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The eurozone needs an "additional fiscal capacity":
the "European Solidarity Mechanism" is the first step

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The current debate on the creation of an additional fiscal capacity for the eurozone is really a debate about giving the leaders of the European institutions competence for a true budgetary policy[1]. This is the first time since the Report on the role of public finance in European integration drafted by MacDougall in 1977[2] that a coupling of budgetary policy with monetary policy has looked like a real possibility. The road ahead is neither easy nor short, and it is crucial that federalists, who must devote all their energies into pursuing this objective, appreciate this fact. In the present note we try to establish the extent to which it is possible as of now (in the current Treaty framework) to introduce an "additional fiscal capacity" for the countries belonging to the eurozone together with those that would like to join it in the future [hereinafter, the eurozone *plus*]. In so doing, we will also highlight the various steps that, instead, demand amendment of the existing Treaties.
The debate on budgetary policy began in 2012, with the report entitled "*Towards a genuine Economic and Monetary Union"* (presented in a provisional version by Van Rompuy in the June 2012 and in its definitive version on December 5), and, in the November, with the European Commission's Blueprint and the European Parliament's resolution. In discussing the legal and institutional aspects of creating an "additional budget", we shall refer to a note by the European Parliament ("*Legal options for an additional EMU fiscal capacity*")[3] [hereinafter: "document"] and to a European Parliament [EP] resolution relating to differentiated integration within the EU[4].

1. Differentiated integration: an "additional fiscal capacity" for the eurozone *plus*

The establishment of a "fiscal capacity". The EP document analyses the possibility of establishing a "Fund", separate from the European budget and also looks at the policies that this "Fund" would be required to finance. The first aspect examined is the broad question of whether it is actually possible, within the existing Treaty framework – but outside the Multiannual Financial Framework (MFF) and its limits –, to introduce an "*additional fiscal capacity*" for the eurozone *plus* countries. Indeed, this is the condition to ensure that the resources deployed through the activation of a "fiscal capacity" are truly "additional" to those already allocated to the EU budget (rather than replacing them), and will be guaranteed, in the future, the flexibility of a true budgetary policy. The avenue suggested by the document is to reach a decision based on

[1] The concept of "fiscal capacity" dealt with herein is the same one referred in the report by the President of the European Council, Van Rompuy: *Towards a genuine Economic and Monetary Union*, Brussels, 5 December 2012.
[2] Commission of the European Communities, *Report of the study group on the role of public finance in European integration*, Brussels, April 1977; http://ec.europa.eu/archives/emu_history/documentation/chapter8/19770401en73macdougallrepvol1.pdf.
[3] The document can be consulted at: http://www.europarl.europa.eu/RegData/etudes/note/join/2013/474397/IPOL-AFCO_NT(2013)474397_EN.pdf
[4] European Parliament resolution of 12 December 2013, P7_TA (2013)0598.

Art. 352 TFEU and then implement an enhanced cooperation[5]. Alternatively, a "Fund" could be established along the lines of the European Development Fund, while a third option might be to establish an international treaty. In these latter two cases, the EP would be guaranteed a role in controlling the "additional fiscal capacity" only if this were expressly envisaged. Failure to provide for such a role would violate the principle of unity and integrity of the EU budget, but above all it would undermine the budgetary sovereignty of the EP.

What does "fiscal capacity" mean? In the documents issued by the European institutions, "additional fiscal capacity" is discussed in relation to two specific economic policies. The first is a *conditional* aid policy (so-called *contractual arrangements*), designed to encourage structural reforms for competitiveness and growth in the member states. The second policy is to establish a European "insurance system" against the risk of *country-specific,* or asymmetric, economic shocks. Implementation of this policy, which envisages partial absorption of these shocks at central level, would involve the granting of European unemployment subsidies or financial transfers to struggling countries. Since the European Council meetings held between December 2012 and December 2013 failed to discuss this aspect, "fiscal capacity", in the current European debate, must be understood to refer only to the above-mentioned "*contractual arrangements"* and the funding of the same. The EP document deals with these arrangements, and also with the need to correct macroeconomic imbalances.

The conditional aid policy and "contractual arrangements". The first option examined by the European institutions, from the perspective of establishing a "fiscal capacity", was that of "contractual arrangements" (a term actually criticised by the EP). According to the current proposals, such an arrangement would involve the granting of financial aid, on a *voluntary* basis, to a country prepared to deliver the structural reforms needed to restore competitiveness to its economic system. The document, taking into account the "six pack" measures on prevention and correction of "*excessive economic imbalances*", the formalisation of the "European Semester" and the contents of the "*two pack*" (applicable only to the eurozone countries), concludes that they can be included in the preventive and corrective arm of the Macroeconomic Imbalances Procedure and, therefore, integrated into the European Semester[6]. In the framework of the multilateral surveillance procedure, no role is envisaged for the EP, only for the Council. Nevertheless, if "contractual arrangements" do become an integral part of the European Semester, thereby assuming relevance to European budgetary policy, then involvement of the EP will become mandatory. "Contractual arrangements" could be implemented on the basis of an agreement signed by the European Commission, on behalf of the Council, and by the state in question, and, given their *voluntary* nature, would not require amendment of the existing Treaties. Since they are not legally binding, the document does not say how they should be financed. Debate on this point within the European Council after the European Commission had issued its Blueprint and the EP had approved its resolution relating to *genuine economic and monetary union* generally revolved around the activation of a *European Solidarity Mechanism*, the terms and content of which remain to be defined. However, in the months following the publication of the Blueprint, German Chancellor Merkel,

[5] The precedent is set by the establishment of the tax on financial transactions: this initiative was taken by the European Commission which, in the absence of unanimity among the EU countries, launched an enhanced cooperation on the request of the countries that supported it.

[6] Art. 121 TFEU, concerning multilateral surveillance, constitutes the legal basis activating this instrument.

addressing the Bundestag, spoke about the possibility of introducing a eurozone “*Solidarity Fund*”[7]. Within the European Council, on the other hand, the issue continued to be debated until December 2013, when it was decided that any decision should be postponed until October 2014, after Spain (even though the ranks of the unemployed in Spain are equal to those of France and Italy put together) rejected the idea of receiving aid that would limit its “*national sovereignty*”[8]. Certainly, the fact that the Solidarity Mechanism is conceived as a voluntary system operating outside the framework of the Treaties, and therefore outside the framework of the normal functioning of the European institutions, is, objectively, unlikely to encourage its use. On the other hand, its implementation (both as regards its financing and, above all, the payments the Fund would be used to make, which could not be simple unconditional transfers) would require amendment of the Treaties.

The macroeconomic stabilisation policy. To be implemented, the system of unemployment subsidies envisaged by Van Rompuy – understood as “*a complement or partial substitute to national unemployment insurance systems*” and as one of the ways of introducing an insurance-type policy – would have to be compatible with the fundamental principles of member states’ social security systems. A European unemployment insurance system could not be introduced on the basis of the current Treaties as these only allow legislation by means of directives, which would have to be transposed into national social security law and would therefore require harmonisation of a sector, that of national social security systems, that falls outside the scope of the Treaties. The introduction of these grants, according to the EP document, would require Treaty change, or recourse to a separate treaty.

As regards financial transfers designed to absorb asymmetric shocks, these, if *unconditional* and ultimately funded by the member states, would be in conflict with the Treaties as they would impede the pursuit of sound budgetary policies (Art. 125 TFEU). In any case, the activation of EU financial assistance would be possible only if it was “*indispensable for the safeguarding of the financial stability of the euro area as a whole and subject to strict conditions*”. *Conditional* financial assistance would therefore comply better with the provisions of Articles 125 and 136.3 TFEU, but its management would necessitate a profound change in the institutional structure of the EU, for example the formal establishment of a European Treasury. In this case, to maintain a normal institutional balance between the Commission and the EP and a balance between the EU and the eurozone *plus* countries (the European Treasury would be established only for the latter), the Treaties would have to be amended.

Financing the European Solidarity Mechanism (or “Fund”). As regards the financing of the “Fund”, the document seems to rule out the introduction of a true "European tax". Art. 311 TFEU, on EU own resources, does not provide an adequate legal basis for establishing taxes, whereas the subsequent articles would only allow regulation of tax harmonisation at European level. Conversely, the articles on the environment and energy field (192 and 194 TFEU) would allow the adoption of "measures" of a fiscal nature, but only on the basis of a unanimous decision of the Council, with the EP having only an advisory role. However, a procedure of this kind in the field of taxation would alter the relationship between the main European

[7] EUbusiness, *Merkel says open to future eurozone 'solidarity fund'*, 27 June 2013, in: http://www.eubusiness.com/news-eu/germany-finance.pgt.

[8] Philippe Ricard, *Angela Merkel: «Tôt ou tard, la monnaie explosera, sans la cohésion nécessaire»*, in: Le Monde, 21 December 2013.

institutions and between the EU and the member states and, above all, would violate the principle of "*no taxation without representation*" (as well as that of "*no representation without taxation*"). The document indicates that it might also be possible to use the revenue from a financial transaction tax, but it does not specify whether this use would be decided by the EP, or unilaterally by the countries that introduced the tax.

The document also considers the possibility of financing the "Fund" through borrowing. However, is points out that the Treaties do not allow the EU to raise loans, except in certain circumstances (a country with difficulties in its balance of current payments). So the recourse to this instrument may be had in the case of "*project bonds*", but only if the volume of bonds issuance remains within a certain percentage of the EU budget: otherwise, it would amount to a *de facto* circumvention of the provisions laid down in the Treaties and therefore of the incompatibility of bonds issuance with them.

The formal establishment of a European Treasury as the condition for implementing a stabilisation policy. According to the document, should the "fiscal capacity" consist of resources raised through borrowing or revenue from a true European tax, then a European Treasury would need to be established. This would be particularly true in the case of activation of *conditional* financial assistance, which would be subject to parliamentary control. Indeed, in this case, there would be two possible scenarios. Were a European Commissioner to be appointed head of the Treasury, without amending the Treaties, the Commission as a whole would be jointly answerable for acts committed by the said Commissioner and, in the event of a no-confidence motion brought by the EP, would be liable to fall. This collective responsibility of the Commission would create a problem, as such a motion, if related to decisions involving only the eurozone plus countries, would upset the institutional balance between the EU, the Commission and the EP, and especially between the EU and the eurozone *plus*. The same difficulty would arise were the Commission to reach a majority decision on an issue affecting only the eurozone *plus* countries. If, on the other hand, the Treasury were to be placed in the hands of an *ad hoc* institution, represented by a single Commissioner, chosen and voted in by the EP, any no-confidence motion brought would concern only the Commissioner holding the post of Treasury Minister. However, this is an institutional innovation that requires Treaty change.

2. The EP resolution on differentiated integration[9].

The current EP has shown itself to be well aware of the problems outlined above and in particular of the role it is called upon to play in the case of initiatives concerning only the eurozone countries. Indeed, on 12 December, 2013, it approved a resolution that sees it, for the first time, explicitly supporting differentiated integration. The EP, however, is careful to point out that such differentiation should be based on a legal act that is, initially, addressed to all member states, rather than one that excludes, a priori, some states. In particular, with regard to differentiated integration in the economic field, the resolution recalls that the "*coordination of economic, employment and social policies belongs to the category of shared competences*" and can be the subject of an initiative involving only some of the EU member states and that Art. 136 TFEU

[9] The resolution states that "differentiated integration takes two forms: 'multi-speed', in which states seek to achieve the same goals according to different timeframes, and 'multi-tier', in which states agree to differ in their goals".

"*allows the Council, on a recommendation from the Commission and with the vote of only the Member States whose currency is the euro, to adopt binding economic policy guidelines for the euro area countries in the framework of the European Semester*".

However, the EP is against formal differentiation of parliamentary participation rights, stressing that its own internal rules "*offer a sufficient margin of manoeuvre to organise specific forms of differentiation on the basis of political agreement within and among the political groups in order to provide for appropriate scrutiny of the EMU*", although it does not specify whether, on matters of interest to the eurozone countries alone, voting should be restricted to the representatives of the countries in question.

As regards the "contractual arrangements", meant to give rise to a new Convergence and Competitiveness Instrument (CCI), the resolution states that, in the framework of the European Semester, these, as well as being based on conditionality and convergence, should also pursue the objective of solidarity. In particular, it regards the establishment of this instrument as "*an initial phase in strengthening the fiscal capacity of the EMU and stresses that the financial resources of the CCI must be an integral part of the EU budget, but outside the MFF ceilings, so as to respect the EU Treaties and EU law and ensure that the European Parliament is fully involved as the budgetary authority*". The real weakness of the EP's resolution concerns the funding of the additional fiscal capacity. According to the EP, it should, pursuant to an amendment to the decision on own resources, be funded with a new own resource consisting of contributions paid by the member states taking part in the CCI. Furthermore, use of revenue generated by the tax on financial transactions, referred to in the resolution, is regarded as an instrument that substitutes, rather than adds to, the states' contributions.

Finally, the resolution reiterates the EP's call to convene a European Convention entrusted with the task of amending the Treaties, defining the framework of its action: any change should affirm the role of differentiated integration "*as a tool for achieving further integration while safeguarding the unity of the Union*". The resolution also indicates that the EP is aware of the fact that, in the current phase, the institutional leap needed is that of switching to (qualified) majority voting on budgetary matters, but does not broach the issue of creating a true European fiscal power. Indeed, it only goes so far as to call on the next European Convention "*to examine the possibility of introducing a special legislative procedure requiring four fifths of the votes in the Council and a majority of Parliament's component members [...] for the adoption of the regulation laying down the multiannual financial framework" and "for the adoption of the Own Resources Decision*". It is true that, according to the EP, the next Convention should discuss the possibility of allowing member states whose currency is the euro "*to provide for specific own resources in the framework of the EU budget*". But it also seems that currently the only way forward in order to equip the eurozone with own resources is, as suggested by Mario Albertini in his time, to hold a European vote on the sharing of tax revenues between European and national level.

3. Conclusions: a "European Solidarity Mechanism" for a European "*grants-in-aid*" policy

The Commission's Blueprint and the Report by the President of the European Council both envisage two phases for the implementation of an "additional fiscal capacity". They suggest that the "fiscal capacity" should initially serve to finance a policy of voluntary aid, which however would be *conditional* upon the introduction of structural reforms. The second phase would instead see the “fiscal capacity” evolving into a true insurance-type macroeconomic stabilisation policy, involving the granting of European unemployment subsidies, or partial absorption, at central level, of asymmetric shocks through the provision of *conditional* financial assistance. In the first case, the agreement, being *voluntary*, could be implemented within the existing Treaties, albeit at the cost of considerably upsetting the institutional balance between national governments and European institutions and seriously exacerbating the legitimacy deficit that already besets the current EU institutions. However, as seen above, this solution, which favours power-based relations between the states rather than a supranational European policy, is rejected by member states. On the other hand, the implementation of “contractual arrangements” and *conditional* financial assistance demand Treaties amendments, making the EU more similar, politically, to a federal state. Indeed, in such states, conditional aid (or “*grants-in-aid*”) policies are normal practice. In the European setting, such a policy would require, ultimately, the introduction of European taxes and the creation of a "European Treasury Minister” answerable to the EP.

In the short term, federalists can be satisfied with the “contractual arrangements” solution, considering it a first step towards a eurozone fiscal policy. However, it must include *supranational solidarity policies* and be framed in terms that clearly represent a break with the austerity-only policies implemented to date. It is therefore necessary to provide for the formal establishment of a “*European Solidarity Mechanism (or Fund)*” which would be used, through *grants-in-aid*, to finance reforms in the eurozone *plus*. This “*Mechanism*”, in turn, would have to be funded with a share of the revenue from the tax on financial transactions, so as to ensure that the resources mobilised really were *additional* to those of the EU budget. The size of this share would have to be decided by the EP and the national parliaments on the basis of a proposal by the Commission. In this way, there would be no need to resort to voluntary agreements, as it would be sufficient to apply the provisions of the Treaties. Germany can be expected to demand assurances on the correct use of these additional resources. Indeed, German Finance Minister Schäuble, intervening recently in the setting of proposals for strengthening the eurozone, called not only for the establishment of a eurozone parliament, but also for the creation of a “Commissioner” for the eurozone invested with the power to reject the national budgets of countries failing to respect the European rules[10]. This power could be exercised only in relation to the eurozone *plus* countries so as to leave the way clear for a simplified Treaty revision, even though Germany has not yet specified what procedure might be followed. In any case, it is possible to envisage a joint solution based on creation of a “*European Solidarity Mechanism*”, financed by the tax on financial transactions, and empowerment of the Commission to reject a national budget. But this is not enough. We also need to see, at the same time, the opening of a European-wide debate on appointing competence for a true budgetary policy in the hands of the eurozone *plus*, the time frame for the realisation of this objective, and, above all, the need to fund this policy through a European tax or, alternatively, through revenue from a common tax whose distribution, between European and national level, would be jointly decided by the eurozone parliament and the national parliaments.

[10] Wolfgang Schäuble, *Strategy for European recovery*, lecture at the “Fifth Bruges European Business Conference”, 27 March 2014.