What could a euro-area finance minister mean?

The idea of a euro-area budget and finance minister have been around for a long while, but the arrival of President Macron gives the proposals new impetus. Guntram Wolff asks why might the euro-area need a budget, and what would it do?

With the election of Emmanuel Macron as president of France, the idea of a euro-area treasury and finance minister is back in the limelight. The election programme of Emmanuel Macron calls for *"a budget for the euro-area voted by a euro-area parliament and executed by a euro-area finance minister"* with the aim to *"be able to invest much more than currently".*

This call is broad and needs to be filled with content. And unless there is a clearer articulation of what key issues such a project is trying to resolve, there will be little support for moves in that direction – as recent sceptical voices from Germany have already foreshadowed.

I see five major issues that deserve to be discussed. None can be answered in isolation, as they are economically, politically and legally connected.

Why would the euro-area need a budget?

The first and most fundamental question regards the purpose of a euro-area budget. There are various reasons why Europe might want to pursue this project – which are not mutually exclusive. I assess a few of them.

As the budget of a federal euro-area?

The euro-area could decide to become 'fully federal' in the hope that a federal construction (such as in the US or Switzerland) would deliver stability. In that case, important government functions would have to be shifted to the federal level: for example, defence and the social security system. This would also mean significant federal taxation powers. With taxation power, there could also come the ability to issue debt. Such a federal construction would make it possible to centralise macroeconomic stabilisation for the euro-area.

For this to be realistic, a euro-area state would need to be created and the nation state would lose important parts of its sovereignty. This would be a major shift of powers from national capitals to the federal level. The upside of this option is that macroeconomic stabilisation policies could be shifted to the euro-area level. This could, if used wisely, significantly improve the functioning of the single currency zone. The downside of this option is that countries are actually very different in terms of traditions, histories and the ways they spend money. This is not just about some legal-technical obstacles such as the difficulty of enacting treaty changes. It is about the core of the nation state.

My overall take is that the potential upsides of a federal option for improving macroeconomic management are not great enough to warrant giving up the differences between national systems, which result from very different pref-

Developing the fiscal dimension of the euro-area will have profound implications for the legal order, for economic resources and for moral hazard. The euro-area will need a sincere debate about the pros and cons of all options erences about what the state should be doing. I do not see any political will to go down that road, which implies that policy makers throughout Europe have come to the same conclusion. A federal euro-area is therefore not desirable.

As a tool to strengthen public investment?

The formulation in the programme suggests that a euro-area budget is about increasing investment. But is a budget really necessary to increase investment? The euro-area does indeed have an investment deficit. Low private investment combines with public investment that is still well below pre-crisis levels. Public investment is low mostly as a result of national budgetary decisions. Most euro-area countries can borrow cheaply in the market and could use that borrowing for public investment. Many could also save less (such as Germany) or shift spending towards investment and away from unproductive spending items.

However, being members of a monetary union, fiscal space is more limited than it would be outside. Monetary financing of debt is prohibited and fiscal rules impose limits on the fiscal room for manoeuvre. In particular, fiscal rules do not differentiate between investment spending and other spending. This implicitly constrains investment as there is no 'golden rule' that would allow borrowing for investment purposes without affecting the deficit calculation relevant for the fiscal rules. The benefits of investment are spread over many years, while the costs cannot be spread[1] according to the rules. Thus, in tight budgetary years there will be a tendency to cut investments first. On the other hand, a golden rule can of course be misused.

A solution to the investment problem resulting from fiscal rules would be to introduce some form of golden rule (my colleagues have proposed an asymmetric golden rule). So, to increase public investment in the euro-area, political will from national fiscal policy makers and possibly a tweaking of the fiscal rules would go a long way. Investment thus cannot the main justification for establishing a euro-area budget.

To create euro-area borrowing capacity as part of a political deal?

If one wishes to tighten fiscal rules and constrain national borrowing more significantly than currently, a euro-area borrowing capacity could be a way of achieving that. The more 'federal' options exist to fund investment, the easier it will be to credibly enforce tight national borrowing limits. This is ultimately about a political compromise: less national discretion for more federal resources.

One option would be to create a capacity at the federal level that would be sufficiently large to allow the euro-area to manage its business cycle. In exchange, national fiscal policy makers would not be able to borrow in markets for new national deficits beyond tough limits. Such a capacity could also have implications for whether the ECB's Outright Monetary Transactions (OMT) programme was still needed.

Of course, this option would represent a major change in the way the euro-area functions. The advantage is that it would end the moral hazard of current national fiscal policy arising from the possibility of a euro-area bail-out. However, to really achieve such limits to national borrowing, national constitutions would have to be changed, limiting the ability of national sovereigns to issue low-interest debt.

Moreover, the federal 'borrowing capacity' would need to be able to rely on rather significant tax resources to be able to borrow at low rates. Finally, this option would only be possible if all players had trust that the decision-making process at the federal level would be appropriate and not permanently violate their interests.

To support countries at risk of losing market access?

A separate issue is how to deal with government spending in countries that lose or are at risk of losing market access. A euro-area budget could provide relief to such a country and support its spending. It is economically the same whether this support would come in the form of money for investment or as an insurance to back up unemployment spending. The economic equivalence comes from the fact that money is fungible: any transfer can basically be redirected to different purposes.

However, the kind of spending chosen for the euro-area budget has governance implications. In particular, a scheme such as European unemployment (re-)insurance would disburse money automatically rather than based on political-discretionary decisions. The necessary decision-making process would correspondingly be different.

A euro-area budget could thus be a way to support countries in need. Contrary to the ESM financial assistance that makes it possible to reduce national austerity by providing access to funding at below market rates, a euro-area budget would provide an outright transfer in the event of a (large) shock.

To provide public goods?

A euro-area budget could be used to foster projects of a significant supranational nature. For example, transnational highways or energy networks should be funded from a common budget rather than national budgets. However, the logic for this is not particularly strong at the euro-area level, but rather relevant for the EU as a whole. After all, energy networks and highways are relevant also for non-euro-area countries such as Poland.

Politically, however, the calculation changes with the departure of the UK from the European Union. The question is whether the net contribution of the UK will be replaced by others or whether instead some new resources would be devoted to the euro-area budget as the nucleus of stronger European integration.

And there is one area in particular, where the budget could provide a true euro-area public good: financial stability. Completing banking union and backing it up with joint fiscal resources makes sense.

What revenues would fund a euro-area budget?

Having defined the purposes of a euro-area budget, one would also have to agree on how to fund it.

One possibility is to assign a tax, such as corporate income tax, to the euro-area level and give a euro-area parliament legislative power over that tax.

A second option is to design a fee-based system. This would be comparable to the way the Single Resolution Fund is funded through a levy. Similarly, a fee could be levied on labour income to fund a euro-area unemployment (re-) insurance. A fee-based system would not be suitable for a budget that is based on political discretion but more appropriate for a fund.

A third option is to develop the ESM further and make the euro-area budget dependent on the contributions of euro-area member states.

What quid-pro-quo would this require?

The larger and more generous the mechanism at federal level, the more national discretion will need to be limited. The logical counterpart to greater insurance and fiscal resources at the federal level would be greater limits on national fiscal policy, including limits to possible OMT programmes in case of significant 'federal' resources.

Normal fiscal rules would set inadequate limits on national fiscal policy, as we can see from the bad historical performance of current EU fiscal rules. Any limits on national fiscal policy would probably have to come through constitutional changes that directly limit the sovereign right to issue debt (or the right to issue senior debt).

Do we need a euro-area budget or a fund?

Should the new institution be a budget or a fund? With a budget we are talking about recurring spending and recurring revenue raising. In contrast, a fund approach would be about having resources for certain extraordinary events – and those resources would not come from a tax but rather a fee or a contribution from national budgets.

What would be the governance of a euro-area budget?

Last but perhaps most importantly, there is the question of governance. In 2015, André Sapir and myself argued for a *Eurosystem of Fiscal Policy*, in which the Eurogroup would be augmented by a euro-area 'finance minister' and a few other representatives of the euro-area that together would have some voting weight. Our main idea at the time was to allow this body to play a stronger role in the coordination of national fiscal policies, as well as being in charge of the ESM.

Meanwhile, a euro-area parliament would approve major decisions, such as binding limits to national fiscal policy. I continue to argue that the more competence one decides to give to a 'euro-area finance minister', the more important it will be to have the appropriate governance with representatives of the collective interest. A mixed body in which national ministers co-decide with a euro-area finance minister would probably be the appropriate step given the importance of national fiscal policy.

Conclusions

The euro-area needs a discussion on fiscal policy. In this article I discuss four possible avenues and purposes for a euro-area budget. Which ones are discussed and pursued in the end will depend on fundamental political choices.

The first option for a euro-area budget is a political compromise to increase federal resources while at the same time decreasing national borrowing rights. To anchor fiscal discipline and thereby avoid bad national policies that can burden the euro-area as a whole, some federal resources could be provided as part of a political deal.

The basic idea of this deal would be to get rid of the moral hazard arising from national fiscal policy in a monetary union, with the provision of some joint resources in exchange. A small budget that would disburse resources to national budgets depending on the respective economic situation and the overall cycle of the euro-area would go hand in hand with harder and possibly constitutional limits on national borrowing.

However, this raises many important governance questions that deserve far-reaching analysis. Alternatively, a reform of the fiscal rules allowing for some form a 'golden rule' to deficit fund investments could be a powerful avenue to address public investment weakness. In that model, national responsibility would need to be strengthened with a greater credibility of a no-bail-out clause.

The second possible use of a euro-area fiscal support to countries at risk of losing market access. Again, this raises many governance questions. Such form of insurance would require fulfilment of ex-ante eligibility criteria.

The third and perhaps most important aspect of a euro-area budget would be as a common fiscal backstop to the financial system. Financial stability is a euro-area public good for which joint resources are required. It is also part of the solution to increase the credibility of the no-bail-out clause, which I regard as a necessary step for Europe's monetary union.

Lastly, a euro-area finance minister could play a role in debt management. How to develop the European Stability Mechanism and the ECB's OMT programme further, and how to deal with non-sustainable sovereign debt, will all be a fundamental part of the overall discussion.

Developing the fiscal dimension of the euro-area will have profound implications for the legal order, for economic resources and for moral hazard. It will raise major questions about legitimacy, the role of the European Parliament, the role of national parliaments and the link between national fiscal resources, federal fiscal resources and the European Central Bank. The euro-area will need a sincere debate about the pros and cons of all options. ■

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Endnote
1. Expect for specific very large expenditures that can be spread over 4 years

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