The future of EMU: discussion

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Why a shock absorber

Antonio Fatas, Economic Policy, 1998: The main concern arises from the lack of tools that countries will possess to mitigate the effects of asymmetric shocks once they join the EMU. As prices and wages are not flexible enough to compensate for the loss of exchange rates and the degree of labour mobility in Europe is very limited, there is a fear that asymmetric shocks will lead to deep regional recessions and large increases in unemployment, which could create a social burden that is politically unacceptable to many governments.

In this session

Papers presented in this session focus on two issues

1. How would a EA unemployment insurance scheme interact with monetary policy, in particular at the Zero Lower Bound?
   - Claveres Strasky "Euro area unemployment insurance at the time of zero nominal interest rates"
2. Which features should such an absorber have?
   - Lenarcic and Korhonen "A case for a European Rainy Day Fund"
   - Beetsma, Cima and Cimadomo "A minimal moral hazard central stabilisation capacity for the EMU based on exports"

Claveres Strasky

Summary A two-region DSGE with supply, demand and labour market frictions and an area-wide unemployment insurance scheme that is entitled to borrow in financial markets. Two regions: core and periphery. Impact of the EU level insurance scheme (on top of national stabilizers) on the absorption of an asymmetric demand shock is assessed.
Main results

- EU unemployment insurance scheme improves stabilization as interest rates hit the Zero Lower Bound
- The higher the share of credit constrained households, the higher the stabilization properties of the scheme

Comments

The main novelty of the paper is to show how an EA unemployment insurance can improve resilience when interest rates hit the ZLB. To my knowledge this is the first paper focusing on this aspect in the EMU context. Albertini and Poirier (2015) do so for the US.

At the same time the model used is very stylized:

- The EA unemployment insurance is only a top-up of the national scheme
- No consideration of possible moral hazard issues in the peripheral countries, an issue at the heart of the debate (hard to model here I recognize)

Summary

Study a common European Rainy Day Fund with these features:

- It covers only large shocks (first losses borne at the national level - less moral hazard)
- A saving-loan structure in which countries first use their own compartment and can then borrow from the compartments of other countries at an interest
- The trigger event is a change in the national unemployment rate above a certain threshold (UR is cyclical, and looking at its changes rules out permanent transfers and limits moral hazard)
- The fund can also have a borrowing capacity that can be backed by common capital
- Access to the fund could be made conditional on the Country not being in the Excessive Deficit Procedure or the Excessive Imbalances Procedure

Comments

The paper is extends "politically feasible" proposals already on the table (Similar to French and Italian Treasury proposals).

The main novelty is the analysis of the hypothesis of the rainy day fund having the possibility to borrow and how (own capital, taxation powers etc.).

My remarks:

- Up and downs in the unemployment rates can also be driven by changes in labor supply, why not take into consideration only the incidence in job terminations (Brandolini, Carta and D'Amuri, 2017)
- I would have liked to see some estimate of the stabilizing properties of the fund (reduction in GDP's coefficient of variation)
- Conditioning participation to the scheme on SGP and MIP compliance can be tricky; what happens if a country is considered as fit at the start of the scheme and then its position deteriorates over time? There is a risk of further watering down those procedures.

Summary

Study a central stabilization capacity with these features:

- It is based on (exogenous) *changes* in world demand; it covers any shock, irrespective of its size
- For each sector, the country receives a payment if its share on EA exports in that sector is higher than its share on the sum of all sectors AND the value added in that sector decreases at the EA level
- No moral hazard since the government cannot influence trade dynamics for the EA as a whole. Nevertheless the scheme offers more stabilization for less diversified economies
- The scheme is balanced every year (no need to create a fund)

Comments

The paper introduces a completely new approach based on trade; it is appealing since it relies on dynamics that are outside national government control.

My remarks:

- Year on year changes in export shares can be volatile; operating the scheme for small frequent transfers is probably not worth the fixed costs related to its operation
- Looking only at one year changes in trade can be too restrictive: business cycles last longer than a year
- I would have liked to see some estimate of the stabilizing properties of the fund (reduction in GDP's coefficient of variation)