Which Fiscal Union should be optimal for Europe?

December 2015

Policy paper requested by MEP Ernest Maragall i Mira

Policy paper

Which Fiscal Union should be optimal for Europe?

This paper is the result of the debates celebrated from September to November 2015 by the working group on fiscal union promoted by the FCE, aiming to share the EU debate in Catalonia and to provide arguments for the Greens in the EP.

MEP Ernest Maragall,
member of the Greens/EFA group,
has supervised the works

December 2015

Policy paper requested by MEP Ernest Maragall i Mira

Index

1. Executive summary
2. The monetary union
3. EU aggregate demand
4. MS' Fiscal policies
5. EU budget and tools
6. Fiscal union: for what?
7. New balance of competences
8. Conclusions

Authors of the report&FCE Policy briefings

1. Executive summary

A common currency area supposes a full open field where the efforts made in one place can see the benefits in another place; therefore, reduce instead of increase public investment can be seen by some national governments as the winning strategy. And a loss for all strategy if the investment reduction is generalised, as it is presently the case in the EU.

Similarly, by the income side, lowering taxes can attract more companies and increase fiscal incomes in a given country by reducing others' incomes, as we've seen in the recent years with low tax strategies in, among others, Ireland or Luxemburg.

Fiscal sovereignty in a common currency can easily be a race-to-the-bottom, both from the incomes and the expense side. Therefore, the main reason to push for a fiscal union is to overcome the present fiscal theoretical coordination and its incentives to free-riding and to push for a demand driven sustained growth.

From 1945 to 1999, European devaluation of currencies was so frequent that it was almost impossible to set up a single European market. As those devaluations were the result of different inflation paths coming from different monetary policies, the establishment of a common currency managed by a European Central Bank could create a common path that would facilitate the single market expansion. Member States (MS) should retain the rest of economic policies, mainly the fiscal one.

How worked this policies' sharing between the EU and the MS? During the first seven years of the euro period, it went apparently well and growth was high all over the EU. Nevertheless, behind that growth there were important imbalances, external deficits and surpluses that, accumulated, supposed a big bubble of credit and debts. The tendencies and the structural differences among countries forcing currency devaluation previous to the euro were still alive, and now were fed by a unique interest rate that was too low in countries with high inflation.

The financial crisis started in the US made the EU creditors aware of their high risks in countries where the bubble had hidden investments with uncertain return; and as a result, the European bank system almost collapsed. A heavy bail-out process of indebted countries took place and, as a consequence, their public debt sky raped and appeared a new crisis on sovereign debt.

Fiscal consolidation and austerity policies applied since then have certainly reduced the external deficits of bail-out countries, but have also increased the UE external surplus and have left Europe under a horrid lack of internal aggregate demand, a very low growth and a very high unemployment.

Increase job and growths is therefore the present official priority. To get it, the ECB is following an ultra-expansive monetary policy (QE) and the Juncker Commission has put in place the European Fund for Strategic Investment. But if these measures work well and we go back to "business as usual" prior to the crisis, the imbalances will appear again.

Could a Fiscal Union help to solve both problems, the lack of aggregate demand as well as the regional disparities?

A simple vision would say that given the non homogeneity of countries, it is necessary to establish fiscal transferences between the more and the less developed countries; fiscal transfers that could be done with automatic stabilizers as unemployment subsidy.

However, stabilizers are thought for solving temporary problems, not for structural problems. If this is the case, the stabilizers can evolve into permanent fiscal transferences that frozen the disparities instead of solving them. On top, with such transferences' scheme the net receiver is alleviated but condemned also to its underdevelopment, making useless the net payers' effort.

The fiscal union must therefore be thought in a different way. Its capacity to be applied differently in different parts, a characteristic that the monetary policy have not, allows supply and demand measures at the same time: to push the supply where there are excess of demand and, conversely, to push the demand where is weak.

Looking at the past, when the crisis started, it seems quite clear that instead of austerity all over Europe it would have been better an asymmetric programme to push the internal demand in the surplus countries and to reduce the excess of demand in the deficit countries.

The fiscal union must therefore tackle simultaneously the lack of aggregate demand, the regional disparities and the social inequalities. Nothing else! But how to convince the MS's for a greater EU integration and a greater sovereignty cession?

It's quite clear that any policy demanding cross-border transferences, even if they are temporary, can't be done just by "coordinating" fiscal policies. Therefore, it's necessary a greater European budget, feed with real own resources better than with states' contributions and applied directly by the central EU government rather than sharing resources amongst countries.

The first difficulty is the scope of the fiscal and political integration. It's clearly necessary in the Eurozone but not so much for the EU as a whole. However, a deeper Eurozone integration means a two euro-speeds, something until now rejected.

The second difficulty is the MS's resistance to accept a wider sovereignty cession. But there is any real fiscal sovereignty inside the Eurozone? In the present conditions, only exist to reduce taxes and public expenses. If taxes are increased, capital and profits flow to low taxes constituencies; if expenses increase, its positive effects flow to third countries and nobody is therefore interested in.

By the side of the own resources needed, EU direct incomes could be the financial transaction tax, some eco taxes and the corporate tax for multinationals operating the whole EU.

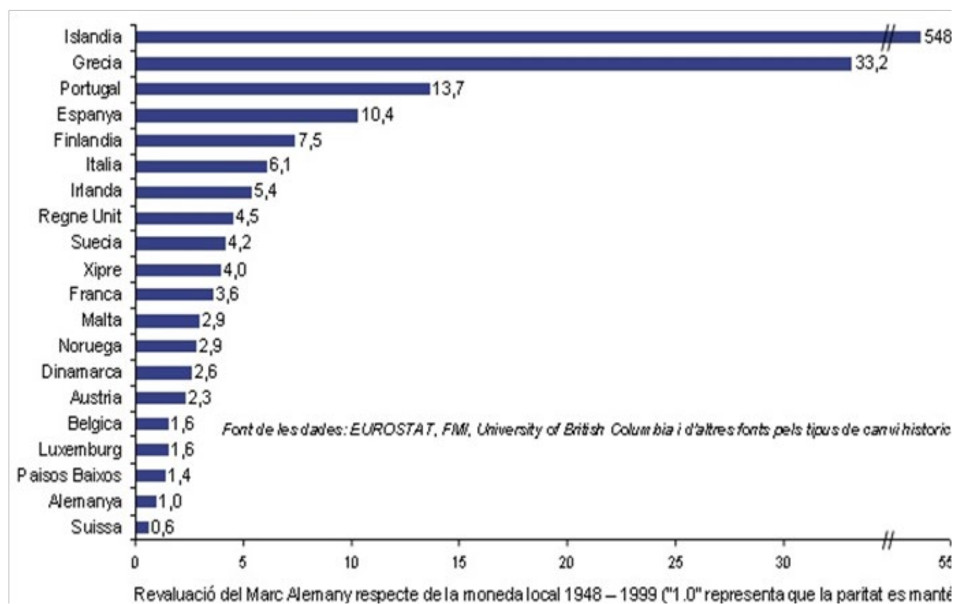
2.

The monetary union

The greater integration step in the EU "process" started after WWII was the adoption of a common currency; something thought for all EU members, even if some of them after an accession process that could take years. The Eurozone and the EU were thought to finally be a unique entity -an ever closer union- and no special institutionalization and governance of the Eurozone was created, neither other specific tools and/or budget accompanying the Euro establishment.

The Eurozone member states (MS) should retain all the economic policies except the monetary policy, which should be managed by a European Central Bank with the price stability as exclusive objective. A centralized monetary policy thought to avoid and overcome the previous currencies' world, where recurrent devaluations made almost impossible a single market. The next chart shows that world, expressed as the factor that a given currency had decreased its value in relation to the German mark, between 1948 and 1999.

Chart 1: Deutsche mark revaluation in front of other European currencies

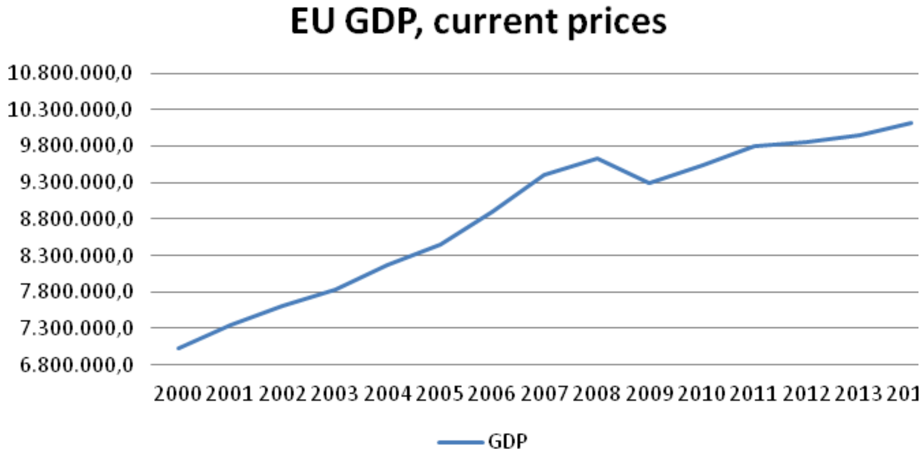


Source: EUROSTAT

If the currency devaluation was the result of different inflation processes, and those inflation processes were the result of different monetary policies, by unifying them under the control of a European Central bank the inflation differences could be avoided and, therefore, the common currency should help the creation of a single market by facilitating the free flow of trade and investments without devaluation risks.

Did it work as expected? As can be seen in the next chart, during the first seven years of sustained growth this was the impression. The doubts only came up with the 2007 financial crisis and its management by the EU, when growth stopped and its recovery became too low and too slow, and asymmetrically suffered by the different Member States.

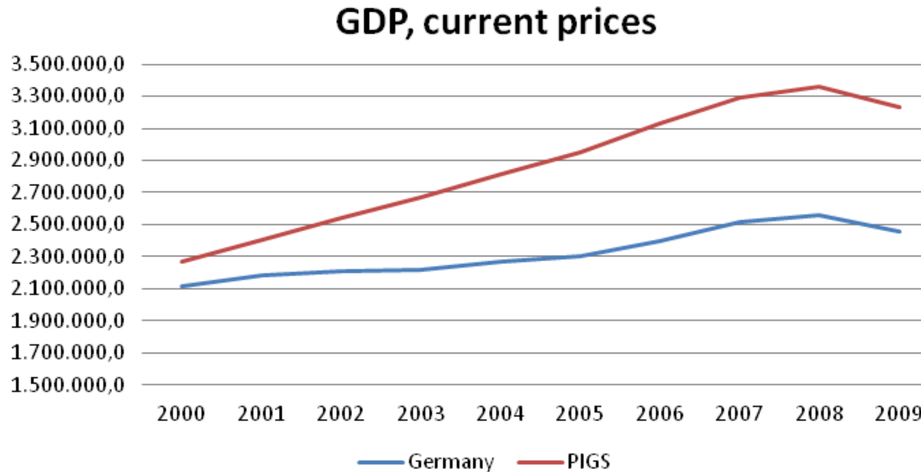
Chart 2: GDP growth in the EU



Source: EUROSTAT

However, if we have a detailed look to the growth period, we can see two different worlds: that of the strong countries like Germany and that of the PIGS countries (Portugal, Italy, Ireland, Greece and Spain).

Chart 3: GDP growth

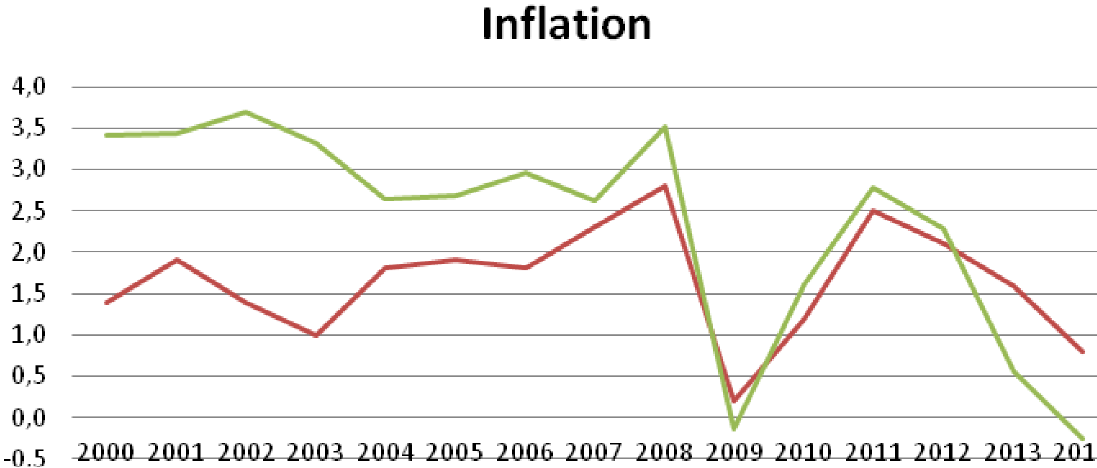


Source: EUROSTAT

Apparently, PIGS countries were the driving growth force of the EU and a convergence process had been achieved, with the less developed countries catching-up the more developed countries.

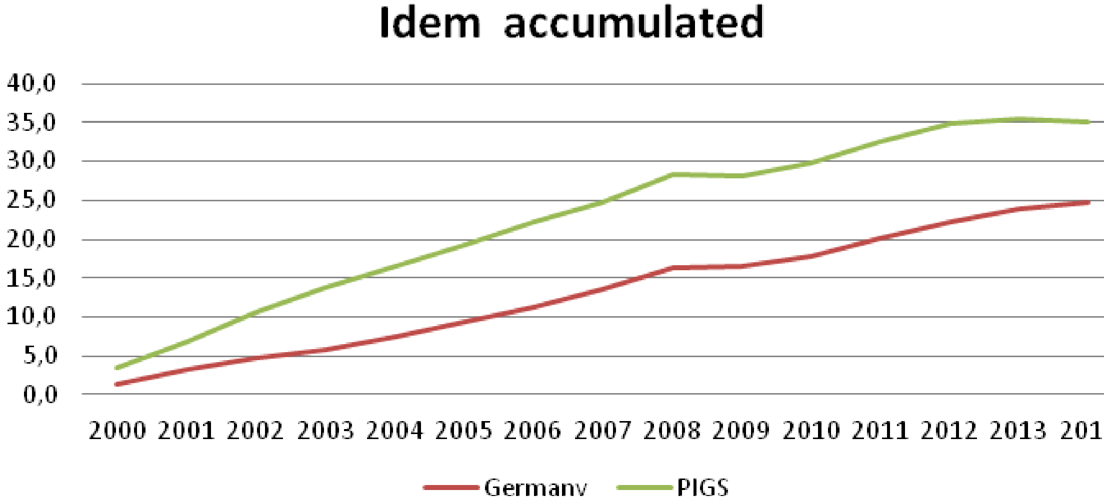
However, this convergence was rather “nominal”, through price increases, as can be seen in the next charts. The theoretical assumption that a common monetary policy would end with the inflation differentials was false and the currency parities established when the euro was created became on a kind of straight jacket for those countries with higher inflation.

Chart 4: Inflation differentials between Germany and the PIGS



Source: EUROSTAT

Chart 5: Inflation differentials between Germany and the PIGS



Source: EUROSTAT

Clearly, the inflation differentials did not disappear by unifying the monetary policy and the unified interest rate was too low for the higher inflation countries as to contain it. And as now they had not the capacity to devalue in order to restore the competitiveness lost through inflation, they started to have huge external deficits in front of the low inflation countries, which started to have symmetrical surpluses.

As a financial counterpart, trade deficits supposed external debts, as surpluses supposed credits; therefore, a big credit and debt bubble that crashed in 2007, at the same time that the US financial bubble crashed. But that EU bubble had inevitably crashed later or sooner, with or without the US crash, given its non sustainable nature.

As a conclusion, the unified monetary policy could not avoid the crisis and in fact fuelled the countries' imbalances during the growth period and until the financial crash. Since then, prices' path in the Eurozone countries have finally converged, but in a deflationary process, and the monetary policy have until now been unable to reignite the economy despite the efforts made by the ECB.

A central bank is clearly not enough to run properly any economy. It use to be a good brake to slow the economy when it runs too fast, but it's not an engine able to reignite the economy when it runs too slow. And in the case of a heterogeneous countries' puzzle like the EU, the ECB could not act even as a brake because, with a single tool, it's not possible to regulate different speeds as it was the case inside the Eurozone the growth period.

Neither the Eurozone countries could regulate their own inflation, as they had no more its own monetary policy tool to do it. Otherwise, being the problem the speeds' differences, it is also not clear which countries have had to react, whether the faster or the slower.

3.

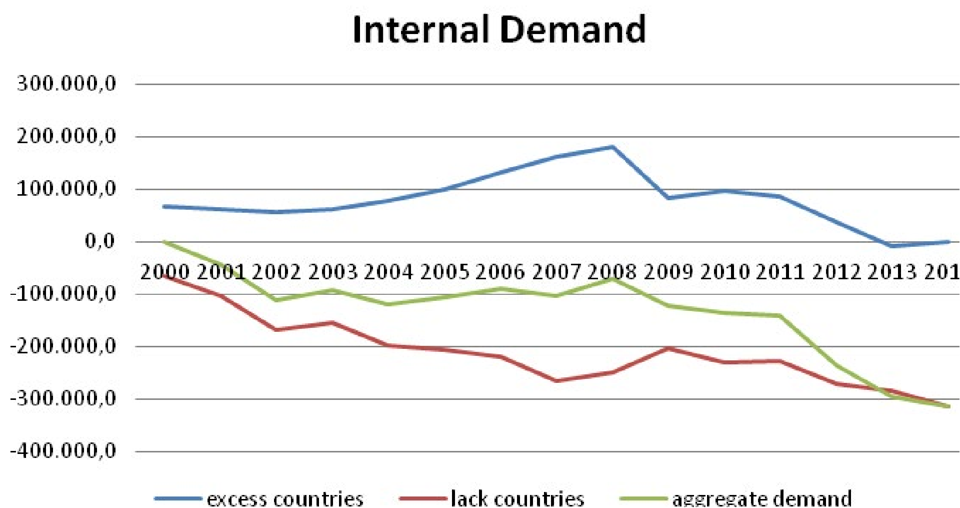
UE aggregate demand

No debt can exist without a previous or simultaneous credit and no external deficit can exist without a previous or simultaneous surplus. The external deficit means an internal demand greater than the internal supply —an excess of demand—, and an external surplus means an internal demand lower than the internal supply —a lack of demand. And while a lack of demand can exist by itself, followed by an economic contraction once the companies can't sell their products, an excess demand is impossible to be if there is not a symmetrical surplus to allow it. That is: a lack of demand brings recession or becomes surplus by allowing third countries deficits and indebting them.

That's why the Keynes design for the IMF consisted in a clearing house for external surpluses and deficits, where surpluses should be penalized in order to avoid them and the consequent symmetrical deficits. A design refused by the US, with a giant surplus when the IMF was settled, and they preferred to use its surplus to consolidate its hegemony in the world; something not too different to the present EU internal situation, with Germany in the similar role.

The next chart shows the EU aggregate internal demand (green line), as a result of the "excess" of internal demand in the deficit countries (blue line) and the lack of internal demand in other EU countries (red line). Until 2008, excess and lack of demand were mutually compensated, allowing sustained growth.

Chart 6: Excess and lack of internal demand countries



Source: EUROSTAT

In 2008, when the model crashed, the creditors (surplus) countries accused the indebted (deficit) countries to be the crisis' responsible —forgetting the global growth they had allowed and the symmetrical surplus allowed— and obliged them to austerity in order to end with their excess of demand, without even recognize the need for a compensatory demand increase in their own countries. As a result, the whole EU entered in a lack of aggregate demand situation, rising unemployment and poverty.

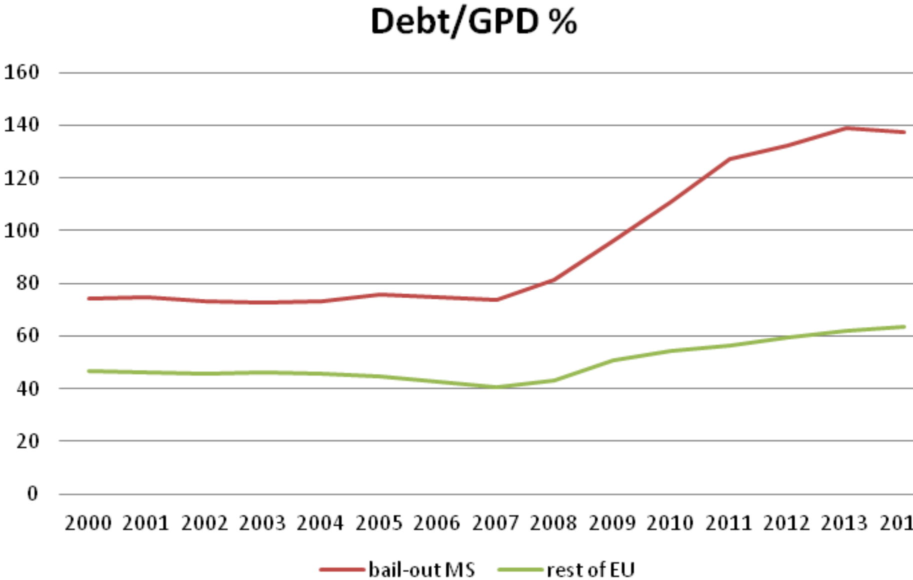
Try to exit from a commonly created dire situation, thanks to the effort of the weakest members have clearly demonstrated to be as unfair as inefficient.

Exports outside the EU have partially compensated the lack of internal demand at EU level. Nevertheless, it means an "externalization" of the growth engine and a high dependency on foreign events. On top, the resulting external surplus means an excess of EU savings that could be applied to foster internal growth instead of indebt third countries.

If we have a look to the other side of the Atlantic, the US treated the financial crisis as one affecting the whole country, despite it was harder in some states than in others, and they applied both monetary and fiscal policy to exit. And they got it well before the EU is getting it. Certainly, the US does not bail-out indebted administrations, as California or Detroit, but the federal government pays the unemployment subsidies all over the country and invested heavily after the crisis in General Motors, the engine of Detroit's economy, and in Silicon Valley, the engine of California's economy.

Conversely, in the EU, the responsibility to exit the crisis have been charged in the weaker countries shoulders, exhausting their public finances with the public sector assuming unpayable private external debts and thus appearing, as a result, a sovereign's debt crisis once the public debts were multiplied. The public debt path and its increase with the crisis can be seen in the next chart.

Chart 7: Debt as GDP % in bail-out countries and EU average



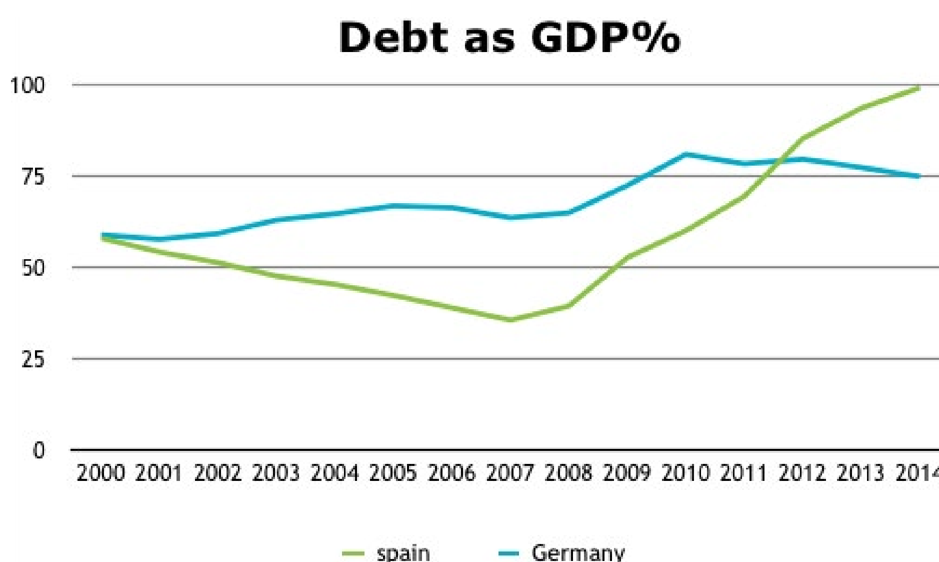
Source: EUROSTAT

4.

MS's fiscal policies

Previous to the crisis, public debt was slightly higher in the bail-out countries; but its fast increase was due to the crisis, and to the austerity policies applied later, and not conversely. In fact, public debt was higher in countries like Germany when the crisis started than in countries like Spain, a good representative of PIGS countries, which reduced heavily its debt during the growth period, while maintaining a high internal demand; and conversely, its internal demand was weak during the second period, despite the high public deficit and debt increase.

Chart 8: Debt as GDP% in Spain and Germany



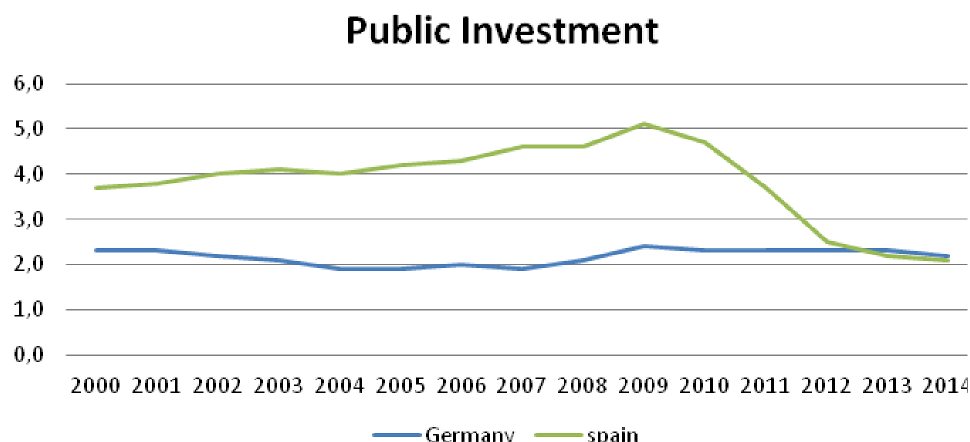
Source: EUROSTAT

Fiscal policies in the MS hands have been unable both to freeze the economy when it was too warm, neither to ignite it when it was declining. Apparently independent of the political decisions, public deficit and debt decreased during the growth period and increased during the crisis and thereafter. The economic stabilizers entered into action and reduced public expenses —and increased incomes— when the employment grew, and increased public expenses —and reduced incomes— when unemployment grew.

Fortunately, the fiscal policy acted as anti-cyclical in a quite automatic way, even if it was not enough to avoid and/or to fix the economic nightmare. Stabilizers like unemployment subsidies are shock-absorbers that can partially reduce the demand fall —subsidies use to be lower than the salaries lost and are always lower than the product per worker. Therefore, a simple increase of public expenses can't be understood as an expansive fiscal policy, which should be that which "increases" the aggregate demand in a given moment.

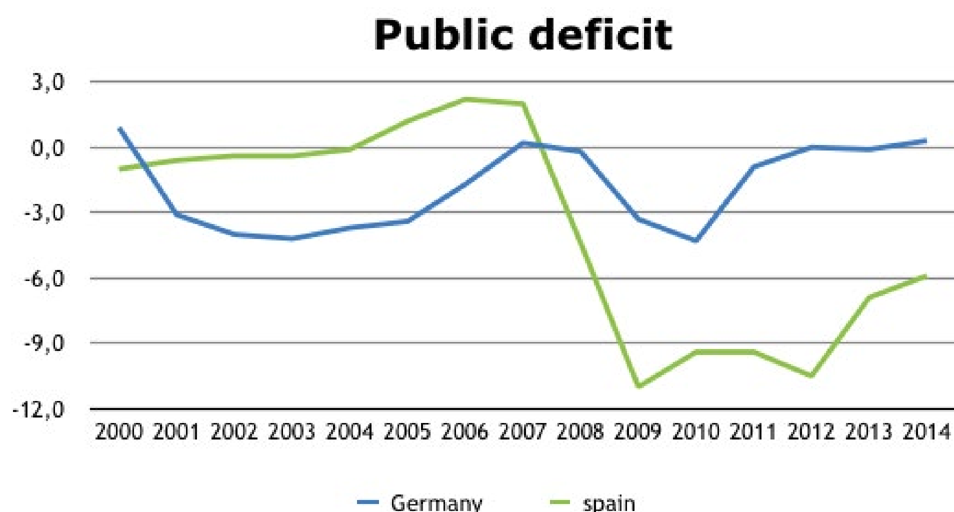
We must therefore look behind the automatisms to see which political decisions were taken; mainly the public investment, a discretionary measure. It can be seen in the next charts. During the high growth period (2000-2007), Spain maintained a high level of public investment while reducing its public deficit and debt. Conversely, after the crisis, the public investment fall and the deficit/debt grew.

Chart 9: Public investment in Germany and Spain



Source: EUROSTAT

Chart 10: Public deficit in Germany and Spain



Source: EUROSTAT

In the case of Germany, representative of the strongest economies, public investment has been lower all over the period. That is a clear divergence of fiscal policies among EU countries, despite the supposed coordination they had to have.

Was the high public investment in Spain responsible for its high growth rate and was the low public investment in Germany responsible for its lower growth rate? If this was the case, the Spanish policy had been the good one in terms of growth; and not only for Spain but for the whole EU, the main beneficiary of the high Spanish imports. Why then the crisis was greater in Spain?

In a common currency area, the openness of the economies have as a result that to grow faster in a given part of the system can easily mean a loss of competitiveness through prices' increases; consequently, a demand-driven growth can find the equivalent supply outside and not inside the country. In other words, high public investment can suppose high external deficits (and external debt). Therefore, what was best for Spain and the EU in growth terms became worst for Spain in terms of country's competitiveness.

With its own currency, a country's demand push is followed by an internal supply increase, even if it is after an inflation process and the consequent currency devaluation to restore competitiveness. Instead, inside a common currency area the demand-creates-the-supply mantra means that an increase of demand in one country can create the supply in another country!

Spain could have reduced further its public debt, and diminish its external deficit during the growing period, by reducing its public investment. But by reducing its internal demand it have had also reduced the EU internal demand and growth.

If something could have been done to avoid external deficits in PIGS countries, without reducing the EU internal demand, it was to restore their competitiveness lost through inflation by productivity gains; that is, a public (and private) investment better oriented to get productivity gains through R&D, education, innovation and key infrastructures, instead of real estate, empty airports and high speed trains.

Nevertheless, productivity gains can not be got as fast as the prices' changes are. And it have had been necessary not only to recover inflation differentials but the German wages deflation!

Chart 11: Salaries as GDP % in Germany and Spain[1]

Source: EUROSTAT

1 A decrease means a wage increase below the productivity vice versa. The high increase during the crisis was a collateral effect due to the fall of the production

For some authors, this wages' deflation is clearly a beggar-thy-neighbour strategy through which Germany got the low inflation behind its competitiveness gain and its external surplus. However, the correlation between salaries and prices is not as direct as usually accepted. Also in Spain the salaries went below the productivity and the inflation was high. In fact, inflation is directly correlated with the demand and indirectly with the salaries —if their increase pushes the demand, which was not the case. Nevertheless, the wages' deflation clearly added competitiveness gains to the German companies, explaining why the huge private investments in Spain were made in sectors like real estate, protected from foreign competitors.

Therefore, very little could have been done in deficit countries, given the huge capital inflow pushing their internal demand and without tools to avoid or to fix the resulting inflation. The real alternative to avoid deficits in debtor countries, without reducing the whole EU internal demand, had been to reduce the lack of demand (surplus) in the creditor countries by increasing their public investment and expenses. Yet, this is what should have to be done now to restore the EU aggregate demand at the full employment level.

Why it does not happen? Probably because the surplus countries have no incentives to do something that could suppose the loss of their healthy —and wealthy— economic situation for the others' benefit. In fact, this is the typical positive-externalities game, where no one is interested to do whatever if he can't be its main beneficiary.

In these situations, the incentives to win thanks to the others' efforts are great! And if we add the limits to the public deficits and debts established in the EU treaties, we arrive to the present race-to-the-bottom situation, where no country is seriously pushing to exit from the crisis, while the EU as a whole has no instruments, neither the resources enough to do that.

The idea that high public investment was crowding-out private investment, which will appear as soon as the public let them the space to do it, have demonstrated to be false or stupid —the private investment was behind the real estate bubble in Spain while the state was also investing and no private investment have appeared after the crisis. Under a weak demand scenario, the return of investment expectative is too low and private investors are waiting or looking for better alternatives outside the EU. Also the corporate and wealthy tax reductions, sold to the public as a way to increase the investment and growth, have demonstrated to be false and it has just increased social inequalities as never before.

5.

EU budget and tools

Why, with its own budget and set of tools, the EU has been unable to exit the crisis?

Starting with the EU budget, it is worth noting that:

- The EU budget is for the whole EU and not only for the Eurozone, which is the space where a common monetary policy makes necessary something else to run properly the economy — because EU countries with its own currency have in their hands all the necessary economic policies.

- The level of resources of the EU budget, close to 1% EU GDP, is clearly not enough to afford a demand shock like the one we suffer. As a useful comparison, the US federal government manages 20% GDP.

- The EU budget has never been thought as a demand shock absorber. Under the "*juste retour*" criteria, the MSs try to get back as much as they can of their contributions, leaving small room for communitarian policies trying to maximize "value for money".

- In fact, the present Multiannual Financial Framework (2014-2020) represents a reduction in real terms (3'5%) related to previous MFF, mainly thanks to the UK. It is therefore evident that the EU budget is not thought as a tool to exit the Eurozone crisis.

While it is probably unfair to say that the EU budget is just one drop in the ocean, it cannot be considered a common EU fiscal policy due its low level of resources, its independence of the economic cycle and its orientation.

If we have a rapid view of the last budget (2016) we can find:

Chart 12: 2016 budget

	Amount	%	Comments
Budget	153 bn		Budget
Smart and inclusive growth	69 bn	45	Includes cohesion, 51 bn
Natural resources	63 bn	41,2	Includes CAP, 43 bn
Security and citizenship	2,7 bn	1,7	
Global Europe	8,8 bn	5,7	
Administration	8,9 bn	5,8	

Source: EUROSTAT

Only cohesion policy could be somehow thought as a fiscal tool. It represents one third of the EU budget and 0'3% of EU GDP, clearly insufficient given the present countries' imbalances of -4% to +6% of the GDP and given the average of public investments made by the MSs, around 2% GDP.

In fact, cohesion policy was not thought to fix imbalances, but to bring regional convergence in terms of GDP. Two quite different but correlated things, sometimes opposed. For example, if the resources transferred to a given country have implied a demand increase over the supply, thus diminishing instead of improving its competitiveness, it has probably increased the imbalances. Similarly with the infrastructure investments, if linking weak areas with strong ones, the final beneficiary can easily be the stronger.

Finally: GDP per capita is not the best indicator to measure the social progress in a given region; in fact, there are higher GDP regions with lower social progress than others with a lower GDP per capita.

To overcome those difficulties, present cohesion policy is, in one hand, working on alternative indicators beyond GDP, and on the other hand, basing its new strategy on the Regional Smart Specialization, thought to increase a competitive supply in less developed areas. With the necessary resources, this policy can get both social convergence and imbalances reduction. Its success should be evident if net receivers of the cohesion policy change along the time, and not only because new less developed countries have entered into the EU. If this is not the case, cohesion policy would suppose the establishment of the kind of permanent fiscal transferences that frozen instead of fix the disparities; a mechanism that some MS fears and will fight against.

Linked to the cohesion policy, the Commission has very recently launched the Structural Reform support programme for MS facing difficulties. Even if it sounds quite interesting, it forgets again that these difficulties can often be originated in the strong countries —expending too few, for example.

On top of the budget, the EU has reacted to the crisis with several other tools.

In 2011 was created the European Semester (ES) and the Macro-imbalances procedure (MIP); a country by country report, including specific recommendations for each but without contemplate any EU global responsibility and policy. The ES has been, in fact, the EU mechanism used to apply austerity policies; and the MIP the tool where the false idea that surplus is good and deficit bad is well reinforced.

It is worth noting that inside the MIP, deficit alert is established on -4% GDP, while surplus alert starts at +6%. Furthermore, while the deficit excess procedure has a complete correction programme, including penalties, for the surplus excess there are just some good words to motivate the country to spend. Therefore, all we can expect from this mechanism is further internal demand reductions instead of increases.

Apart from imbalances, the European Semester report gives recommendations for structural reforms to get competitiveness gains. But competitiveness is always a relative measure of a given country related to others and it's therefore impossible competitiveness gains in all countries. It could be related to non EU countries, but with the rest of the world the EU already has a huge external surplus. As a whole, the EU has not a competitiveness problem, but a growth problem and an unemployment problem.

Nevertheless, the European Semester and the MIP procedure for sure are preventing new high imbalances as we had in the past, being an interesting preventive mechanism. And it's also true that the global EU efficiency can be improved, even without changing the relative competitiveness of the different MS.

As late as August 2014, five years after the crisis started, Mario Draghi made the official recognition that austerity policies had been a mistake that had brought Europe to a low aggregate demand level, evidenced by deflation. He also stated that the ECB should do whatever possible to reignite the economy, but he also exposed the limitations of the monetary policy to do it alone.

As a result, he started an expansionary monetary policy by reducing interest rates close to zero and by increasing the money supply through Quantitative Easing (QE); a programme to by public debt in the banks' hands. By this way, the ECB is providing huge liquidity to the system without having had clear signals of demand increases up to now. Private investment decisions depend on the return expectative rather than in the availability of money; therefore, in a lack of demand situation, it will be difficult to see queues of investors demanding credits to the banks and to see the banks multiplying money through loans.

As have been already said: monetary policy is a good brake, not an engine. Monetary policy can hardly reignite the economy. Printed money (ECB money) is the minor part of what the economy uses as money; the main part is the banks one, created through loans that fed new deposits. And loans require investors with sound projects to be financed. Something difficult to exist when the demand is weak and the return expectative not too good. Apart from that, a low but positive inflation rate as the one followed by the ECB is good as an indicator of a good level of economic activity, as deflation is bad because it reflects a low activity level. Therefore, push for inflation for itself, as sometimes seems the ECB tries to do, is useless. So again the aggregate demand is the key factor and not the money supply.

Yet it is true that QE have had some good results: interest rates have fallen close to zero, making cheaper the public debt burden and preventing bankruptcy of very indebted countries; a kind of debt restructuring by its cost side. And QE has also weakened the euro in front of the dollar, facilitating exports —however the present huge external surplus makes hard to hope for an economic recovery from outside.

The Banking Union under the ECB control is also another positive step forward the monetary union strengthens. However, it still lacks of an EU deposits guarantee, able to avoid financial flows to countries apparently safer. If money is not perceived equally safe in all the euro constituencies, the monetary union does not really exists.

The 2014 European Commission, led by JC Juncker, started its term by announcing a huge investment plan to shortcut the investment gap in the EU: the European Fund for Strategic Investment (EFSI). Unfortunately, that plan to mobilize up to 315 billion in three years is nothing else than a wise financial tool for those investors willing to invest without finding funds, a strange situation, given the above said related to QE, or for those carrying high risk projects rejected by banks.

Since the lack of liquidity is not the problem at present, it's hard to believe that there will be so many projects knocking at the ECB doors, unless if it is for projects with higher risk than desired.

And this adds the risk of reintroducing moral hazard as a common practice in the EU. Not to forget that in a previous similar programme, the ECB financed projects like the Castor, in Spain, cancelled after several earthquakes and then "reimbursed" by the Spanish taxpayers.

As conclusion, there is nothing in the present EU oriented to solve the demand lack and to reignite the economy!

6.

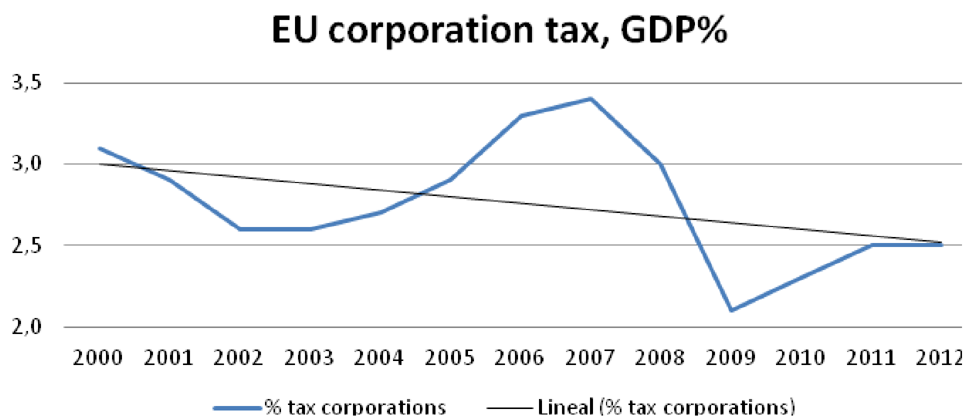
Fiscal Union: for what?

As already said, a common currency area supposes a full open field where the efforts made here can see the benefits in another place; therefore, reduce instead of increase public investments and expense is the winning strategy. And an all-loss strategy if the reduction is generalised, as it is presently the case in the EU. The paradox is that the resulting low growth, due to the low public expense, ends increasing the debt/GDP ratio; thus giving the impression of a false expansionary fiscal policy.

Similarly, by the fiscal income side, lowering taxes can attract more companies and increase fiscal incomes to a country by reducing other countries' fiscal incomes, as we've seen in the recent years with low tax strategies in Ireland or Luxemburg among others. The result is a global EU loss in fiscal incomes and a benefit for the corporations, which finally supposes the increase of public debts and/or the increase of taxes for the rest of the taxpayers.

The next chart shows the fiscal contribution of corporations as GDP% in the EU. As a combination of nominal tax rates reductions in all countries and of ad-hoc or generalised tax privileges to corporations, their contribution's decrease tendency is quite clear.

Chart 13: Corporate taxes as % of GDP



Source: EUROSTAT

As a matter of fact, fiscal sovereignty in a common currency area finally means a race-to-the-bottom, both from the incomes and the expenses side. This is the main reason to push for a fiscal union to overcome the nonexistent fiscal harmonization —taxes—and the theoretical fiscal coordination —expenses— and to avoid the incentives for any MS to free-ride or a preventive race-to-the bottom by all. It is true that free-riding exists also outside the EU and it hurts also the EU, but there's no doubt that the EU's and Eurozone's openness makes the risk greater and more dangerous.

There is also another reason for a fiscal union: the need of (temporary) fiscal transfers among MS for asymmetrical shock absorption; probably, the most difficult reason to be accepted by the MS. Almost impossible if it appears as the base for "permanent" fiscal transfers from the ones to the others.

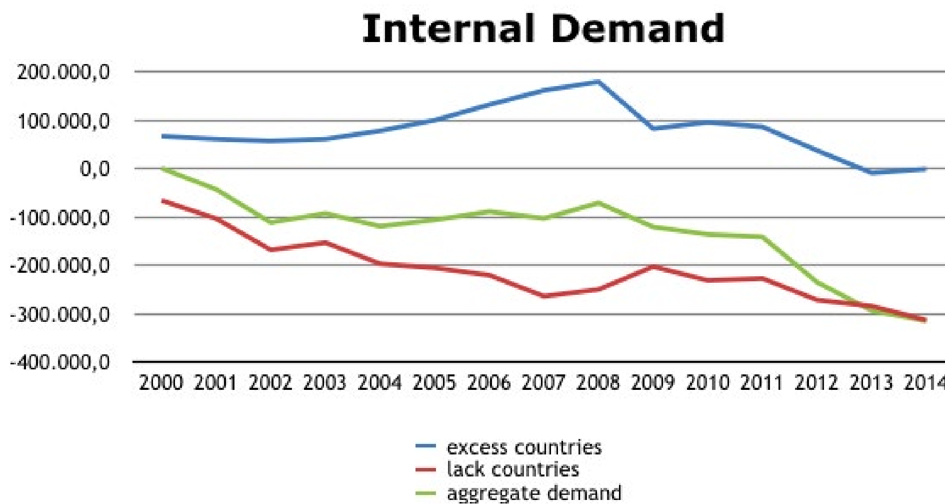
In fact, a simple vision of the fiscal union could be seen as the extension of the present cohesion policy: as MS are not homogeneous, it's necessary a fiscal transfer mechanism between more

and less developed countries. A quite wrong logic in an open world! In a closed one, a simple transfer mechanism based on unemployment subsidies should increase the consumption and then the production and the employment; a virtuous circle that does not exist in an open world. In fact, also the deficit-and-surplus is a transfer mechanism, but it uses to increase disparities rather than reduce them. To do it fiscally will similarly increase disparities or, at best, will freeze them. There are justice reasons to help giving fishes, but it is always preferable to provide fishing poles!

Homogenise GDP per capita is a justice aim that goes beyond the EU, but that is not directly related with the need for a fiscal union, which must be mainly oriented to guarantee the aggregate demand at EU level without internal imbalances. The associated redistribution effects to reduce social inequalities and regional disparities will come through the progressivity of the taxes raised and through the raising of salaries and employment thanks to the greater investment.

Looking again to the excess and lack of demand chart previously shown:

Chart 14: Internal demand, lack and excess



Source: EUROSTAT

A unified fiscal policy have had to avoid imbalances by reducing the lack of demand in red line countries —increasing the expenses there— and by increasing the supply in the blue line countries —increasing the productive investments there. As a result, it had had to guarantee the aggregate demand at the full employment level (green line at zero level).

Yet, this is what must be done. And to do that, the main indicators must be the output and the demand gap; not the GDP per capita ranking!

As an output gap can mean unemployment, an EU unemployment stabilizer can be useful if and only if it means a supply increase —at least through training—, and it will be useless if it is just a subsidy to maintain the demand, as quite often it is. Similarly, a lack of demand is evidenced through an external surplus that can be reduced by increasing investments and expenses there.

2. There is plenty of instruments to do that, whether as automatic stabilizers or as discretionary

measures[2]; the stabilizers as shock-absorbers when the demand falls, and the discretionary measures to increase the demand in a given situation. The key question is to avoid moral hazard and free-riding behaviours; therefore, fiscal union means not only unified investments at EU level, but also a unified budget control top down, consistent with the subsidiarity principle but assuring consistent coordination. That is: the EU must invest there where being necessary and convenient for the whole EU, no MS is investing or not enough; and there where can add value for money thanks to scale effects.

It must be clear, in any case, that the resources flow will must be not always in the same direction, thus creating a transference union where permanent fiscal deficits in one country will suppose permanent fiscal surplus in others. This mechanism has already existed in several countries, like Spain and Italy, and as a result the disparities have been frozen instead of fixed and the global growth has been slowed.

Just as an example: If we add to the economic challenges the climate change and the energy transition challenges, it clearly appears the need for a "public" green investment plan that could bring the kind of solutions we need.

As unemployment is greater in the south, that is the sunniest part of the EU, a huge investment plan in solar energy there could:

- Generate jobs
- Help to the energy transition
- Diminish EU energy dependency
- Attract heavy energy industries
- Improve south competitiveness

Clearly, a kind of projects that justifies the EU investment for, at least, two reasons:

- Requires cross-border energy interconnection
- Requires huge resources to phase-out the existing fossil and nuclear energy production plants

Investments like the above described could facilitate the MS convergence while increasing the EU internal demand and reducing its energy dependency. And it's not the unique example. Europe as a whole has not a competitiveness problem —we have a huge external surplus— but a sustainable growth problem. And the resources needed to push that growth are in the hands of the 25 millions of unemployed people. This must be the aim of the unified fiscal policy.

---

2 Transfer tools for deeper convergence & solidarity in the E(M)U. MEP Sven Gigold, Ansel Daneker

7.

New balance of competences

To go towards a fiscal union means a new balance of competences between the EU and the member states. In short, it means more Europe; exactly the opposite direction that the eurosceptics are willing for, including the UK with its referendum. In fact, fiscal union is necessary for those countries inside the Eurozone but not so much for those with its own currency. But to go further with the Eurozone probably requires the acceptance of two speeds and two institutional frameworks in the EU, something rejected until now.

The EU treaties establish that all EU members will adopt the euro, even if it's after an accession process. That's why the Eurozone, supposed temporarily different than the EU, has a weak institutional framework; so weak that it can be seen as a free-democracy zone, given that no parliament controls it and that it's managed by non EU elected people.

Nevertheless, if the UK remains in the EU with the conditions they claim for, the obliged euro accession must be forgiven and two different institutional bodies must be developed; thus maintaining the EU as it is and to go deeper with the Eurozone by establishing its own parliament, government and budget.

The first step: to counterpart the ECB with a Treasury. It means an economic Minister responsible for growth and employment, and therefore for the MS fiscal coordination and supervision, as the ECB president is responsible for prices' stability and for the MS's central banks coordination and supervision.

This EU split to go deeper with the Eurozone is probably the main obstacle to overcome. It is about what do we want the EU to be and if we want two or more speeds to reach it. In other words, if we want a wide but thin EU with a deeper and narrower Eurozone in.

The Shauble's proposal for Grexit, letting the Eurozone for the "good" boys, should be another option: to maintain what we already have now, without further integration but expelling the "bad" boys from the euro instead of reinforcing it.

The sole idea that Germany could finally be the net payer of any Transference's Union, makes it hard to sell them the fiscal union concept. And they are not the unique fearing; the majority of MS will resist to any further sovereignty cession.

That's why it is so important to make evident, at least, three things:

1. That the fiscal policy at the macroeconomic level, has little to do with the sovereignty for the euro countries, given the few degrees of freedom they have to act.

2. That the fiscal union means not a mechanism of permanent transferences from some countries to the others, but a way to assure the common benefit and for the benefit of any MS entering in troubles

3. That the subsidiarity principle will be always respected.

It will be not an easy task, but it's necessary. Present challenges like climate change, migration, tax havens and economic globalization, clearly overcome the capacity of any single state and,

unfortunately, the EU as it is now, puts the states under the market control instead of be the markets controlled by the states.

Furthermore, the euro is not stable in the present conditions and exit it can finally be a preferred option for many members —Finland will debate about it soon next year.

In any case, convince the MS will be a hard and long way, with false shortcuts appearing time to time. Today, for example, the declared terrorist war could be by itself the (bad) investment plan that Europe needs. France has already declared that will not accomplish with the deficit and debt limits, in order to reinforce its defence budget, and it's quite probable that other MS follow the French.

It means: the race to the bottom finally substituted by a race to the hell. Instead of a huge green investment, an even greater defence and attack investment. To the economy does not matter, even if it matters a lot to the humanity. The economy could ignite and the occupation could be increased, without the need of taking difficult decisions less supported by voters than it is war when people fear.

Supposed it's nevertheless possible to go ahead with the fiscal union, the new balance of competences will mainly affect the EU budget both by its income and expense side. The expense must include whether one-shoot investment plans or the inclusion of automatic stabilizers to absorb demand lacks or excesses. The first is discretionary and can be previously budgeted; the second gives to the budget a relative autonomy and, therefore, the potential need for debt issuance.

Both things require a wider autonomy for the EU budget: whether to finance investment plans or to guarantee debt issuance; something impossible under the present EU rules.

The EU budget, around 1% EU GDP, is presently defined for seven years through the Multiannual Finance Framework (MFF) and it is mainly (>85%) nurtured by member states' contributions based on VAT and GNI.

This scheme means that:

- The ownership of the EU remains in the MS hands
- Any EU budget increase means less disposable incomes for the MS

There is any way to increase the EU democratic legitimacy and fiscal capacity, which could be acceptable for the MS?

If there is, it is by establishing new EU taxes and by reducing the high present tax avoidance. Collecting what nobody is collecting could facilitate a real EU budget, both in terms of volume as in terms of own management capacity. Furthermore, as the non collected taxes presently are mainly those due by the wealthiest, its collection will also help to stop the inequalities race.

The best candidates seem to be the financial transactions tax (FTT), the corporate tax, the wealth tax and the green taxes.

A lot of years after its proposal to fight against speculative investments, the FTT seems to be now almost ready to be applied for 10 EU countries. As those 10 are less than the EU members (28), and less than the Eurozone members (19), it seems quite difficult to see how could be an EU tax. And if it is not an EU tax, another big opportunity will be lost.

The Luxleaks scandal has been useful to demonstrate both how multinationals are avoiding taxes and how some states are helping them to do that and to do it legally, as a way to attract corporations to their constituencies. Clearly, the radical solution to end these practices should be through the establishment of an EU corporate tax. In fact, multinationals generate profits at the single market level and it should be fair that they pay also at the single market level.

Nevertheless, this seems far to become reality. At present, the EU is trying to impose the Country by Country Report (CBCR), a tool thought by the OCDE for all countries, being them part or not of a common currency area; and is also trying to re-launch the Common Consolidate Corporate Tax Base (CCCTB), a clear step towards harmonization and common tax collection. Unfortunately, a first phase is foreseen without consolidation; and this is the maximum we can expect in the coming years.

If CCCTB should finally be applied and collected by the EU, it could mean an amount of 3'5% GDP —nowadays the corporations pay around 2,6% GDP after avoiding approximately 1% GDP. Therefore, only with corporate taxes could the EU could end with the present MS contributions and still having and EU budget 3.5 bigger.

Similar to corporations, wealthy people can freely transfer their wealth to low taxes constituencies; therefore, if a single country tries to increase wealth taxes, a cue of wealthy people exiting the country appears. Only a harmonized global wealth tax should end this tax avoidance, independently if it is collected at EU or at countries' level. Harmonization is here the key word.

Contamination ignores borders and its taxation at EU level should be highly recommended, improving the present ETS (emissions trade system). At countries' level, harmonization is needed to avoid market distortions and green de-localizations.

All in all, fiscal harmonization, instead of fiscal competition, could help all the EU MS; and the direct EU tax collection of those taxes better collected at upper level, would allow to the EU the necessary budget for the investments needed and with the necessary legitimacy to decide which and where those investments must be done, to guarantee the EU full employment aggregate demand level. It means, to benefit the whole EU and not just some countries at the cost of others.

Moreover, with "real" own resources, the EU could also raise money from the financial market by issuing Eurobonds or other debt vehicles when necessary and could also finance a redemption fund for MS' public debts to alleviate indebted countries and to add them to the demand push.

With the incomes coming from new and avoided taxes, and the expenses oriented to the common benefits, and not to permanent fiscal transferences, MSs would have no arguments to oppose if they really want to reach the goals behind the EU creation.

8.

Conclusions

A monetary union cannot run properly without a symmetrical fiscal union to guarantee full employment demand level while avoiding internal imbalances. It can also help to reduce social inequalities by facilitating the taxation to the wealthy, persons or corporations, and by placing the investment where can better generate growth and well paid jobs.

Despite terrorist attacks, refugee crisis, war on the EU borders, UK referendum claiming for less Europe, the Greek crisis and the Shauble's suggested Grexit... all that compose a picture where fiscal union, and the deeper political integration it means sounds like a joke, the EU must seriously advance towards or to accept its actual fracture, its world's irrelevance, its surrender to the markets and, finally, the high risk of disintegration.

To avoid that risk and to bring Europe again to the sustained and shared prosperity path, it is necessary to advance towards a fiscal union, which must be synonymous of transforming union; not a transference union, by recycling trade surplus through fiscal deficits, but a transforming union able to fix the demand and supply gaps to boost sustainable growth without internal imbalances.

A fiscal union which requires a Treasury with budget autonomy, directly collecting new and presently avoided taxes, and that supposes a new balance of competences between the EU and the MS, respecting always the subsidiarity principle.

The review of this new balance of competences, symmetrical and opposed to that made by the UK for its exit referendum, can bring to a permanent differentiation between the EU, thin and wide, and the Eurozone, deeper and narrower. This would make probably necessary a Eurozone's budget, parliament and government, while maintaining the present EU architecture.

A lot of decisions must be taken in the short term. To remain as we are is not a solution and in any case the UK will force to take decisions before their referendum in 2017. A wide and immediate European debate is therefore necessary.

The precedent pages' aim is to serve that debate.

December 2015

The FCE policy papers and the team

Fundació Catalunya Europa (FCE) is a private, not-for-profit foundation that is ideologically plural, independent and financed by contributions from businesses and individuals. FCE was founded according to the will of President Pasqual Maragall, with the mission of promoting debate generating knowledge about Europe in Catalonia based upon four main axes of analysis: Economy and Welfare, Governance and Democracy, Society and Culture, and Cities and Territories.

Within the framework of FCE's lines of work, the Foundation provides political and consultation analysis services, among which the new editorial line of the European Policy Papers (EPP) stands out.

A. Objectives of the EPPs

The EPPs have the objective of encouraging debate starting from informed, updated positioning on specific areas of sector-specific European policy and provide recommendations oriented to the taking of policy decisions, with particular attention given to the effects of European policies within the territory. They are executive documents addressed to political decision-makers, activists, the media, etc., with a vocation that is more proposal-based than analytical.

The authorship of the EPPs may be individual or collective and always relies on an expert rapporteur who is responsible for guaranteeing that the EPP is a rigorous and relevant contribution, and a coordinator in the case that a collaborative work is concerned. With regard to authorship, the EPPs seek to combine expert knowledge from academia with expert knowledge from political action and praxis.

B. Thematic axes

The EPPs have sector-specific focuses and prioritise the following thematic axes:

i) Poverty and social exclusion
ii) Unemployment, youth and lifelong learning
iii) Sustainable development and energy debates
iv) European cities
v) Europe-Mediterranean: security, cooperation, migration.

C. The team

Coordinated by Jordi Angusto, MEP Maragall's adviser on economic issues, several experts have participated in the elaboration of this policy paper:

Jordi Angusto: He is economist. He has been CEO of Barcelona Tecnologia SA and CEO of the Centre Tecnològic Aeroespacial of Catalonia, Professor of Economic Theory at the Universitat Autònoma de Barcelona (UAB) and is the author of several publications on the economic crisis, and columnist of economic analysis. Currently he works as a consultant in economic analysis and co-chairs the Committee on Innovation at the College of Economists of Catalonia.

Joan Majó: He is entrepreneurship, political and industrial engineer. Former Minister of Industry and Energy of the Spanish government, Former Mayor of the city of Mataró, and Former CEO of the Catalan Corporation of Radio and TV. He is Advisor to the European Union in the field of telecommunications and information's technology, and chairs the Information Society Forum, the European Institute for Media and the Committee of Experts responsible for the analysis of the scientific and technologic policies in the European Union.

Francesc Raventós: He is economist. He completed his training at ESADE and IESE. Its activity has been linked to both the private and public sector. He has been director general of the Spanish health system, INSALUD; Deputy Mayor of Barcelona; Dean of College of Economists of Catalonia and then at the Spanish College of Economists; Promoter of the Strategic Plan Barcelona 2000 and member of the Organizing Committee of the 1992 Olympic Games. He is currently a trustee of the Foundation Solidarity Action against Unemployment. In 2011 the General Council of Colleges of Economists of Spain awarded him the Grand Cross of Merit of the Service Economy.

Joaquim Coello: He is a naval engineer with specialization in Naval Operation and Construction and Maritime Transportation at Technical School of Naval Engineers of Madrid. He holds a MBA at IESE. He held various positions related to research and technology: he has been Dean of the University of Naval and Ocean Engineers of Spain. He was President of the Motor Industry Group (ESG). He was President of the Association of Manufacturers of Basque Aerospace Equipment (Hegan) and he also has chaired EUSKALIT, the Foundation for Quality in the Basque Country. Since 2007 he is President of the Executive Council of the University of Barcelona.

Xavier Vidal-Folch: He is journalist. He works at the Spanish journal El País since 1982 and is the assistant director of the newspaper since 1989. He was part of the delegation in Brussels of El País, who received the Ortega y Gasset Prize for best informative work in 1999. He was responsible for Catalan edition of the journal until March 2009. He is president of the World Editors Forum since December 2008. In 2013 he was awarded with the Francisco Cerecedo Prize for Journalism by the Spanish section of the Association of European Journalists.

Albert Aixalà: He holds a degree in political science and public administration (1997-2002) and Master in European Integration (2012-2013) by the Universitat Autònoma de Barcelona (UAB). He was associate professor of political science at the UAB (2008-2009) and is currently an associate professor of political science at the University Pompeu Fabra, ESADE academic collaborator and member of the research group on multilevel governance EUGov. He was director of the Rafael Campalans Foundation (2005-2013) and in 2015 he joined the team of the Catalunya Europa Foundation to coordinate their programs and activities.

And it takes into account the debate with the following:

- Albert Aixalà, Professor of Political Science at University Pompeu Fabra
- Pere Almeda, Professor of Political Science at Universitat de Barcelona
- Jordi Angusto, Economist
- Joan Armangué, Economist
- Pia Bosch, Former councilor for the city of Girona
- Patrícia Cantarell, Member of Oxfam Intermon
- Josep Centelles, Industrial Engineer and master on Urban Economy at London School of Economics
- Francesc Colomé, Former secretary on educational policies at Catalan government
- Josep Lluís Checa, Manager of the Center of Excellence in Nanotechnology Leitat
- Xavier Ferrer, Economist and Vice-president of Commission for International and EU policy
- Joan Herrera, National coordinator of Iniciativa els Verds
- Joan Majó, Industrial engineer and Former Minister of Industry and Energy of the Spanish government
- Ernest Maragall, MEP
- Jaume Menéndez, Director of Taxation at Gas Natural
- Francesc Raventós, Economist
- David Ros, Economist
- Ferran Tarradellas, Director of the Representation of the European Commission in Barcelona
- Josep Martín Vives Abril, Member of the Trade Union UGT
- Max Vives-Fierro, Director of the Catalunya Europa Foundation
- Josep Maria Ureta, Journalist at El Periódico

Peer review and approval by MEP Ernest Maragall i Mira