**FIRSTRUN – Fiscal Rules and Strategies under Externalities and Uncertainties**
Funded by the Horizon 2020 Framework Programme of the European Union
Project ID 649261.

# FIRSTRUN Deliverable WP3 - sub-task 1.2

# Towards an EU budget with an effective stabilisation function

## Abstract

This paper reviews the extent to which EU budgetary tools provide a shock mitigation function and explores potential avenues to reform these tools to strengthen their stabilisation role. The EU budget is based on principles of medium-term budgeting, co-financing rules with fixed areas of intervention and a very limited possibility for budgetary reallocations. This rigid system makes EU financial support rather ill-suited to address a situation of fiscal emergency when a member state has to react to shocks. Nevertheless, there is evidence of a growing mandate for a stabilisation function within the EU budget, developed particularly in response to labour market shocks. The Youth Employment Initiative and the European Globalisation Adjustment Fund, despite their modest results, represent a concrete step towards introducing shock mitigation among the objectives of EU expenditure. Flexibility arrangements introduced in recent years within the EU budget also move in the direction of adapting the EU budgetary architecture to make it better suited to ex-post shock mitigation in the medium-term. The revenue side of the EU budget is also found to contribute to stabilisation. This paper argues that the EU policy design to address stabilisation, as developed so far, is not performing and is not well-suited for the task. Since resistance to enhancing the stabilisation capacity is lower at EU than at EMU level, we explore the room for reform of the post-2020 budget and propose an integrated approach to boost the responsiveness of the EU budget to unforeseen events through the establishment of an EU Fund for Employment and an extended mandate for the European Union Solidarity Fund.

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## 1. Introduction

In an influential paper exploring policy solutions for creating a fiscal union at the euro area level, Bénassy-Quéré, Ragot, and Wolff (2016) identify three purposes for the EU budget, in line with the conventional classification of public intervention derived by Musgrave and Musgrave (1989): 1) **provision of EU public goods,** such as research and infrastructure, defence and diplomacy; 2) **territorial cohesion**, by means of financial support to disadvantaged regions; and 3) **macroeconomic stabilisation**, to smooth business fluctuations. To claim that the EU budget "*has so far been entirely devoted to the first two objectives*". (Bénassy-Quéré, Ragot, and Wolff, 2016: 3) In the present paper, we first review such purposes and provide a distinction between economic stabilisation and macro-financial stability, both of which are essential objectives for a federal budget. Albeit the latter two functions, at an embryonic level, are both present at the EU level; macro-financial stability has developed principally at the level of the euro area, first with the Greek Loan Facility and the European Financial Stability Facility (EFSF) and then with the European Stability Mechanism (ESM) in a second step[1]. Conversely, an economic stabilisation function within the European Monetary Union (EMU) is totally absent and has rightly been the subject of vast academic and policy-oriented research.

**The case for automatic stabilisers within the euro area is undoubtedly very strong**, since the members of the common currency area cannot resort to domestic monetary policy or currency fluctuations to stabilise the business cycle and react to an economic downturn. Nonetheless, it is our opinion that due to the level of interdependence of EU economies and to the common governance framework promoting coordination and consolidation of domestic fiscal policies, **a robust economic stabilisation function should be developed at the EU level as well**.

To make the European economy more resilient and able to absorb and react to economic shocks, there is indeed a need for a policy mix that allows factors of production, i.e. capital and labour, to move and adapt rapidly to the changing economic environment. With the Capital Markets Union still under construction and intra-EU mobility curbed by language barriers and difficulties in the recognition of qualifications and social rights, the EU budget remains the main EU instrument to generate countercyclical effects and stabilise incomes at the national level.

Contrary to common knowledge, we identify and outline an economic stabilisation function within the EU budget and its flexibility arrangements. Without considering the general macroeconomic stabilisation function of ESI funds and EU revenues, **the stabilisation function provided via flexibility arrangements amounts to approximately €11 billion for the 2014-2020 Multiannual Financial Framework** (MFF), comprising €6.4 billion from the Youth Employment Initiative (YEI), €1.05 billion from the European Globalisation Adjustment Fund (EGF), and €3.5 billion potentially available via the EU Solidarity Fund (EUSF).

Although these instruments are endowed with a relatively clear mandate for shock absorption and are set to provide counter-cyclical support, the extent to which they can perform a veritable stabilisation function

[1] See Casale et al. (2012) and Alcidi et al. (2017) for an account of the rationale and development of macro-financial stability instruments to support member states.

is curbed by some caveats that we discuss in the paper and that are largely due to the way in which funds are operationalised.

Although we agree with Bénassy-Quéré, Ragot, and Wolff (2016) on the fact that fiscal stabilisation will continue to rely mainly on national fiscal measures, we seize the opportunity of the upcoming debate on the post-2020 budget and the Commission's Mid-term Review/Revision of the 2014-2020 MFF to provide some recommendations to make the EU budgetary architecture better suited to short- and medium-term ex-post shock mitigation.

We propose a rather integrated approach based on two main policy instruments catalysing the stabilisation function of EU expenditure, its potential for shock mitigation and the visibility of EU actions vis-à-vis its citizens in two key domains: labour market imbalances and responsiveness to emergencies.

The paper is structured as follows: Section 2 reviews the rationale for stabilisation at the EU level and sheds light on the distinction between stabilisation and stability objectives; Section 3 explores EU budget arrangements and flexibility instruments to identify the scope and limitations of policy instruments conducive to stabilisation; Section 4 provides policy recommendations.

## 2. The EU Mission for Stabilisation

Both the financial crisis and the subsequent sovereign debt crisis reinforced the EU mandate and focus on stability and stabilisation. Due to the high interdependence of EU economies, policy tools that prevent or mitigate the impact of economic shocks in a given country also bring a shared benefit as they inhibit the inevitable spillovers on the functioning of the internal market and EMU.

In recent years, the economic governance of the Union has evolved rapidly to address the concerns arising from the need to reinforce the macroeconomic backbone, with **particular emphasis on preventing shocks and just minimal steps towards developing ex-post stabilisers**. The active expansion of the EU's role in promoting stabilisation is clearly attested to by the establishment of the Macroeconomic Imbalance Procedure (MIP) and by the Single Supervisory Mechanism (SSM): two key policies designed to decrease the vulnerability of EU economies to economic shocks.

Other concrete steps have been taken to allow the monetary policy carried out by the European Central Bank (ECB) to become more accommodating in case of member states' special needs – with the Outright Monetary Transactions for instance – and more generally, to enhance the support for macro-financial stability of member states that joined the currency union.

Stability and crisis management in the EU is generally associated with the ESM, which at the moment remains outside of the Treaties and works in an intergovernmental framework. There are however two other instruments directly managed by the European Commission, which are meant to provide support to the macro-financial stability to member states in the euro area – the EFSM, with €60 billion – and to member states outside the currency union – the Balance of Payment facility (BoP), with €50 billion. As stressed in Alcidi et al. (2017) however, in the long run, the ESM will likely remain the only macro-financial stability instrument, as other existing facilities such as the EFSM, the Greek Loan Facility and the European Financial Stability Facility are phasing down operations and gradually shifting their functions to the ESM.

At this stage however, for the sake of clarity, it is appropriate to distinguish between the two similar although distinct objectives of stability and stabilisation; the latter being the focus of this paper.

**Ensuring macro-financial stability** means having in place a crisis management mechanism that can resolve sovereign debt and banking sector crises. Following, Fuest and Peichl (2012), stability is brought by an emergency facility which kicks in to rescue member states in financial distress or having problems with the stability of their banking system. It is meant to prevent contagion, avoid excessive risks of financial meltdown and defaults.

Interventions to ensure macro-financial stability of member states in financial distress are subject to a thorough assessment of their solvency and are accompanied by a macroeconomic adjustment programme that sets out the conditionalities attached to the assistance. (Thirion, 2017 and Casale et al. 2012)

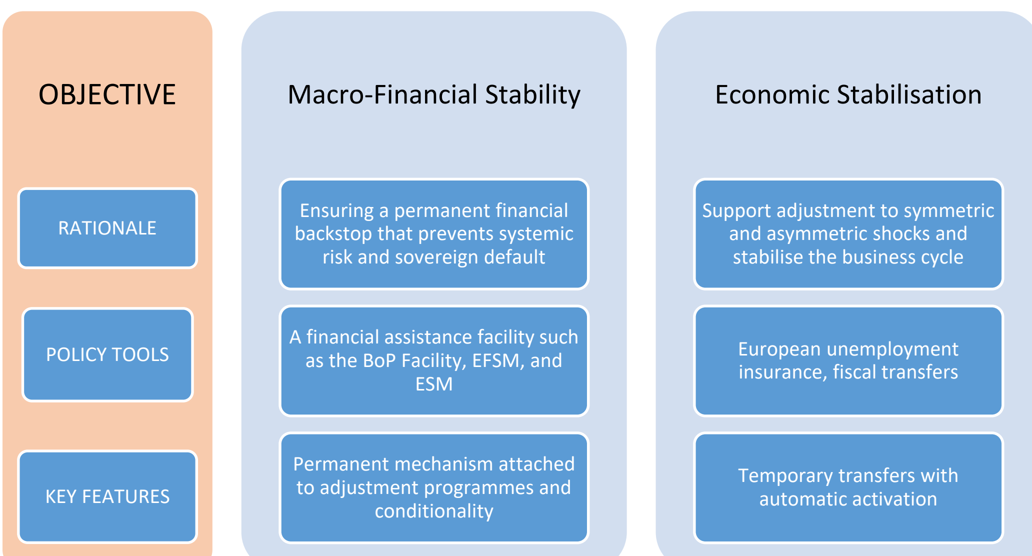
**Assisting (macro-)economic stabilisation** is instead related to endowing EU economies with a shock absorption capacity. In this case, the pivotal objective is not to address systemic risks but rather to provide stabilisation against shocks in order to stabilise the business cycle and allow a prompt recovery from downturns with the goal of preventing protracted recessions and their negative spillovers in the internal market, and in social and territorial cohesion.

Stabilisation itself is a rather broad concept involving a set of different economic issues. The need of a stabilisation function can in fact arise because of:

- Asymmetric shocks affecting one single member state or a small group of member states,
- Symmetric shock affecting all or most of the member states, which implies stabilising the business cycles within the EU, and
- General stabilisation of the domestic business cycle to generate counter-cyclical mechanisms.

In short, as summarised in Figure 1, an economic stabilisation function has the objective of countering the economic cycle and mitigating the effect of shocks, while the objective of a macro-financial stability instrument pertains to the overall stability of the euro area by containing the risk of default and contagion.

***Figure 1 – Understanding the objectives of EU financial assistance***




Source: *Authors' elaboration based on Alcidi et al. (2017), Thirion (2017) and Fuest and Peichl (2012).*

Providing clarity about the two goals and scope for EU intervention is also functional to understanding that there is actually no conflict or competition between enhancing the ESM and providing the euro area with a fiscal capacity or an unemployment insurance scheme. (Alcidi et al., 2017)

In practice, the two objectives can be mutually reinforcing. Conceptually, the stabilisation function supports macro-financial stability. In other words, a risk-sharing mechanism for stabilisation, by kicking in automatically as soon as a shock affects the economy, prevents or mitigates the possibility that it degenerates into a more serious imbalance that puts stability at risk. A powerful intervention via economic stabilisers is therefore meant to diminish the recourse to financial backstops and adjustment programmes.

The Five Presidents' report supports this idea, implicitly distinguishing between stability and stabilisation and clarifying that a prospective stabilisation function for the EMU "*should not be an instrument for crisis management. The European Stability Mechanism (ESM) already performs that function. Instead, its role should be to improve the overall economic resilience of EMU and individual euro area countries. It would thus help to prevent crises and actually make future interventions by the ESM less likely*." (Juncker et al., 2015: 15)

European Commission (2012), further backed by the Four and Five Presidents' Reports identifies three key features for a stabilisation function to be developed to strengthen the EMU: 1) it should be based on an automatic mechanism; 2) it should not involve or lead to permanent transfers; and 3) it should avoid moral hazard and preserve member state's incentives to run sound fiscal policies and implement structural reforms.

Of course, the need of a stabilisation function is greater for the euro area as the monetary union prevents member states to recourse to monetary policy to react to a country-specific downturn or shock. Furthermore, the room for manoeuvre to make use of fiscal policy, may also be constrained by unfavourable capital markets or by the Stability and Growth Pact and the Maastricht convergence criteria. Alcidi and Thirion (2016) provide empirical evidence that the fiscal governance framework for EMU – 1995 to 2014 – fell short of expectations in terms of counter-cyclical policy outcomes.

In such a context, a fiscal stabilisation scheme may provide insurance through financial transfers to member states affected by negative macroeconomic shocks in order to avoid the pro-cyclicality of contractionary fiscal policies and stabilise the business cycle.

As constraints on fiscal policy apply EU member states even outside the euro area and given the fact that the EU budget represents the primary resource for financial transfers within the Union, we deem it appropriate to focus on expanding the stabilisation function for the Union as well, with no detriment to the parallel discussion for the introduction of a stabilisation mechanism specific to the EMU.

## 3. The EU Budget for Stabilisation

As the EU budget represents the most relevant transfer mechanism for funds of a significant magnitude between EU countries, it is crucial to look at its policies and functioning to assess, explore and enhance a stabilisation capacity for European economies.

In the previous Section, we have noted the emergence of two key functions for spending at EU level, in response to the global financial crisis and sovereign debt crisis. On top of (1) **stabilisation** and (2) **stability** however, which remain side objectives for the EU budget, the pivotal aims are: (3) **redistribution**, i.e. territorial cohesion and regional development, (4) **provision of public goods with an EU added value**, i.e. research and innovation, defence and security, climate and environment protection, energy security and efficiency, infrastructure and technology for mobility, migration and development policy, etc.

As suggested by this – non-comprehensive – list of policy areas featuring a European value added, the EU budget has to accommodate a large number of priorities and challenges, which have grown substantially in recent times. (Núñez Ferrer, 2016) Two main structural difficulties weaken the EU budget's capacity to deliver the EU's shared objectives: its limited capacity and its rigid architecture.

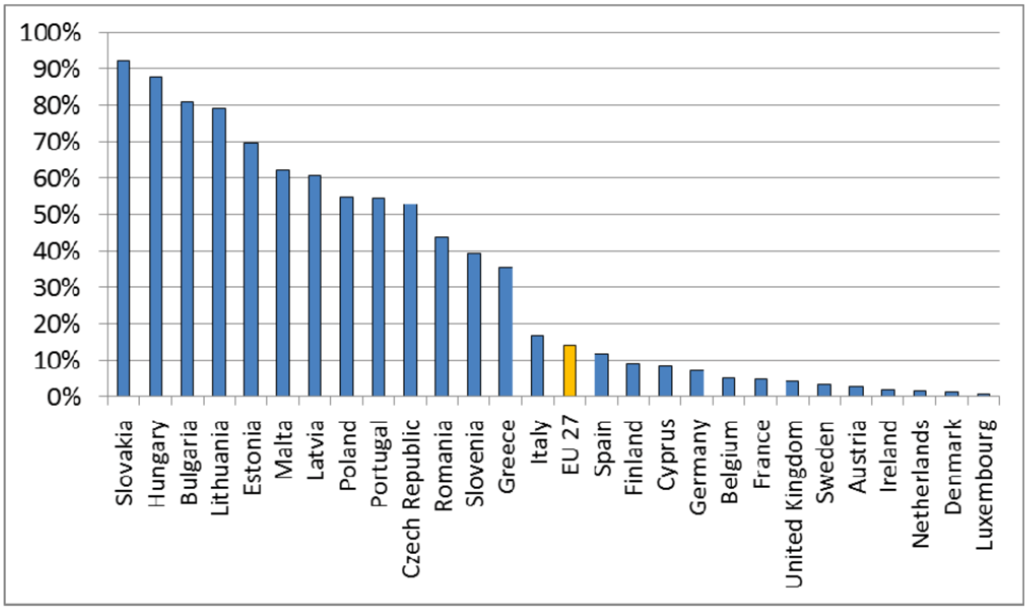
The current system is in fact based on principles of medium-term budgeting – seven years with a mid-term revision, which is extremely difficult to substantially reform – and almost no possibility of major reallocations. The areas of intervention are fixed with limits imposed by regulations and programming that involves national and local authorities. All in all, this rigid system is rather inconsistent with a situation of fiscal – or financial – emergency when a government needs to significantly cut expenditure and requires an ability to prioritise and restructure.

The size of the EU budget is quite small, bounded at approximately 1% of the GNI of the EU28, so that the magnitude of the transfers is also quite limited. It is particularly limited if one compares it with the federal budget of the U.S. for instance, which represents about 50% of final public spending and about 15-20% of the U.S. GDP. (Alcidi and Thirion, 2017 and D'Alfonso et al., 2017)

Nonetheless, the relevance of EU financing on public expenditure decisions is in fact quite high. Even though the limited means of the EU budget only represent 2% of total public expenditure in the EU – with Cohesion Policy representing only approximately 1% – funds are rather concentrated on specific areas of action and regions, so that it can stabilise public investment levels in selected areas and in targeted regions.

In some countries, the EU budget represents a significant source of resources for investment: in 12 member states, especially new-member states the EU budget, consists of a share of total public spending significantly higher than 2% - with figures ranging between 4.85% for Slovenia and 12.90 % for Bulgaria. Furthermore, if one looks at the investment-related financing from the EU budget, the contribution to public investment is higher: on average, cohesion policy in the 2007-2013 MFF represented 6.5% of government capital investment across the EU, with Hungary, Latvia, Lithuania, and Slovakia peaking at over 50%. (D'Alfonso et al., 2017: 17,18 and 23)

*Figure 2 - Share of Cohesion Policy-related financing as % of total public investment during the crisis*




*Note: Cohesion Policy-related financing includes national co-financing. The crisis average is computed over the three-year period 2010-2012.*
*Source: European Commission (2013).*

As the support of the EU Cohesion Policy is largely extent focused on regions lagging behind, it is clear that the EU budget can play a central role in securing high levels of investment by the public sector for poorer regions, despite the business cycle. Figure 2 shows the total public investment triggered by EU investment, i.e. EU spending via ESI funds and its national co-financing, as a share in public investment, at a time when the economic crisis was at its peak.

For Slovakia, Hungary and Bulgaria, in a period of economic downturn such as the 2010-2012, EU financing was responsible for over 80% of public investment. **By sustaining high levels of public investment, structural and cohesion funds play a macro-economic stabilisation function**. To a certain extent, such stabilisation function concentrated primarily in cohesion regions is empowered by the rigidity of budgetary planning at EU level. The seven-year programming period provides member states with a setting in which commitments – i.e. contributions to EU resources – and investment planning – i.e. national strategies and operational programmes – are decided ex-ante and are not to be scaled down in case of economic downturn. This framework, together with the co-financing system, designs a situation in which EU intervention through the European Structural and Investment Funds (ESIF or ESI funds) ensures a stabilisation of member state investment across time.

For years, the regulation and management of EU budget transfer mechanism has been unrelated to fiscal coordination and the functioning of the monetary union. The regulation for the current MFF, however, introduced however new types of conditionalities for the use of EU financial arm, one of which establishes a link between EU funds and the coordination of economic policy. Art. 23 of the Common Provision Regulation disciplines the measures linking effectiveness of ESI Funds to the wider EU framework for economic governance and introduces the notion of macroeconomic conditionality, which *de facto* makes the disbursement of EU funds subject to member states delivering on shared and expected objectives.

Since conditionalities are perceived by net donors as a way to ensure that EU spending is aligned with EU priorities and with respect to Maastricht criteria, they are likely to evolve and expand in the future MFF. It is therefore relevant to wonder about their effect on the stabilisation capacity of the budget. Notably, requests for reprogramming may well go in the direction of enhancing the responsiveness of EU financial assistance to changing priorities and emerging new fiscal challenges, but the suspension of funds for member states under the macroeconomic imbalance procedure could substantially weaken the macroeconomic stabilisation capacity that ESI funds play through supporting public investment. Jouen (2015) points out that reprogramming may not be a good tool to get a higher anti-cyclical capacity for ESI funds.

In the following subsection, we map different areas and funds to highlight and uncover the stabilisation capacity that is at times intrinsically interlinked to EU financial interventions. We begin with looking at the revenue side (Section 3.1) and then move to mapping the flexibility arrangements that are meant to provide the EU budget with sufficient flexibility and responsiveness to deal with shocks and mid-term adjustments (Section 3.2). We subsequently look at the specificities and limitations of three funds whose mandate encompasses stabilisation objectives: the Youth Employment Initiative (Section 3.3), the European Globalisation Adjustment Fund (Section 3.4) and the European Union Solidarity Fund (Section 3.5).

### 3.1 The Revenue Side

Interestingly, Pasimeni and Riso (2016) find that it is the revenue side of the EU budget that actually performs most of the stabilisation of incomes across EU member states, thanks to national contributions based on GNI and on VAT.

With a dataset covering the 2000-2014 period, they perform a quantitative analysis on the responsiveness of the EU budget to changes in income. Although the explanatory power of the model employed is rather low, the analysis can still bring useful insights to inform a qualitative discussion.

They find that overall, the expenditure side of the EU budget is nor significantly, not statistically correlated with changes in income per capita. This result confirms the notion that the EU budgetary architecture is rather rigid and unresponsive to changing economic conditions.

A first estimate of the actual stabilisation operated by the EU revenue side highlights instead that €1 fall in per capita GDP is linked to a €0.008 reduction in the per capita contribution to the EU budget by a member state. The responsiveness to changes in per capita income is largely due to the national contributions, based on GNI and VAT, whilst traditional own resources are about four times less responsive. (Pasimeni and Riso, 2016)

Such results are in any event very modest, compared to the responsiveness of the U.S. federal revenues to income fluctuations. A comparison between estimations for the EU by Pasimeni and Riso (2016) and estimations for the U.S. by and Fayrer and Sacerdote (2013) points out that the reduction in taxes paid by a state to the federal budget associated with a reduction in income is 30 times higher in the U.S.

The stabilisation capacity is reduced by the various correction mechanisms applied to the revenue side of the budget, most prominently by the UK and relates rebates. With this in mind, the potential exit of the UK from the EU with the consequential end of the UK contribution to the EU budget would translate into an enhancement of the stabilisation potential performed by the EU revenue system. This will particularly be the case if Brexit is also used as an occasion to revise contributions and abandon the entire system of rebates. (Núñez Ferrer and Rinaldi, 2016)

According to the quantitative exercise carried out by Pasimeni and Riso (2016), abandoning the entire system of rebates would increase the responsiveness of EU revenues to income by approximately 20%.

### 3.2 Flexibility Arrangements within the EU budget architecture

Nearly 15 years ago, Sapir et al. (2003) issued a severe judgment on the EU budget. The report concluded that "*the EU budget is a historical relic, […]expenditures, revenues and procedures are all inconsistent with the present and future state of EU integration*."[2] Since then the global financial crisis, the sovereign debt crisis as well as the emergence of other shocks such as the refugee crisis have brought some changes to the rigid architecture of the EU budget. It has become clear that shocks in the EU due to economic, trade, or even climatic events are bound to increase, and whether it is true that the EU budget has not been designed to address those shocks, it is necessary to find ways for it to effectively face such unexpected events. A number of flexibility instruments have been devised for this purpose.

Clearly, flexibility instruments are not directly supportive of a stabilisation function for the EU budget, rather they represent a concrete step towards allowing EU budgetary instruments to be more responsive to unforeseen circumstances. In this sense, flexibility arrangements represent a pre-requisite for the stabilisation function to operate and perform.

Reforms undertaken in both the 2007-2013 and 2014-2020 MFF to introduce flexibility and special instruments are therefore to be considered as the first steps setting the framework for the development of a real stabilisation function for the EU budget.

The list of flexibility arrangements is quite long; Table 1 provides some insights into the major instruments that are most closely linked to stabilisation.

The rationale for the introduction of such reforms aimed atsoftening the rigidity of the EU budget can be reduced to three elements:

- Allowing reserves to be mobilised to respond to unforeseen circumstances, in order to allow a prompt management of crisis and emergency situations;
- Allowing budgetary resources to respond to evolving priorities;
- Collecting additional resources on top of those already available at the EU level.

In fact, to overcome the biggest rigidity of the budget, i.e. its limited capacity, some flexibility mechanisms have been kept outside the MFF so that funding can be mobilised above the expenditure ceilings.

The account of flexibility arrangements provided in Table 1 allows for some considerations about recent developments in EU budgetary practices for stabilisation:

- Most of the financial support to address shocks due to migration flows is based on a preventive logic which, in simple terms, aims at preventing additional spikes in the inflows of refugees and economic migrants. It follows that the fiscal space leveraged thanks to the newly introduced flexibility arrangements is to be spent out of the EU borders. No arrangement has been foreseen to counteract the shocks to the labour market and fiscal expenditure caused by the record inflows of 2014 and 2015.

[2] See Sapir et al. (2003), p.172.

- Thanks to frontloading, reprogramming and a more flexible use of global margins, it is by now feasible at national and local level to shift, to a certain extent, the financing from the ESI funds across the MFF period. More limited flexibility allows for shifting budgetary allocations to new emerging priorities. Basically no flexibility is introduced to shift pre-allocated budget from one member state to another.

***Table 1 – Major flexibility arrangements in the EU budget***

| **Instrument** | **Legal basis** | **Description** | **Notes** |
|---|---|---|---|
| Flexibility Instrument | Art. 11 for MFF Regulation | Provides funding for clearly identified expenses that cannot be covered by the EU budget without exceeding maximum annual amounts set out in the MFF.<br>Allows for a maximum of €471 m per year. Unused amounts in year n can be used until n+3. | Called for in full for 2014 and 2015. In 2015 another €1,504 m for the refugee crisis was mobilised for the years 2016-2019, using past unused funds from the instrument. |
| Global Margin for payments | Art. 5 of MFF Regulation | Commission adjusts the payment ceiling upwards by an amount equivalent to the difference between the executed payments and the MFF payment ceiling of the year n-1. | Limited to €7 bn in 2018, €9 bn in 2019 and €10 bn in 2020. It remains budgetary neutral over the MFF period, as any upward adjustment is fully offset by a corresponding reduction of the payment ceiling for year n-1. |
| Contingency Margin | Art. 13 of MFF Regulation | Allows an increase of the payment appropriations by MS in the range of 0.03% of GNI; to be offset with one or more future payment ceiling reductions. | This is a last resort instrument to respond to unforeseen circumstances. It has been used in 2014 to be offset in 3 in reductions of equal size in the years 2018, 2019 and 2020. |
| Global margin for commitments for growth and employment, in particular youth employment | Art. 14 of MFF Regulation | Allows the unused margins of commitment appropriations for the period 2014-2017 to be reallocated to the 2016-2020 commitments in the areas of growth and employment, youth employment in particular. | Calculated for the first time in 2015, in the technical adjustment for 2016. |
| Frontloading of YEI, education & research | Art. 15 of the MFF Regulation | Allows frontloading up to €2.1 bn in 2014-15 for the Youth Employment Initiative and up to €400 m for research, Erasmus and SMEs. A reduction of ceilings will follow in 2016-2020. | The full amount was frontloaded. Any remaining margins will be carried forward towards in the 2016-2020 period. The measure remains budgetary neutral over the MFF period. |
| Flexibility to add to the Fund for European Aid to the most Deprived (FEAD) | | A MS can, on a voluntary basis, increase its contribution to FEAD by up to €1 billion; but it has to be offset by reductions in the Heading of economic, social and territorial cohesion. | It involves a change within operational programmes of the national envelopes of MS. |
| Exceptional reprogramming and transfer of commitments | | Due to delays of implementation of operational programmes in the first year, unused commitment appropriations were exceptionally carried forward from 2014 to 2015. | Approximately €20 bn carried over. |
| European Union Solidarity Fund (EUSF) | Art. 10 for MFF Regulation, Council Regulation No 2012/2002, Art. 222 of TFEU | A fund developed to release financial aid to MS and candidate countries in response to major disasters. Maximum ceiling of €500 m per year. | In 2015, €201 m have been mobilised to assist countries affected by natural disasters. |

| | | | |
|---|---|---|---|
| European Globalisation Adjustment Fund (EGF) | Art. 12 of MFF Regulation and Regulation (EC) No. 1927/2006 | A fund providing one-off support to policies aimed at reintegrating workers laid off due to serious economic disruption (crisis or change of trade patterns). Maximum ceiling of €150 m per year. | € 79 m have been committed. The maximum ceiling was €500 m per year during the 2007-2013 MFF. |
| Emergency Aid Reserve | | Designed to finance humanitarian, civilian crisis management in non-EU countries, in order to quickly respond to unforeseen events. Maximum ceiling of €280 m per year. | Was used for conflicts in Syria and Mali and the drought in the Sahel. |
| EU Regional Trust Fund in Response to the Syrian Crisis | | The fund set up to address the needs of refugee and host communities outside the EU (in Iraq, Lebanon, Jordan, Turkey, and Egypt). | €300 m from the EU budget and European Development Fund (EDF), to be topped up by MS contributions. |
| EU Emergency Trust Fund for Africa | | This Trust Fund was set up to contribute to better migration management from Africa. | €2.4 bn from the EU budget and EDF, to be topped up by MS contributions and other donors. |

*Note: Figures are in 2011 nominal prices. Flexibility instruments pertaining to the EU external actions and blending facilities are not included.*

*Source: Authors' elaboration based on Council Regulation (1311/2023) and European Commission website.*

Three specific initiatives, which we describe below, further highlight that a stabilisation function in the EU budget is already operational although limited and partly effective. **The EU financial envelope dedicated to shock absorption and emergency measures**, which combines assistance for natural disasters (€500 million a year), for labour market imbalances linked to youth unemployment (approximately €910 million a year) and to trade shocks and the economic crisis (€150 million a year) **amounts to €10.95 billion in the 2014-2020 period**. To that, one should add the stabilisation provided by the ESI funds and the revenue side.

The fact however that a stabilisation function is present within the EU budget does not imply that it actually works or is sufficient to respond to the several shocks affecting the economies of European countries. In what follows we discuss the rationale and limitations of the main EU budgetary instruments embodying a stabilisation function.

### 3.3 The Youth Employment Initiative (YEI)

The purpose of the YEI is to provide fiscal support to relaunch youth employment in the regions most affected by the phenomenon. The Initiative is open to all regions – NUTS level 2 – with a level of youth unemployment above 25%.[3]

In concrete terms, financial assistance via the YEI complements expenditure from national budgets and European Social Fund (ESF) allocations aimed at supporting the design, implementation and effectiveness of national Youth Guarantee schemes.

Examining the performance and effectiveness of the measures supported by the YEI, particularly of the Youth Guarantee, is not the objective of our analysis. Rather, we want to focus on the changes that the

[3] Regions with youth unemployment between 20% and 25% are also eligible if the rate increased by more than 30% in 2012.

Initiative brought to the use of the EU budget, especially thanks to the creation of a dedicated budget line to address labour market imbalances and to the introduction of a special front-loading dictated by the urgency of counteracting perhaps the most severe effects of the economic crisis.

The budget available for the YEI for the 2014-2020 MFF, which amounts to €6.4 billion, comes from two different sources:

- €3.2 billion is made available via the ESF and should respect common provision concerning co-financing and pre-financing.
- An additional €3.2 billion is made available through an ad-hoc YEI budgetary line for which it has been possible to introduce accelerated financing and special provisions.

The whole YEI, however, is implemented in accordance to ESF Rules and integrated in the programming of the ESF.

In order to allow for a substantial and prompt mobilisation of pro-youth employment measures, **the total sum of resources allocated to the YEI has been frontloaded in the first two years** of the current MFF, 2014 and 2015. Such frontloading, applied to the standard n+3 rule, implies that YEI-supported projects should in principle end by 2018 rather than on 2023, as would be the case for other ESF and ESIF co-financed projects. (Núñez Ferrer et al., 2016 and European Commission, 2015d)

Such frontloading however, did not lead to the quick mobilisation of resources that the Commission expected. European Commission (2015d) explains that slow progress was due to: i) the length of the process of negotiation for the operational programmes, ii) the implementation at member state level, iii) the lack of capacity in some local authorities and iv) the lack of sufficient pre-financing. The latter point is particularly significant as those countries with regions struggling with youth unemployment rates higher than 25% were also those facing sovereign debt risk and constrained fiscal space.

There was political commitment to provide an "*immediate and quick response to the unacceptably high level of youth unemployment*"[4] and the Council Recommendation on establishing a Youth Guarantee[5] further clarifies that the initiative is embarked upon also because of a "*need for a short-term response to counter the dramatic effects of the economic crisis on the labour market*". It follows that a "swift implementation" of the YEI and Youth Guarantee was recognised as one of the pivotal and necessary characteristics.

Such emphasis on the need for prompt intervention and results translated into **a special regime for pre-financing**. In order to mobilise YEI-backed actions on the ground as fast as possible, pre-financing from the YEI budget line was increased from 1% to 30% in 2015 budget allocations.[6]

This implies that a little less than a third of the YEI budget line, i.e. €963 million,[7] was made available to the 20 eligible member states swiftly upon adoption of the Operational Programme.

Such pre-financing however, specific to the YEI budgetary line capped at €3.2 billion, did not alter the initial pre-financing paid from the ESF to operational programmes implementing the YEI.

[4] European Commission (2015d:3).
[5] Council Recommendation of 22 April 2013 on establishing a Youth Guarantee (2013/C, 120/01).
[6] Initial pre-financing immediately paid upon adoption of an operational programme amounts to 1% of the EU share of the budget foreseen in the operational programme; pre-financing reaches 1.5% for member states under financial assistance.
[7] See Table A, in the Appendix.

According to the Commission, such pre-financing applied to the YEI budget line, i.e. on half of the whole YEI budget, would translate into a substantially higher reach for the initiative: for the year 2015, the range of beneficiaries involved could pass from 14,000-22,000 young people to 350,000-650,000.

Another special feature of the YEI budget line consists in its **special standing with respect to co-financing**. It was in fact decided that for expenditure under the YEI budget line, no national co-financing is required. Such allocation for the YEI is the only source of funding under shared management that benefits from the exemption of the national co-financing requirement. (European Commission, 2015d)

For these reasons, the YEI, and specifically the YEI budget line, has developed characteristics similar to those that are envisaged for an automatic stabiliser:

- A clear threshold that defines eligibility and safeguards against political influence over allocation decisions.
- A front-loading and pre-financing regime that allows for EU resources to be programmed and available immediately after the occurrence of an excessive imbalance in labour market outcomes.
- A null or limited co-financing requirement for member states, which translates into direct support to national spending.

For other aspects, of course, the stabilisation capacity of the YEI has remained rather limited, which is attributable to several causes: **i)** the complexity and length of the process conducive to agreeing on operational programmes (a critical point for all ESI Fund, particularly relevant for here given the urgency of the intervention), **ii)** the heterogeneity of the measures supported, which included the creation of new services facing operational risks, **iii)** the sometimes limited capacity of Public Employment Services which have been highly involved in the implementation of YEI (partnering up with managing authorities in 91% of cases) and proved at time to be unable to make the best of the funds available, **iv)** the strong focus on vocational education and training courses in many member states (65% of managing authorities implementing such measures, which provides no direct or immediate support to income, so that stabilisation can at best be attained with a medium-term mitigation of income losses.

One additional aspect highlights that although the YEI carries a stabilisation function, **its design is still very much linked to the logic of cohesion funds rather than to that of economic stabilisation**. In fact, despite the identification of a neat threshold identifying eligible regions, the set of beneficiaries was not allowed to change over time. As is the case for the convergence objective, eligible regions are determined at the beginning of the MFF; for YEI the identification of the 20 eligible regions[8] was based on 2012 youth unemployment rates.

Based on 2012 data, 114 out of 276 EU NUTS 2 level regions in 20 member states have been found eligible for YEI financing. If one looks at 2015 data, eligible regions would decrease to 89 in 15 member states: 31 regions would no longer suffer from an excessive imbalance and would no longer be eligible for YEI support; 6 new regions would instead be added, one of which is located in Finland, a new potentially eligible country, whilst 6 member states would leave the YEI entirely (CZ, IE, LV, LT, SI, SE). (European Commission, 2016b) To a certain extent, that proves that a different arrangement that does not entail permanent transfers would have been possible.

[8] See Figure 4, in the appendix, for a graphical visualisation of eligible regions.

### 3.4 The European Globalisation Adjustment Fund (EGF)

Introduced in 2006,[9] the EGF was established to provide support to workers who have lost their job as a result of trade liberalisations or major structural changes in global trade patterns and globalisation.

Initially designed to respond to trade shocks uniquely, with a first revision in 2009, the EGF extended its mandate to respond to shocks due to the ongoing economic crisis and to those that may come in the future. Regulation (EU) No 1309/2013 specifies: "*In order to enable the EGF to intervene in ongoing or future crisis situations, its scope should cover redundancies resulting from a serious economic disruption caused by a continuation of the global financial and economic crisis […], or by a new global financial and economic crisis*." It can therefore be fully characterised as an instrument providing support to respond to negative economic shocks and reverse the business cycle.

Just like the YEI, the EGF is very much focused on supporting public spending directed at active labour market measures, with the goal of supporting a rapid re-activation and re-integration in the labour market. Active labour market policies (ALMPs) do constitute a counter-cyclical investment, but compared to unemployment benefits, they are generally less responsive to economic shocks, as lost incomes may not be immediately replaced. The stabilising power of social protection arrangements might be higher but, as stressed in Hemerijck (2012), ALMPs, inscribed in a social investment framework, can play a 'capacitating' function. In simple words, by enlarging the capacities of workers, ALMPs make them better equipped to adapt to unforeseen events and react to new social risks. By strengthening the resilience of individuals, the economy as a whole benefits from enhanced agility. (Vandenbroucke, Hemerijck and Palier, 2011)

It co-finances projects, lasting a maximum of two years, involving ALMPs, mentoring and coaching, entrepreneurship, mobility and relocation allowances, and microfinance. Financial allowances cannot exceed 35% of the project cost, as the main focus must remain on training and activation measures. In no case can it be used to finance social protection measures.

The EGF was designed to intervene when redundancies have a significant impact on a region or a sector, so that there is not only a solidarity function, but also an EU dimension in terms of scale and magnitude of the potential impact. Initially the Fund could be activated, upon the request of a member state, when at least 1,000 people are made redundant in a company, a set of integrated companies, or in a sector within a region. The threshold has since then been reduced to 500, as in some member states even a shock of a lesser magnitude would be sufficient to induce imbalances worth addressing. The notion of 'small labour markets', e.g. remote and sparsely populated areas, and 'exceptional circumstances' have also been used to derogate to the 500 people threshold and allow the Fund to provide assistance where the shock, i.e. the redundancies, was considered big enough in relation to the local economy.

The largest fault of this instrument is that **it remains outside the MFF**, so that for each application the Commission has to involve the European Parliament and the Council and then await a decision of the Budgetary Authority.

When first established, the maximum amount available through the EGF was set at €500 million per year. In February 2013 however, the European Council agreed to extend the Fund to the 2014-2020 MFF but drastically cut back its maximum annual budget to €150 million.[10]

[9] See Regulation (EC) No 1927/2006.
[10] See Council Conclusion, EUCO 37/13, 8 February 2013. The annual budget is expressed in 2011 prices.

As Figure 3 shows, annual EGF financing peaked in 2011 at €128.2 million and with just below €9,000 support per beneficiary.[11] As the original annual budget was hardly ever mobilised more than 20%, EU leaders comfortably opted to reduce the ceiling, in order to limit the potential budgetary consequences.

Since its first activation in 2007, the EGF has been activated 167 times, with a total EU contribution of €588.4 million, which tops up a total of about €422 million of national co-financing. **The final beneficiaries are over 141,800 persons receiving, on average, €4,180 each from the EGF.**[12]

Both the mid-term and the ex-post evaluations of the MFF 2007-2013 find that the average re-employment rate achieved at the end of EGF assistance was about 49%. However, the effectiveness of the programme varied considerably, from 4% to 86%. (GNK, 2011 and European Commission, 2015c)

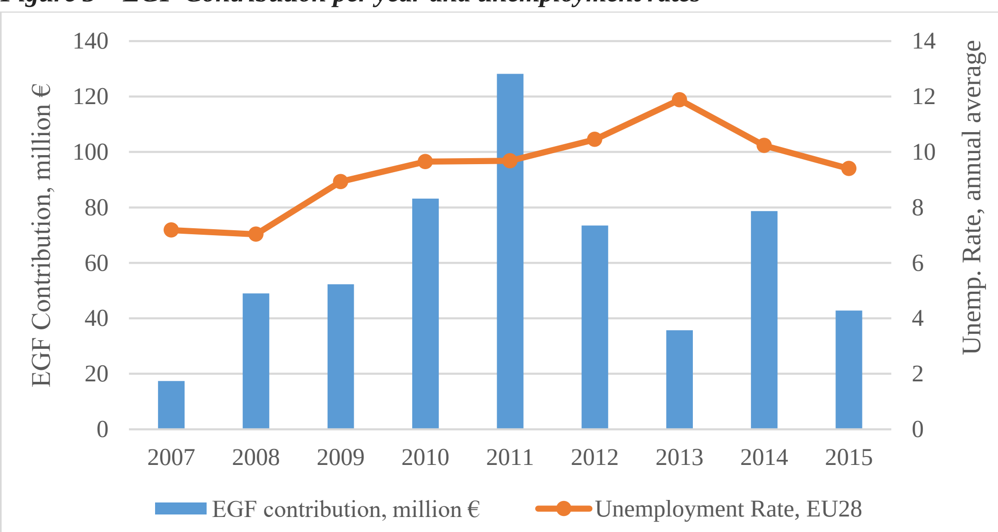
The positive trend from 2009 to 2011 is partly due to the extension of the eligibility criteria that included redundancies due to the economic crisis, and also partly due to changes in the co-financing rate, which was 50% till June 2009, 65% from mid-2009 to 2011 and decreased to 60% afterwards.

On top of the lack of a dedicated budget which can be promptly disbursed, other critical aspects concern the length of time taken for the procedures, so that the EGF departs from the ideal stabilisation mechanism featuring an automatic trigger.

In certain cases, the budget implementation has been very low; and with an average implementation rate of approximately 55%, a significant share of allocated funds went unused. (European Commission, 2015c).

Despite such shortcomings, the ex-post evaluation carried out at the end of the 2007-2013 MFF concludes that in most cases EGF assistance made a positive contribution to addressing significant social and labour market problems in the locality after large-scale redundancies, contributing to family earnings and avoiding negative unemployment traps. (European Commission, 2015c)

***Figure 3 – EGF Contribution per year and unemployment rates***




*Source: Authors' elaboration based on European Commission* *EGF Data* *and Eurostat [une_rt_q].*

[11] The reader can refer to Table B, in the Appendix.

[12] Overview of EGF applications up until 21 February 2017. Source European Commission EGF Data.

### 3.5 The European Union Solidarity Fund (EUSF)

The EUSF was created in 2002, in the wake of massive flooding of rivers affecting several member states. It consists of a supplement to a member state's public expenditures to finance essential emergency operations.

It recognises that EU financing should kick in to provide assistance to member states – and countries applying for accession – in case of shocks due to major natural disasters. Unexpected circumstances due to natural disasters have immediate repercussions for living conditions, the economy and the natural environment.

The very name of the Fund testifies to the fact that "solidarity" is the leading rationale for intervention; nonetheless, given that it focuses on major disasters only, it basically targets situations in which natural disasters cause serious damage to national income and is therefore functional to decrease the fiscal burden on the affected member state. A natural disaster is considered as 'major' if it causes a direct damage of at least 0.6% of the GDP of the damaged country or as much as €3 billion excess expenditure. (Haase, 2016)

The maximum annual budget available via the EUSF amounts to €500 million – in 2011 prices – but **it is funded outside the EU budget, meaning that the funds are not immediately available** and that Commission should raise its financing through other member states, as the need arises.

Since its entry into force, the EUSF has been activated on the occasion of 70 disasters including floods, earthquakes, forest fires, storms and drought in 24 different European countries. Against a potential ceiling of about €7 billion, the Fund has allocated about €3.7 billion, since 2002.

**The operability of the Fund however is a critical point that weakens its scope for stabilisation**. It is not an automatic transfer but rather it requires a formal application by the member state affected by the natural disaster and it involves a rather extensive procedure before the budget is approved.

The application process is rather time consuming for an instrument that is supposed to intervene in case of emergencies. Haase (2016) reports that, from the moment of the calamity, a member state has 12 weeks to submit a request for assistance which should include: i) an estimation of the total direct damage and its impact on the economy, the population and the environment affected; ii) the cost of the measures required; iii) an indication of the other sources of funding available; and iv) an update on the implementation of EU legislation on disaster risk prevention.

The procedure for allocating a grant – which involves the Commission, the EP and the Council, if new budgetary means are needed – can take several months. The EESC (2012) reports that in many instances grants can be paid out only 9 to 12 months after the disaster, sometimes longer.

On different occasions the Commission has tried to improve the operability of the Fund. Proposals made in 2005 and 2011 were blocked by a majority of member states, which mainly oppose reforms because they are fearful of potential budgetary implications. (EESC, 2012)

Finally, a proposal presented in June 2013 led to some amendments to the regulation[13] of the Fund and brought marginal improvements to the rules governing EUSF implementation. Two are the most relevant changes which enhance the use of EUSF as a means for stabilisation: 1) a more rapid procedure with the introduction of advance payments, 2) an extension from 12 to 18 months to make use of the grant.

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[13] See amending Regulation (EU) No 661/2014 of 15 May 2014.

Despite these improvements, the EUSF remains a rather bureaucratic arrangement in response to a natural shock and still carries the 'original sin' of remaining outside the EU budget, *de facto* preventing a rapid disbursement of financial assistance. The steps taken to introduce advance payments are still minimal: the advance cannot exceed 10% of the anticipated amount of the financial contribution, with a cap at €30 million.

## 4. Towards a more effective EU budget for stabilisation

The previous section identifies a situation in which stabilisation objectives and outcomes are present in the EU budgetary architecture but are definitely not integrated or structured in a way to perform shock absorption effectively.

This this is largely due to the process that brought about the establishment of the YEI, GEF and other measures assigned a stabilisation function. The latter in fact has often been incidental and not the main aim triggering the creation of the budgetary arrangements.

It has to be recognised that the two pivotal and conceptual problems hampering a full development of these embryonic stabilisers into fully-fledged automatic economic stabilisers for the Union are linked. The first such problem is the infamous resistance of member states to equip the budget with the financial means it would need to address its multiple purposes, not least the resistance to abandoning the net balance approach and establishing true EU own resources. The second obstacle takes the form of the predominant cohesion-like logic, which is politically difficult to abandon, has strong historical roots and is largely responsible for the rigidity and slowness in the operational aspects of the budget.

With the purpose of reforming ESI funds and EU budgetary tools to make them better suited to short- and medium-term ex-post shock mitigation, actions should ideally focus on **removing those structural deficiencies that prevents EU funds with a stabilisation function to perform**. To this end, the main avenues for reform would consist in:

- <u>*Ensuring the possibility of a prompt disbursement of financial assistance responding to shocks and imbalances*</u>. This would explicitly imply that funds, for instance from the EGL and EUSF, should be made available at the EU level on the spot with no need to launch a budgetary procedure and negotiation with the Council and the European Parliament. In simple terms, it means agreeing in advance and budgeting resources in the MFF.
- <u>*Redesigning the instruments so that triggering is as automatic as possible*</u>. That does not necessarily mean that activation of assistance should bypass a formal request by member states, but rather points to having an immediate response to such request, a response based on eligibility criteria set with clear thresholds preventing financial allocation to be subject to political considerations and influence.
- <u>Conceiving the assistance as temporary and designing the set of beneficiaries as dynamic.</u> Member states and managing authorities should be within or outside the set of eligible beneficiaries according to their situation against the eligibility threshold, with evaluation running on a continuing basis and not only at the beginning of the MFF. It goes without saying that having on-the-spot one-off assistance, which may cease to reach the beneficiary in the short-to-medium term, should not

come at the detriment of the effectiveness of the measures to be supported. For this reason, simple arrangements like a mid-term/slow phasing out could help strike the balance between ensuring automatic support where most needed and the sustainability of the measures financed. It also implies that assistance should not go to new measures but rather to measures and policy solutions already carried out by member states or that the member states would like to implement anyway but have limited fiscal space to do so.

Of course, enhancing the EU budget so that sufficient resources are made available and having more of these resources to target shocks directly is a politically difficult process that is hard to materialise. The IMF (2010:14) already recommended a larger central budget which includes a stabilisation function taking the form of an insurance against asymmetric shocks. The Commission White Paper (European Commission, 2017) includes this opportunity in its most ambitious scenario and clarifies that an EU budget that is "*significantly modernised and increased, backed up by own resources"*, such that "*additional EU financial support is made available to boost economic development and respond to shocks at regional, sectoral and national level*" is a viable solution only if all member states agree to do more together.

### 4.1 Political resistance towards stabilisation measures

But what are the chances that the EU will move in this direction? How likely is it that EU leaders and EU institutions will recognise the relevance of the stabilisation function and decide to strengthen it? The indications we can take from discussions at the EMU level are not encouraging in this sense.

The case for fiscal transfers carrying a stabilisation function for the currency union has been made and several policy options have been designed.

Introducing arrangements to secure the stabilisation of business and fiscal fluctuations within EMU has – rightly – attracted much attention from the side of researchers and experts. Among the options that have been put forward to strengthen EMU and equip it with effective tools to mitigate the effects of economic shocks on employment and income one can mention the following: devices for a European unemployment insurance or re-insurance scheme (CEPS, 2017; Beblávy, Gros and Maselli, 2015a; Beblavý, Marconi and Maselli, 2015b; and Dullien, 2013), output gap-based transfers (Enderlein et al., 2013), reforms to the ESM with a view to allowing it to run an automatic stabilisation mechanism, the establishment of a European Debt Agency, the introduction of Stability Bonds (European Commission, 2011, Green Paper), and last but not least the creation of a proper fiscal capacity for EMU.

Nonetheless, political support for such measures still appear still very weak. Perhaps because most of these proposals, stemming from economic considerations and analyses about the economy of the euro area and its vulnerabilities, also involve political changes that relate to the democratic accountability of new financial instruments and the need to enhance the coordination of national fiscal policies. In other words, risk sharing arrangements are likely to be accompanied by sovereignty sharing as well, in the form of an EU or EMU Fiscal Council or the allocation of increased powers to a dedicated Commissioner, who would function as Minister of Finance for the euro area.[14]

The introduction of economic stabilisers within the EMU architecture was described as a desirable outcome in the Four Presidents' Report (Van Rompuy et al., 2012); furthermore, the Five President's Report (Juncker

[14] See Thirion (2017), Enderlain and Haas (2015) and Alcidi et al. (2014).

et al., 2015) openly identifies the need to equip EMU with both a stability mechanism for crisis management and a (macro-)economic stabilisation system to improve the resilience of the euro area and make crisis management less needed. (Alcidi et al., 2017)

Instead of making progress in that direction, however, we see a political impasse. Notably, with the recent White Paper on the Future of Europe (European Commission, 2017), progress towards "a euro area fiscal stabilisation function" is mentioned only in the most ambitious scenario involving 'doing more together'.

If it is true that it is the political sphere and prospects of political integration that prevent economic stabilisers from becoming operational within EMU, then **there is more scope for action at the EU level**, where political cooperation is well established and federal institutions manage the budget. The scope for EU28 budgetary instruments to address stabilisation has already been introduced and although at the embryonic level, it offers a platform and a setting to better equip European economies to react to unforeseen economic and natural circumstances, with logical spillovers on the resilience of EMU as well.

### 4.2 The MFF Review/Revision process and concrete proposals

The European Commission has already started a reflection process intended to bring forward a proposal for the next MFF. There are several issues at stake and there are increasing expectations about rather substantial transformations to be introduced in the EU budget. For instance, the opportunity presented with the UK's exit from the core of the EU budget may open the way to a rationalisation of the resource side (Núñez Ferrer et al., 2016 and HLGOR, 2016). The proliferation of financial instruments may also require a revision and a more integrated approach, and a push focusing on EU value-added actions may further reduce expenditure for projects with local value added (contraction of certain CAP allocations, for instance). Most importantly, for the sake of our argumentation at least, because of the emergence of new EU risks, challenges and priorities such as migration and security, defence and border control, climate change and social imbalances, the expenditure side of the budget may be subject to deep reform and abandon part of the rigidity it has acquired over the years. (Núñez Ferrer, 2016)

The mid-term MFF review (European Commission, 2016), which includes certain improvements on the functioning of the budget, opens the discussion on how to address unexpected events with the EU budget. Of course, being in the middle of a programming period, prohibits a thorough 'revision', but it already gives indications of which direction the Commission is willing to embark in and sets the basis for instruments to be recalibrated or further reformed.

Among the general trends that can bring benefits to the functioning of the budget and its stabilisation function we identify: 1) a focus on removing restrictions that hinder the effectiveness of budgetary instruments, 2) an extension and improvement in the reuse of margins, i.e. Global Margin for Commitments, Global Margins for Payments and contingency margin, and 3) a commitment towards simplification.

More importantly, **the MFF review includes several concrete proposals that go in the direction of strengthening the stabilisation potential of the EU budget**:

- It proposes supplementing YEI with an additional €2 billion over the period 2017-2020; €1 billion from the YEI dedicated budget line to which special pre-financing and co-financing arrangements apply and €1 billion from the ESF.
- It sets the basis for securing "*a strong capacity for the budget to react to unforeseen circumstances*" (European Commission, 2016a: 14), by means of:

- a more efficient activation of the EGF and EUSF,
- a new instrument to provide emergency assistance – within EU borders – to respond to needs generated by particularly high in-flows of migrants and asylum seekers,
- a European Union Crisis Reserve, to be financed from de-committed appropriations, which is meant to enhance the responsiveness of the EU budget to crises and unforeseen events with serious humanitarian or security implications.

Even though all these measures taken singularly may well have the potential to enhance the stabilisation capacity of the EU budget, we consider the designed architecture to be rather fragmented so that both implementation and visibility of these measures could suffer. With a view to establishing a more integrated approach, creating a veritable stabilisation capacity of EU expenditure and enhancing citizens' perceptions about the responsiveness and solidarity of EU actions, we recommend the following reforms for the financial framework post-2020:

1) Regrouping the financial envelopes that are meant to provide assistance to stabilising the labour market into a single instrument. A single instrument would: 1) improve the uptake of simplification measures, which by reducing the administrative burden for managing authorities, can speed up implementation and results; 2) enhance synergies and make the best of stakeholders' capacity, employment networks and best practices in the large set of ALMPs, mobility and entrepreneurship programmes supported; 3) provide greater visibility and a more tangible approach to the EU's commitment to employment and job creation. Specifically, we propose **the creation of an EU Fund for Employment with a financial envelope of at least €1.1 billion a year, within the EU budget**. Such a Fund would maintain two separate envelopes: i) a Youth Employment Window endowed with approximately as much as the current YEI, i.e. €900-950 million a year, and ii) a Globalisation and Crisis Window, with about €150-200 million a year. It is crucial that both windows enjoy a facilitated pre-financing, at least such as is currently in place (30%) for the YEI budget line. In contrast to the latter, the Fund could foresee a co-financing rate of 70-80%.
2) **Expanding the scope of the European Union Solidarity Fund**, to accommodate the needs that the Commission identified for the creation of the new migrants-related emergency assistance in EU member states and the European Union Crisis Reserve. The EUSF could become the very means for the Union to react to unforeseen events and crises. A dedicated window should remain in place to specifically address natural disasters, plus a second window with a broader mandate could make place for assistance towards spending due to migration shocks and other crises – although not linked to labour markets or financial stability for which other instruments are in place. It could be financed with €700-800 million a year within the EU budget, so that funds are quickly deployable. We suggest no specific fixed envelope for the two windows and the possibility for the new, post-2020 EUSF to be replenished by de-committed appropriations, as well as by surpluses, sanctions, fines and penalties collected by the Commission, for instance in the area of competition policy.

## 5. Conclusions

The EU budget has a rather rigid structure and a limited capacity which makes it unfit to respond promptly with measures that contrast business cycle fluctuations. However, we have identified that on top of public good provision, cohesion and redistribution, the EU budget has also been given a mandate towards stability and stabilisation.

Stability, aimed at ensuring a financial backstop mechanism preventing default and systemic risk is present in the EU budgetary architecture with the BoP and the EFSM; such a function, however, such function has developed further at the intergovernmental level with a marked focus on the euro area.

A stabilisation function instead, for which there is a strong case and demanded at the EMU level, has already been – partly – developed within the EU budget, even though it remains at an embryonic level.

In this paper we have collected evidence that economic stabilisation is *de facto* one of the objectives of the EU budget. In the first instance, a stabilisation function is performed via support to public investment and infrastructure thanks to ESI Funds and cohesion objectives in particular. Secondly, the revenue side of the budget also entails a stabilisation function, as member states' contributions to the federal budget are partly responsive to GDP changes. Thirdly, there are funds and initiatives within the budget and its flexibility arrangements that embody a clear objective for stabilisation. In fact, the YEI is meant to react quickly to excessive imbalances in the labour market and support member states' expenditure on social policies, i.e. reactivation and ALMPs in general. The EGF responds to trade shocks and is meant to provide one-off assistance counteracting the effects of the economic crisis. The EUSF is devised to respond to shocks arising from natural circumstances and the environment.

The fact, however, that a stabilisation function is present within the EU budget does not imply that it actually works or provides a sufficient response to the several shocks affecting the economies of European countries.

We have identified several limitations affecting the EU funds and initiatives endowed with a stabilisation function that prevent their performance as stabilisers. In particular, they are often operationalised in a manner that rests on cohesion-like support and does not embrace some of the key features of a real economic stabilisation tool, which would require an automatic trigger, prompt disbursement, and a dynamic set of beneficiaries - i.e. no permanent transfers. Furthermore, some of the measures that are intended to absorb shocks and reverse the business cycle in case of downturns, besides being part of the EU budgetary architecture, remain outside of the MFF, so that resources are not available on-the-spot but rather must be requested each time. This situation is largely due to the fact that the stabilisation function emerged at the EU level incidentally, as a result of the threats and emergencies posed by the crisis and its effect. A political process that clearly identifies stabilisation as a desirable and necessary feature of the EU expenditure is still missing.

Making progress towards an integrated EU-level framework able to respond to shocks and mutualise the response to risks, for instance coming from serious imbalances in labour market outcomes, may play a big role in turning down the worrisome loops between economic, social and political stability, especially in some more vulnerable countries.

The Commission Revision of the current MFF does take steps to make the EU budget more responsive to unforeseen events and reinforce the funds with a stabilisation capacity. For the post-2020 MFF, however, we recommend rationalising expenditure for unforeseen events and enhancing the capacity of the European Union Solidarity Fund so that if can provide fiscal assistance to member states also for emergencies other than those caused by natural disasters. Furthermore, we also point at the opportunity of integrating the stabilisation function for employment-related issues into a single fund, with two separate envelopes and enhanced pre-financing, that addresses both excessive imbalances in youth unemployment and shocks from trade and economic disruptive events.

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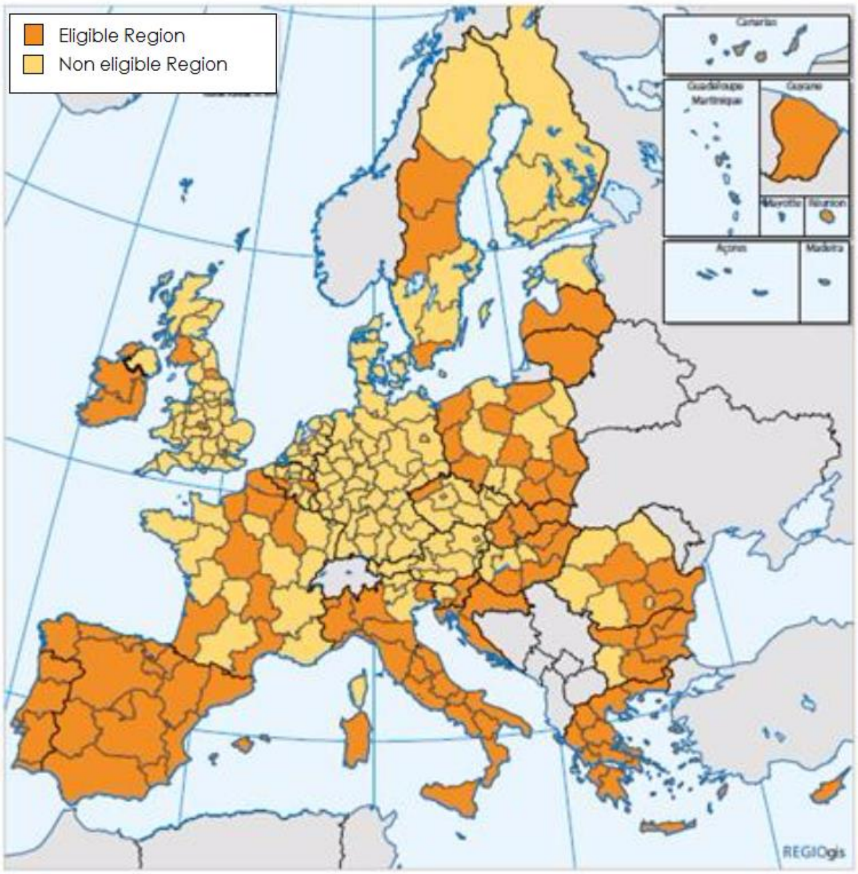
# Appendix

*Table A – Allocation of specific YEI resources and pre-financing, by member state*

| Member State | Region(s) eligible for funding under the YEI | Specific Allocation to YEI (EUR) | Pre-financing from the YEI specific allocation after amendment (EUR) |
|---|---|---|---|
| Austria | No | - | - |
| Belgium | Yes | 42 535 070 | 12 730 521 |
| Bulgaria | Yes | 55 188 745 | 16 556 624 |
| Croatia | Yes | 66 177 144 | 19 853 143 |
| Cyprus | Yes | 11 572 101 | 3 471 630 |
| Czech Republic | Yes | 13 599 984 | 4 079 995 |
| Denmark | No | - | - |
| Germany | No | - | - |
| Estonia | No | - | - |
| Finland | No | - | - |
| France | Yes | 310 161 402 | 93 048 421 |
| Greece | Yes | 171 517 029 | 51 455 109 |
| Hungary | Yes | 49 765 356 | 14 929 607 |
| Ireland | Yes | 68 145 419 | 20 443 626 |
| Italy | Yes | 567 511 248 | 170 253 374 |
| Latvia | Yes | 29 010 639 | 8 703 192 |
| Lithuania | Yes | 31 782 633 | 9 534 790 |
| Luxembourg | No | - | - |
| Malta | No | - | - |
| Netherlands | No | - | - |
| Poland | Yes | 252 437 822 | 75 731 347 |
| Portugal | Yes | 160 772 169 | 48 231 651 |
| Romania | Yes | 105 994 315 | 31 798 295 |
| Slovakia | Yes | 72 175 259 | 21 652 578 |
| Slovenia | Yes | 9 211 536 | 2 763 461 |
| Spain | Yes | 943 496 315 | 283 048 895 |
| Sweden | Yes | 44 163 096 | 13 248 929 |
| United Kingdom | Yes | 206 098 124 | 61 829 437 |
| Total | | **3 211 215 406** | **963 364 625** |

*Source: European Commission YEI Country Fiches and Núñez Ferrer et al. (2016)*

***Figure 4 – Map of Eligible Regions for YEI allocations***




*Source: European Commission (2016)*

***Table B – Overview of the European Globalisation Adjustment Fund by year***

| Year | EGF contribution, million € | Final beneficiaries | EGF contribution per beneficiary, € | Unemployment Rate, EU28 |
|---|---|---|---|---|
| 2007 | 17.4 | 10,679 | 1,629 | 7.18 |
| 2008 | 49 | 5,435 | 9,016 | 7.03 |
| 2009 | 52.3 | 26,332 | 1,986 | 8.93 |
| 2010 | 83.2 | 26,867 | 3,097 | 9.65 |
| 2011 | 128.2 | 14,305 | 8,962 | 9.68 |
| 2012 | 73.5 | 9,436 | 7,789 | 10.45 |
| 2013 | 35.7 | 12,683 | 2,815 | 11.88 |
| 2014 | 78.7 | 15,741 | 5,000 | 10.23 |
| 2015 | 42.8 | 14,324 | 2,988 | 9.4 |

*Source: European Commission EGF Data and Eurostat [une_rt_q].*