Towards a fiscal federation?

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At last! The black hole in European debate that has been ongoing for the last two decades, the problem of the common budget, is back in the limelight and on the agenda of the European Council. The debt crisis has contributed to this immensely.

The last time the heads of State and government held a real debate on the budget dates back to … 1984, during the European Council of Fontainebleau! On that day François Mitterrand, Helmut Kohl and Margaret Thatcher decided on the main amounts and means of financing the budget of the "Single European Area", which could potentially rise up to 1.24% of the Community's GDP. Since then the European Council is supposed to update this mechanism every seven years by adopting a new annual general budgetary framework for the Union. But in the meantime an insidious phenomenon has occured – own resources which fed this budget have slowly dried up, whilst national contributions that were supposed to serve simply as top-ups, now fund nearly 80% of the revenues. Hence, for the last twenty years, whenever they have discussed the common budget the heads of State and government have left Europe out. Everyone has focused on the way to maximise the money his country can get from the Union and to minimise his own contribution to the family budget. A formidable gap has thus been created between the countries which receive more than they give, the net beneficiaries and the others, the net contributors, those who systematically have the last word "he who pays the piper, calls the tune". The result of this is that more than 25 years after Fontainebleau, in spite of the two-fold rise in the number of Member States the Community budget has remained frozen at 1% of the GDP, i.e. well below the level that even Mrs Thatcher found acceptable! It is globally twenty times less than the national budgets.

The next seven-year budgetary period covers 2014-2020. Might we hope that this time the crisis will help the main leaders to place the question on the level it deserves: what kind of European budget do we need for the rest of the decade? How big should it be? How should it be financed? What should it be devoted to?

To avoid frightening the net contributor countries, José Manuel Barroso simply put forward marginal adjustments: the budget would be brought up to 1.08% of the GDP by 2020, without even challenging the level of the agricultural appropriations, nor those of the cohesion policy – which alone take up 80% of the total. But even this symbolic increase was the cause of an immediate outcry – not only in London but also in Berlin, The Hague and all the Scandinavian countries, and, unfortunately, Paris believes that the right Europe is the one which spends less.

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An approach revived by the crisis

Triggered off during the autumn of 2008 by the bankruptcy of Lehman Brothers, the thing we still call a "crisis", without being able to name it exactly, occurred mainly in Europe, then in the eurozone, then in two European countries, which were the most badly managed. Entering the 2009 world recession in debt already, some States are now the focus of banking suspensions. They can only recover with the help of their more fortunate European partners.

It has taken three years to shape how this help is to be provided. Steered by the European Council, the decision-making process proved to be particularly chaotic. But painfully and in spite of the contradictions, faux-pas and back-peddling, a true European model of solidarity has started to emerge. One might compare it to the treatment of a sick athlete.

The first stage of the operation comprised the ambulance service. The heart-attack victim was brought back to life at home with mouth-to-mouth resuscitation by the emergency service – this was the role of the ECB, which finally accepted to play the game.

The second stage involved the patient being taken to hospital. He was put under permanent monitoring and, if necessary, equipped with an intravenous drip. But he had to accept the diet imposed on him and also to take his medicine – this was the fiscal golden rule. Then the so-called European Stability Mechanism (ESM), which provided vital nutritional extras, entered into play. It could devote up to 700 billion € to it. One might note by the way that this amount is four and a half times more than the Community budget!

The stay in hospital might be long, but it is not supposed to go on forever. The third stage will be returning to normal life, once the patient has recovered and can start eating and living normally again.

But once this has been achieved – further work has to be undertaken. In an era of exacerbated world competition, Europe can be considered as an athlete who absolutely has to achieve maximum fitness if it is to compete, on an equal footing, in the merciless battle with its tremendous American, Chinese, India, Brazilian rivals, which have out-distanced it during its absence from the race. High-level training, muscle-building, a champion's diet – these are the goals of the future competitiveness and investment policies which are summarised in the "Europe 2020" programme.

And this is where the budget comes in, since rescue loans to reimburse old debts will not be enough. Financing research, new technologies, major continental networks, renewable energies cannot do without a real European-scale fiscal effort. In these areas efficiency demands a critical mass that can only be found on a continental level. Moreover the convalescent countries will not be able to provide themselves with an investment budget beyond the partial co-financing of the Community programmes for a long time. And so who will finance what and in which context?

The crux of the matter: who will be the tax payer of last resort?

Curiously enough for the last three years this purely fiscal dimension has systematically been left out of the projects meant to strengthen the EU and the eurozone. But it is constantly in the back of the minds of the leaders and public opinion of the countries in the North of Europe who are being called upon to help Southern Europe. Because lurking behind the experts' debates over the bank of last resort is the fundamental political question – if the loans granted to the indebted States are not paid back, who will be the tax payer of last resort? This is how we should now regard the question of European solidarity.

There are three possible answers to this question:

1 – First option – no one. There is no tax payer of last resort apart from the one in the struggling country. Hence, no default on the part of a debtor State towards the ESM

or any other creditor will be tolerated. This means that the beneficiaries are bound by exceptionally tough conditions. And this transfers all of the animosity over the consolidation policy over to Europe. This was the stance adopted for a long time vis-à-vis Greece. We have seen how unrealistic it is.

2 – The second option is that the tax payers in the countries of "ants", are the only ones, beyond all appearances, who can guarantee the Fund. This is the solution implicitly retained at present. But it is unacceptable to the electorates in the donor States, whilst the conditions set by the "ants" in exchange for their aid are also becoming intolerable for the public opinion in the "cicada" countries. With this option, a formidable infernal machine has been set in motion that might rekindle all of the worst nationalist resentment and prejudice in Europe. In the North it has made the electoral fortune of the populist, xenophobic parties, from Anvers, to Helsinki, Vienna to The Hague. Whilst in the South demonstrations of anger are rising during which effigies of German Chancellor Merkel are burned in the streets of Athens, Madrid, Barcelona and Lisbon. This is an unsustainable situation.

3 – Hence the third option, whereby the tax payer of last resort can only be the European tax payer. It is the only truly European solution. It is also the only one compatible with a democratic decision-making process and under parliamentary supervision worthy of the name. Therefore, we have to come up with new fiscal resources, levied across Europe in replacement of the national contributions and to have all European citizens assuming the commitments made in the Union directly. Whether this means guaranteeing loans made to struggling countries or especially financing future investments decided upon together.

This does not require a new treaty, but we simply have to adhere to the Lisbon Treaty to the letter: the principle is clearly set out that the Union's financial commitments must be financed by own resources affected to the Union. And this does not imply any transfer of fiscal sovereignty. The European Union must simply be considered as a territorial authority, which will be of a certain geographical size, bigger than each of the States which it comprises, but with fiscal resources delegated by the latter.

This is because the European Parliament has made it a specific condition in the negotiations over the next financial framework that the Commission has tabled, the proposals for which are now ongoing – the tax on financial transactions and a new VAT resource. One might naturally think of others, notably in the area of pollutant energies.

A false route: more budgets for less money

The autumn of 2012 witnessed a wealth of the most different ideas on how to complete monetary union thanks to financial solidarity that went beyond lending mechanisms merging all or in part with sovereign debts, a European Treasury issuing short term bonds, common redemption funds for banks in distress, a European guarantee fund for bank deposits, etc. The most spectacular was the proposal for a budget for the eurozone. Inspired by Berlin, it gave rise to eloquent one-upmanship on either side of the Rhine. On the right bank the idea was to help the struggling countries which were courageous enough to honour their roadmap by funding investments that they were no longer able to assume. On the left bank the idea was nothing less than "compensating asymmetric shocks" and pooling unemployment insurance schemes! They both wanted to take an additional step towards European integration. Which federalist would not support that?

But can you believe it? The players' basic logic has not changed – each one hopes to find the means to be generous ... with someone else's money! This is why the idea of providing the eurozone with its own budget has to be gauged against the answers given to four questions.

– Are we talking about a real budget or a new type of bank fund? Lending more to countries which are already in debt would be going over the top. Helping them to take advantage of a true budgetary transfer immediately points us towards the next question.

– Where would the money come from? Who is ready to pay and how much? The German leaders who support this idea endorse all of Ms Thatcher's arguments against any increase in the Union's budget. They are violently against the increase that was timidly put forward by the Commission of less than 1/1000 of the GDP by 2020! And they refuse to provide any new "own resource". 2013 is an electoral year in Germany and public opinion is extremely tired of the aid being given to our Southern partners. It is clear that the present European lyricism is not a bid to announce any additional facility but to compensate for its absence.

– Which type of spending would be covered? Aid to the poorest? Again Germany and its Northern neighbours have gone as far as referring to the Court of Justice to put an end to the only social spending financed by the Union, i.e. food aid to the most vulnerable. And what about vocational training aid to people who have been laid off? The Globalisation Adjustment Fund was created with this in mind and it is operating at full capacity – the means simply have to be increased. And what about competitiveness investments? This would mean re-inventing the structural funds and the framework research programme.

– And finally which countries would be involved? Only the eurozone members? This idea is now outmoded: a year ago, President Sarkozy, a firm defender of the organisation of an independent eurozone, had to accept including eight non-euro countries to the fiscal compact, since they absolutely wanted to remain at the core of Europe. This desire can but grow, because their national currencies already depend entirely on the euro, and their economies are totally linked to ours.

It made sense to imagine having an independent body in the euro countries fifteen years ago when we thought there would only be about half a dozen members. In 2013, the opposite problem has arisen. From now on "useful Europe" must not be seen as the "eurozone plus" but as the European Union "minus": minus our partners who do not want to go further, and who even want to go backwards. Article 50 of the Lisbon Treaty – the divorce clause – was designed for this. And the British Prime Minister has announced that he intends to submit the question of confidence to his fellow countrymen at the next general election in two years time.

Conclusion: the fiscal dimension of European solidarity will not emerge via new institutions, new treaties or new budgets but via the adjustment and adaptation of the good old Community budget.

In support of European budgetary solidarity

The crisis has provided an opportunity for audacious reform but unfortunately this does not entail public generosity beyond our national borders. On the contrary, the Flemish, the Scots, the Basques, the Catalans, the Lombards would even like to reduce the geographical framework by stepping away from national solidarity. Whether there are 17, 25 or 27 States, a budget that is worthy of being called "federal" remains out of reach. However a true qualitative leap might be achieved if the financial pillar of the solidarity model, which has been emerging over the last two years, is completed with a three-part budgetary pillar:

1 – The adaptation of the Community budget to the requirements demanded by the 21st century – from the point of view of resources: the financial transactions tax and/or the carbon tax to replace customs rights – and also from the point of view of spending – new technologies, the major continental networks, university exchanges, more excellence hubs, whilst intelligent decentralisation would transfer a share of traditional

policy, for which the European dimension is no longer pertinent, over to the national or regional levels.

2 – The creation of an investment fund that would complete the budget appropriations to finance long term projects with deferred profitability. Many solutions are possible to supply the fund – the pooling of future project bonds, the re-allocation of the loan repayments granted by the ESM or of its financial products, the pooling of national loans designed to finance future investments etc. A fund like this would aim to become the investment budget which the Union does not have right now. It would be a realistic translation of the idea that was clumsily launched under the name of the "eurozone budget".

3 – Finally, the introduction of fiscal coordination between the Member States that is not just limited to the respect of safeguards, but which focuses on the very content of economic and fiscal policy. If we make a musical comparison we would just have to check that each musician in the European orchestra does not play out of tune; the scores have to lead to a harmonious symphony, i.e. maximising healthy, sustainable growth for the entire Union. With the debt crisis we must not forget that the most serious problem in Europe is that of the pernicious anaemia of growth. Instead of constantly putting forward other treaties, other sanctions, other disciplines, it is time for the major leaders to discuss the content of their respective policies.

And so a new question arises then. If it seems that one Member State has a policy that is too selfish, we have to convince it to show greater cooperation towards its partners, who *will be the decision maker of last resort?* Shhhh! You'll find out in the next edition of the Schuman Report!