Stabilising EMU and Shaping its Social Dimension: A Case for a European Unemployment Benefits Scheme

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Introduction

Monetary policy and fiscal policy form the two principle means, by which governments can influence economic developments. Monetary policy instruments affect the nominal levels of prices for goods and services as of wages denominated in a given currency. Fiscal policy instruments have, according to Keynesian economics, an impact on the aggregate demand. Assume now[1] that, first, two countries form a currency union, in which monetary policy is supranationalised and fiscal policy remains in the national competence, that, second, there is a shift of demand from one country to the other one and that, third, wages and prices cannot be reduced in the short term. In such a situation unemployment rises in the one country whilst there is inflation pressure in the other. Supranationalised monetary policy instruments can now only aggravate the problem since a decrease in money supply would result into higher unemployment rates in the one country whereas an increase in money supply would intensify the inflationary pressure in the other country. Fiscal policy measures must now also undertake tasks previously assumed by monetary policy instruments.

The Theory of Optimum Currency Area

The theory of optimum currency area, which was developed on the basis of the just described scenario, explains that only those national economies should form a currency union that have similar business cycles, that are comparably diversified in terms of economic sectors[2] and that provide for cross-border mobility of factors of production[3] (capital and labour). In addition, it is discussed that a "common fiscal capacity as a mechanism of shock absorption and risk-sharing" is a constitutive element for an optimum currency area.[4] Such common fiscal capacity is supposed to automatically shift resources towards participating countries that suffer from negative region-specific or asymmetric shocks.[5]

With a view to the Euro area, one can only consider the criterion of the cross-border mobility of factors of productions (as guaranteed by the fundamental freedoms) to be fulfilled. Diverging business cycles between Member States and differently diversified national economies contradict the assumption that the Euro area could be an *optimum currency area*, not to mention the non-presence of a shock absorption mechanism. Whilst the initial phase of EMU, however, seemed to prove the foundations of the theory of optimum currency areas to be too pessimistic,[6] the external shock of the financial and economic crisis that emerged in 2007 revealed the shortcomings of the EMU.

[1] This follows MUNDELL, Robert. A Theory of Optimum Currency Areas. *American Economic Review*, September 1961, vol. 51, No. 4, pp.657-665 at 658.

[2] KENEN, Peter. The Theory of Optimum Currency Areas: An Eclectic View. In: MUNDELL, Robert and SWOBODA, Alexander K. (eds.). *Monetary Problems of the International Economy.* Chicago: University of Chicago Press, 1969, pp.41-60. Available at: WorldCat | a-z.lu

[3] MCKINNON, Ronald. Optimum Currency Areas. *American Economic Review*, September 1963, vol. 53, No. 4, pp.717-725.

[4] Cf. PASIMENI, Paolo. An Optimum Currency Crisis. *European Journal of Comparative Economics*, 2014, vol. 11, No. 2, pp.173-204 at 174, 180 et seqq.

[5] Cf. already INGRAM, James C. State and Regional Payments Mechanisms, *Quarterly Journal of Economics*, 1959, vol. 73, pp. 619-632 at 629 et seqq. Available at: Publisher | WorldCat | a-z.lu

[6] PASIMENI, Paolo. *Cit.*, p.199.

Centralised Shock-absorption to Address Economic Crises

As a reaction to this several proposals were put forward aiming at establishing a centralised shock-absorption mechanisms under the name of "fiscal capacity".[7] These proposals intend to provide for a cure when region-specific or asymmetric shocks hit an optimum currency area. One of the proposals refers to "European Unemployment Benefits Scheme"(EUBS).[8] This proposal is based on the observation that a monetary policy, which is legally bound to primarily achieve price stability (Article 127(1) TFEU), leads in a currency demand because of an economic shock that only hits parts of this area from prices for products to wages and, by that, to labour. Cross-border mobility of workers, although it rose in the aftermath of the recent crisis, is not able to significantly alleviate the pressure on employment in crisis countries.[9] Conclusions based on these observations are twofold. First, it is labour that has to bear the consequences of an asymmetric shock hitting the Euro area. This fact has already as such an undermining effect of citizens' support for EMU. Second, increasing expenses in crisis countries because of a rise of unemployment diminish these countries' financial abilities to compensate for declining private demand by making use of fiscal policy measures. The combined shortfall of private and public demand might the trigger a recession in these countries.

In order to avoid these negative effects, the idea of an European Unemployment Benefits Scheme (EUBS) addresses explicitly unemployment and the expenses linked to it. Since wages and, because of the latter's inflexibility downwards, employment bear the costs for the lack of differentiating monetary policy instruments, the Euro area should compensate for unemployment expenses of Euro area countries that accrued because of an asymmetric shock. Furthermore, EUBS could embody a political sign towards unemployed citizens that the EU also cares about their fate. Those were already the reasons for the study group *Economic and Monetary Union 1980* chaired by Robert Marjolin to require in its report of 1975 the establishment of an EUBS as a precondition for creating an EMU.[10] In 2013, the European Commission, in its communication on the social dimension of EMU, referred to the idea of EUBS but considered it unrealisable as its introduction would require a Treaty change.[11]

The legal feasibility of a European Unemployment Benefits Scheme[12]

The legal feasibility depends, however, highly on the concrete design of the EUBS. In principle, one can distinguish two different models: Equivalent EUBS, which reinsure national unemployment benefits schemes in a way that they pay a lump to national budgets earmarked for the use for unemployment benefits after a certain "crisis" trigger is activated,[13] and genuine EUBS, which pay out a European benefit once the risk of unemployment of an eligible person materialises and which supersede national schemes when their scope overlaps. The first are macroeconomic stabilisation mechanisms, which could be based on Article 352(1) TFEU because the conditionality requirement in Article 122(2) TFEU prevents the use of this legal base as it conflicts with the automatic activation of payments in case the predefined trigger is activated. The latter are measures that aim at reducing social disparities between the EMU countries. Macroeconomic stabilisation

[7] See for instance VAN ROMPUY, Herman et al. Towards a Genuine Economic and Monetary Union. Report to the European Council. Brussels, 5 December 2012, p.9.

[8] BEBLAVY, Miroslav, MARCONI, Gabriele and MASELLI, Ilaria. A European Unemployment Benefits Scheme: The rationale and challenges ahead. Working paper. Brussels: CEPS, European Commission (DG EMPL), January 2017, p.8 et seqq.

[9] PASIMENI, Parolo. *Cit.* , p. 176 et seq.

[10] EUROPEAN COMMISSION. DG ECFIN. Report of the Study Group "Economic and Monetary Union 1980" (so-called "Marjolin Report"). Brussels: European Commission, 8 March 1975.

[11] EUROPEAN COMMISSION. Communication on Strengthening the social dimension of the Economic and Monetary Union, Brussels, 2 October 2013, COM(2013) 690 final, p.11 et seq.

[12] The following section draws on REPASI, René. *Legal options and limits for the establishment of a European Unemployment Benefit Scheme.* Brussels: European Commission (DG EMPL), January 2017.

[13] This trigger is characterised by an indicator and a threshold: When the short-term unemployment rate (covering an unemployment period of 0 to 12 months) of a specific country at a specific time (indicator) exceeds the threshold, which is defined by the sum of 10 years moving average of the short-term unemployment rate in that country, payments from the EUBS Fund to the country in question are activated.

is a by-product of these genuine models. As a means to promote social cohesion, genuine EUBS could be established as "specific actions" under Article 175(3) TFEU. The European Globalisation Adjustment Fund (EGF),[14] which allows to provide *inter alia* support to workers made redundant as a direct result of the global financial and economic crisis, can be considered a nucleus of genuine EUBS and was based on this article. The impact of genuine EUBS, although they do not replace but co-exist with national schemes, on the national social security systems requires to additionally base genuine EUBS on Article 352(1)TFEU. The Treaty requires that whenever national social security systems could be affected by European measures, the Council has to vote unanimously granting each Member State a veto right against such interference. The limitations have also to be respected when basing genuine EUBS on Article 175(3) TFEU, which would allow a qualified majority voting. The use of Article 352(1) TFEU is, in relation to both models, justified by the Union objectives to establish "a highly competitive social market, aiming at full employment and social progress" and to promote "social justice and protection", "economic, social and territorial cohesion" and "solidarity among Member States".

The main challenge for EUBS is therefore less the alleged lack of a legal base but the limits set by the "no bailout clause". In short, as long as financial transfers to a Member State cannot be based on explicit Union competences, Article 125(1) TFEU requires that such transfers must prompt a Member State to implement sound budgetary policies or, in other words, do not set any incentives for national policies to avoid necessary structural reforms. Against this background EUBS must be complemented by minimum requirements for job activation and must provide for mechanisms that level out net transfers between Member States in the medium term (such as experience rating and clawback clauses). The latter certainly reduces the economic performance of EUBS but it is the price to be paid for its establishment without Treaty change.

Conclusions

In order to work as an "optimum currency area" the EMU has to be complemented by an automatic fiscal stabiliser. Various models are discussed. The establishment of a European Unemployment Benefits Scheme would achieve such macroeconomic stabilisation and contribute, at the same time, to shaping the social dimension of EMU. As such, EUBS could restore citizens' acceptance of EMU. Legal obstacles can be overcome. Political will is now required.

[14] EUROPEAN PARLIAMENT AND COUNCIL. Regulation (EU) No 1309/2013 on the European Globalisation Adjustment Fund (2014-2020). OJ L 347, p.855.