A Federal Budget for the Eurozone: the Böge-Berès Proposal

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Back to basics

A common market and a single currency are typical features of all political federations. A common market without a monetary union is dysfunctional: inter-state trade is more cumbersome, while competitive currency devaluations could be used to cheapen the goods and services of one Member State of the common market vis-à-vis all other partners. In the case of Europe, the establishment of a common market endowed with a supranational currency can be traced back to the Ventotene Manifesto of 1941, though it is explicitly proposed in its 1943 preface written by Eugenio Colorni. Thus the euro is in origin a federalist idea, because sharing a single currency is a typical attribute of political federations.

However, the setting up of a monetary union also requires a fiscal union. Indeed, a monetary union means that countries give up monetary policy, and thus the only remaining tool to fight economic recessions is fiscal policy (reforms of product and labor markets directed at boosting competitiveness, productivity and long term economic growth are by definition deflationary and should not be implemented during economic downturns). Without control of monetary policy, countries cannot devalue the currency in order to boost exports, nor lower interest rates to encourage spending and investment. Finally, national governments will not be able to use their national central banks in order to buy up and monetize the public debt incurred in financing countercyclical fiscal policies during the recession.

Instead, Germany believed that in the context of a monetary union the recourse to national fiscal policies should be strictly limited, in order to provide credibility and stability to the common currency. In short, without a strong fiscal power at the European or Eurozone level available to deploy countercyclical economic policies in favor of those in need, participating countries would be left with little room to deal with asymmetric economic crises (those affecting some but not all Member States).

In May 2010, the theoretical scenario predicted by this analysis became true: the unsustainability of a currency union in which national governments lack either monetary or fiscal tools to stabilize the economy, while there is no federal “spender of last resort” (a larger, countercyclical EU or Eurozone budget). Furthermore, the problems of financial instability and economic depression were deepened by a European Central Bank that did not actively intervene in support of the Euro until the summer of 2012, two full years after the start of the Greek debt crisis.

The response of the Member States was to set up an intergovernmental body, the European Stability Mechanism (ESM), endowed with 750 billion euros to lend to countries unable to finance themselves in capital markets. The ESM is not accountable to the European Parliament. In any event, it is important to bear in mind that both the single currency and a proper EU or Eurozone budget are not only two sides of the same coin from the economic point of view, they are also political objectives.
This was clearly the case at the time of the Maastricht Treaty, when the launching of the Euro was agreed. Now, the same goes for the demand for a larger EU budget or the setting up of a Euro area fiscal capacity, particularly if they are endowed with real own resources that strengthen the European polity vis-à-vis the Member States.

The European Parliament’s position: the Böge-Berès Draft Report

The crisis has shown the problems of an incomplete economic union, so the debate about the setting up of a Eurozone fiscal capacity is back, even though already in the 1970s the McDougall report called for a community budget of 5-7 per cent of GDP in order to deal with economic shocks. More recently, the 5 Presidents Report of 22 June 2015 called for the establishment of this fiscal facility.

Currently the European Parliament is working on a non-legislative report stating its position on the matter, led by two MEPs, Reimer Böge from the EPP and Pervenche Berès from S&D. The amendments to the report will be voted on 26 September 2016 at the committee level. The Parliament can only hope that the Member States will take on board its position. The draft report by Böge and Berès acknowledges the contradictions of the current Economic and Monetary Union, with the lack of fiscal instruments and the impossibility to resort to exchange rate adjustments in order to improve short-term competitiveness (p. 5). It stresses as well that, as a result, the anti-crisis policy has been left mainly in the hands of the European Central Bank (p. 6).

It also points out that at least until the establishment of the European Financial Stability Mechanism (EFSM), and the ESM, the Euro area countries lacked financial support, while non-euro countries were able to benefit from the Balance-of-Payments mechanism (p. 4). In addition, the ESM lacks “democratic oversight and parliamentary control” (p. 6). Moreover, it is said that “a shock absorption capacity at euro area level (...) is needed to ensure the sustainability of the euro (...) and to restore the trust of citizens and markets” (p. 6). As for the guiding principles of the fiscal capacity, the draft report considers that it should be conditional on achieving policy goals and reforms, additional to existing EU funding instruments, endowed with “sufficient resources”, and on avoiding “permanent transfers” (p. 7). This means that fiscal capacity cannot be used to tackle structural unemployment.

Regarding the objectives of the proposed Eurozone budget, the draft report proposes three pillars: the financing of structural reforms and economic convergence, the absorption of asymmetric shocks, and the absorption of symmetric shocks (p. 7). The absorption mechanism would adopt the shape of a “Rainy Day Fund”, based on national contributions, and/or a European Unemployment Benefit Scheme. The Rainy Day Fund will make “payments to all Member States suffering from economic downturns”.

In order to achieve these three goals, the draft report proposes to set up a Eurozone treasury in charge of managing the “budgetary capacity for the euro area”, which will be headed by a Vice President of the Commission and President of the Eurogroup. The Eurozone treasury should be fully accountable to the European Parliament (p. 10).

At the same time, the ESM must be transformed into a “European Monetary Fund”, with a mandate to fund the Euro area fiscal capacity, while it is “integrated into the Union’s legal framework” (pp. 7 and 8). This new “EMF should be managed by the Commission and held democratically accountable to the European Parliament”. The EFSM and the Balance-of-Payments facility should be merged into the EMF (p. 8). Finally, the EMF should increase its resources through “the issuance of equities via
a rise in guarantees” (p. 10).
A five-year period is envisaged to set up the EMF, during which Member States would have to implement a “convergence code” in the field of taxation (corporate tax), labour market (including minimum wages) and investment in research (p. 10).
Finally, the Euro area fiscal capacity should act “as a fiscal backstop for the Banking Union”, meaning that it could provide additional resources for the recapitalization and liquidation of Eurozone banks (p. 10).

**Critique of the Böge-Berès Draft Report**
The draft report puts forward a good analysis of what went wrong with the current Eurozone framework, while proposing interesting ideas regarding the tasks of the fiscal capacity (the three pillars) and the transformation of the ESM into the EMF.
However, in its current version, the draft report incurs in inconsistencies and contradictions, while it fails to spell out important technical and political details. Hopefully, a better paper will come out after the approval of the amendments in September of 2016.
First of all, the proposed EMF should logically hang from the Eurozone treasury, but this is not said, at least explicitly. Also, if there is a Treasury, then it should be able to collect taxes and other resources, and issue debt, but nothing on this is mentioned.
Secondly, if the EMF is to be managed by the Commission and be accountable to the European Parliament, then the Member States can hardly remain the ESM shareholders, unless they accept to play a passive role. Alternatively, the Commission can become the sole ESM shareholder, but the draft report also says that “no financial liability will be incurred by the two countries with opt-outs from the EMU in the framework of any fiscal capacity for the euro area” (p. 4). So, in this case a compensation mechanism will have to be put in place, at least for Denmark (assuming Brexit goes forward).
Thirdly, two funding mechanisms are envisaged, the EMF itself, and national contributions for the Rainy Day Fund. The EMF, if it works along the same line as the ESM, will borrow from capital markets in order to lend at better rates to needy Member States. So, this is a financial, not a fiscal capacity. It seems then that Member States will have to repay the loans, which is not much of an improvement with regard to the current ESM.
As for the Rainy Day Fund, relying on national contributions is not a particularly good idea. The draft report itself acknowledges that the current EU budget is made up mainly of Member States contributions, by saying in quite stark terms that “contrary to budgetary arrangements in all other federations, the EU budget is dependent on contributions from Member State level to EU level”.
This system reinforces the negative-net-balance debate (how much goes into the budget and how much returns to the Member State), while it introduces a deflationary bias in the EU’s spending since national capitals try to minimize their contributions.
So, what the draft report is missing is precisely the definition of the fiscal funding sources of the Eurozone budget capacity. If the budget only relies on national contributions and lending from the ESM/EMF, then it is not by definition a fiscal capacity, at least from the revenue side, and only partially from the spending side. In other words, there is no credible Eurozone treasury without the ability to tax and issue debt. Also, it is not possible generally to issue debt without the ability to collect taxes, since the attractiveness of sovereign debt for investors is precisely that the states can use tax proceeds to pay back. The only alternative is once again to increase national contributions to the ESM, which indeed borrows from the financial markets, but, as said above, in order to lend
to Euro area Member States. Thus, the Eurozone fiscal capacity should be endowed with new own resources of the fiscal type. For instance, the New Deal 4 Europe campaign has advocated since 2012 an additional European investment plan financed by newly-issued bonds and backed by supranational taxes. In particular, this civil society movement led by several UEF national sections and backed by trade unions and other non-profit organizations, proposed to use the Financial Transaction Tax (FTT), and a CO₂ tax. In addition, it can also be considered, as possible new fiscal resources, a share of the Common Consolidated Corporate Tax Base (whenever it is agreed in the Council), a share of the Value Added Tax (VAT) base, and an air travel tax. In addition, as is the case with the U.S. Treasury, the profits from the ECB should also accrue to the proposed Eurozone treasury (in average, this amounts to 1 billion euros per year).

The FTT is currently a strengthened cooperation of 10 Member States, so not all Eurozone countries are included. The Council has yet to agree to its implementation. National authorities will be in charge of collecting the tax, which in a way makes it akin to a national contribution. It is worthwhile remembering that the European Coal and Steel Community, back in 1951, already introduced the first (and so far only) supranational European tax on the production of these two commodities, which was paid directly by companies to a bank account held by the High Authority. The same system is possible with the FTT; in fact, it will be even easier, given the current technology. The original FTT proposal would have raised 30 billion euros per year (the Council may exclude derivatives and other financial products from the scope of the FTT).

The “European VAT” proposal goes back to the McDougall Report of 1977. The Barroso Commission proposed a version of this idea at the beginning of the crisis, as a new own resource for the EU budget, but the Council did not even consider it. This share of the VAT base could have raised annually around 40 billion euros at the EU-level, with just 1 per cent of VAT receipts coming from the basket of goods and services, with no national exemptions. Similarly, the air travel tax for trips outside the EU was briefly considered by the Commission and shelved in order to prioritize work on the FTT.

In conclusion, we European federalists have a lot of pushing to do in order to secure a proper Eurozone budget, the next big political step in completing the Economic and Monetary Union in a federal direction.

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1 A previous version of this paper was presented on Tuesday the 30th of August 2016 at the 33rd International Seminar on Federalism, FEDERALISM IN EUROPE AND THE WORLD, From the monetary union to the United States of Europe, held in the island of Ventotene (Italy).
3 See http://www.newdeal4europe.eu/en/