ECOWEEK

No. 18-38, 19 October 2018

Strengthening the eurozone: prospect of progress at last?

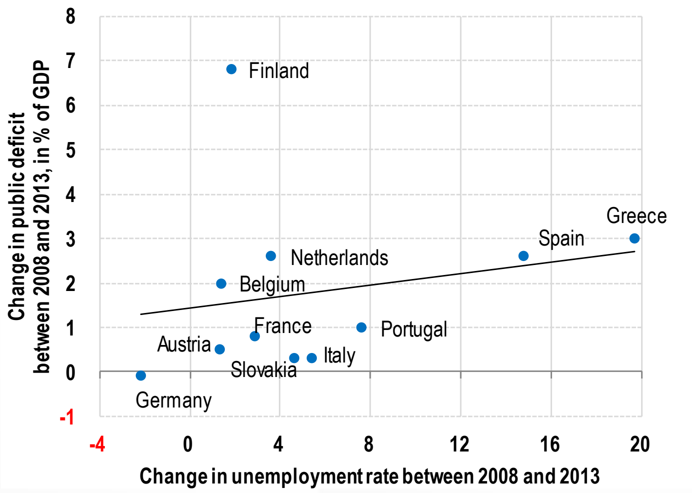
■ The German finance minister has made a plea for the creation of a pan-European unemployment fund ■ Being able to borrow from the fund would require having contributed in the past as well as having met certain criteria in terms of economic policy ■ This form of risk-sharing would soften the impact of downturns and hence would be an important contribution to strengthen the eurozone

For anybody who has read last week's The Economist on how bad the next recession might be and how the eurozone in particular is challenged in terms of policy leeway to address downturns, press reports this week on ideas to create a cyclical stabilisation fund must have sounded like music to the ears. Clearly, after a long wait (calls for such an initiative go back to the Four Presidents' Report of December 2012), there is a genuine risk that signs of timid progress are welcomed with excessive enthusiasm. After all, German finance minister Olaf Scholz only produced a "non-paper" about creating a pan-European unemployment fund which would allow countries faced with a big increase in unemployment to borrow from this fund (and pay back later), rather than to borrow from the markets and be faced with rising bond yields on the back of a perceived increased riskiness of the paper which is being issued.

Although only a "non-paper", the initiative should be welcomed, not only because it should lead, as reported by Handelsblatt, to a proposal submitted at the Eurogroup meeting on 3 December, but even more so because at long last something might really be moving. This interpretation is supported by the interview of the Spanish minister of economy Nadia Calvino in Les Echos in which she stated that Spain is working together with France, Germany and Portugal on a European unemployment insurance system.The merits of this particular system of risk-sharing have been explained in research papers of, amongst others, the Bundesbank and the IMF. In a nutshell, enabling a country faced with a big increase in unemployment to borrow from a central fund, consisting of annual contributions of its members, avoids that this country would be forced to cut other expenditures, thereby reinforcing the downturn, so as to limit the increase of its budget deficit.

.../...

UNEMPLOYMENT AND PUBLIC FINANCES



Source: OECD, BNP Paribas

Eco WEEK

ECONOMIC RESEARCH DEPARTMENT

BNP PARIBAS

The bank for a changing world

Avoiding a procyclical fiscal tightening will support confidence of households and business that the recession will be shallower and shorther and will also limit the increase of the risk premium required by investors, i.e. the spread versus Germany. As emphasized clearly by the IMF, having the possibility to call upon the resources of the stabilisation fund would suppose that in previous years fiscal policy would have been in line with the jointly defined objectives. This is a clear additional advantage of the proposed system: solidarity and discipline go hand in hand. However, the sceptical reaction in Germany to minister Scholz's initiative is a reminder that work remains to be done to strengthen trust amongst the eurozone members. One can only hope that the December Eurogroup meeting will bring confirmation that there is progress and that a "non-paper" is translated into a concrete roadmap at the European summit on 13 and 14 December.

William De Vijlder