



**European Committee
of the Regions**

ECON-VI/018

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OPINION

Fiscal capacity and automatic stabilisers in the Economic and Monetary Union

THE EUROPEAN COMMITTEE OF THE REGIONS

- believes that in order to regain trust, the euro must deliver on its promise of stability, convergence, growth and jobs. A fiscal capacity could help in achieving such goals;
- reiterates its belief that, in the short term, completion of the Banking Union is the most effective instrument for preventing crises in the financial system and minimising the negative effects of economic shocks ;
- takes note of the belief that fiscal capacity is necessary to equip EMU with a temporary shock absorption mechanism. A possible fiscal capacity should not overlap with cohesion policy instruments but be complementary to those instruments;
- considers however that a fiscal capacity at the EU level should not be designed in such a way that the risk of permanent transfers would arise, thus undermining the incentives for sound economic and social policy making and policy implementation at national or regional levels or incentives to address national or regional structural weaknesses. Accordingly, and to prevent moral hazard, it should be tightly linked to compliance with the broad EU governance framework and progress in convergence;
- considers that two functions could be fulfilled; firstly, Member States' structural reforms could be incentivised in good economic times in order to foster economic and social convergence within the euro area and improve its economic competitiveness and resilience; and, secondly, differences in the business cycles of euro area Member States stemming from structural factors could be smoothed out by the creation of an instrument to address asymmetric shocks;
- points out that it would be worth examining whether an additional tool to enhance structural reform, designed to provide funding in the form of loans for a Public Investment Strategy, would be useful. This could allow the identification of a pool of financing sources and investment projects needed to support the implementation of the necessary reforms.

Rapporteur

Rapporteur: Carl Fredrik Graf (SE/EPP), Member of Halmstad Municipal Council

Reference document

Opinion of the European Committee of the Regions – Fiscal capacity and automatic stabilisers in the Economic and Monetary Union

I. POLICY RECOMMENDATIONS

THE EUROPEAN COMMITTEE OF THE REGIONS

II. INTRODUCTION

1. acknowledges that the euro was meant as a shield against exchange-rate fluctuation and was conceived as a tool for ensuring better long-term growth. However, its introduction has eliminated policy options for counterbalancing asymmetric shocks, including exchange-rate devaluation;
2. regrets that shortcomings have existed in the Economic and Monetary Union (EMU) since its design under the Maastricht Treaty, with the attribution of monetary policy to the European level while budgetary policy remains the responsibility of the Member States and is only framed by provisions for relatively light coordination of national policies;
3. considers that EMU exposed its vulnerability during the global financial and economic crisis when, in the context of excessive public and private debt levels, unsustainable imbalances led to a sovereign debt crisis, in which government borrowing costs dramatically increased in some Member States, jeopardising, in the absence of a proper fiscal backstop, the very existence of the euro area;
4. acknowledges the results achieved since the beginning of the crisis in the area of risk reduction and the many measures taken by the EU institutions to strengthen coordination of national fiscal policies;
5. notes that notwithstanding these efforts and the return to positive growth rates in several EU regions, due in large part to external factors, mere coordination of national fiscal policies has neither enhanced the national capacity to absorb economic shocks, nor prevented the emergence of an investment gap and rising levels of inequality within the EMU¹, and that the policies have proved insufficient to trigger growth-enhancing, sustainable and socially balanced structural reforms;
6. recognises that the ECB has ensured the stabilisation of the economic cycle since the beginning of the crisis. The President of the ECB has called for integrated institutions, for a stronger and more proactive fiscal policy on a euro area scale and for euro area Member States to deliver on structural reform. While warning that monetary policy on its own cannot stimulate the economy, underlines that the current low interest rates are conducive for borrowing and investments. Fundamental structural reforms and ownership of them at the level closest to citizens and fiscal responsibility are the paving blocks to return to long-term, sustainable growth;

¹

Cf. Annual review of Employment and Social Developments in Europe, published by the European Commission on 20 December 2016.

7. notes that the Five Presidents' Report on Completing Europe's Economic and Monetary Union points out that a shock absorption capacity at euro area level is needed to complement automatic stabilisers at national level, if and where necessary;
8. believes that in order to regain trust, the euro must deliver on its promise of stability, convergence, growth and jobs. A fiscal capacity could help in achieving such goals. Solidarity is closely linked to and dependent on responsibility, meaning that additional financial support at the euro-zone level should only be provided in the continuous presence of both fiscal responsibility and structural reforms;
9. reiterates its request that in all decision-making regarding the development of EMU, such as the introduction of a fiscal capacity and automatic stabilisers, the role of local and regional authorities in creating the conditions for sustainable growth should be fully recognised, and strengthened wherever possible, particularly as concerns the implementation of economic and social policies and structural reforms, the creation of a business-friendly environment which facilitates the creation of jobs, and the promotion of investment;

III. GENERAL PRINCIPLES

10. reiterates its belief that, in the short term, completion of the Banking Union is the most effective instrument for preventing crises in the financial system and minimising the negative effects of economic shocks²;
11. believes that the Banking Union adds credibility to the ECB's principle that the financing needs of national banking systems must be uncoupled from the national public budgets and that a banking crisis in one country must not lead to a banking crisis throughout the EU;
12. stresses that local and regional authorities as well as economic and social partners must be included and involved in the discussion on the introduction of new instruments such as automatic stabilisers that aim to soften the impact of asymmetric shocks;
13. believes that the social dimension of EMU should be strengthened by following up on development indicators in individual regions and countries, with a focus on active labour market initiatives and structural social indicators. The social partners at regional, national and EU level should be involved in following up on these indicators;
14. takes note of the belief that fiscal capacity is necessary to equip EMU with a temporary shock absorption mechanism³. A possible fiscal capacity should not overlap with cohesion policy instruments but be complementary to those instruments;

² Lindquist opinion, point 24.

³ Paul Lindquist's opinion on the Follow-up to the Five Presidents' report: Completing Europe's Economic and Monetary Union, adopted 7 April 2016, COR-2015-05112, point 35.

15. considers however that a fiscal capacity at the EU level should not be designed in such a way that the risk of permanent transfers would arise, thus undermining the incentives for sound economic and social policy making and policy implementation at national or regional levels or incentives to address national or regional structural weaknesses. Accordingly, and to prevent moral hazard, it should be tightly linked to compliance with the broad EU governance framework and progress in convergence;
16. requests that Member States be required to demonstrate responsible economic policy in order to gain access to European economic stabilisation instruments. Use of these instruments should go hand in hand with the full implementation of structural reforms, with a view to greater convergence, coordination and integration, and stabilisation should not under any circumstances result in permanent, one-way flows between countries⁴. This assistance must be defined at European level and must be temporary, with a clear schedule;
17. highlights that the Stability and Growth Pact must be respected, as specified in the Commission Communication on making the best use of the flexibility within the Stability and Growth Pact of January 2015, and stresses the importance of each Member State having a sound economy and stable public finances, as a prerequisite for the necessary short- and long-term public investment;
18. considers further that in order to ensure there is enough room to invest while respecting the fiscal rules, there should be a fixed real deficit for public investments for local and regional governments, in addition to the medium-term objective (MTO) of a debt brake of structural deficit;
19. reiterates its call for more economic and social convergence and strengthening of good governance as they are crucial for preventing permanent transfers and moral hazard, and stresses that more convergence is needed;
20. at the same time emphasises that social, economic and territorial disparities both between Member States and within Member States can only be reduced through a concept that includes a territorial dimension. The concept of fiscal responsibility must not be reduced to the centralised application of common rules. Indeed, the more decentralisation and localisation in public expenditure, the more the incentives and the conditions for fiscal responsibility, reforms and attractiveness of investments;
21. considers it necessary to address regional disparities in order to tackle social inequalities, boost growth and jobs, and improve competitiveness and cohesion within the EMU and the EU, and highlights the key role played by local and regional authorities as employers, investors, providers and enablers of services, planners, catalysts for and regulators of change, and investment partners;

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Paul Lindquist's opinion on the Follow-up to the Five Presidents' report: Completing Europe's Economic and Monetary Union, adopted 7 April 2016, COR-2015-05112, point 33.

22. points out that a high level of ownership of structural reforms on the ground by the relevant local and regional authorities is essential for their success, and highlights the territorial dimension of the European Semester. The Committee reiterates its call for the Commission and the European Parliament to adopt a code of conduct to guarantee that local and regional authorities are involved in a structured way in the European Semester, which is also a means of preparing structural reforms⁵;
23. urges Member States to implement the Capital Markets Union, which will enable capital flows across borders without threatening the stability of different regions and countries, and help businesses, and particularly microenterprises and SMEs, to access a wide range of funding sources, and thus contribute to reducing economic shocks⁶;

IV. BUDGETARY ASPECTS

24. notes that the euro was introduced without a fiscal support structure to handle imbalances in the euro area and that the EU budget is largely inappropriate for mobilising funding rapidly where needed to stabilise markets, refinance banks and deal with balance of payments crises;
25. calls on the Commission to allow for the option of using economic indicators for each region which identify its economic well-being in terms of public debt and its contribution to the growth of Europe's GDP, when framing future European economic and financial policies;
26. underlines the need for an intensive discussion about the structure and design of fiscal capacity and the need to reach a solution that is in line with demands for transparency and democratic scrutiny, and with the "bailout ban" in Article 125 TFEU⁷;

V. CONSIDERATIONS FOR THE FISCAL CAPACITY

27. considers that two functions could be fulfilled; firstly, Member States' structural reforms could be incentivised in good economic times in order to foster economic and social convergence within the euro area and improve its economic competitiveness and resilience; and, secondly, differences in the business cycles of euro area Member States stemming from structural factors could be smoothed out by the creation of an instrument to address asymmetric shocks;
28. stresses that significant progress in sustainable structural reforms is needed in order to foster convergence, growth, jobs, and competitiveness so as to effectively prevent asymmetric shocks;
29. urges Member States to consider more fiscal autonomy for local and regional authorities as a way of creating ownership, and ensuring better implementation, of structural reforms;

⁵ COR-2016-05386-00-00-DT.

⁶ Lindquist opinion, point 30.

⁷ Resolution on a Sustainable future for the Economic and Monetary Union (EMU), point 21.

30. considers that financial support from the European level, other than the existing cohesion policy instruments, for the implementation of agreed structural reforms in the Member States should be approached with caution. Any potential additional support should not overlap with, but rather should complement, existing instruments;
31. considers that financial support should be linked to the implementation of the country-specific recommendations and that the Structural Reform Support Programme (SRSP), which is designed to provide technical support to national authorities, could be further developed as a contribution to the structural reform function of the fiscal capacity;
32. points out that it would be worth examining whether an additional tool to enhance structural reform, designed to provide funding in the form of loans for a Public Investment Strategy, would be useful. This could allow the identification of a pool of financing sources and investment projects needed to support the implementation of the necessary reforms;
33. believes, that, regardless of present efforts regarding convergence and sustainable structural reforms, asymmetric shocks with an impact on the stability of the euro area as a whole cannot be ruled out completely, given the strong integration of the euro area Member States; therefore stresses the need to have an instrument available to provide an immediate stabilisation effect in the event of emergencies;
34. highlights that local and regional authorities in some countries can be more vulnerable to the effects of asymmetric shocks, given their important role in the social welfare systems of Member States;
35. calls for the European Stability Mechanism (ESM) to be further developed and turned into a European Monetary Fund with adequate borrowing and lending capacity and a clearly defined mandate, including its possible contribution to a euro area fiscal capacity;
36. considers that the fiscal capacity should be subject to joint decision-making and implementation at the level of EMU, but should also be open on a voluntary basis to Member States outside the Euro area;

VI. FINAL COMMENTS

37. reiterates its request that it be involved in the preparation of the White Paper on the transition between phase 1 and phase 2 of the reform of EMU;
38. highlights the importance of ensuring that efforts to deepen monetary union also take account of the implications for non-euro countries;

39. stresses that any measures regarding the completion of EMU should be implemented as transparently as possible and with the democratic legitimacy of the currency union in mind.

Brussels, 8 February 2017

The President
of the European Committee of the Regions

Markku Markkula

The Secretary-General
of the European Committee of the Regions

Jiří Buriánek

VII. PROCEDURE

Title	Fiscal capacity and automatic stabilisers in the Economic and Monetary Union
Reference(s)	/
Legal basis	Article 307(4) TFEU
Procedural basis	Own-initiative opinion (Rule 41(b)(ii))
Date of Council/EP referral/Date of Commission letter	/
Date of Bureau/President's decision	14 June 2016
Commission responsible	ECON
Rapporteur	Carl Fredrik Graf (SE/EPP), Member of Halmstad Municipal Council
Analysis	13 October 2016
Discussed in commission	28 September 2016
Date adopted by commission	2 December 2016
Result of the vote in commission (majority, unanimity)	By unanimity
Date adopted in plenary	8 February 2017
Previous Committee opinions	
Date of subsidiarity monitoring consultation	