FUNDAMENTAL CONDITIONS FOR A FISCAL UNION

Since 2012 increasing attention has been devoted to the highest institutional level in order to reflect on a fiscal capacity for the euro-area. There seems to be growing awareness among EU institutions and Member States on the need for such an instrument although divergences remain concerning the functions, forms and funding of this new dedicated euro-area budget. The Chair, Harald Waiglein, opened the discussion noting that this exchange of views would focus on the fundamental conditions for a fiscal union, querying whether Europe is ready for this.

1. The EU needs a fiscal union

1.1. The definition of fiscal union

Alessandro Rivera highlighted the importance of a proper definition of 'fiscal union'. The term must be defined before a design can be produced. One definition of fiscal union would be a centralised pool of resources for managing shared policies by central institutions. Tuomas Saarenheimo agreed on the need to define fiscal union. The term is used with widely different meanings. Tuomas Saarenheimo felt the ESM is not part of a fiscal union; rather, it is an international organisation similar in nature to the IMF. This difference in view reflects the different ambitions for the role the ESM might play, rather than what it is today.

1.2. The process of fiscal union is underway

Alessandro Rivera suggested that the process of fiscal union has already started in Europe. It is not the case that Europe could establish an ideal fiscal union which did not exist previously and therefore reap a huge benefit. Fiscal union is already being built. European institutions are developed to tackle problems that emerge during the life of the Union. Europe has pooled resources from the beginning of the European Community. Risks have always been mutualised, which is necessary for a fiscal union. This mutualisation already exists in the ESM, the Single Resolution Fund and the common backstop. Europe already has centralised borrowing capacity in the balance of payments facility and the ESM. Additionally, discussions are underway at the Single Resolution Fund to expand further borrowing capacity.

1.3. Progress towards a fiscal union requires a strengthening of democratic accountability

Alessandro Rivera stressed that the benefits to be reaped by making progress towards fiscal union must be measured against the costs, acknowledging the need to manage sensitive technical, economic, legal and constitutional issues. Alessandro Rivera suggested that progress towards complete fiscal union would necessarily have to be accompanied by progress in terms of political union and increased accountability. Alessandro Rivera felt that this would happen in the very long run. Noting that many people are aware of the complex discussions between Italian parties and the President of the French Republic, Alessandro Rivera described how Emmanuel Macron and President Juncker both appeared in the Italian media recently. This is being done precisely because the two presidents, in one way or another, feel themselves accountable to the Italian and European electorate. The same thing could not have happened 15 years ago. As an economist, and not a lawyer, Alessandro Rivera felt this is a measure of accountability.

1.4. Towards a safe asset

Alessandro Rivera felt that the history of the European Union demonstrated the need to be pragmatic. Europe does not have everything it needs, but it is more important to assess Europe's progress towards its goals. This can be measured on the basis of two variables: the amount of resources available at the central level and the institutions that are created to manage these resources. Europe has institutions which can be developed to help reach this objective, but the process needs more resources and additional institutions, i.e. a different borrowing capacity arranged towards a proper safe asset at the European level. Tuomas Saarenheimo suggested that the discussion on safe assets is 'too clever'. In federations, federal bonds are the safe asset. If Europe seeks to create a safe asset, it should build on federal bonds. The alternatives being debated contain highly uncertain risks. There is a reason these safe assets do not exist elsewhere.

2. A fiscal union would not complete EMU

2.1. A fiscal union would not stabilise the monetary union

Tuomas Saarenheimo felt there are many reasons to have a fiscal union in Europe, but the stabilisation of the monetary union is not one of them. There are endless opportunities for the Union to spend common resources more effectively than using the current process of spending individually at the national level. 1% of GDP is not the optimum level of resource for Europe. It needs a distribution of the provision of public goods between the federal level and the state level.

2.2. A fiscal union could add new fragilities to the monetary union: fiscal integration would indeed shift responsibilities from national elected bodies to the hands of European non-elected bodies, thus narrowing the scope of democratic decision-making

Tuomas Saarenheimo suggested that a fiscal union which is part of a European monetary union would have two key features. First, there would be a common pot of money which would be collected and distributed to member states for the purposes of convergence, competiveness, perhaps investment and at some point, in time perhaps stabilisation, although this is not "on the cards" currently. Second, there would be increased central control over national fiscal policies. This is different from what exists in any federation, and it is different from what the EU has done previously. The monetary union follows the same monetary policy for the entire EU. The Banking Union is the single regulatory framework for the whole union. Europe is seeking to build a capital markets union. There is also a customs union. The common factor in each of these projects is a single policy for the Union. Fiscal union is completely different, however. It entails tailored policies for the 19 eurozone countries, and they are decided at the centre. This is a recipe for trouble. It has the potential to become a serious political liability. It breaks down the accountability structures in national political systems. However, Tuomas Saarenheimo noted that some countries might appreciate outside intervention if they do not trust their domestic political system. These countries might prefer to delegate decisions to an external body. In any case, this would undeniably reduce the democratic nature of economic policy making. Tuomas Saarenheimo agreed with Alessandro Rivera's point about how this links the issue of fiscal union to political union. There will never be fiscal union unless Europe manages to proceed with political union.

Harald Waiglein understood that Tuomas Saarenheimo's point is more about governance and queried whether, as Robert Mundell had said in 1961, "in an optimal currency area some sort of budgetary risk-sharing mechanism is necessary even if this cannot be achieved in the current political system".

2.3. The significance of fiscal integration for the stability of EMU is not obvious

Tuomas Saarenheimo felt the role of the fiscal budget in the matter of stability is overstated. A reasonable amount of research has been conducted on this in a variety of countries. The role of a central fiscal budget in stabilising asymmetric shocks at the state level is very small. There are countercyclical elements in the United States such as Medicare, Medicaid and food stamps, but the procyclical elements on the expenditure side counteract this, meaning that the net effect is zero. The only reliable stabilisation comes from taxation, which is very small. The United States' expansionary budget of 2009/10 is a relevant example here. Data shows that the expansion went more to the states which were better off, and not to the states which were worse off.

Alessandro Rivera did not agree completely with Tuomas Saarenheimo's comments. There are many analyses of the degree to which a centralised federal budget contributes to the impact of asymmetric shocks in federations. Whatever the degree of impact, it complements another important feature of the US system, which is the capacity of the private sector to deal with transfer flows between states. This does not happen to a satisfactory extent in Europe. Europe must continue the work on a Banking Union and a capital markets union. Currently during periods of crisis there is a tendency for the private sector to withdraw its support rather than be countercyclical. Something is needed at the central level to enhance the performance of the monetary union. There are also several structural issues which must be addressed. Alessandro Rivera felt it would be useful to provide a simplified view of how dynamics could develop within a monetary union. When there are competitiveness gaps, there are countries with structural commercial surpluses and countries which become less competitive and accumulate commercial deficits. The first country accumulates financial assets; the second one accumulates financial liabilities. This contributes to increasing the spread and the difference in the cost of funding.

Alessandro Rivera queried how this could be managed, wondering whether it could be managed through fiscal discipline or an agenda of structural reforms, which would apply to both the least and most competitive countries. This leaves downward salary adjustment as an adjustment mechanism for the least competitive countries. Alessandro Rivera suggested that this model would be suboptimal, because it would systematically lead to suboptimal public investment. Additionally, it is dangerous because it facilitates crisis inside and outside the monetary union. It does this internally due to the creation of gaps that may become unmanageable and externally by making the monetary union heavily dependent on trade and external demand. To address this, Europe needs a centralised tool that can contribute significantly to reducing gaps and boosting convergence by facilitating structural reforms for countries with competiveness gaps and investments to fill these gaps.