

Die EU auf dem Weg in die Fiskalunion? Die Transformation europäischer Fiskalinstitutionen in der Pandemie (und Energiekrise)

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“Wirtschaftspolitik in stürmischen Zeiten: Wohin steuert die
Europäische Wirtschafts- und Währungsunion?”



ZEW

GEGEN DIE ENERGIEKRISE

Der Streit um neue EU-Schulden geht in die entscheidende Phase

VON HENDRIK KAFSACK UND WERNER MUSSLER - AKTUALISIERT AM 07.10.2022 - 10:24



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Opinion **European Central Bank**

The ECB's new backstop introduces atrocious incentives

Populist governments will now be able to introduce irresponsible spending policies

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VORBILD PANDEMIE-FONDS

Brüssel erwägt neue EU-Schulden für Wiederaufbau der Ukraine

AKTUALISIERT AM 06.05.2022 - 20:10



ECB president Christine Lagarde says the transmission protection instrument would be activated if there is a threat to monetary policy in the eurozone © Alex Kraus/Bloomberg

OUTLINE

- The Maastricht perspective and the two competing models for a „European Fiscal Union“
- Institutional innovations in the pandemic
 - Monetary policy: PEPP
 - Fiscal policy: NGEU
- ECB on its way into a „fiscal dominance“ regime?
- Outlook for Europe’s Fiscal Union: the risk of a dysfunctional hybrid

THE HOPE FOR THE „ENDOGENEITY OF TOCA CRITERIA“ WAS SHATTERED IN 2010/12

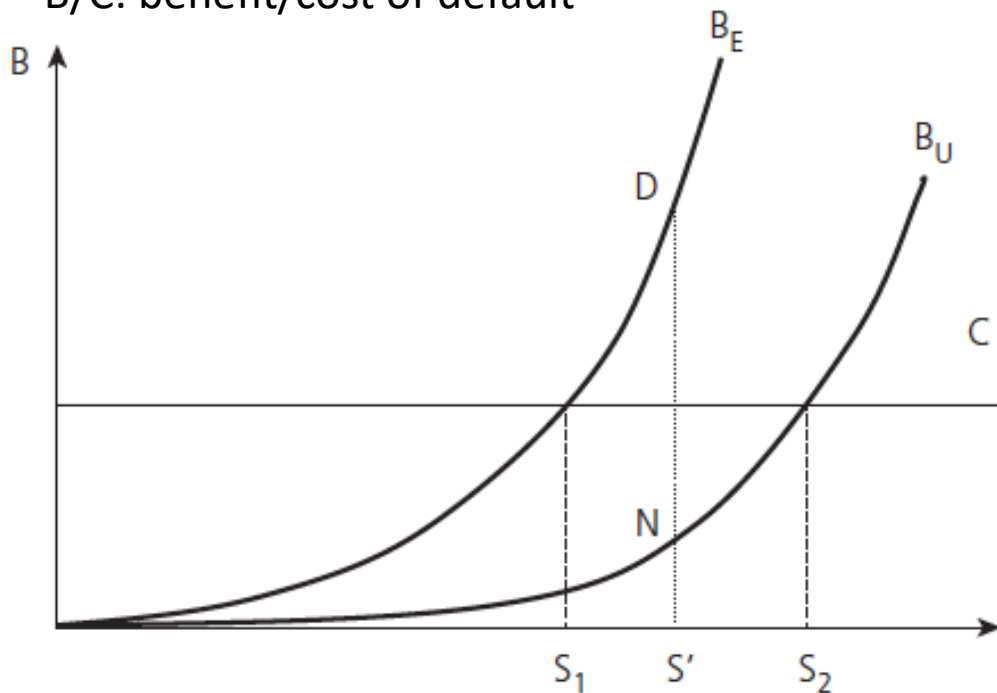
Frankel/Rose (1996), De Grauwe (2005)

The single currency itself

- promotes economic integration and increases symmetry of shocks (uniform monetary policy),
- incentivizes structural reforms that provide more good and labor market flexibility (i.e. promote price and wage flexibility – the first best adjustment instrument).
- Paul de Grauwe (2005) on **TOCA endogeneity**: „*Our preliminary conclusion is one of moderate optimism*“.
- Since then, this optimism has been deeply shattered in 2010/2012

THE MULTIPLE EQUILIBRIUM CHALLENGES SINCE THE EURO AREA DEBT CRISIS 2010/12

Bad Equilibrium in a model of “optimum default”:
Illiquidity versus Insolvency (De Grauwe, Ji, 2013)
B/C: benefit/cost of default



Medium range of fundamentals:

$$S_1 < S < S_2$$

Two equilibria: N and D, both
consistent with expectations

Bad fundamentals: $S > S_2$.

Default guaranteed:

Only choice is the one between
restructuring and transfers
(liquidity assistance/optimism
do not help).

European Commission (2018) Debt Sustainability Monitor: six euro countries “at high fiscal sustainability risk in the medium-term”

THE STRUGGLE BETWEEN TWO CONSISTENT STRATEGIES

Decentralized fiscal union:

“Maastricht model”

- Member States keep their fiscal autonomy
- National liability, credible no-bailout
- Feasible sovereign debt restructuring
- Market discipline effective
- A national sovereign debt crisis remains an isolated event without significant spillovers
- Coordinated macro-policies

The federal model

- Mutual guarantees
- „European Minister of Finance“ with right to intervene in national budgetary policies
- Euro area budget/equalization
- Stronger role for European Fiscal Board
- A national sovereign debt crisis leads to binding EU guidance for its budget

THE PANDEMIC AS A CATALYST

THE PANDEMIC NARRATIVE IS FUNDAMENTALLY DIFFERENT TO THE 2010/12 NARRATIVE

“This crisis is exogenous – no national responsibility, hence no moral hazard”.

- ESM-type conditionality rejected
- Weakening case against insurance/transfers/joint borrowing

Monetary Policy:

- ECB establishes the Pandemic Emergency Purchase Programme (PEPP) in March 2020, Transmission Protection Instrument (TPI) in July 2022

Fiscal Policy:

- Stability and Growth Pact: Activation of Escape Clause in March 2020
- 540 billion EUR loan package (SURE, ESM, EIB) in April 2020
- 750 billion EUR Next Generation EU – political agreement in July 2020

PSPP/PEPP AND THE SOFTENING OF RULES

	PSPP 2015	PSPP 2020	PEPP
Credit quality minimum requirements	Greece excluded	Greece excluded	Greece included
Issue limit	25%	33%	None
Issuer limit	33%	33%	None
Remaining maturity	2-30 years	1-30 years	70 days - 30 years
Yield below deposit facility rate	Not permitted	Permitted	Permitted
Role of ECB capital key	Strict both for flows and for stocks	Only for stocks	Flexible

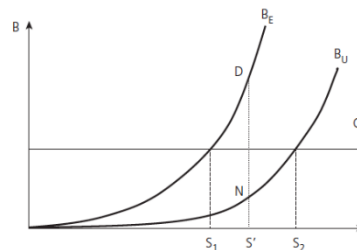
ONE QUESTION UNANSWERED BY THE ECB

How does the ECB operationalize „fundamentally unjustified spreads“?

Empirics

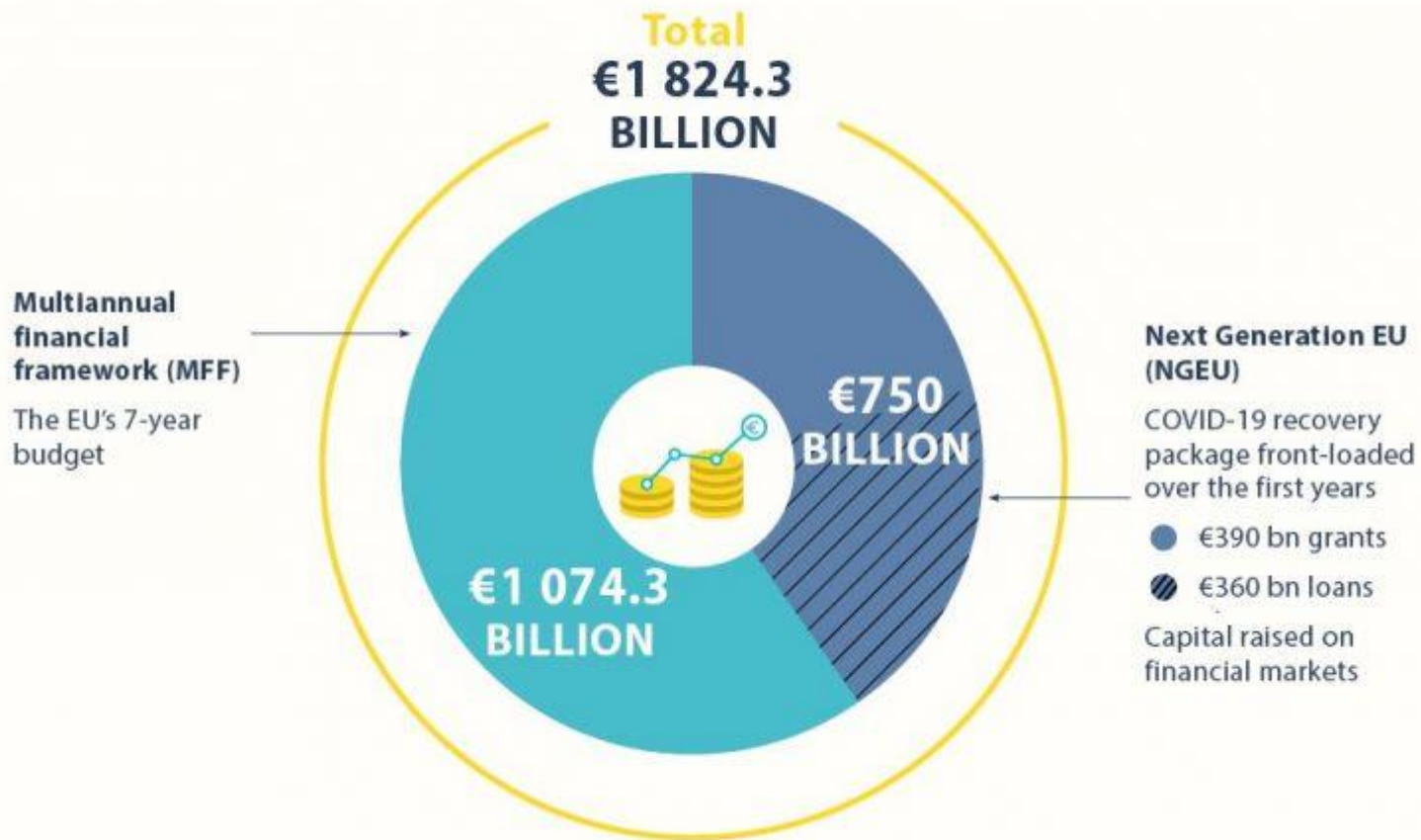
Current spreads far below the spreads to be expected in a calm market environment:

Pamies, Stéphanie, Carnot, Nicolas and Pătărău, Anda (2021), Do Fundamentals Explain Differences between Euro Area Sovereign Interest Rates?, European Commission, European Economy Discussion Paper 141.



750 BILLION IN ADDITION: “NEXT GENERATION EU”

EU expenditure 2021-2027



PROVISION FOR NON-PAYMENT OF A MEMBER STATE – ART. 9

*(5) ... If a Member State fails, in full or in part, to honour a call on time, or if it notifies the Commission that it will not be able to honour a call, in order to cover for the part corresponding to the Member State concerned, the Commission shall provisionally have the right to make **additional calls on the other Member States. Such calls shall be pro rata to the estimated budget revenue of each of the other Member States.** The Member State which failed to honour a call shall remain liable to honour it.*

(6) The maximum total annual amount of cash resources that may be called from a Member State under paragraph 5 shall in all circumstances be limited to its GNI-based relative share in the extraordinary and temporary increase in the own resources ceiling as referred to in Article 6. . . .

Mutual guarantee established through EU budget.

Different to ESM: no effective upper limit for German guarantee.

REQUESTED GRANTS AND LOANS FROM RRF

	Official submission date	Grants requested	Estimated grants	Loans requested	Maximum loans
Austria	01/05/2021	4.5	3.5	0	27.2
Belgium	01/05/2021	5.9	5.9	0	32.8
Bulgaria	15/10/2021	6.6	6.3	0	4.2
Croatia	15/05/2021	6.4	6.3	0	3.7
Cyprus	17/05/2021	1.0	1.0	0.2	1.5
Czechia	02/06/2021	7.1	7.1	0	14.3
Denmark	30/04/2021	1.6	1.6	0	21.9
Estonia	18/06/2021	1.0	1.0	0	1.9
Finland	27/05/2021	2.1	2.1	0	16.4
France	29/04/2021	40.9	39.4	0	168.4
Germany	28/04/2021	27.9	25.6	0	240.9
Greece	28/04/2021	17.8	17.8	12.7	12.4
Hungary	12/05/2021	7.2	7.2	0	9.7
Ireland	28/05/2021	1.0	1.0	0	18.7
Italy	01/05/2021	68.9	68.9	122.6	122.8
Latvia	30/04/2021	1.8	2.0	0	2.0
Lithuania	15/05/2021	2.2	2.2	0	3.2
Luxembourg	30/04/2021	0.1	0.1	0	2.7
Malta	13/07/2021	0.3	0.3	0	0.8
Netherlands	Not yet submitted		6.0		55.3
Poland	03/05/2021	23.9	23.9	12.1	34.8
Portugal	22/04/2021	13.9	13.9	2.7	14.2
Romania	31/05/2021	14.3	14.2	15.0	15.0
Slovakia	29/04/2021	6.6	6.3	0	6.3
Slovenia	01/05/2021	1.8	1.8	0.7	3.2
Spain	30/04/2021	69.5	69.5	0	84.8
Sweden	28/05/2021	3.3	3.3	0	33.2
EU26		331.0	325.9	166.0	892.7
Remaining 1 country			12.3		59.5

Source: Bruegel
Update June 2022

A CRUCIAL QUESTION: FISCAL OR MONETARY MEASURES MORE CRUCIAL?

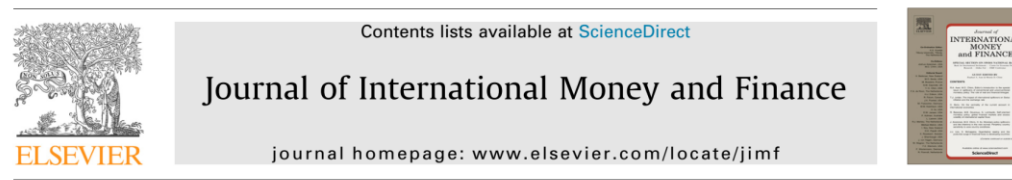
Measures (PEPP, NGEU) have so far stabilized the markets for euro area sovereign bonds, smooth refinancing of high pandemic government deficits.

Unclear: Which side is more important? This is a crucial question for the future of the euro area set-up – the looming “**fiscal dominance**”

- Central banks increasingly constrained by the urgent need to guarantee liquidity of highly-indebted governments
- Central banks effectively lose independence

AN EMPIRICAL TESTS

Event study on euro area spread compression in the pandemic: The relative role of PEPP and NGEU



Dispelling the shadow of fiscal dominance? Fiscal and monetary announcement effects for euro area sovereign spreads in the corona pandemic



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MESSAGE EVENT STUDY

European emergency measures have successfully contributed to shielding euro sovereign markets

- Results suggest that most of the European fiscal rescue measures (SURE program, EIB, and ESM) have played no crucial role in this respect
- NGEU is associated with a small and robust reduction in sovereign spreads
- PEPP exhibits a noticeable and robustly effect
→ instantaneous and sizeable spread compression

Spread compression was a success – but fiscal dominance is a real risk

EUROPEAN FISCAL UNION MIGHT BE HEADING TOWARDS A DYSFUNCTIONAL HYBRID

Decentralized fiscal union: “Maastricht model”

- Member States keep their fiscal autonomy
- ~~National liability, credible no-bailout~~
- ~~Feasible sovereign debt restructuring~~
- ~~Market discipline effective~~
- ~~A national sovereign debt crisis remains an isolated event without significant spillovers~~
- ~~Coordinated macro policies~~

The federal model

- Mutual guarantees (both fiscal and monetary)
- ~~„European Minister of Finance“ with right to intervene in national budgetary policies~~
- Euro area budget/equalization
- ~~Stronger role for European Fiscal Board (Asatryan/Heinemann)~~
- ~~A national sovereign debt crisis leads to binding EU guidance for its budget~~

POSSIBLE MEDIUM- AND LONG-RUN “SOLUTIONS”

- **NGEU as a growth driver and turning point that fixes the TOCR inconsistency of EMU** (wishful thinking?)
- Accepting **fiscal dominance as a permanent feature** of the euro area (inflation, legal risks?) with the central bank organizing a financial repression strategy
- Making **NGEU/SURE and joint borrowing a permanent feature** (moral hazard, transfer union?) – politically attractive because of its intransparency
- Preparing for **orderly debt restructuring of insolvent countries**, first step: ESM reform with bank risk weighting of sovereign bonds (market pressure, political resistance?): Unlikely due to large political costs for over-indebted governments

Heinemann, F. (2021). The Political Economy of Euro Area Sovereign Debt Restructuring. Constitutional Political Economy. 32: 502-522.