BRIEFING

Initial Appraisal of a European Commission Impact Assessment 2021-2027 MFF

# Establishing a European Investment Stabilisation Function

Impact assessment (SWD(2018) 297, SWD(2018) 298 (summary)) accompanying a Commission proposal for a regulation of the European Parliament and of the Council on the establishment of a European Investment Stabilisation Function (COM(2018) 387)

*This note is one of a series of brief initial appraisals of European Commission impact assessments (IA) accompanying the multiannual financial framework (MFF) proposals, tailored to reflect the specificities of the MFF package and the corresponding IAs.[1] It provides an initial analysis of the strengths and weaknesses of the IA accompanying the above-mentioned proposal,[2] submitted on 31 May 2018 and referred to the Committee on Economic and Monetary Affairs (ECON).*

## Political and legal context; objectives

Against the backdrop of the current controversial debate on what would be the appropriate fiscal framework to provide stabilisation and increase the resilience of the euro-area, the IA defines the **problem** to be tackled by the current initiative as the **lack of instruments to absorb large macroeconomic shocks in the euro area** (IA, pp. 3-5). It sees the underestimated dichotomy of the common monetary policy on the one hand, and the divergent national fiscal policies, on the other, as the origin of the problem (IA, pp. 5, 16).[3] Based on a thorough review of the most recent crises, the IA identifies **two drivers** of the problem: first, the **divergence of the business cycles in the euro area**, and second, the risk of **pro-cyclical policies** entailing increased deficits and a drop in public investment even in cases where initial debt levels are low (IA, pp. 6-13).[4] Contrary to the better regulation guidelines, the IA does not analyse the negative effects of the problem on the relevant affected groups, nor does it specify these. Furthermore, it does not define the size and scale of the problem, citing the technical limitations posed by the statistical data and by the quantification of future macroeconomic developments, which depend on 'partially random' events (IA, pp. 4-5). The IA indicates **raising cohesion** 'by supporting single Member States to withstand large shocks' (IA, p. 23)[5] as the **general objective** (and legal basis) of the proposal. It identifies six **specific objectives**; however, these remain largely general and do not meet the better regulation 'S.M.A.R.T' criteria, according to which objectives should not only be relevant, but also specific, measurable, achievable and time-bound.[6] The IA does not present any *operational* objectives that could have specified further the preferred option. Notwithstanding these weaknesses, the objectives are in line with those of the European monetary union (EMU), the banking union and the European Stability Mechanism (ESM) (IA, p. 25).

## Programme structure and priorities; delivery mechanisms of the intended funding

The IA screens four policy options, each seeking to establish a stabilisation function (IA, pp. 25-33):

**Option 1**: A dynamic baseline scenario, assuming that pending legislation, such as the package on non-performing loans and the Reform Support Programme, will be adopted.

**Option 2** (preferred option): A borrowing and **lending scheme with favourable loans** for Member States affected by a large shock. The scheme would be triggered by a double condition on unemployment rates. In addition, it would include a grant component to cover interest payments.



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**Option 3:** An **insurance mechanism** based on regular contributions or an own resource to provide pay-outs to Member States under (non-specified) pre-defined conditions.

**Option 4:** A **euro area budget** to stabilise common investments in case of economic shocks.

According to the IA's short description of the **baseline scenario**, the continued absence of a common fiscal instrument would lead, in case of a large macroeconomic shock, to pro-cyclical policies, even if the banking union were complete (IA, p. 27). The focus of the IA lies clearly on the preferred option 2, whose expected 'added value' is noted consistently, whereas options 3 and 4 are only addressed briefly and in general terms (IA, pp. 31-33, 46-47, 52). The mostly qualitative analysis of the expected impacts focuses on the mitigating effect on growth and debt levels in a recession following a simulated 2018 crisis (IA, pp. 48-56). However, a number of details concerning the practical functioning of the options are not addressed in sufficient depth. These include, among others, the conditionalities and modalities of the activation procedures, the possible sanctions in case of misuse of the loans or the grant component (relating to option 2), or the features of a possible future 'own resource' (option 3). The IA notes that the options could be cumulated, starting with a loan facility that would later be followed by an insurance mechanism ('when conditions for it are met'), but does not elaborate upon this progressive concept (IA, pp. 33, 47, 58). Overall, despite offering different options, the text reads more like an account of the advantages expected to accrue from the Commission proposal than an IA that precedes and prepares it.

The IA presents possible criteria to trigger the loan support, discussing output gaps, recession and growth as well as different unemployment indicators (IA, pp. 34-39). It reflects on the appropriate budget of the programme (see below) and seems to make the case for an application beyond the euro area, but the geographical coverage is not coherently assessed (it refers mostly (only) to the euro area). It is not always clearly indicated if the text refers to one or to all options. (IA, pp. 34-39). To ensure the effective and timely provision of loans under a 'quasi-automatic' mechanism, the IA recommends decisions to be taken by the Commission, not the Council. This suggestion might have deserved a more thorough and substantiated discussion (IA, pp. 29-30, 33-34).

Based on QUEST model simulations, the IA states that the **main direct economic impact** would consist in a shock absorption of an estimated 10 % under option 2, and 20 % under option 3, thus having a smoothing effect on a recession (IA, pp. 48-52). Yet, the option's specific effects on the identified problem drivers (the synchronisation of business cycles across Member States and the prevention of pro-cyclical fiscal policies) are not assessed in a comprehensive way. While the potential risks of moral hazard are briefly explored in the context of cross-country neutrality (IA, p. 53-54), indirect, unintended or negative consequences are not assessed, nor are social or environmental impacts. The IA argues that the latter two are 'extremely difficult to assess', but it expects, without substantiation, 'beneficial spill-overs' for social and environmental investment (IA, p. 56). The IA does not provide a cost-benefit assessment of the preferred (or any other) option.

In the concluding comparison of the options against the baseline scenario, option 3 appears to be the most effective one. Option 4 has, according to the IA, good potential, although its size and composition remain unspecified (IA, p. 59). The IA's selection of option 2 as the preferred option 'at this stage', seems to be motivated by political feasibility, rather than based on the results of the analysis (IA, pp. 57-58).

## Budgetary or public finance implications

Regarding the budget of the programme, the IA runs simulations of the maximum volume of outstanding loans, ranging from €30 billion to €100 billion (IA, pp. 40-42). At the same time, it refers to the margin of the annual EU budget (€30 billion) as a 'prudent strategy' able to cover guarantees for all potentially emitted loans. The IA explains convincingly why it favours a modulation over fixed loan amounts, as a modulation would allow to tailor the loan amounts to the severity of the shock (IA, pp. 43-44). It also provides a formula to cap the loan provision and thereby avoid budget overruns.[7] According to the IA, the grant component of the loans used for subsidising the interest rate could be financed either by the EU budget or by annual national contributions, therefore affecting national budgets. Here, the IA considers any estimation of the resources needed for that purpose as 'highly uncertain', yet forecasts nonetheless that they would reach a maximum of €2 billion per year (IA, pp. 42-43).[8]

### SME test / Competitiveness

The IA does not mention SMEs or the effects on competitiveness at EU or national level.

### Simplification and other regulatory implications

The IA discusses simplicity only in the context of the rules for activating the programme and the modulation of support, opting both times for the less 'simple' solution (in order to adapt the loans to the severity of the macroeconomic shock) (IA, pp. 28, 43).

## Subsidiarity / proportionality

The IA considers national fiscal stabilisers and existing EU instruments insufficient to solve the problem, in particular in the event of large macroeconomic shocks (IA, pp. 17-21). It suggests using this initiative to fill the legislative gap at EU level, possibly as the first step of a more comprehensive future stabilisation policy, whose effects it does, however, not assess. No reasoned opinions were received from the national parliaments by the subsidiarity deadline of 24 September 2018.

## Quality of data, research and analysis

The IA's internal and external sources, as well as the evidence base and illustrations (mostly referring to Eurostat and European Central Bank data) seem solid and transparent. At the same time, the IA acknowledges the limitations of its simulations and quantifications due to the uncertainty of future macroeconomic events (IA, pp. 4-5, 53, 72). A sensitivity analysis of these caveats and additional explanations of the assumptions, methods and models used by the IA would have increased its accessibility and transparency (the software R., Stata and QUEST are only briefly mentioned). As indicated, the analysis seems imbalanced: it places the main focus on the positive effects of option 2, while neglecting the other options and, generally, the potential unintended, negative or indirect effects. Some aspects, including the eligibility conditions of the programme, the scale of the potential risks and the decision-making process, would have deserved a more thorough and better substantiated analysis.

## Stakeholder consultation

The IA admits that, contrary to the better regulation guidelines, which require a mandatory 12-week open public consultation for every IA, no such consultation was conducted for this initiative, due to a 'compressed timeline' (IA, p. 69).[9] Instead, it describes the controversial public debate on an EU macroeconomic stabilisation function in a separate chapter and in Annex 2 (IA, pp. 21-22, 69-71). The divergent Member States' positions appear to have prevented clear support for any of the options presented. The IA notes that, in addition to certain Ecofin and Eurogroup meetings, at which the topic was discussed in 2017 and 2018, the Commission met with stakeholders in 10 Member States in the framework of 'outreach missions' during the first quarter of 2018 (IA, pp. 70-71).

## Monitoring and evaluation

The IA dedicates a relatively long section to the monitoring and evaluation of the programme. First, it suggests monitoring the use of support continuously (IA, p. 62). Second, it envisages an ex-post evaluation of each loan, two years after it has been granted, as well as an evaluation of the entire programme three to five years after its start (IA, p. 60). To this end, while it presents macroeconomic indicators related to the problem drivers, it could have been more specific regarding the form and timeline of data collection and processing (IA, pp. 61-62). Third, it proposes an ambitious ex-ante assessment of the quality of the Member States' public investment management systems before they receive a loan. This would be based on the 15 indicators built into the IMF's Public Investment Management Assessment Framework (PIMA) (IA, pp. 63-64).

## Commission Regulatory Scrutiny Board

The Regulatory Scrutiny Board issued a positive opinion with reservations on the draft IA on 27 April 2018. While some recommendations – such as links to existing EU instruments, loan caps or political feasibility

– were taken into account in the final IA, other issues – such as the specifics of the options, their relevant impacts and the geographical coverage of the programme – remain unclear.

## Coherence between the Commission's legislative proposal and IA

The proposal appears to follow the indications of the IA's preferred option.

## Conclusions

While the IA presents four options to stabilise the euro area, it focusses on the characteristics and the expected positive effects of the preferred option, corresponding to the Commission proposal, rather than providing a balanced assessment of all policy options and all relevant direct and indirect impacts. The mostly qualitative analysis builds on solid internal and external sources, but is complemented by some quantifications that are, by the Commission's own admission, based on uncertain assumptions. These caveats, as well as the methodologies of the IA, could have been explained more thoroughly and transparently. The selection of the preferred option 2 seems to be based on political feasibility rather than on the assessment. In particular, the IA fails to demonstrate to what extent the option would contribute to achieving the general objective of increasing cohesion across the EU.

## ENDNOTES

[1] The almost parallel adoption of the spending programmes and the MFF proposals had an impact on the IA process and resulted in simplified IAs, with their format and scope differing from the standard IAs as defined by the Commission's better regulation guidelines (see also Toolbox #10 Financial Programmes and Instruments).

[2] See EPRS's 'EU Legislation in progress' briefing, C. Scheinert, European Investment Stabilisation Function (EISF), January 2019.

[3] The IA does not question this assumption or address the opinion that a single fiscal policy would be 'prone to wider swings and errors than the aggregate result of many national policies, each of which is subject to different shocks which would tend to cancel out each other at least partially', see D. Gros, Does a single monetary policy need a single fiscal counterpart?, in-depth analysis, Policy Department for Economic, Scientific and Quality of Life Policies, European Parliament 2018.

[4] The IA presents the problem drivers in Figure 13, classifying them into internal and external ones and adding several elements that do not feature in the text. For some of them, the link to the problem is not clear. (IA, p. 16).

[5] To establish this link, the IA highlights that the trend towards economic convergence between Member States, which was observed until 2008, has reversed, and that divergences have been increasing ever since (IA, p. 6).

[6] Tool 16. The IA's specific objectives are: to contribute a) to reduced asymmetries of business cycles across Member States, b) to counter-cyclical fiscal policies, c) to steadier investment flows, d) to preventing financial markets crises, e) to cross-country neutrality and f) to the integrity of the Union (IA, p. 24).

[7] The formula includes exceptions to the cap 'in specific circumstances', which have not been assessed (IA, p. 30).

[8] Assuming the mobilisation of a €30-100 billion lending capacity and an interest rate of 2 %.

[9] The IA does not mention the six online public consultations clustered by policy areas, which the Commission conducted for most of the other MFF proposals.

This briefing, prepared for the ECON committee, analyses whether the principal criteria laid down in the Commission's own Better Regulation Guidelines, as well as additional factors identified by the Parliament in its Impact Assessment Handbook, appear to be met by the IA. It does not attempt to deal with the substance of the proposal.



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