of the SGP. The European Semester by and large replicates the open method of coordination that had failed under the Lisbon strategy. Deroose and Griesse (2014) observe that in 2012-13, only around 10% of all country-specific recommendations have been fully or largely implemented. Legally enforceable reforms remain limited to competencies that are “exclusive” or “shared”.

On the other hand, SGP provisions allow the use of available fiscal space to enable desirable structural reforms. The complementarities between accommodative fiscal policy and structural reforms have been analysed at length elsewhere (Gaspar et al. 2016). One very relevant concern is to somewhat relax political constraints through the compensation of losers of reforms and through raising the possibility to cash in early on reforms by boosting aggregate demand in sync with the reduction of supply bottlenecks.

Crucially, current discussions about elements of a fiscal union such as a central fiscal capacity (Buti and Muñoz 2016, European Commission 2016) and other risk-sharing mechanisms (e.g., through a Banking Union) raise additional concerns on the reform front. The moral hazard issue inherent in risk-sharing can only weaken Member States’ incentives to increase their economies’ resilience with politically costly reforms (Vandenbroucke et al. 2016). Hence, the collective benefits of a stronger currency union should somehow make its way to national incentives driven by local politics.

4.3 Merits of an EMEF

The Commission's communication on the role of an EMEF (European Commission 2017a) explicitly recognises the ministry's potential role in promoting the implementation of structural reforms in the Member States, which strengthens economic policy coordination across different areas as well as in contributing to the reform agenda for the EU as a whole. In the context of this paper, we try to understand why an EMEF should play a role in advancing structural reforms and how she could achieve this goal.

As to the “why” the arguments rest on the case for coordination of national reform strategies. In principle, the case for international policy coordination is premised on the existence of economies of scale and externalities which, if ignored by individual Member States, may result in a low-reform equilibrium. The follow-up question is whether the EMEF is better placed to coordinate reforms than other existing institutions, most notably the European Semester and the SGP; or whether an EMEF could strengthen these institutions.

As to the “how” the discussion boils down to the weak coordination procedures of national policies within the European Union, especially those regarding structural policies. Coordination relies mostly on benchmarking and peer pressure—the so-called “open method of coordination.” It is only at the margin that the EU fiscal framework can provide carrots to reformist governments in the form of a potentially more lenient implementation of the common fiscal rules. Absent policy delegation to the centre – a prospect that does not seem politically conceivable – the answer must lie in the incentives provided to Member States. How could an EMEF develop and manage such incentives is the core of the matter. Thus the central challenge is to find a politically palatable middle ground between an approach that does not work – *open coordination* – and one that remains largely illusory – *delegation to the centre*.

As a driver for reform, the EMEF could use a number of levers to create incentives for Member States, in particular:

- The EMEF could become a key player in naming and shaming countries that have not followed through on their commitments on structural reforms. Experience with the SGP suggests that the credibility of formal sanction mechanisms is non-existent. Instead, a vocal and visible EMEF supported by persuasive analysis and good communication could amplify the reputational costs of lagging behind.
- The EMEF's role as an advocate of reforms could place her in a key advisory role when using fiscal space to promote reforms is envisaged under the SGP. For instance, Member States could only request exceptions for structural reforms under the SGP if those have been vetted by the EMEF.
- To limit states' moral hazard (which is inherent to other components of the fiscal union), the EMEF could condition access to such instruments—e.g. the central fiscal capacity or other financing mechanisms—to guarantee compliance with agreed reforms programs.

- The EMEF could organise a systematic exchange of information on structural reforms, their effects among Member States and best practices. This would facilitate learning and magnify the political economies of scale by raising the perceived costs of being a laggard. The EMEF could also inform and advise Member States on specific complementarities between EU-wide and national structural measures.
- The EMEF could assess whether certain reforms, whose impact is on aggregate supply is expected to be large, would justify special access to the central fiscal capacity. Impactful reforms amount to a positive supply shock. Closing the output gap requires discretionary fiscal action as neither monetary policy nor automatic stabilisers can play such role.

4.4 Conclusion EMEF and structural reforms

The discussion above shows that the case for structural policy coordination is stronger than ever. The 2008/09 financial crisis and the ensuing sovereign debt crises serve as powerful reminders that the resilience, dynamism and fiscal sustainability at the national and European levels are public goods. Only structural reforms – many of whom conducted at the national level and subject to national political constraints – can deliver this public good, which is essential for the success of the euro. Because local politics does not necessarily internalise the union-wide benefits of greater resilience and stronger growth, the resulting externalities as well as the strong complementarities between structural and macroeconomic policies make policy coordination indispensable.

Other likely elements of a fiscal union aggravate the structural coordination problem even further. While proposals aimed at increasing risk sharing are important to strengthen the euro area (e.g. Berger et al. 2018), they create moral hazard that runs counter to incentives for reforms.

In light of these challenges we think that the EMEF could serve as a helpful arrangement for policy coordination. In particular, the minister can employ both sticks and carrots to incentivise reforms at the national level. Of course, the ultimate success of this approach depends on whether these levers are sufficient to overcome local obstacles and secure sufficient ownership.

5 Optimum provision of European public goods through the EU budget

5.1 Underlying general problem

The Commission communication only sees a limited EMEF role for the EU Budget, but we want to ask whether there could be a wider potential. A functioning EFU should promote the efficient provision of public goods and appropriately allocate spending items to different federal layers

(Oates 2008). For example, items with significant cross-border spillovers or European economies of scale are candidates for the European level. This is particularly true if voter preferences are aligned across Member States. In a nutshell, the calculus involves a cost-benefit-analysis of centralisation: With positive spillovers to other jurisdictions within a federation, a decentralised approach will lead to underprovision of the public good. A central provision with equal cost sharing among the local jurisdictions, on the other hand, might not fit local preferences and needs (Besley and Coate 2003, originally formalised in Oates 1972). Relatedly, an argument in favour of decentralisation is that it encourages allocative efficiency, i.e., the public goods match the preferences of the citizens (Barankay and Lockwood 2007). Other forms of efficiency that can arise through decentralisation are an increased accountability of politicians (Seabright 1996) and yardstick competition (for an overview see Bordignon et al. 2004). Arzaghi and Henderson (2005) observe a rise in decentralisation internationally and explain it mostly by population and income growth.

Recently, Weiss et al. (2017) have applied this kind of reasoning to existing or potential European policies. They find that fields such as agriculture and education should be handled on the national level, whereas other areas are better delegated to the European level. The policy issues associated with the latter have large cross-border spillovers and economies of scale, whereas those of the former (agriculture and education) do not. Moreover, in these two policy areas the voter preferences across countries are heterogeneous. These findings and recommendations correspond to a whole strand of earlier literature (Alesina et al. 2005a, Heinemann and Begg 2006, ECORYS et al. 2008) which all point to the conclusion that the European budget's spending priorities do not correspond to an optimal division of labour between the European and the national level. Agricultural and regional spending appears to hold a disproportionately large share of Member States and a strikingly lower share for European public goods (e.g. defence, migration, development).

With that in mind, it is worth discerning the policy areas for which a centralisation to the European level could be beneficial. The natural questions are: why is a large weight of the EU budget not designated for European public goods? And why do attempts to reform meet a great deal of resistance?

One of the key explanations are “common pool” disincentives. The common pool theory (Shepsle and Weingast 1981, Weingast et al. 1981) analyses incentives of political representatives with local jurisdictions that jointly decide on the spending from a centralised budget where this budget is funded from a jurisdiction-wide taxation.

As a consequence of usual common pool problems, too much of the budget's weight is placed on local or national goods instead of EU-wide priorities without any clear justifications. This is a broad consensus of the literature based on fiscal federalism theory.

5.2 Current institutional shortcoming

In the European context, the EU budget with its EU-wide own resource financing would be considered the “common pool”. Although the European Commission has the mandate to represent the “general interest of the EU” (Commission 2018), decision makers on the EU budget (both in the Council and EP) are supportive of those spending categories which are highly visible within their constituencies. Their support is a straightforward consequence of the re-election constraint and the fact that voters tend to reward policies with high visibility. This explains large support for regional or agricultural spending and often low enthusiasm to expand other policies at the costs of these budgets with their high popularity among voters at home. Hence, local goods are more attractive than European public goods that have a low visibility at home and that might not be that attractive for the specific Member State.

Common pool incentives also explain the pre-occupation of national representatives with net balances and “juste retour”. Budget negotiations can become highly politicised, e.g. in case politicians face re-election concerns at home (Schneider 2013). Hence, in order to please their electorate, Member States do not want to contribute more to the EU budget than they get back, as a juste retour attitude would suggest. This net balance approach is intellectually flawed since it is based on a too narrow indicator of national self-interest. Nevertheless, it is politically powerful and a fact of European life. The crucial questions then become: how would the EU channel these incentives and how to do it as to minimise their detrimental effects.

Theory predicts that common pool disincentives lead to (a) an overexpansion of budgets above a welfare-maximising level, (b) an excessive debt level because of the incentive to also use resources from future tax payers, and (c) a structure of the budget with a bias to local projects (“pork barrels”).

Today, EU budgetary institutions offer effective precautions against (a) and (b) but fail to successfully cope with (c). The Multiannual Financial Framework (MFF) sets annual maximum amounts that can be spent within the programme period. Moreover, the own resource principle states that all expenditures have to be covered by own resources. Hence, these two provisions provide effective upper limits on spending pressure resulting from the common pool problem. Moreover, the annual budget must be balanced and debt financing of the EU budget is not allowed. Still, we have not addressed the bias towards local public goods, thus the question is whether a European Finance Minister would or would not be part of the solution.

5.3 Merits of an EMEF

The Commission’s communication on the role of an EMEF (2017a) does not discuss her potential role for the EU budget or European public goods beyond a narrow range of euro area related policies (Investment Plan). However, they do mention that the common interest of the EU, including shared priorities, is ill-represented.

How could the EMEF help to improve the efficient allocation of public goods in the European Union? Hallerberg and von Hagen (1999) develop a model to counteract the common pool problem in the budget process with two different mechanisms: delegation to a strong finance minister versus rule commitment to fiscal targets. In the delegation approach, the finance minister makes a first proposal for the budget. The higher her agenda-setting power, the closer the final budget will be to her initial proposal and the closer the deficit to the “collectively optimal outcome” (Hallerberg and von Hagen 1999, p.215). The finance minister also monitors the spending ministers and can punish or reward them. Relatedly, von Hagen and Harden (1995) suggest that a finance minister can reduce administrative uncertainties arising from fiscal illusion created by ministers responsible for specific policy areas. In the commitment approach, the government sets its own fiscal targets. Also here, someone has to monitor the ministers, and here too can the finance minister take on such responsibility.

Their considerations could help to answer this chapter’s underlying question of how to maximise the EMEF’s effectiveness. However, as already discussed, the EU budget is limited to its own resources; taking on deficit is not an option. Hence, the efficient spending of the EU budget takes on broader objectives than simply sound public finances (Hallerberg and von Hagen 1999 investigate this). Moreover, their analysis does not explicitly include the possibility that a strong finance minister changes the structure of the budget, i.e., that she proposes public goods that have not yet been included in the budget. The responsibilities for some of the potential European public goods could be shared between the EU and the Member States, others might be left under national responsibility. The EMEF would need to consider the adoption of “new” European public goods.

Hallerberg and von Hagen (1999) state that a finance minister would be best suited in one-party majority governments, while the commitment approach is better suited multiparty governments. Clearly, this line of reasoning cannot be directly applied to the EU and to its budget decision process, where the Council plays a crucial role (through the unanimity requirement on the MFF) and where the European Parliament holds subsequent veto power (as the MFF requires the consent from the EP, Art. 312 TFEU). However, the divergent interests across Member States (in the Council and EP) and across parties (in the EP) can better be analysed by using the multiparty analogy from a national system than the one-party majority setting. Hallerberg and von Hagen (1999) point to the difficulty of the delegation approach in a multiparty government as the finance minister with his party affiliation will then not be recognised as impartial. An analogous problem would arise with an EMEF who is a citizen of a Member State and – with an increasingly political orientation of the Commission – a member of a party. Hence, Member States might not wish to delegate a strong agenda-setting power to an EMEF at the costs of their own veto power. Therefore, it is difficult to see how an EMEF could achieve a more efficient EU spending structure, even if she is influential in the agenda setting for the MFF. It may be more promising to increase the relative attraction of European public goods compared to local goods from the perspective

of national policy makers. This could be achieved, for example, through higher national co-financing rates for public goods with a strong regional or national benefit (Heinemann 2016).

5.4 Conclusion EMEF and EU budget

The current EU budget does not place enough weight on European public goods. The misallocation is a product of the common pool problem and the Council and Parliaments' *juste retour* mentality. Overall, a budgetary process delegation to an EMEF is inappropriate. It would not be well-targeted to the underlying problems and most Member States would be unfavourable to a high agenda-setting power of a single person due to heterogeneous preferences. Instead, what would be more effective is changing the fiscal incentives of Member States.

6 Discussion

To resolve complex governance issues within the EU, the Commission has ambitiously proposed the creation of a new institution, the European Minister of Economics and Finance. This policy report clarifies the role of the EMEF in the context of the reform debate on a new European Fiscal Union (EFU). An important methodological assumption is that the assessment of pros and cons of the EMEF is conditional on the intersection between the general approach to EMU reform (e.g. Maastricht 2.0 vs. confederal model) and the specific design of the new institution. Hence, for obvious reasons of prominence we focused on the Commission's proposal, but we have also sketched how different views may fare comparatively.

Table 1 below presents a synthesis of the EMEF's main potential challenges and its possible contributions in light of the four EFU dimensions surveyed in this paper.

Fiscal sustainability: As predicted by the Optimum Currency Area theory, coexistence of rules aimed at fiscal discipline with residual sovereignty after the loss of monetary power remains a challenge for a stable and functional EMU. Can the creation of EMEF help overcome these drawbacks? The Commission's EMEF does not seem very likely to make fiscal rules more credible nor to promote long-run sustainability of Member States' budgetary policies. On the contrary, the concept might even exacerbate the problem that opaque and "weighted" political bilateral negotiations drive SGP interpretations. Less problematic may be a classic checks and balances model with clear-cut separation between political prerogatives and independent control. This design can be reached with a reformed EFB.

Stabilisation: The assessment is more favourable for the stabilisation task although here the future role of an EMEF crucially depends on whether new euro area stabilisation tools are set up or not. If no innovation materialises, the EMEF would be confined to the coordination of national fiscal policies, where the notorious problem is resistance created by divergent national interests.

The Commission has so far failed to enforce fiscal-space-dependent contributions to the euro area fiscal stance. So will the EMEF. One reason may be that the Commission has no clear mandate to coordinate because this function is not explicitly included in the Treaties, and, so far, it has not been endorsed by governments. Hence, once again, the profile and mandate of the EMEF vis-à-vis governments' prerogatives is critical. The potential is clearer if the European level gets new "own" stabilisation instruments where the EMEF would be the natural candidate to steer and coordinate these instruments.

Structural reforms: We are largely optimistic with regards to the EMEF's role as a structural reformer. An EMEF in control of new central fiscal capacities, along with the aforementioned stabilisation tools, could employ them as "carrots" for reforms. The EMEF would also have a role in organising an efficient exchange of information of reforms and best practices.

European public goods: The Commission's EMEF would not be helpful in correcting the built-in bias in the EU budget that favours regional and national public goods at the expense of European public goods. Again, the literature points to more promising remedies that entail new financing rules for different types of spending items (with larger national co-financing for national or regional goods). An EMEF would still be confronted with a similar level of heterogeneity in spending preferences across Member States and parties in the European Parliament as experienced today. Therefore, we remain unconvinced that this institutional innovation would bring any progress.

Table 1: Overview of EFU dimensions' main challenges and potential EMEF contributions

Current challenge	EMEF Contribution
Fiscal sustainability: overall assessment negative	
<p>The complexity of the existing fiscal governance rules and benchmarks weakens compliance and encourages a maximalist interpretation of the flexibilities embedded in the SGP.</p> <p>The greater weight of the Commission (relative to the Council) in enforcing SGP does not help de-politicise enforcement decisions which further weakens compliance in larger countries and making it uneven across countries.</p>	<p>The Commission's EMEF, who simultaneously serves as Vice President of the Commission and chairs the Eurogroup, is unlikely to meet the key challenges. An EMEF may increase opaque and potentially disorderly political negotiation <i>vis-à-vis</i> the enforcement of rules. This risk may jeopardise potential benefits like greater coherence in SGP implementation.</p> <p>Priorities in the reform of EU fiscal governance are elsewhere, such as in the significant simplification of rules and independent institutions.</p> <p>Should the EMEF be put in place, a classic checks and balances model is preferable with clear-cut separation of political prerogatives and independent control that may be assigned to a reformed EFB.</p>
Macroeconomic shocks: overall assessment weakly positive	
<p>Not enough fiscal buffers built up in good times.</p> <p>Harmful lack of coordination of fiscal policies during the crisis, e.g., between countries with less and more fiscal space.</p> <p>Common shock absorbers are difficult to implement due to the threat of moral hazard and concerns that permanent transfers might be the consequence.</p>	<p>EMEF has potential to better coordinate national fiscal policies based on appropriate euro-wide fiscal stance and national fiscal space.</p> <p>Coordination (also in consideration of different fiscal spaces) faces the challenge of national resistance. The EMEF design is crucial as to the way national preference/interests are aggregated in order to overcome non-cooperative strategies.</p>
Structural reforms: overall assessment weakly positive	
<p>Economies of scale and externalities can result in a low-reform equilibrium.</p> <p>Two of the existing institutions, the European Semester and the SGP, have not proven sufficient to escape from this equilibrium.</p> <p>Elements of a deeper fiscal union such as a central fiscal capacity and other risk-sharing mechanisms create moral hazard issues and further weaken states' incentives to reform.</p>	<p>EMEF improves cross-national policy coordination both by using new instruments and by strengthening existing institutions.</p> <p>EMEF supported by persuasive analysis and good communication amplifies the reputational costs of lagging-behind reformers.</p> <p>EMEF can also use sticks in the form of access to central fiscal capacity when incentivizing the implementation of reforms.</p> <p>However, the ultimate success of this approach rests on whether these levers are sufficient to overcome local obstacles and secure sufficient ownership.</p>
Public goods: overall assessment negative	
<p>Common pool disincentives: poor structuring of budget creates politicians' bias towards local projects ("pork barrels").</p>	<p>EMEF as budgetary agenda setter would be confronted with heterogeneous spending preferences (variety of interests across Member States, in the Council and EP, and across parties, in the EP).</p> <p>EMEF remains hardly a promising institution to tackle common pool disincentives.</p>

Bundling of tasks: In addition to this single-issue assessment, it is also important to reflect strengths and weaknesses that emerge from the bundling of tasks in one institution and even in one person. First of all, multiple responsibilities for one person could lead to a capacity problem. Even with strong institutional support, it is hard to imagine that one person could convincingly cope with the workload from the long list of responsibilities which the Commission communication has foreseen. Similarly, the extraordinary responsibility comes with enormous power. A Minister with this broad portfolio would be a powerful player which in itself, from a political economy perspective, will raise resistance. It is difficult to imagine that Member States will accept to replace a national minister as chairman of the Eurogroup by a Commissioner. A kind of hierarchical inconsistency would emerge if the EMEF as the “Number one” (President) of the Eurogroup would at the same time be the “Number two” (Vice-President) of the Commission. This idea is particularly toxic as it creates a direct and powerful link between bodies that should have the EU-wide interest at heart (EC, ESM/EMF) and those where national political interests typically dominate (Eurogroup/Council which by construction looks like a “senate”).

Bundling of tasks will create both complementarities and conflicts. A potential conflict arises from a joint responsibility for both stabilisation and sustainability and the different time perspectives of both issues. The shorter-run interest for stabilisation may lead to larger compromises on needs for a fiscally sound policy. This conflict is more dramatic when an insolvent euro country is involved. In this case, fiscal sustainability can only be regained with debt restructuring. However, this may cause short-run uncertainties and macroeconomic turbulences (at least in the absence of an orderly insolvency procedure). Hence, an EMEF might be tempted to avoid restructuring by activating stabilisation tools to finance the insolvent country. Likewise, the EMEF might prefer to “look the other way” on SGP fines as to not be forced to deal with that Member State.

Despite the risk of conflict, a centralised stabilisation tools in the hands of the EMEF may also increase her influence on structural reforms. The EMEF could condition access to a central fiscal capacity and other financing mechanisms on compliance with agreed reform programs. This would leave the EMEF with harder instruments when incentivising reforms.

Overall, we find that the EMEF - according to the Commission design - is unlikely to be as much of a breakthrough as the Commission had advertised. The intricacies of the EMEF idea, which here we have sought to disentangle but not to hide, is however a message in itself: There is a real risk that another symbolic reform will be ill-targeted, bring much unsubstantial change and irritate and alienate voters.

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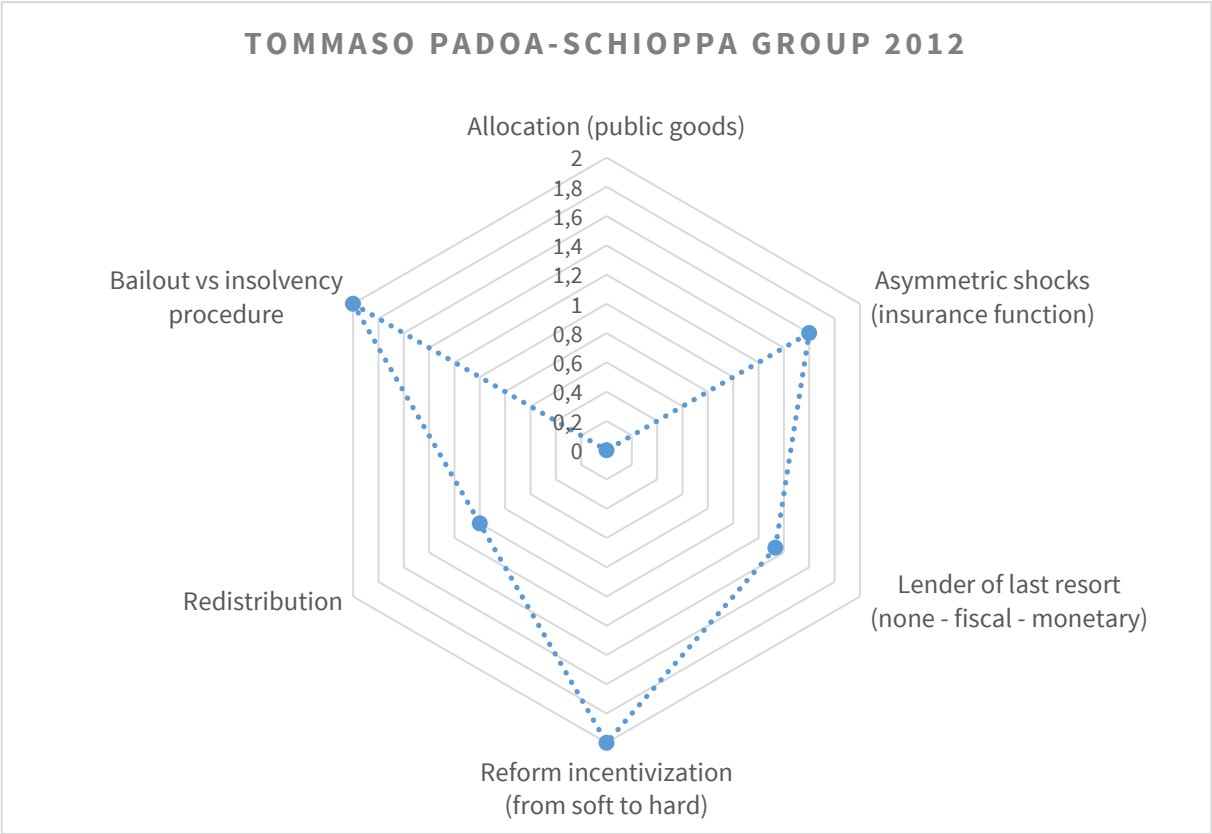
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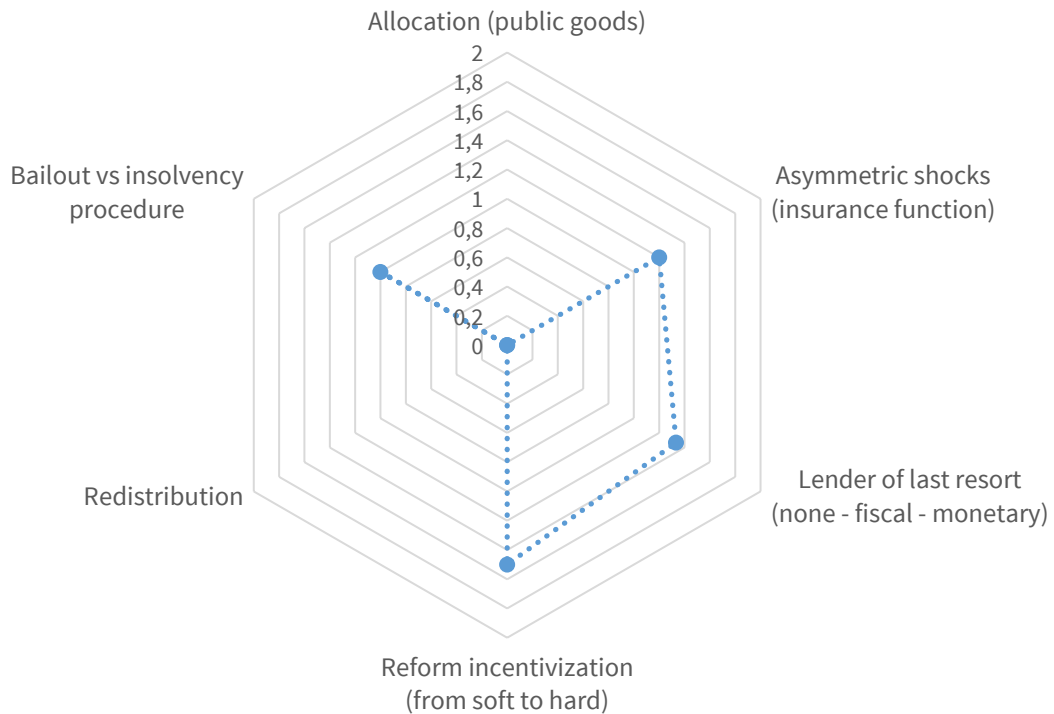
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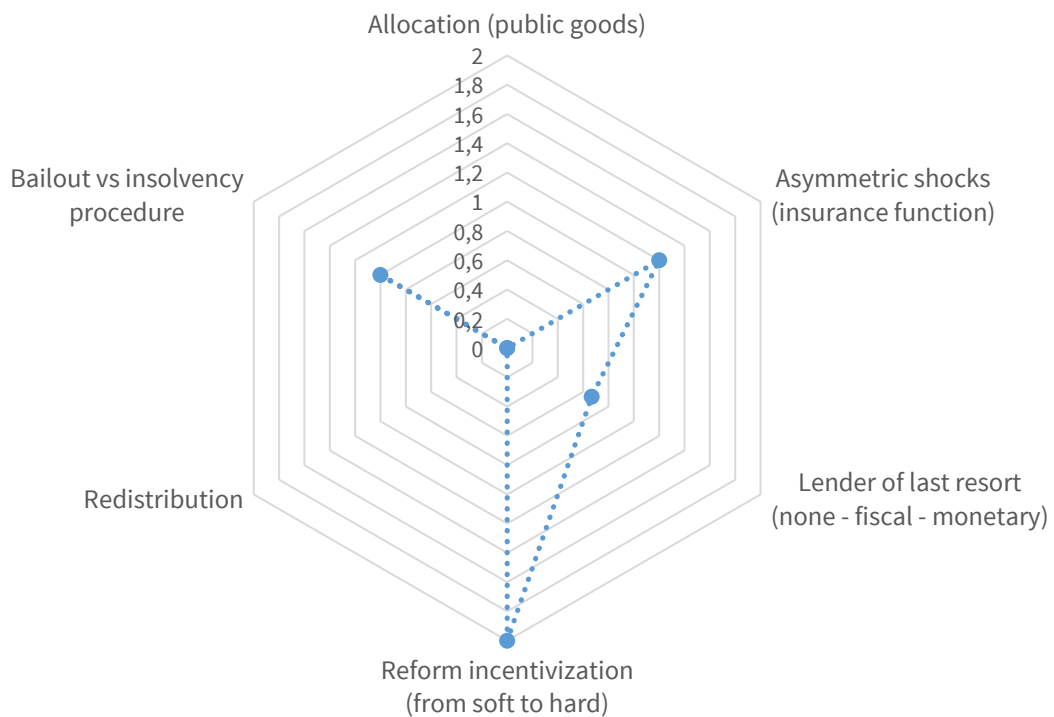
Appendix - Figure 1: Relative strength of fiscal union dimensions in three union blueprints



BÉNASSY-QUÉRÉ ET AL. 2016



SAPIR AND WOLFF 2015



EconPol Europe

EconPol Europe - The European Network for Economic and Fiscal Policy Research is a unique collaboration of policy-oriented university and non-university research institutes that will contribute their scientific expertise to the discussion of the future design of the European Union. In spring 2017, the network was founded by the ifo Institute together with eight other renowned European research institutes as a new voice for research in Europe.

The mission of EconPol Europe is to contribute its research findings to help solve the pressing economic and fiscal policy issues facing the European Union, and thus to anchor more deeply the European idea in the member states. Its tasks consist of joint interdisciplinary research in the following areas

- 1) sustainable growth and 'best practice',
- 2) reform of EU policies and the EU budget,
- 3) capital markets and the regulation of the financial sector and
- 4) governance and macroeconomic policy in the European Monetary Union.

Its task is also to transfer its research results to the relevant target groups in government, business and research as well as to the general public.