21. February 2019

Eurozone Budgetary Instrument – possible ways forward after the December 2018 Summit

Economic rationale for a Eurozone budgetary instrument:

During the financial and economic crisis, the Eurozone has taken significant steps to strengthen its rules (both in the banking and economic/fiscal area) and institutions (banking supervision, resolution board and – fund, EFSF/ESM). This has increased the stability of the Eurozone decisively.

But we still have steps to take in the direction of a more solid Monetary Union. MS themselves have to bring down public debt levels to create margins for shock absorption and allow for a more effective single monetary policy.

Also structurally, reform needs remain. Compared to the theoretical model of an optimal currency union, mobility on our labor markets and the capacity of our economies and especially our financial sector to absorb shocks through more private risk-sharing needs to be improved.

There is a need for a higher level of convergence and competitiveness within the Eurozone to ensure stability of the euro area as a whole. The range of options for Eurozone MS to address convergence and competitiveness are more limited since they lack monetary policy and exchange rate adjustment instruments at national level. In this light, Euro area MS also need to comply with more stringent requirements in the context of economic policy coordination.

Cohesion in the whole Eurozone requires dedicated national strategies, comprising public investment expenditure as well as reforms aimed at raising competitiveness and convergence.

It is in the interest of the whole Eurozone to support national reform efforts. A Eurozone budgetary instrument as part of the EU-budget should support national reforms which have been identified in the European Semester. These represent a Eurozone common interest and the coordination process should ensure that the spill-over effects of such reforms are taken into account.

By also financing investment projects or public investment programmes in policy areas identified in the European Semester and preferably related to these reforms, potential growth, competitiveness and convergence could be raised especially in diverging countries

This would also improve the adjustment channels in the Eurozone. It would have a stabilizing effect during bad times, preventing a backtracking of convergence achieved during a crisis.

Purpose:

The purpose of the Eurozone budgetary instrument would be to foster competitiveness and convergence in the Eurozone and, on a voluntary basis, in ERM II MS, as agreed by leaders in December. Progress in competitiveness and convergence would also increase the stability of the Eurozone.

To reach its objectives, the instrument should support both regulatory and project oriented reform activity by MS in areas of special relevance to the Eurozone, related to competitiveness and convergence. This could be done in either of two ways: either by co-financing costs directly related to reforms or by supporting investment expenditures in strategic areas related to the reform and/or investment priorities identified within the European Semester.

This would create additional reform incentives and boost cross-country investment capacity in the Eurozone. There could be a link with InvestEU by using part of the funds as a budget guarantee.

The result would be a policy package in the overall interest of the Eurozone: reform efforts by MS themselves flanked and supported by funds from the European/Eurozone level.

Structure and governance:

In line with the decision by the summit, the instrument should be subject to criteria and strategic guidance from Eurozone MS, and be coherent with other EU policies. Legally, it would be based on an act under EU-law that regulates its functioning and generally sets out the priorities and an IGA. It would have to be ensured that key decisions would be taken by formations of the participating MS only, i.e. the Eurogroup and the Eurosummit, possibly involving participating ERM II-MS. The IGA could be used to agree procedures where necessary, within the limits of EU-law, such as voting arrangements and detailing the role of the Eurosummit or the participation of ERM II MS in proceedings.

To stay as closely as possible within the framework of other EU-policies, the starting point should be the existing European Semester and especially the Eurozone recommendation.

The recommendation for the Eurozone is currently already discussed in the Eurogroup, before being adopted by the Council and being endorsed by leaders. This recommendation identifies key policy areas of relevance for the Eurozone. It would therefore allow implementing a process for strategic guidance by Eurozone MS only, while staying in the EU legal framework. To do this, the set-up of the recommendation could be changed in the future to contain a special section of priority areas representing key challenges for competitiveness and convergence in the Eurozone-MS. These areas would be those where action by MS could be supported by the Eurozone budgetary instrument. These priorities should then be broken down to the level of MS.

Once the priority areas are identified by the Council officially adopting the Eurozone recommendation on the basis of a Commission proposal, MS would submit policy plans to the Commission that contain both their planned reforms and proposals for projects to be supported under the budgetary instrument.

The projects could either represent costs of the reform measures themselves or investment projects/programmes, especially in areas related to the reforms undertaken.

The Commission would then approve these plans in consultation with the MS in the context of the EU-Semester. Funding would flow depending on progress in implementation.

The timeframe would be shorter than for structural and cohesion funds, allowing for more flexibility. It would allow supporting newly emerging challenges more quickly than under usual structural and cohesion funds. The use of the instrument would fall under the usual conditionality linking effectiveness of funds to sound economic governance as the rest of structural funds.

Expenditures:

Financing would have to be linked either to the costs of individual project-oriented or regulatory reform measures or the cost of concrete investment projects/programmes. MS would be obliged to co-finance substantial shares of the investment projects from national or sub-national budgets.

Apart from the direct financing of projects in the MS, the funds could also be used for guarantees from the budget line for private investment projects as under InvestEU, if proposed by the MS and approved by the Commission. This would allow for leverage and hence for a far larger impact on investment from fairly limited budgetary resources.

The instrument should concentrate on convergence and reform needs and hence be of greater efficiency for diverging MS with a need for structural reforms in order to raise their potential growth. The instrument's contribution could also play a stabilizing role in the Eurozone, especially as investments are prone to be shed in case of pressure on national public finances. However, in case of severe downturns that are defined ex-ante, MS' co-financing rates in this budgetary instrument could be reduced temporarily.

The political guidance would allow for identifying specific challenges that mostly impact some MS that require supplementary action.

Financing:

As agreed by the summit, the instrument should be part of the EU budget. It would not be credit-based. The overall size of the instrument will be determined in the context of the MFF so that each MS would know its overall contribution to the EU budget.

Financing could be ensured as follows:

- Regular contributions to the budgetary instrument on the basis of an intergovernmental agreement (IGA), generating external assigned revenues, possibly including funds generated by the FTT, once implemented.
- Wherever possible funds from the EU-budget, funded by regular own resources, e.g. by using the Euro area component of the RDT.
- There could be a link to part of the funds to be used under InvestEU as a budget guarantee, without prejudice to the functioning of InvestEU.

Institutional set-up:

The budgetary instrument should be a dedicated part of the EU-legal framework. In light of its role to promote competitiveness and convergence, the legal base for such an instrument could be Article 175 (3) TFEU possibly in conjunction with Articles 121 and 136 TFEU.

This instrument should not be a precedent for the EU's cohesion policy.

An IGA would address the financing through assigned revenues.

Interaction with other instruments:

The summit emphasized the need for the instrument to be coherent with other EU policies. As it would be part of the EU budget, it must be in coherence with overall EU policies and satisfies budgetary principles and requirements in terms of sound financial management, budgetary control and parliamentary accountability.

The summit decided to work on the basis of an existing COM-proposal. Since the instrument proposed above aims at supporting reform activity in the MS, as the RDT does, it could be constructed as a further development of RDT, even if the current COM-proposal would have to be considerably amended.
In addition, the instrument could be interlinked with InvestEU. In general, it should be complementary to the structural funds and the envisaged link between the structural and cohesion funds and the European Semester. A clear distinction to structural funds concerning purpose and content of the instrument is necessary.

Evaluation:

Evaluations of the budgetary instrument will be conducted on a regular basis to assess the progress made towards achieving the instrument's objectives and to build an appropriate evidence base to improve the implementation of the budgetary instrument. The evaluations will assess whether the measures are effective, efficient, in line with EU legislation, relevant and add value.

Outlook:

This proposal focuses on the implementation of the mandate by leaders from 14 December 2018 to the Eurogroup to work on the design, modalities of implementation and timing of a budgetary instrument for convergence and competitiveness for the euro area. In parallel, as agreed by the Eurogoup on 4. December 2018, technical discussions on a stabilization function continue.