A budgetary capacity for the Eurozone: a federalist view

SUMMARY

The economic, financial and sovereign-debt crises that have hit Europe over the last 8 years have exposed the weaknesses of the Economic and Monetary Union (EMU). The superficial symptoms of these structural flaws was addressed through changes to Eurozone governance and institutions between 2012 and 2013. Today the Eurozone appears more resilient than before the 2011 crisis, an impression certainly facilitated by a more stable global economic and financial situation outside of Europe. As a consequence, Member States have de facto shelved even the moderate proposals towards a fiscal and economic union contained in the “Five Presidents’ Report: Completing Europe’s Economic and Monetary Union”. However, as the President of the European Central Bank has repeatedly warned, some of the essential root causes that once pushed the Eurozone to the edge of implosion, have not been addressed. The robustness of the new construction is yet to be tested in a time of financial turmoil. It could very easily cave in should there be a radical political change at the national level or serious financial difficulties affecting a sizeable Eurozone Member State.

The European Parliament is today at the forefront of the reflection on one of the key matters of the reform of the EMU: a budgetary capacity, which both the Commission’s 2012 “Blueprint for a deep and genuine economic and monetary union: Launching a European Debate”, the 2012 Four Presidents’ Report “Towards a Genuine Economic and Monetary Union” and the Five Presidents’ Report of 2015 recognised as an essential element in the creation of the “fiscal leg” for the EMU.

This Policy Brief attempts to provide some answers from a federalist perspective to the comprehensive series of questions listed by rapporteurs Pervenche Berès MEP and Reimer Böge MEP ahead of the own initiative report on “a budgetary capacity for the Eurozone” in preparation by the Economic and Monetary Affairs Committee and the Budget Committee of the European Parliament. These questions and answers concern the structure, purpose and functioning of an eventual EMU fiscal capacity, as well as the ways to overcome the main political challenges that this sort of fiscal integration would entail.

RECOMMENDATIONS

- Supporting the deployment of European economic policy instruments.
- Allowing for strategic European public investment.
- Increasing the resilience of the Eurozone by supporting macroeconomic stability and the integrity of the Single Market.
- Based on genuine own resources with a common payment procedure and a simpler system for their eventual reform.
- Sizable enough in order to avoid the expectations-capability gap (approx. 3.5% of the Eurozone GDP).
- Put under the authority of a European economic government duly accountable to the European Parliament and the Council.
1. WHY IS A FISCAL CAPACITY NEEDED TO ACHIEVE A GENUINE EMU?

The idea that the EMU would need its own budget is not new, but it has never gained sufficient political support, partly due to the lack of common vision among key Eurozone Member States as to its purpose, size, use and resources. The fact remains that the Eurozone represents an imperfect monetary union, with supranational monetary policy managed by an independent and non-political institution (the European Central Bank) but without a proper European government with the competences, instruments and resources of policy-making at European level. In the absence of such instruments, an increasingly complex rules-based governance framework has been put in place to try to ensure convergence between the Eurozone economies and to prevent and control national economic shocks.

The various crises of the last few years have pushed the Member States of the Eurozone to create intergovernmental instruments and institutions financed mainly through ad hoc national contributions to address the most pressing shortcomings of the monetary union. These instruments have provided financial assistance to Member State and financial institutions in difficulty. Such steps forward are far from ensuring the long-term sustainability and robustness of the EMU. However, despite considerable debate, no progress has been made in the creation of own fiscal instruments for policy-making at the level of the Eurozone itself. The approach followed so far, apart from being politically exhausting, has contributed to deepening the creditor-beneficiary divide and pitted national democracies and constituencies against each other while not providing a definitive solution to the symmetric and asymmetric economic shocks currently affecting the Eurozone.

It is our view that an EMU budget - as the key element of a shift in paradigm from coordination of national economic policy to a real European economic policy - is a necessary element and key to the EMU’s long-term sustainability.

There are five key reasons why an EMU budget is necessary at this time. First, an own fiscal capacity would allow for the deployment of instruments to reduce the probability of symmetric or asymmetric economic shocks within the Eurozone. This would be achieved by supporting long-term policies increasing economic convergence and fostering strategic objectives that would make the EMU more structurally resilient.

Second, given that the risk of asymmetric shocks cannot be brought to zero, an EMU budget could provide automatic and discretionary instruments and the necessary resources to react to such shocks in a timely fashion. The regional effects of economic shocks could then be tackled before they produce negative externalities affecting other Member States.
Third, an own fiscal capacity would enable the EMU to make investments in infrastructure and initiatives of pan-European relevance and other “European public goods”. Such European public investment could constitute a fundamental tool for anti-cyclical intervention in case of economic shocks affecting the Eurozone at large. In addition it could also be used more generally throughout the economic cycle to make the Eurozone’s economy more integrated, dynamic and attractive and by better exploiting the synergies of the Single Market.

Fourth, an EMU budget of sufficient size would enable the Eurozone to back some of the financial assistance instruments created in the past few years. This would release contributing Member States from the burden related to financial contributions and guarantees, and would reframe the discussions on financial assistance programmes (be it to Member States or financial institutions) on concerns of European relevance, instead of national interests.

Finally, fiscal resources at the EU level would prevent the refragmentation of essential sectors of the Single Market (starting from the banking and capital markets). This is what happened during the crisis after Eurozone Member States were forced to use their budgets to prevent key sectors of their economies from collapsing.

2. WHAT FUNCTIONS SHOULD A BUDGETARY CAPACITY FOR THE EUROZONE FULFIL?

We need to draw from the experience of the last years in order to identify the functions necessary to the EMU’s viability which cannot be exercised by national budgets. As explained above, in our view these functions are essentially four, namely: (1) supporting an incentive-based approach to convergence, (2) substantivizing the EMU’s economic policy through strategic investments, (3) ensuring the macro-economic and social stability of the Eurozone as a whole, and (4) reinforcing the Eurozone’s credibility as public guarantor of last resort in order to preserve the integration of the financial and capital markets. Therefore, the main functions that a budgetary capacity of the Eurozone should fulfil are:

Supporting the deployment of European economic policy instruments designed to reduce the probability of asymmetric shocks. This could be achieved by conducting long-term policies increasing economic convergence, addressing structural flaws, favouring labour mobility and fostering economies of scale. Even when the coordination of economic policies would primarily be implemented through the adoption of secondary legislation, from an economic and political point of view, the implementation of convergence measures would be much easier if:

a. the costs of their implementation were compensated through financial incentives¹:

b. access to European financial assistance were conditional and based upon compliance with an EMU Economic policy;

c. the Eurozone had the financial means to fund incentives addressed directly to the private sector and citizens, which would help it gain support for Eurozone policies².

Making direct public investments in infrastructure and projects of pan-European interest. Direct investment from the EMU would make its economy more integrated, dynamic and attractive by exploiting the synergies of the Single Market and preventing the inevitable bottlenecks and limited impact of uncoordinated national investment policies. In addition, while order and balance in national accounts is fundamental to build trust between Member States, the EMU’s fiscal capacity could be used to breathe the necessary stimulus into national or regional economies during periods of downturn³, particularly at times when regional stagnation phenomena may have negative spill-overs for the Eurozone at large.

Increasing resilience of the Eurozone by supporting macroeconomic stability. Given that the risk of asymmetric shocks cannot be brought to zero, it should also rely on automatic macroeconomic stabilisers to react in a timely fashion when the regional effects of economic shocks represent a risk for the entire Eurozone. This function would aim to prevent circumstantial financial difficulties from becoming chronic weaknesses, thus reducing the necessity of supporting public investment and financial assistance.

Providing credibility to a European fiscal backstop for the Single Resolution Fund and an eventual Common Deposit Insurance Guarantee. An EMU budget with sufficient and genuine own resources would provide the Economic and Monetary Union with sufficient political weight and credibility to guarantee the effectiveness of the Eurozone instruments created in the last few years. This would avoid a new refragmentation of the banking and capital markets and allow ECB monetary policy to reach all of the regions of the Eurozone equally.

² Although the US federal government lacked any competence in the field of unemployment insurance in the 1930s, it managed to create the country-wide Unemployment Compensation programme by providing tax credits to enterprises located in states having adopted the federal scheme. Although the programme was voluntary, employers and workers together acted as advocacy agents of the federal government. (See Domenico Moro, “For a Federal European Unemployment Insurance Scheme”, UEF Reflection Paper, March 2016)

3. HOW COULD EXISTING TOOLS, NOTABLY THE EUROPEAN STABILITY MECHANISM (ESM) AND/OR THE YOUTH GUARANTEE, BE MOBILISED AS EMBRYOS FOR A BUDGETARY CAPACITY FOR THE EUROZONE

Although the ESM could not constitute the core of the EMU fiscal capacity, it could play a much greater role in the stabilisation of the Eurozone by allowing the Banking Union and the Capital Markets Union to achieve their objectives fully. The Single Resolution Fund and the eventual Common Deposit Insurance Guarantee need a common fiscal backstop, which could be provided by the ESM transformed into a European Monetary Fund (EMF). The EMF could in turn be backed by the Eurozone budget in the last instance. As long as the EMU does not have a sizable enough budget and it is not used to guarantee the losses of the ESM in a credible manner when it plays its role of lender of last resort, the risk of refragmentation of the capital markets and divergence between national economies remains likely.

In our view the European Stability Mechanism does not meet the characteristics that the EMU fiscal capacity should have in order to fulfil the tasks mentioned above. It therefore seems difficult to imagine that it could evolve into the basis of the budgetary capacity of the Eurozone. It does not have own resources but is funded through national contributions. Payments from the ESM require a type of political conditionality that would make EMU policies very difficult to implement on a day-to-day basis. However, even without being a part of the EMU budget, its current structure could be integrated into the EU system in order to constitute a European Monetary Fund (EMF). This EMF fund could be hosted by a European Treasury and could carry out several insurance / backstop roles, particularly for the Banking Union.

The recently created Single Resolution Mechanism and, more concretely, the Single Resolution Fund (SRF) – financed through contributions from major European banks – could be made more resilient if it were backstopped by the ESM. Indeed, any private insurance fund is as credible as the government that backs it. In the current situation, an exhaustion of the resources of the SRF would require the mobilisation of national budgets. Should this point be reached the link between governments and banks and between private and public debt would come into play again and could have considerable destabilising effects for most Eurozone countries.

The risks that pushed for the creation of the SRM and the SRF have thus not yet been adequately addressed. In our view, the completion of the Banking Union requires a credible European public backstop to private insurance schemes such as the SRF and an eventual Common Deposit Insurance Guarantee. The ESM could constitute a good basis for a European fiscal backstop.

However, one problem remains in the current functioning of the ESM, since its losses as lender of last resort would still be supported by national governments. As a consequence, net contributors to the ESM are still reluctant to the idea of a common backstop, particularly if its size were to increase. The EMU budget could thus take over the national guarantees of the ESM. In such case, the own resources of the EMU (and more particularly an autonomous power of taxation at EMU level) would be the real guarantor for stability in the EMU and integrity of the Banking Union and the Capital Markets Union.

”AS LONG AS THE EMU DOES NOT HAVE A SIZABLE ENOUGH BUDGET THE RISK OF REFRAGMENTATION OF THE CAPITAL MARKETS AND DIVERGENCE BETWEEN NATIONAL ECONOMIES REMAINS LIKELY.”
4. HOW TO STRIKE THE RIGHT BALANCE BETWEEN SOLIDARITY AND RESPONSIBILITY, BY ADDRESSING ISSUES INCLUDING GEOGRAPHICAL REDISTRIBUTION EFFECTS, MORAL HAZARD AND PERMANENT FISCAL TRANSFERS?

HOW COULD A FISCAL CAPACITY ADDRESS THE CHALLENGES OF SPILLOVER EFFECTS, DIVERGENCES AMONG EUROZONE MEMBER STATES, THE DESIRABLE FISCAL STANCE OR THE NEED TO SUPPORT STRUCTURAL REFORMS?

From a zero-sum game to a win-win policy: making economic and political integration more attractive

In order to address the difficulties linked to a currency union (spillover effects, divergence between national economies and respect of fiscal rules), the EMU fiscal capacity needs to enable the Eurozone to exploit all its economic potential and be accompanied by strict discipline mechanisms. It needs to make the economic and political integration of the EMU more attractive (“the carrot”), so that the benefits that citizens draw justify the cost of coordinating fiscal policies and harmonising social and economic policies. At the same time it needs to be backed by solid and enforceable discipline and convergence mechanisms (“the stick”).

The existing European economic surveillance framework already provides a basis for economic policy coordination but not for effective ex ante coordination mechanisms nor for effective enforcing mechanisms for use on Member States disregarding policy recommendations. This makes the EMU a zero-sum game, devoid of both “carrots” and “sticks”. In many cases the necessary reforms are not carried out because of the short-term economic, social and political costs for national governments, even if the long-term benefits could be sizeable.

The establishment of a Convergence Code and of the necessary enforcement means, incentives and monitoring instruments would allow the EMU to go beyond the current Macroeconomic Imbalance Procedure. By creating a policy framework aimed at formulating and implementing a common economic strategy, it would create the necessary trust between Member States and a feeling of shared responsibility as regards soundness of national economies. Discretionary expenditure from the EMU fiscal capacity would be a key element of this policy. It would make the difference, on the one hand, by incentivising the implementation of those reforms which, for the moment, cannot be made compulsory for Member States under EU law. On the other hand, if EU investment in the private economy was sizable enough, making it conditional upon compliance with the Convergence Code would also constitute an important “carrot”. The Convergence Code would thus help to fully exploit the potential of both articles 136 TFEU and 11 TSCG - on coordination of national budgetary policies towards greater convergence within the Eurozone - and would be very close to the proposal made in the Commission’s Blueprint of a Convergence and Competitiveness Instrument.4

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**Addressing problems linked to automatic stabilisers: moral hazard…**

As regards automatic stabilisers, the moral hazard and the potential permanent transfers need to be addressed separately. As to the first, the activation of automatic stabilisers should in principle not be conditioned, since it would be in the interest of the entire EMU that they play their role in order to prevent negative spillovers in the rest of the Eurozone. However, in case of serious and repeated breach of the Convergence Code by one Member State, a mechanism could be foreseen for the Eurozone institutions to decide on the suspension of the relevant state’s access to automatic stabilisers.

Given that, in the case of automatic stabilisers, conditionality cannot be used as the main tool for addressing this issue, moral hazard needs to be tackled through the harmonisation of some parts of the social policy of the Member States. This would require modification of article 153 TFEU, which precludes the harmonisation of Member States’ social policies. Yet, in some cases, such as the eventual establishment of a European Unemployment Insurance Scheme (not as a re-insurance scheme, but as a scheme creating a direct link between the EU and its citizens), moral hazard could be addressed through the adoption of European parameters, which would apply directly to the individuals (in this case: eligibility criteria, replacement rate, duration of benefits and even a common tax rate). Such a construction would not require deep harmonization of social policies.

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**…and permanent fiscal transfers**

Existing proposals for automatic stabilising mechanisms at the Eurozone level show the difficulties in addressing the issue of permanent fiscal transfers effectively. Most contributions show that real macro-economic stabilising effects can only be achieved through mechanisms provoking permanent fiscal transfers. However, some fixing solutions can be found within the current treaty framework, such as a correction mechanism financed by own resources that would help bridge the gap between the contributions made by a country and the benefits it receives.

However, the only solution that could allow the European Union to create a system of solidarity between citizens would require a complete switch of paradigm. As long as the funds used to finance such mechanisms are ultimately considered as money coming from one Member State or another, the issue of transfers will remain extremely sensitive. But more and more tax-type instruments from which national budgets benefit exist or can be maintained thanks to the existence of the EU (e.g. VAT, corporate taxation, excises on tobacco or alcohol products, etc.) and new forms of taxation are made possible by the size of the Single Market (e.g. the financial transaction tax, the European emissions trading system). The EU has proven its ability to provide public goods, many of which could not exist in the framework of the nation state. Against this background the EU should be allowed to use at least part of the fiscal revenues coming from the taxation of public goods that it makes possible, to finance European welfare and stabilisation mechanisms with European money. Such a system change would eliminate the issue of permanent fiscal transfers between Member States and the connected political and public opinion sensitivities.

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**Restoring the credibility of the no bail-out clause**

The financial assistance programmes for Greece have seriously undermined the credibility of the no bail-out clause of art. 125 TFEU, while at the same time they have created unprecedented democratic tensions. By drastically confining the systemic risks arising from a Member State’s default of payments through robust integration of the financial and capital markets, an EMU fiscal capacity would make the application of the no bail-out clause possible again.

In the framework of a robust banking and capital union, the impact of a Member State defaulting would be limited to the scope of activities directly related to governmental activity (and, in some countries, social security systems) and the economic recovery would be considerably easier. At the same time, this option would not be incompatible with the possibility of financial assistance programmes granted by the ESM (or eventually by the EMF). Indeed, it would even make EMU-led debt restructuring schemes more politically acceptable.

However, even if this may go beyond the scope of the report being prepared by the European Parliament Economic and Monetary Affairs and Budget Committees, application of the no bail-out clause could have considerable consequences on other European policies, such as the Area of Freedom, Security and Justice. If the EMU is to follow a strict no bail-out policy, then it should itself be prepared to extend its scope of activities and be equipped with the financial, human and political resources necessary to take over essential tasks linked to the security of the EU external borders, should a Member State find itself financially unable to cope with its obligations.

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5. **SHOULD A FISCAL CAPACITY INTRODUCING AUTOMATIC STABILIZERS AT THE EUROPEAN LEVEL ALSO ACT AS A CARROT TO INDUCE STRUCTURAL REFORMS?**

The establishment of a system of European automatic stabilisers can serve at the outset as an incentive for Eurozone countries to implement structural reforms. However, once such stabilisers are created and operational their functioning should not be related to political considerations, given that their purpose and main function should consist of avoiding systemic risks for the Eurozone as a whole and not ensuring fiscal discipline.

Although the most visible effect of automatic stabilisers is of a social nature (e.g. unemployment schemes or income tax), their main objective remains macroeconomic. They are meant to prevent economic downturns in one region from becoming a systemic risk for the rest of a currency union. The lack of automatic stabilisers had particularly strong consequences at the beginning of the sovereign-debt crisis, when the financial struggles of the Greek government initiated the fragmentation of the financial and capital markets in the EU. This cut the flow of capital to peripheral countries and put other Governments in serious difficulties.

It is in the greatest interest of the Eurozone that automatic stabilisers play their role under any circumstances, even if the beneficiary Member State is not in full compliance with
EMU economic policy and country specific recommendations. Therefore, no automatic trigger should exist that would disrupt their functioning. However, in case of serious and repeated breach of the Convergence Code by one Member State, a political mechanism could be foreseen for the Eurozone institutions to decide on the suspension of the Member State’s access to the stabilisers.

The EMU also needs carrots to promote structural reforms in the Eurozone. Direct political intervention from Brussels (“the stick”) is very negatively perceived by citizens and should be seen as a solution of last resort. As explained below, European public investments, financial incentives to Member States or fiscal advantages to citizens and companies domiciled in Eurozone countries complying with the EMU economic guidelines could also be very effective ways to promote structural reforms.

6. HOW SHOULD AN EMU FISCAL CAPACITY BE FINANCED?

RESOURCES COULD INCLUDE, INTER ALIA, VERTICAL BUDGETARY TRANSFERS, A TAX TYPE INSTRUMENT, EUROBONDS ETC.

The way the EMU fiscal capacity is funded will have a great impact on the scope of EMU policies and the political autonomy that the EMU will enjoy at the decision-making and the implementation stages. The reflection on the resources of the EMU budget should strive to avoid the mistakes already identified in the general EU budget.

Firstly, the system should be simple and transparent, avoiding the complexity introduced by national rebates or the statistical VAT-based resources. Secondly, it should avoid pitting net contributors and net beneficiaries against one another by making sure that resources are genuinely own. Thirdly, it should strive to ensure that payment appropriations are made on time, irrespective of national financial situations. Finally, it should provide for a simpler decision-making process. In addition to these EU-specific pitfalls, the EMU system of own resources should address general concerns, such as volatility of tax-based resources.

Genuine own resources to avoid “juste retour” rhetoric

Regarding its sources of revenue, we believe that the EMU fiscal capacity should be financed through true own resources. Own resources are revenues accruing irrevocably to the EU in order to finance its budget without being conditional upon a decision by national authorities⁶. They can be fiscal or non-fiscal and they have to be put at the disposal of the EU through a common procedure⁷. This point is crucial when it comes to policy making, since GNI-based contributions from Member States will inevitably induce a “juste retour” debate and will provide net contributors with greater bargaining power. Ad hoc financing should be avoided as it tends to short-circuit EU decision-making pro-

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cedures, either by concentrating the debate in the European Council or by preventing proper implementation of decisions made.

Own resources can consist of tax instruments (e.g. financial transaction tax, carbon tax, a European bracket from a harmonised corporate tax, excise on tobacco and alcohol products, etc.) or non-fiscal revenue (part of the revenue from the EU Emissions Trading System or the benefits produced by the financial activities of the ECB).

In order to overcome the issue of permanent inter-state transfers, automatic stabilisers should rather serve horizontal equity (e.g. by financing a European Unemployment Insurance Scheme through a common tax rate on the payroll).

**A common payment procedure**

The procedure for making these resources available to the EMU fiscal capacity needs to be as streamlined as possible. It should also prevent the EMU’s own resources from being put in direct competition with national spending.

Drawing inspiration from the former tax on coal and steel products, which was paid directly by the industry to the High Authority of the European Steel and Coal Community and, later, to the Commission, the European Union should be given tax-collection powers regarding the EMU own resources. Although this would require a reform of the Treaties, transition solutions could be found based on the harmonisation of the payment procedure. Given that Member States act as agents of the EU when they collect EU own resources, the revenue corresponding to these entries should not appear in their respective national budgets. Rather, it should be transferred directly from national treasuries to the European budgets through a separate procedure. In order to accommodate resources based on statistical calculations (e.g. VAT-based own resource), the adjustment should be calculated by the EU and the cash balance repaid to or requested by the EU from the Member States.

**“THE PROCEDURE FOR MAKING THESE RESOURCES AVAILABLE TO THE EMU FISCAL CAPACITY SHOULD PREVENT THE EMU’S OWN RESOURCES FROM BEING PUT IN DIRECT COMPETITION WITH NATIONAL SPENDING”**

**A more democratic and credible Economic and Monetary Union: the need for taxation powers...**

In order to ensure democratic decision-making procedures and stability in the Eurozone, the EMU should be given taxation powers, in respect of the principles of subsidiarity and proportionality, and applicable in the fields of competence conferred to the Union by the Treaties.

The justification of the need of taxation powers at the European level is twofold. First, the creation of a democratic political space within the EMU, legitimate enough to carry out the harmonisation of national social policies, requires increased fiscal autonomy from national parliaments and proportionate empowerment of the EU institutions. Second, in order to provide credibility to the European public backstop for Banking Union private insurance funds, the Eurozone would need the autonomous capacity to increase its revenue in a suitable manner. Neither political accountability nor financial credibility could be achieved through ad hoc or regular national contributions. Indeed, such sources of revenue tend to place the authority, as regards the final implementation of EU decisions,
in the hands of the largest Member States’ national parliaments and governments and creates political insecurity.

Apart from tax collection powers, the EU should be able to determine the types and amount of its own resources. The decision-making procedure applicable to the EU’s system of own resources (unanimity at the Council and ratification by all national parliaments) has shown its limits in a scheme of economic integration. It is clearly also unsuitable for a project of political integration. Political union must start by co-decision and majority voting in fiscal and taxation matters.

... and for borrowing capacity

Granting borrowing capacity to the EMU would facilitate the establishment of automatic stabilisers and provide a strong contribution to the creation of a Capital Markets Union by establishing a sizable market of truly European securities and related financial activities.

The contributions to the debate on the necessity of the so-called “Eurobonds” can be split in three categories, according to the function that European debt could carry out.

First, Eurobonds can be an instrument to pool a part of the existing stock of national debt into European debt. To our eyes, at the moment this type of Eurobond would remove credibility from the no bail-out clause and the rules of the Growth and Stability Pact and would be extremely problematic in terms of political acceptability.

Second, Eurobonds can be European debt instruments used to finance European infrastructure projects, with the related revenues directly serving the connected interest expenses. The current Treaties already provide for project-bonds. This option seems less interesting in the context of the debate on the financing of a Eurozone fiscal capacity.

Finally, Eurobonds can be a European general debt instrument issued to finance European policies. This type of bond could be one of the essential financing instruments for a Eurozone budget complementing a proper system of own resources.

The capacity to borrow could reinforce the stabilising effect of the EMU budget in the Eurozone if added and coupled to a general power of taxation. While tax-type instruments are subject to volatility and their revenue tends to shrink in periods of economic downturn, the capacity to issue debt would allow the EMU fiscal capacity to bridge the gap during periods where fiscal income decreases, while reaching the financial balance by the end of the economic cycle. Prospectively, a structural level of public debt reflecting the size of public goods that the Eurozone is required to provide would be reflective of a mature monetary union backed by adequate taxation powers.
7. WHAT SIZE WOULD THE BUDGETARY CAPACITY HAVE TO BE IN ORDER TO FULFIL ITS FUNCTIONS?

The size of an EMU fiscal capacity should reflect the policies to be financed in order to avoid the expectations-capability gap. A careful study should be carried out of each function endorsed by the EMU budget. Even an approximate assessment shows that a meaningful fiscal capacity should be a number of multiples of the current EU budget.

As regards the support to the implementation of the European economic policy, some functions would be substantially cost-free. Supporting the implementation of the Eurozone Convergence Code by conditioning access to, for example, European public investment schemes upon compliance with the Code, would cost very little.

Financial incentives given to Member States should be decided on a case-by-case basis. However the Commission should be able to rapidly and autonomously mobilise funds for this purpose. Appropriations under €30bn per year would not give the EMU the necessary fiscal room to have a real impact on the implementation of economic policies.

The EMU could also gain citizens’ and economic actors’ support to structural reforms through fiscal advantages. For instance, according to our calculations, an EMU-wide tax credit of 6% granted to employers on the taxes they pay to employ lower-wage earners (first decile of the average earnings) with fixed contracts would cost approximately €3.5bn per year. If access to such fiscal advantages were limited to employers based in countries complying with specific EMU recommendations (e.g. in the framework of the establishment of a European Unemployment Insurance Scheme), the private sector could act as an advocate for European initiatives. In order to have a sizable impact this function should be funded by a line of €20bn.

Public investment would constitute the greatest part of the EMU budget and the financial backbone of a European economic policy. While an increase in public investment of 1% of GDP could bring a gain of 1.5% of GDP (and over 2% in the lower phases of the economic cycle), public investment in the Eurozone has plummeted from 4% to 2% of GDP in the last decades. An increase of 1% of GDP in public investment would help mobilise up to €600bn of private capital in the Eurozone’s economy (assuming a leverage of 5). If the EMU budget were used to bridge that gap, it would need over €100bn in own resources.

Finally, as regards the macroeconomic stabilisation function, proposals for a European Unemployment Insurance Scheme estimate the system would require an annual revenue of €50bn in order to have significant macroeconomic effects.

Therefore, in order to carry out the functions listed above, the EMU fiscal capacity should have a size of approximately €350bn per year, i.e. approximately 3.5% of the Eurozone GDP.

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8 Based on Eurostat data on years 2008-2012
Should the EMU fiscal capacity serve as public backstop of the ESM, a much greater size would have to be considered, also depending on whether the EMU level would be granted an autonomous and direct taxation power to support its function of public backstop.

8. WHAT SHOULD THE RELATIONSHIP BE BETWEEN THE EMU FISCAL CAPACITY AND THE EU GENERAL BUDGET?

SHOULD A EMU FISCAL CAPACITY EXPAND OR SHIFT REVENUE?
WHAT, IF ANY, CONSEQUENCES WILL THE ESTABLISHMENT OF A FISCAL CAPACITY HAVE FOR THE SIZE AND THE POLITICAL PRIORITIES OF THE EU BUDGET?

SHOULD THE EMU FISCAL CAPACITY BE ESTABLISHED INSIDE OR OUTSIDE THE BUDGETARY FRAMEWORK?

The EMU budget should be financed through new own resources, although among those own resources there could be a small contribution from the EU budget. The EMU budget would be a de facto separate budget, irrespective of its position within or outside the EU general budget. However, it seems difficult to imagine that the EU general budget would be able to accommodate two fundamentally different financial frameworks, each with its respective own resources and governance structure.

The questions of the positioning and resources of the EMU budget vis-à-vis the general EU budget needs to be addressed in three steps, i.e. the participation of non-euro Member States to the EMU budget, the type of integration underlying the EMU budget compared to the general EU budget, and the size of an eventual EMU budget.

First, in the same manner as the policies developed within the framework of the Economic and Monetary Union should respect the rights of the Member States which have not adopted the euro, the establishment of a budget or fiscal capacity for the Eurozone should not erode the benefits non-euro Member States draw from the EU budget. Therefore, only resources directly linked to the EMU should be redirected to a Eurozone budget.

In this sense, two headings of the EU general budget could be partially used to finance an EMU fiscal capacity. First, the share of the Structural Funds (heading 1.b) transferred to euro-area countries (approximately €24bn per year) could be transferred to the EMU fiscal capacity to finance policies promoting cohesion between Eurozone economies. The same could be done with a part of the Commitment Appropriations under heading 1a. “Competitiveness for growth and jobs”, which would amount to approximately €10bn per year. This would also enable the restructuring of the mechanism to design, allocate and spend Structural Funds around a more coherent and pan-European policy framework at the Eurozone level.

Second, the reforms required to make the EMU viable in the medium and long term would require a combination of the traditional market-led and economy-based
integration of the Single Market and a new type of political integration. This would inevitably touch upon fundamental parts of economic and social preferences. This switch leads to two complementary conclusions: (a) non-euro Member States’ contributions to the EU budget should not be used in order to finance policies they do not participate in, and even less a new type of integration to which they have not subscribed, and (b) the impact of fiscal integration between euro countries on their social policies should be compensated by new forms of legitimacy of the Eurozone governance, which the current EU general governance framework does not provide for.

Finally, an evolution of the Economic chapter of the EMU to also include the tasks mentioned above would constitute a considerable extension of substantive policy making at the EMU level. The preliminary assessment of the required size of the EMU fiscal capacity made in the previous answer shows that a significant increase in EU resources would be required.

9. WHAT IS THE APPROPRIATE INSTITUTIONAL SETTING FOR THE FISCAL CAPACITY?

As a first consideration, the creation of an EMU fiscal capacity financed through genuine own resources would entail a further loss of decision-making and control powers for national parliaments. Therefore, the EMU governance framework should be equipped with appropriate European parliamentary accountability mechanisms. Secondly, the institutional construction around the EMU fiscal capacity cannot be seen in isolation, but in the context of the strengthened economic governance framework which has emerged since 2010. Thirdly, its decision-making procedures could not afford political blockage or lowest-common-denominator compromises. Given the necessary transfer of powers in the field of social policy, they should ensure that EMU economic policy and spending are as effective as possible in promoting growth, supporting job market recovery and reinforcing resilience in the Eurozone. Finally, the governance structure of the EMU should ensure that economic policy reflects the economic needs of the Eurozone as a whole and not the specific preferences of the largest economies.

A. Should there be an economic government for the Eurozone? Who should it be made of (Eurogroup president, one/more EU-Commissioners, ECB President, EMF/ESM Director)? Should it be independent or linked to one of the institutions (Commission/Council/EMF)?

Experience from the last years has shown that the more intrusive the economic and fiscal decisions made at the European level are, the greater the use of the intergovernmental decision-making procedures, mostly by the European Council. This role of last-resort decider that the European Council has assumed for the last 7 years has brought extremely high costs in terms of the inability of the EU to make timely decisions of the required scale and with enough democratic legitimacy.

If an EMU fiscal capacity by itself would help alleviate the political cost of European
decisions for national Governments (as it would release pressure on the national resources required to finance the EMU sustainably), alone it would not be enough to make decision-making processes completely timely, effective and reflective of the needs and interests of the Eurozone as a whole. Neither would it achieve transparency and represent democracy in the perception of European citizens and other stakeholders. A concentration of executive powers would be required in the hands of positions accountable to the European constituency.

Currently two positions seem good potential candidates to hold those powers: the President of the Eurogroup and the Vice-President of the Commission for the euro. However, because of the competences involved (in the sense of the Treaties), neither of these two positions could concentrate all the executive powers of the EMU in their hands. In order to allow accountability mechanisms to work effectively, the positions of President of the Eurogroup and Vice-President of the Commission for the euro should be merged in order to create a de facto EMU Finance Minister. This position would be able to exercise both existing community and intergovernmental competences, and in summary should endorse the following functions:

- Legislative initiative powers
- Agenda-setting powers at the Council
- Powers of assessment, monitoring and surveillance of the implementation of the European Semester and other EMU policies by Member States
- Direct horizontal coordination (between the Council/Eurogroup, the Commission, the ECB and the Parliament)
- Direct vertical coordination (between the EU and Member States, and between Member States)
- Use of financial instruments (ESM, European Fund for Strategic Investments)
- Use of administrative capabilities (DG ECFIN of the Commission, DG G of the Council Secretariat-General)
- Right to bring actions for annulment to the ECJ in case of misuse of powers by the European Council or other institutions
- Capability to effectively report to the European Parliament
- External representation of the euro in international financial institutions

Therefore, should the Commission acquire the power of direct intervention on national budgets to ensure their compliance with the rules of the European Semester, as proposed by certain instances, the EMU Finance Minister would become a central figure.

Accountability of the EMU Finance Minister

In the current institutional set-up, the position of EMU Finance Minister would be institutionally placed between the Commission and the Council, since intergovernmental competences currently included in the European Semester process could not be exercised by a Commissioner. This position would be similar to the current High Representative/
Vice-President of the Commission, but with considerably greater powers. In order to allow for proper accountability mechanisms, an interinstitutional agreement concluded between the Council (Eurogroup), the European Parliament and the Commission could provide for:

- A nomination procedure requiring the consent of the President of the Commission, the Council and the European Parliament, following the example of the HR/VP (art. 17.2 and art. 18.1 TFEU).
- The EMU Finance Minister’s dismissal from the position of President of the Eurogroup (and all other positions related) if he or she ceases being a member of the Commission.
- Information and transparency requirements to the European Parliament similar to the ones included in the Declaration of Political Accountability to the European Parliament concluded by the High Representative / Vice-President.

This construction would be politically sustainable for one Commission term’s time, since it would rely on the will of Member States within the European Council to abide by a purely political agreement.

In order to provide the position of EMU Finance Minister with the necessary powers to carry out its functions in the long run, the next revision of Treaties should introduce two major reforms:

- First, the Union should be given shared competence on economic policy (today economic policy is completely out of the scope of the Union’s competences12). This shared competence should be articulated in two chapters: the European Convergence Code and the Single Economic and Fiscal Policy. The European Convergence Code would constitute the framework for coordination of national economic policies and a benchmark for the European Semester. The Single Economic and Fiscal Policy would go beyond coordination of national economic policies by identifying common objectives and deploying European resources. The Single Economic and Fiscal Policy would also require some harmonization of social and fiscal policies.
- Second, all residual executive powers currently held by the Council should be transferred to the Commission. The EMU Finance Minister could then be fully accountable to the European Parliament and the Council on an equal footing.

B. Which will be the appropriate parliamentary decision-making structure to ensure democratic scrutiny of the decisions related to the fiscal capacity and economic governance of the Eurozone?

The current Treaties allow for relatively little flexibility in the way the European Parliament can work on EMU matters. However, if the EMU is to be equipped with its own budget, and all the more with its own resources and tax instruments, the issue of the representation of Eurozone citizens must be addressed. The representatives elected in non-euro countries (currently 34.5% of MEPs) have a great degree of influence in euro-area matters without being accountable to their own constituencies for those decisions. This is an obvious democratic anomaly.

12 In the current state of the Treaties, Member States are bound only to coordinate their economic policies within the Union (According to article 5 TFEU) and to decide on non-compulsory economic guidelines (articles 121 and 136 TFEU), leaving the Union short of enforceable instruments for the formulation and implementation of a European economic policy.
Within the framework of the current Treaties, the European Parliament could create an Economic and Monetary Union Committee, responsible for deliberations on the EU action based on article 136 TFEU. An arrangement between political groups could allow this Committee to be composed exclusively of MEPs elected in euro Member States. But this would not solve the initial problem, since the Committee’s reports would need to be adopted by the Plenary.

While the unicity of the institutional structure of the Union should be preserved as an essential principle, Treaty changes to enable the creation of an EMU Committee and a Euro Plenary composed exclusively of Members elected in euro Member States need to be seriously considered, imitating the arrangements already existing for the Council. This is an option more consistent with the overall EU institutional architecture, and more adequate in terms of democratic accountability for Eurozone decisions than the option proposed by some quarters for a separate Eurozone Parliament consisting of members appointed by national parliaments or national governments. This later solution would prevent the necessary constitution of a European political space able to reflect the EU citizens’ preferences in social, fiscal and economic policies.

10. WHAT WOULD THE LEGAL FORMS OF THE OPTIONS SUGGESTED BE?  COULD THEY BE IMPLEMENTED WITHIN THE SCOPE OF THE CURRENT TREATY OR WOULD THEY REQUIRE A REVISION?

The current Treaties offer four options to establish a fiscal capacity for the Economic and Monetary Union.

On the one hand, the EMU fiscal capacity could be created within the EU general budget. First it is possible to earmark specific resources for specific purposes. Second, the establishment of an enhanced cooperation scheme requires the creation of a specific line in the EU general budget, which is to be funded by participating Member States. These two options would perfectly respect the institutional framework of the Union. However, it would present serious limits, like the fact that its funding would be submitted to the ceilings of the Multiannual Financial Framework. In addition, the cumbersome decision-making procedures for the adoption of the MFF and the Own Resources Decision would apply and non-euro countries would have a right of veto on the EMU budget. Some of these restrictions could be addressed in a next reform of the Treaties.

On the other hand, an EMU Budget outside the EU budget would also be possible. There already exist two intergovernmental fiscal capacities used to finance European policies. The European Development Fund, created through an Internal Agreement of the Council, and the European Stability Mechanism, created through an international treaty. The ECJ has extensive case law on those fiscal capacities, which shows that Member States can decide to integrate intergovernmental funds into the EU Institutional framework. Although this is not the case for the EDF and the ESM, according to the ECJ Member States could give the same powers to the Institutions as they have for the EU general budget.

13 See art. 136.2 TFEU, art. 330 TFEU, art. 6 of Protocol No 15, art. 1 of Protocol 21, art. 1 of Protocol 22
The greatest advantage of these two options is that the Ordinary Legislative Procedure could be applied to adopt its Multiannual Financial Framework and that a simplified procedure for the adoption of its Own Resources Decision could be created. In addition, this fiscal capacity could finance the implementation of decisions belonging to both the intergovernmental and community dimensions of the EMU. However, the greatest drawback of these options is that their great flexibility could backfire, since Member States may not be willing to give such powers to the EU institutions.

11. SHOULD THE CAPACITY BE LIMITED TO EUROZONE MEMBER STATES OR SHOULD IT BE OPEN TO OTHER MEMBER STATES (IF SO, UNDER WHICH CONDITIONS)?

Current legal provisions regarding differentiated integration would indicate that any form of tighter integration concluded between a subset of Member States should be open to the others. However, the different elements which compose the Economic and Monetary Union cannot be seen as ordinary separate schemes of differentiated integration in the sense of the Treaty provisions regulating enhanced cooperation. Together they constitute a complex structure which underpins the monetary integration of the Eurozone. As such, they cannot be dissociated by allowing non-euro Member States to pick and choose the parts of the EMU that would most benefit them.

If an EMU fiscal capacity were created along the lines described in this contribution, the minimum requirements for non-euro countries wanting to access it should consist of:

- Approving a roadmap towards the adoption of the euro within an agreed time frame.
- Meanwhile joining at least the Exchange Rate Mechanism II.
- Immediately joining the Convergence Code and the European economic policy.
- Joining all fiscal arrangements concluded for the purposes of the EMU own resources system.
ABOUT THE ORGANISATION:

The Union of European Federalists (UEF) is a pan-European, non-governmental political organisation dedicated to the promotion of European political unity. Throughout the past 70 years it has been a leading voice in the promotion of European unity and an early campaigner for key milestones in the development of the European Communities and the European Union.

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