INVESTMENT STABILISATION FUNCTION

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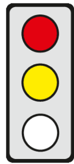
KEY ISSUES

Objective of the Regulation: Eurozone countries experiencing an economic shock are to receive loans for public investment and interest subsidies from a "European Investment Stabilisation Function" (EISF).

Affected parties: Governments and economies of eurozone countries.



Pro: The "one-year eligibility criterion", which requires an increase in the unemployment rate of at least one percentage point, ensures that loans are only granted in exceptional circumstances.

Contra: (1) The EISF may incentivise countries to follow laxer fiscal policies as they do not have to cushion a shock alone but can rely on being bailed out in the event of a shock.

(2) The credit line cap of 30 billion euros will be insufficient for maintaining public investment, especially if several eurozone countries request an EISF-loan.

(3) The EISF postpones ESM intervention without addressing the fiscal problems.

The most important passages in the text are indicated by a line in the margin.

CONTENT

Title

Proposal COM(2018) 387 of 31 May 2018 **for a Regulation** of the European Parliament and of the Council **on the establishment of a European Investment Stabilisation Fund.**

Brief Summary

► **Context and objectives**

- In general, if a country is hit by an economic shock, such as the bursting of a housing bubble (hereinafter "shock"), it needs to stabilise macroeconomic demand in order to cushion the shock.
- To stabilise macroeconomic demand, it can resort to monetary and economic policy [Impact Assessment, p. 5]:
  - Monetary policy can stabilise macroeconomic demand by reducing the base interest rate of the currency and – in that way – reduce the costs of taking out a loan. This spurs credit-financed demand, e.g. investment.
  - Economic policy can stabilise macroeconomic demand by raising public expenditure or keeping it constant. However, this generally results in a significant rise in public deficit because, as a result of the shock, tax income falls.
- If, within the eurozone, only one or some countries are hit by a shock (hereinafter "asymmetric shock"), the affected countries cannot use monetary policy to stabilise macroeconomic demand, as monetary policy for the eurozone countries is uniformly applied for the whole euro area [cf. Impact Assessment, p. 7, 16, 18-20].
  - Due to this limitation eurozone countries that are hit by an asymmetric shock, can only rely on economic policy and therefore need more time or even higher public expenditure to cushion a shock than countries with their own currency.
  - This increases the risk of budgetary distress, which can
    - imperil access to capital markets,
    - protract a crisis resulting from a shock and
    - result in negative spillover effects on other eurozone countries, e.g. when the country in crisis decreases imports from other eurozone countries.
- For the stability of the eurozone and eurozone countries, the European Stability Mechanism (ESM) may support a eurozone country under strict conditions if the latter experiences severe financing distress [Art. 1, 3 ESM Treaty].
- In order to prevent eurozone countries (hereinafter "countries") from experiencing severe financing distress in the event of an asymmetric shock, the Commission plans to provide them with quick financial support, targeted at public investment, by way of a European Investment Stabilisation Function ("EISF") [Impact Assessment, p. 20].

► **Type of financial support**

- The financial support provided by the EISF consists of two integral parts [Art. 1 (2), (3)]:
  - EU-loans:

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- They are limited to 30 billion euros in outstanding amounts (hereinafter "credit line") [Art. 7], i.e. at no point in time may the amounts to be paid back exceed 30 billion euros.
- They are guaranteed by the EU budget [Art. 2 (4)]. To that end, the Commission can borrow funds on the capital markets on behalf of the EU and on-lend these to eurozone countries [cf. Art. 220 (1) of the Financial Regulation (EU, Euratom) 2018/1046].

- Interest subsidies: They are paid on the loans from a Stabilisation Support Fund (hereinafter "SSF") [Art. 18]. The SSF is
  - endowed with annual contributions from the countries based on a voluntary international agreement to be concluded [Art. 17 (2), Recital 27] and
  - "prudently" managed by the Commission [Art. 19 (1), (2)].

► **Eligibility criteria**

– Once a year a country may request EISF support from the Commission if the following criteria are met [Art. 6 (1)]:
  - Firstly, the country experiences a shock, i.e. its last quarterly unemployment rate [Art. 4 (1)]
    - exceeds its average unemployment rate for the preceding 60 quarters (15 years) and
    - has increased by at least one percentage point compared to the rate for the same quarter in the previous year.
  - Secondly, the country has complied with the EU rules on economic policy coordination in the two years prior to its request. This is not the case e.g. if the Council [Art. 3 (1) (a)-(d)]
    - has adopted two successive "recommendations" that the country's plans to tackle excessive macroeconomic imbalances are insufficient [cf. Art. 8 (3) Regulation (EU) 1176/2011 on macroeconomic imbalances], and/or
    - has established that the country did not tackle an excessive fiscal deficit [cf. Art. 126 (8), (11) TFEU] and/or
    - has decided that the country did not address significant deviations from its medium-term budget plan [Art. 6 (2) or Art. 10 of Council Regulation (EU) 1466/97 on budgetary and economic surveillance]; the medium-term budget plan presents a three-year budgetary objective that guarantees sustainability of public finances.
  - Thirdly, the country does not already receive financial assistance from e.g. the International Monetary Fund or the ESM [Art. 3 (1) (e), (f), Recital 16].

– A country cannot receive an interest subsidy if it has not contributed to the SSF [Art. 3 (2)].
– The criteria have to be fulfilled in the year, in which the country applies for EISF support.

► **Loan: Procedure, amount and conditions**

– The Commission handles requests in the order it receives them [Art. 6 (1)].
– If a country requests EISF support, the Commission
  - adopts a decision on the terms of the loan (in particular, amount, maturity and interest rates) [Art. 6],
  - borrows the amount from the capital markets [Art. 12 (2)] and
  - disburses the loan to the country [Art. 11].
– The amount of the loan, specified in the Commission decision, is calculated according to a formula which inter alia takes into account [Art. 8]
  - public spending on investment in the EU – i.e., not that of the requesting country – over the past five years,
  - the increase in unemployment as an indicator of the severity of the shock.
– The Commission can increase the amount of the loan above the formula result in case of an exceptionally severe shock [Art. 8 (1)].
– The amount of the loan is in any case limited to 30% of the amount of the credit line still available [Art. 8 (3)].
– The loan is disbursed "in principle" in one instalment [Art. 11].
– The maturity, and hence the repayment, of the loan are specified by the Commission on a case-by-case basis.
– The loan is disbursed under the conditions that the country [Art. 5 (1)]
  - has to spend it in the same year,
  - at least maintains in that year its average level of public investment in the five previous years and
  - uses the amount of the loan for public investment in support of [Art. 2 (3)]
    - education and training and/or
    - "goals" or concrete projects of the cohesion funds, i.e. European Structural and Investment Funds, which e.g. foster a "greener, low-carbon" EU or regional connectivity of information technology.
– The Commission [Art. 5 (2)],
  - verifies in the year following the disbursement of the loan, whether these conditions have been met and
  - reclaims the loan in whole or in part if the conditions have not been met.

► **Interest subsidy: Procedure, amount and conditions**

– If a country requests financial support, the Commission will also adopt a decision on the interest subsidy [Art. 6].
– The interest subsidy is disbursed once the country repays the loan or the interest becomes due [Art. 15].
– The amount of the interest subsidy should in principle cover the entire interest of the loan [Art. 9 (1)] but can be reduced by the Commission [Art. 9 (2)].
– The interest subsidy is disbursed under the condition that the country uses it to pay the interest of the loan [Art. 18 (1)].

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Statement on Subsidiarity by the Commission

Due to the architecture of the economic and monetary union (EMU) with a centralised monetary policy and a decentralised fiscal policy at national level, eurozone countries are insufficiently capable of absorbing large asymmetric shocks alone. In consideration of the necessary scale of the respective action, the EU is in a better position to achieve such a stabilisation function.

Policy Context

Following the Five President's Report of 2015 on the EMU, the Commission's Reflection Paper on deepening the EMU proposed to establish a macroeconomic stabilisation function to be in place by no later than 2025. The Roadmap for deepening the EMU of 6 December 2017 [COM(2017) 821] and the Communication [COM(2017) 822] contain the relevant proposals [see cep**PolicyBrief** No. 2018-04].

Legislative Procedure

31/05/2018	Adoption by the Commission
Open	Adoption by the European Parliament and Council, publication in the Official Journal, entry into force

Options for Influencing the Political Process

Directorates General:	Economic and Financial Affairs
Committees of the European Parliament:	Budgets, Economic and Monetary Affairs (jointly leading), Rapporteur: Pervenche Berès (S&D, France), N.N. (EVP)
Federal Germany Ministries:	Finance
Committees of the German Bundestag:	Budgets
Decision-making mode in the Council:	Qualified majority (acceptance by 55% of Member States which make up 65% of the EU population)

Formalities

Competence:	Art. 175 (3) TFEU (specific actions for cohesion)
Type of legislative competence:	Art. 4 (2) TFEU (shared competence)
Procedure:	Art. 294 TFEU (ordinary legislative procedure)

ASSESSMENT

Economic Assessment

Cushioning an asymmetric shock may indeed take longer in eurozone countries because they lack monetary instruments. This leads to the situation that the national fiscal policy of eurozone countries – when hit by a shock – comes under more pressure than countries which have their own currency. The euro, however, is no justification for the introduction of a stabilisation function. Quite the opposite: in normal economic situations, countries should have balanced budgets and sufficiently low levels of debt, enabling them to maintain or increase their spending during a shock for a longer period and without fear of capital market actors losing confidence. Furthermore, as part of their economic policy, countries should have flexible labour markets that help to cushion shocks.

The credit line cap of 30 billion euros will be insufficient for macroeconomic stabilisation as – due to the 30% limit –, whatever the circumstances, a country can receive a loan of no more than 9 billion euros, which e.g. in the case Germany only amounts to 0.27% of GDP. This problem will be exacerbated if **several countries request an EISF-loan at the same time** because then the amount will be even lower. This is very likely as the EISF does not ensure that loans are only granted in case of asymmetric shocks. It is therefore possible that a large number of countries could request an EISF loan in the event of a symmetric shock.

It is true that **the EISF** can prevent or delay the need for an ESM loan. In doing so, however, it undermines the incentive for countries to maintain sound budgets for fear of an ESM adjustment programme. Furthermore, for countries with unsustainable fiscal policies, it **postpones ESM intervention without addressing the fiscal problems (e.g. excessive public debt).** The Commission's attempt to solve this problem, by limiting eligibility for EISF support to countries that abide by the rules of economic policy coordination, is unconvincing as non-compliance, and thus exclusion from EISF loans, is subject to a finding by the countries in the Council themselves. Experience shows that such findings on compliance depend on political considerations, and not only on numerical rules. Countries will have even more incentive to water down economic policy coordination, especially the European fiscal rules such as the Stability and Growth Pact.

Basing the endowment of the SSF on an international agreement allows countries not to contribute to the SSF.

The Commission's proposal to establish the existence of a shock based on an increase in the unemployment rate is appropriate as the latter is a reliable indicator for detecting shocks. **The "one-year eligibility criterion"**, in particular, **which requires an increase in the unemployment rate of at least one percentage point** compared to the rate for the same quarter in the previous year, **ensures that loans are only granted in exceptional circumstances** because such an increase cannot be caused simply by cyclical variations in the unemployment rate or by structural problems, e.g. erosion of competitiveness. Furthermore, this criterion ensures that countries have no incentive to keep the unemployment rate high after the shock as they would not be eligible for further EISF support. However, it might be the case that countries with structural problems are more likely to face a steeper increase in the unemployment rate once they have been hit by a shock than countries without such problems. In this case, **EISF support can lead to transfers**. **To avoid such a risk, countries should pay a higher contribution into the SSF after every loan.**

The interest subsidy is inefficient as some countries have better financing conditions than the EU. If such a country applies for EISF support, the interest rate – and hence the subsidy – will be higher than the interest rate which the country would pay if it borrowed directly from the capital markets. For reasons of financial efficiency, the subsidy should in these cases cover the interest which the country has to pay to creditors. The country would not incur any loss while the fund would save resources.

Legal Assessment

Legislative Competence of the EU

Ultimately, unproblematic. EISF support serves to maintain cohesion [Art. 175 (3) TFEU].

Subsidiarity

Unproblematic.

Proportionality with respect to Member States

Unproblematic.

Compatibility with EU Law in other Respects

EU law allows neither the EU nor Member States to be liable for financial commitments of another Member State or to assume such commitments [Art. 125 TFEU, so called 'no-bail-out clause']. A violation may arise here for two reasons: Firstly, the EU will need to use its own resources to serve creditors if a country defaults on its EISF loan. Secondly, the interest subsidies are also funded by other countries and not only by the requesting country; even if the contributions to the SSF are subject to an international agreement, countries are not released from respective limitations of EU law [cf. Art. 4 (3) TEU]. However, the current case law of the CJEU [cf. CJEU, Judgement of 27 November 2012, Pringle, C-370/12, para. 129-147] allows this kind of financial support by the EU or by Member States as long as steps are taken to ensure that benefitting Member States follow a sound fiscal policy and "remain subject to the logic of the market" [cf. ibid, para. 132, 135-137]. The EISF aims to ensure sound fiscal policies by not releasing a defaulting country from its financial obligations to the EU and by requiring countries to have complied with the rules of economic policy coordination This approach hardly ensures the maintenance of sound fiscal policies.

The EISF may incentivise countries to follow laxer fiscal policies because they can rely – to a certain extent – **on being bailed out in the event of a shock.** Hence, while the purpose of the no-bail-out clause is to prompt budgetary discipline and to contribute to the "attainment of a higher objective, namely maintaining the financial stability of the monetary union" [CJEU, Pringle, C-370/12, para. 135], the EISF may actually defeat this higher objective, unless the rules of economic policy coordination are applied more strictly and with less flexibility.

Conclusion

The credit line cap of 30 billion euros will be insufficient, especially if several countries request an EISF loan at the same time. The EISF may incentivise countries to follow laxer fiscal policies because they can rely on being bailed out in the event of a shock. The EISF postpones ESM intervention without addressing the fiscal problems (e.g. excessive public debt). The "one-year eligibility criterion", which requires an increase in the unemployment rate of at least one percentage point, ensures that loans are only granted in exceptional circumstances. EISF support can lead to transfers. To avoid such a risk, the countries should pay a higher contribution to the SSF after every loan.