

# A Budget for the Euro Area: Objectives, Procedures and Institutions

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## INTRODUCTION

**BY DOMENICO MORO**

Member of the Federal  
Committee of the Union  
of European Federalists

The origin of the economic and financial crisis afflicting the European Union (EU) is political, not economic. The fact that the crisis continues to bite in Europe, whereas the USA and Japan, albeit slowly, are overcoming it, shows that the market penalises the EU not for its sovereign debt, but rather for the absence of any European federal sovereignty. The market punishes the intergovernmental method of eurozone economic governance, which is also proving to be increasingly damaging to the individual member states. In the absence of a European federal budget to support a policy of economic growth and by the constraints of the Stability and Growth Pact (SGP) and the fiscal compact, if the European economy as a whole is in recession, member states inevitably find themselves in persisting with pro-cyclical recessionary policies, thereby triggering a vicious cycle of ever-worsening economic problems. On the other hand, the states like Germany are reluctant to pursue a development policy, fearing to find themselves in difficulty if their economic growth slows

down. Paradoxically, the European governments have continued to seek answers through intergovernmental methods, even stepping outside the framework of the existing Treaties, thereby compounding the European democratic deficit. However, since 2012 the awareness of the inadequacy of existing measures and of the institutional framework, has been growing in the European institutions and among member states. There is an ongoing debate on the long-term sustainability of the eurozone and the ultimate objectives of a fiscal union, economic union and eventually a political union, even though the nature of these unions is still unclear. The European institutions have started to acknowledge that the eurozone must have its own budget. This paper analyses the measures possible to take within and outside the Treaties to strengthen the economic governance of the eurozone, before finally discussing the prospect of equipping it with its own budget, and analysing its objectives, the procedures possible to establish it, and the institutional mechanisms to manage it. ■

# THE COST OF TODAY'S INTERGOVERNMENTAL EUROPE

## THE EVOLUTION OF ECONOMIC GOVERNANCE WITHIN THE EXISTING TREATIES: THE SIX PACK AND THE TWO PACK

The Six Pack, consisting of five regulations and one directive, was approved in late 2011.<sup>1</sup> Under the regulation dealing with preventive measures and reform of the SGP, which gives the “European semester” a legal basis, the Commission, at the start of each year, is required to present an annual growth survey. On the basis of this survey the European Council draws up economic and fiscal policy guidelines both for Europe and for the single member states, in the latter case setting in motion the mechanism of surveillance of the budgetary policies of the states, which are required to submit “national reform programmes” (taking into account the “EU 2020 Strategy”) and “stability and convergence programmes”, setting out their medium-term objectives. In the case of countries with a public debt exceeding 60 per cent of their GDP, the budget objectives will be assessed taking into consideration the expected improvement of the structural deficit, which must amount to at least 0.5 per cent of GDP per year (without considering cyclical effects

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and one-off measures). In particular, the regulation modifying the corrective arm of the SGP requires countries whose debt-to-GDP ratio has exceeded 60 per cent to show that they have implemented measures capable of reducing it at an adequate pace, i.e. at an annual rate of at least 5 per cent over the previous three years. By the end of June each year the Commission proposes country-specific economic and budgetary policy recommendations; countries found to have an excessive deficit are informed and the Council may formally invite them to take appropriate measures.

The last two Six Pack regulations introduce, for the first time in the European context, the concept of macroeconomic surveillance and, like the SGP, they comprise, on the one hand, a preventive arm and a corrective arm to deal with excessive macroeconomic imbalances and, on the other, a system of sanctions impossible on euro area countries failing to implement the necessary corrective measures. The Commission will carry out periodic assessments based on indicators of internal imbalances (public and private debt, the evolution of bond and real estate values, unemployment levels, etc.) and external imbalances (current account

balances, foreign investment trends, real exchange rates, evolution of export market shares, evolution of costs and prices, etc.). Should an “excessive imbalance” be found to exist, the Council, upon the recommendation of the Commission, will request the country concerned to take corrective action within a specified period of time, and in accordance with a plan of action that the Council will first have approved. With regard to this second, corrective, part of the procedure, a state repeatedly failing to implement the Council’s recommendations will be liable to a fine amounting to 0.1 per cent of its GDP. The decision to impose a fine — to which only eurozone countries are liable — is reached by the Commission and, unless opposed by a qualified majority of member states, taken as approved by the Council. Finally, Directive 2011/85/EU introduces stricter requirements on budgetary frameworks including the requirement to supply cash-based data on a monthly basis in order to ensure better control of national public finances.

The Two Pack comprises two regulations, approved by the European Parliament on 12 March 2013, which apply only to the countries of the euro area. One concerns countries in severe financial difficulties receiving or needing to receive assistance from: one or more other states, the IMF, the European Financial Stability Facility (EFSF) or the ESM. The other relates to the prevention and correction of excess deficits in eurozone countries.<sup>2</sup> Under the first of these regulations, the

Commission, on the basis of its assessments, can decide to step up surveillance of a country that risks finding itself in a situation of financial instability and may ask the Council to recommend that the said country requests financial assistance. Once a member state has requested assistance, it, together with the Commission, must draw up an adjustment programme aimed at re-establishing a healthy and sustainable economic situation. The second regulation entitles the Commission to issue an opinion on the budget of the state concerned, before it is submitted to its national parliament for approval. According to the timetable established by the regulation, by 15 April each year, every member state must submit a medium-term budgetary framework drawn up on the basis of independent macroeconomic forecasts, while the draft budget for the following year must be published by 15 October each year. If the Commission finds that the proposed budget does not respect the financial policy obligations laid down in the SGP, it will ask for it to be reviewed. The budget must be approved by 31 December each year.

The innovative feature of the Six Pack and the Two Pack lies in the fact that the Commission, on the basis of a more stringent schedule and the adoption of severe measures by the member countries, is required to express a preliminary opinion on national budgetary policies and, in the case of countries with excessive macroeconomic imbalances, to agree on plans for reform. In addition, these measures endeavour to make the system of sanctions more streamlined and automatic. Indeed, in principle, the Council is required to support the Commission's decision to impose a penalty on a defaulting member state

and may reject the decision only if a qualified majority of the states votes against it (reverse qualified majority).

### THE EVOLUTION OF ECONOMIC GOVERNANCE OUTSIDE THE EXISTING TREATIES: THE EUROPEAN STABILITY MECHANISM AND FISCAL COMPACT

The market, in the absence of a vigorous European policy for managing the current crisis, translated the persistent political and economic uncertainty into continuously rising interest rate spreads on government bonds issued by the most heavily indebted countries. As a result, the interest rates on these bonds reached levels far higher than those normally recorded by the bonds of financially struggling member states of existing federations. Pressured by the markets, the European governments were forced to put mechanisms in place to defend the euro, which they did in three stages, differentiated by the adoption of three different instruments, including two new treaties. In chronological order, on 9 May, 2010 the eurozone member states decided to establish, temporarily, the European Financial Stability Facility (EFSF), which can issue bonds or other debt instruments on the market in order to raise the funds needed to provide loans to euro area countries in financial difficulty, recapitalise banks or buy sovereign debt.<sup>3</sup> However, in a context of continuing financial instability it was immediately clear, since the EFSF was established only for a limited period — it is due to expire this year —, that the market would accept only measures designed to guarantee structural stability within the eurozone; therefore, the heads of state and government, less than six

months later, were forced to hurriedly take steps to set up a permanent financial crisis management mechanism, in place of the EFSF. Thus, the European Council of 28-29 October 2010 had to launch the Treaty establishing the European Stability Mechanism (ESM),<sup>4</sup> better known as the “bail-out fund”. In the meantime, during the European Council of 9 December 2011, 25 EU countries (the UK and the Czech Republic did not participate), acknowledging the British opposition to the adoption of measures for coordination of budgetary policies and for deficit and public debt reduction, alongside the Council, decided to adopt the so-called fiscal compact.<sup>5</sup>

Unfortunately, the press and the mass media in general tend to talk about Europe only when Europe is demanding sacrifices and not when it is advancing towards the achievement of institutions, like the ESM, that are capable of promoting active policies for the economic and financial governance of the eurozone. Cohn-Bendit, at odds with the French Socialist Party, which, had, at first, intended to vote against the ESM, remarked that this institution can be seen as the embryo of a future treasury,<sup>6</sup> albeit one limited to the eurozone countries. Not long afterwards, the IMF made a similar point.<sup>7</sup> Indeed, the ESM: 1) can borrow on the capital market: these loans — it matters little what name they are given — would be something along the lines of US treasury bonds; 2) it can use the resources it has to recapitalise (through the intermediary of loans to member states) banks and insurance companies that are in difficulty (following the signing of the Fiscal Compact and the creation of the banking union, it will, subject to a formal request for assistance from the ESM by a state in financial difficulties, be able to

contribute directly to the recapitalisation of financial institutions, adopting a policy comparable to the bailouts of AIG and Fannie Mae and Freddie Mac by the US Treasury); 3) it can use its resources to reduce the difficulties of the eurozone countries and in this sense would be providing something similar to US intergovernmental grants, although only in some respects, given that it would be providing loans and not subsidies; 4) it can purchase the bonds of struggling states, both on the primary and on the secondary market: in this case, it would even have more powers than Federal Reserve System, which cannot buy, on the primary market, bonds issued by states of the American federation; 5) finally, it is worth noting a major difference between the EMS and the EFSF: because of the different legal nature of these two institutions, their issuing of bonds on the European capital market would have a different impact in statistical terms. In the case of the EFSF, the debt would be allocated, pro rata, to participating states, thus increasing the size of the public debt of the eurozone. In the case of the EMS, on the other hand, it would be considered the debt of a "European institution" and would not therefore be allocated to the member states. The public debt incurred by the EMS would therefore be, to all intents and purposes, a European debt.<sup>8</sup>

As already mentioned, because of the inadequacy of the SGP as a means of enforcing fiscal discipline, the heads of state and government had to introduce additional rules that, lacking the agreement of all twenty-seven members, had to be approved in a separate Treaty, namely the Treaty on Stability, Coordination and Governance in the Economic and Monetary

Union, of which Title III is the Fiscal Compact. The aim of this Treaty is to reinforce fiscal discipline, especially in the eurozone countries, by further strengthening the SGP, already strengthened by the Six Pack and the Two Pack. The main new elements are the following: on the one hand, the balanced budget rule, which must be incorporated into the states' respective constitutions, and the automatic correction mechanism (to be based on a set of principles which the European Commission will propose), which must be transposed into national law; and, on the other, the strengthening of the excessive deficit procedure. The balanced budget criterion will be deemed met if the annual structural deficit is in line with the medium-term objectives, as defined in the SGP's preventive provisions, and does not exceed 0.5 per cent of GDP.<sup>9</sup> Every member state, in the event of another state violating the new rules, may call upon the Court of Justice to enforce the budget balance and correction mechanism rules. Furthermore, the Treaty does not include the obligation to reduce debt exceeding 60 per cent of GDP according to a numerical parameter, i.e. a mean annual rate of 5 per cent of accumulated debt. The other innovation introduced by the Treaty is the more efficient and automatic triggering of the procedure for remedying an excessive deficit. Indeed, the procedure, launched on the initiative of the Commission, can be blocked only if the eurozone members of the European Council, deciding by a qualified majority, vote against it. Finally, provision is made for further measures to improve coordination of national budgetary policies, and thus to promote the convergence and competitiveness of the European economies.<sup>10</sup> The Treaty's most

important innovation, however, is the rule on its entry into force. The Treaty will come into effect when twelve of the seventeen euro area members have ratified it, and thus on the basis of a qualified, not a unanimous, majority, which will be an absolute first in the European setting. Overall, these are significant measures that, as pointed out, are not found even in existing federations.<sup>11</sup> But this only makes their incorporation into the framework of a federal democracy even more urgent.

## THE LISBON TREATY - ALREADY OVERTAKEN BY EVENTS

The "reverse qualified majority" principle was introduced with a view to making the adoption of measures more streamlined and automatic, but, as pointed out by the ECB, the regulations provide for a procedure that sanctions excessive deficits, but not violations of the public debt rule.<sup>12</sup> Furthermore, in spite of the approval of the Six Pack and Two Pack rules, some weaknesses remain in the implementation of fiscal policy in the single member countries, namely: the greater complexity of the new, strengthened, structure of fiscal governance (which risks reducing its transparency and enforceability and, ultimately, its accountability); the clause on the many "exceptional circumstances" that can temper decisions on the presence of an excessive deficit or debt; a lack of automaticity in the identification of failures to comply with the enhanced SGP; the need for the necessary national political will in order to implement, effectively, sound fiscal policies; and the need for a real will, on the part of the Commission,

to establish the existence of excessive deficits and to act on requests for adoption of the necessary corrective measures.

Indeed, taking, for example, the measure that, more than all the others, really ought to encourage the member states to pursue virtuous policies — i.e. the system of sanctions —, it has to be noted, also in the light of the fact that the larger countries are the worst offenders,<sup>13</sup> that this stage in the procedure has never yet been reached. Here, we are referring not only to 2003, when France and Germany, having both exceeded the deficit ceiling of 3 per cent, agreed, with Italy's support, to loosen the constraints of the SGP, but also to the more recent approval of the 2014-2020 European financial framework. It has been suggested in the press that, on that occasion, Germany suggested that the excessive deficit procedure against France need not be initiated, providing France agreed to a reduction in its funding.<sup>14</sup> It is always worth remembering that what really matters in order to ensure that the financial rules are respected by the different levels of government is not so much the size of the penalty as its certainty (as is true in the prevention of wrongdoing generally). Indeed, the SGP is not working as it should precisely because this condition is lacking, and it is lacking for a very simple reason: the fact that art. 126, paragraph 11 of the Treaty on the Functioning of the European Union stipulates that it falls to the Council

to decide whether or not sanctions must be imposed on countries that do not respect the SGP constraints, in other words, to an institution in which the parties involved are represented. This is the only possible explanation of why Greece, for an entire decade, managed to lie about its financial situation, without being unmasked. The supposed incompetence of Commission officials, initially blamed when the true extent of the Greek public debt became public, actually had nothing to do with it; there is nothing the Commission can do in the face of a mechanism that objectively favours collusion between the countries of the euro area. If European economic governance, of which the SGP is an important part, is to work, the European institutional system must be based firmly on the principle of separation of powers and on their democratic legitimacy. Therefore, for example, the decision to impose fines should be entrusted to an institution that is above the states and independent of them, as the European Commission should be. In the absence of this distinction between the responsibilities of the various European institutions, the mechanism of checks and balances, which serves to guarantee the effectiveness of the rule of

law, simply cannot work.

Finally, there is also a more concrete aspect to be taken into account. As a consequence of the procedures laid down in the rules here considered, the period of time that elapses before the excessive deficit procedure, or procedure for excessive macroeconomic imbalances (around a year and a half), reaches the stage at which it might be decided to impose sanctions, and also the way in which the SGP really operates, it is actually the market, rather than the Council, that imposes sanctions first. What is more, the penalties envisaged (ranging from a minimum of 0.1 per cent to a maximum of 0.5 per cent of GDP) are actually relatively small compared with the additional cost to the national budget due to the size of the interest spreads inflicted, by the market, on countries not striving to achieve sound finances. Without Europe's intervention, Greece could have ended up paying much more than Germany does on its government bonds (as much as 20-25 per cent of GDP), while Italy's spread already stands, today, at around 2-3 per cent of GDP. ■

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## THE BENEFITS OF A EURO AREA BUDGET FUNDED BY OWN RESOURCES

The report entitled *Towards a Genuine Economic and Monetary Union*,<sup>15</sup> submitted by Herman Van Rompuy to the European Council of 28-29 June 2012, opened a debate on the prospect — welcomed by all the main European institutions — of equipping the eurozone with its own budget.<sup>16</sup> In particular, the European Parliament, on 20 November 2012, approved a resolution in which it denounced the limits of the inter-governmental method and argued that “a leap should be made towards a truly federal Europe.” Furthermore, having remarked that “the completion of a genuine EMU within the Union will require in the medium term a Treaty change to be completed”, it reserved the right to make proposals that would subsequently need to be examined by a new European Convention. In particular, with regard to the euro area, the Parliament pointed out that “under the existing Treaties the member states whose currency is the euro can finance an increased Union budget in the framework of the own resources procedure by introducing specific taxes or fees in accordance with an enhanced cooperation procedure.”<sup>17</sup> Instead, the European Commission, on 28 November 2012, presented a document entitled *A blueprint for a deep and genuine economic and monetary union - Launching a European Debate*<sup>18</sup> which also highlights the need for the eurozone to create its own, independent budget and reiterates a number of times that the Treaties have to be modified, proposing a series of measures and a timetable for implementing them. Finally, on 5 December, ahead of the European Council

meeting of 12-13 December 2012, the Presidents of the European Council, European Commission, Eurogroup and ECB presented their definitive report on economic and monetary union<sup>19</sup> The report, after recalling that the “history and experience of other currency unions shows that there are various ways of progressing towards a fiscal union and [that] the EMU’s unique features would justify a specific approach”, pointed out that “while the degree of centralisation of budgetary instruments and the arrangements for fiscal solidarity against adverse shocks differ, all other currency unions are endowed with a central fiscal capacity.” A new report by the same four Presidents is expected to be presented at the meeting of the European Council at the end of June, as requested by the European Council in December 2014 and will likely address similar proposals.

### THE KEY IMPORTANCE OF A EURO AREA BUDGET FINANCED BY OWN RESOURCES

The reasoning of those who advocate the creation of an adequate budget for the eurozone countries stems from the fact that the Maastricht Treaty has not proven effective in the face of the current major economic crisis. The Treaty envisaged that the eurozone countries would take advantage of normal economic times to keep their budgets practically balanced or in surplus, so as then to have sufficient resources to rely on during economic downturns. What actually happened, however, was

that many countries used the higher fiscal revenues generated in favourable economic phases to reduce taxes or spend more; as a result, in negative phases of the cycle, they found themselves with no choice but to pursue pro-cyclical policies, increasing taxes or cutting spending. But the present financial crisis, in the absence of a federal budget, has not even spared countries with sound public finances: Spain and Ireland both complied with the terms of the Treaty (recording, before the subprime crisis, a public debt/GDP ratio of 40 and 25 per cent, respectively), and yet their low public debt was not enough to protect them from the ferocity of the real estate crisis that overwhelmed them, and both eventually had to be bailed out by the European Union.

The debate has also drawn in research centres and European intellectuals. As a rule, their reflections start from the observation that the euro area is the first example, in history, of a centralised monetary union in which fiscal policy remains the sole responsibility of the member states. Given that it concerns a new institutional formula, it is inevitable that debate over how the future eurozone fiscal union should be structured will give rise to differences of opinion on the right model to pursue. However, the current debate has at least made it possible to highlight that the euro, to survive, needs a fiscal union and that in turn the fiscal union, to work, demands the meeting of a series of conditions, namely those indicated by a study that analysed the experience of five existing federations: Argentina, Brazil, Canada,

Germany and the USA.<sup>20</sup> The economist Michael Bordo and others have identified five conditions that, for the sake of clarity, are here listed in a slightly different order from that in which they were originally presented: 1) a degree of revenue and public expenditure for the member governments that reflects the preferences of their citizens; 2) the ability to learn from mistakes and adapt to changing economic and political circumstances; 3) credible commitment to a no-bailout rule; 4) the creation of a euro bond market guaranteed by taxes collected at supranational level; and 5) an efficient European system of transfers between member states designed to benefit countries subject to asymmetric shocks. If we consider the experience of the EU and, in particular, of the euro area countries, we can say that, looking at the considerable extent of public spending at national level, the first condition is undoubtedly met, whereas the second, since the explosion of the Greek debt crisis, has started to be met. Instead, in the framework of the current Treaties and as shown by the Greek situation, the condition of credible commitment to a no-bailout rule is not met, given that, contrary to what occurs in the existing federal systems, the eurozone, not having a federal budget to safeguard the economic and monetary union, cannot intervene to help a member state in difficulty without running the risk of triggering the collapse of the entire monetary union. If the eurozone decides to confirm the provisions of the existing Treaties, a credible commitment to the

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no-bailout rule will be possible only in the presence of a separate budget for the eurozone. An adequate budget for the eurozone countries is also the prerequisite for meeting the last two conditions listed above.

The second aspect of the debate over the question of a eurozone budget concerns the role of federal fiscal policy in avoiding excessive fluctuations in per-capita levels of income and consumption in the event of regional economic shocks. In this regard, some contributions have looked at the role played by risk-sharing mechanisms in smoothing the effects of these shocks on income levels; risk-sharing mechanisms can be divided into, on the one hand, public policies such as welfare and federal fiscal policy and, on the other, actions of the market, such as

portfolio choices, decisions on direct investments, access to the credit market and workforce migrations. A pioneering study focusing on the US federation in the period 1963-1990 found that "39 per cent of shocks to gross state product are smoothed by capital markets, 13 per cent are smoothed

by the federal government, and 23 per cent are smoothed by credit markets. The remaining 25 per cent are not smoothed."<sup>21</sup> Obviously, if market mechanisms and public policy instruments are to be able to work adequately, a number of conditions have to be in place, such as the presence of a stable and fully integrated continental financial market, the absence of balance of payments constraints,

and, above all, the existence of a federal budget. According to the risk-sharing model quoted above, almost two thirds of the shock are smoothed by the market, as opposed to less than a sixth by federal budget policy. However, what should really be highlighted here is not so much the entity of the role played by each of the three conditions just mentioned, as their relative importance and, above all, the importance of the related institutional aspects. A financial and monetary market that is fully integrated on a continental scale helps to smooth the negative effects on income levels of a regional shock far more than the budget laws of a single member country can. This means two things: on the one hand, that financial market integration and stability help to reduce the amount of public resources needed to smooth the impact of regional shocks on per-capita levels of income and consumption and, on the other, that the establishment of a eurozone budget that makes it possible to intervene to minimise the effects of an asymmetric shock is, for the market, a guarantee that the region experiencing a negative cycle does not risk having to leave the economic and monetary union. Therefore, the public leverage (government intervention) has a positive multiplicative effect far exceeding its size in absolute terms. What all this means, transferring the reasoning to the European setting, is that had the eurozone had a federal budget funded by European taxes, the cost of the public intervention necessary in the case of the Greek, Irish, Portuguese and Spanish crises would have been significantly lower than it actually was, and significantly lower also than the cost of these countries' spiralling national debts following the financial crisis. However, it is important not to draw the wrong conclusions from the above study, such as the idea that

the limited role of the federal budget in smoothing regional shocks makes achievement of financial stability a priority objective.<sup>22</sup> It is, after all, the use of the federal budget to counter regional shocks that makes it possible, in turn, to make the best use of the market mechanisms and minimise the mobilisation of public resources; in other words, it is the upstream political choices that enable optimal market functioning, not the other way round.

This is why support must urgently be thrown behind the creation of a eurozone budget, providing two conditions are met: the first is that this budget be additional to the current EU budget; and the second is that, once it has been incorporated into the current Treaties, it be subject to the provisions of the Treaty on Stability, Coordination and Governance in the Economic and Monetary Union, including the possibility for the euro area to reach a maximum structural deficit of 0.5 per cent of GDP, and thus to issue eurobonds worth around 50 billion euros a year. Needless to say the request for an additional budget and for the possibility of borrowing up to 0.5 per cent of GDP must go hand in hand with the recognition and establishment of a European power of taxation in order to guarantee the additional resources necessary to service the debt.

### WHAT SHOULD BE THE OBJECTIVES OF THE EUROZONE BUDGET?

Considering that the fundamental objective to be pursued is the establishment of a eurozone budget financed by own resources (taxes and borrowing), the question that must inevitably be asked is what objectives this budget should be given. To answer it,

it is necessary to distinguish between two options that are complementary to each other, but have different time frames. The first is to fund European public goods, such as a single foreign and security policy and the introduction of a sustainable development policy for the entire eurozone; the second is to introduce economic policies designed specifically to cope with asymmetric shocks and guarantee financial market integration and stability on a continental scale. A single European foreign and security policy is clearly necessary: one only has to think of the negative experience of the Balkan conflict or the more recent military intervention in Libya, the need to secure the safety of the Mediterranean and Middle East, and the need to make savings in times of scarce resources. That said, at European level the necessary will to move rapidly in this direction has yet to be demonstrated.

On the other hand, with regard to the promotion of a sustainable development policy for the entire euro area, the most suitable approach is to set up a "European Agency for Sustainable Development", which would have the task of promoting the transition from an economy based mainly on the accumulation of physical capital and the consumption of scarce resources, such as the land and, more generally, the environment, to an economy based mainly on knowledge and thus on the accumulation of human capital and on respect for the land and the environment. The Agency would thus work towards long-term objectives shared by the European Parliament and the national parliaments, and would have to enjoy broad guarantees of independence. The eurozone budget should start by earmarking the necessary resources.

However, the economic and financial crisis demands answers in the short term. To date, the objectives around which there is emerging broad consensus at the level of the European institutions (Parliament, Commission, European Council and ECB) are those of financial stability, the implementation of an income and employment stabilisation policy in the event of asymmetric shocks, and a policy of income support for the unemployed.

With regard to the financial stability objective, the incorporation of the ESM into the existing Treaties would, given the powers it has (e.g. to borrow on the capital market), represent a major step towards stabilisation of the European financial market and the issuing of eurobonds. Furthermore, its faculty to borrow on the market would also make it the institution that could be used to create the European Redemption Fund proposed by German economists as an instrument for reducing government debt in Europe,<sup>23</sup> and it is actually identical to the instrument created by Alexander Hamilton after he proposed that the US federal government should purchase the debts of the states.<sup>24</sup> The European Parliament has already expressed its support for this solution. Intervention of the ESM, incorporated into the Treaties, would therefore help to reduce the spread that, linked to the risk of having to leave the euro, is currently a major source of instability and a major cost factor for national public finances.

However, this, in isolation, would not be enough to end the crisis, because European public opinion would not take kindly to efforts exclusively targeting the financial system by many considered, rightly to a large extent, the cause of the current economic and financial crisis. It is necessary to

give a clear signal that the eurozone is a community of destiny within the broader European Union — a signal that can only be the promotion of a policy to support economic growth and employment. This is why a separate budget has to be created for the euro area, financed with its own resources (through taxes and borrowing). The document presented by the European Commission in 2012 may be taken as a starting point for reflection on this topic. The Commission's proposals took into account the requirements that were expressed by France and Germany as soon as the debate on a centralised budget for the eurozone got under way. France would like the budget to contain resources for the financing of an "unemployment fund", while Germany would be willing to grant countries in need only temporary aid, subject to the adoption of measures designed to boost the competitiveness of the beneficiary country's economic system.<sup>25</sup> The Commission document proposed two types of intervention: on the one hand, contractual arrangements, linked to the beneficiary country's undertaking to pursue, as just mentioned, greater competitiveness of its economic system. However, in the document, provision is also made for the activation of a stabilisation policy, in addition to the one promoted by the countries hit by an economic shock. The transfers of resources, which would have to be temporary

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to avoid giving rise to moral hazards, may, together with project bonds, be used in investment projects in the energy, environment, transport, and telecommunications sectors, for example. The other measure proposed by the Commission, which would have the advantage of strengthening support, in public opinion, for the European project, is that of paying contributions to the unemployed as a supplement to their state contributions, along the lines of what already happens in the American federal system.

### THE PROCEDURE FOR CREATING A EURO AREA BUDGET

The question of the procedure to be followed in order to create a separate budget for the eurozone has, in part, already been addressed both in the resolution adopted by the European Parliament, and in the document issued by the European Commission in late November 2012, which highlights two aspects of the eurozone budget problem. If provision must be made for a budget that is financed with its own fiscal resources, but must also be balanced, it would, in the view of the European Parliament and the Commission, be possible to go down the enhanced cooperation route,

remaining within the framework of the existing Treaties. This procedure, however, has its limitations: all it allows is

the establishment of a common tax, put in place at national level in the countries participating in enhanced cooperation — a tax whose proceeds could be assigned, in part or in whole, to the European budget; it does not allow the transfer of fiscal sovereignty to the European institutions, which, instead, would require an amendment of the current Treaties. According to the European Parliament and the Commission, a Treaty revision would also be necessary if the eurozone budget were to be financed by borrowing.

The resolution of the European Parliament, while it had the merit of quite correctly raising a problem that is very real, i.e. the need to establish a eurozone budget, was, at the same time, also very weak. It deferred the incorporation of the ESM Treaty and Fiscal Compact into the existing Treaty framework, even though an acceleration of this process would, in several ways, strengthen the euro area. As already mentioned, making the ESM part of the existing Treaty framework would imply recognition of the eurozone's power to issue eurobonds and, above all, would make it possible to overcome the problem of democratic legitimacy underlying the ESM. Incorporation of the Fiscal Compact, on the other hand, would introduce, into the Treaties, a principle not accepted at the time of the drafting of the Lisbon Treaty, but which is, instead, embraced by the Fiscal Compact, namely the principle that a treaty can come into force when a majority of the EU countries, in this case the members of the eurozone, have ratified it. On this basis, it can be argued that a future treaty should come into force on its ratification by a majority of the eurozone countries. However, the European Parliament should undertake

to submit, as soon as possible, a draft reform of the existing Treaties, explicitly indicating the need to give the eurozone a budget financed with its own fiscal and debt instruments and the need for the new treaty to come into effect following its ratification by the majority of the European states and citizens, thereby ensuring that the next European elections are true constituent elections. Such an initiative on the part of the European Parliament would be strengthened if, in the meantime, the eurozone countries were to enter into a “pre-constitutional”<sup>26</sup> agreement having the same objectives.

### WHAT INSTITUTIONAL STRUCTURE TO MANAGE THE EUROZONE BUDGET?

As regards the institutions that, within the current institutional framework, might, in the first instance, be called upon to supervise the management of the eurozone budget — additional to the EU budget —, it must be noted that the existing Treaties would need to be amended in order to allow for a separate vote on the two budgets: in the first case, the budget would be voted on by the European Parliament operating in restricted composition (i.e. only the part of the Parliament representing the countries of the

eurozone) and, in the second, by the European Parliament operating in its full composition. Should, instead, the eurozone budget, rather than being funded by own resources, result from a splitting of the revenue from a given tax (like the tax on financial transactions or the carbon tax) between European and national levels, it would be possible to proceed in accordance with the terms of article 13 of the Fiscal Compact, which states that “the European Parliament and the national Parliaments [...] will together determine the organisation [...] of a conference of representatives of the relevant committees of the European Parliament and representatives of the relevant committees of national Parliaments in order to discuss budgetary policies.” This “conference of representatives” would, however, have to have jurisdiction on revenue sharing and it would fall to the European Parliament, in the restricted composition of the eurozone countries, to decide on the budget policy to adopt.

The need for allocation of shared resources to be decided jointly by the European Parliament and national parliaments was highlighted over three decades ago by Mario Albertini.<sup>27</sup> The real issue, however, is to work out how the mechanism of a joint decision (let alone debate) by the two parliamentary levels might work in practice. An

indication in this regard is provided by the historical precedent of the Australian federation during the crisis of the 1930s, when it was agreed that only the federal government, on behalf of all the levels of the federation, should borrow on the capital market. The Loan Council, in which both state level and federal level were represented on an equal footing, was established to decide on debt policy and the allocation of the revenue derived from borrowing. In the event of equality of votes cast, the president of Loan Council had the deciding vote.<sup>28</sup> This solution could also work for the eurozone budget. The “conference of representatives” of the parliaments should be composed, in equal measure, of the European Parliament in the composition of the eurozone countries, and the parliaments of the eurozone countries. Both would be chaired by a president chosen jointly, for example the president of the Eurogroup. If the vote on resource allocation resulted in a tie, the president, i.e. the figure representing the common European interest, would have the casting vote. The vote on the division, between European and national level, of the revenue from the new tax on financial transactions, which would represent the first own resource of the additional eurozone budget, could be a first practical application of this mode of operation of the “conference”. ■

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### About DOMENICO MORO



*Domenico Moro is a member of the national board of the Movimento Federalista Europeo (MFE) and of the Federal Committee of the Union of European Federalists (UEF). He is a former director of the Altiero Spinelli Institute for Federalist Studies.*

### ABOUT THE UEF

*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.*

### CONTACT

#### **UEF European Secretariat**

Square de Meeus 25  
B - 1000 Brussels  
Tel: +32 (0)2 508 30 30  
Email: [contact@federalists.eu](mailto:contact@federalists.eu)