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Deepening of EMU: how to improve macroeconomic stabilisation using fiscal policy at the euro area level?

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01

Basic approach for deepening EMU: Solidarity and market discipline are complements, not substitutes

Franco-German 7+7 Proposal for Eurozone Reform

1. Breaking the "doom-loop" between banks and sovereigns (**less sovereign exposure, deposit insurance**).

2. Reform of fiscal rules including enforcement (**junior govt. bonds**).

3. Making the no-bailout-rule more credible.

4. A **fiscal capacity** for **large economic disruptions**.

5. Reform of institutional framework for policy coordination.

6. **Euro Area Safe Asset (Esbies)**.

02

Fiscal stabilization – European system of unemployment insurance

European system of unemployment insurance

- Should provide stabilisation in the presence of **large asymmetric shocks,** no need to be active in ‚normal' times
- **Interregional ‚smoothing': ** Eurozone level system of unemployment Insurance, budget balanced in each period
- **Interregional and intertemporal smoothing:** Budget balanced over the business cycle but not in each period

Counterfactual simulation of the fiscal effects 2000-2013 (Dolls et al (2018))

- **Microdata based simulation for the Euro Area 18**
- Budget balanced over the business cycle but not in each period
- **Base scenario:** Eurozone wide unemployment insurance, 50% replacement rate, benefit duration 12 months
- Financed through **proportional insurance contribution**
- Income and employment are taken as given – no feedback eff.
- **Focus of the analysis:** Counterfactual financial flows 2000-2013
- **Alternative scenario:** system is only activated in deep crises (trigger: increase in unemployment rate)

Figure 2: Overall contributions and benefits at Eurozone-level, 2000-13

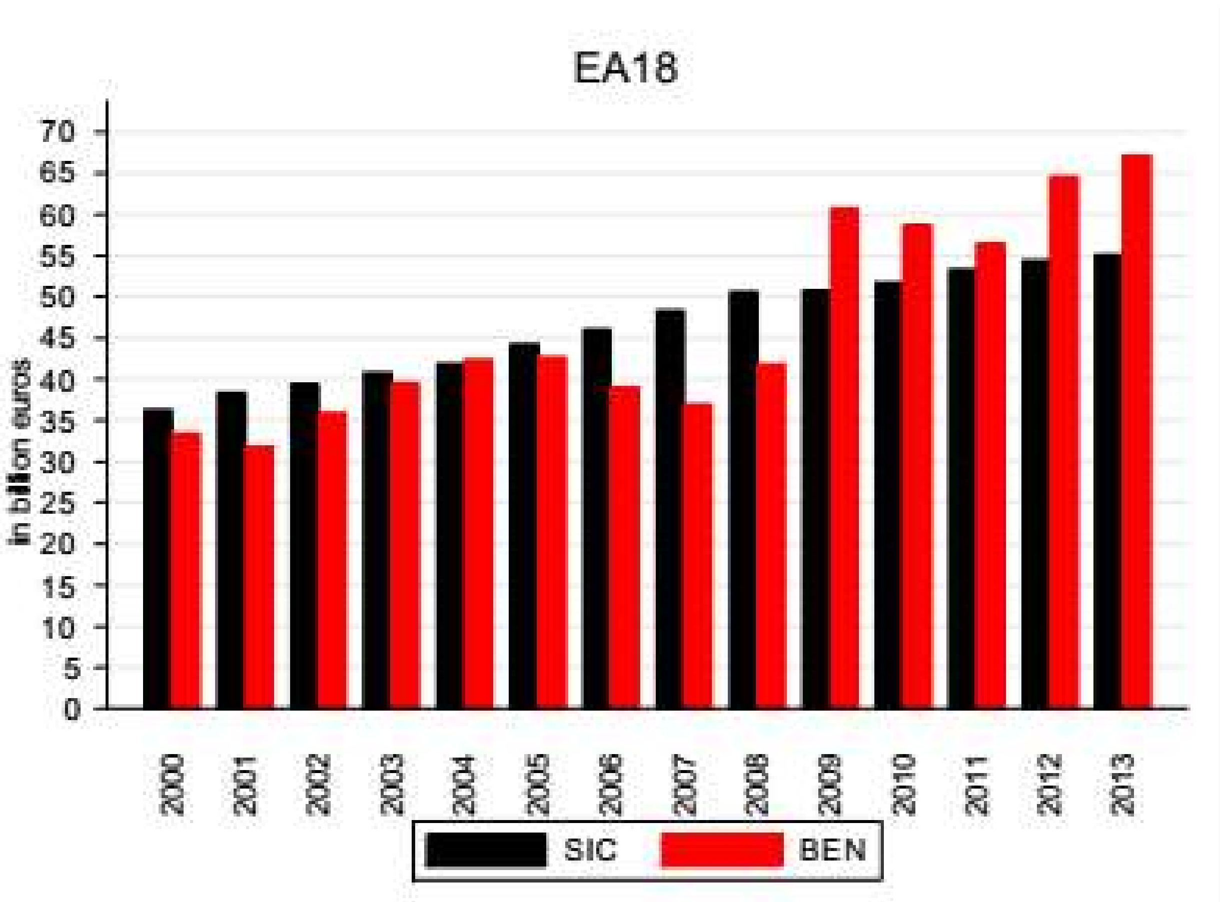
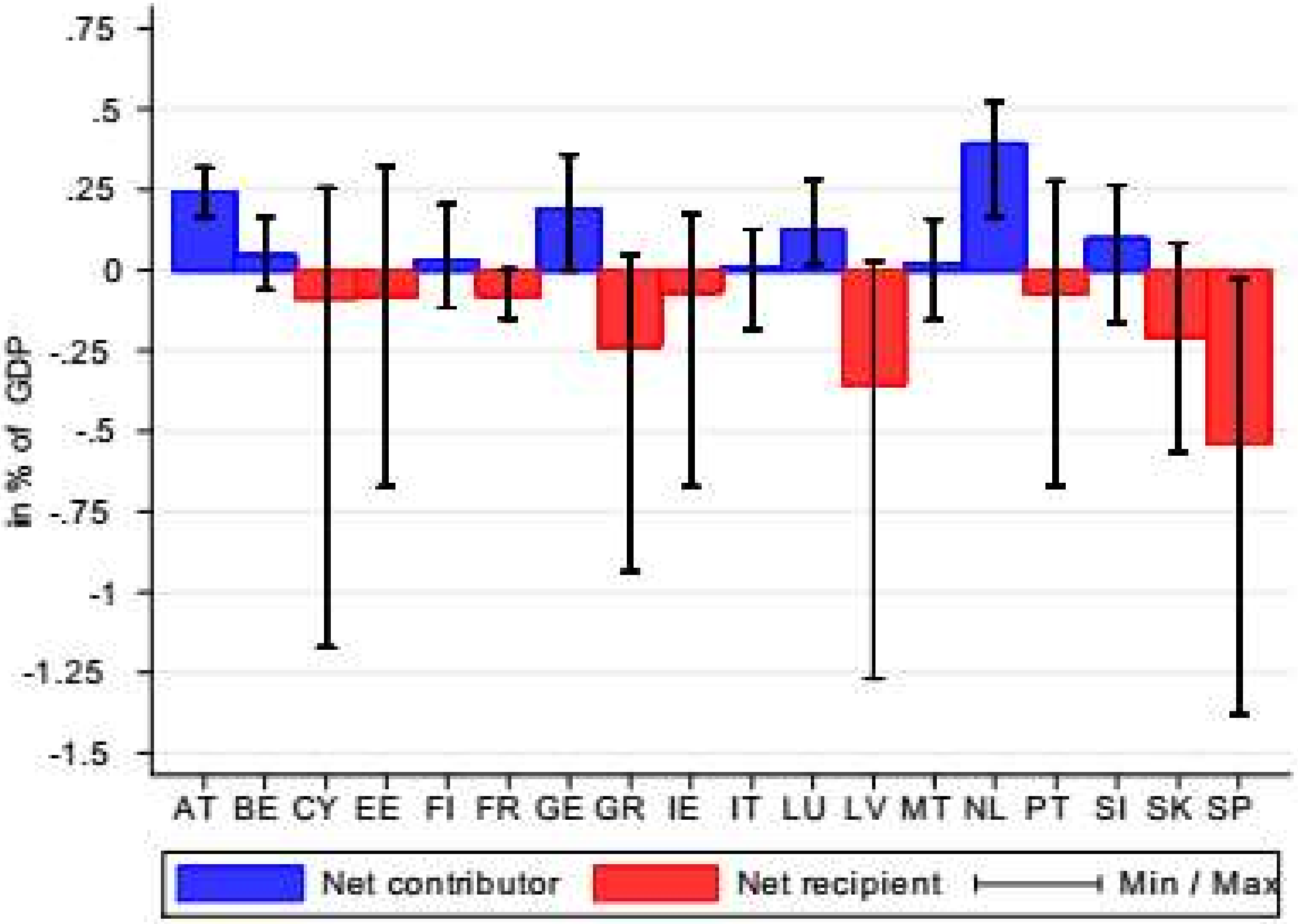


Figure 3: Average yearly net contributions, 2000-13



Contribution rates for different variants

- Base Scenario A: **1,56 %**
- Scenario B: Max. benefit 50% of median income, 2 months waiting period: **1%**
- Scenario D: Replacmeent rate of 35% max benefit 50% of median income, 2 months waiting period: **0,7%**

Contribution rates for variants with ‚triggers‘ (50 per cent replacement rate, like in base version)

- Unemployment rate one percentage point higher than in years t-1, t-2, t-3: **0,72%**
- Unemployment rate one percentage point higher than in years t-1, t-2: **0,64 %**
- Unemployment rate one percentage point higher than in year t-1, : **0,42 %**

- **Volume**: **13-22 bn Euros** per year (compared to 47bn without trigger)

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