

# AUTOMATIC STABILIZERS FOR THE EURO AREA: WHAT IS ON THE TABLE? PROMISES AND PROBLEMS OF THREE PROPOSALS FOR CYCLICAL STABILIZATION

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## EXECUTIVE SUMMARY

This Policy paper contributes to the debate on how to equip the euro area with a mechanism for asymmetric shocks absorption. It responds to the challenge of automatic stabilization and adds to potential solutions by analysing the promises and problems of automatic stabilization mechanisms for the euro area. The Policy paper considers three of the most influential proposals for an automatic stabilization mechanism: a cyclical shock insurance put forward by Enderlein, Guttenberg & Spiess, (2013); a European Unemployment Insurance proposed by Dullien (2014a); and a Reinsurance proposed by Beblavý, Gros & Maselli (2015). The analysis reveals the underlying assumptions of each proposal, identifies main requirements and compares net payments as well as stabilization properties.

The analysis finds that all three proposals offer sophisticated mechanisms that could be implemented at the European level to ensure automatic stabilization. All three offer different promises and problems and a preference for one or the other is a question of priorities. The CSI is based on an indicator with limited precision but offers lean requirements. The proposal offers a technical solution by smoothing cyclical deviation; it is based on a narrow economic approach. The EUI is based on a more holistic approach. Payments at the individual level make the mechanism tangible to citizens but, at the same time, add complexity to the design. The major challenges lie in the harmonization of labour markets and a consequentially complex legal procedure, including treaty changes. The Reinsurance provides insurance for severe crisis, and is thus only semi-automatic. Although it can be understood intuitively, the discretionary element adds an administrative burden that is difficult to realize at the European level.

The introduction and part 1 lay out the problem of macroeconomic stabilization, part 2 reviews existing proposals and assesses their specificities. Part 3 analyses the findings and discusses potential remedies to mitigate the proposals' identified challenges. The Policy paper concludes providing policy makers with a sound basis to evaluate the promises and problems of the three automatic stabilizer proposals.

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## INTRODUCTION: THE DEBATE ON AUTOMATIC STABILIZATION

The euro crisis revealed major flaws within the Economic and Monetary Union (EMU). Ever since, there have been significant attempts to complete its structure. While the immediate impulse of reform has diminished, the question of the medium term structure of the euro area remains to be answered, with important reform ideas left to debate and potentially implementation. A widely acknowledged problem is the divergence of cyclical developments in the currency union making monetary governance increasingly difficult and ineffective. A possible solution to this problem is the introduction of an automatic stabilization mechanism at the European level, an idea put on the agenda by the four Presidents of the European institutions (Van Rompuy, Barroso, Juncker & Draghi, 2012) and the European Commission’s “blueprint for a deep and genuine EMU” (European Commission, 2012). Since 2012, the debate on automatic stabilization has advanced significantly with a large strand of literature<sup>1</sup> devoted to it and two high level conferences held in Brussels on the topic.<sup>2</sup> The most recent “Five Presidents’ Report” introduced an expert group working out details of a macroeconomic shock absorption mechanism.<sup>3</sup>

There have already been detailed proposals brought forward, among them: (1) a Cyclical shock insurance (CSI) by Enderlein, Spiess & Guttenberg (2013), (2) a European unemployment insurance (EUI) program as suggested by Dullien (2014a), and (3) a Reinsurance mechanism suggested by Beblavý, Gros & Maselli (2015).

This paper considers these three proposals and analyses the options that are on the table for mechanisms of cyclical stabilization in the euro area. It aims to flesh out promises and problems of the three proposals, setting a frame in which the debate on automatic stabilization is taking place.

## 1. The policy problem: diverging business cycles

### 1.1. Lack of adjustment channels

The incomplete structure of the euro area leaves it with a lack of important adjustment channels. Adjustment channels could be provided through capital and labour mobility as well as the mobility of goods and services, none of which are sufficiently developed in the euro area. As a result, diverging GDP growth rates and inflation differences between member states remain: since 2001 some member states have been growing significantly faster than others<sup>4</sup> and inflation differentials have not only persisted over a decade but grown worse. This leaves business cycles unsynchronized with country-specific shocks remaining substantial and frequent as Figure 1 shows.<sup>5</sup>

1. For an overview of literature on automatic stabilization at the European level consider: Beblavý, Gros & Maselli (2015); Dolls et al. (2015); Beblavý & Maselli (2014); Claeys, Darvas & Wolff (2014); Claeys, Ganem, Hüttl & Walsh (2014); Dolls, Fuest, Neumann & Peicht (2014); Dullien (2014a); Dullien (2014b); Epaulard (2014) Fichtner & Haan (2014); Lellouch & Sode (2014); Allard et al. (2013); Enderlein, Guttenberg & Spiess (2013); Furceri & Zdzienicka (2013); Pisani-Ferry, Vihriälä & Wolff (2013); Bernoth & Engler (2012); Hagen & Wyplosz (2008); Bajo Rubio & Diaz-Roldan, 2003); Hamond & Von Hagen (1998); Bayoumi & Masson (1995); Italianer & Vanheukelen (1993); Majocchi & Rey (1993); Pisani-Ferry, Italianer & Lescure (1992).

2. Bertelsmann Foundation in Cooperation with DG EMPL: “Let’s think out of the box” *Automatic stabilizers for the Eurozone: Pros and cons of a European Unemployment Benefit Scheme*. Brussels, 11 October 2013. And: *Economic shock absorbers for the Eurozone. Deepening the debate on automatic stabilizers*. Brussels, 20 June 2014.

3. *Five president report*.

4. Growth as measured in terms of GDP. At the same time productivity did not increase equally fast, leading to current account deficits and loss of competitiveness (Enderlein, Guttenberg & Spiess, 2013), see annex for details.

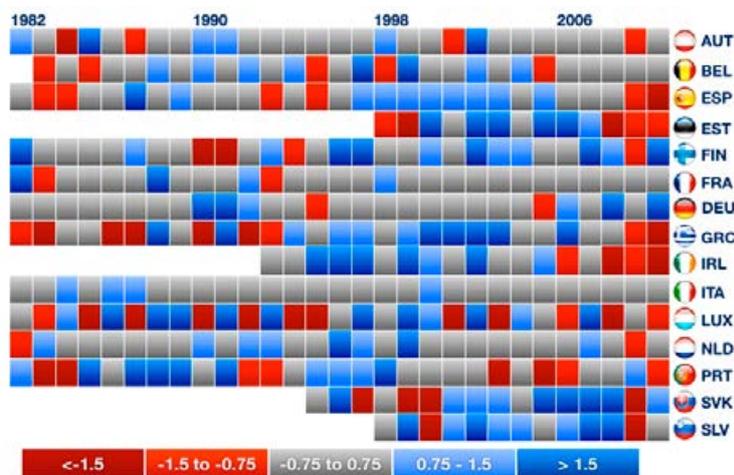
5. See also Pisani-Ferry (2012).

“UNSYNCHRONIZED BUSINESS CYCLES NEGATIVELY AFFECT THE ECB’S ABILITY TO CONDUCT MONETARY POLICY THAT IS NECESSARILY TAILORED TO EURO AREA AVERAGES”

Unsyncronized business cycles negatively affect the ECB’s ability to conduct monetary policy that is necessarily tailored to euro area averages. If differences persist, interest rates will be too high for some countries, risking an overheated economy; while being too low for others, in need of a stimulus. Such a situation creates negative feedback loops, where booms and busts are enforced rather than smoothed. The ECB’s policy is conducted in a “one size fits none” fashion, for a country that does not exist.

FIGURE 1 ► Country specific growth shocks, selected countries (percent)

Country-specific shocks have remained prevalent in the euro area



SOURCE: OECD and IMF staff calculations

NOTE: The idiosyncratic growth shocks are derived as the part of the country-specific growth shocks that are not explained by euro area-wide growth shocks. Growth shocks (both for the euro area and individual countries) are computed as the residuals from a regression of the country's (resp. Euro Area's) growth rate over two lags.

Source: Allard et al., 2013, p.8.<sup>6</sup>

## 1.2. How to approach the problem

Several options have emerged from ongoing debates around reform attempts to tackle the problem. The idea behind cyclical stabilization is to rely on automatic stabilization as it is done at the national level. There, “automatic stabilization is associated with the ability of taxes and transfers to automatically stabilize disposable income and consequently consumption (and GDP itself) (...) in the event of macroeconomic shocks” (Dolls, Fuest, Neumann & Peichl, 2014, p.15). In the context of the euro area, this would mean that countries in an upswing provide those in a downturn with additional recourses. Hence, it would be a form of risk sharing able to regionally stabilize divergent business cycles: it would increase the fiscal leeway of weaker countries and reduce the risk of an economic overheating in stronger ones. (Fichtner & Haan, 2014).

Some voices suggest to structurally reform national economic systems and enforce the SGP, with an extended scope (Thomas, 2015). This paper argues that establishing a mechanism at the European level instead of leaving it up to the individual countries to insure themselves against asymmetric shocks is important for two reasons:

1. National action suffers from a future tax liability that would be factored into consumption behaviour by forward-looking consumers, a disadvantage that a mutual (European) insurance does not face. (Bayoumi

<sup>6</sup>. The idiosyncratic growth shocks are derived as the part of the country-specific growth shocks that are not explained by euro-wide growth shocks (Allard et al., 2013, p.8).

& Masson, 1997). The multiplication effect of a European insurance system is, therefore, higher than it would be at the national level.

2. National budget constraints, particularly in times of crises, make counter-cyclical spending less likely (Von Hagen, 2007). The euro crisis showed that countries might not even have access to capital markets in order to finance their fiscal expansion.

Another important design question for an automatic stabilization mechanism is whether fiscal stabilization is triggered automatically or works discretionary. Attaching automaticity to the mechanism holds several advantages over discretionary options as outlined by Dullien (2014a; 2007):

1. Discretionary policies require lengthy parliamentary decision-making that is difficult nationally and even more so at the European level; so that there will always be a time lag between initially detecting a cyclical downswing and taking action. This problem would be compounded by the difficulty of getting real time data of a country's position within the business cycle.
2. The provisions of the SGP/Fiscal Compact do not allow states to exceed a certain level of debt; excessive deficits need to be avoided, which makes it more difficult to provide for a stimulus in a crisis.

These conditions result in the question how exactly the euro area can be equipped with the much-needed possibility to react to asymmetric shocks. The respective debate has given rise to a number of proposals, providing well-developed mechanisms. The main contribution of this paper is to identify core differences between proposed mechanisms and to analyse their most important features to outline the promises and problems of three proposals for automatic stabilization.

## 2. The policy approach: Analysis of three options

### BOX 1 ▶ Automatic Stabilization over the decades

The literature on the flaws of the euro's construction and possible cures has grown significantly in the aftermath of the financial crisis and the subsequent euro crisis. Ideas for a "deep and genuine EMU" (European Commission, 2012) and ways "towards fiscal union in Europe" (Enderlein, et al., 2013) have been discussed widely.

The debate can be traced back to the 1970s when the idea for a European monetary union first started to evolve, and with it the idea to establish a system of fiscal transfers to absorb shocks.<sup>7</sup> In 1977, a group of experts argued that a European monetary union would need a common budget of 5-7% of GDP to account for cyclical shocks (MacDougall et al., 1977). The Marjolin Report of 1975 (Commission of the European Communities, 1975) even mentions an unemployment insurance system at the European level, installed as an independent administrative body, providing individuals with a certain amount of their unemployment benefits. The 1989 Jacques Delors Report envisioned the establishment of the EMU as we know it today, and discussed the necessity to have a shock absorption mechanism at the European level. Such a mechanism would not only be economically necessary but "both the product of, and the source of the sense of national solidarity which all relevant economic and monetary unions share" (Committee for the Study of Economic and Monetary Union, 1989, p. 98).

Following these more general considerations of the 1970s and 80s, the debate was fuelled by more concrete ideas and proposals at the time of the euro area's initial creation. However, once it became clear that the fiscal element at the European level would not surpass the provisions of the SGP, the debate became less prominent. But it regained its momentum with the euro area crisis and is now back on the agenda.

The analysis of the three proposals aim to flesh out different approaches to automatic stabilization and to scrutinize how they translate into different requirements and results. The proposals are analysed according to six categories and are visualized using the idea of "logic models" to enhance comparability between them.<sup>8</sup>

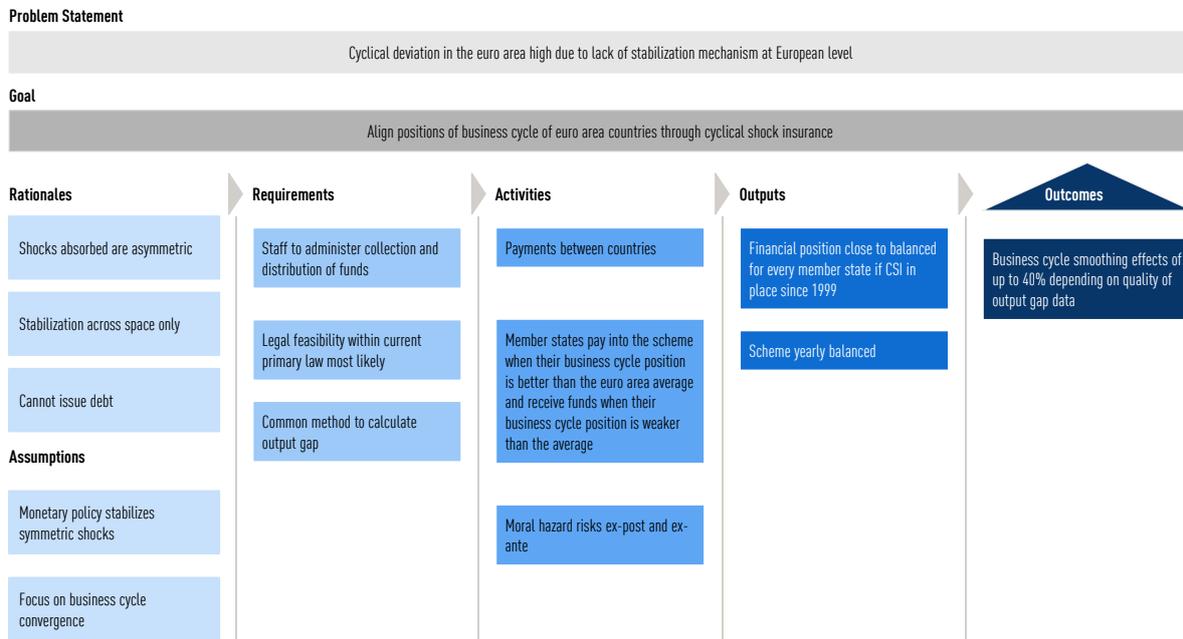
7. In 1969, P. Kenen first mentioned the general idea of fiscal transfers in a currency area to absorb shocks that can not be channeled through exchange rate adjustments (Kenen, 1969).

8. The logic model was developed in the context of program and policy evaluation and has been in use since the late 60s, with an increase in popularity in recent decades (McLaughlin & Jordan, 2010). The model's main purpose is to visualize the link between a policy's input and its output, it allows for more systematic thinking about different policy elements and how they link together. Consequently, strengths and weaknesses as well as gaps in the policy can be detected.

- **Rationales** refer to the type of stabilization that is necessary (asymmetric vs. symmetric, stabilization across space vs. time, possibility to issue debt).
- **Assumptions** refer to the understanding of the functioning of the euro area
- **Requirements** are the resources and the input necessary to set up the mechanism (administration, legal design, harmonization of labour markets and indicator)
- **Activities** is what the mechanism actually does (who pays in, trigger for payments) at what level this is taking place (country vs. individual) and what moral hazard risks are implied
- **Outputs** are the payments between countries or individuals.
- **Outcomes** are the stabilization properties of the mechanism in macroeconomic terms as well as social and political changes

Figures 2 to 4 reveal that the problem statement is the same for all three proposals; the goal is different for each of them, as are the assumptions and rationales. The considerations for input and activity are bound by the institutional structures of the multi-level governance area of the European Union. However, the numbers for net payments (output) and stabilization (outcome) are not reality so far; they are based on the calculations of the proposals' authors. These calculations are done within clear statistical limits and face a high degree of uncertainty and limited data availability. They are, however, the best approximation available and can therefore still serve as a general indication within the relevant logic model categories.

FIGURE 2 ► Logic Model CSI



AUTOMATIC STABILIZERS FOR THE EURO AREA: WHAT IS ON THE TABLE?

FIGURE 3 ► Logic Model EUI

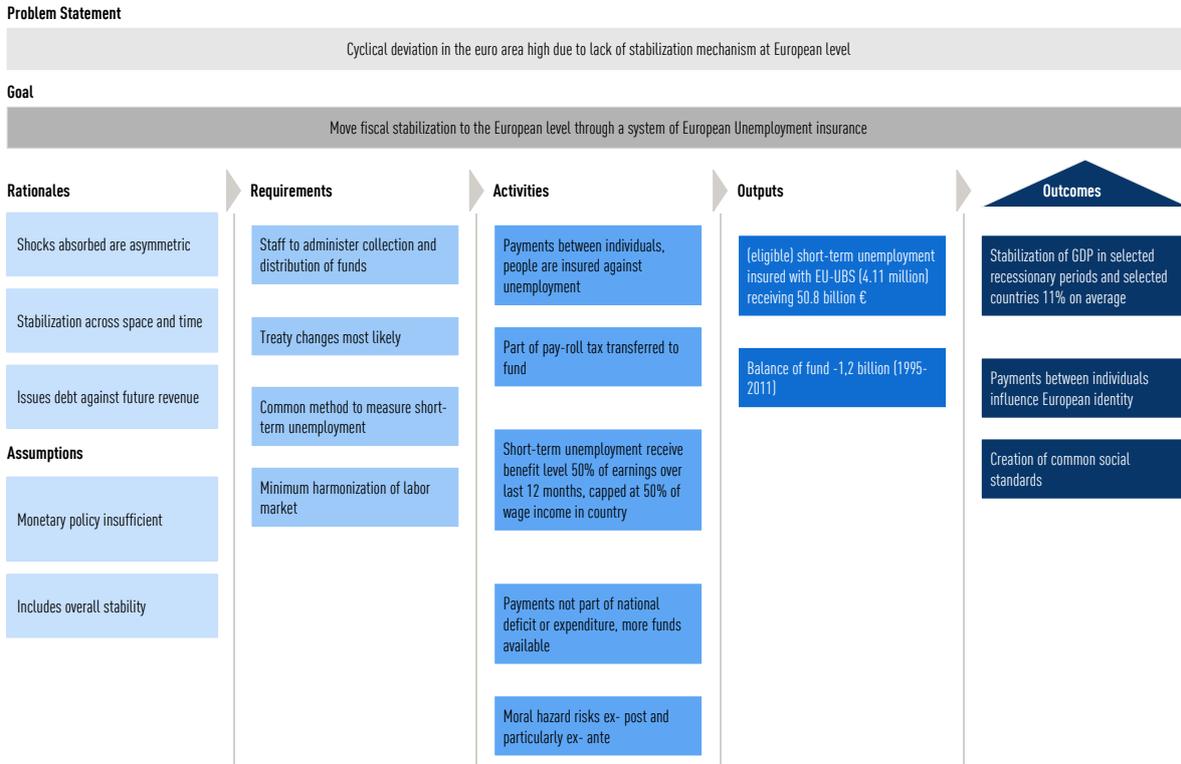
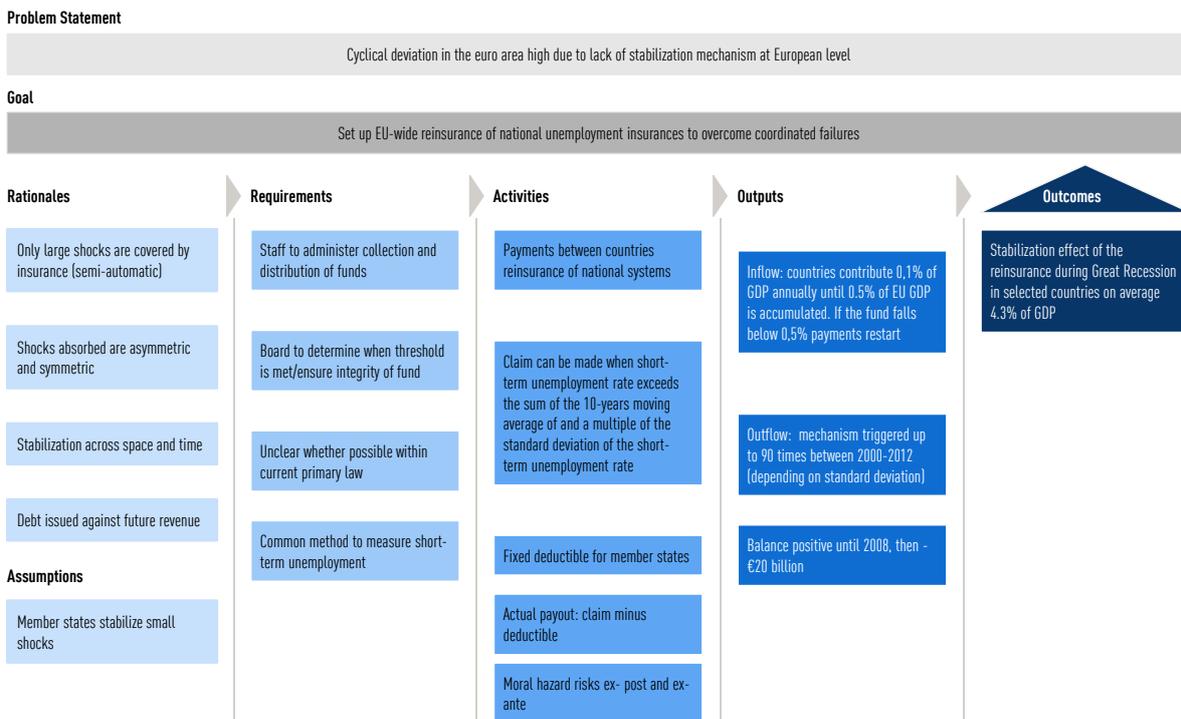


FIGURE 4 ► Logic Model Reinsurance



Source: all three models own representation.

The subsequent analysis considers three proposals in detail, following the structure of the logic models.

## 2.1. Problem statement and goals

”CYCLICAL DIVERGENCE  
IN THE EURO AREA LEADS  
TO IMBALANCES”

All three proposals start with the recognition that cyclical divergence in the euro area leads to imbalances. However, the initial ideas and hence the goals of all three proposals differ: while Enderlein, Spiess & Guttenberg (2013) propose to align the positions of business cycles of euro area countries through a CSI, Dullien (2014a) proposes to introduce an EUI and Beblavý, Gros & Maselli (2015) would like to see a Reinsurance of national unemployment systems.

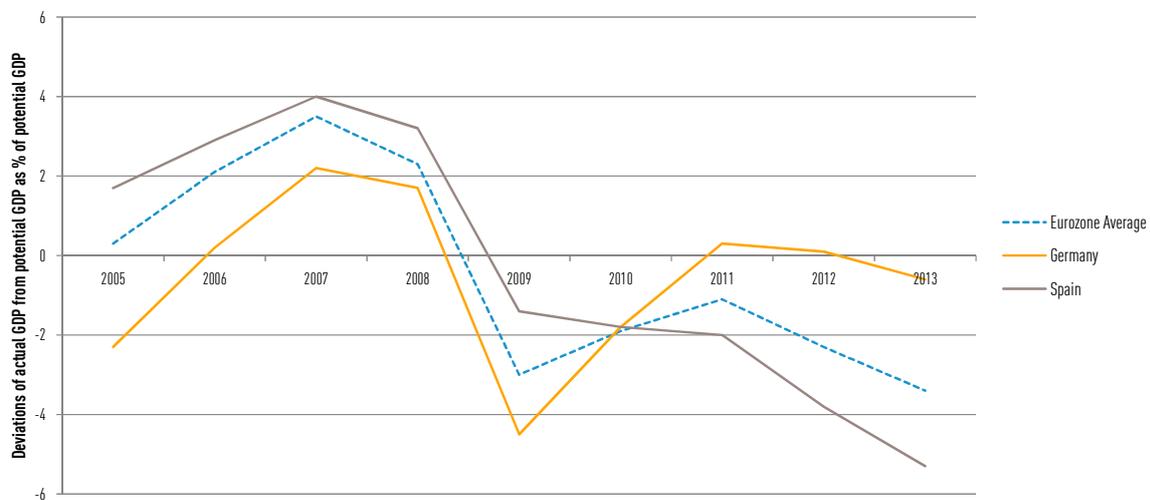
## 2.2. Rationales and Assumptions

The assumptions about which kind of stabilization is necessary depend on the authors' understanding of the functioning of the euro area as a whole. Enderlein, Spiess & Guttenberg (2013) argue that in case of symmetric shocks, the ECB is well equipped to conduct monetary policy. Their proposal, therefore, focuses only on asymmetric shocks and payments are tied to the relative business cycle position of a country compared to the euro area average. Consequently, the CSI provides stabilization only across space (from countries with lower growth to countries with higher growth), not across time (from times of overall low economic growth to times of higher growth). The mechanism cannot issue debt, as all funds collected are distributed over the course of one year. The reason not to issue debt is mainly functional, but this feature of the CSI is also viewed as a way to increase political acceptability. (Enderlein, Spiess & Guttenberg, 2013).

The Reinsurance and the EUI base their mechanism on different assumptions and aim to stabilize both symmetric and asymmetric shocks. As a result, stabilization is provided both across space and time, which makes it necessary for the mechanisms to issue debt. This approach provides stabilization also in the case of area-wide crises and can serve as an instrument to provide countries with additional funds in case they are running out of fiscal space.

Their reasoning is based on the assumption that “monetary policy has proven to be less effective in stabilizing the euro-area business cycle than assumed in the past” (Dullien, 2014a, p. 70f.). This is mainly due to the zero-bound interest rate that limits the (conventional) action that the ECB can take. Apart from the limitations of monetary policy Dolls, Fuest, Neumann & Peichl (2014, p.16) argue that “any shock absorption scheme without debt financing can have destabilizing effects if the union as a whole is hit by a shock (...)”.

Figure 5 illustrates how this problem would have materialized between 2008 and 2011, when the euro area as a whole was hit by a symmetric shock and went into recession simultaneously. While the mechanism would have stabilized business cycle divergences between Germany and Spain, it would have been probably perceived as dysfunctional politically.

**FIGURE 5** ▶ Euro area average output gap and relative position of Germany and Spain, 2005-2013

Source: OECD Economic Outlook 2014.

The idea of Reinsurance rests on somewhat different assumptions regarding the size of action triggering shocks. It assumes that member states are well equipped to smooth shocks of minor amplitude. Only where shocks reach a certain threshold the responsibility is shifted to a European wide mechanism. Instead of smoothing many small shocks to only a small extent, the rational is to consider only large shocks and to provide member states with a significant amount of money in such cases. This introduced an element of discretion into the mechanism and makes it only semi-automatic with implications especially on administrative requirements.

## 2.3. Requirements

The requirements of the three proposals are analysed in terms of: (2.3.1.) administrative requirements; (2.3.2.) legal requirements; (2.3.3.) requirements for labour market harmonization.

### 2.3.1. Administrative Requirements

The question about administrative requirements boils down to the choice between a fully automatic mechanism (CSI and EUI) and a semi-automatic one (Reinsurance). The first case requires the definition of allocation questions, a priori e.g. as part of the mechanism's founding treaty. Of course, this does not preclude the possibility of fervent discussion about allocation; the decision itself would be automatic.

With the Reinsurance on the other hand, a case-by-case judgment is necessary to determine when the threshold is met so that payments are triggered. The time lags of unemployment data or differences of measurement can easily be imagined as sources of dissent. A decision-making body at the European level would therefore be necessary. Such a body would require a high degree of independence and credibility - a combination that is difficult to imagine, especially in the multilevel governance environment of the EU.

Semi-automaticity poses another administrative challenge, since a fund would be built up at the European level without definite certainty how the money is spent. A track record of reallocation and rededication of funds should be viewed as critical in this context. The Barroso II Commission rededicated money to fund the youth guarantee scheme; Juncker's new European Fund for Strategic Investments is based on the rededication of funds as well (Zuleeg, 2014). It is likely that the Reinsurance fund would awaken similar desires, especially so in times of economic prosperity. Further, the administrative body would also need to serve as a watchdog to ensure that the money was spent for intended purposes.

CSI and EUI administrative requirements will largely depend on the particular arrangement. Generally speaking, the CSI would have to deal with an allocation of funds at the macro-level (between countries). Creating an administrative apparatus should therefore be relatively easy. With an EUI it would be necessary to create a mechanism that reaches all the way to the individual. Clearly it is possible to draw on existing national administrative capacities for revenue collection and benefit distribution. However, significant national differences would still effect how these processes work, and the coordination of these processes would require a significant effort, thus complicating administrative requirements substantially.

### 2.3.2. Legal Considerations

”THE DECISIVE QUESTION IS WHETHER A MECHANISM CAN BE SET-UP WITHIN THE EXISTING LEGAL FRAMEWORK, OR WHETHER TREATY CHANGES ARE NECESSARY”

The authors of the CSI “refrain from making a clear judgment whether CSI would be possible under current primary law” (Enderlein, Spiess & Guttenberg, 2013, p.38). They do argue, however, that it should be possible to realize the mechanism without treaty changes, as it does not entail the “transfer of additional sovereignty to a European institution” (ibid., p.38). The authors of the other two proposals refrain from judging the legal feasibility of their mechanisms altogether. Exploring all legal options in detail is an exercise that will have to come later in the policy process; at this stage it is beyond the scope of the debate. Nonetheless, this paper highlights important legal considerations and outlines general considerations. The decisive question is whether a mechanism for automatic stabilization can be set-up (1) within the existing framework of the Treaty on the European Union (TEU) and the Treaty on the Functioning of the European Union (TFEU), or whether (2) treaty changes are necessary.

#### 2.3.2.1. Within existing treaties

The procedure to create additional competencies at the European level is article 352 TFEU – known as the flexibility clause (Beukers, 2013, p.9). Under this clause a mechanism could represent an enhanced cooperation between participating member states. Changes could be made with unanimity in the Council and the consent of the European Parliament; national ratification is not required. However, Repasi (2013) argues that this option is not available for the EUI understood as a “partial substitute to national unemployment insurance systems” (Van Rompuy, Barroso, Juncker & Draghi, 2012, p.9). He contends that article 153 (1)(c) TFEU specifies the nature of European legislation in the case of unemployment insurances and suggests that for the EUI treaty changes would be necessary. Nonetheless, neither the Reinsurance nor the CSI proposals interfere with national unemployment systems, the paths of article 352 TFEU seems to be viable for them.

Another legal challenge concerns the conditionality of payments. Within existing treaties, it is possible to provide member states with financial assistance if the assistance is “indispensable for the safeguarding of the financial stability of the euro area as a whole and subject to strict conditions” (article 125, TFEU). Repasi (2013, p.26) argues that “unconditional payments based only on the transgression of certain macro-economic indicators where the spending remains national conflict with article 125 TFEU”. This legal interpretation would not be problematic for the EUI because it allocates funds directly. The Reinsurance considers earmarking payments but discourages it for economic reasons. The CSI addresses earmarking in the context of moral hazard. Ultimately, however, it should be possible to meet this legal requirement.

A third point is that of democratic legitimization for a decision making body at the European level. In case of the CSI and the EUI this question is less relevant, as their operation is fully automatic. The semi-automaticity of the Reinsurance and the resulting administrative requirements, have already been discussed under chapter 2.3.1. and Repasi (2013) adds a legal dimension to this analysis in arguing that a decision making body charged with the identification of thresholds to trigger payments needs proper democratic control. To provide for this oversight, institutional changes would be necessary that would require treaty changes. Depending on how far-reaching the competencies of the body within the Reinsurance mechanism were it might not be realizable under existing primary law.

### 2.3.2.2. Treaty change

An ordinary treaty revision would be carried out under article 48(2) to (5) TEU. However, the ordinary procedure is lengthy, cumbersome and does not necessarily lead to success, as the 2005 attempt of a Constitutional Treaty has shown. In the current political situation where anti-European sentiments are growing, populist parties gain votes all over the continent, and Great Britain is playing with leaving the Union altogether, it is questionable whether opening Pandora's box is advisable. (Beukers, 2013). Choosing the road of treaty change would also assume that there is a consensus, at least on the broad agenda, on how the euro area and the EU as a whole should be reformed. But with the immediate pressure of a euro area collapse being lifted, the pressure for reform, let alone a treaty change, has faded away.

The alternative to the ordinary procedure is the simplified procedure of 48(6) TEU. The simplified procedure does not include the transfer of new competencies to the European level, and correspondingly the procedural bar is lower as well. A treaty revision would have to be "approved by the Member States in accordance with their respective constitutional amendments" (article 48(6) TEU), but it would not necessarily need ratification at the national level, including referenda and a parliamentary vote (Véron, 2013).

While the legal opinions discussed above are very valuable and can serve as a good indication of the challenges that the proposals would face in legal terms, it is important to consider them as what they are: legal *opinions*. An opinion can change and post-crisis reform has shown that, where there is political will, legal constructs can be established that "involve complicated institutional questions" (Dullien 2014a, p. 124), the banking union being the prime example.

”THE MINIMUM REQUIREMENT IS UNANIMITY IN THE COUNCIL: A PROPOSAL WOULD HENCE NEED THE SUPPORT OF ALL COUNTRIES”

The analysis has shown that the EUI is difficult to implement legally without treaty changes. In case of the Reinsurance proposals it depends on the competencies that a board would have over the decision on payments. The CSI is imaginable to be implemented without treaty changes. Yet, such an approach would come at the expense of democratic oversight and control. It is therefore questionable whether the precedent of other post-crisis legislation should be used. On the other hand, treaty changes would span at least a decade, while implementation within several years would be possible, if the mechanism was based on existing treaties (European Commission, 2012). The minimum requirement, in any case, is unanimity in the Council: a proposal would hence need the support of all countries.

### 2.3.3. Harmonization of Labour Markets

The question of labour market harmonization in the EU, and the euro area in particular, is as old as the integration process and viewed by many as a goal in and of itself (Krause, Rinne & Zimmermann, 2014). Successful labour market integration could lead to higher mobility rates, a development that would provide for more stability in the euro area, as Mundell (1961) argued. However, integration in this area was and is difficult and only slowly progressing, due to its complexity and the fact that national systems reflect deliberate social choices and historically grown structures. In this context, therefore unemployment is not only important from a macroeconomic point of view, "it is [also] a central element of social policy." (Claeys, Darvas & Wolff, 2014, p.3).

Unlike the CSI and the Reinsurance proposals, the EUI includes national labour markets in its design, through payments at the individual level attached to the rate of short-term unemployment. This requires a certain degree of labour market harmonization, so that the insurance covers a comparable amount of risk in each member state. However, the situation in the member states is rather heterogeneous, both concerning (2.3.3.1.) the national unemployment schemes themselves and (2.3.3.2.) the general characteristics of labour markets.

### 2.3.3.1. National unemployment schemes

Esser, Ferrarini, Nelson, Palme & Sjöberg (2013) and Andor (2014) provide a very detailed overview of national unemployment benefit schemes in Europe. According to their analysis the unemployment schemes differ with regard to:

- *Eligibility and Coverage:* varying eligibility criteria according to age, type of labour contract and status of self-employed workers, leading to stark differences in the coverage ratios of short term unemployed workers actually receiving benefits, from 16% in Italy to over 80% in Germany (see Table 1).
- *Level of Payments:* Generally, the level of payment is calculated as a percentage of previous earnings in a reference period, but other factors such as the presence of children in the household are considered in some countries as well (e.g. in Germany). In other cases, benefits are paid out as a flat amount (e.g. in Greece, Portugal and Ireland). The different concepts lead to widely differing replacement rates of past earnings, from 29% in Greece to 80% in Lithuania (see Table 1).
- *Length of Payments:* The length of unemployment payments varies from 6 months in Cyprus, Malta and Slovakia to 48 in Belgium (see Table 1). This is again due to different conceptual and methodological approaches.
- *Source of funding:* depending on tradition of the welfare state, unemployment systems are either financed via taxes (e.g. in Scandinavia) or linked to employment and hence financed via contributions from employer and employee (e.g. in Germany).

**TABLE 1** ▶ Heterogenes labour markets, selected countries

	Max. duration (months)	Replacement rate (%)	Coverage ratio (%)
Austria	12	55	49
Belgium*	48	65	58
Bulgaria	12	60	23
Croatia	15	70	23
Cyprus	6	50	25
Czech Rep.	5	65	36
Denmark	48	60	49
Estonia	12	50	41
Finland*	16	45	56
France	36	75	49
Germany	24	60	82
Greece**	12		29
Hungary	3	60	31
Ireland**	8		
Italy	14	75	16
Latvia	9	65	29
Lithuania**	9		29
Luxembourg	12	80	36

Source: The EU's Mutual Information System on Social Protection (MISSOC) comparative tables for duration and replacement rate; Bruegel calculation using Eurostat's Labour Force Survey for the coverage ratio. Note: \* provide an indefinite unemployment stipend after other benefits have been exhausted; \*\* provide flat rates of insurance coverage (Greece: €360/month, Ireland: €188/week, Malta: €12.35/day, Portugal: €190/month, Romania: €130/month). Replacement rate: unemployment benefit as a percent of previous wage. Coverage ratio: the number of short term unemployed receiving benefits to total number of short-term unemployed (%).

Source: Claeys, Darvas & Wolff (2014, p.2).

### 2.3.3.2. General characteristics of labour markets

” THE SYSTEM OF UNEMPLOYMENT BENEFITS IS EMBEDDED WITHIN THE LABOUR MARKET AND WELFARE SYSTEM OF EACH COUNTRY”

The system of unemployment benefits is embedded within the labour market and welfare system of each country. Unemployment schemes therefore interact with pension entitlements, and health and nursing insurance systems that have very peculiar characteristics. Hall & Gingerich (2004) also point out that “in the spheres of labour relations and corporate governance, there are systematic differences among [European] nations” (p.37). These differences have important consequences for the wage setting process (Iversen & Soskice). Claey's, Darvas & Wolff (2014) identify a link between different levels of employment protection legislation and varying degrees of labour market flexibility across the euro area.

Against the background of significant differences between countries, an EUI without a certain degree of harmonization would lead to a different amount of risk ensured in each country. Thus, effective stabilization depends on the degree of harmonization of labour markets. That is however difficult to achieve and a politically sensitive issue. Nonetheless, Esser, Ferrarini, Nelson, Palme & Sjöberg (2013) provide concrete recommendations for the harmonization of the national unemployment insurance systems, and the debate about labour market harmonization is progressing as well (Pernicka & Glassner, 2014). There is however a cost attached to harmonization efforts that needs to be weighted against the benefit of the mechanism.

Both the Reinsurance and the CSI proposal are less demanding in terms of harmonization requirements. The case of the CSI is straightforward: the mechanism avoids involvement with national labour markets as allocation is relative to the euro area average. To reach the goal of cyclical stabilization, no labour market harmonization is required. The case of Reinsurance is somewhat more complex, as the indicator does involve labour markets, but payments are triggered not in absolute terms but in terms of the standard deviation of the ten-year moving average of a country's short-term unemployment rate. Since national unemployment insurances are not directly involved harmonization requirements are lower. If the mechanism included conditionality for the payments, a certain degree of harmonization could be expected. Such are, however, not ex-ante requirements.<sup>9</sup>

### 2.3.4. Indicators

All three proposals need to decide on an indicator that measures the position of a country within the business cycles. It is the output gap for CSI and short-term unemployment for Reinsurance and EUI. Both indicators come with different technical challenges and require a common method of measurement across all member states.

#### 2.3.4.1. Output gap

The output gap is defined as the deviation of an economy's GDP from its long-term growth potential. Data about the actual GDP of a country are available, but the calculation of the growth potential<sup>10</sup> is much more controversial. Because it is so difficult to calculate long-term growth potential, output gap data are subject to frequent revision and hence not very reliable. Figure 6 depicts the calculations - and revisions - of the output gap by the OECD between 2007 and 2014.<sup>11</sup> Enderlein, Spiess & Guttenberg (2013) argue that adjustments are mostly done across all countries and would therefore not change the relation of payments significantly. However, it is very questionable whether politically sensitive payments between countries should be attached to an imprecise indicator. The output gap is also used in the context of the newly introduced debt ceiling in

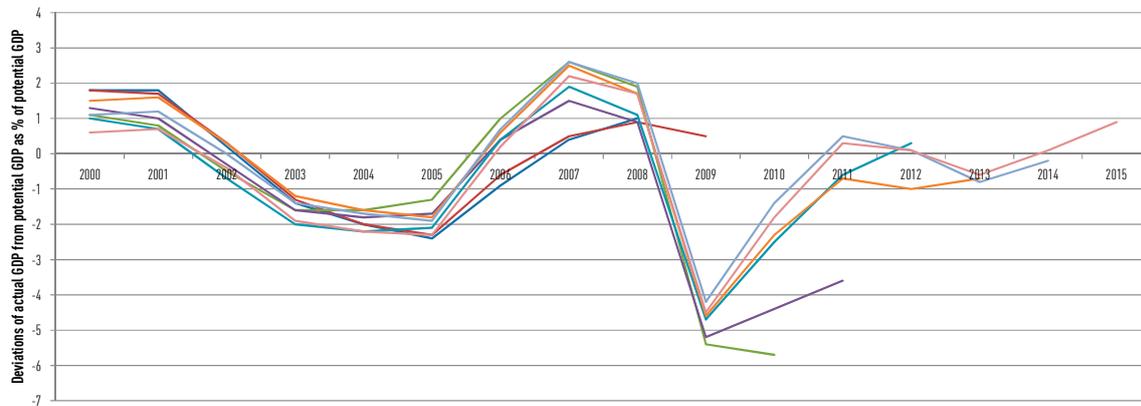
9. Although not suggested by the authors, conditionality is included as an issue to debate in the publication. The authors propose provisions on active and passive labour market policies (Beblavý, Gros & Maselli, 2015).

10. Understood as the maximum growth rate without developing inflationary pressure (Jahan & Mahmud, 2013).

11. For further analysis, see: Deutsche Bundesbank (2014).

Germany as well as in the context of the SGP at the European level. While this might lead to greater political and public acceptance of the indicator in the medium run, its technical problems will remain.

**FIGURE 6** ▶ Output Gap estimation over time - Germany



Source: OECD Economic Outlook 2007-2014, issue 1, similar representation Fichtner (2014, p.3).

### 2.3.4.2. Short-term unemployment

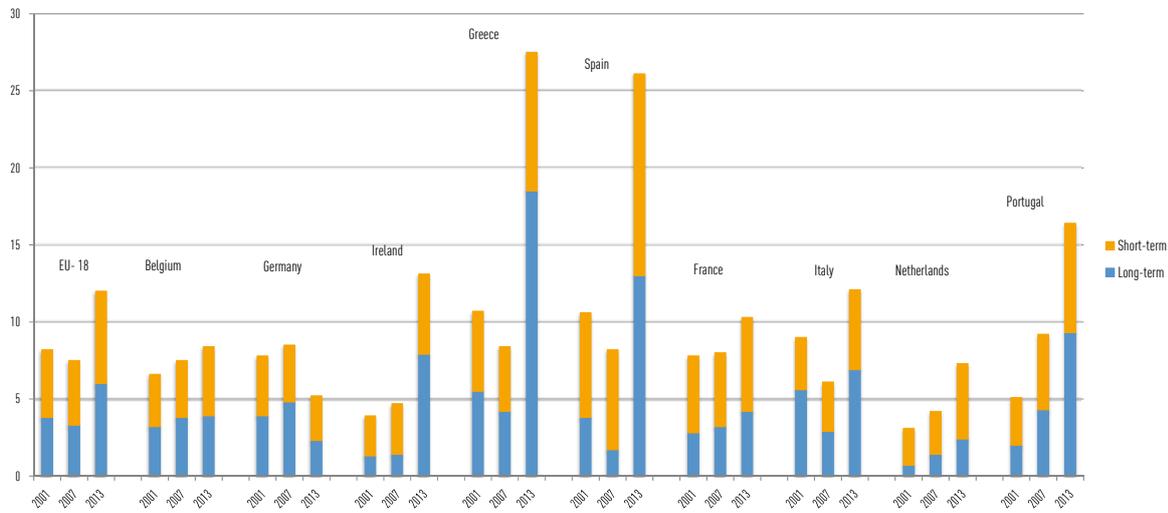
” SHORT-TERM UNEMPLOYMENT IS THE INDICATOR OF CHOICE BOTH FOR THE REINSURANCE”

Short-term unemployment is the indicator of choice both for the Reinsurance and EUI proposals. It depicts the cyclical position of a country with a minimal time lag and considers workers who have been employed and looking for a job for less than 12 months. The idea is to avoid moral hazard by choosing only short-term unemployment and not long-term unemployment, which is a structural component of a labour market. To account for national differences, the indicator is adjusted for seasonality, which plays a bigger role in countries with high levels of tourism (Dullien, 2014a).

In the case of the EUI the level of short-term unemployment in different countries is connected. Figure 7 shows that these numbers differ greatly. Since the number of short-term unemployed is also a function of the flexibility of the national labour market an element of structural convergence is introduced into the EUI. Therefore, Dullien (2014a) discusses the option to include a “national structural surcharge” (p.123) that influences the distribution rate based on the share of the population receiving EUI benefits.

The Reinsurance approach accounts for this problem by referencing not the absolute numbers of short-term unemployed, but the standard deviation of the ten-year moving average of a country. Both proposals face the challenge that national data collection is focused on diverging national benefit schemes. It would thus be necessary to streamline data collection to make the indicator feasible.

**FIGURE 7** ▶ Unemployment rates by duration (%) in selected countries, selected periods



Source: Eurostat, similar representation Claeys, Darvas & Wolff (2014, p.5).

” THE ANALYSIS SHOWS THAT SHORT-TERM UNEMPLOYMENT CARRIES A STRUCTURAL COMPONENT ”

The analysis shows that short-term unemployment carries a structural component and the output gap that suffers from inaccuracy. Especially in the case of the CSI it is conceivable to think about alternative indicators (for further considerations see chapter 3.2.1).

Through their choice of indicators, the Reinsurance and the EUI stabilize only income from labour, while the CSI factors in income from both capital and labour. This difference does not only have macroeconomic implications: Piketty & Goldhammer’s (2014) recent publication has sparked a lively debate on the topic, exacerbating its political sensitivity.

## 2.4. Activities

This section revisits the channel of adjustment and the level at which it takes place, either between countries or between individuals. In a second step, it also explores moral hazard risks resulting from each proposal.

### 2.4.1. Level of mechanism

The adjustment channels foreseen by the proposals vary between country level (CSI) and individual level (EUI). The Reinsurance proposal technically relies on country level adjustment channels, but since the reinsurance of unemployment systems is envisioned, the individual level plays a certain role here as well.

While the macro level of the CSI reduces the complexity of the mechanism and makes requirements in terms of administration, legal support and harmonization simpler, at the same time it suffers from its technicality. Not only does it have significant deficiencies concerning the indicator, it is a detached mechanism that would add to the technocratic character of the EU.

The Reinsurance operates at the macro level as well. It offers an intelligible mechanism as most people have a similar insurance for their car, where a deductible has to be paid first, before the insurance pays for damage. The mechanism furthermore provides insurance only in times of severe crisis – a fact that makes support in countries that would likely be net-contributors more probable. However, this semi-automatic element adds a significant administrative burden.

The EUI proposal connects the micro and the macro level. This makes the tool very visible to European citizens; it is a mechanism they can directly relate to but mixes up very different goals. National unemployment insurances aim first and foremost at smoothing individual consumption, whereas the EUI tries to achieve cyclical stabilization of the euro area. It is hence questionable whether the two should be connected so closely. The connection adds significant complexity to the mechanism.

## 2.4.2. Moral hazard risks

Paul Krugman defines moral hazard as “any situation in which one person makes the decision about how much risk to take, while someone else bears the cost if things go badly” (Krugman, 2009). The context of automatic stabilization is such a situation. As in any other insurance-type scenario the principal-agent relation leads to a moral hazard risk by the agent. The following analysis will employ the popular scheme of (1) ex-ante and (2) ex-post moral hazard risks:

### 2.4.2.1. Ex-ante risks

Ex-ante refers to the behaviour after having a mechanism in place. The risk structures look rather different for the three models: The CSI would increase the incentives for countries to reduce resilience to asymmetric shocks, thus increasing deviations from the average to get more payments. It is however difficult to benefit from this knowledge as the composition of the output gap is complex, and hence difficult to influence directly. This opens however the door to statistical discretion and administrative imprecision in reporting data to calculate the output gap. To avoid such behaviour, a common rulebook for national automatic stabilizers is proposed.

The Reinsurance suffers from a similar problem. Here, the knowledge that most of the costs are covered in case of a crisis, once the threshold is reached, incentivizes countries to engaged in less self-insurance through national macroeconomic prudence. However, the authors argue that the political cost of a big crisis is higher than the moral hazard risk and behaviour is therefore not influenced. This assumption might not hold if a country were just below the threshold of receiving money. In such a case the risk structure would again look unfavourable.

” THE INCENTIVE  
STRUCTURE FOR LABOUR  
MARKET REFORMS  
REMAINS INTACT”

The EUI approach faces the greatest set of risks. There is evidence from national labour markets that with the EUI's focus on passive labour market policies (PLMP). Thus, policies that actively attempt to put people back to work are likely to be neglected, since member states will not have to bear the full cost of the unemployed (Andor, 2014). Some authors (Feld & Osterloh, 2013) fear there could be an adverse incentive to refrain from structural reform. However, Dullien (2014a) counters that structural reform is usually associated with long-term unemployment, which remains untouched by an EUI. Consequently, the incentive structure for labour market reforms remains intact.

Andor (2014) points out that an EUI could much on the contrary lead to a deregulation of labour markets, as flexible labour markets mean more individuals laid off in times of crisis. This observation could be a further argument why harmonization of labour markets would be necessary to combat changing incentives for active labour market policies, as well as a race to the bottom in terms of social standards. Moral hazard effects on the individual level of unemployment insurance is a widely debated topic in the national context, but since the EUI would not change the overall benefit level, there are no specific moral hazard risks associated. Another source of moral hazard could be administrative discretion in determining the short-term unemployment rate, as well as the output gap as far as that is possible – a risk relevant for all three models. A possibility to account for these risks is to introduce an experience rating or claw back mechanism into the proposal, an idea further discussed under chapter 3.2.2.

### 2.4.2.2. Ex-post risks

Ex-post risks refer to the risks once payments are made. In case of the CSI and the Reinsurance approaches, this means that funds from the automatic stabilizer could be used in a way that is politically desirable but not economically effective to increase business cycle convergence. The situation is similar in case of the EUI plan, where funds indirectly become available through the substitution of unemployment benefits. While the EUI does not provide for a remedy of this risk, both CSI and the Reinsurance propose earmarking of funds. The complexity of the output gap as an indicator is to the benefit of the CSI's risk structure. Distortion of incentives is comparatively low. In case of the Reinsurance, it does not seem to be so clear how important ex-ante risks are, while ex-post risk exists here as well. The EUI would have to face the greatest set of risks, especially ex-ante.

## 2.5. Outputs

This section considers the payment flows created by the proposals and what they indicate about short and long-term transfers between countries. There is an important dividing line between the Reinsurance and the EUI approach on the one side and the CSI on the other.

In the CSI case, the question of (long-term) transfers is tied to the general similarity of business cycle developments across the euro area. The “close to net-zero position” of countries' financial positions (Enderlein, Spiess & Guttenberg, 2013) is only possible if countries behave in a similar way to the average cyclical development in the euro area. With the continuing enlargement of the euro area, however, more and more (Eastern) European countries join the currency union with different levels of economic development. This has implications for their business cycle position in relation to the average (Fidrmuc & Korhonen, 2004). Imbalances could be created if a member state experiences an unusually long boom or recession, as it is the case with Greece today. The calculations done by the authors from 1999-2014 show that annual payments in that period are below 1% of GDP, and none of the euro founding members would have had a net position of more or less than 0,25% of GDP (Enderlein, Spiess & Guttenberg, 2013).

For the Reinsurance and the EUI plan, the situation looks different to the extent that long-term transfers between countries would result not from a relative position in the euro area, but an absolute position.

To avoid long-term transfers, the Reinsurance introduces claw back or experience rating. On top of basic contribution payments to the fund (0.1% of GDP paid annually until 0.5% of EU GDP is accumulated) countries make specific contributions depending on their use of the fund within the last ten years. Calculations show, for example, that Spain's contribution rate would go up to close to 0,2% of GDP between 2000-2010, and would rise even higher in the years to come. (Beblavý, Gros & Maselli, 2015). Dullien (2014a; 2014b) is discussing in his proposals for an EUI a similar mechanism in order to avoid permanent transfers. He proposes that countries with permanently higher shares of short-term unemployed would pay higher contributions, and those with permanently lower rates would pay lower contributions.

”THE LARGER THE  
TRANSFER PAYMENTS,  
THE MORE DIFFICULT IT  
BECOMES TO WIN POLITICAL  
SUPPORT AND CONVINCE  
CONSTITUENTS”

The larger the transfer payments, the more difficult it becomes to win political support and convince constituents (Bernoth & Engler, 2012). The overarching aim is monetary stability, with more cross-country redistribution leading to more automatic stabilization effects (Dolls, Fuest, Neumann & Peichl, 2014). It is therefore necessary to find ways to balance the two.

### 2.5.1. Limitations

It is important to recognize that there are a number of difficulties concerning the author's calculations that lead to a considerable amount of uncertainty concerning results of the three proposals. Starting and cut-off dates are arbitrarily chosen, and information about payments depends on the quality of available data. In the context of the output gap, the limitations lie within the indicator itself and for the short-term unemployment rate, the available data are not detailed and uniform enough for exact calculations. The results provided by the authors are still a good indication and can serve as a basis for the political debate about the right level of redistribution and desired stabilizing effect.

## 2.6. Outcomes

This section primarily considers outcomes in macroeconomic terms as measured by stabilization of GDP. It also looks at outcomes in the political and social realm.

Stabilization properties for the Reinsurance can be measured in those countries that would have profited from the mechanism. For the economic crisis between 2008-2012, the authors calculate stabilization effects of 0,46% and 0,48% of GDP in Portugal and Ireland respectively. The stabilization effect goes up to 10,8% of GDP in Spain (Beblavý, Gros & Maselli, 2015).

Dullien (2014a) calculates stabilization properties for selected countries in recessionary periods. In Germany GDP would have stabilized by 3,7% between 2001 and 2003. More recently Portugal would have experienced stabilization effects of 10,5% between 2008 and 2009.<sup>12</sup> The authors of the CSI study the effect the mechanism would have on the reduction of output gap deviation from the average and conclude that it could be as high as 40% (Enderlein, Guttenberg & Spiess, 2013).

### 2.6.1. Limitations

Again the results of the authors' calculations have to be considered with some caution. To make predictions about the stabilization properties of these mechanisms the authors need to make assumptions about the multiplier effect of the additional funds. Beblavý, Gros & Maselli, (2015, p.25) believe that there is a variation "between \$0.7 and \$3 for every \$1 spent on unemployment insurance" depending on the methodology and the country. In their calculations they decide to use a multiplier of 1,5. Enderlein, Spiess & Guttenberg (2013) use a multiplier of 1,2 and Dullien (2014a) calculates with a multiplication effect of 1. These assumptions make it difficult to compare the proposals directly in terms of their stabilization properties.

### 2.6.2. Social Outcomes

”THE VISIBILITY AND TANGIBILITY COULD POSITIVELY INFLUENCE EUROPEAN IDENTITY”

As a result of ex-ante harmonization requirements, discussed in detail above, the outcome especially of the EUI includes not only macroeconomic stabilization. It also entails common labour market standards, a fact that could increase its acceptance among European citizens. The visibility and tangibility could positively influence European identity since payments on the individual level could foster a sense of solidarity between Europeans (Beblavý & Maselli, 2014). The current political setting might however lead to a negative connotation of these payments, especially if unidirectional. Stereotypes about unemployment could be a further obstacle to perceive support for unemployed as an act of solidarity. The macro-level aim of economic stability is likely not going to be part of individual considerations. Further research would be required to explore the effects on European identity. Interestingly,

12. Calculations are based on "Assumption A" that implies a payroll tax of 1.66%.

unlike Lellouch & Sode (2014), Dullien (2014a) does not mention the social dimension as an intended goal of the proposal.

### 3. Assessment of the proposals

#### 3.1. Three options for policy makers

Table 2 summarizes the three proposals, using the important categories of the analysis. Red cells indicate major flaws of the proposals and obstacles, orange cells indicate difficulties that can be overcome and green cells are used when no flaws or major problems are attached to the characteristic. Grey cells are used where a judgment is not possible or inappropriate. The labelling can be understood in relative terms and as an indication of the relation between the three proposals.

TABLE 2 ► Assessment of proposals

	Cyclical Shock Insurance	European Unemployment Insurance	Reinsurance
<b>Rational</b>	Cyclical divergence only	Overall stability	Large shocks only
<b>Indicator</b>	Output gap, imprecise	Absolute values of short-term unemployment carry structural component	Standard deviation of short-term unemployment
<b>Administrative requirements</b>	Collection and distribution of funds at country level	Collection and distribution of funds at individual level	Decision when threshold for payments is met
<b>Labor market harmonization</b>	Labor markets not involved	To insure similar risks, minimum harmonization necessary	Labor markets not directly involved
<b>Legal requirements</b>	Implementation within primary law (4 years)	Implementation with treaty changes (10 years)	Implementation within primary law not clear
<b>Moral hazard</b>	Ex-ante, ex-post	Especially ex-ante, ex-post	Ex-ante, ex-post
<b>Output (payments)</b>	Cross country distribution avoided if similar long-term development	Trade-off between degree of cross country redistribution and automatic stabilization effects	
<b>Outcome</b>	Mainly macroeconomic	Macroeconomic and social/political	Mainly macroeconomic

Source: own representation.

- **Option 1: Technical solution**

” THE MECHANISM  
WOULD AVOID  
UNIDIRECTIONAL  
PAYMENTS ”

The CSI offers a technical approach aiming only at the stabilization of cyclical divergences. The major flaw of the CSI is the output gap, which is an imprecise indicator. Sensitive payments between countries should not be tied to it. However, the narrow understanding of the economic problem makes it an option based on lean requirements: an administration would only have to oversee the collection and distribution of funds between countries. Legally, it could be imagined within existing treaties and hence within a legislative period (four years). As the technical set-up indicates, outcomes are deliberately only in the macroeconomic realm. The question of cross-country redistribution depends on how economies behave towards the average; the mechanism would avoid unidirectional payments only if economies develop similarly in the long-term.

- **Option 2: Big bang solution**

” THE EUI WOULD  
PROVIDE FOR A CLEAR  
VISION OF POLITICAL AND  
SOCIAL INTEGRATION ”

The EUI is the „big bang“ solution, based on a holistic understanding of macroeconomic stabilization. The full-scale EUI comes with substantial requirements. The indicator of short-term unemployment links absolute numbers to each other, hence introducing a structural element that is politically not desirable. In administrative terms, it would be necessary to collect and distribute funds all the way to the individual. The EUI requires at least a minimum harmonization of labour markets, which is a difficult undertaking but is a way in itself to provide for more stabilization in the euro area. However, the main obstacle is the likely requirement for treaty changes - which make the project one of the coming decades. Cross-country redistributions would have to be weighed against desired stabilization. The far-reaching set-up of the EUI would lead not only to macroeconomic stabilization but provide for a clear vision of political and social integration of the EU as well.

- **Option 3: Semi-automatic solution**

” A VERY  
UNDERSTANDABLE  
APPROACH WITH A CLEAR  
SELLING POINT ”

The Reinsurance would offer assistance only in the case of severe crisis, a very understandable approach with a clear selling point. It involves labour markets only indirectly, with the standard deviation of a country's short-term unemployment rate as the indicator. Requirements for labour market harmonization would be low - unlike in the case of administration. Here a body would have to be installed that decides when the threshold for payments is met. Such a construct is not only difficult politically but requires appropriate democratic control, with additional demands for the legal design. It remains unclear whether treaty changes would be necessary. Cross-country redistributions would have to be weighed against desired stabilization. Outcomes of the mechanism are mainly of macroeconomic nature.

## 3.2. Thinking ahead

### 3.2.1. Alternative indicators

Especially for the CSI, where the indicator is the main point of criticism, it is conceivable to think about alternative indicators, such as:

- *Inflation Differentials*

Payments could be linked to relative rates of inflation within the euro area. Those member states with inflation rates above the euro area average would pay into a fund and those below the average would receive money. As a result, inflation differentials - as a measure of a country's business cycle position - would converge within the euro area. The major concern with a mechanism tied to relative inflation levels is that it does not only portrait a country's position within the business cycle, but other characteristics as well. Égert, Ritzberger-Grünwald & Silgoner (2004) show in their analysis that factors, such as dependency on oil, oil prices and openness of an economy, play an equally decisive role in determining the inflation level. Moreover, the utilization of inflation in this context carries a message about what the desirable level of inflation might be. Members of the euro area have however varying ideas about high and low inflation.

- *Corporate tax levels*

Another idea would be to develop a Europe-wide common corporate tax base and tie transfer payments to the level of corporate tax income, since the level of tax revenue is closely linked to the cyclical position of a country. Countries in a strong cyclical position would have higher tax incomes and would pay into the fund; countries with lower tax income would receive money. The initiative would also discourage tax competition within the EU. The idea to link payments to corporate tax levels has been brought up by Hagen & Wyplosz (2008) as well as Pisani-Ferry, Vihriälä & Wolff (2013) in different contexts. While the idea is appealing, significant political obstacles have been the reason why tax harmonization has so far not been pursued successfully.

### 3.2.2. Experience rating

Both the Reinsurance and EUI face the problem that they could become one directional payment schemes - if not corrected by an additional mechanism. In the jargon of this discourse such a mechanism is called experience rating or claw-back mechanism. Beblavý, Gros & Maselli (2015) include such a mechanism in their initial proposal: „if a country has a negative balance of more than 0.1% of GDP in any given year, the experience rating starts to worsen proportionally to the negative balance” (p.28). Countries, which use the fund more, will therefore pay more in. Dullien (2014b) adopted this idea when faced with the criticism that within the EUI, countries could become net-contributors, which would be a problem. He proposes a similar mechanism as Beblavý, Gros & Maselli (2015): if the balance for a country is above 1% of GDP for two consecutive years, contribution rates are cut. If on the other hand the balance of a country falls below 0, rates are increased. Here, criteria are not as strict as in the first case. The EUI relies on a certain degree of similarity between national labour markets. There are possibilities to account for their differences through adjusted payments, but the less harmonized labour markets are, the more complex the mechanism would have to be.

### 3.2.3. Further considerations

” THE SUCCESS OF AN INSURANCE MECHANISM ALSO DEPENDS ON ITS CREDIBILITY AND WHETHER IT CAN ENFORCE COMPLIANCE”

The success of an insurance mechanism also depends on its credibility and whether it can enforce compliance. However, the question of compliance is treated only marginally in the three proposals. Enderlein, Guttenberg & Spiess (2013) briefly talk about mechanism to ensure compliance with a common rulebook, introduced to avoid the undermining of national automatic stabilizers. They propose either a mechanism similar to the excessive deficit procedure or the fiscal compact's procedure in case of non-compliance with the debt-break provision. The authors do not discuss the effectiveness of such a mechanism or the implications this would have in terms of administrative requirements. Dullien (2014a) and Beblavý, Gros & Maselli (2015) do not discuss the matter of compliance at all.

The way the SGP has been watered down and violated by both Germany and France, under the eyes of the Economic and Financial Affairs Council and accepted by all other member states, should be a warning that a sufficiently strong compliance mechanism should be part of any automatic stabilizer.

A discourse about a two-speed Europe or even a multi-speed Europe takes place with any new step of integration: the introduction of the Euro sparked such a debate as well as (Alesina & Grilli, 1993), the Eastern enlargement (Ellison, 1998) and the Lisbon treaty (Král, 2008). All these debates circle around the question whether it is desirable and feasible for EU member states to integrate at different levels. The question should also be raised in the context of automatic stabilization Beblavý, Gros & Maselli (2015) included all 28 member states in their calculations, they argue, among other things that a broader membership base allows for a better diversification of risks. Dullien (2014a) raises the question whether non-euro area members would truly have a strong incentive to participate in such a mechanism, as Mundell's (1961) argumentation does not hold true for (most) of them. Independent of incentive structures, the question about who should be a member of an automatic stabilization mechanism needs to be considered, for the sake of stabilization properties as well as the broader integration process.

## CONCLUSION

**T**he discourse about adjustment channels to account for asymmetric shocks within a currency union is much older than the euro area. From its inception, the EMU has sparked the question of how to balance monetary and fiscal policy in a multilevel governance setting. The euro crisis has shown that the EMU's birth defect can entail severe consequences and needs to be accounted for in some way, so that asymmetric shocks can be absorbed.

The Presidents of the European Institutions have given a vision for this development and this paper has taken up the current state of the debate. The analysis has taken a policymaker's perspective and evaluated three carefully designed proposals for automatic stabilization, identifying their approach and underlying assumptions. All three offer different promises and problems and a preference for one or the other needs to be based on clear priorities in the following areas: a choice for a time horizon for implementation and the underlying rationale for stabilization, a choice between a far-reaching mechanism with a clear vision for European integration or a more restricted approach, with implications for requirements as well as outcomes. As well as the question how much cross-country redistribution is acceptable to reach a desirable level of stabilization.

**”THE THREE PROPOSALS OFFER SOPHISTICATED MECHANISMS THAT COULD BE IMPLEMENTED AT THE EUROPEAN LEVEL TO ENSURE AUTOMATIC STABILIZATION”**

The three proposals offer sophisticated mechanisms that could be implemented at the European level to ensure automatic stabilization. While the analysis serves as a good basis of information, a lot of questions remain unanswered and further research could focus on stabilization properties of the mechanisms, their political feasibility and aspects of compliance.

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