COMPLETING ECONOMIC AND MONETARY UNION 3: FISCAL UNION

Centrum für Europäische Politik

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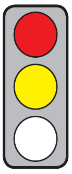
KEY ISSUES

Objective of the Measures: The five Presidents want to create a Fiscal Union. The Commission has submitted initial proposals for its implementation.

Affected parties: All citizens and companies.



Pro: The exchange of best practice between national fiscal councils may help them to better fulfil their task.

Contra: (1) Coordinating national fiscal policies by way of a fiscal "stance" for the eurozone will not achieve its aim because the economies of the individual eurozone countries are not sufficiently integrated with one another.

(2) A "macroeconomic stabilisation function" for the eurozone will reduce the incentives for the eurozone countries to maintain a sufficient buffer for absorbing severe shocks.

CONTENT

Title

Report of 22 June 2015 **Completing Europe's Economic and Monetary Union**, submitted by Jean-Claude Juncker, President of the European Commission in close cooperation with Donald Tusk, President of the European Council; Jeroen Dijsselbloem, President of the Eurogroup; Mario Draghi, President of the European Central Bank and Martin Schulz, President of the European Parliament;
Communication COM(2015) 600 of 21 October 2015: **Steps towards Completing Economic and Monetary Union;**
Commission **Decision (EU) 2015/1937** of 21 October 2015 **establishing an independent advisory European Fiscal Board**

Brief Summary

► **Context and Objective**
- In the Five Presidents' Report of June 2015, the Presidents propose the creation of four unions:
  - an Economic Union (see cep**PolicyBrief**),
  - a Financial Union (see cep**PolicyBrief**),
  - a Fiscal Union (this cep**PolicyBrief**) and
  - a Political Union (see cep**PolicyBrief**).
- The objective is to strengthen "economic policy coordination, convergence and solidarity" in the eurozone (p. 2 Five Presidents' Report).
- The four unions will be achieved in two stages (p. 5 Five Presidents' Report):
  - Measures under Stage 1 will be completed by 30 June 2017.
  - Measures under Stage 2 will be completed by 2025 at the latest. Some of these measures require "changes" to the current "EU legal framework".
- The Commission submitted the following documents in October 2015 aimed at setting out the details of Fiscal Union:
  - a Communication on all four Unions [COM(2015) 600] that also deals with the creation of the Fiscal Union and
  - a Commission Decision "establishing an independent advisory European Fiscal Board" [Decision (EU) 2015/1937].
- The following analysis deals with the proposals contained in the Five Presidents' Report regarding Fiscal Union and the accompanying Commission proposals. The Fiscal Union includes (p. 13 et seq. Five Presidents' Report)
  - the creation of a European Fiscal Board for the eurozone (Stage 1), substantiated in the Commission Decision (EU) 2015/1937 and
  - the creation of a "macroeconomic stabilisation function" for the eurozone (Stage 2) which has not yet been substantiated.

► **European Fiscal Board: Responsibilities**
- The Commission has decided - as proposed by the five Presidents - to set up an independent advisory European Fiscal Board for the eurozone [Decision (EU) 2015/1937].

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– The European Fiscal Board will act on behalf of the Commission [Art. 2 (2) (a) Decision (EU) 2015/1937]
  - to evaluate the implementation of the European fiscal rules and, on that basis, develop proposals to improve European fiscal rules as well as
  - to assess the current fiscal "stance" of the eurozone as a whole and of individual eurozone countries; the assessments will be based on European fiscal rules - in particular the Stability and Growth Pact.
– The European Fiscal Board prepares advice for the Commission on the future fiscal "stance" of the eurozone as a whole and of the individual eurozone countries [Art. 2 (2) (b) Decision (EU) 2015/1937].
  - The national fiscal "stances" will support the eurozone's "stance" and be consistent with the Stability and Growth Pact.
  - Where the European Fiscal Board identifies budgetary risks which jeopardise the functioning of the Economic and Monetary Union, the advice will also contain possible options for action under the Stability and Growth Pact.
– The European Fiscal Board must provide "ad hoc advice" at the request of the Commission President [Art. 2 (2) (d) Decision (EU) 2015/1937].
– It will work together with the national "fiscal councils" [Art. 6 (1) b Directive 2011/85/EU] – which, as independent bodies, oversee compliance with national fiscal rules. In this regard, there will be [Art. 2 (2) (c) Decision (EU) 2015/1937]
  - a common understanding on European fiscal rules and
  - an exchange of best practice.
– The European Fiscal Board publishes an annual report summarising the advice and evaluations which it has rendered to the Commission [Art. 6 Decision (EU) 2015/1937].

► **European Fiscal Board: Composition**
– The European Fiscal Board consists of a Chairman and four additional members [Art. 3 (1) Decision (EU) 2015/1937].
– They are proposed by the Commission President and appointed by the Commission [Art. 3 (2) Decision (EU) 2015/1937].
  - Before proposing the Chair and one other member, the Commission President consults the Commission Vice-President for the Euro and Social Dialogue and the Commissioner for Economic and Financial Affairs, Taxation and Customs.
  - Before proposing the other three members, the Commission President consults the national fiscal councils, the European Central Bank (ECB) and the "Eurogroup" Working Group.
– All members of the European Fiscal Board must be renowned international experts in the areas of macroeconomics and public finances [Art. 3 (3) Decision (EU) 2015/1937].
– The four ordinary members are appointed for three years. The period can be renewed once. No such rule applies to the Chair. [Art. 3 (4) Decision (EU) 2015/1937]
– The European Fiscal Board is supported by a secretary [Art. 3 (7), (8) Decision (EU) 2015/1937].

► **European Fiscal Board: Method of working and decision-making**
– Members of the European Fiscal Board are independent and are not permitted to seek or take instructions [Art. 4 (1) Decision (EU) 2015/1937].
– They have to disclose any possible conflicts of interest which may arise in relation to an evaluation or advice. Any decision to exclude an ordinary member from an evaluation or advice is taken by the Chair; a decision to exclude the Chair is taken by the whole Board [Art. 4 (2) Decision (EU) 2015/1937].
– The European Fiscal Board adopts advices by consensus. If this is not possible, decisions are made by simple majority. In the event of a tie, the Chair has the casting vote [Art. 5 (1) Decision (EU) 2015/1937].

► **"Macroeconomic stabilisation function"**
– The five Presidents propose a "stabilisation function" for the eurozone to absorb severe macroeconomic shocks (p. 14 Five Presidents' Report).
– The "stabilisation" function will only be set up once the following conditions have been met (p. 14 Five Presidents' Report):
  - a "significant degree" of economic convergence in the eurozone,
  - "financial integration" in the eurozone and
  - better coordination on national budgets.
– Eurozone countries will only be permitted to "join" the "macroeconomic stabilisation function" where they (p. 9 and 15 Five Presidents' Report)
  - show "convergence" towards "similar" "resilient" economic structures in line with those which the five Presidents are aiming to achieve within the framework of the Economic Union (see cep**PolicyBrief**) and
  - comply with fiscal and economic-policy EU rules .
– The five Presidents propose using the European Fund for Strategic Investment (EFSI, Regulation (EU) No. 2015/1017; see cep**PolicyBrief** and cep**Input**) as a "stabilisation function" (p. 15 Five Presidents' Report).
  - For this, the participating eurozone countries can use "financing sources and investment projects" - depending on the economic situation in their country.
  - In addition to the fund, other sources of financing will be considered.

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– The "stabilisation function" will be designed, in particular, according to the following principles (p. 17 Five Presidents' Report):
  - It should not lead to permanent transfers between countries.
  - It should not be conceived as a way to equalise incomes between states.
  - It should not undermine incentives for sound fiscal policy or for addressing structural weaknesses.
  - It should not be an instrument for crisis management as the European Stability Mechanism (ESM) already performs that function.

Policy Context

The Five Presidents' Report builds on the 2012 "Four Presidents' Report" (without the EP President) on Economic and Monetary Union (see cep**PolicyBrief**) and on the Commission Communication on "A blueprint for a deep and genuine economic and monetary union [COM(2012) 777]. The Euro Summit of 24 October 2014 called on the Presidents to prepare "the next steps on better economic governance" in the eurozone. In mid-2016, the Commission wants to set up an expert group to examine the "legal, economic and political preconditions" for the measures in Stage 2. In spring 2017, the Commission will submit a White Paper, prepared also by the Presidents of the other EU institutions. The White Paper will assess the progress made in Stage 1 and outline the next steps – particularly the legal measures of Stage 2.

ASSESSMENT

Economic Impact Assessment

Sustainable levels of public debt are necessary to avoid further crises. The European fiscal rules should eliminate non-sustainable levels of public debt but up to now, some eurozone countries have failed to consolidate their budgets because the Commission is flexible in its interpretation of the rules. The decision to set up the European Fiscal Board may counteract this. The requirement for this is that, in its proposals for improving the European fiscal rules, the Board reduces the Commission's scope for interpretation. In particular, it should call on the Commission to withdraw the flexible interpretation of the Stability and Growth Pact, which the Commission published on 13 January 2015 in its Communication [COM(2015) 12]. Since then, for example, it has been possible for structural reforms to justify a higher deficit even before they have been adopted.

Coordinating national fiscal policy by determining a fiscal "stance" for the eurozone as a whole, which the European Fiscal Board will do, **will serve no purpose**. Although many eurozone countries are currently having to consolidate their budgets - irrespective of the economic situation - which may aggravate recessionary tendencies in these countries, a coordinated fiscal stance for the individual eurozone countries will do nothing to change this **because it would require the economies of the individual eurozone countries to be so closely integrated as to allow the expansive fiscal policy of one eurozone country to counterbalance a recession in another eurozone country.** Despite the internal market, this is not the case in the eurozone. Due to the insufficient level of integration, a fiscal policy which is appropriate for other eurozone countries but not one's own country, will exacerbate the economic fluctuations in this country.

Exchanging best practice between national fiscal councils may help them to better fulfil their task - making national policy more responsible for securing long-term sustainable budgets.

The fact that the European Fiscal Board only publishes its evaluations and advices once a year in the form of a report, reduces the pressure on the Commission to follow the Board's suggestions. All evaluations and advices from the Board should therefore be published immediately.

States affected by a severe economic shock can support the economy by way of debt-financed expenditure and/or devalue their currency. The second alternative is not open to eurozone countries. This increases the pressure to absorb shocks by way of new public debt. If the debt level is already very high, this alternative may also be blocked. In the second stage of Fiscal Union, the five Presidents therefore want to create a "macroeconomic stabilisation function" for the eurozone. This refers to measures to stabilise the economy which eurozone countries can use in a recession and which are financed jointly by all the eurozone countries. On balance, such **a "macroeconomic stabilisation function" for the eurozone** is misguided because it **reduces the incentive** for the eurozone countries to ensure they can deal quickly with economic shocks themselves by way of flexible labour markets. In addition, it reduces the incentive **to maintain a sufficient buffer for absorbing severe shocks by way of low dept level.**

The proposal of the five Presidents, aimed at dealing with this incentive problem by only allowing eurozone countries to take part in the "stabilisation function" when they display convergence towards "similar" "resilient" economic structures and when they also comply with the fiscal and economic EU rules, will not work. Firstly, there is a danger that countries will be included for political reasons even though they do not display any "convergence" or do not comply with the EU rules. Secondly, there is a risk that the convergence rules and the EU rules will be given such a lax interpretation that all eurozone countries will meet them. Thirdly, once a country has taken part in the "stabilisation function" it will not be politically possible to exclude it even if it does not comply with the EU rules.

Legal Assessment

Legislative Competency

Whether the EU has the competence to introduce a "macroeconomic stabilisation function" depends on its actual design. In order to be able use the EFSI as a "macroeconomic stabilisation function" for the eurozone, it is probable that the EFSI Regulation [Regulation No. 2015/1017] will have to be amended because it does not provide for the use of financing sources and investment projects on the basis of economic development. In addition, the EFSI aims to promote projects "without geographical pre-allocation" (No. 8 Annex II EFSI Regulation). This could exclude investment projects for macroeconomic stabilisation aimed specifically at the eurozone. Incidentally, it should be noted that the EFSI is funded ultimately by all Member States and not only by eurozone countries.

It is doubtful whether the competence exists to amend the EFSI Regulation to enable the EFSI to be used, in future, for investment projects in the eurozone based on economic development. The EFSI Regulation was based on the EU powers for the establishment and development of the trans-European networks (Art. 172 TFEU), promoting competitiveness (Art. 173 TFEU), strengthening economic, social and territorial cohesion (Art. 175 (3) TFEU) and establishing a multiannual framework (Art. 182 (1) TFEU). Only Art. 173 TFEU is available for the proposed amendment of the EFSI Regulation. This power specifically permits the EU to take "specific actions" necessary for strengthening the economic, social and territorial cohesion of the EU "as a whole" (Art. 175 (3) TFEU in conjunction with Art. 174 TFEU). The aim of "stabilisation function" is not, however, the cohesion of the EU as a whole but relates only to the eurozone. Another legislative competence is not apparent so attention turns to the flexibility clause (Art. 352 TFEU). Whether changes to the EFSI can be based on the flexibility clause depends on the actual design of "stabilisation function". Otherwise – as the five Presidents have already mentioned in relation to some of the measures in Stage 2 – amending the EFSI will require changes to the EU Treaties in order to obtain the necessary powers.

Subsidiarity

In principle, due to its cross-border nature, a Fiscal Union can only be realised at EU level. This is unproblematic in relation to the European Fiscal Board and otherwise dependent on the specific design of the Fiscal Union.

Proportionality with respect to Member States

Unproblematic in relation to the European Fiscal Board. Otherwise dependent on the specific design of the Fiscal Union.

Compatibility with EU Law in other respects

Unproblematic in relation to the European Fiscal Board. Otherwise dependent on the specific design of the Fiscal Union.

Impact on German Law

Unproblematic in relation to the European Fiscal Board. Otherwise dependent on the specific design of the Fiscal Union.

Conclusion

Coordinating national fiscal policies by way of a fiscal "stance" for the eurozone will not achieve its aim because the economies of the individual eurozone countries are not sufficiently integrated with one another. The exchange of best practice between national fiscal councils may help them to better fulfil their task. A "macroeconomic stabilisation function" for the eurozone will reduce the incentive to maintain a sufficient buffer for absorbing severe shocks.