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Towards a European Federal Fiscal Union

by

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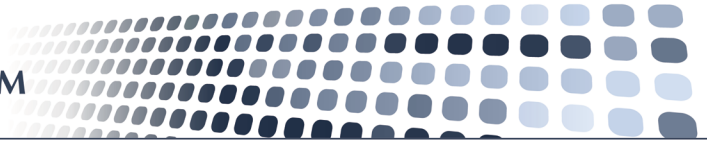
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Abstract

The financial crisis revealed the inadequacy of the European Economic and Monetary Union. The response of the EU and of the countries of the Eurozone has been slow and weak, due to the substantially confederal character of the Union and to the limited dimensions of its budget. To try getting out of this impasse it is necessary to promote as soon as possible an initiative to start a political project envisaging the creation of a European Federal Fiscal Union, along the lines followed in the past to achieve the single currency. The first stage should be the creation of a European Fiscal Institute, whose main task should be to save those countries that risk being swept away by the sovereign-debt crisis and to pave the way for the subsequent institutional move toward a Federal Fiscal Union and the institution of a European Treasury. The Fiscal Institute could play the role, in the realization of the Fiscal Union, that had been entrusted to the European Monetary Institution as a prerequisite for the start of the ECB. During a second phase, an issue of Eurobonds would be necessary to supply the UE the financial means needed to support the setting up of a recovery plan of the European economy, to favour a productivity and competitiveness increase, to promote a transition toward a sustainable economy. To be politically manageable, the European budget should increase moderately and should not exceed, in the medium term, 2% of GDP. However it should be necessary to anticipate the return to a system of real resources, substituting what is known as the fourth resource with a European surtax on the national income taxes paid directly by the citizens to the European budget. A new resource could also be assured with the approval of the proposal recently put forward by the European Commission in a Draft Directive to introduce a carbon/energy tax as from 2013. Still from this budget reform perspective, the introduction of a tax on the financial operations of a speculative nature could be considered in the perspective of also guaranteeing a more orderly development of the international financial system. During the last phase, aimed at creating a real Federal Fiscal Union, the budget, based on own resources, would be managed by a federal European Treasury, responsible for the coordination of the EU economic policy and the transition to



a sustainable economy. Once this institutional reform is carried out, it would be quite realistic to envisage the creation of a European Finance Minister.

With the creation of a Federal Treasury, after the single currency, would see the birth of a second arm of the Federal State in view of the attribution process to the Union of a decision-making power in foreign policy and in the security sector, starting within the perimeter initially of the Eurozone, where an ever increasing interdependence is manifest and where it is possible to foresee further development in a Federal direction.

The decision to go ahead with the constitution of a Fiscal Union, with a Treasury and a Federal Finance, must be accompanied by a contextual decision fixing the date for the start of a fully fledged completed European Federation since one fundamental principle of democracy is “No Taxation without Representation”.

Key-words:

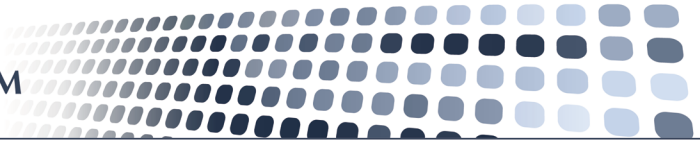
European Federal Fiscal Union, European Economic and Monetary Union, Eurozone.



I- From the financial to the sovereign debt crisis

1.- The greatest crisis that the world economy was forced to face since the end of WWII started in 2007 with the crash of the housing bubble in the United States. The origin of the crisis has a financial nature: the American banks had granted mortgage loans for the purchase of houses also to families with low incomes, with the declared aim to give everybody the possibility to own a property. In reality, for the banks, the guarantee was based on the fact that the ever increasing housing demand did favour a constant price increase of property and that the properties' value did represent a real guarantee for the repayment of the loans: should the new owner fail to repay the loan's instalments, the banks could always make up by repossession and then putting the property on the market at a purchase price higher than the amount of the loan itself. Furthermore, the widespread housing possession did favour the granting of further loans to the families, enabling them to purchase not only home furnishing on credit, but also cars and other consumer goods. The generalized use of credit cards for everyday purchases, far above the families' economic means, represented another step for the increase of the demand and, by consequence that of production. A land of plenty built on a house of cards: the continuous credit expansion. At a certain point, when the housing bubble crashes and the banks are forced to ask the repayment of the granted credits, the pyramid collapses. For many banking companies it is the start of the financial difficulties until the crisis reveals all its gravity with the Lehman Brothers bankruptcy on 15 September 2008.

But the financial crisis also clearly reveals the structural weakness of the American economy. Since many years, internal demand exceeds domestic production, and the difference is made up by net imports of goods from abroad (i.e. imports exceed exports). The federal budget deficit should be added to this external deficit. And these imbalances are managed not only by capital imports from China, but also from other emerging industrialized countries: to put to use the huge budget surplus of the balance of payments and the consequent accumulation of foreign exchange reserves, these capitals are reinvested on a large scale in American *Treasury bonds*. At the same time the consumer



goods imports, at a much lower prices than the American ones, help to guarantee on the one hand a huge outlet market for the emerging industrialized countries' products, and on the other hand to keep up the American families living standard in spite of the low pro-capita income dynamics, especially for the middle-low classes. The dream of a limitless American growth, backed by the housing bubble, by the domestic credit without limits, by the role of the dollar as International currency and by the New York financial centre that attracts capitals from the rest of the world comes to a rude end with explosion of the financial crisis.

Very soon, the crisis, born in the United States, becomes a worldwide one. The American banks sold the “toxic” titles (those who have no chance of being covered by the payment of those that received the loan) wrapped up in other titles of different nature that are resold on the International markets. Very soon also the European banks became involved with the American banks, forcing the European States to intervene in support of the banking system with great injections of public money. At the same time, the banks, facing serious financial difficulties, are forced to impose a credit squeeze on their customers and in particular on the productive system. The enterprises in financial straits reduce their levels of productive activities with the consequent contraction of the families' income, with a further impact on the demand of consumer goods. At this point, the crisis extends itself to the real sector and involves, even if to a different extent, all the other industrialized areas of the world.

2.- Faced by the risk of a recession at world level, the states react strongly overcoming the tendency to limit more and more the public intervention that become dominant since the Reagan and Thatcher times and finance heavily the real economy, guaranteeing at the same time - in Europe in particular – the levels of employment through the extensive use of the social support provisions. The reaction to the crisis is stronger and immediate in the United States than in Europe, where only the ECB – which is an organ of a federal nature – is in the position of taking the necessary decisions to face the greatest crisis of the postwar period. The reaction of the EU and that of the countries of the Eurozone is slower and weaker for two reasons which become stronger reciprocally: first of all, the European Union is an institution of a confederal nature as far as the interventions in economic policy are concerned, that must essentially be based on coordination – slow and inefficient – of decisions taken at a national level; furthermore, as



far as the interventions of a fiscal nature are concerned, the decision must be taken unanimously giving rise to further delays with – inevitable - compromises necessary to reach the agreement.

The second reason of the weakness is due to the fact that in a strictly interdependent economic area, for each country it's convenient to act as *free rider*, i.e. wait that the other countries take the initiative, because the positive effects of interventions in other countries quickly spread to the whole area. In conclusion, no country has any interest in taking on the burden of financing the recovery of the European economy, whose cost would fall on its citizens, while all the countries of the economically integrated area would benefit from it; on the other hand, the intervention of the European Union is also slowed down by the institutional weakness, by the limited budget dimensions. In conclusion, the United States, with their Federal Government and a budget of adequate dimensions, can sustain with strength the economic recovery, in Europe, the intervention is entrusted to the Member States, has more restricted dimensions also because of the constraints imposed by the Maastricht Treaty to the all extents of public deficit and has the limited aim of – of great importance, but totally inadequate as regards the scale of the phenomenon – avoiding that the crisis turns into a recession of catastrophic dimensions.

3.- Thanks to the interventions carried out by several countries, family income holds and gradually the productive processes assume a faster pace. All countries undergoing a new industrialization start growing again at a high rate and the expansion of the world demand contributes in keeping up the export of the strong countries, Germany's in particular, that is growing also thanks to a greater dynamism of its internal market. But it becomes immediately clear that the crisis has moved from the private sector to the public one.

Ireland which for years was held up as the model to imitate is the most emblematic case. To save the banking system in crisis, the Irish Government was forced to make available huge funds to the domestic banking system and the result of this increase of public expenditure was a budget deficit of 32,3% of the GDP in 2010. In Greece, instead, the conservative government, eager to bring the Drachma in the Eurozone, swept the dust under the carpet, showing a GDP budget deficit inferior to 3%, in line with restrictions imposed by the Maastricht Treaty. But when the new government, led by the socialist Papandreou, comes to power it discovers and denounces in public the enormous cash



deficit in the public accounts (the budget deficit in Greece reached 10,5 in 2010 and the debt stock 142,8%). The financial markets react immediately with a loss of confidence that makes placing the new issues of Greek bonds more difficult: that's the birth of the crisis of the sovereign debt.

The weak countries of the Eurozone (i.e. PIGS – Portugal, Ireland, Greece and Spain, according to a disparaging Anglo-Saxon acronym) are greatly penalized by the market that believe they are no longer in the condition to meet their obligations. To issue the new bonds necessary to finance their deficits they must pay increasingly higher interest rates, with a greatly negative impact on the public finance equilibrium. The risk of default of these countries provokes a reaction in the other countries of the Eurozone that, after long and exhausting negotiations, arrange a loan of 110 billion Euros - and a further loan of 109 billion is agreed upon in the extra-ordinary meeting of the Heads of State and Government of the euro area held in Brussels on 21 July 2011 to avoid forcing Greece to turn to the market for help before 2014 -, in exchange of a plan of serious restrictive measures in a country where the GDP decreased of 4,5% in real terms in 2010 after a fall of 2,0% in 2009. And, after having granted Ireland a 85 billion loan (35 of which earmarked to rescue the banks), a plan of slightly inferior dimensions – 78 billion Euros – is being drawn up to rescue Portugal.

But the political consequences are being heavily felt. The German Government lost important regional elections, highlighting the aversion of the German taxpayers for rescue operations of countries considered guilty of having managed their public finances incorrectly, forgetting that a huge quantity of the bonds of the countries that are today facing a serious financial crisis were bought by German banks (from the data of the Bank for International Settlements it emerges that the German banks hold 62 billion dollars of countries peripheral to the Eurozone, of which 22,7 billion of Greek bonds), attracted by the high interest rates that can be earned with these bonds. And during the recent Finnish elections, a new party anti-European obtained 19% of the vote.

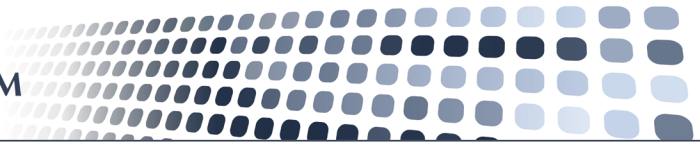
4.- To face the crisis of the sovereign debts, Daniel Gros and Thomas Meyer, in a Policy Brief of Ceps, put forward the proposal to create a European Monetary Fund and this idea has been successively taken up by the German Finance Minister, in an interview with Welt. Gros and Meyer start from the consideration that seen that the Member States of the Eurozone must follow the principle of reciprocal solidarity and can therefore expect



to receive aid from the other countries in case of financial difficulties, they are likewise obliged to create a fund of resources necessary to meet prospective support requests. To avoid the moral hazard risks inevitably connected with each insurance mechanism – as the Member countries of the Eurozone could be induced to adopt an irresponsible financial conduct knowing they can count on an external resource support in case of need-, the two authors suggest that the European Monetary Fund should be exclusively supplied by the countries that break the fiscal rules of the Treaty of Maastricht. In particular, the contributions would be calculated to an extent equal to a yearly 1% of the debt stock exceeding the 60% limit and likewise 1% on the excess of the yearly deficit with respect to the 3% limit. Thus, in 2009 Greece with 115% ratio debt/GDP and a deficit of 13%, should have paid to the Fund a contribution of 0,65% of its GDP (0,55% for the debt excess and 0,10 for the deficit excess).

The intervention of the Fund to help a State in difficulty could be realized either through the granting of a loan or through a guarantee granted for the new issue of public debt bonds. The drawing on the Fund would be without conditions within the limits of the transfer from each State; beyond these limits the State in difficulties should present a program of adjustment that would be evaluated by the Eurogroup and by the Commission. The concrete execution of this plan would be guaranteed by the enforcement instruments held by the EU. In the first place, the guarantee granted by the Fund could be withdrawn or the outpayments of the structural Funds could be suspended. As a last instance, the ECB could decide to stop accepting as collateral for the new liquidity the bonds of the defaulting country. In conclusion, the Fund could support the country in difficulty, which, however, would lose its own sovereignty as far as the management of the economic policy is concerned which would fall under the control of the European level that granted the aid..

Another proposal envisaging the issue of a European Bond to face the crisis of the sovereign debt crisis is put forward by Depla and von Weizsäcker. In a Policy Brief of the think tank Bruegel, the two authors suggest that on the one side the European States should put together their public debt to an extent not exceeding 60% of the GDP (approximately 5.600 billion Euros) by means of an issue of a European Bond (Blue Bond), thus significantly reducing the cost of this share of the debt. For the part of the debt exceeding 60%, the issues would remain a national responsibility (Red Debt), with higher costs that would become a strong incentive to promote a stricter fiscal discipline. Juncker's



and Tremonti's proposal to issue European Bonds through a European Debt Agency is moving along a similar line, in a measure that should progressively attain 40% of the GDP of the member States, absorbing at least 50% of the new issues of the member States. Furthermore, the Agency could exchange national bonds for European bonds with a discount on the face value that increases in proportion to the growth in the level of debt of the country from which the bonds are bought. This would represent a strong incentive to reduce the deficit, the same would apply to the Red Debt of the Depla and von Weizsäcker proposal. A hypothesis similar to the conversion of the national debt and of a financing of a European New Deal issuing Euro bonds was also put forward by Amato and Verhofstadt, supported by Baron Crespo, Rocard, Sampaio e Soares.

5.- A more advanced proposal aiming at further developments of the European Debt Agency was also put forward in Belgium at a political level by Prime Minister Yves Leterme – and taken up again by the President of the Liberal-Democratic Group of the European Parliament Guy Verhofstadt – and at an academic level by Paul De Grauwe and Wim Moesen. In an interview on Le Monde of 5 March 2010 Leterme points out that “the recent market tensions show the limits of the monetary union lacking an economic government” and suggests “creating a common treasury in the Eurozone or a European Debt Agency”. The Agency would act as a European Union institution charged with the issue of the government debt of the Eurozone, under the authority of the finance ministers of the Eurogroup and of the European Central Bank. The European Investment Bank will act as the Agency's secretariat.”. The Agency could take on the burden of existing debt, but each State would continue to pay the market interests according to their solvency degree. This way, observe De Grauwe e Moesen, the risk is avoided that the weak countries would behave as free riders shifting the burden of their debt on the financially stronger countries. Instead, the new issues could benefit from a uniform interest rate, and as the debt becomes due, the Eurozone governmental debt would take the form of a unified debt “which implies that each Member State would implicitly guarantee the debt of all the others”.

During a first phase, after the debt level for each State within the Eurogroup is established, the Agency will gather the corresponding resources and will lend them to the State in question, which, should it not respect the deficit target, will be forced to turn directly to the market paying higher interest rates as consequence of non respect of the Pact. And this penalization will represent a strong incentive to respect the rules of the Pact



itself. Subsequently, a real unified European public debt market will be established, with significant advantages in terms of liquidity, especially for the smaller countries or those more exposed to the risk of a financial crisis, as well as in terms of a reduction of the interest rates, which will also benefit the bigger countries. Finally, at longer term, according to Leterme, the Agency could become “a financing organ for the great projects of transeuropean infrastructures and an instrument to achieve an anti-cyclical budget policy”. It is clearly a proposal with a political relevance as it prefigures, beyond the short term advantages, to come through the Greek crisis in a positive way, the creation of a fund to finance a European development policy and, in perspective, of a federal finance side by side with the national policies of anti-cyclical stabilization.

6.- An analysis of the sovereign debt origins in the countries of the Eurozone is clearly put forward by a paper of De Grauwe, who uses as starting point a comparison between the English and the Spanish economies. In 2011 public debt stock in the UK amounts to 89%, that is 17% higher than the Spanish one (62%). However, the financial markets have picked on Spain and not on the UK, with a gap between the respective interest rates that, in the beginning of 2011 reached 200 basis points (this means that in order to sell its State bonds Spain must offer two percentage points more than the UK).

According to De Grauwe, the explanation for this difference of behaviour of the markets is due to the fact that Spain is a member of a monetary Union, while the UK maintains the control of the currency in which it issues its debt. “National governments in a monetary union issue debt in a ‘foreign’ currency, i.e. one over which they have no control. As a result, they cannot guarantee to the bondholders that they will always have the necessary liquidity to pay out the bond at maturity. This contrasts with ‘stand alone’ countries that issue sovereign bonds in their own currencies. This feature allows these countries to guarantee that the cash will always be available to pay out the bondholders”.

In such a situation, should the International investors perceive a risk of default for the United Kingdom, they would immediately sell the English state bonds in their hands thus provoking a fall of the price of these bonds and, in parallel, an increase of the interest rate. But those who sold the bonds will not want to hold the pounds thus obtained and, most probably, will sell them on the currency market, causing a reduction of the pound’s value. Consequently, the pounds remain available on the internal market and the currency stock remains unchanged. Part of this currency will then be reinvested in State bonds.



Should this not happen and should the government have difficulties in selling its bonds on the market at reasonable interest rates, the Bank of England would be forced to buy new bonds, averting thus that the liquidity crisis triggers a default of the United Kingdom government.

In a situation where the default risks should show up in Spain, the investors would sell their share of Spanish bonds, with a subsequent increase of the interest rates; but it is probable that they would use the Euro realized from these sales to buy German bonds. Consequently, the potential crisis of the sovereign debt would become a liquidity crisis and the Spanish government would have ever increasing difficulties in placing the new issues at reasonable interest rates and, on the other hand, it would not have the power to induce either a support intervention from the Bank of Spain or from the ECB, which is the only one in the position to control the liquidity level within the monetary Union. Therefore, a country within the monetary Union is strongly conditioned by the behaviour of the financial markets.

Analogue considerations are put forward by De Grauwe as regards the problem of the differentials of competitiveness among the countries of the monetary Union. If the unit labour costs grow more in the PIGS than in the rest of the Eurozone and the countries involved cannot devalue their currencies, the only alternative is to start a deflationary process that would lead to a wage and price reduction to render the economy more competitive. But a recession situation leads endogenously to a worsening of the deficit through a contraction of the revenues induced by reduction of the growth rate of the GDP. The worsening of the deficit will provoke a further loss of confidence by the financial markets that can increase the risk of default, with negative consequences even on the other countries of the monetary Union due to the high level of financial integration existing within the area.

De Grauwe's conclusions are also important to evaluate the recent decisions of the European Council in terms of governance. "Like with all externalities, government action must consist in internalizing them. This is also the case with the externalities created in the Eurozone. Ideally, this internalization can be achieved by a budgetary union. By consolidating (centralizing) national government budgets into one central budget, a mechanism of automatic transfers can be organised. Such a mechanism works as an insurance mechanism transferring resources to the country hit by a negative economic



shock. In addition, such a consolidation creates a common fiscal authority that can issue debt bonds in a currency under the control of that authority. In so doing, it protects the member states from being forced into default by financial markets”. And concludes: “This solution of the systematic problem of the Eurozone requires a far-reaching degree of political union”. The problem to be solved is not of a technical nature, but is a political one and it is therefore necessary to single out the course to follow to achieve at last a real Federation. As Amartya Sen rightly points out in a comment on The Guardian with the significant title (Europe’s democracy itself is at stake), “monetary freedom could be given up when there is political and fiscal integration (as the States in the USA have)”. And even more clearly, Joschka Fischer concludes that “at the heart of resolving the crisis lies the certainty that the Euro - and with it the EU as a whole – will not survive without greater political unification. If Europeans want to keep the Euro, we must forge ahead with political union now; otherwise, like it or not, the euro and the European integration will be undone”.

II. The recovery plan and the creation of a Federal Fiscal Union

7.- With the worsening of the sovereign debt crisis and the slowness of the European economic recovery, the member countries of the EU find themselves clamped in a vice increasingly tight: on the one hand they were forced to adopt measures, many very hard and of immediate effectiveness, to avert the risk of collapse of whole sectors, financial as well as industrial; on the other hand, they were forced to meet the unavoidable need to support the workers that lost their jobs and, in general, lower income classes that suffer the effects of the crisis to a greater extent. All this in a situation where the public finance is deteriorating endogenously due to the contraction of the revenues following the fall of income, which is also tied up by the necessity to avoid overcoming in a significant manner the restrictions imposed by the Maastricht Treaty to avoid being strongly penalized by the markets.

Considering the budget problems that weigh heavily on the countries of the Eurozone, limiting heavily the possibility to launch a recovery policy, at this point it is widely felt that a decisive role to help the recovery should be played by the European



Union, reducing the social tensions that are becoming unbearable in many countries and reducing – through the automatic expansive effects on the tax revenues – the ties that weigh on the national budgets. But the budget resources of the Union are limited and, in any case, at the moment the governments seem taken up by discussions about the measures of bailout without taking the trouble to implement a wider ranging plan. Therefore, to try getting out of this impasse it is necessary that the federalists understand how to promote as soon as possible an initiative to launch – in full synergy with similar initiatives that are gaining ground within the European Parliament – the accomplishment of a political project envisaging the creation stage by stage of a federal finance in Europe, along the lines followed in the past to arrive at the single currency. And the starting point for the elaboration of this plan is represented by the consciousness that the current crisis marks the end of a phase of the growth process of the European economy and that the current crisis will not be overcome with a policy exclusively aiming at supporting the demand of consumer goods.

Instead, to launch the recovery in Europe, it is necessary to promote the realization of a sustainable development model on the economic, social and environmental plan; by consequence, the motor for this new development phase is represented by the public investments for production not only for material goods- necessary as much as the infrastructures (transports, energy, broadband) – but rather for the immaterial ones, in particular basic research and higher education and investments aimed at supporting technological innovation, with the aim of increasing the productivity and competitiveness of the European industry that by now has reached the technological frontier. But in Europe and in the member States, this revival of the public investments clashes with the budget limits: as a consequence of the financial restrictions common to all the Eurozone countries, from 1980 to 2010 the ratio of public investments/GDP fell from more than 3,5% to less than 2,5%. As it was recently pointed out in the report “Europe for Growth. For a Radical Change in Financing the EU”, presented by the members of the European Parliament, Haug, Lamassoure e Verhofstadt, the revival of the European economy requires a strong inversion of tendency, with an increase of approximately 1% of new public investments of the European GDP, that is 100 billion Euros.

8.- In this perspective, to overcome the financial crisis that is holding back the growth of investments and, consequently the GDP growth in Europe, with the ensuing



serious social tensions and with the difficulties of balancing the public budgets in a stagnating economy, the first step of the plan is to create a European Fiscal Institute, whose main task is to arrange the bail-out of the countries that risk to be swept away by the sovereign debt and to pave the way for the subsequent evolution toward a Federal finance and the setting up of a European Treasury. The Fiscal Institute could play a role in the setting up of a Fiscal Union that was entrusted to the European Monetary Institute and as prerequisite for the start of the ECB.

An important step in this direction was the decision of the European Council with the resolution of 24-25 March 2011 to go ahead with the creation of a European Stability Mechanism, also through an amendment to article 136 of the Treaty that allows activating the support mechanism when necessary to guarantee the stability of the Eurozone. The ESM loan capacity will be 500 billion Euro and should become operative in June 2013, replacing the European Financial Stability Facility (EFSF), launched by the Eurozone in May 2010 and made operative in the following June. The EFSF is a company that issues bonds and other debt instruments on the market to fund the States of the area in difficulty with loans guaranteed by the other member States and conditional on the accomplishment of a plan of debt reduction by the countries receiving the loans. In the meeting of the Heads of State and Government of the euro area, held in Brussels on 21 July 2011, the lending capacity of the EFSF was largely increased – up to 440 billion Euros – and, furthermore, the right to purchase bonds of every State of the Eurozone on the secondary markets is guaranteed, with limited constraints. At the same time, the conditions of the loans are improved and the time for reimbursing the loans received is extended.

These decisions support a radical change of the EFSF that was previously only an instrument for granting loans to avoid the risk of default of countries that are facing a sovereign debt crisis, and is now aiming at becoming effectively a lender of last resort, having the power to purchase bonds, on the secondary market, of those countries risking default. But a further step forward is carried out, on the institutional field as well, with the agreement for launching the ESM, which is an intergovernmental institution created with a treaty endorsed by the Eurozone countries. It will be led by a Board of Governors formed by the Finance Ministers and will take decisions by a qualified majority vote and only the granting and the conditions of a loan to a country with financial difficulties and the changes of the dimensions and instrument composition at the ESM disposal will have to be decided



by mutual agreement, which implies that the decision will have to be taken unanimously by the countries that are taking part in the vote, therefore, an abstention will be prejudicial to the taking of a decision.

The limitations of this institute are obvious as each decision about the allocation of funds is subject to the unanimous consensus of the governments that take part in the decision; furthermore the granting of loans is penalized by the rates of interest (the provision cost plus 200 basis points) and is subject to a costly fiscal adjustment at the social level, as well as unrealistic in the absence of a European policy that can guarantee the starting up of a renewed phase of growth. But this first phase of the process – if it is clearly announced to the market with a political decision as a prelude to the creation of a true Federal Fiscal Union – should be able to guarantee the financial stability of the weak countries and, by consequence, reduce the spread vis-à-vis the bonds of the stronger areas, as was the case in the '90 with a reduction of the interest rates for the countries engaged in organizing the conditions for the entry in the single currency.

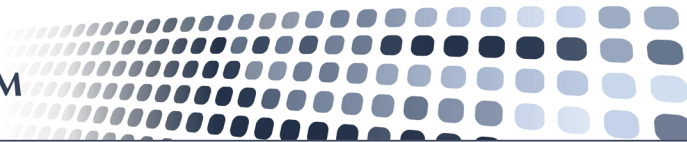
In a second phase it is necessary to start the issue of Eurobonds to contribute to the provision of the necessary financial means to support the realization of the plan for the recovery of the European economy, in order to favour an increase of the European productivity and competitiveness and at the same time to promote a transition toward a sustainable economy. The European Investment Bank could provide the financing of the investments that could guarantee a yield on the market, thus covering - with the income generated from the investments - the cost of the interests and the repayment of the capital, through the issue of Eurobonds. But to finance the investments earmarked for the production of European public goods (secondary education, research and innovation, new technologies, environmental conservation, as well as of the natural resources and of the artistic heritage, renewable energies, soft mobility) that represent a *conditio sine qua non* to guarantee a long term sustainable growth of the European economy, it is necessary, on the one hand, to provide the issues of Eurobonds, and at the same time to guarantee to the European budget the necessary fiscal resources for the service and the repayment of the debt.

To make it politically manageable, the increase of the European budget must be very moderate and must not exceed in the medium term 2% of the GDP, as was already suggested in 1993 by the commission of experts charged with studying the role of the fiscal



policy in a monetary and economic Union through the report “Stable Money - Sound Finances. Community Public Finance in the Perspective of EMU”. It is clear that if the needs of investments to be financed with the European debt grow, the necessity to proceed to a reform of the structure of the European budget will gain strength. Obviously it is necessary in the first place to envisage the return to a system of veritable own resources. In fact, the c.d. fourth resource is not real own resource, but only a National contribution proportional to the GDP that could be replaced by a European surtax on the National income tax – that would not be affected by the reform – paid directly by the citizen to the European budget guaranteeing a greater transparency of the levy and at the same time strengthening the responsibility of those who use the resources.

9.- A new resource could be guaranteed to the European budget by the approval of the proposal of a Directive, recently put forward by the Commission, relative to the introduction of a carbon/energy tax as from 2013. In a situation where the risks connected to the climate changes are by now more and more clear and the need of replacing the fossil fuels with alternative energy sources is becoming more and more pressing, a tax also in line with the carbon content of the energy sources appears as an adequate instrument to start up virtuous processes of energy-saving and of fuel-switching to renewable energy sources, thus reducing the negative impact of the energy consumption on the environment and facilitating the introduction of productive processes less energy-intensive. In this prospective of budget reform, the introduction of a taxation of the financial operations of a speculative nature could be taken into consideration in perspective of guaranteeing as well a more orderly development of the international financial system. At the same time, part of the yield of this tax could be earmarked to the financing of the production of global public goods by means of a European contribution to promote the constitution – in agreement with the United States and the other countries of the G20 – of a world fund for a sustainable development. During the last phase of the realization of a Federal Fiscal Union, the budget, financed with own resources by the Union, should be run by a European Treasury of a federal nature, responsible of the realization of a sustainable development plan and for the coordination of the economic policy of the member states.. In this way, also the attractiveness of the debt instruments issued by the Union would grow, guaranteed by the levies flowing directly into the Federal coffers. Once this institutional change is made, it would then seem realistic to envisage the creation of a European Finance Minister,



as was proposed by the ECB President, Trichet and, later, by the Dutch Governor, Wellink and by Jacques Attali.

The plan aimed at the creation of a Federal Fiscal Union and at the institution of a European Treasury should be the subject of a decision of the European Council, establishing the deadlines for the different phases and, most of all, the final date that will mark the beginning of Fiscal Union operations. But a decision of this nature, as relevant as it might be, is not sufficient. There is a basic difference between the Fiscal Union and the Monetary Union. The ECB is a constitutional organ whose independence is ratified by the Treaty of Maastricht and whose task – important but limited – is to guarantee price stability with interventions decided in full autonomy. The Treasury is a constitutional organ of a different nature because the fundamental principle of democracy is “No Taxation without Representation”. The Treasury can operate efficiently only if it has consensus and therefore must be subject to the democratic control of the Parliament and act within the framework of a government representative of the people’s will. In conclusion, the decision to go ahead with the construction of the Fiscal Union, with a Treasury and a Federal Finance, must be backed by a contextual decision fixing the date for the start of the complete Federation, also contemplating, in perspective, a European Foreign and Security policy.

10.- A plan including from the beginning the objective to arrive at a Federal Fiscal Union, could presumably have the same impact on the market as the single currency had on the interest rates. Various proposals for the creation of a European debt have been put forward several times, but, as was the case for the single currency, these proposals have been rejected so far, in particular by the German and English governments. This last objected as a matter of principle because it is quite aware that to go forward on the field of European finance presupposes that in the meantime the Union evolves toward a federal type structure. On its side, the German government rejected the idea of a common European bond because its issue would imply an additional cost for Germany.

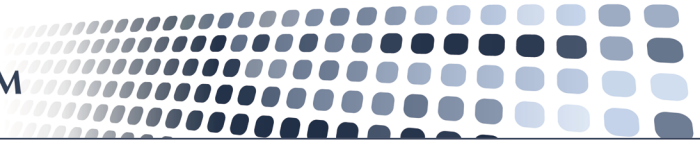
The validity of this prediction is based on the idea – questionable insofar as the creation of a European debt is connected with the step by step setting up of a Fiscal Union of a federal nature – that the market must necessarily incorporate in the price of the European bond the risk of the emissions issued by the weakest countries. Furthermore, the German government does not take into account the negative effects that the public finance deterioration, fuelled by the increase of the issue cost triggered by the widening of the



spread, and the risk of default of these countries would have all the same on the German economy and, more generally on the development perspectives or, even on the Eurozone survival. Likewise, financing a European plan for the recovery of the economy financed by a European debt is no longer avoidable since, given the interdependence of the economies of the monetary Union, it is in the interest of each country to act as a free rider, avoiding to launch measures backing the economy at the national level as it can benefit from the positive effects stemming from the recovery policies carried out in the other countries.

11.- Two conclusive comments can be drawn from these considerations. First of all, Europe following the crisis is increasingly seen as something, not only unrelated to the citizens' ordinary lives, but even as something hostile, imposing restrictions and sacrifices without guaranteeing a better and safer future. It is therefore time to change, setting rapidly up in the Eurozone a development plan to relaunch the European economy and employment. The plan can be financed with the issue of Bonds denominated in Euro, guaranteed by the European budget and bound to collect the huge money stock circulating in Europe. With a change of the development perspectives and the solution of the problems connected with the sovereign-debt crisis, the citizens' confidence will be reinstated, thus favouring the evolution towards a Federal outcome of the European unification process through the creation of a Federal Treasury responsible for the budget management and the coordination of the European economy policy to promote a sustainable development. In this way, after the single currency, the second arm of a Federal State would be created, in view of the process completion assigning to the Union of a decision-making power even in foreign and security policy.

The second consideration regards the perimeter within which this process can be started off. The point of departure is certainly represented by the Eurozone, where an ever increasing interdependence is manifest and where it is possible to foresee further development in a Federal direction. Within this perimeter – whose contours cannot be defined a priori, but that surely does not correspond with the framework of the Union of 27 – it is necessary to reckon which are the countries that can take on the initiative. Historically at the start there has always been a Franco-German initiative, with Italy pushing in the direction of a Federal outcome of the process. The Federalists' task, as at the epoch of the struggle for the European currency, is to devote themselves to the mobilization of the political and social forces, with the aim of promoting a political

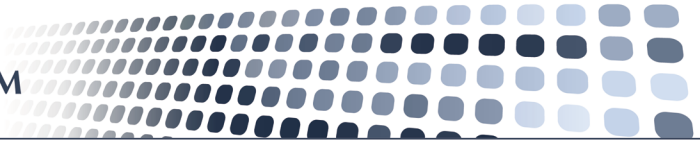


decision from the Eurozone governments, pushed by the support of the European Parliament, to achieve the creation of a European Treasury and of a Federal Fiscal Union, an important step in the direction of a completed European Federation.

At the moment is difficult to foresee how the sovereign-debt crisis will develop, but it already had the effect of showing the inadequacy of the present set up of the Economic and Monetary Union. The ten years growth of the euro seemed to have swept away the doubts on the efficiency of the Maastricht norms and of the restrictions of the Stability Pact. But, first the financial tsunami that hit the world economy and then the Greek crisis and the effect arising in other countries emphasized the weakness of the institutional structure of the EMU. The Eurozone governments succeeded in avoiding the collapse of the economy putting into effect the bailout of the banking system and guaranteeing a minimum of support to the productive system also in order to avoid a collapse of the social stability. But nor within the Ecofin, nor within the Euro Group it was possible to start off a serious strategy to guarantee in a short time a significant economic recovery and consequently of the competitiveness of the European industrial system.

Furthermore, the Greek crisis highlighted the weakness of the government structure of the European economy. While the European Central Bank, being a Federal body, with a decision-making power, acted immediately to promote the financial sustainability, guaranteeing to the system the liquidity supply using as collateral even the bonds of the Greek public debt, the decisions about the financial support mechanisms within the Eurogroup have been slow and most probably inadequate. The reason for this weakness clearly derives from the confederal nature of Europe in the economic policy management, which favours free rider behaviours and, with the right of veto, guarantees an unjustifiable privilege particularly of the stronger States.

As it already happened in the past, each European crisis presents a twofold aspect: on the one side it makes the break-up of the results already achieved concretely possible. Today the more concrete risk is that speculative attacks can arise against the other countries of the Eurozone, with serious risk for the survival of the single currency itself. But, at the same time, each crisis makes new headways possible for a greater integration within the Union, and in particular for the countries where the integration level already reached is more advanced. In fact, after the Greek crisis, a debate started up among those that intend to carry on with the integration process, also with the creation of new



institutions and the start of new policies, and those who instead plan to strengthen the decision-making power at a national level, preventing in fact the solution of the European crisis.

Lately, the balance pendulum between the National levels and the Union level shifted considerably in favour of a return of the decision-making power in the hands of the National governments and of the body at the highest level that unites them in the Union, i.e. the European Council, that many consider as the natural depositary of the decision-making power as regards the economic policy management. But some proposal put forward recently include instead significant passages toward a more efficient governance of the European economy, less bound by the national powers. But it is necessary to make clear that the decisive point is essentially political: it is a question of transferring at a European level the power – that up to now had been jealously guarded by the Member States – to manage autonomously the fundamental decisions in political economy matters, thus completing the construction of the Economic and Monetary Union through the creation of a Federal Treasury with the possibility of guaranteeing an effective coordination of the national policies by means of a power, limited but real, at a European level of government.

In the sovereign debt crisis that started in Greece, the first thing that surfaced was the serious behaviour of the Greek Government, with the manipulation of the data relative to the public budget. But the crisis is also the consequence of a steadily growing divergence between the real trend of the economy of the weak countries and that of the other partners of the EU. In this sense even a tightening of the restrictions of the Stability Pact, as recently proposed by various sources, appears totally inadequate. Instead, it's necessary to strengthen the possibility of starting a development policy at the European level through the availability of greater funds to promote an increase of the productivity and by consequence of the competitiveness of the Eurozone economic system. But it's also necessary to strengthen the coordination powers of the National economic policies to avoid that the diverging trends of the different economic systems within the Eurozone that cannot be balanced by currencies exchange variations, lead to an implosion of the Eurozone. *Hic Rhodus, hic salta*. The Greek crisis proved that the modest institutional progress obtained with Treaty of Lisbon are totally inadequate to achieve the establishment of a European Federal State, with temporarily limited competences in the sector of the



economy and currencies management, in the context of the group of countries within the EU where the integration level is more advanced, and in particular in the Eurozone.