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Monetary and Fiscal Arrangements for the Eurozone: Some Unconventional Proposals

by

Fabio Masini*

Perspectives on Federalism, Vol. 8, issue 2, 2016

Abstract

Contributions in this special issue argue make a number of points with regard to the urgent need to change the economic governance of the Eurozone, pointing at some tools to increase its spending capacity. The process of potential fragmentation ignited by the recent vote on Brexit make such changes even more urgent, signalling the need to provide concrete responses to citizens, in order to show that the euro area, and the EU at large, are able to satisfy some of their crucial needs. The papers which make up this special issue were presented in Florence, at a meeting held in the framework of a *Jean Monnet + Project* called *MoreEU*. The first section deals with the reform of the budget; the second with a further use of quantitative easing and the role of the ECB.

Key-words

Eurozone, economic governance, European Central Bank, Brexit crisis

1. Introduction

The US financial crisis, which started in 2007, precipitated a euro sovereign-debt crisis from 2010. The generalized credit crunch, followed by unprecedented, and concerted, liquidity injections via both fiscal and monetary impulses, created an enormous amount of financial resources in the world, waiting for remunerative opportunities for speculation. The Greek crisis, ignited by the recognition of fake budgetary reports to the EU Commission, gave financial markets a spectacular chance of investment. Speculation attacks vulnerable systems; and currently the most vulnerable economic system in the world is the euro-area, where monetary authority is completely detached from any other economic policy tool. Domino effects soon affected the PIIGS, thus igniting a euro-area sovereign-debt crisis that is still unresolved. The ECB took up the responsibility to halt speculation, flooding the market with euros. But the intrinsic shortcomings of Eurozone governance transformed monetary easing into a liquidity trap.

Since the start of the crisis, asymmetries among euro countries have grown deeper, making it more and more urgent to effectively tackle EU-specific critical features. The euro crisis is endogenous to EU economic and political governance, and thus requires a dramatic change in its operating mechanisms. Economic policy is a complex system of objectives and tools that have to be appropriately coordinated in order to be effective. The coordinating system adopted at the euro level is not only insufficient, but actually so perverse that negative effects are the most likely result of any action. In this (nation-centred stabilization policy) framework, fiscal consolidation and expansionary austerity (Alesina, Ardagna 2009) were the only viable strategies that could be adopted, hoping they might work. Unfortunately, they did not. Each and every contribution in the following pages acknowledges the urgent need to change the economic governance of the Eurozone, pointing at some tools to increase its spending capacity. The process of potential fragmentation ignited by the recent vote on Brexit make such changes even more urgent, signalling the need to provide concrete responses to citizens, in order to show that the euro area, and the EU at large, are able to satisfy some of their crucial needs. Although any turmoil following this event had not yet happened when the following papers were presented in Florence, at a meeting held in the framework of a *Jean Monnet + Project* called *MoreEU*, we think they can provide food for thought and action in the next months. We will briefly discuss them in the following sections, trying to address the main issues they raise. The first section deals with the reform of the budget; the second with a further use of quantitative easing and the role of the ECB.

2. From the MFF negotiations to a Eurozone Budget

An important area of change concerns the budget. As it is well known, the Treaties require that the EU budget balance and changing this provision requires unanimity in the Council. Nevertheless, there are many interesting points on which a reform of the EU budget can be looked at. The first is radical, and concerns the creation of a separate budget for the Eurozone, within an enhanced cooperation, that may be able to collect its own resources, issue project bonds, and decide the allocation of financial resources to the provision of specific (and well defined) collective goods. Both the economic literature (Haug et al. 2011) and EU institutions (High Level Group on Own Resources 2014; European Parliament 2016) have recognized the need to enhance the budgetary capacity of the EU. Only politicians seem to be reluctant to make any step further on this.

Although the debate concerning the proper dimension of the budget, dating back to the Seventies (MacDougall 1977), crucially depends on the attributions given to the supranational institutions, there are a couple of general reflections worth underlining. As suggested by the first report of the Monti Group: "reforming the system presents a formidable challenge" (High Level Group on Own Resources 2014, 7), the major problems stems from the collection system, still mainly organized on a national basis: "own resources are not 'genuine' for the most part but de facto national contributions. This criticism reflects the fact that around 83% of the Union's revenue come directly from the national budgets" (*ibid.* 13), and the report acknowledges the difficulty of any improvement: "the decision making process makes it extremely difficult to reform the system, since the 28 Member States must agree to any change." (*ibid.* 14). Given this framework for institutional change, and acknowledging at the same time the urge to increase budgetary responsibility to the supranational level, there is only one possible short term solution: to create a specific budget for the Eurozone, or for a core of countries within the euro area that agree to step further towards integration.

These revenues should come from fiscal and borrowing capacity. As concerns fiscal capacity, this should count on its own additional resources - as already had afforded to the *European Coal and Steel Community* and as envisaged in the *Four Presidents Report* (Van Rumpuy et al. 2012) and the *Five Presidents Report* (Juncker et al. 2015) - such as 'federal' taxes, levied on some *common evils*, such as gambling, tobacco, carbon emissions, and on the financial sector. A *Financial Transaction Tax*, assuming no reduction in financial transactions in Europe, might not cast "sand in the wheels of international finance" (Tobin 1974; 1978), but might effectively contribute to finance the European commons. The "Commission proposed the introduction of a financial transaction tax (FTT) own resource and a new VAT resource, both from 1 January 2018 at the latest" (High Level Group on Own Resources 2014, 19). One might even think of taxes on personal income, but the whole extent and structure of the euro-area budget depends on the competencies it is assigned and these may vary according to the results of negotiations.

In this wider reflection on own resources, Cieslukovski (infra) claims that a special place should be occupied by compliance of such resources with sustainable development goals (SDGs). Although certainly not completely new (Majocchi, Missaglia 2001; Gros 2009; Majocchi 2013). it is a challenging perspective, as it addresses, and provides a bridge between, two very urgent needs: the supply of collective goods to match European citizens preferences, and the needs of a more far-sighted perspective on stability and growth.

As concerns borrowing capacity, the idea of Euro-project bonds is long-standing: as early as 1993 Delors' *White Paper on Growth, Competitiveness, Employment*, suggested that European-wide investments should be financed with the issue of specific Eurobonds. Occasionally, such proposals have also been made in the last two decades (e.g. Sapir 2003). It's time to reconsider these again. The technicalities of different options for Eurobonds have been widely explored (Delpla and Von Weizsäcker 2010; De Grauwe 2011; Prodi and Quadrio Curzio 2011). At least one point is worth recalling: they should be project-bonds, issued with one or more specific aims, so that potential stakeholders may monitor the return on those investments. In other words, they should not be used to reduce debt stocks (Amato, Verhofstadt 2011), so that each country bears the burden of its responsibilities. We should recall that the Lisbon Treaty requires the budget to be in balance. To make new debt, the current treaties would need to be changed, whereas project-bonds could be issued by the *European Investment Bank* (as provided for in the Juncker Plan) in order to overcome the clause concerning a balanced budget.

As concerns expenditures, if the final objective of the institutional changes is to have more effective economic governance in Europe and greater capacity to satisfy the needs of European citizens, the Eurozone budget should aim at providing Eurozone collective goods, i.e. goods that can efficiently be provided *only*, or *more efficiently,* at the supranational level. Investments in collective goods might comprise: transport, communication and energy infrastructures; higher education and research; and support to technological innovation. According to some commentators, they should also relate to a European army and a single foreign policy, therefore enhancing the EU's capacity to tackle diplomatic challenges and strategic alliances worldwide and reduce current inefficient national expenditures. The key point is that these investments should be made at the Eurozone level, so as to compensate for the intrinsically restrictive stance of policies within the euro area. While some of these investments might be attractive to private funds, and indeed, the Juncker Plan relies on private funds for some investments,the point here is nevertheless different; in order to provide some public goods it may be necessary to have more public funds, irrespective of the interest of private investors.

Summing up, a general reconsideration of the budget in the EU is crucial, as underlined by D'Alfonso (infra), in many respects and under different criteria. The key element, nevertheless, is to go beyond the mere negotiations and logic on the Multiannual Financial Framework, and take the chance of the mid-term revision to substantially change the nature of the logic on the budget, still based mainly on the balance between pros and cons for each single country (*juste retour*). From this point of view, the paper by Sapala (infra) addresses exactly this issue, although she might have overestimated the extent of the revision itself. Although it acknowledges the legitimacy and efficacy shortcomings of present governance in the euro area, Nicoli's contribution (infra) focuses rather on procedural aspects, although procedures, as it is in this case, may significantly impact on policymaking. He suggests the adoption of a single budgetary procedure, designed as a coordinated action at the EU level, to make the coordination mechanism enforceable.

3. Monetary Policy Beyond QE

Another crucial actor in the reform of economic governance within the Eurozone is the European Central Bank. Through an increasing use of unconventional tools of monetary policy, the ECB has acquired a status similar to that of a normal central bank. Notwithstanding the constraints of its explicit mandate (from the Council) and with an extensive interpretation of its role of targeting inflation, the quantitative easing (QE) program has allowed for the survival of the euro against speculative attacks, buying some times for governments to make the necessary reforms of the economic governance of the Eurozone. However, the absence of reforms, which the MS governments have never implemented, cast some doubts on the long term sustainability of the euro.

There are two main questions here: a) whether the ECB should become *de jure* a lender of last resort, as De Grauwe (2013) suggests; b) whether the ECB should go further beyond the present *unconventional* instruments of monetary policy. As concerns the latter point, helicopter money is risky, given the inflation potential of the liquidity injection (although now deflation seems the most urgent problem); whereas fiscal stimulus via further quantitative easing to European institutions (Stiglitz et al. 2014; Varoufakis et al. 2013; Watt 2015; Wolff 2014; Bibow 2015) might be of some help, unless it undermines ECB credibility, which brings us to the former point. Credibility is a crucial asset for monetary policy, and a strict statute may provide a solid backbone on which a young central bank might build it. Nevertheless, credibility is required more urgently in difficult times; and, in such times, discretionary power is necessary not only to be effective, but also to be credible. But any change of the explicit mandate of the ECB calls for a new, ample consensus within the Council, which is hard to imagine at present.

In this debate, an interesting proposal (requiring no change of the Treaties) is put forward by Fontana and Vannuccini (infra). They suggest that the ECB should expand QE to back a fiscal stimulus of the European Commission. In line with similar proposals, and although recognizing that this is has an inflationary potential, they claim it might be a short-term solution to substitute for the lack of effective fiscal power in the Eurozone.

There is an increasing divergence between citizens' and governments' preferences, making an increasing and dangerous gap in agency. This gap reflects the different nature between the *exercise of power* and the *exercise of sovereignty*. The first represents the struggle aimed at acquiring, conserving and expanding (the potential) power of decision, irrespective of the satisfaction of the need of citizens (and constituency). The exercise of sovereignty means being able to satisfy collective needs of citizens. They are different in nature and may coincide only incidentally. The use of a combination of fiscal and monetary stimuli is crucial to finance the provision of such goods.

4. Concluding Remarks

The current crisis in Europe is endogenous - for it had its roots in the structure of its governance, with decision-making attributed to intergovernmental institutions and methods, which proved (and still prove) ineffective to tackle economic hard times. Furthermore, Europe has no means to absorb asymmetric shocks, and to finance countercyclical policies for recovery, lacking a reasonable supranational budget and given the constraints at the national level. The only resulting strategy available was expansionary austerity, in the hope that it might work. Unfortunately, it did not.

Given the endogenous nature of the present crisis, it is necessary to change the institutional structure of economic governance. The European economy needs both demand and supply side interventions that require much more than a monetary impulse (that might prove barely sufficient in times of general distrust and liquidity traps). At the very minimum, it is necessary to pool fiscal resources for collective investments.

Given the huge policy externalities within it, this can and should be done urgently in the Eurozone framework, through enhanced cooperation, providing the euro area with: the minimal institutions to tackle effectively domestic-European asymmetric shock absorption and financing growth; a more effective executive power to the Commission, with the creation of a true supranational Treasury; a more legitimate process through a greater role for the European Parliament and the use of majority vote within the Council. We have also highlighted the difficulties in *selling* this reform package to national governments and citizens. Given the lack of forward-looking authoritative leaders, we should rely on a more transparent communication system in Europe, and to giving greater voice to NGOs and the European Parliament. Furthermore, we should make people understand the exact nature of the crisis: a lack of effective sovereign power that can only be exercised at the European level.

We should do our best to come as quickly and as closely as possible to these new arrangements, within existing Treaties in the short run; and struggle to make more profound and larger changes outside of them, in the longer run, via a new fundamental law that may re-write the mechanisms of civil society cohesion in Europe. It is no longer time for drafting reports and roadmaps, but to start implementing them, with a precise, rigorous and urgent time schedule. The crises hitting Europe in the last few years have opened up a window of opportunities for radical change in EU governance. Nevertheless, there is a time constraint imposed on European citizens; and time is a scarce resource. We are aware that this, at present, is an exercise in imagination. But in times of doom and lasting crisis, even imagination may turn out to be a precious asset. The proposals suggested here, though an exercise in imagination, may turn out to be precious advice.

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A Sustainable European Union Own Resources System

by

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Abstract

From 1992, after the UN "Earth Summit" in Rio de Janeiro, sustainable development has become a priority of many countries and international organizations, including the European Union. After the crisis of 2008+ and the strong criticism of traditional economics, it also became a fundamental element of economic development in the XXI century. This new model is based on a solid and integrated economic, socio-cultural and ecological order. Such a development should be supported by suitable budgetary systems at each level of public government. The paper presents a conception of the sustainable EU own resources system and proposes the methodology of its evaluation.

Key-words

European Union own resources, sustainable development, multi-criteria statistical analysis

1. Introduction

After the crisis of 2008+, the criticism of traditional economics increased because of its impotence against social and economic problems (Stiglitz 2012; Frydman, Goldberg 2011). The economics of sustainable development model proposes an alternative path for the development of the economy in the XXI century, according to a new paradigm of integrated economic, socio-cultural and ecological order (Montaldo 2013: 1 – 4). From 1992, after the UN "Earth Summit" in Rio de Janeiro, sustainable development has become a priority of many countries and international organizations, including the European Union, as illustrated in its main documents, e.g.: the Treaty on European Union, the EU Sustainable Development Strategy 2006, and the Strategy "Europe 2020".

The sustainable development literature does not devote enough direct attention to public finance, for its primary focus is on the idea of "greening" public expenditure and tax systems. The European Union also associates sustainable development primarily with ecology and encourages Member States to green their fiscal systems. However, such an approach seems to be narrow, for the current literature does not investigate interactions between public revenues and expenditures with regard to all sustainable development objectives and the analysis does not include the EU's own resources system. Instead, a new model of the economy requires a budgetary system on each level of public finance, which supports all objectives, (ecological, economic and socio-cultural), in a balanced and integrated way, in what might be called a sustainable budgetary system.

Because of the multi-objective features, and complexity, of the system, it also requires a suitable method of assessment. Such a method should employ both qualitative and quantitative criteria of evaluation and hence provide more objectivity in the results from analysis. Previous subject literature provides rather simpler and predominantly qualitative methods of evaluation.

The paper investigates the role of the EU own resources system in achieving sustainable development objectives. The aim of the paper is to assess and compare two EU own resources systems (the binding system in the years 2000 – 2013 and the projected system for the years 2014 – 2020) according to sustainable development criteria and, if necessary, to propose changes towards this development. Preliminary research allows a formulation of a hypothesis that both systems supports sustainable development very poorly and needs changes.

We make our evaluation with the use of multi-criteria comparing analysis, based on the Hellwig[i] method consisting of a comparison of the real object with the model. The model is described by 29 detailed features (criteria of assessment) grouped into 12 positions within four main categories. In order to assess the projected system we employ the method of simulation of new resources in fiscal condition in the years 2000 – 2013.

The paper has three methodological and political advantages. Firstly, it proposes a new set of assessment criteria of EU own resources, which consider new challenges in the economy. Secondly, it proposes a new method of evaluation of EU own resources. The multi-criteria statistical analysis considers both qualitative and quantitative criteria and gives an evaluation that is more objective. Thirdly, it proposes the changes in the EU own resources system that adjust it to the new sustainable challenges in the XXI century.

2. Previous results in EU own resources assessment

Until the end of 1980s the EU own resources system was assessed mostly with the help of simple descriptive statistics, and as such indicated general disadvantages of the system and gave proposals for its reform. In 1988 the Council obliged the Commission to prepare special regular reports on own resources. In the 1990s the Commission introduced assessment criteria for a possible new own resources framework (Commission 1992) and for binding resources (Commission 1998). Since then studies on the resources system have developed.

The subject literature formulates many different rules, principles, postulates and demands in respect of EU own resources. Some of them have become legislative norms and many of them can be also treated as assessment criteria. Figure 1 shows the sources of EU own resources criteria.

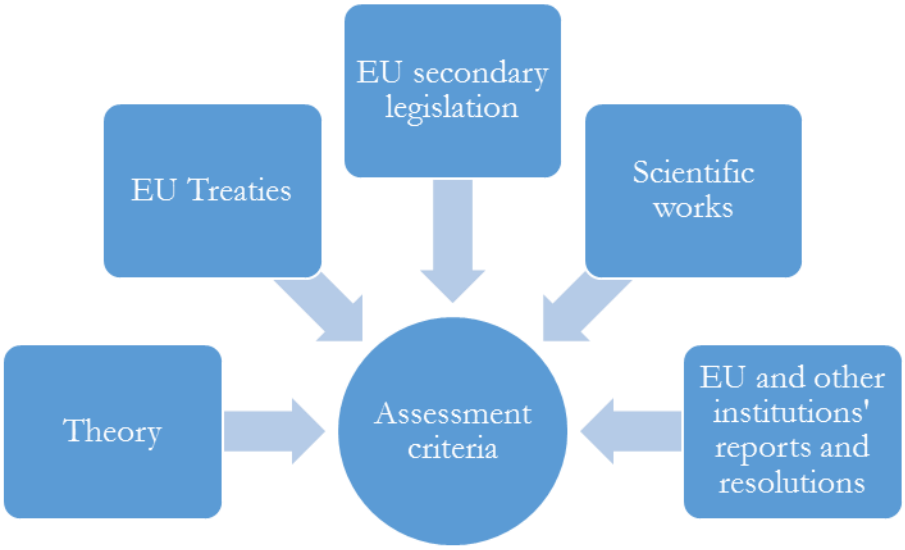


Figure 1. Sources of EU own resources criteria

Source: own study.

Theory provides an original, and the most important source of assessment criteria, and there is a wide range of theories and conceptual frameworks that can give the most relevant and useful criteria that can be used in the analysis of legislative acts, reports and other works. These include the theory of economic integration, the theory of fiscal federalism, clubs theory, tax principles, the theories of optimal taxation and optimal tax base, the conception of performance management and also more recently economics of sustainable development (Cieslukowski 2013, chapter 1; Begg, Grimwade 1998, chapter 2; Laffan 1997, chapter 2). EU Treaties present the general and fundamental principles on which European Union and Member States exist. Many principles, e.g. subsidiarity, solidarity, equity, social justice, common market, effective public finance may also determine general frameworks for EU revenues.

EU secondary legislation, mainly Council decisions on EU own resources (1970, 1985, 1988, 1994, 2000, 2007, 2014) and Council regulations on financial principles applicable to the EU general budget (1977 and 2002), introduces more detailed budgetary rules that create financial frames not only for the EU own resources but also for the whole budgetary system.

Scientific works fall into two groups: a) surveys conducted under contract with the Commission or European Parliament and b) research carried out by independent scientists.

Up to 2015, the Commission had signed nine such contracts and five of them (Stable Money-Sound Finance 1993, Keen report 1995, Sapir report 2003, Begg and others report 2008 and High Level Group on Own Resources report 2014) contain criteria and evaluation on both binding and potential resources. In the same period, the European Parliament had signed only one contract for evaluation (Gretschmann report 1998).

Independent literature in English, or Polish, on EU own resources is not extensive; In the 1990s research on the criteria of binding and potential EU resources was limited to works by Spahn (1993), Begg, Grimwade (1998) and Henke (1998). From 2000 research has been carried out on the criteria by Cattoir (2004 and 2009), Cieslukowski (2005 and 2013), Alves, Cieslukowski (2006), Le Cacheux (2007) and Heinemann, Mohl, Osterloh (2008).

Important sources of the assessment criteria are also independent Commission reports (1992, 1998, 2004, 2010 and 2011), European Parliament resolutions (1994, 1999, 2007, and 2011), Court of Auditors' reports on the implementation of the budget (2005, 2006, 2007, 2008, 2009, 2010, 2011, and 2012) and House of Lords of British Parliament report (2005). The Commission usually supports the stances of the European Parliament and the Court although in some cases the criteria and methods of evaluation are debatable.

Table 1 shows the results of a meta-analysis of the most comprehensive and detailed evaluations of binding EU own resources made in the years 1998 – 2015. The following signs mean +++ (very positive), ++ (positive), + (rather positive), + − (difficult to assess, neutral), − (rather negative), − − (negative), − − − (very negative). A lack of sign means that particular research does not contain a clear assessment and empty place means that a particular criterion is not considered.

Any differences in results are mainly consequences of the author's particular views, assumptions, different periods under evaluation, and different methods of evaluations. However, the studies give quite similar results in most cases. Authors tend to agree that GNI derived resources assure fiscal efficiency and stability for the system and help to keep budgetary discipline. However, it is not consistent with EU policy and its increasing share in total revenues throws doubts on financial autonomy of the European Union. Apart from that, the system is generally cost effective, with the biggest criticism usually concerning fairness and transparency. I would stress that the Court of Auditors, the European Parliament and High Level Group on Own Resources all gave similar opinions, which postulate changes in the EU own resources system towards increased financial autonomy for the Union, greater solidarity between Member States, reduced complexity and improved visibility for citizens (Parliament 1994, 1999, 2007, 2011; HLGoOR 2014). In contrast, the view of the House of Lords of the British Parliament considered the system quite complex and invisible for citizens, but fair between Member States (HoL 2005).

Table 1. Results of evaluation of binding EU own resources in the years 1998 – 2015

Study	Fiscal efficiency, stability and discipline	Financial autonomy	Fairness	Cost effectiveness	Simplicity and transparency	Economic integration and market effectiveness
Commission report (1998)	TOR*: + VAT**: + + GNI***: + +	TOR: + VAT: − − GNI: − −	TOR: − VAT: + + GNI: + +	TOR: − − − VAT: + + GNI: + + +	TOR: + + VAT: − − − GNI: + −	
Commission report (2004)	TOR: + VAT: + GNI: + + +	TOR: + VAT: − − GNI: − − −	TOR: VAT: GNI: + + +	TOR: − − − VAT: + + GNI: + + +	TOR: + + VAT: − − − GNI: + −	TOR: + VAT: − − − GNI: − − −
Cieslukowski (2005)	TOR: + VAT: + GNI: + + +	TOR: + VAT: − − GNI: − − −	TOR: + − VAT: + − GNI: + −	TOR: − − − VAT: + + GNI: + +	TOR: + VAT: − − − GNI: −	TOR: + + + VAT: + + + GNI: − − −
Alves, Cieslukowski (2006)		TOR: + VAT: − − GNI: − − −				
Begg, Enderlein, Le Cacheux, Mrak (2008)	TOR: + VAT: + GNI: + + +	TOR: + + VAT: − − − GNI: − − −	TOR: − − VAT: + GNI: + + +	TOR: − − − VAT: − GNI: + + +	TOR: VAT: − − − GNI: + + +	TOR: + + VAT: − − − GNI: − − −
Heinemann, Mohl i Osterloh (2008)	TOR: + + + VAT: + + + GNI: + + +	TOR: + + + VAT: + GNI: + +	TOR: − − VAT: − − GNI: − −	TOR: − − − VAT: − − − GNI: + + +	TOR: + VAT: − − − GNI: + + +	TOR: − − VAT: − − GNI: − −
Cattoir (2009)	TOR: + VAT: + GNI: + + +	TOR: VAT: − − GNI: − −	TOR: − − − VAT: − − − GNI: − − −	TOR: VAT: + + GNI: + +	TOR: VAT: − − − GNI: − − −	TOR: + VAT: − − GNI: − −
Commission report (2011)	TOR: + + VAT: + + GNI: + + +	TOR: VAT: − − GNI: − −	TOR: − − VAT: − − GNI: − −	TOR: + + VAT: + + + GNI: + + +	TOR: VAT: − − − GNI: − − −	TOR: + VAT: − − GNI: − −
Cieslukowski (2013)	TOR: + VAT: + GNI: + + +	TOR: + + + VAT: + GNI: +	TOR: + VAT: + + GNI: + +	TOR: + + VAT: + + + GNI: + + +	TOR: + + VAT: + + GNI: + +	TOR: + + + VAT: + + GNI: − −

Source: own study based on: Commission 1998: 5 - 8; Commission 2004, Vol. II: 8 - 13; Cieslukowski 2005: 9 – 14; Alves, Cieslukowski 2006: 4 – 8; Begg, Enderlein, Le Cacheux, Mrak 2008: 10 - 11; Cattoir 2009: 9 – 16; Commission 2011: 12 – 16; Cieslukowski 2013: 229.
*TOR – Traditional Own Resources, **VAT – Value Added Tax, ***GNI – Gross National Income

On the grounds of these studies, we propose three main directions of reform. First, a simplification of the system by replacing traditional and even VAT resources by GNI resources, second, replacing the GNI resources by new resources in order to improve visibility for citizens, to give financial autonomy to the European Union, and make the system more consistent with EU policy; and third, a reform of the correction mechanism to increase fairness. Table 2 shows the ranking of potential new EU own resources.

In the latest studies, resources such as FTT, modulated VAT, European CIT and environmental taxes score relatively higher. The European Commission has, on many occasions, submitted proposals of new own resources to the Council; in its latest report from 2011 it proposed to replace GNI and VAT resources by Financial Transaction Tax and new VAT- base tax.

Table 2. Ranking of potential new EU own resources derived from different studies (1 – first place)

Type of own resource	European Economy 1993	Keen 1995	Begg, Grimwade 1998	Gretschmann 1998		Cattoir 2004, 2009	Cieslukowski 2005	Begg, Enderlein, Le Cacheux, Mrak 2008; Begg 2011	Commission 2011	Cieslukowski 2013
				Quantitative analysis	Qualitative analysis					
PIT	5	5	5	6	7	2	5	6		
European CIT	2 i 3	3 i 4	4	1	1	5	6	1 i 2	-	
Withholding Tax	4	2	7	7	4		3	-		
Financial Transaction Tax (FTT)						7		5**	+	1
Financial Assets Tax (FAT)									+	
Modulated VAT	3	1	1	8	5	3	1	3	+	2
Communication Taxes	-	-	2	5	8	5	4	3		
Environmental Tax/Energy Tax	1	2	6	2	6	1, 4*	2	1*, 2***, 7****	-, -*, -****	
Excises on Alcohol and Tobacco Products	4	4	3	4	3	6	7			
Wealth Tax	5									
Seigniorage Revenues	2	3	8	3	2	5	8	4		

Source: own study based on: European Economy 1993: 85; Keen 1995: 81; Begg, Grimwade 1998: 146; Gretschmann 1998: 108; Cattoir 2004: 15 – 37; Cieslukowski 2005: 18 and 19; Begg, Enderlein, Le Cacheux, Mrak 2008: 95 - 97; Begg 2011: 15 – 17; Commission 2011; Cieslukowski 2013: 268.
* airplane charge on CO_2 emission; ** no numerical assessment of fiscal efficiency and stability but it seems to have huge fiscal potential, *** petrol charge; **** revenues from the trade of CO_2 emission.
+ possible to introduce, - impossible to introduce

However, Members States did not reach a final agreement and the core of the system, apart from small corrections, remained unchanged for the years 2014 – 2020. Instead, Member States promised to continue discussion and some of them (Italy, Portugal and Spain) decided to introduce FTT in their tax systems in the near future. In February 2016, Poland also introduced a new tax on assets of some financial institutions.

Previous studies on the EU characterize own resources by the following features:

1) In Commission reports in particular the link between criteria and theory is very loose,
2) The number of criteria used in evaluations is small with the focus on fairness between Member States. Additionally, there are more qualitative criteria than quantitative ones. Consequently, results of evaluations have become less objective and more open to discussion. Current statistical methods give possibilities to conduct more objective evaluations,
3) Criteria are not weighted. Weighting improves credibility and objectiveness of evaluation,
4) Most current studies (particularly Commission reports) evaluate the whole system from the angle of some "explosive" criteria. They do not analyze the system in detail and do not give an objective assessment of the whole system,
5) In most cases resources are evaluated over short periods of time which creates difficulties in drawing reliable conclusions about changes in the quality of the whole system over a longer period of time,
6) The evaluations do not compare particular resources,
7) The evaluations do not consider sustainable development objectives in integrated and balanced ways.

Studies on EU own resources need further improving towards obtaining more objective and convincing results. Analysis should consider:

1) A better link between theory and criteria,
2) The use of a larger number of detailed, weighted, qualitative and quantitative criteria,
3) The employment of multi-criteria analysis that allows the integration of different criteria, comparison of resources, to produce more objective results

4) An evaluation of the whole system over a longer period of time,
5) Evaluation should employ sustainable development criteria.

3. The role of public revenues in sustainable development

Analysis of sustainable development takes place across different scientific disciplines, economy sectors and all public government levels. However, the subject literature does not direct particular attention to public finance and public revenues; their focus is on ecological taxes and "greening" tax systems (Rogall 2010: 280 – 287; Koglin 2009: 11; Environment Group 2006: 89 – 93; Wallart 1999: 138). Sustainable development economists willingly promote these taxes not only for their ecological advantages but also for the assumption of additional positive influences on the economy, the work place, innovation, the social security system and even on world peace.

States both developed and developing, e.g. China and Turkey, have already conducted "green" reforms (OECD 2001: 49 – 55). However, the results of the reforms turn out to be different depending on the models of evaluation employed (general or partial equilibrium), and assumptions made (types of taxes, period, dependent variables, directions of expenditures etc.). The subject literature is extensive, but a comprehensive overview is given by the research of Hoerner and Bosquet (2001); this contains a meta-analysis of 104 simulations of the results of "green" tax reforms conducted by ten EU developed Member States in the 1990s, from which we derive four conclusions. Firstly, 78% of simulations predict an increase in employment, although a more effective way is the reduction of obligatory social contributions rather than a reduction of income taxes. Secondly, 75% of simulations predict little influence on GDP (from – 0,5 do +0,5%).Thirdly, ecological taxes should replace obligatory social contributions since reductions of VAT and income taxes give moderate results. Finally, most simulations predict an increase in prices and decrease in investments.

Another study by Bosquet (2000: 23 – 28) shows that eco-taxes may have an adverse impact on companies that have huge demands for energy. Some simulations carried out in Poland also confirm these conclusions, notably a study on Coal Tax in 2001 by the Institute for Eco-development (Stodulski (ed.) 2001). Simulations made for the years 1995 – 2005 with the help of the general equilibrium model, and for six scenarios, assumed a different scope for reform. Simulations confirm a positive influence on reduction of CO_2 emission and on economic growth and employment; however, this was only valid under a condition of a reduction on labour costs. Conversely, the research does not confirm any negative influence on prices and energy-intensive sectors.

Apart from "greening", proponents of economics of sustainable development also propose other changes in taxes; however, these need further theoretical and empirical verification. The recommendations are as follows (Rogall 2010: 339; Felber 2015: 89 - 90]: imposing taxes on financial transactions, increasing the top PIT and basic VAT rates, elimination of tax havens, introduction of high penalties for tax avoidance, stimulation of sustainable behavior by tax reliefs and preferences, and employing appropriate inheritance tax.

Sustainable development economists also claim that the new model needs global management. They suggest either creating a new international organization, or equipping existing international organizations (e.g. United Nations) with additional and efficient fiscal resources, such as: a tax on financial transactions, penalty customs duties for failing in meeting ecological standards, and contributions for consumption of global sources (e.g. air space, oceans).

Sustainable development has also become the priority for the European Union, as illustrated in its main documents: The Treaty on European Union (Treaty 2012: art. 3), The EU Sustainable Development Strategy 2006 (Council 2006) and The "Europe 2020" Strategy (Strategy 2020: 11). However, the objective is mainly achieved through budgetary expenditures. All beneficiaries of EU subsidies are obliged to evaluate their projects with regard to sustainable development criteria. In respect of revenues, until now the European Union influenced sustainable development in a rather indirect manner. It mainly encourages the Member States to "green" their tax systems (Council 2006: 24). Additionally it harmonized the taxation of energy in 2003 (Commission 2003) and is still consider introducing a solidarity contribution on air tickets (Commission 2005).

4. Conception and assessment criteria of the sustainable European Union own resources system

The subject literature also proposes conceptions of the sustainable tax and tax system and criteria of their assessment (Cieslukowski 2014). However, with regard to the present European Union's stage of political and economic development, their employment is impossible; they need modifying in the context of the current specificity of the European Union.

The sustainable EU own resource is a resource that contributes to sustainable development, and, as such, it should meet all fundamental criteria: (ecological, economic, and socio-cultural) as well as administrative criteria.[II] It is possible to create a typology of these resources with regard to their degree of meeting the criteria: (strongly) sustainable, sustainable moderately, sustainable poorly, neutral, unsustainable poorly, unsustainable moderately and unsustainable (table 3).

Table 3. Types of EU own resources with regard to the degree of sustainability

Type of a tax	Objectives			
	Ecological	**Economic**	**Socio-cultural**	**Administrative**
Sustainable	+	+	+	+
Sustainable moderately	+ + 0	+ 0 +	0 + +	+
Sustainable poorly	+ 0 0	0 + 0	0 0 +	+
Neutral	0	0	0	+
Unsustainable poorly	-	0 +	0 +	+
Unsustainable moderately	-	-	0 +	+
Unsustainable	-	-	-	+

Source: own study.
+ positive; - negative, 0 neutral

A moderate resource meets at least two fundamental criteria and administrative criteria and a poor resource meets only one group of fundamental criteria and administrative criteria. A neutral resource does not affect the sustainable development nor in a positive or negative way and an unsustainable resource affects in a negative way at least one type of criteria.

We define the sustainable EU own resources system as a system of logically connected resources that as a whole contributes to sustainable development. Such a system can only be composed of resources categorized as sustainable and neutral. Apart from the sustainable system, we can identify neutral and unsustainable systems, where the former has no effect on sustainable development and the latter, dominated by unsustainable resources, affects sustainable development negatively. We can also develop a framework for categorizing resources in the same way that we did for the debate on systems, although this is more of a challenge. Table 4 contains the proposals of such criteria, drawn from the theory and sources presented in point 1 of the paper, and recommendations of sustainable development economics.

Table 4. Assessment criteria of EU own resources sustainability

Ecological criteria	Economic criteria	Socio-cultural criteria	Administrative criteria
Sustainable exploitation of natural resources	Fiscal efficiency and stability	Democratic accountability	Cost effectiveness
Healthy life conditions	Fairness between Member States	Fiscal sovereignty of the Member States	Transparency
Pro-ecological behavior of consumers and companies	Economic integration	Financial autonomy of the European Union	Sustainable statistics

Source: own study.

The first rubric, Ecological criteria, is qualitative, and divided into three criteria. The role of public revenues in sustainable exploitation of natural resources generally comes down to the internalization of the ecological costs. It consists of employing special ecological taxes and fees, which increase the prices of particular goods and services, and through this, the consumer should rationalize their consumption and exploitation. Healthy living conditions are improved by the elimination of harmful substances, noise, radiation, air pollution etc. Special taxes, fees and financial penalties can be imposed on different institutions and companies in order to prevent such activity. Public resources can also be used to encourage companies and citizens to pro-ecological behavior, mainly in order to maintain the species and landscape diversity. Such instruments as additional taxes, fees and penalties can limit negative impact on environment but on the other hand, such instruments as special tax allowances and preferences can be used to encourage companies and citizens to ecological investments and leading ecological style of life. For all the above we limit our assessment to legal solutions on EU own resources with regard to their influence.

The second rubric includes economic criteria [based on quantitative data]. Fiscal efficiency of the resource means its capability to reinforce the EU budget with revenues in particular periods of time, and its inherent fiscal discipline (in the years 2000 – 2013 own resources cannot exceed 1,24% of EU GNI and the EU budget must be balanced). The optimal solution is where a few fiscally similar resources reinforce the EU's general budget (Cieslukowski, 2013: 165). We measure fiscal efficiency by the share of the resource in the EU's total revenues, according to the formula:

$$FEI_{r_t} = \frac{r_t}{\sum Tr_t} - \frac{1}{l_t}, \quad (3.1)$$

where: FEI_{r_t} – fiscal efficiency indicator for the particular resource *r* in the period *t*, r_t – revenues from the particular resource in period *t*, $\sum Tr_t$ – total EU budget revenues in the period *t*, l_t – a number of EU own resources in period *t*. In the years 2000 – 2008 an optimal share of a particular resource in total revenues is 16.67% and in the following years – 20%.[III] For each year, five different brackets of efficiency are set, showing the difference between optimal and real shares.

Stability of the resource means its resistance to fluctuations caused by internal and external factors; we measure stability with a fiscal stability indicator according to the formula:

$$FSI_{r_t} = \frac{S_y}{\overline{X}} \cdot 100, \quad (3.2)$$

where: FSI_{r_t} – fiscal stability indicator of the particular resource in period *t*, S_y – a standard statistical error of the regression function for particular series of revenues (*Y)* in period *t*, $\overline{X}$ – an arithmetic average for particular series of revenues *(Y)* in period *t*. Statistics assumes that the phenomena is stable when the indicator is lower than 20%. In the paper, five brackets of stability are set: [0 − 10%) (very stable); [10 − 20%) (stable); [20 − 30%) (moderately stable); [30 – 40%) (unstable) and over 40% (very unstable).

Usually we would see to analyse the fairness of the fiscal burden both between EU Member States and between their citizens. However the current and proposed EU own resources systems do not impose taxes directly on citizens, so analysis of fairness in the second case seems to be pointless. Fairness between Member States, according to the Treaty on European Union (protocol 28), exists when the fiscal burden on Member States is proportional to their share of EU GNI. We evaluate fairness with the help of the Pearson Concentration Coefficient (K). In the paper ten brackets of concentration are set: [0,0 – 0,2] (very fair breakdown), [0,2 – 0,4] (fair breakdown), [0,4 – 0,6] (moderate breakdown), [0,6 – 0,8] (unfair breakdown) and over [0,8 – 1,0] (very unfair breakdown).

We draw economic integration criteria from economic integration and fiscal federalism theories, which also express the Treaty rule of subsidiarity. We define three detailed criteria: 1) an even breakdown of revenue bases between Member States, 2) tackling negative external effects and 3) tackling accidental division of public revenues between Member States.

We treat revenue bases in a broad perspective: for customs duties, it is the value of imports; for sugar fees, the size of sugar production in tons; for VAT resources, the value of consumption; and for GNI resources, the value of GNI. Once again, we used the Pearson Concentration Coefficient (K) to determine the breakdown of the bases between Member States, using the same brackets as above.

Criteria of tackling negative external effects and accidental division of revenues are rather qualitative. However, in the paper we assume that the resources perfectly meet the criteria if they reinforce the EU budget completely. Then we employ the Resource Property Indicator according to the formula:

$$RPI_{r_t} = \frac{r_t}{Tr_t} \cdot 100, \quad (3.3)$$

where RPI_{r_t} – resource property indicator in period *t*, r_t – EU revenues from a particular resource in period *t*, Tr_t – Total revenues from a particular resource in period *t*. We employ the following brackets of EU resource property: [zero– 20%] (state resource), [20 – 40%] (divided state resource), [41 – 60%] (moderate divided resource), [60 – 80%] (divided EU resource), and [80 – 100%] (EU resource).

In the third rubric, we develop the socio-economic criteria. Democratic accountability is a qualitative criterion and with regard to the EU's own resources assesses the influence that citizens have on resources. Such influence can only exist with the help of the European Parliament, which should have real legislative power over resources.

Fiscal sovereignty of the Member States is also a qualitative criterion and means that the EU resources cannot be deployed without respect for national independence and interest; in other words, all Member States should reach agreement in the case of the resource.

The European Union has a degree of financial autonomy when it possesses real own resources. According to the theory, a real resource should meet the following conditions: 1) it is situated on EU territory; 2) it belongs to the EU entirely and permanently; 3) it is directly imposed on taxpayers; and 4) the EU decides on its construction (Alves, Cieslukowski, 2006: 3 – 4). Most of the criteria are qualitative, only completeness is quantitative and we assess this with the help of the Resource Property Indicator (3.3).

The costs of collecting EU revenues should be as lowest as possible for the European Union, Member States and "tax payers". Our assessment of the scale of resource costs for the European Union and Member States is based on the relation of costs to collected revenues, according to the formula:

$$CI_{r_t} = \frac{c_{r_t}}{Tr_t} \cdot 100, \quad (3.4)$$

where CI_{r_t} – cost indicator of particular resource *r* in period *t*, c_{r_t} – collecting costs of particular resource *r* in period *t*, Tr_t – EU revenues from particular resource *r* in period *t*. Five brackets of cost effectiveness are employed: [zero – 1,0%] (very low costs), [1,0% – 2,0%] (low costs), [2,0% – 3,0%] (moderate costs), [3,0% – 4,0%] (high costs) and over 4,0% (very high costs).

The EU costs comprise those of legislation, revenue management, control, audit and advisory. Such costs are paid by the EU Council, European Parliament, European Commission (General Budgetary Directory), OLAF, Court of Auditors, Internal Audit Service (IAS) and Committee of Socio-economic Affairs (CSEA). The costs of the EU Council linked to particular resources are assessed on the number of legislation pages dedicated to the revenues and total costs of functioning. The costs of the European Commission are assessed on the base of employment structure in particular revenue departments and total costs of functioning. The costs of the Court of Auditors are assessed on the base of the number of pages dedicated to the particular revenues in all issued documents (annual operating reports, annual financial reports, detailed reports and opinions) and total costs of functioning. The costs of OLAF are assessed on the base of the number of the proceedings and total costs of functioning. The costs of IAS are assessed on the base of the number of audits in General Budgetary Directory and the total cost of functioning. The costs of the CSEA are assessed on the base of the number of opinions dedicated to EU resources and the total costs of functioning. Finally, the costs of the Parliament are assessed based on the number of issued law acts with the EU Council (Customs Code), separate opinions, the costs of expert evaluations dedicated to the EU resources and the total costs of functioning.

We evaluate the costs of the Member States on the basis of the costs of the tax and customs duties administration. The sources of information are two OECD documents from 2004, and 2011, comparing the tax administration in OECD countries: *Tax Administration in OECD Countries: Comparative Information Series 2004* [OECD 2004, p. 65] and *Tax Administration in OECD and Selected Non-OECD Countries: Comparative Information Series (2010)* (OECD 2011: 126 and 127). Such a way of costs assessment seems to be suitable in the case of customs duties, sugar fees and VAT resource because Member States are responsible for administering the collection and transfer of revenues to the EU budget.

In the case of GNI resources the role of Member State comes down mainly to the calculation and transferring of due payments according to the EU's schedule. Then the costs of Member States are rather marginal and they are assumed at the level of 0.1% of transferred amounts.

We measure costs for "tax payers" with the help of two indicators. We derive the costs of VAT and sugar fees by taking the average number of hours necessary to calculate and pay taxes in particular Member States. Five time brackets are set in each year of analysis. We calculate costs of customs duties by the number of obligatory documents necessary during customs clearance procedure in particular Member States. We source our data from two reports: *Paying Taxes. The global Picture* from the years 2006 – 2012, issued by PricewaterhouseCoopers and World Bank; and *Doing Business* from the years 2006 – 2012 issued by the World Bank and International Monetary Fund. In the case of sugar fees, we make our assessment using the example of Polish organizational solutions.

Transparent resources means that EU citizens know how much and why they pay for EU, who decides about the resources and if the resources are managed professionally. We define transparency using a number of detailed qualitative and quantitative criteria: 1) openness, 2) public consultations, 3) number of law acts, 4) independent control and audit, 5) transparency of construction, 6) accessibility in a mother language, 7) high accountability standards, 8) essential grounds for the revenues and 9) performance management. On the further analysis, we find that only the third criterion is quantitative, and we set five brackets of assessment for each year according to the number of law acts.

Sustainable statistics, a qualitative criterion, present new models of calculating our prosperity and wealth. Such indicators as GDP or GNI are currently strongly criticized because they are strictly monetary measures, and do not take into consideration many important variables that concern the quality of life, e.g. the quality of the natural environment, the quality of health and education, and happiness. The subject literature proposes some new indicators (New Zeeland Composite Sustainable Development Index, Ecological Footprint, Environmental Sustainable Index etc.), which express better sustainable development (Lawn (ed.) 2006). New indicators should also be used in European statistics, including calculations connected with EU own resources.

5. The Methodology of evaluation

We evaluate the data through a compilation of two linear classification methods: 1) a benchmarking method; and 2) a scoring method. Hellwig originally presented the benchmarking method in 1968, and at the core is a hypothetical model to which the evaluated object is compared, using special measures to calculate the distance between the model and the object. The scoring method evaluates the object's features (weighted and normalized variables) with regard to the criteria with the help of a special system of points.

The evaluation procedure of one object (the particular resource or the whole system) consists of the following steps:

1) Preparing the benchmarking positive model,
2) Weighting the criteria,
3) Calculation of the weighted value of the model,
4) Evaluation of the object with regard to the criteria with the help of the scoring method,
5) Comparing the object with the model (calculation of the taxonomic measure that indicates the stage of development of the object in comparison to the model),

6) Graphic presentation of the results and interpretation.

The benchmarking model consists of qualitative and quantitative criteria, to which we compare the evaluated object. With regard to the limits of information the model has only a positive character (is a stimulant) which means that high values of variables are preferable to low values. We select our variables (criteria) with the help of the heuristic method and they meet statistical essential and formal features. We present the main categories of criteria in table 4; in total, we employ 29 detailed criteria, grouped into 12 positions within four main categories.

All four categories of criteria have the same weighting (0.25), and are normalized. Equality between the criteria arises due to the sustainability of the system. The total weighted value of the model (A_w) equals the sum of the weighted variables (V_{wj}):

$$A_w = \sum_{j=1}^{n} V_{wj}, \quad (4.1)$$

where: $V_{wj} = w_j \cdot q_{wj}$, V_{wj} – value of the weighted model with regard to the criterion j, w_j – weighting of criterion j, q_{wj} – maximum value of the assessment with regard to the criterion j y, w – benchmarking object, j = 1,…, n – assessment criteria. We express the maximum value of the assessment (q_{wj}), dependent on the criterion, in a special point scale or indicator (e.g. quotient).

The evaluation of the object is the measurement of the degree to which the particular weighted criterion is met by the particular object, and is expressed by the following formula:

$$V_{ij} = w_j \cdot q_{ij}, \quad (4.2)$$

where: V_{ij} – weighted value of criterion i of the object with regard to assessment criterion j, w_j – weighting of assessment criterion j, q_{ij} – evaluation of the object i with regard to the assessment criterion j, i = 1,…, m – objects of the evaluation, j = 1,…, n – assessment criteria.

Evaluation of the object (q_{ij}) can be expressed in a special point scale or indicator (e.g. quotient). The final aggregated total value of the object (A_i) is the sum of weighted values of particular variables (V_{ij}):

$$A_i = \sum_{j=1}^{n} V_{ij}. \quad (4.3)$$

We can calculate the distance between the model and the evaluated object a number of measures. Usually different measures are employed for quantitative (e.g. Euclidean, urban, Bray and Curtis, Jeffreys and Matusito, "Canberra") and qualitative (e.g. Russel-Rao, Jaccard, Dice'a, Sokal-Michener) variables. Here, both types of criteria describe the EU own resources system, so firstly the special procedure of transforming variables into one quantitative category is employed (by the scoring method). We evaluate Evaluation of each resource with regard to the particular criterion with the help of the following uniform scoring scale:10 pt. – meets criterion very well, 8 pt. – well, 6 pt. –moderately, 4 pt. – poorly, 2 pt. – very poorly and 0 pt. – does not meet the criterion at all or is neutral.

Next, we calculate the distance between the model and the evaluated object with the help of normalization and Euclidean distance:

$$d_{iw} = \sqrt{\sum_{j=1}^{n} (V_{ij} - V_{wj})^2}, \quad (4.4)$$

where d_{iw} – Euclidean distance between the model w and the object i, V_{ij} – weighted value of the object with regard to the j criterion, V_{wj} – weighted value of the model with regard to the j criterion. The distance is smaller the object is closer the model.

Finally, each object is described by a taxonomic measure (m_i) that indicates the stage of its development, according to the formula:

$$m_i = 1 - \frac{d_{iw}}{d_w}, \quad (4.5)$$

where

$$d_w = \sqrt{\sum_{j=1}^{n} (V_{wj} - V_{-wj})^2} \quad (4.6)$$

and d_w is the Euclidean distance between the positive and negative model with regard to the criterion j and V_{-wj} – weighted value of the negative model with regard to the criterion j. The assessment value comprises the range [0-1], $m_i = 0$ for the negative model and $m_i = 1$ for the positive. The higher the value of m_i, the closer the object is to the model. However, the analysis comprises only positive models, so the distance $d_w = 1$ and finally:

$$m_i = 1 - d_{iw}. \quad (4.7)$$

The paper presents analysis for both systems (binding and projected) in three dimensions: 1) an assessment of the whole system with regard to all criteria, 2) an assessment of the whole system with regard to 12 criteria and 3) an assessment of particular resources with regard to all criteria. Additionally we assess the binding resources according to four main categories of criteria and compare the projected resources with the binding ones. Depending on the dimension analysis and results, we assess the sustainability rate m_i according to a different scoring scale. It means that the rates m_i result in different dimensions and cannot be compared to each other because they use different bases in distance calculation. The general rule is that the nearer m_i is to 1, the more the system (resource) is sustainable. We present our results in radar and bar graphs.

6. Results of the evaluations

6.1. The EU own resources system in the years 2000 – 2013

Between 2000-2006, and 2007-2013, two financial perspectives were applied and there were changes to EU own resources; in Table 5 we present the main features of the system in these periods.

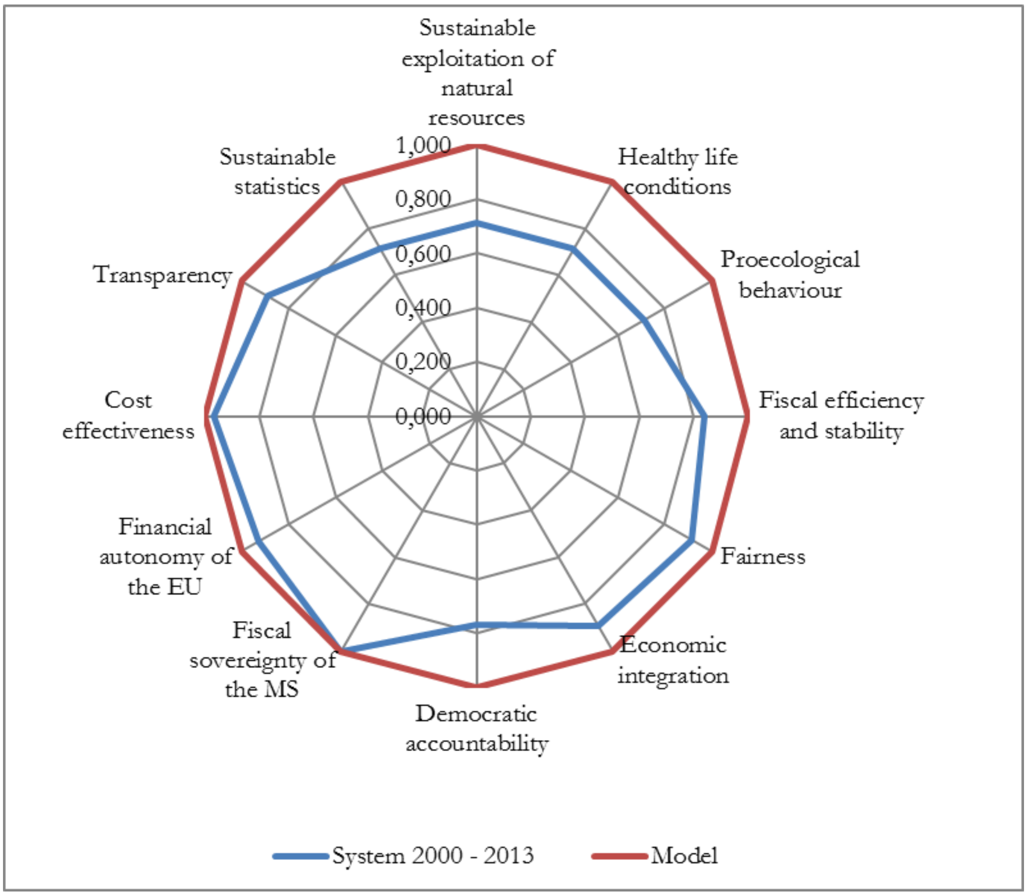
The taxonomic rate of development for the whole EU own resources system ($m_{2000-2013}$) is assessed at the level of 0,331 in the scale [0,0; 1,0]. It means that the system is generally poor but acceptable.

Analysis according to the main 12 criteria shows an unequal development of the system. Graph 1 shows that the system mainly supports fiscal sovereignty of the Member States, assures European Union fiscal autonomy and is cost effective. Additionally the system supports economic integration quiet well. On the other hand, the resources do not support natural environment protection or they are neutral with regard to this challenge.

Table 5. Construction of the EU own resources in the years 2000 - 2013

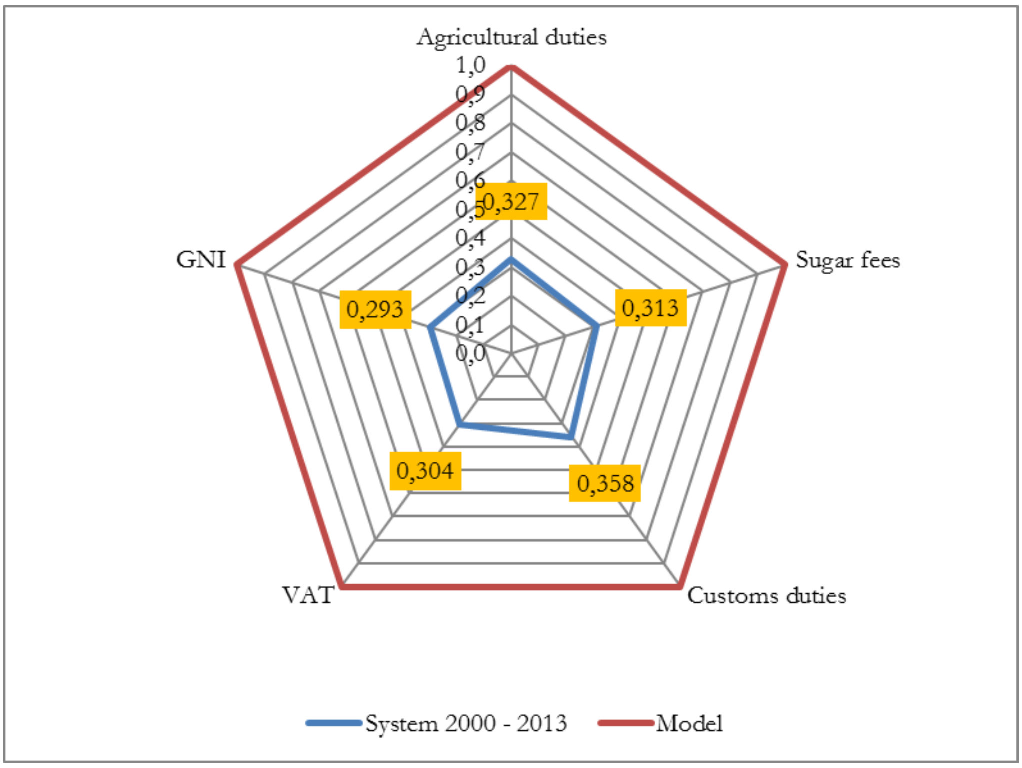
Category	2000 - 2006	2007 - 2013
Types of resources	Agricultural duties, sugar fees, customs duties, VAT, GNI (GNP in 2000 and 2001)	Agricultural duties (until 2008), sugar fees, customs duties, VAT, GNI
Customs duties and sugar fees	Collection costs 10 and 25% (since 2001), Different collection rules for customs and agricultural duties	Collection costs 25%, Common Customs Tariffs for agricultural and customs duties
VAT	Base limitation to 50% of GNI (GNP in 2000 and 2001), Uniform rate (difference between Maxima rate and „frozen" rate)	Base limitation to 50% of GNI, Uniform rate 0,30%, Reduced rates for: Austria 0,225%, Germany – 0,15%, Netherlands and Sweden – 0,10%
GNI	Base calculated in market prices, ESA 95 (GNI) (ESA 79 (GNP) in 2000 and 2001, Uniform rate calculated during the budgetary procedure	Base calculated in market prices, ESA 95 (GNI), Uniform rate calculated during the budgetary procedure, Yearly relief amount for Netherlands (€605m) and Sweden (€150m) in 2004 prices
Corrections	Rabate for UK, Relief in financing UK rebate for Germany - 2/3 original amount in the years 2000 and 2001 Reliefs in financing UK rebate for Austria, Germany, Netherlands and Sweden - ¼ original amount since 2002	Some changes in UK rebate since 2009, Reliefs in financing UK rebate for Austria, Germany, Netherlands and Sweden - ¼ original amount
Limits	For payments: 1,27% of GNP in the years 2000 – 2002, 1,24% of GNI Since 2003, For commitments: 1,335% of GNP in the years 2000 – 2002, 1,31% of GNI since 2003	1,24% of GNI for payments and 1,31% GNI for commitments

Source: own study based on Council (2000) and (2007).



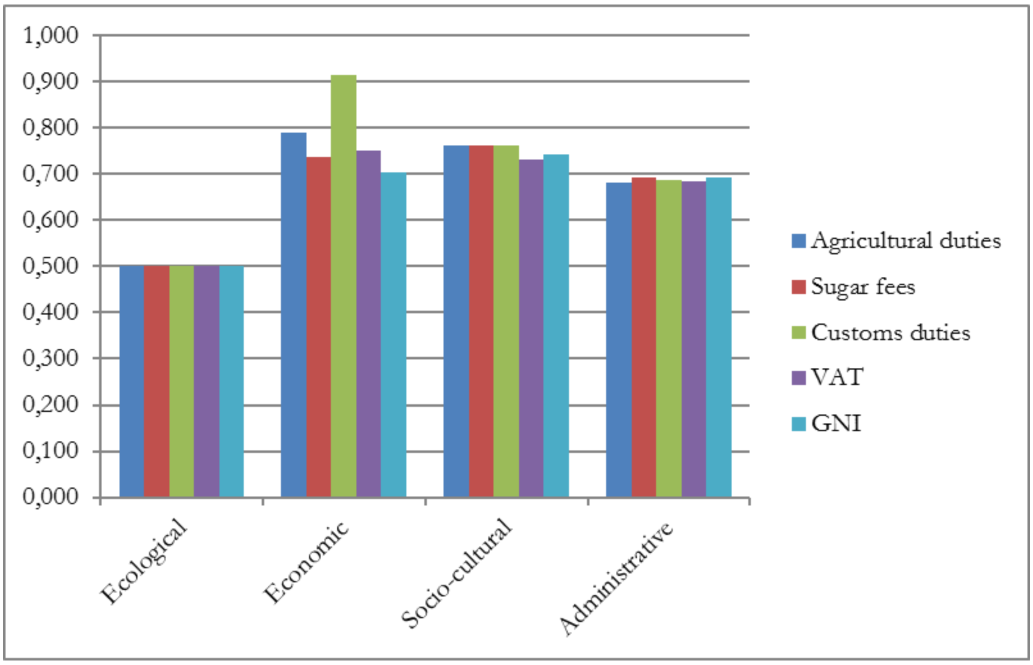
Graph 1. The EU resources system according to the main categories of criteria
Source: own calculations.

We assessed particular resources at a similar level to the whole system (graph 2), from which we can generalize that all resources support sustainable development poorly. Customs and agricultural duties attained the highest level whereas GNI received the poorest score in our assessments.



Graph 2. Taxonomic rates of EU own resources development in the years 2000 – 2013
Source: own calculations.

Graph 3 shows relations between the resources with regard to the main four categories of criteria. It shows a generally equal development of resources except for the influence on ecology. Resources mainly support economic and socio-cultural development and are acceptable with regard to the administrative criteria. In particular, our assessment shows that customs score highly as quite good tools of economic integration, fiscal efficiency and stability. On the other hand, legal acts that regulate resources do not, in the main, include clear rules supporting ecological development. In this result, we assess the resource as neutral.



Graph 3. Sustainable development of EU own resources in the years 2000 – 2013
Source: own calculations.

6.2. EU own resources system for the years 2014 – 2020

In 2011, the Commission presented proposals of two new resources that were to go into effect from 2014: a financial transaction tax (FTT) and VAT-base tax (Commission 2011d). The Council did not accept the Commission's proposals; however, it is worth investigating how the new resources meet the criteria of sustainability. The analysis consists of carrying out the simulation of new resources and other proposed changes in budgetary conditions in the years 2000 – 2012, based on our use of the following assumptions:

1) New VAT and FTT replace the VAT and GNI resources.

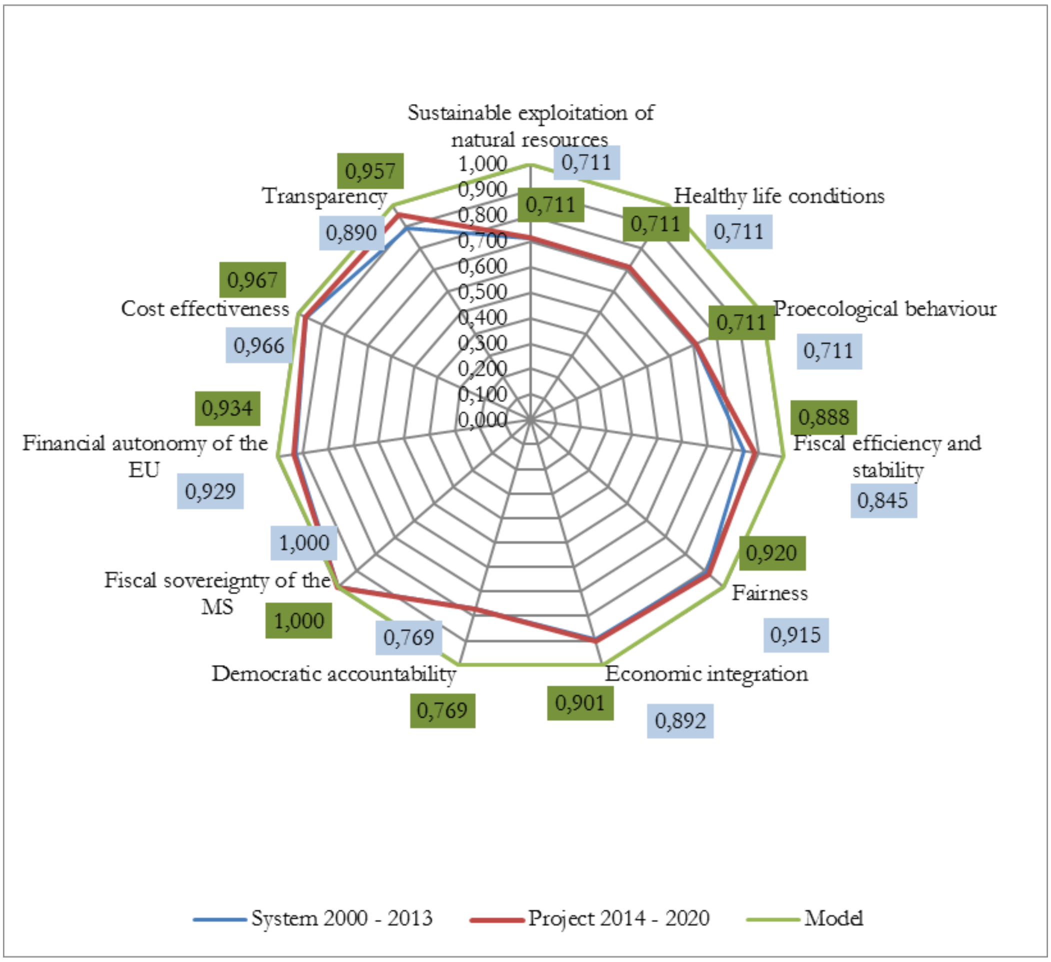
The FTT, apart from increasing the financial autonomy of the European Union, is supposed to stabilize financial markets and increase the share of financial institutions in financing the costs of the post 2008 economic crises. It is imposed on the gross turnover of all financial transactions on the secondary market between commercial financial institutions (banks, investment funds etc.). The Commission proposes two minimum tax rates: 0,1% for regulated market (turnover of shares, bonds) and 0,01% for the rest of transactions. The intention is for two-thirds of the revenues collected to reinforce the EU's general budget, and rest of the amount national budgets.

New VAT is supposed to increase transparency and connection with EU citizens; and is a new tax based on an independent tax base and rate. Generally, the main changes, in comparison to old system, consist of a limitation of the tax base, introducing new and easier methods of tax calculation, and introducing an independent EU tax rate (1% of tax base).

2) Administrative costs of traditional resources decrease from 25 to 10%,
3) Own resources celling is reduced to 1,23% of GNI for payments and to 1,29% – for commitments,
4) A replacement of binding correction mechanisms by yearly lump sum compensations, deducted from GNI resources. The Commission proposes the following compensation amounts: for Great Britain, €3,6bn; Germany, €2,5bn; The Netherlands, €1,5bn; and Sweden, €350m.

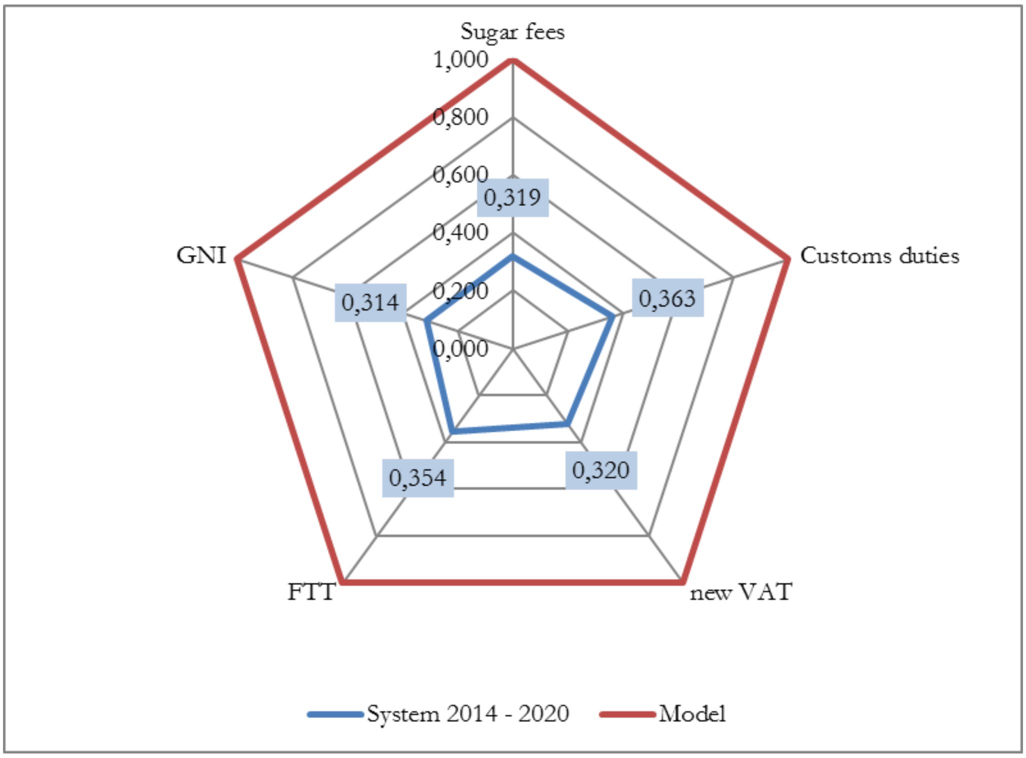
The taxonomy rate of development for the whole projected system ($m_{2014\ -\ 2020}$) is assessed at the level of 0,350 in the scale [0,0; 1,0]. This means that the project is slightly better than the system in force in the years 2000 – 2013 ($m_{2000\text{-}2013} = 0,331$) however, overall, it is also weak with regard to sustainable development criteria.

Analysis according to the main 12 criteria results shows an unequal development of the system. Graph 4 shows that the projected system shows significant improvements in comparison to the previous one, mainly in respect of transparency, fiscal efficiency and stability, and very slightly with regard to economic integration, fairness and financial autonomy. The weaknesses of the project and reasons of them are the same as in the case of the previous system. It does not support ecology and democratic accountability.



Graph 4. The EU resources system 2000 – 2013 and the new EU system according to the main categories of criteria
Source: own calculations.

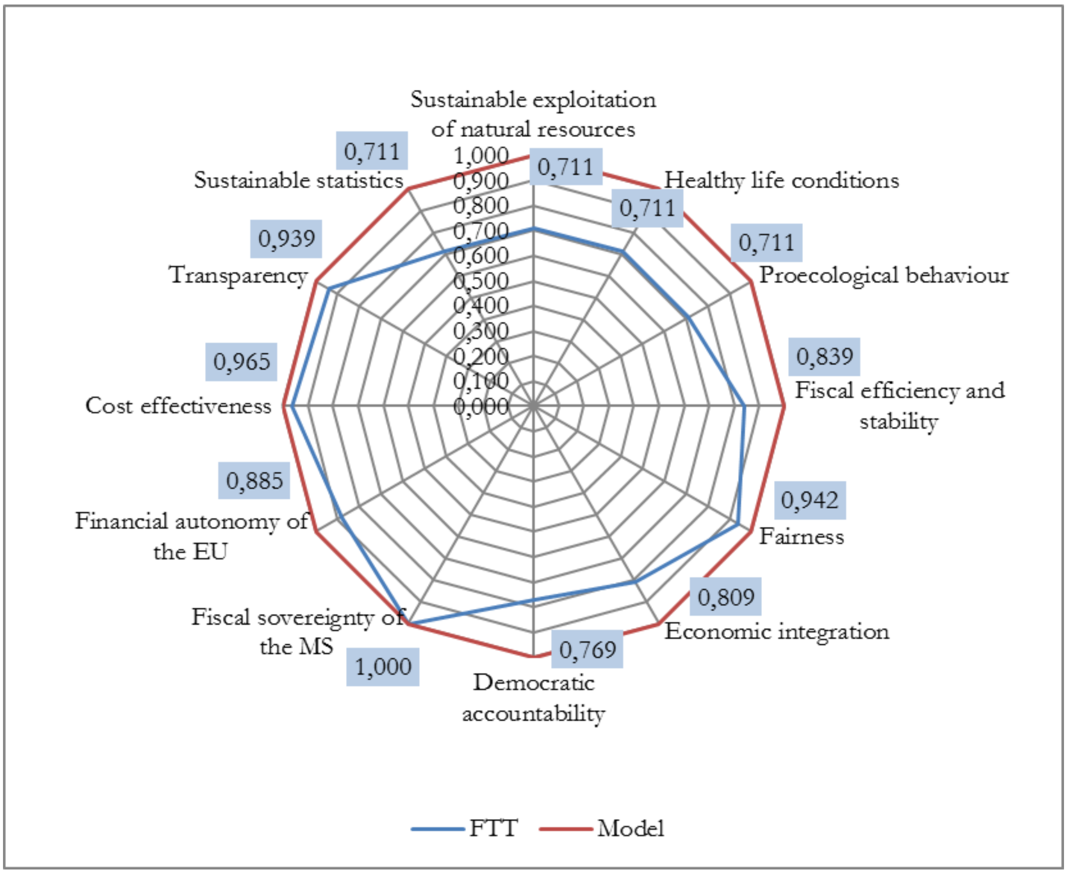
Once again, we assess particular resources in the projected system at a similar level to the whole system (graph 5), and find that resources support sustainable development poorly, but at an acceptable level; customs duties and FTT received the best scores whereas the GNI resource obtained the worst.



Graph 5. Assessment of EU resources for the years 2014 - 2020

Source: own calculations.

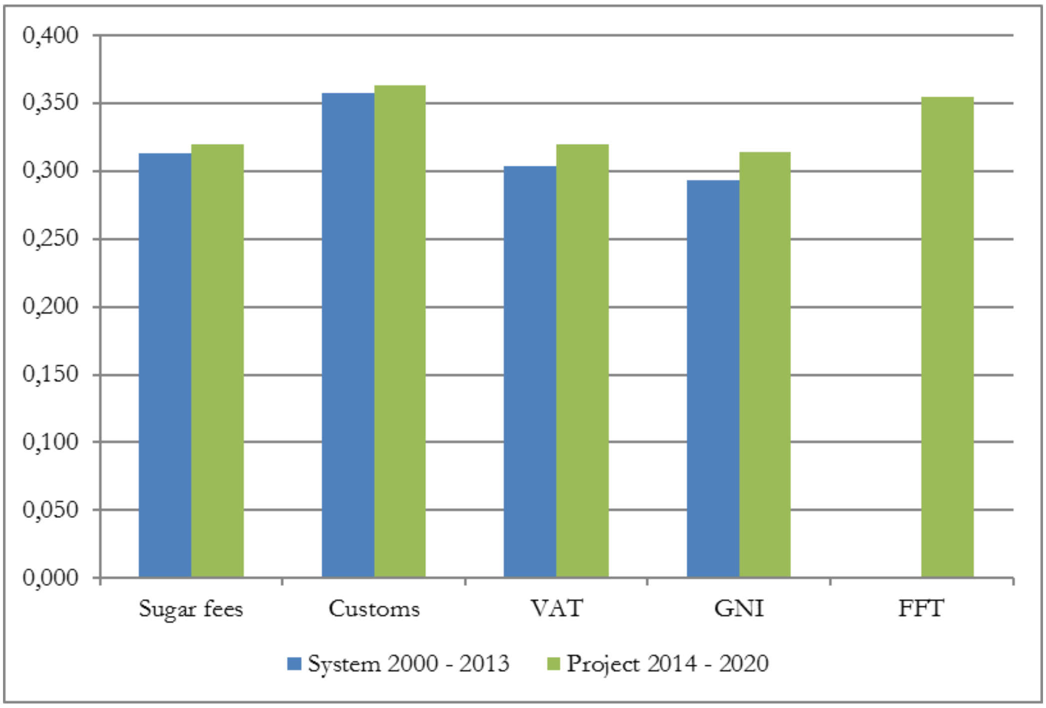
The FTT turns out to be quite transparent, cost effective, and quite fair, and works in accordance with the sovereignty of the Member States (graph 6). It also has a positive influence on the financial autonomy of the European Union and on economic integration. It is also fiscally very efficient and replaces GNI resource very effectively. However, the new resource is not very stable because of fluctuations on the financial markets. The weaknesses of the resource are typical – it does not support natural environment protection (or is neutral) and democratic accountability.



Graph 6. Assessment of FTT according to 12 main criteria

Source: own calculations

The projected resources, in comparison to the previous ones, generally improved (graph 7); all of them scored more points than the previous ones. In particular, the new VAT resource, thanks to its better transparency and better influence on financial autonomy, gains the most. Sugar fees and customs gained mainly because of a reduction in collection costs. GNI resource improved in the field of efficiency because FFT replaces it and as a result, the GNI share in total revenues is nearer the average.



Graph 7. A Comparison of EU own resources 2000 – 2013 with the project 2014 - 2020
Source: own calculations.

7. Final conclusions

The paper presents the conception of a sustainable EU own resources system and an assessment of two EU own resources systems with regard to sustainable development criteria: the system in place between 2000 and 2013, and a system projected for the years 2014 – 2020. We base our study on multi-criteria comparison analysis and Hellwig's conception of a taxonomic development indicator.

The analysis shows that both systems, and in particular the EU own resources, support sustainable development poorly. According to table 3 the systems and resources can also be classified as poor rather than moderate. Generally, while they meet economic, socio-cultural and administrative criteria at an acceptable level, they do not support (or are neutral on) natural environment protection. Formal regulations of particular EU own resources do not contain any obvious and straight solutions in this case, although it is difficult to discern any harmful effects caused by these resources. From this result, we can confirm the hypothesis formulated in the paper.

We assess the projected system for the years 2014 – 2020, with new VAT and FTT, higher than the previous one, mainly in terms of transparency and fiscal efficiency. In order to support sustainable development both systems should be equipped with typical ecological taxes or fees (e.g. a tax on the airplane tickets, the highway fee, the CO_2 tax) or with some ecological instruments, such as e.g. ecological allowances. Nevertheless, an assessment of all resources always ought to be carried out with regard to all sustainable criteria.

The methodology proposed in the paper allows for the use of both qualitative and quantitative criteria, assesses the whole system, and particular resources in different configurations, and allows for their comparison and the creation of rankings. The multi-criteria comparative analysis makes the evaluations more transparent and gives results that are more objective. However, the analysis also shows some disadvantages. The most significant is that it is difficult to compare results received in different dimensions, e.g. results at the level of 29 criteria with the ones at the level of 12 criteria. The general indicator, (m_i), is the most important as it shows the quality of the whole system or the particular resource. Other indicators, (e.g. graphs 4, 6, 7), can only show relations between different criteria and indicate advantages and disadvantages of particular objects in different configurations. The other problem is that while a scoring method improves the quality of qualitative criteria, it weakens the quantitative ones, with the transformation of these results into points. Employment of different methods of distance calculation between the model and the real object can also give different results. These comments notwithstanding, while we constantly seek to improve the methodology, we maintain that multi-criteria analysis seems to be more convincing than typical qualitative assessment made by the prism of the main resources and the most conflict criteria.

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[i] Zbigniew Henryk Hellwig (1925 – 2013): Polish economist, professor, a creator of academic school of statistics, econometrics and cybernetics. In statistics, he worked out so called the Hellwig method.

[ii] Here is an assumption that the resources should always meet all administrative criteria, which is the base of the functioning of each public revenue system.

[iii] Including an additional resource comprising all miscellaneous; since 2009 agricultural duties have been incorporated into the Common Custom Tariffs. Roma Tre.

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Reforming the financing of the EU budget: Outlook

by

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Abstract

This paper provides a general overview of the EU's own resources system, and of the debate on its possible reform within the current legal framework. Two alternative reforms are discussed, along with their possible advantages and drawbacks: 1) a simplified system based only on a resource related to gross national income; and 2) the introduction of new genuine own resources and the possible elimination of some current own resources. The second option, which has long been called for by the European Parliament, is explored in further detail, with an overview of the potential candidates for new own resources analysed by the European Commission prior to its 2011 reform proposal. The current outlook for a possible reform focuses on the ongoing work of the high-level group on own resources chaired by Professor Mario Monti, presenting the main obstacles to change and possible ways forward. This paper updates the author's in-depth analysis *How the EU budget is financed: The "own resources" system and the debate on its reform* (European Parliamentary Research Service, Brussels).

Key-words

European Union, own resources system, reform proposals

1. Introduction

The EU's annual budget is worth around 1% of its Member States' gross national income (GNI), or 2% of total public spending in the EU. It ignites heated debate on both its nature and objectives. Recent crises have triggered criticism that the current EU budget is unfit to tackle the challenges with which the EU is confronted. The revenue side of the budget is equally controversial, and also the subject of debate. Different options for financing EU policies reflect different visions of the EU, ranging from the inter-governmental to a more integrated approach.

Contributions from national budgets are the usual means of financing international organisations, such as the United Nations, in which citizens are only indirectly represented through their governments. In the EU, citizens are represented both directly in the European Parliament (EP) and indirectly by their governments in the Council. In many respects, the EU institutional structure is unique, being neither an inter-governmental organisation nor a federal State.

This originality is also seen in the financing of the EU budget. With a view to ensuring the financial autonomy of the Union, Article 311 of the Treaty on the Functioning of the European Union (TFEU) states that "own resources" finance its budget. The Council decides the rules governing the own resources system through a special legislative procedure, which requires unanimity and ratification by all Member States, while the EP is only consulted.

In the absence of a definition of own resources, academia has long debated their nature. Over time, their *automaticity* has been recognised as one of their main characteristics. This means that, once the system has been ratified, own resources are automatically due to the EU without the need for a further decision at Member State level. The Court of Justice of the EU (ECJ) has confirmed this crucial aspect, through its ruling that delays by Member States in making available own resources are unlawful.[1]

The need for unanimity explains the difficult evolution the own resources system has experienced. That has not prevented agreements from being reached, with six Decisions having been adopted after the first one in 1970. However, many analysts deem the requirement for unanimity to have resulted in a system that is more opaque than it otherwise would be. Modifications have often added new layers of complexity onto the existing mechanism rather than streamlining it.

2. The current system

2.1. Main data

The Council Decision (EC, EURATOM) 2007/436 is the legal basis currently in force, pending ratification of the new Decision,[II] which will apply retroactively from 1 January 2014. The maximum level of resources that the EU may raise during one year, its *own resources ceiling,* is set at 1.23% of the Union's GNI. The total revenue, which is always below the own resources ceiling, was €143.9 billion in 2014.

The financing of the EU budget comes from three categories of own resources:

- *Traditional own resources (TOR),* mainly customs duties, represented 11.5% of total revenue in 2014. Member States retain 25% of the amounts to cover collection costs.
- *VAT resource* accounted for 12.3% of total revenue in 2014. Based on a very complex statistical calculation to harmonise Member States' VAT bases, its link to actual VAT proceeds collected in Member States is very weak. With different consumption patterns across the EU, VAT bases are capped at 50% of GNI to counter potentially regressive aspects of the resource. For 2007-13, the standard call rate of this resource (0.30%) was lowered for Austria, Germany, Sweden and the Netherlands.
- *GNI resource* now represents by far the most significant source of revenue (around 69% of the total in 2014), despite being introduced as the "budget balancing element".

Other revenue, which is not classified as own resources, includes taxes on EU staff salaries, contributions from non-EU countries to certain programmes, and fines on companies for breaching competition law. In 2014, other revenue of €8.6 billion accounted for 6.9% of the total.

The UK rebate means that its contribution is lowered by a reimbursement. The UK government argues that the reasons for this arrangement, introduced in 1985 (and subsequently modified on a number of occasions), remain valid. Based on a complex statistical calculation, it changes every year (see table 1). It was worth almost €6.1 billion in 2014, reducing the UK contribution by around 35% to €11.3 billion. Three Member States (France, Italy and Spain) funded 58% of the UK rebate. Austria, Germany, Sweden and the Netherlands benefit from a permanent reduction in their contributions to the financing of the UK rebate, paying one-quarter of their calculated share. The same four countries also enjoyed one or more temporary correction mechanisms for 2007-13. The estimated effect of these adjustments on the draft budget for 2012 ranged from €95 million for Austria to €1.6 billion for Germany. For 2007-13, several countries obtained exceptions for the expenditure side of the budget,[III] such as resources earmarked for projects, regions or Member States. Despite appearing less significant in size, these additional corrections for expenditure contributed to the overall opacity of the system.[IV]

Table 1 - UK national contribution and rebate (in million euros)

	2009	2010	2011	2012	2013	2014
Gross National Contribution (GNC)	12 922	15 627	14 780	17 186	18 757	17 458
UK rebate	5 658	3 563	3 596	3 804	4 330	6 066
Final National Contribution	7 880	12 146	11 273	13 461	14 510	11 342
UK rebate as % of GNC	44%	23%	24%	22%	23%	35%

Data source: Elaboration on European Commission data.

2.2. How the system is performing

The Commission and the EP, as well as academic researchers, have identified several criteria against which the financing system and its components can be assessed. These include economic, political and administrative factors such as revenue sufficiency, simplicity, fairness between Member States and EU financial autonomy. A good system would aim to strike the right balance among the various goals of all these factors; however, these goals may conflict with each other.

On the positive side, the current system has provided sufficient and stable resources, thus overcoming the financing problems the EU experienced in the 1980s. In general, it is considered to have achieved this result effectively; according to a qualitative analysis by the Commission, the operating costs of the system are likely to be marginal. In addition, actual payments remain below the *own resources ceiling*. The unused margin under the 1.23% threshold has served as a guarantee for the European Financial Stabilisation Mechanism (EFSM), the temporary rescue mechanism that the EU created in 2010 to tackle the debt crises.

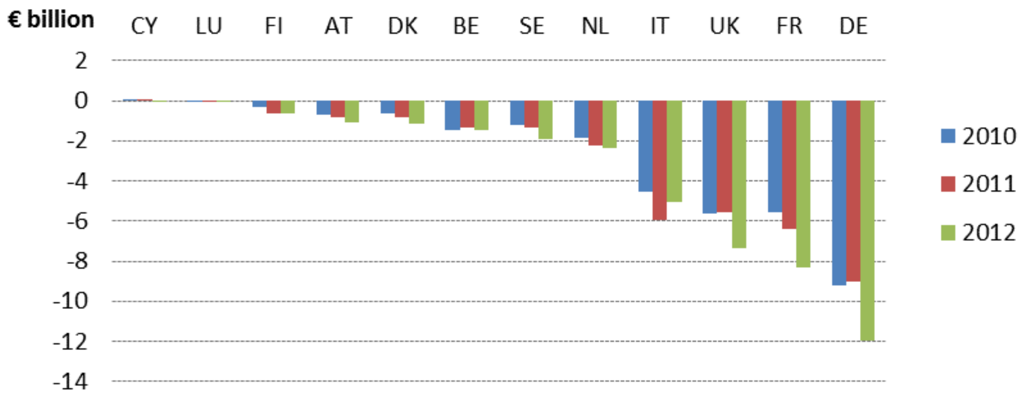
On the negative side, the Commission's EU Budget Review[V] of 2010 notes a series of shortcomings identified by stakeholders, who see the financing system as complex and opaque, and lacking fairness, mainly due to correction mechanisms. In addition, the system relies too much on resources which have little relationship to EU policies and, despite their *automaticity*, are often considered as national contributions, which Member States aim to minimise. This debate has been running for many years; in a 1999 resolution, for example, the EP presented its analysis of the weaknesses of the financing arrangements, calling for an overhaul of the system. Then, in 2003, the report of a high-level group commissioned by the Commission President (Sapir et al. 2003) highlighted the need for reform of the EU budget, including its revenue side.

2.3. The thorny debate on balances

Over time, the debate on the EU budget has increasingly focused on budgetary balances, which measure the difference between contributions to and receipts from the EU budget for each Member State.

Apparently simple, the concept is highly controversial. Estimates of Member States' budgetary balances are necessarily based on assumptions, including that of which items to be considered in calculating revenues and payments. According to the European Commission (1998), "*combining only the two or three most important assumptions [...] produces no fewer than 30 to 40 perfectly defensible definitions of budgetary balances*", with each of them giving different results – sometimes significantly so for smaller Member States. In many cases, it is difficult to identify the final beneficiary of funds with much precision. For example, Structural Funds are attributed to a Member State, but contracts implementing related projects may be awarded to companies from other Member States. Both students' Member

Figure 1 - Member States with negative operating budgetary balances (2010-12)*



*Cyprus' balance was positive in 2010 and 2011 and negative in 2012. Belgium and Luxembourg have negative balances, but these figures would be more favourable when taking into account administrative expenditure, since the largest EU institutions are mostly located on the territories of these two Member States.
Data source: European Commission.

States of origin, and the countries hosting these same students under Erasmus, can reasonably be expected to benefit from the same funds.

In addition, according to some analyses (e.g. Le Cacheux 2005), the concept is weak from an economic standpoint. As purely an accounting exercise, it results in a "zero-sum game" in which one participant's gains are balanced by another participant's losses. This cannot reflect positive spill-over effects of EU policies. They argue that, on the contrary, European integration would be better seen as a "positive-sum game" from which all participants benefit thanks to achievements such as the internal market. While the Commission publishes operating budgetary balances, it emphasises the fact that this is an accounting allocation which does not provide an exhaustive picture. Neither TOR nor administrative expenditure are taken into account in this calculation.

The excessive focus on budgetary balances (also known as "*juste retour*" or fair return) is often considered to be one cause of several shortcomings in the current system. It results in decisions that favour instruments with geographically pre-allocated funds rather than those with the highest EU added value, while representing an obstacle to change in the structure of expenditure. In addition, *ad hoc* correction mechanisms make the system less equitable and have distortive effects.

3. The European Parliament's role

With regard to EU expenditure, the EP is now co-legislator on an equal footing with the Council for the adoption of the annual budget. For the establishment of the EU's long-term financial plans, the Lisbon Treaty sets out that the Council needs Parliament's consent before adopting the Multiannual Financial Framework (MFF).

This is not the case for EU revenue. The Council establishes the own resources system by unanimity after consulting the EP. Some analyses (e.g. Patterson 2011) argue that this asymmetry between the expenditure and revenue sides of the budget sharpens the differences in the perspectives of the two institutions. One limited change introduced by the Lisbon Treaty is that the implementing measures for the own resources system now require the EP's consent before the Council can adopt them (by qualified majority).

A 2007 resolution reflects the critical opinion the EP has of the current system; its structure is considered complex and opaque for EU citizens. In addition, the system has departed from the provisions of the Treaty which aimed to ensure the EU's financial autonomy, because it mainly depends on resources from national budgets. The text called for a reform that should first improve the system of national contributions and subsequently explore new resources, but without increasing overall public expenditure or the tax burden for citizens. The EP also stressed the need to respect fully the principle of fiscal sovereignty of Member States.

In the framework of the negotiations on the 2011 budget, the EP pushed for a reform proposal to be tabled and discussed. Parliament established a Special Committee on Policy Challenges and Budgetary Resources for a Sustainable European Union after 2013. In its report, which the Plenary adopted in June 2011,[VI] the Special Committee underlined the link between EU expenditure and the reform of its financing, while calling for a more transparent, simpler and fairer own resources system. Further resolutions[VII] reiterated the need for an in-depth reform and the creation of new genuine own resources.

4. Agreement on 2014-2020 MFF: limited changes in own resources

4.1. 2011 Commission's reform proposal

In 2011, the Commission put forward proposals for a Council decision[VIII] and four related regulations with a view to improving the functioning of the system. The key suggested changes were:

- Member States' contributions would be simplified by abolishing the *current VAT resource* on 31 December 2013. The European Commission deems that this resource creates administrative burden (complex statistical calculation) without producing real added value (weak link to actual VAT proceeds); it can be seen as a different version of a GNI-based resource rather than as a genuine own resource.
- A *financial transaction tax (FTT) resource* and a *new VAT resource* would be introduced (respectively in 2014 and by 2018). They would be more closely related to EU policies and objectives (e.g. with stronger links to VAT harmonisation and actual VAT proceeds for the latter, see below). The resulting revenue would reduce the amounts of national contributions correspondingly.
- As of 2014, a new system of temporary corrections would replace all the mechanisms which existed at that time, for which the underlying conditions have changed significantly since their creation. It would consist of lump sums in favour of Germany, the Netherlands, Sweden and the UK. Furthermore, the "retention rate" for collection costs on TOR would be lowered from 25% to 10%. This retention rate, says the Commission, can be regarded as a hidden correction, beneficial to Member States that are significant entry points for imports into the EU's single market (e.g. the Netherlands and Belgium).

According to the Commission, these changes would have resulted in a different mix of resources in 2020, with TOR and the two new own resources respectively accounting for 20% and 40% of total revenue. The *GNI resource* would thus have been reduced to 40%. This was expected to decrease the focus on budgetary balances.

However, the Commission's estimates soon became outdated, since no agreement could be reached on the introduction of an FTT at EU level. In the meantime, the Council authorised 11 Member States to move ahead with an FTT by way of the enhanced cooperation method. In its updated proposal,[IX] the Commission estimates that an FTT could raise around €31 billion per year. The press reports that the 11 Member States have conflicting opinions on using part of this potential revenue as an EU own resource.

4.2. Reactions and developments

4.2.1. European Court of Auditors

In 2012, the Court of Auditors[X] analysed the Commission's proposals; in its opinion, the elimination of the *current VAT resource* would address a weakness of the system. The *new VAT resource* is considered complex, but less so than the current one. The Court notes that, being based on volatile economic activity, the revenue raised by an *FTT resource* would be by nature unpredictable. In addition, it deems lump sum corrections to be simpler than the current mechanisms, but still not transparent. Finally, the amount of TOR in 2020 could be overestimated. The link between the retention rate on TOR and the real collection cost is considered unclear.

4.2.2. Parliament and European Council

On 23 October 2012, the EP[XI] asked for the Commission to put forward proposals for new own resources should the new system not result in a significant decrease of the *GNI resource*. The EP supported[XII] the *new VAT resource*. It called on the Commission to investigate how to further reform it in order for the new own resource to accrue directly to the EU budget.

In February 2013, the European Council reached[XIII] the following conclusions on the MFF 2014-20: collection costs on TOR should be lowered to 20%; a *new VAT resource* should be further worked on to (potentially) replace the existing one; Member States cooperating on an FTT should examine if this could become an own resource; the UK rebate should be kept; corrections should be granted to Denmark, Germany, the Netherlands and Sweden until 2020 (and to Austria until 2016) by means of lump sum reductions in their GNI-based contribution and/or a reduced rate of call of the VAT resource.

Later that year, the EP succeeded in keeping the debate on own resources high on the political agenda, obtaining the establishment of an inter-institutional high-level group (EP, Council and Commission) tasked with paving the way to possible reforms of the financing system (see Chapter 9).

4.2.3. Council of the European Union

In January 2014, the Permanent Representatives Committee of the Council agreed the texts of the three legal acts that are meant to implement the February 2013 conclusions of the European Council. These include: the new Own Resources Decision; the regulation setting implementing measures for the Own Resources system; and the regulation establishing how to make Own Resources available. In April 2014, the EP gave its consent to the implementing measures,[XIV] whilst it was only consulted in the other two cases. Following adoption by the Council, the three legal texts were published in the Official Journal of the EU on 7 June 2014.[XV]

Once ratified by Member States, the new Own Resources Decision will apply retroactively as of 1 January 2014. The process can take many months: for example, the current Decision was adopted by the Council in June 2007, but entered into force on 1 March 2009 (after ratification by all Member States), with retroactive effect back to 1 January 2007.

5. Reform options

5.1. Two main models

According to the mandate set out in the joint declaration, the inter-institutional high-level group (HLG) will take into account existing and forthcoming input provided by the EP, the Council, the Commission and national parliaments. In the long debate on the reform of the Own Resources system, a wide range of options has been discussed, with two main models emerging:

- One scenario would see the EU budget financed only through a *GNI resource*. Such a system would be simple. Its supporters consider it would also be fair towards Member States, taking GNI as an indicator of a Member State's ability to pay/contribute. However, the latter assumption is open to debate, given that, for example, the current system of correction mechanisms entails distortions and would need to be reformed. In addition, a reform in this direction is not likely to address the current shortcomings (e.g. the focus on geographically pre-allocated expenditure rather than on initiatives with EU added value) and would go against the spirit of the Treaty, which assigns own resources to the EU so as to ensure the achievements of its objectives.
- The other scenario would imply streamlining the system, with an increase in the

share of the budget funded by genuine own resources and a corresponding reduction of the resources currently perceived as national contributions. The Commission's 2011 reform proposal went in this direction, building on the Lisbon Treaty, which for the first time explicitly mentions the possibility of establishing new categories of resources and abolishing existing ones. Opponents[XVI] of such an approach consider that the "*juste retour*" attitude is inevitable in EU budgetary discussions, sometimes suggesting other ways of improving the perceived fairness of the system.

5.2. A few areas of common ground

Customs duties, and more generally TOR, appear to be suitable EU's own resources. They are closely linked to EU policies and objectives. Since entry points for imports into the EU serve the entire single market and benefit from its existence, it can be reasonably argued that relevant duties are related to the EU level rather than to individual Member States (see section on assessment criteria below). Therefore, there appears to be no real need to eliminate this source of financing for the EU budget. However, TOR currently account for just over 10% of the resources needed each year and have shown a declining trend over time, due to developments in trade policy.

As long as the EU budget cannot run a deficit,[XVII] a balancing resource is necessary. Unlike its predecessor in this role (the *VAT resource*), the *GNI resource* has ensured the availability of sufficient resources to finance the EU budget.

Widely recognised as complicated, the current *VAT resource* does not appear to provide any significant added value to the system and is not perceived as a genuine own resource. According to the Commission, its abolition would only slightly modify Member States' contributions, while simplifying the financing of the budget. However, an obstacle to its elimination lies in the fact that it is an essential component for the calculation of the UK rebate and is therefore linked to the politically sensitive topic of correction mechanisms.

5.3. Correction mechanisms

Current correction mechanisms, which only apply to a limited number of Member States, contribute significantly to the opacity of the system. The Treaty does not make any reference to such mechanisms, which rest on the conclusions of the European Council held in France in June 1984. According to [these, known as] the *Fontainebleau principles*, "*expenditure policy is ultimately the essential means of resolving the question of budgetary imbalances*", but any Member State "*sustaining a budgetary burden which is excessive in relation to its relative prosperity may benefit from a correction at the appropriate time*". The concepts of excessive budgetary burden and relative prosperity are not defined, remaining open to interpretation.

In 2011, the European Commission presented examples of data (see table 2), indicating that there was no clear correlation between net contributions and relative prosperity under current arrangements and in a context that had significantly evolved since 1984 (lower share of the EU budget devoted to agriculture spending; increased relative prosperity of the UK; and significantly reduced role of the VAT resource in the mix of resources financing the EU budget).[XVIII] The Commission also considered that existing net contributions were generally low. In addition, the UK rebate can have a distortive effect on UK expenditure of EU funds, potentially making their use less interesting for the country. For example, if the UK obtains resources under the European Union Solidarity Fund, which provides support in the event of major natural disasters, in practice the actual aid received will be reduced by two-thirds due to the mechanism of the rebate.

Table 2 - Prosperity and net contributions

	Operating budgetary balances average 2007-2010 (% GNI)	Prosperity 2010 (GNI pc PPS, EU-27=100)
Denmark	-0.29%	127.0
Germany	-0.32%	120.2
France	-0.23%	108.7
Italy	-0.26%	98.2
Netherlands	-0.31%	134.4
Austria	-0.18%	124.7
Finland	-0.19%	117.3
Sweden	-0.27%	125.3
United Kingdom	-0.17%	115.5

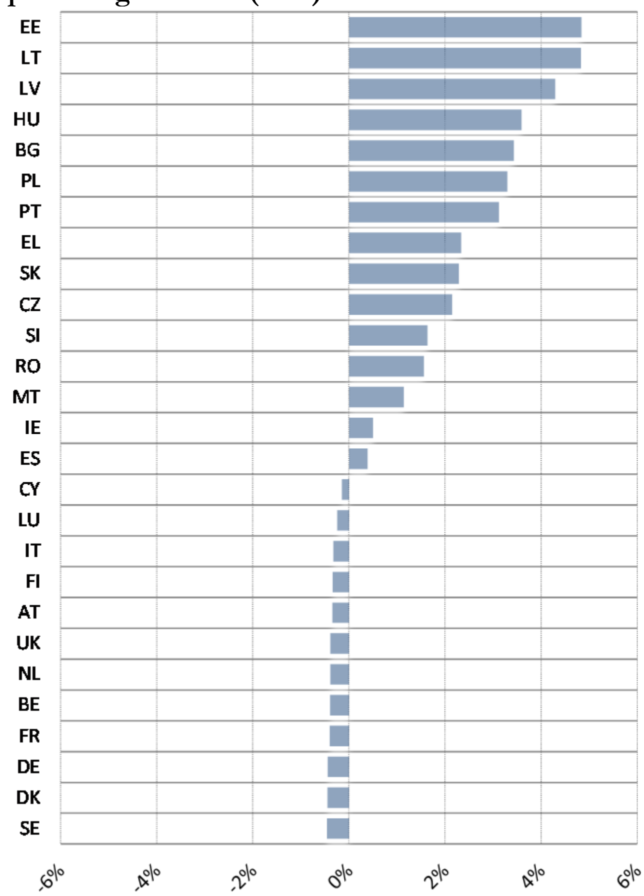
Data source: European Commission (2011).

On the basis of these considerations, the Commission has repeatedly tried to reform correction mechanisms, by putting forward proposals for a general correction mechanism applicable to all Member States (2004) or a system based on temporary lump sums for a limited number of countries (2011). However, the issue has proved to be politically sensitive, with relatively limited changes agreed by Member States after both proposals. In discussions in 2012, many delegations favoured[XIX] the abolition of all corrections. According to the Court of Auditors (2005),[XX] the existence of any correction mechanism has a negative impact on the simplicity and transparency of the system.

5.4. Should the EU budget have some redistributive effects?

In 1957, the Treaty of Rome mentioned the need to promote harmonious economic development and help less favoured regions close the gap they experience. At the time the UK rebate was created in 1984-85, 69% of the EU budget was spent on agriculture. On the one hand, agriculture was (and still is) a policy area with spending mainly concentrated at EU level. On the other hand, EU agriculture spending had redistributive effects that did not appear necessarily to be related to countries' relative prosperity.

Figure 2 - Operating budgetary balances as a percentage of GNI (2012)



Data source: European Commission.

Subsequent years saw a significant increase in the resources assigned to cohesion policies[XXI] with redistributive objectives clearly related to relative prosperity. This trend aimed at counterbalancing the impact of the completion of the single market on less developed Member States and regions, but can also, in part, be seen as an attempt to implement the first *Fontainebleau principle* (expenditure policy as the main tool to address budgetary imbalances), by reducing the share of the budget devoted to agriculture expenditure.[XXII] However, the European Commission notes that Member States with lower relative prosperity currently contribute to financing correction mechanisms, which results in a partial neutralisation of cohesion objectives. At the same time, geographically pre-allocated resources play a role in increasing the focus on budgetary balances, but some analysts consider that overall the EU budget has rather modest redistributive effects, due to its size and capping. Nonetheless, for some countries, the EU budget may represent a significant source of resources for investment: for central and eastern European Member States, for example, the very rough indication given by operational budgetary balances shows positive annual surpluses, in most cases corresponding to between 2.14% and 4.84% of GNI in 2012 (see figure 2). Enderlein et al. (2012) note the need to address persistent structural divergences so as to build a more balanced EU.

6. Criteria to assess the system and/or its components

In the long debate over possible reforms of the own resources system, many analyses have been carried out at both an institutional (e.g. EP and European Commission) and an academic level since the 1970s. Each of them identifies sets of criteria against which individual resources and/or the system as a whole can be assessed, taking into account both elements of tax theory and the unique institutional configuration of the EU. Even if they partly differ in their definition or scope, many criteria recur in most analyses, as pointed out in a 2008 study carried out for the European Commission (Begg et al. 2008). A non-exhaustive list of criteria can be organised in six broad categories, though some criteria can relate to more than one category

6.1. Budgetary criteria

These include sufficiency and yield stability. The system needs to provide resources that are sufficient to cover agreed expenditure, and are reasonably stable over time to avert the risk of sudden financing difficulties. These principles should also apply to the selection of new own resources given that reforming the system has proved to be a long and difficult process. For example, it can be argued that it may not be efficient to introduce a new own resource whose expected proceeds would be small in comparison with the size of the EU budget, highly volatile and/or likely to be on a downward path. The financing problems experienced in the 1980s show the importance of budgetary criteria.

6.2. Democratic accountability criteria

Since the EU is a Union of States and citizens, the financing system and its components should be characterised by simplicity, transparency (both explicitly mentioned in the mandate of the HLG) and visibility so as to allow a closer bond between the Union and its citizens. The Treaty principle of EU financial autonomy, which some analysts (Heinemann et al. 2008) do not recognise as a criterion proper, could also be seen as part of this category.

6.3. Economic criteria

In principle, the system and its components should distort economic choices as little as possible, for example not discriminating against individual sectors (neutrality). However, in the case of economic activities producing transnational negative externalities,[XXIII] the system or one of its resources could be designed to address a market imperfection (so-called corrective or "Pigouvian" taxation), in line with EU policy objectives (e.g. environmental goals).

6.4. Equity criteria

The system should take into account the ability to pay. Entities in similar situations should each provide a similar contribution. Regressive aspects, implying a proportionally higher contribution from those worse off, should be avoided. In tax theory, these concepts apply to equity between citizens. In the EU context, they are also often related to the objective of ensuring fairness between Member States. Equity is another of the guiding principles mentioned in the joint declaration on the high-level group.

6.5. Integration criteria

The link to a common EU policy can strengthen the rationale for assigning a resource to the EU level. In addition, fiscal theory speaks of regional arbitrariness, when the tax base cannot be easily linked to the place where the tax is collected and there is potentially a high mismatch between the collection and the burden of a tax. TOR provide a practical example of this concept: customs duties are collected in the Member State where the goods enter the EU's internal market, but their burden may be borne by economic agents who are resident in other Member States depending on the destination of the goods. Therefore, the assignment of customs duties to the EU level appears to make sense, given that entry points of goods benefit from the existence of the EU's internal market, and it is difficult to determine how relevant revenue should be shared between individual Member States.

6.6. Technical and administrative criteria

Cost-effectiveness should characterise the collection of resources. This means that administrative costs need to be low in comparison with the proceeds. At the level of individual resources, this objective can be favoured by a number of factors such as: the existence of a harmonised base for the resource; a reasonably short time needed for implementation once the resource has been selected; and the absence of any major potential legal issues for implementation.

The need for prioritisation

The perfect resource does not exist, since the various goals of all these factors may partly conflict with each other. In any case, a prioritisation of objectives, which implies a certain degree of subjectivity, is needed to launch a reform of the system. The joint declaration on the HLG appears to provide some indications to this effect. However, different stakeholders have so far shown different preferences. A good system and its components would aim to strike a balance among the various criteria, possibly resorting to a mix of resources.

7. The two new resources proposed by the Commission in 2011

In the EU budget review of 2010, the European Commission identified six financing means as possible new own resources for the budget of the Union:

- taxation of the financial sector;
- revenues from auctioning under the EU's greenhouse gas Emissions Trading System (ETS);
- a charge related to air transport;
- energy tax;
- VAT;
- and corporate income tax.

The 2011 report on the operation of the own resources system presents an analysis of each hypothesis (usually including some variants). Its annex briefly explains the reasons why two additional options, (an EU communications tax; and a resource related to *seigniorage*, part of the monetary income that the euro area central bank system derives from its activities), were discarded. The two documents show the grounds on which the Commission selected VAT and financial transactions for its reform proposal.

7.1. A new VAT resource

The variant of the VAT resource put forward by the Commission in 2011 aims to create a closer link between actual VAT receipts in Member States and the EU budget. While simplifying the calculation in comparison with the current system, it would focus only on the final consumption of goods and services that are subject to the standard VAT rate in each and every Member State,[XXIV] with a share of relevant VAT proceeds assigned to the EU. This narrow base is meant to overcome the issues created by the incomplete harmonisation of VAT across the EU that triggered the transformation of the current resource into a mainly statistical tool through a long series of corrections and compensations (e.g. capping of the base).

The European Commission considers that such a VAT resource would have a series of positive features. It would provide a significant yield, but be subject to limited volatility: applying a 1% EU rate to 2009 data, revenues for the EU budget were estimated at between €20.9 billion (with the current degree of harmonisation of VAT rules in the EU) and €50.4 billion (with further harmonisation of VAT rules). While increasing simplicity and visibility in comparison with the current system, such a resource would not create a disproportionate burden for specific sectors, says the Commission.[XXV] In addition, it is linked to EU policy objectives, with further on-going efforts to streamline VAT provisions and thus strengthen the single market.[XXVI] As regards cost-effectiveness, the selected option is said to be the variant with the more limited impact on businesses and national administrations.

According to an analysis (Schratzenstaller 2013) based on partially different criteria, VAT would qualify as a suitable base for a genuine EU own resource only for its long-term yield and visibility, but not so against other parameters. Conversely, another paper (d'Oultremont et al. 2013) considers that a new VAT resource would improve the current system in many respects, while noting the possible difficulties in reaching an agreement at the political level. The decision-making process is mentioned as the main short-term obstacle (ahead of the regressive character of VAT and different levels of VAT fraud across the EU) to the adoption of a new VAT resource in another article (Leen 2013), which assesses the pros and cons of such a source of revenue. Commenting on its 2011 estimates, the Commission says that the VAT burden in some Member States (e.g. Cyprus, Luxembourg and Malta) would be higher than average, but argues that the regressive aspects of VAT are not clear-cut and that different consumption patterns could also be due in part to factors such as cross-border shopping and tourism.

Where the new VAT resource proposal stands

The EP has supported the introduction of a new VAT resource, identifying transparency, fairness to taxpayers in all Member States, and improved simplicity as its main advantages and calling for proposals to reform this resource further. The European Council has not ruled out the replacement of the current VAT resource with a new one, but has called for further work by the Council. Whilst the European Commission had identified 2018 as the target date for introduction of the new VAT resource, this was postponed to 2021 in an interim document prepared by the President of the European Council during the MFF negotiations. The conclusions of the European Council on the MFF do not include any precise date for the introduction of the new resource. In any case, the proposal remains on the table for consideration by the HLG in the wider review of the system.

7.2. An FTT resource

In the wake of the financial crisis, the idea of taxing the financial sector was revived. After examining several options to this end, the European Commission recognised some positive aspects in a Financial Activities Tax (FAT), but highlighted also a series of obstacles an FAT would face (e.g. from an administrative and political standpoint along lines that are similar to those identified for a hypothetical EU corporate income taxation, see section on other potential candidates below). On these grounds, the Commission deemed financial transactions to be a more suitable tax base in a first phase and put forward a proposal for an EU-wide FTT, suggesting that the revenue of this new source be shared among national budgets (one-third of the receipts) and the EU budget (two-thirds).

The reasons advanced for using part of an FTT as an own resource include economic criteria; the financial sector is deemed to enjoy a tax advantage due to the current VAT exemption on most financial services, while it benefitted from huge state aid measures during the crisis. The sector would repay part of these costs through such a scheme, which would aim to curb the volume of speculative financial transactions and reduce the volatility of the market (thus addressing negative externalities). These objectives would be better achieved at the EU level, due to the high mobility of the tax base. In addition, an FTT may contribute to EU policies (e.g. by strengthening the internal market) and has a potentially high yield (according to the initial Commission estimates, a variant limited to a low rate on transactions between financial institutions could raise between €30 billion and €50 billion per year for the EU-27 by 2020). Such an own resource could be perceived as unfair towards some Member States, since a high volume of financial transactions is concentrated in a few Member States. However, in the context of the single market, the European Commission considers that the proceeds would be characterised by regional arbitrariness, since they would not necessarily be attributable to the country in which a transaction takes place.

On the negative side, the European Court of Auditors notes the high volatility of financial transactions, which would result in unpredictability of revenue. In addition, the economic effects of an FTT are controversial and much debated in the literature, with opponents arguing that it can have a negative impact on the economy without being able to reduce market volatility or speculative transactions. For example, Kaiding (2014) considers that an FTT does not qualify as a Pigouvian tax, suggesting that a reform of VAT on financial services[XXVII] or an FAT would be more suitable solutions to address the tax advantage of the financial sector. An additional criticism of an FTT is that it would have low visibility for citizens.[XXVIII]

Conversely, Schratzenstaller (2013) concludes that an FTT is the most suitable base for a new own resource among the options examined by the European Commission in 2011, while recalling that there are no resources able to meet all the assessment criteria. Another analysis (d'Oultremont et al. 2013) considers that the economic effects of an FTT will largely depend on its final design and gives a positive overall assessment of this option.

Where the FTT proposal stands

The idea of establishing an FTT at EU level encountered strong opposition from a number of Member States, including the UK and Sweden. Following an updated Commission proposal, 11 Member States (Belgium, Germany, Estonia, Greece, Spain, France, Italy, Austria, Portugal, Slovenia and Slovakia) decided to cooperate to introduce an FTT by way of the enhanced cooperation method. In April 2014, the Court of Justice of the EU dismissed an action[XXIX] brought by the UK against the Council decision authorising this move. The EP, which had repeatedly called for the introduction of an FTT at global and European level, gave its consent to the creation of an FTT under enhanced cooperation. Updated Commission estimates indicate that annual proceeds could amount to around €30-35 billion under the new proposal. The European Council conclusions on the MFF left the door open to the possibility of using part of this revenue to finance the EU budget. This would correspondingly reduce GNI-based contributions. However, it remains to be seen whether such a solution - if agreed upon by participating countries - would help to address the current shortcomings of the system; a resource stemming from only some Member States would not increase its simplicity, while net balances would be likely to remain the main logic and the benchmark underpinning budgetary debates. While participating countries initially planned the launch of the first phase of the FTT by 1 January 2016,[xxx] negotiations have repeatedly been beset by difficulties and delays.[xxxi]

8. New own resources: other possible candidates

In the run-up to the completion of the review of the own resources system, it may also be worth reconsidering the options that the Commission did not retain in its reform proposal.

8.1. Revenues from the EU Emissions Trading System (ETS)

The ETS is the centre-piece of EU policy to fight climate change. It sets limits on the total quantities of certain greenhouse gases which entities in the scheme (e.g. industrial installations) can emit, while emission allowances can be traded by these entities within the established limits. Revenues stemming from the allowances auctioned under the ETS could be shared between EU and national budgets. Contrary to tax-based own resources, the revenue would thus depend on the prices of allowances determined by demand and supply on the relevant market.

Elements in favour of the use of ETS revenue as an own resource include: the clear link to an EU policy and economic criteria with neutrality towards installations already subject to ETS rules; as well as the possibility of further addressing negative externalities (e.g. by earmarking relevant revenue for additional environmental actions, even if current provisions already include targets to this end).

Among the risks to be minimised, the European Commission notes that re-opening negotiations on the ETS Directive could affect the legal certainty of the scheme, which is needed for its good functioning. In addition, fairness between Member States could be a source of friction, since significant differences can be observed in the distribution of auction rights, whose allocation is reported to have played an important role in the final agreement on the climate and energy package.

According to Commission estimates from 2011, ETS revenues accruing to the EU budget could reach €20 billion in 2020. As noted above, market factors would have a direct impact on the actual proceeds. In the meantime, the functioning of the ETS has raised criticism, with some analysts[XXXII] arguing that it is a flawed policy and identifying a gradually rising carbon tax as a better means of meeting carbon reduction objectives.

A 2014 IMF working paper argued that national considerations alone would already justify a substantial carbon tax (or CO_2 pricing through trading systems), estimating the average efficient price for the top twenty emitters at USD57.5 per tonne of CO_2 (but with significant variations from one country to another), and noting that this was much higher than the recent prices in the EU's ETS.

In 2015, following a Commission proposal to tackle the over-supply of allowances in the ETS, Parliament and Council agreed to introduce a new mechanism under which surplus allowances would be placed in a Market Stability Reserve, starting in 2019. According to data by Thomson Reuters Point Carbon, the price of emissions allowances will go from €7.50 in 2015 to €19 by 2020. Point Carbon's analysis adds that the reform should allow governments to increase their revenue from emissions auctions by 89% (with the total revenue between 2015 and 2025 now estimated at €151 billion).[XXXIII]

8.2. Charge related to air transport

The liberalisation of the EU air transport market is regarded as a success story, with significant economic benefits for the wider economy. While, in comparison with other activities (including road and rail transport), the sector enjoys a favourable tax regime with virtually no taxation of kerosene and no VAT on air tickets, some Member States have introduced national air passenger taxes. The ETS, which is applicable to air transport since 2012, has also ignited a debate in this sector.

According to the Commission, integration criteria would support the establishment of an air transport duty (either on passengers or on flights) at the EU level rather than at the national level, so as to avoid fragmenting the internal market and distorting competition. In addition, companies' relocation of activities undermined attempts by some Member States (e.g. smaller ones) to introduce such a duty, suggesting that the national level is not the optimal one for this. Cost-effectiveness considerations could also play a positive role, as shown by the example of some national air duties which needed only a few months to be introduced.

While the uneven distribution of air transport across the EU could raise equity issues, the European Commission argues that air transport activities are characterised by a degree of regional arbitrariness due to their cross-border nature. In relation to economic criteria, the analysis notes the need for careful design of the scheme, for example to avoid a negative impact on the international competitiveness of EU air transport and on the economy of regions that are much dependent on air transport due to their geographical features. The example of the UK Air Passenger Duty (APD), in force since November 1994, is presented to support the idea that such a scheme can function, and that its potential negative impact should not be overestimated.

An air transport duty could provide a significant yield, estimated at €20 billion or more in 2020. Since the cyclical nature of the sector would entail some volatility in the proceeds, its use in a mix with other resources should be considered.

Schratzenstaller (2013) agrees that a charge based on air transport would qualify well as an own resource of the EU, noting that it would also meet the visibility criterion. If this option was chosen, opposition from the industry might be expected; for example, a group of UK and Irish companies commissioned a study to measure the impact of the abolition of the UK APD on the economy and on public finances. In addition, there has been much debate on the differentiated application of the UK APD in Scotland and Northern Ireland.

8.3. Energy/carbon tax

A framework for various aspects of energy taxation in the EU is set by Council Directive 2003/96/EC (Energy Taxation Directive, or ETD), which the European Commission proposed to amend in 2011.[XXXIV] This basis could facilitate the introduction of an energy-related own resource. However, in March 2015 the Commission withdrew its proposal for an amendment of the energy taxation framework on the grounds that Council negotiations had resulted in a draft compromise text that completely distorted the substance of the proposal. In addition, there was not even agreement in the Council on the compromise text.

In 2011, the Commission identified two main options (each with several possible variants): an energy levy (linked to energy products released for consumption); and a carbon levy. The latter would require the adoption of the amended ETD and could complement the ETS so as to ensure a coherent approach and avoid overlaps in the policy to fight CO_2 emissions.

Under the integration criteria supporting the establishment of an own resource in this field, the link to an EU policy and attempts to strengthen the internal market for energy could be envisaged. For example, the new resource could be used to finance part of the significant EU energy infrastructure needs that have been identified by the European Commission.

In the case of a carbon levy in particular, economic criteria would include the goal of addressing negative externalities. According to the Commission, neither option would automatically imply a different tax burden for the energy or other sectors, since these levies would mainly determine a transfer of some resources from Member States to the EU budget. Their final effect would depend on how Member States adapted their national tax rates. The need to analyse in further detail the potential impact of even a limited price increase on the competitiveness of EU industry is underlined. In recent years, energy prices rises and divergences in the EU have been a source of concern; a 2014 Commission communication[XXXV] analyses the topic, with particular focus on electricity and gas prices.

As regards budgetary criteria, rough estimates show a significant yield. For example, an energy levy could provide the EU budget with between €17.5 billion (when assuming an EU levy on petrol and diesel used as road motor fuel of €50 for 1 000 litres) and €21.8 billion (when broadening the scope of the levy). Proceeds from a carbon levy could be even higher, but they might gradually decrease over time, as CO_2 reduction targets are progressively met.

In relation to equity criteria, the European Commission calculates that an energy or carbon-levy-based own resource would modify the current shares of Member State contributions to the EU budget, with those countries having a more energy- and/or carbon-intensive economy expected to contribute more. As regards in particular a resource based on excise duties on road transport fuel, more prosperous Member States would contribute a proportionally lower share of their GDP, but significantly higher amounts in absolute terms.

8.4. EU Corporate Income Tax (EUCIT)

The taxation of corporate income is largely diversified and uncoordinated across the EU. The Commission considers that this hampers the functioning of the single market, not least by creating red tape for companies that operate in more than one Member State. To address this issue, in 2011 the Commission put forward a proposal to create a Common Consolidated Corporate Tax base (CCCTB) for the EU-wide activities of these companies. The EP supported the proposal, which has stalled in the Council, facing difficult negotiations.

On 17 June 2015, the Juncker Commission presented an Action Plan for Fair and Efficient Corporate Taxation in the EU, which includes the re-launch of the CCCTB proposal. Stressing the CCCTB's potential as an anti-tax avoidance tool, the Commission declared that it would present an updated proposal in 2016, with a mandatory CCCTB (at least for multinational companies) and a step-by-step approach, organising the original proposal into different and smaller stages to facilitate agreement in the Council: 1) a definition of the common base; and 2) consolidation. The end-result would be a system in which countries share the consolidated tax base and divide the related revenue on the basis of a formula (some countries with federal-type fiscal frameworks such as the USA, Canada and Switzerland are already using these so-called 'formulary apportionment systems'). The business lobby group BusinessEurope immediately withdrew its support for the Commission initiative on the grounds that the CCCTB would be mandatory under the new proposal (contrary to the 2011 proposal).

An own resource assigning part of corporate income taxation proceeds to the EU, or EUCIT, would have a broader scope than a CCCTB. In its declaration of 17 June 2015, the Commission says that the CCCTB is not a first step towards the harmonisation of tax rates. A company's taxable profits would be "shared out between the Member States in which the company is active, according to an agreed formula. Each Member State would tax their share of the profits at their own national rate."

Integration criteria supporting a EUCIT could include not only the possible strengthening of the single market, but also aspects related to regional arbitrariness. For example, Schratzenstaller (2013) notes that location of activities is increasingly severed from the place where related profits are taxed. Budgetary criteria suggest that the EUCIT could produce a high yield (estimated by the Commission at €15 billion per year with a tax rate lower than 2%), but it would be volatile due to the cyclical nature of the tax base.

As regards economic criteria, the European Commission indicates that there could be a higher impact on certain sectors and the cost of adaptation to the EUCIT could be high for businesses active only in one Member State. Technical and administrative aspects might create difficulties as well. Last but not least, in past analyses of the own resources system the Commission did not appear to consider the EUCIT a feasible option for the near future, due to the high political sensitivity of the corporate income taxation area.

The Commission Action Plan for Fair and Efficient Corporate Taxation should be seen in the wider context of the international debate on how to reform corporate taxation and tackle tax avoidance, and notably the work of the OECD Task Force on Base Erosion and Profit Shifting or BEPS (see Section 8.6). In 2015, an Independent Commission for the Reform of International Corporate Taxation, including Nobel-prize winning economist Joseph Stiglitz, called for broad reform of the system, considering, among other points, that the current 'separate entity' principle is fictitious and that multinational firms should be considered and taxed as a single entity at global level. According to the Financial Times, Pascal Saint-Amans, Director of the Centre for Tax Policy and Administration in the OECD, said that the proposal for a 'formulary apportionment system' at global level lacks pragmatism, while he agreed that the BEPS project should take the views and needs of developing countries more clearly into account.

Peeters (2015) considers that the introduction of a EUCIT would have many advantages, including contributing to progress at EU level on the OECD Action Plan on BEPS.

8.5. A resource related to *seigniorage*

Seigniorage is a form of monetary income that central banks derive from their monopoly position in issuing notes. In the euro area, *seigniorage* is currently distributed by the European Central Bank to the National Central Banks of the countries whose currency is the euro. From time to time, it has been suggested that *seigniorage* related to the euro be attributed to the EU budget instead. In its 2011 report, the European Commission recalled that it has already analysed this hypothesis on previous occasions, discarding it on various grounds. In addition to legal and institutional obstacles, the Commission considers that such a resource would produce a limited yield in comparison with the size of the EU budget.

The fact that the Union has exclusive competence in monetary policy for the Member States whose currency is the euro is one argument in favour of using *seigniorage* or monetary income as source of financing for the common budget. A 2008 study carried out by I. Begg, H. Enderlein, J. Le Cacheux and M. Mrakfor for the Commission says that the *seigniorage* income on euro holdings outside the euro area cannot be easily assigned to any specific country and thus belongs rather to the euro area as a whole. Leen (2012c) draws a parallel between monetary income and custom duties, arguing that in a common currency area there is no obvious allocation key for the monetary income among participating countries (just like it would be rather arbitrary to assign custom duties to the country where related imports first enter a single market).

However, the common monetary policy is currently limited to 19 EU countries. Thus, it would be necessary to design an alternative resource for the countries that have not adopted the euro. This would add a layer of complexity to the financing of the EU budget; and this need to create a two-tier mechanism for euro area and non-euro area countries is another reason why in 2011 the European Commission discarded the idea of an own resource based on *seigniorage*.

The European Central Bank and National Central Banks are opposed to the idea of attributing euro area *seigniorage* to the EU budget, which, according to some observers, could be perceived as a limitation of their independence. Conversely, Leen (2012c) considers that, due to its link to an EU policy, *seigniorage* would qualify well as an own resource, while estimating that relevant proceeds would not be negligible and could cover up to a quarter of the EU budget, although would be volatile.

8.6. An EU communications tax

In its 2011 report, the European Commission discarded ideas for own resources related to communication activities such as telecommunications, deeming their rationale difficult to justify (in the absence of clear externalities to be addressed) and possibly even contrary to EU policy objectives (e.g. Digital Agenda for Europe and roaming price reductions across voice calls, SMS and data in the single market).

Leen (2012b) focused on the idea of an Internet communication tax at EU level, but agreed that in the current framework this would not be a feasible option, despite having some positive aspects (e.g. as far as visibility, equity and neutrality are concerned). According to the author, the acceptability of such a scheme might evolve in the future, for example with EU resources allocated to cross-border investments in digital infrastructure for the single market, but technical aspects would need to be investigated in further detail.

Tarschys (2015) argues that the digital economy is dramatically changing the fiscal landscape, drawing attention to risks such as loss of territorial control and fiscal mobility. According to the author, the EU should look for new EU own resources among tax bases (often linked to the digital economy) which escape individual governments, and can only be tapped through joint action. The author adds that much research is still needed to explore these possibilities.

Indeed, internet companies are often seen as a prominent example of aggressive tax avoidance strategies. In 2014, in the context of a project launched by the G20, the OECD published an intermediary report[XXXVI] on addressing the tax challenges of the digital economy, concluding that, since the digital economy is becoming the economy itself, it would be very difficult to separate it from the rest of the economy for tax purposes. Therefore, Base Erosion and Profit Shifting (BEPS) risks should be addressed in a comprehensive tax regime including the digital economy. In May 2014, a Commission Expert Group on Taxation of the Digital Economy (chaired by Vítor Gaspar, a former finance minister of Portugal) delivered its final report. This came to the same conclusion, that digital companies should not be subject to a special tax regime, and said that "the only immediate practical way forward at the global level is via the G20/OECD BEPS project". Among other points, the report of the Commission expert group calls for a thorough review of the concepts relevant for defining and applying the taxable presence of a company in a country, with a focus on two features:

- "The Group supports work within the G20/OECD BEPS Project considering whether and under what circumstances sales of goods or services of one company in a multinational group should be treated as effectively concluded by dependent agents."
- "When defining exceptions to the concept of a Permanent Establishment (PE), the Group recommends taking into account that the digitalisation of the economy may have changed the distinction between auxiliary activities and core activities."

On 5 October 2015, the OECD presented the final package of measures for a reform of the international tax rules.

9. The high-level group on own resources

9.1. Composition and mandate

In February 2014, the EP, the Council and the European Commission officially launched the high-level group (HLG) on own resources, establishing for the first time an inter-institutional group tasked with a thorough review of the own resources system, and involving the EP.

Each of the three institutions appointed three members of the group, while jointly choosing Mario Monti, President of Bocconi University, former Prime Minister of Italy and former Commissioner, as its chair. On 3 April 2014, the first meeting of the HLG took place in Brussels, with three subsequent meetings during the year. The composition of the HLG was partially modified following the entry into office of the new European Commission, with the replacement of the members of the HLG appointed by the previous Commission. In addition to the chair, the current nine members are:

- Ivailo Kalfin (former MEP, Deputy Prime Minister of Bulgaria and Minister of Labour and Social Policy), Alain Lamassoure (French MEP in the EPP group) and Guy Verhofstadt (Belgian MEP, chair of the ALDE group), appointed by the EP;
- Daniel Dăianu (former MEP and Finance Minister of Romania), Clemens Fuest (President of the Centre for European Economic Research ZEW in Germany) and Ingrida Šimonytė (former Minister of Finance of Lithuania), appointed by the Council; and
- Kristalina Georgieva (Vice-President of the Commission in charge of budget and human resources), Pierre Moscovici (Commissioner for economic and financial affairs, taxation and customs) and Frans Timmermans (First Vice-President of the Commission responsible for better regulation, inter-institutional relations, rule of law and Charter of Fundamental Rights).

The joint declaration of the three EU institutions defines the mandate of the HLG, detailing the four guiding principles for the review of the own resources system: 1) simplicity; 2) transparency; 3) equity; and 4) democratic accountability.

The HLG is meant to drive discussion forward on the future of the own resources system, with its final report of 2016 potentially leading to new reform proposals from the Commission. Its work is to be based on both existing and new analyses provided by the three institutions and national parliaments, and to draw on relevant expertise.

9.2. The first assessment report

On 17 December 2014, Mario Monti presented the first assessment report of the HLG to the Presidents of the three institutions that created the group. The document recaps the key features of the current system, singles out those that are perceived by stakeholders as requiring modifications, and analyses the most recent (and, by and large, unsuccessful) reform proposals. In addition, the group sketches out some elements of the methodological approach that will guide its work and be set out in more detail in the months to come. Members of the group underline that they take part in the deliberations as individuals rather than as representatives of the institutions that appointed them.

An intermediary and tentative conclusion is that the financing system of the EU has not experienced any major modifications over the last 25 years, proving difficult to change. However, the group notes that keeping reform of the own resources system on the political agenda shows that European stakeholders are aware that progress in this area could help tap the full economic potential of the EU budget and focus on issues of European common interest. A precondition for any progress, the report adds, is that all those involved in any overhaul of the system acknowledge that, from both an economic and a political perspective, the EU budget has positive spill-over effects, thus representing much more than a zero-sum game with net beneficiaries and net contributors.

9.3. Perceived shortcomings of the system

While observing that some stakeholders do not see any major reasons to change the current way of financing the EU budget, the assessment report recapitulates the main shortcomings of the system perceived by others. These include complexity and lack of transparency, notably in relation to the wide range of correction mechanisms and to the configuration of the current VAT-based resource. Another section of the report says that one effect of the correction mechanisms and their financing is that the current system of national contributions could be seen as regressive overall, meaning that less affluent[XXXVII]

Member States do not contribute proportionally less to the EU budget.[XXXVIII]

The key role gained over time by GNI- and VAT-based resources (providing more than 80% of total revenue in 2013), which are perceived as national contributions rather than as genuine own resources of the EU, is said to have sharpened the difference in perspectives between countries classified as net beneficiaries of, or net contributors to, the EU budget, with a potential negative impact on the focus and effectiveness of EU spending. GNI and VAT resources are both based on statistical calculations that had never been questioned until recently, when higher-than-usual annual adjustments of the relevant statistical aggregates brought their technical aspects into the spotlight.

In addition, according to the report, some limits of the EU's financing system have been exposed by the economic crisis, and the fiscal difficulties that this has triggered at the national level. The text draws a link between the above-mentioned criticisms of resources perceived as national contributions and the year-end backlog of payments that has afflicted the EU budget in recent years, given that in many national budgets the contribution to the EU budget appears as an item of expenditure.

Last, but not least, attention is drawn to the very complex decision-making mechanism for changes to the rules of the system, which requires unanimity and ratification by all Member States. While attributing to this aspect much of the failure of major reform proposals up to now, the group points to the need to draw lessons from the latest negotiations to ensure progress in future.

9.4. Some methodological elements

The first report sketches out some of the methodological elements that will inform the HLG's deliberations, so as to avoid the gridlock in which past proposals have resulted. While any proposals will need to be sound from an economic and budgetary standpoint in order to succeed, their success will also depend on a careful consideration of the institutional and political aspects of the process, including the clustering of decision-makers in subgroups sharing the same interests and objectives.

Along these lines, the report identifies a set of criteria against which to evaluate the operation of the own resources system, placing them in two categories:

- five general economic and financial criteria (equity/fairness; efficiency; sufficiency and stability; transparency and simplicity; democratic accountability and budgetary discipline); and

- three EU-specific criteria (focus on European added value and constraining narrow self-interest; the subsidiarity principle and fiscal sovereignty of Member States; and limiting political transaction costs).

The HLG has selected and defined these criteria, building on the guiding principles set out in the mandate given by the institutions, and taking into account recent analyses of the topic. The report notes that the exercise implies a certain degree of subjectivity, with some criteria appearing more difficult to unequivocally define and interpret than others. For example, experience is said to show not only that the various decision-makers may have very different interpretations of fairness, but also that each interpretation may change over time, depending on domestic priorities.

In addition, individual criteria may partially conflict with each other. The report therefore says that viable reform recommendations should entail a mix of different own resources, since jointly these can meet a higher number of criteria.

9.5. Towards the final report

Considering that substantial analyses on the functioning of, and possible changes to, the own resources system already exist, the HLG expressed its intention to focus in particular on the broader economic and political context of reform proposals as well as on their legal, institutional and procedural aspects. Therefore, the group asked external experts to produce a study on these topics. In addition, it identified a number of related questions that deserve further analysis, for example:

- whether previous proposals foundered as a result of their intrinsic features or because of procedural elements;
- whether significant modifications of the system will be impossible without changes in the decision-making mechanism;
- whether differentiated solutions for subgroups of Member States, for example through enhanced cooperation, could make reform happen;
- whether the traditional approach of linking the negotiations on own resources with those on the EU's multiannual expenditure plans under the MFF may represent a stumbling block or instead ease the way to an agreement on the revenue side of the

budget;

- and whether the euro area is of relevance for the reform process.

Finalised in June 2016, the study commissioned on behalf of the HLG (Núñez Ferrer J. et al. 2016) tackles multiple aspects of a possible reform, including: its political and legal dimension; potential new resources; and improvements on the expenditure side of the budget. On this basis, the authors present a series of possible package deals for a reform, analysing their merits.

In addition, the work of the HLG has revived the debate on the financing system of the EU, with many contributions produced by academia and stakeholders. Examples include the working papers produced by two German universities (Buettner T. et al. 2016) in a research project for the German Federal Ministry of Finance. These papers explore the concept of European public goods and the meaning of the subsidiarity principle in the context of the EU budget, before analysing two possible new resources (European road transport fuel taxes and an electricity tax). The Dutch Presidency of the Council (in place for the first half of 2016) included the reform of the EU budget among its institutional priorities, putting strong emphasis on the link between the revenue and expenditure sides of the budget.

Based on all these contributions, the most promising options for a reform will be assessed by national parliaments at an inter-institutional conference to be hosted by the European Parliament in September 2016. The HLG will take the outcome of this debate into account for its final report, which it expects to present by mid-December 2016.

10. Outlook.

There is a widespread consensus among political stakeholders and researchers that the EU budget needs reform. This includes its revenue side which, some analysts say, should be the starting point, considering that a higher degree of EU financial autonomy could help to modify the structure of EU expenditure as well, aligning it more to the new challenges that the Union has to tackle. Even those who oppose more financial autonomy for the EU generally agree that the current financing system should be streamlined.

As Becker (2012) puts it, the need for reform does not necessarily translate into the ability to reform. A major obstacle to this end lies in the decision-making procedure that applies to the own resources system, which requires unanimity in the Council and ratification by all Member States. This makes veto threats extremely credible. Times of economic crisis may prove to be an additional obstacle to reforming the financing system.

However, experience shows that reforms and agreements are possible even if difficult. An overhaul of the system should not aim at marginal adjustments, since over time these have often proved to introduce new layers of complexity. A reform should rather be the opportunity for real simplification and streamlining.

The EP has very limited influence on the revenue side of the EU budget, but has long pushed for its overhaul. A July 2016 resolution (European Parliament 2016) strongly reaffirmed this; recalling the new and serious crises that the EU has been confronted with in recent years, the EP stressed that changes in both the MFF and the own resources system are needed if the EU is to address properly a number of challenges and to fulfil effectively its policy objectives. As regards own resources in particular, the EP is expecting an ambitious final report from the HLG this year and an equally ambitious reform proposal by the Commission in 2017, with an overhaul of the system as of 2021.

In July 2016, in an exchange of views with the EP's Committee on Budgets, the chair of the HLG Mario Monti said that recent crises have shown that the current EU budget is not fit for purpose. While the mandate of the HLG is only on the revenue side of the budget, the HLG will underline that improvements are also needed on the expenditure side. Monti noted that the way to reduce conflict over net contributions would be by focusing on the notion of European public goods that cannot be provided effectively at the national level, but which are crucial for the welfare and security of citizens. In addition, some related policy-driven resources could contribute to the achievement of policy objectives and give, at the same time, a clearer picture of what the EU does. Examples cited of possible European public goods were: internal and external security; financial stability and fight against tax avoidance (with related resources such as an FTT or an FAT); economic growth and investments; and quality of the environment and fight against climate change (with related resources such as a carbon tax, ETS revenues or a share of national fuel taxes).

In line with this possible focus on European public goods, the data of a 2016 Eurobarometer survey appear to suggest that, in many policy areas, there is a gap between citizens' perception of current EU involvement and their expectations and preferences for future EU action.[xxxix]

To conclude, Commission documents and proposals, Parliament's resolutions and academic research have identified the main areas for consideration, which include:

- The possible introduction of new genuine own resource(s) in line with Treaty provisions. No potential candidate seems able to meet all the numerous assessment criteria that have been developed over time. However, some should allow the striking of a good balance (possibly with a mix of resources).
- Addressing the issue of correction mechanisms, which are widely recognised as a source of inequity and distortion in the system.
- Eliminating the current VAT resource, since it is extremely complex and does not appear to provide any real added value to the system.

In addition, some kind of link between a new own resource and specific objectives could help to increase the focus on the provision of collective goods with EU added value. For example, an EU energy tax could be coupled with cross-border investment in energy infrastructure. In 2014, manufacturers called for a coordinated EU energy policy, underlining the strategic importance that developing a European "smart grid" would have for the competitiveness of the entire European industrial sector. A new resource could be expected to gain support if it helps to address issues widely perceived as not being easily addressed at the national level, but necessitating joint action. With regard to this, some analyses (e.g. Tarschys 2015) draw attention to the emergence of footloose tax bases often linked to the digital economy, while others (e.g. Peeters 2015) focus on the challenges posed by corporate tax avoidance (the OECD conservatively estimated annual losses due to this issue between USD100 billion and USD240 billion in the framework of the BEPS project).

The objective of the final report of the HLG will be to devise viable recommendations to resolve the stalemate seen up to now, despite the rather broad consensus among stakeholders that the current financing system could be improved. Following the final report, the European Commission will examine whether the outcome of the work justifies new initiatives in the field of Own Resources, with possible reform of the financing of the EU budget for the period covered by the next MFF.

* The content of this document is the sole responsibility of the author and constitutes a personal opinion.

[I] ECJ, Case 93/85, *Commission of the European Communities v. United Kingdom of Great Britain and Northern Ireland*, 1986, ECR 4011.

[II] Council Decision (EU, EURATOM) 2014/335 on the system of own resources of the European Union (OJ L 168, 7.6.2014, p. 105). In June 2016, the ratification process was still ongoing since two Member States had not yet ratified the 2014 Decision.

[III] With some Member States granted exceptions for both the expenditure and the revenue side.

[IV] The European Parliament drew attention to the high number of exceptions in its resolution of 29 March 2007 on the future of the European Union's own resources (P6_TA (2007)0098).

[V] The EU Budget Review - COM (2010)700 - of 19 October 2010.

[VI] EP resolution of 25 November 2010 on the on-going negotiations on the 2011 budget (P7_TA (2010)0433).

[VII] See for example: EP resolution of 13 March 2013 on the general guidelines for the preparation of the 2014 budget - Section III - Commission (P7_TA (2013)0081).

[VIII] Amended proposal for a Council Decision on the system of own resources of the European Union - COM (2011)739 - of 9 November 2011.

[IX] Proposal for a Council Directive implementing enhanced cooperation in the area of financial transaction tax - COM (2013)71 - of 14 February 2013.

[X] ECA's opinion No 2/2012.

[XI] EP resolution of 23 October 2012 in the interests of achieving a positive outcome of the Multiannual Financial Framework 2014-2020 approval procedure (P7_TA (2012)0360).

[XII] EP legislative resolution of 23 October 2012 on the proposal for a Council regulation on the methods and procedure for making available the own resource based on the value added tax (P7_TA (2012)0361).

[XIII] Conclusions of the European Council as regards the item Multiannual Financial Framework of 8 February 2013 (EUCO 37/13).

[XIV] EP legislative resolution of 16 April 2014 (P7 TA (2014)0431).

[XV] EP legislative resolutions of 16 April 2014 (P7 TA (2014)0432 and P7 TA (2014)0433).

[XVI] See for example a study financially supported by the German Federal Ministry of Finance: Heinemann et al. (2008). The authors suggest creating a generalised but limited correction mechanism, with a clear distinction between policies with redistributive objectives and those supporting the provision of European public goods.

[XVII] This topic is not tackled in this document, since providing the EU with the ability to borrow would require a Treaty change.

[XVIII] In the subsequent debate, the UK maintained its view that the EU budget continues to have distortions on the expenditure side and that, on this basis, the rebate remains consistent with the *Fontainebleau principles*.

[XIX] Presidency Issues Paper: Multiannual Financial Framework 2014-2020 of 30 August 2012.

[XX] ECA's opinion No 4/2005.

[XXI] The policy of economic and social cohesion was established by the Single European Act in 1986. The Lisbon Treaty has widened the concept to include territorial cohesion.

[XXII] In its 1999 report on the need to modify and reform the European Union's own resources system (A4-0105/99), the Budget Committee of the EP suggested further reducing the share of the EU budget devoted to agriculture by introducing 50% co-financing of this policy from national budgets. Parliament did not retain this idea in its resolution of 11 March 1999.

[XXIII] Also known as spill-over costs, these are external costs (e.g. pollution) suffered by third parties that receive no compensation.

[XXIV] Therefore, if one category of goods is not subject to the standard VAT rate in just one Member State, it is automatically excluded from the base in all Member States.

[XXV] As mentioned, the European Court of Auditors deems the proposal to bring some improvements in terms of simplification in comparison with the current system, while noting aspects of the text that need further clarifications.

[XXVI] In 2010, the Commission published a Green Paper on the future of VAT.

[XXVII] Attempts to reform EU VAT provisions in this direction have been so far unsuccessful.

[XXVIII] See for example: Leen 2012a. Nevertheless, the author notes that opinions differ on the desirability of meeting the visibility criterion, at least for governments.

[XXIX] ECJ, Case C-209/13, *United Kingdom of Great Britain and Northern Ireland v Council of the European Union*,

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XXX 3310th Council meeting (Economic and Financial Affairs) of 6 May 2014 (9273/14).
XXXI EU Financial Transactions Tax Could Face New Hurdle / Dendrinou V., in: The Wall Street Journal, 25 January 2016.
XXXII See for example: Europe still sets the standard for a low-carbon future / Sachs J., in: Financial Times, 28 January 2014.
XXXIII Greece, other EU strugglers emerge winners from carbon reforms-data / Twidale S., Lewis B., 7 May 2015.
XXXIV Proposal for a Council Directive amending Directive 2003/96/EC restructuring the Community framework for the taxation of energy products and electricity – COM (2011)169 - of 13 April 2011.
XXXV Energy prices and costs in Europe – COM (2014)21/2 -of 29 January 2014.
XXXVI OECD/G20 Base Erosion and Profit Shifting Project, 2014, *Addressing the Tax Challenges of the Digital Economy*.
XXXVII In terms of GNI per capita.
XXXVIII This may appear to contradict the rationale behind the 'Fontainebleau principles', which underpinned the creation of the UK rebate, the first correction mechanism. According to these principles, while 'expenditure policy is ultimately the essential means of resolving the question of budgetary imbalances', the contribution of a country should be considered in relation to its relative prosperity.
XXXIX For more details, see for example: Dobreva A. et al., 2016, *Public expectations and EU policies: Identifying the gaps*, European Parliamentary Research Service, Brussels.

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Mid-term review of the Multiannual Financial Framework 2014-2020 – A round-up of key issues at stake

by

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Abstract

By the end of 2016 the European Commission is expected to present its mid-term review of the Multiannual Financial Framework (MFF) 2014-2020. The results of the review may open the way for a revision of the MFF Regulation. The scope of the review, as laid down in the legislation, as well as the difficult implementation of the MFF in its first years, give grounds to expect changes in the MFF Regulation. However, experience of past reviews and the requirement of a unanimous vote in the Council on the revision of the MFF raise concerns about the final result of the exercise.

This paper explains how the idea of the mid-term review of the MFF has evolved, why it has become so important, and what issues are at stake at the outset of the debate. It shows that in order to ensure a smoother implementation of the MFF in the future years some radical changes are necessary, including an increase of the ceilings and flexibility. Besides, the problems with the implementation of the current MFF give arguments for a thorough reform with a view of the post-2020 MFF.

Key-words

EU budget, Multiannual Financial Framework, review, revision

1. Introduction

Even a cursory review of the literature and studies on the financing of European integration leaves no doubt that the EU's budget needs reform. Experts criticise the revenue and expenditure mechanisms as well as the management rules of the budget. Back in 2003, the Sapir report described the EU budget as 'a historical relic' and called for a major overhaul (Sapir at al. 2003: 172); this description remains valid and is often cited by experts (Cipriani 2007:1; Buti and Nava 2008: 1; Núñez Ferrer 2016: 1). Despite the conviction that profound budgetary reform is required, most authors say that the prospects for such a reform are weak. The EU budget is seen as a 'reform-immune' and 'path-dependant' system (Cipriani 2007; Heinemann at al. 2010; Benedetto, Milo 2012). Among the obstacles to profound change is one that recurs in conclusions, namely an excessive focus by the Member States on their net financial balance, exacerbated by unanimity voting in the Council on the MFF.[1]

Any changes to the budgetary system of the EU take place slowly, but there are only a few opportunities for taking decisions on change and they are usually limited by the requirement of a unanimous vote in the Council. Certainly, the most important opportunity is during the process of deciding on the MFF. Another opportunity for stock-taking and for presenting ideas for reforms is the mid-term review of the MFF. This exercise has been gaining importance since the introduction of seven-year financial planning in the EU. Multi-year financial planning in the public sector has definite advantages, but it is not easy to create a system with the right balance between stability, predictability and flexibility, allowing quick responses to unexpected circumstances. Experience in recent years shows that the longer the time-frame, and the more dynamic the political and economic circumstances facing the EU, the greater the need for various mechanisms for interim evaluation and adjustment of the MFF (Allen, Tommasi 2001; Spackman 2002).

This paper sets out to provide insight into the upcoming mid-term review of the EU's MFF 2014-2020. It contains an overview of the evolution of the idea, the legal framework and scope and a round-up of the main issues at stake at the outset of the debate, i.e. still before the official presentation of the review by the European Commission.

2. What have we learnt from the past?

The multiannual approach to spending was introduced by the European Communities in 1988, with the aim of improving budgetary discipline, making expenditure more predictable, and ensuring a steady source of financing for Community policies.[II] The first financial perspective covered a period of five years (1988-1992), but all others since then have covered seven years.[III] For as long as the EU has had multiannual financial plans, they have come under pressure from political and economic developments, both anticipated and unanticipated, requiring certain adjustments to agreed figures and rules. Thus, the dilemma of how to ensure stable and predictable financing for European policies while at the same time being able to respond to unexpected needs, is not new. One of the solutions to this dilemma is to schedule a review of certain elements of the plan, more or less at the mid-way point of its duration. This exercise has, to varying degrees, also been provided for in past EU multiannual financial perspectives and frameworks (Table 1).

Table 1: Development of the idea of a mid-term review of the EU's multiannual financial perspectives/frameworks 1988-2020

1988-1992	1993-1999	2000-2006	2007-2013	2014-2020
No formal mid-term review or revision provided for by the rules.	Provisions of the IIA* to be 'confirmed or amended' at the time of the intergovernmental conference scheduled for 1996. Mid-term review of the agricultural guidelines intended for 1996.	Special adjustment of the Financial Perspective to cater for enlargement in 2003.	'A full, wide-ranging' mid-term review of the MFF laid down in the European Council Conclusions.	Mid-term review/revision of the MFF laid down in Article 2 of the MFF Regulation.

*IIA - Interinstitutional Agreement
Source: Sapala 2016

The first Financial Perspective, for 1988-1992, covered a period of five years, with no mid-term review.[IV] The provisions of the second perspective covered a period of seven years (1993-1999), and although they did not explicitly provide for a comprehensive mid-term review, the intergovernmental conference scheduled for 1996 (in the middle of this period) was intended as an opportunity to introduce amendments to the Interinstitutional Agreement (IIA) laying down the provisions of the Financial Perspective.[V] In addition, the European Council conclusions of 1992 provided for an interim review of the operation of the Own Resources System, and of the scope of the agricultural guidelines.[VI] This could be seen as an intention to conduct a mid-term review of the Financial Perspective (Sapala 2016).

The provisions of the 2000-2006 Financial Perspective did not provide for a mid-term review or revision, aside from a special adjustment to cater for the EU's enlargement in 2004. As a consequence, the amounts were revised in the middle of the period covered, through the financial package for EU enlargement in 2003.[VII]

In line with the provisions of the IIA, the Commission launched a debate on the next financial perspective by presenting a Communication in February 2004.[VIII] This was around the same time as the European Parliament (EP) elections in June 2004, and the organisation of a new Commission. In September, a newly elected EP set up a special temporary committee tasked with defining its priorities and drawing up proposals for the 2007-2013 MFF. In this early debate, the EP's position focused on appropriate financial resources to match the EU's political ambitions and growing responsibilities, modernising the structure of the EU's budget, and improving the quality of its implementation. A mid-term review of the MFF was not among the most hotly debated issues, but as a result of the negotiations on the 2007-2013 MFF it was included for the first time in both the Council conclusions and the IIA. The Council asked the Commission 'to undertake a full, wide-ranging review covering all aspects of EU spending, including the CAP, and of resources, including the UK rebate' (Council of the EU 2005). This agreement was further developed in Declarations 1 and 3 attached to the IIA, which specified that the results of the review were to be accompanied by an assessment of the functioning of the IIA and, if necessary, by proposals for improving it. Moreover, the EP was to be involved in the review at all stages of the procedure, including the formal follow-up steps.[IX] Some say that the idea was the result of a compromise between those Member States that expected a more thoroughgoing reform of the CAP on the one hand, and those in favour of abolishing the UK rebate on the other (Taylor 2011).

The results of the review were meant to be presented by the Commission in 2008/2009. In December 2009 the European Council encouraged the Commission to present the review covering all aspects of spending and resources (European Council 2009), but important circumstances and events delayed the debate until late 2010. The European elections in 2009 and the formation of a new Commission (Barroso II), as well as the protracted ratification of the Lisbon Treaty (which was only completed in December 2009) stood in the way of the presentation of the review. Moreover, the economic crisis had just struck the Member States. None of these pressures were conducive to a radical debate about the budget (Begg 2010).

Nevertheless, in order to gather ideas on reforming the budget in preparation for the review, the Commission carried out public consultations (from September 2007 to June 2008), which generated a substantial response from academic and expert circles, governments, and NGOs. Many participants in the debate saw the review as an opportunity for change and had high expectations (European Commission 2008). The EP expressed its ambitious position on the budget review in a resolution in March 2009, with a view to feeding into the Commission's proposal (European Parliament 2009).

When the Commission finally presented the results of its budget review on 19 October 2010, both the EP and experts were disappointed by the lack of any proposals for genuine reform (Begg 2010, Becker 2012). They assessed the Commission's document as rather weak and lacking any sense of a clear break with the past. It would not, therefore, have any impact (Begg 2010). By the time the review was published, the 2007-2013 MFF had already been revised four times; for example, to cover the additional needs of the Galileo project and the Food Facility.[X]

The Lisbon Treaty created the legal basis for the MFF – in place of the voluntary IIA used previously – mandating the form of a regulation and establishing a new role for the EP. Moreover, the Europe 2020 Strategy presented at the beginning of 2010 prompted calls for a new MFF, rather than a revision of the current one. In order to take all these factors into account, the EP decided to focus on the next MFF, and set up a special committee for debate on the EU's finances post-2014.[XI] Thus, what was meant to be the first formal, full and wide-ranging mid-term review of the MFF, turned out to be merely a contribution to the debate on a future MFF (Sapala 2016).

3. The scope of the mid-term review of the MFF 2014-2020 as laid down in the legislation

Given the unsatisfying experience with the mid-term review of the 2007-2013 MFF, it was feared that a similarly empty promise might be made under the pressure of the negotiations on 2014-2020. From the beginning of the debate, therefore, the EP strongly insisted that, if the MFF period were made longer than five years, 'an obligatory mid-term review allowing for a quantitative as well as qualitative analysis and stock-taking on the functioning of the MFF' would be necessary (European Parliament 2011). Another argument in favour of the review stemmed from a conviction that a newly elected Parliament and newly installed European Commission have the right to reassess the EU's political priorities. Moreover, the EP called for a 'specific procedure, including a binding calendar, which ensures the full involvement of the Parliament' (ibid) and provides real scope to revise the MFF ceilings, should the review establish that they are inadequate. This became one of the most important demands and conditions for the EP's consent to the 2014-2020 MFF.

The Commission's legislative proposal for the MFF regulation included a point referring to a mid-term assessment of the implementation of the MFF. It was developed during the negotiations and, eventually, a compulsory mid-term review plus an optional revision (called the mid-term review/revision) were introduced into the Council Regulation laying down the MFF for the 2014-2020 (known as the MFF Regulation).[XII] The formalisation of this dual exercise, was undeniably a success for the EP, although the demand for a special procedure with a binding calendar was not included in the provisions. This detail may therefore be put on the list of issues for the negotiations of the post-2020 MFF.

It should be emphasised that according to Article 2 of the MFF Regulation the review should, as appropriate, be followed by a proposal for a revision. Therefore, whether a relevant procedure for the revision will be triggered, depends on the European Commission. In this case it would be the special legislative procedure laid down in Article 312 TFEU. It requires a unanimous vote in the Council, unless the European Council authorises the Council to act by qualified majority, and the consent from the EP given by a majority of its members.

According to the MFF Regulation, the Commission should present the mid-term review/revision by the end of 2016 at the latest. It should take into account the updated economic situation and macroeconomic projections. Since there is no synchronisation between the duration of the MFF and the Commission's or EP's legislative terms, such a review/revision should allow the newly elected EU institutions to reassess the EU's political priorities and endow the MFF with renewed democratic legitimacy. For this reason, the procedure is sometimes, especially in the EP, referred to as 'the post-electoral' review/revision.

Moreover, based on the Commission's political declaration attached to the MFF regulation it can be expected that particular attention will be paid to the functioning of the global margin for payments in order to ensure that the overall payments ceiling remains available throughout the period.

However, if any changes to the regulation are introduced these should not result in a reduction of the national envelopes.[XIII] In addition, the mid-term review/revision will be an opportunity to consider the appropriate duration of the next MFF, with a view to aligning it with the political cycles of the EU institutions.

4. What issues are at stake and why?

There are reasons to expect a thorough mid-term review of the MFF 2014-2020 with thoughtful conclusions which can be followed by a proposal for a revision of the regulation. The list of issues at stake includes both current problems requiring immediate action, and long-standing, contentious aspects of the MFF. The former concern the MFF's flexibility, and adjustment of expenditure ceilings in the light of various recent crises and new political priorities. The latter would cover aspects that need to be considered with a view to a post-2020 MFF.

Implementation of the 2014-2020 MFF has already proven to be challenging in its first two years. First of all, the resources agreed for the current MFF were not only substantially lower than the Commission's proposal, but also below those of the 2007-2013 period. Secondly, the reduced MFF had to absorb the abnormal backlog of payments (€24.7 billion in 2014) that had built up in the EU budget since 2011 (D'Alfonso, Sapala 2015). Thirdly, since December 2013, when the current MFF was adopted, the political situation in the EU has changed significantly, and the need for funding has dramatically increased in some areas. Some of the decisions and actions taken by the EU in response to unexpected domestic and international developments, such as the refugee crisis, the conflict in Ukraine, the increased threat of terrorism, agricultural sector crises and the protracted economic crisis in Greece, have major budgetary consequences. The greatest pressure for increased spending has been on MFF heading 3, 'Security and citizenship', and heading 4, 'Global Europe', and resources under these headings have been completely exhausted. Moreover, in order to mitigate the impact of the ongoing economic downturn, a decision was taken to establish a new financial initiative with a contribution from the EU budget: the European Fund for Strategic Investments (EFSI). This decision entailed shifts and cuts to amounts previously allocated to Horizon 2020 and the Connecting Europe Facility.

Therefore, although barely two years have passed since the beginning of the current MFF, in order to accommodate these needs and ensure the smooth implementation of the EU budget, the budgetary authority (the Council and the EP) has already had to resort to almost all the special, 'last-resort' margins and flexibility instruments provided for in the MFF Regulation (Table 2).

Table 2. Flexibility provisions and special instruments employed so far in the 2014-2020 MFF[XIV]

Instrument	Amount	Decision	Legal basis in the MFF regulation	Purpose
Contingency Margin	€3.2 billion	Decision (EU) 2015/435 of 17 December 2014	Article 13	To reduce the backlog in payments in 2014. The margin was used at no additional cost to national budgets (due to unexpected additional revenue for the year 2014), but it will have to be offset against margins under the payment ceilings for 2018, 2019 and 2020.
Flexibility Instrument	€1.53 billion	Decision (EU) 2015/2248 of 21 October 2015	Article 11	To finance support for measures for managing the refugee crisis
Global Margin for Commitments	€543 million	Amending Letter No 1 to the Draft General Budget 2016	Article 14	To finance the European Fund for Strategic Investments
Emergency Aid	€98.1 million in	Union's general	Article 9	To tackle migration

Reserve	2014, €282.5 million in 2015 and €150 million in 2016	budgets for the financial year 2014. 2015 and 2016		crisis
Revision in case of late adoption of rules of programmes under shared management	€21.1 billion	Council Regulation (EU, Euratom) 2015/623 of 20 April 2015	Article 19	Transfer of unused allocations for 2014, due to a late agreement on the MFF and a delayed start to implementation

Table compiled by the author

In addition to the flexibility instruments applied so far, on the basis of Article 15 of the MFF and the European Council Conclusions of 27/28 June 2013 it was decided to frontload the appropriations for programmes supporting youth employment, research and small and medium-sized enterprises, which consequently reduced the level of appropriations for subsequent years. Similarly, in order to boost uptake of the European Structural and Investment Funds in Greece, it was decided that the level of initial pre-financing paid in 2015 and 2016 would be increased (Regulation (EU) 2015/1839). These decisions put an additional pressure on the budget.

It should be noted that most of the adjustments made to the MFF so far do not increase overall MFF ceilings; they merely shift amounts already allocated and will have to be offset in full against margins in the years 2018-2020. This raises questions about the consequences of these measures for the functioning of the MFF through to 2020. The picture may become even more complicated in coming years since some problems, especially the refugee crisis, are likely to continue and require further political action and, hence, financial support. Such intensive recourse to flexibility provisions so soon after the start of the new MFF provides arguments for advocates of a greater flexibility and of a revision, including an increase in the ceilings of the MFF.

Alongside an assessment of the functioning of the 2014-2020 MFF, the debate around the review/revision will be an opportunity to highlight certain issues related to the EU's finances beyond the current MFF. The most fundamental question concerns reforming the financing of the EU budget. The publication of the MFF review is likely to coincide with presentation of the report by the High-Level Group on Own Resources led by Mario Monti and could feed into the content of the Commission's document. A bold reform of the revenue side of the EU budget is as much awaited as difficult to introduce, but it could remedy many problems on the expenditure side.

Another issue present in the current budgetary discussions, especially in the EP, is the unity of the budget. Recently developed trust funds used to finance certain EU measures raise questions about the character and democratic accountability of these new tools. Similar concerns are expressed about the proposals to create a fiscal and budgetary capacity of the euro area.[XV] If further developed, these ideas may have a big impact on the architecture of the EU budget after 2020.

Given the experience of the current MFF and the frequent use of the various flexibility tools, it can be expected that new ideas to improve this aspect will feature in the debate. Furthermore, growing economic and political instability requires rapid reactions; thus, we should expect rather more than less flexibility in the EU budget. The issue, however, raises many new questions, for example about types of flexibility, their limits, and consequences for the configuration of budgetary priorities (Mijs, Schout 2015; Núñez Ferrer 2016).

Changes in the decision-making and negotiation process of the MFF could be one of the remedies for the drawbacks of the budgetary system of the EU. The current procedure is criticised for many reasons, not least because it emphasises a *juste retour* ('fair return') approach by the Member States. Suggestions that have already been made for reform include a shift in decision making power on the structure of expenditures from the European Council to the EP, and modification of decision making by application of qualified majority voting instead of unanimity in the Council (Kölling 2014; Fuest at al 2015).

Furthermore, as indicated in the recital 3 of the MFF Regulation, the mid-term review/revision should be an opportunity to renew the debate about aligning the duration of the MFF with the legislative terms of the main institutions. This, seemingly technical aspect, may have important consequences for institutional and budgetary responsibilities as well as the implementation of EU programmes and policies. The decision on the duration of the MFF will have to be taken before the presentation of a proposal for the post-2020 MFF, i.e. before January 2018.

Both the review of the current MFF and the proposal for the post-2020 MFF will also be opportunities to promote the Commission's broader "Budget Focused on Results" initiative.[XVI] Performance based budgeting is becoming a leading concept for the overall construction of the EU budget; and it triggers changes in the way the funds are allocated and the results are measured.

5. The positions of the main decision-makers

The review of the MFF is included in the Commission's 2016 Work Plan under 'New initiatives', but the exact timing of the presentation of documents has not yet been announced. The issue is, however, high on the Commission's agenda and, according to President Juncker, the review should be used as an opportunity to "orient the EU budget further towards jobs, growth and competitiveness". Kristalina Georgieva, Commission Vice-President for the Budget, has on many occasions also expressed her commitment to a thorough review, taking a close look at the budgets' priorities and the options for improving the way it functions.[XVII]

The Council has not yet presented its position, and it is not expected to do so before the Commission announces the results of the next review and any proposal for a revision of the MFF. The Council did, however, initiate an informal debate on the future MFF at a Dutch Presidency conference on this topic organised in January 2016 in Amsterdam. Moreover, the ministers of finance discussed the matter over an informal meeting on 22 April 2016. It should be emphasised that the Council plays a central role in the special procedure leading to a revision of the MFF, and that any changes to the Regulation require a unanimous vote by the Member States. It is fair to assume, therefore, that the Council's position will be crucial for the outcome of the upcoming review/revision.

The EP has consistently and firmly supported the idea of an obligatory, genuine, post-electoral mid-term MFF review and, if necessary, a revision of the MFF regulation. Now that the time has come to put the provisions of the review/revision into effect, the EP's ambition is to set the agenda and to be at the forefront of the debate. Therefore, in December 2015, the Committee on Budgets (BUDG) launched discussions with a view to adopting a strategic own-initiative report ahead of the Commission's review and proposal for a revision. On 6 July 2016 the EP adopted the resolution on the topic. It concluded that the implementation of the 2014-2020 MFF has proved exceptionally difficult, the ceilings have proved to be too tight in some headings and the MFF has 'essentially been pushed to its limits'. Therefore, the EP considers the revision of the MFF, including the figures, as 'absolutely indispensable' (European Parliament 2016).

In parallel to this, the EP set out a list of changes to be considered for the second half of this MFF period: significant reinforcements to funds and initiatives in the area of migration and the refugee crisis, and the EU's external actions; offsetting of the EFSI-related cuts to Horizon 2020 and the Connecting Europe Facility; the continuation of the Youth Employment Initiative; and transfer to the following year's budget of any surplus resulting from under-implementation of programmes, fines or de-commitments. Furthermore, the Parliament's document incudes considerations concerning the post-2020 MFF. In particular, the EP proposes that the future MFF would be better aligned with the political cycle of the EU institutions and last 5+5 years for programmes requiring long-term programming (with compulsory mid-term revision) and 5 years for other elements of the MFF. The EP calls for a thorough reform of own resources, for enhanced flexibility of the MFF and proposes to set up a permanent crisis reserve counted over and above the MFF ceilings. Furthermore, the Parliament sees a shift towards qualified majority voting in the Council as a way to improve the procedure for the adoption of MFF regulations.

As far as other stakeholders are concerned, the most visible in the debate have been local and regional authorities and their associations, such as Eurocities or the Conference of Peripheral Maritime Regions of Europe. The latter presented a technical paper containing preliminary deliberations on the review/revision, emphasising its importance for the regions (Conference of Peripheral Maritime Regions of Europe 2016). Moreover, in June 2016 the Committee of the Regions adopted an opinion on the issue, which largely converges with the Parliament's views and demands (Committee of the Regions 2016).

The ambitious proposals and demands put forward by the EP have already boosted the debate, but the formal start of the procedure will depend on when the Commission presents the MFF review and any proposal for revision. This has not yet been announced, and it is worth noting that the later the presentation of the review/revision takes place, the more it may overlap or conflict with other events provided for in legislation, such as the mid-term review of sectoral policies (2017) and the presentation of a draft post-2020 MFF (before 1 January 2018). Finally, it is not clear to what extent the United Kingdom's decision to leave the EU will have an impact on the course and direction of the debate.[XVIII]

6. Conclusions

Given the magnitude of the new challenges confronting Europe and the scope of the review/revision as intended by Article 2 of the MFF regulation, the European Commission is expected to propose concrete changes. The list of problems to be addressed is extensive. They concern both the difficulties implementing the current MFF and long-awaited reforms to EU financing.

As demonstrated in this paper, short and medium-term changes to the EU budgetary system are expected by the EP, academic and expert circles, and stakeholders. The first opinions and official position papers were recently presented by the Member States or their representatives. They include proposals for both minor adjustments and far-reaching changes.[XIX] Experience shows, however, that amendments and adjustments to the MFF are never easy. Often the problem lies not in the lack of proposals for change, but in securing the unanimity needed to adopt them.

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[*] The views presented in this article are solely those of the Author and should not be attributed to the European Parliament, the European Parliamentary Research Service or any other institution, agency or body of the European Union.

[I] As the matter of fact, the recent study by Richard Crowe shows that participation by the Member States represented in the European Council in the decision-making procedure leading to the agreement on the MFF, is more extensive in practice than what is provided for in the treaty (Crowe 2016).

[II] The first three financial periods, 1988-1992 and 1993-1999 and 2000-2006, were known as 'financial perspectives'. The provisions for 2007-2013 introduced the term ‘multiannual financial framework’, also used for 2014-2020.

[III] Under Article 312 of the Treaty on the Functioning of the EU, the MFF must cover a period of at least five years.

[IV] Interinstitutional Agreement on Budgetary Discipline and Improvement of the Budgetary Procedure, 15.07.1988, L 185/33 (Delors I package).

[V] Article 24 of the Interinstitutional Agreement of 29 October 1993 on budgetary discipline and improvement of the budgetary procedure 93/C 331/01 (Delors II package).

[VI] See: Council Conclusions, Part C Future financing of the Community, Delors II Package, Edinburgh, 12 December 1992.

[VII] The revision based on Article 25 of the Interinstitutional Agreement of 6 May 1999 between the European Parliament, the Council and the Commission on budgetary discipline and improvement of the budgetary procedure.

[VIII] Communication from the Commission COM(2004)101, 26 February 2004; Before this, in February 2003 the Commission adopted an internal communication on the preparation of a new perspective (SEC(2003)241/2). It then updated the vision in July 2004 in Communication COM(2004) 487, 14 July 2004. Parliament expressed its position in a resolution in April 2004 on building our future: policy challenges and budgetary means of the enlarged Union 2007-2013.

[IX] Interinstitutional Agreement between the European Parliament, the Council and the Commission on budgetary discipline and sound financial management, 2006/C 139/01.

[X] The Galileo programme is the EU initiative launched in 1999. It is aimed at creating a state-of-the-art global satellite navigation system, providing a highly accurate global positioning service under civilian control. The Food Facility was set up in 2008 in order to provide a rapid EU response to soaring food prices in developing countries.

XI Special Committee on Policy Challenges and Budgetary Resources for a Sustainable European Union after 2013 (SURE).

XII Article 2 and recitals 2, 3, 9, 11 refer to the mid-term review/revision of the MFF. This procedure should not be confused with the flexibility provisions and instruments that allow for correcting and revising the MFF during its duration, which are specified in Articles 17-22 of the MFF regulation. Council Regulation (EU, EURATOM) 1311/2013 laying down the multiannual financial framework for the 2014-2020, OJ L 347.

XIII Amounts pre-allocated to each Member State in the areas of rural development, fisheries and cohesion policy.

XIV The table does not include funds mobilised under the European Globalisation Adjustment Fund (€81 million in 2014 and €44.2 million in 2015), and the EU Solidarity Fund (€126.7 million in 2014 and €50 million in 2014) as they are more frequently applied instruments to tackle specific problems.

XV They were expressed for example in the European Parliament during the debate on the own initiative Report on budgetary capacity for the Eurozone (2015/2344(INI)).

XVI For more about the initiative see: European Commission, Roadmap, http://ec.europa.eu/smart-regulation/roadmaps/docs/2016_sg_003_mff_2014-2020_en.pdf, [accessed on 20.04.2016]; European Commission, Budget Focused on Results, http://ec.europa.eu/budget/budget4results/index_en.cfm [accessed on 15.02.2016].

XVII For example during the conference "EU budget focused on results" on 22 October 2015 in Brussels, http://ec.europa.eu/budget/budget4results/programme/index_en.cfm [accessed on 15.02.2016].

XVIII The Commissioner in charge of Budget Kristalina Georgieva clarified that by the end of 2016, when the Commission is supposed to present the review, the UK objectives will not be known and they cannot be taken into account in the document. See: Read-out of the College meeting of 27.07.2016, Audiovisual Services of the European Commission.

XIX See for example: 'Position paper Nederland - Tussentijdse evaluatie MFK', Den Haag, Nederland, juli 2016, www.rijksoverheid.nl [accessed on 29.07.2016] and Schäuble Wolfgang, 2016, 'The future of EU finances', speech presented during a symposium on 'The Future of EU Finances' in Brussels, 15 January 2016.

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EU governance in the run-up to 2025: A Joint Budgetary Procedure

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Abstract

The Euro Area (Eurozone, or EZ) is navigating uncharted waters; it has started, in slow motion, to slide towards a fiscal federation, while still lacking both the fiscal capacity and the democratic qualification to achieve this goal. Strengthening the EMU's democratic profile is a fundamental requirement for the sustainability of the EMU as much as its completion with a fiscal and economic arm. Yet, according to the Five Presidents Report released in 2015, no substantial progress is expected to be achieved before 2025. Against this background, this paper is structured in two parts. The first part analyses the most recent trends in the Governance of the Eurozone. The second part discusses whether a transition from *governance* to *government* of the Monetary Union is both feasible and effective, advancing a new proposal -a Joint Budgetary Procedure- tailored to strengthen the European Semester with stronger incentive mechanisms, greater reach and stronger governance.

Key-words

Eurozone, Economic and Monetary Union, Joint Budgetary Procedure

1. Introduction

The Euro Area is navigating uncharted waters; it has begun, in slow motion, to slide towards a fiscal federation. However, it currently lacks both the fiscal capacity and the democratic qualification to achieve this goal. Politicisation and democratisation are fundamental requirements for the sustainability of the EMU as much as its completion with a fiscal and economic arm. The weak point of the EMU has been known since before its inception; while the rationale for a monetary union fiscal capacity could be tracked back to Mundell's (1960, 1961) work on Optimal Currency Areas, whose common budget would allow several adjustment functions (De Grauwe, 2012), the actual strengthening of EU budgetary powers was proposed by McDougall (1977) who reported that a budget of 7% of EU GDP would have been necessary to support the Monetary Union Plan presented by Werner (1971).[1] Yet, there is today little appetite in European Capitals for a further pooling of sovereignty and resources in the short run. Although "the long overhaul", recently agreed at the EU level, is still contested, the timeline proposed by the Five Presidents' Report in 2015 is realistic. Calls for a more politicised and legitimised economic governance have multiplied in the second half of 2015 (Zuleeg, 2015; Terzi, 2015). Yet, while the process of politicisation of EU public life and institutions has fascinated many scholars for many years, it provoked minimal excitement among the public at large until recent years. The crisis, however, has contributed to change this picture; from anti-Austerity protesters to opportunistic politicians, Europe has witnessed a growing rhetoric against the "unelected bureaucrats" (courtesy of Nigel Farage, (2014)) taking decisions instead of the people. The academic politicisation debate has focused, over time, on two interdependent strands: the first concerns the changing role of the European Commission, while the second investigates the emergence of the European Parliament as key actor in EU policy making, bringing the traditional right/left divide in European politics.

In particular, Hix (2011, 2013, 2014) has long supported the strengthening of the European Parliament's powers in order to foster politicisation and thus [mass] participation in EU governance. The lack of salience of European policy for mass-politics has been often referred to as one of the most worrying features of the EU, pushing some scholars like Viviane Schmidt (2006: 223) to argue that the EU is creating "*policies without politics*". A contrasting argument is made by Majone (1997) and Moravcsik (2002), who argue that as long as the EU deals primarily with non-redistributive policies, it does not need politicisation and can better pursue its goals, being kept "insulated" from party politics. However, Majone (2014) recognises that, in the wake of the crisis, integration of redistributive policies has taken place and thus politicisation should follow. A politicisation narrative has often been developed as a solution to the alleged "democratic deficit" of the European Union, which is discussed in detail by Nicoli (2015). In general, politicisation has been perceived as a consequence of ever-increasing powers of the European Union, resulting from both a bottom-up process (the electorate's change in attitudes "from permissive consensus to restrictive dissensus", as argued by Hooghe and Marks (2009)) and a top-down process, with an incremental self-understanding of the European Commission (and of its president) as the true executive power in the EU (Christiansen, 1997, 2001). The evolution of the constitutional base of the Union has followed these two trends, strengthening the autonomy and powers of the Commission on the one hand, and reinforcing the link between the Parliament and the European elections on the other. The role of the European Commission has always been stretched between two poles: on the one hand, the Commission was seen as "guardian of the Treaties", i.e. as the supranational enforcer of a multilaterally agreed, rule-based governance; on the other hand, the Commission is increasingly perceived as the "kingmaker" of the European political game, acting instead as the pivotal power in a supranational form of government (Zuleeg, 2015). Against this background, this paper is structured in two parts. The first part analyses the most recent trends in the Governance of the Eurozone, focusing, in particular, on the debate on fiscal rules. We then show that a transition from *governance* to *government* of the Monetary Union is both feasible and effective; finally the paper advances an alternative proposal to strengthen Economic Governance before 2025, a "Joint Budgetary Procedure" aiming to reinforce the European Semester with a fiscal pillar.

2. A governance under stress: trends and evolution

2.1. The governance as it stands today

A working monetary Union needs three essential functions: a crisis-resolution mechanism, a shock-absorbing capacity, and a system of prevention of asymmetric shocks. In two fields substantial progress was achieved during the crisis: the strengthening of the fiscal pillar of economic policy coordination, and progress on crisis-resolution mechanisms. While progress on the creation of a "safety net" in case of crisis was substantially achieved thanks to the creation of the ESM in 2012 and to the factual change of stance of the ECB under the leadership of Mr. Draghi, the Union's capacity to shape a coordinated economic policy, to provide a joint budget, and to enact counter-cyclical expenditure is heavily underdeveloped. Even fiscal rules, as they are conceived today, are not perceived as optimal by member states. Their reform, however, is a major source of division among member states. The original set of fiscal rules of the EU is laid down in articles 121 and 128 of the TFEU and is operationalised by a protocol known as the Stability and Growth Pact (SGP), established in 1998 and reformed several times thereafter. It was originally organized on two well-known pillars (the "preventive" and "corrective" arms) with three goals: preventing excessive deficits, ensuring debt convergence, and ensuring medium-term deficit reduction. The SGP was first modified in 2005 after German and French failures to comply with deficit thresholds; to avoid sanctioning, a reform was introduced to grant greater autonomy to governments, and weaken the Commission's power of delivering sanctions. The SGP was modified again, this time in the opposite direction, in 2011, tightening the thresholds for Euro Area member states and introducing the Reversed Majority Voting principle on sanctions, granting to the Commission the automatic approval of decisions on sanctions unless member states in the Council succeed in forming an opposing majority. The SGP reform was accompanied by four other important measures in fiscal policy: the introduction (with the Six Pack), and subsequent reform (with the Two Pack) of fiscal monitoring and coordination; the introduction (with the Six Pack) of a common fiscal framework; and the approval of the Treaty on Stability, Coordination and Governance (TSCG, also known as Fiscal Compact) which requires the constitutionalisation in national basic laws of the fiscal rules introduced with the 2011 SGP reform. In sum, the period from 2010-2013 was characterized by intense reforms in the fiscal and economic framework of the Union, heading in the direction of more supervision, more control, and more sanctioning.

Since 2012 the EU has entered a phase of long-term overhaul of its governance framework. The Four Presidents' report, in December 2012 co-authored by Juncker (at the time President of the Eurogroup), Draghi, Van Rompuy and Barroso, set the governance agenda for the following years with the aim of addressing the missing features of Governance apparatus. For each timeframe a number of key policies were introduced. Table 1 recalls the priorities set by the report along with their timeframe and their actual status. Three years later, the EU is still far from completing the key policy actions included in the period 2013-2014, let alone past-2014. Moreover, the Five-Presidents' Report, published in 2015 and originally expected to provide guidance for the completion of the original plan, constituted in fact a decisive backtracking exercise. Several priority actions of primary importance have disappeared from the report, including the introduction of a shock-absorbing mechanism and the introduction of a system of contractual agreements. The creation of a European Treasury, which could, in theory, provide both cancelled functions, has been delayed to no sooner than 2025; the headline "political union and democratic legitimacy" has been shrunk, de facto, to a formal presentation of the Annual Growth Survey in front of the European Parliament and to the introduction of common representation in international economic institutions by 2025. None of the missing fundamental features (effective coordination to prevent rising asymmetries, shock-absorbing capacity) are to enter into force before 2025.

Introduced in December 2011the European Semester is perceived as a weak juncture of governance. The European Semester inherited the practice of economic policy coordination applied in Europe since the Maastricht Treaty, in particular the "*Broad Economic Policy Guidelines*" and the "*employment guidelines*" (the main building blocks of the "*open method of coordination*[OMC]" introduced to achieve the goals of the Lisbon 2010 Agenda), the "*national reform programmes*" that member states had to deliver as a part of the OMC, and the "*stability plans*" delivered according with the Stability and Growth Pact (SGP) .

Table 1

2012 Four Presidents' Report & 2015 Five Presidents' Report Priorities compared

<table>
<tr><th colspan="4">2012</th><th colspan="3">2015</th></tr>
<tr><th>Period</th><th>key actions</th><th colspan="2">Status</th><th>Period</th><th>Key actions</th><th>Status</th></tr>
<tr><td rowspan="5">2012-2013</td><td>completion and implementation of Six Pack, Two Pack, Fiscal Compact</td><td>approved by March, 2013</td><td>in time</td><td rowspan="3">2015-2017</td><td>Competitiveness councils & fiscal council of the EZ</td><td>EZ fiscal council introduced in November 2015; competitiveness Councils recommended to the Council in Nov. 2015</td></tr>
<tr><td>creation of an ex-ante coordination mechanism for structural reforms</td><td>Communication in March 2013; legal text never proposed</td><td>not approved</td><td>Common insurance scheme; Capital market union</td><td>Common Insurance Scheme to be presented by End 2016*</td></tr>
<tr><td>Banking Union: Single Supervisory Mechanism</td><td>approved by October 2013; operational 2014 Q4</td><td>in time</td><td>Change of the European Semester structure & increase parliament's involvement</td><td>Communication presented in November 2015</td></tr>
<tr><td>Framework for bank's recapitalization through ESM</td><td>approved in December 2014</td><td>Delayed approval</td><td rowspan="6">2017-2025</td><td>Binding Macroeconomic convergence procedure</td><td rowspan="4">Details to be published in the 2017 white paper</td></tr>
<tr><td>Banking Union: harmonization of deposit guarantees</td><td>approved in June 2014</td><td>Delayed approval</td><td>fiscal stabilisation mechanism</td></tr>
<tr><td rowspan="2">2013-2014</td><td>Banking Union: Resolution authority</td><td>Approved in July 2014. Only 2 ratifications of the intergovernmental agreement by June 2015. Once approved, it will be phased in 10 years.*</td><td>in time, but slow application</td><td>Euro Area Treasury</td></tr>
<tr><td>Contractual agreements</td><td>Communication in March 2013; legal text never proposed</td><td>not approved</td><td>ESM into EU Law</td></tr>
<tr><td rowspan="2">2014-</td><td>shocks- absorption fiscal capacity through unemployment insurance scheme</td><td>in-depth analysis begun in 2015</td><td>Ongoing</td><td rowspan="2">Joint EZ representation in International economic institutions</td><td rowspan="2">Communication & Proposal for a council decision presented in November 2015</td></tr>
<tr><td>political integration</td><td>?</td><td>?</td></tr>
</table>

*Commission 2016 Working Programme, p.9

The 2011 reform integrated the guidelines into a single document of economic policy, the Annual Growth Survey (AGS) approved by the European Commission in October each year. By April, Member states have to submit their Stability Plans and National Reform Programmes presenting their actions to implement the AGS goals and the fulfillment of SGP obligations; by June each year, the Commission and the Council deliver a set of recommendations to member states concerning yearly priorities on their budgets and economic policy. In March 2013 the process was strengthened even further by adding supervision of the actual implementation in national budget plans of the commitments undertaken in the programmes submitted in April; by end of October member states must submit their draft budgetary laws for the following year, and the Commission is in charge of checking their compatibility with the recommendations delivered earlier in the year. These reforms notwithstanding, the Semester remains burdensome, and moreover is still ineffective (De Finance, 2014). There are currently only limited means available to induce a country to respect its own commitments; only the subset of recommendations concerning deficit and debt reduction (the fiscal rules discussed in the next section) can be enforced through the preventive and corrective arms of the SGP. The existence of macroeconomic imbalances could also be potentially sanctioned under the new Macroeconomic Imbalances Procedure introduced in 2011, but it has never been used so far and moreover its criteria do not constitute, *di per se*, a set of policies or economic measures. As a consequence, the EU is missing a form of instrument to deliver any incentives (both negative, as sanctions, and positive, like financial support) to ensure the implementation of structural reforms in countries in need of them. While the flexibility clause of the SGP introduced in January 2015 may provide some incentives, not all kinds of adjustments on the side of member states can be met by a simple relaxation of fiscal rules. Finally, the proposal to establish a contractual agreements mechanism was abandoned in 2014. The creation of such a system of contractual agreements had been discussed, under various labels, in each Head of States and Governments' meeting since June 2012. It constituted one of the three priorities of the Van Rompuy report endorsed by the European Council in December 2012 but disappeared in the 2015 update. A first proposal from the Commission (Communication 165/2013) was put forward in March 2013. Later in the year, the contractual agreements mechanism became one of the cornerstones of the Franco-German bilateral agreement of May 21st, 2013. It was further discussed in the European Council meetings of June, October and December 2013. The last European Council of 2013 registered, for the first time, a preliminary agreement on the forms, functions and structure of the "partnerships for growth, jobs and competitiveness"- the final denomination of the contractual agreements mechanism in the EU's jargon.

Finally, the last pillar of the genuine economic union agenda -constituted by a shock-absorbing fiscal capacity, notably through a European Unemployment Benefit Scheme (Beblavy and Maselli, 2015; Beblavy et al., 2015)- is in its early stages of exploration, and should not be expected to deliver actual results, let alone a legislative proposal, in the coming years. The Juncker Fund, which formally aims to foster growth through enhancing investment across the EU, appears to work -thanks to its flexibility clauses and to the exclusion of investment contributions from national deficits calculations- rather as a backdoor solution for the introduction of a golden rule rather than as a true fiscal stimulus initiative (for an in-depth discussion of the issue please refer to Nicoli 2016b). The construction of a genuine economic union, however, remains a medium and long term priority for the Euro Area. In this regard, the second part of this paper discusses two alternatives for an incremental process towards the 2025 deadline for the creation of a genuine economic union; a contractual agreements scheme and a joint budgetary procedure.

2.2. Legitimacy and effectiveness shortcomings

Whether the European Commission enjoys sufficient democratic legitimacy to implement strengthened Economic Governance is still an open question. Article 17.7 TEU, in the Treaty of Lisbon, introduced an electoral link between the Commission and the majority in the European Parliament. This has been reflected in an inter-institutional power game that led to the election of Mr. Juncker to the presidency of the Commission, thanks to an inter-party agreement establishing a de-facto Grand Coalition in the European Parliament, able to overcome Germany's scepticism and the UK's vetoes at the moment of the election. Although a Grand Coalition in the European Parliament is hardly news, the polarization of the Parliament has increased thanks to the growing success of Eurosceptic parties, which control- both in the soft ECR groups and in the extreme EFD and ENF- around 20% of the Chamber, and to the increased salience of integrationist-Eurosceptic dynamics in the Parliament during the crisis (Otjes and Van der Veer, 2016). Politically, a large minority has created the need for strengthened coordination between Juncker and his majority, who reportedly meet at least once a month (Palmeri 2015). However, such a coalition has no practical effectiveness outside the formal competences of the European Parliament, whose role in economic governance is so far extremely limited. Moreover it cannot hold decision making powers (and therefore veto powers) on joint economic policy (by necessity Europeanized) or offer a viable alternative, as exemplified by the Greek crisis of July 2015. As a matter of fact, it makes little difference if the veto is expressed by a government- as in classical intergovernmentalism- or by a parliament, as in the "interparliamentarism" theorized by Nicolaidis (2013) and Hefftler and Wessels (2013) and implemented in the Lisbon Treaty (art. 8 TEU) the TSCG (at. 13) and in the agreement for a new settlement for the UK (Tusk, 2016). Even its proponents realise it differs from democracy so that a new noun– *demoi-cracy*— had to be minted to mark the difference. Both interparliamentarism, as it is enacted in today's setting, and intergovernmentalism, require unanimous decision making on fiscal and economic policy, which is a violation of the fundamental principle of democratic decision making; majority voting (Nicoli 2016).

3. From Governance to Government: an alternative path towards 2025

The previous sections have shown that, despite the undeniable shortcomings of the Eurozone, the EU does have a map, a Captain and a schedule to navigate the uncharted waters of fiscal integration. Yet, while the suggested timeline might be realistic, it is surely overly cautious; for no change (other than cosmetic) is expected to be even discussed before spring 2017, when the Commission is to propose a white paper on the future of the Eurozone (COM 600/2015). Afterwards, negotiations for Treaty Change are set to begin after the German and French elections in 2018 with the new Treaty expected to enter into force by 2025. However, it is evident that this timeline implies no effective change until 2025: muddling through until 2017 and treaty negotiations thereafter. In other words, the existing budget of the EU, the Multiannual Financial Framework (MFF) is not expected to move beyond the 1% GDP threshold for the time being, remaining substantially below central governments' expenditure in existing fiscal federations (table 2) and thus unable to address the shortcomings of the EMU, which would require a minimum of a 2% EMU GDP dedicated budget. While there is no lack of proposals for reform, most existing plans to finalise EMU with fiscal powers (see Pisani-Ferry, Vihriälä and Wolff 2013 for a good summary) rely heavily on Treaty Change, which is not to be expected in the next ten years.

Table 2

Central Government Expenditure, % of GDP

	Switzerland	Germany	Canada	United States	Spain	Belgium	Austria
2005	11,3	14,2	16,1	19,0	17,6	29,5	34,5
2014	10,5	12,9	14,2	20,3	21,6	30,6	35,5

Source: Eurostat, World Bank, Kierkegaard (2015)

3.1. Rationale behind coordination mechanisms in federal budgets

Macroeconomic theory identifies three leading rationales justifying a federal budget: providing federal public goods, providing macroeconomic stabilization, and providing incentives for convergence. Existing federal states (for instance the US) tend to emphasize the first pillar, accompanied by some degree of counter-cyclical stabilization mechanisms (federal spending on unemployment benefit, for instance, reached its maximum of 1% of US GDP in 2010 (Kierkegaard, 2015)); adjustment and convergence is usually left to market flexibility, which is not very strong in the EMU (Wolff, 2012). While the provision of "European common goods" is undoubtedly of great importance, it would require further transfers of competences (for example in the military field) and thus involves Treaty change, which is not discussed in this paper. This section therefore develops the rationale behind providing financial incentives to member-states in order to achieve better coordination, convergence and adjustment. As will be seen in the next section, the European Council and the Commission have discussed different rationales for such a mechanism. On the one hand, the European Council seemed to stress the support for reforms which would enable stronger growth, while the European Commission paid more attention to incentives for reforms aiming towards a coordinated macroeconomic adjustment which is required for Monetary Union stability. Stimulating growth, however, does not represent a sufficient rationale for such a system. Either growth-enhancing reforms are effective, or they aren't. If they are, the incentive is already there and it is represented by the strengthened economic performance of the country in the medium term. Elaborating from Bonatti (2014), we identify four key rationales for providing central financing for reforms and coordination.

a. **Catching-up:** countries failing to reform their own economic system may be lagging behind in the Euro Area, becoming potentially a liability for all others. Thus, it is justified to provide incentives in the catching-up process.
b. **Negative Spillover:** introducing certain reforms may provoke severe negative externalities on neighbour countries when such reforms fail to be coordinated; this might be the case, for example, of uncoordinated labour reforms.
c. **Coordination added-value:** certain policy actions yield higher benefits when they are implemented in a coordinated approach; it is the case, for example, of fiscal stimuli to strengthen demand but also transport and services liberalisation. It is a form of prisoner-dilemma, where countries benefitting less from a liberalisation or a reform would oppose its introduction, but countries benefitting more would not proceed without symmetric implementation.
d. **Race-to-the-bottom:** when timely coordination is missing, there is a risk of "race to the bottom", which may have high social costs and could undermine support for integration.

Yet, member states falling in the categories above may still find it profitable to enact legislation without the need for the corresponding European financial resources. To justify a system of incentives, a mismatch between costs and benefits of coordination must exist. When costs and benefits, for some reason, don't match the expectations of the political actors, an effective coordination equilibrium is out of reach. Such "coordination failure" constitutes indeed the main rationale for a centralised financial intervention, having the goal of setting in place an appropriate system of incentives aimed at making effective coordination attractive enough for national elites to act. We individuate, in particular, four types of coordination failures which, if not addressed, may prevent the enacting of a reform programme:

a. The costs of introducing the desired reforms (for example, labour market, retirement, judiciary systems, healthcare, education) exceed the "fiscal space" available for a country, given the set of regulations and treaty obligations in place at EU level (type 1);
b. There is a *temporal mismatch* between costs- concentrated in the short run- and benefits, apparent on the medium and long run (type 2). On the one hand, such a mismatched repartition of costs and benefits reduces the political consensus for reforms,

undermining the ownership of the reform process; on the other hand, politicians are unwilling to bear the costs of reforms which would benefit their successors;

c. There is a *societal mismatch*, at least in the short run, between the winners and the losers of a given reform; thus the preservation of social cohesion requires temporary expenditure in social policies (type 3);

d. There are inherited problems and long-lasting legacies in given institutions, regions or sectors (such as diffused regional criminality, or high public debt) the correction of which, solely on the basis of national efforts, demands a constant inflow of resources for protracted periods of time and is not compatible with the smooth functioning of a Monetary Union (type 4).

In these cases it is reasonable to put in place a financial instrument in order to provide adequate incentives for coordination and to support national ownership and implementation of agreed reforms. For incentive costs of the first type (insufficient fiscal space at a domestic level because of international and European commitments on deficit targets), it would be sufficient to engineer a gradual, ad-hoc loosening of the SGP, in order to allow the member state concerned the opportunity to amass the resources needed to implement the agreed reform. This is already in place thanks to the Commission communication on flexibility (COM 12/2015: 10) and only needs to be better linked, through secondary legislation, to CSRs. Addressing costs of types 2 and 3 may require a more complex solution. *Mismatches* between costs and benefits of reforms imply both real financial costs and political costs determined by the complexity of the construction of consensus towards the agreed reform. The latter often become financial costs as well as governments enact expenditure programmes to support citizens bearing the short-term costs of reforms. Of course, it is a national prerogative to decide whether it is worthier to gain the support of those penalized by a reform by enacting compensative measure or to strengthen its consensus in the rest of the constituency. However, both types of mismatches may hamper states' willingness to reform, which would end-up (in some cases but not in all) in generating negative spillovers across borders. When (1) national inaction is due to such mismatches and when (2) such inaction generates negative spillovers, then the EU is legitimized to set-up forms of financial support. The same reasoning applies to type 4 costs (inherited problems). While purely solidaristic approaches have been attempted in the past without much success, conditional forms of financing can provide better outcomes. Such financing can be provided, without Treaty change, by changes in the secondary legislation on the European Strategic Investment Fund (Regulation 1017/2015), the EFSM (regulation No. 407/2010, articles 1 and 3), and the funds accompanying the structural funds of the European Union (Regulation 1303/2013, art. 26). Ad-hoc financing provided through the latter case, however, requires a two-step process. First, as suggested in the Commission's Communication of October 2015 on the reform of the European Semester (COM 600/2015: 6-7), existing funding can be modulated to provide support to CSRs' implementation that fall into their respective domain of action. Second, in view of the 2017 review of the Multiannual Financial Framework secured by the Parliament in 2013 (Regulation 1311/2013, art. 2), the Commission may propose amendments to existing regulations in order to create an ad-hoc vehicle for the purpose by pooling already committed financing. Finally, financing coming from the eventual introduction of a Financial Transactions Tax may help in replenishing the pool of resources available over time.

3.2. A joint budgetary procedure

The abovementioned instruments do not require treaty change, only the amendment of secondary legislation; however, the provision of financial incentives to reform is better delivered through an organized revision of the European Semester process. The idea of a Joint Budgetary Procedure (JBP) was originally proposed by Nicoli (2013) and Dhéret et al. (2013), and has been recently re-framed by Enderlein and Haas (2015). The essential feature of a JBP is to embed the national budgetary process into a European-wide, iterative procedure in which financial and budgetary incentives are so structured as to reward continued compliance. At the core of the JBP is a reformed AGS, which should be reorganized in two parts: *Headings requiring Joint Action* and *Headings requiring Coordinated Action*. The first part concerns the creation of special-purpose vehicles to deal with issue-specific concerns by pooling national resources. The second part concerns policy areas normally in the domain of national policy-making, in which the Commission considers there is a need for enhanced coordination of domestic policies. The third part concerns specific policies required in a given country. The procedure behind both headings is to be divided in five distinct steps: inception, negotiations, finalisation, implementation and approval.

3.2.1. Joint Action: pooling finances

Joint actions would be organised, following the input from the Commission or the European Council, to deal with specific issues requiring pooling of resources. The lack of financial means is, indeed, one of the major limitations of the EMU, which lacks its own budget and is supported only by the 1% GDP EU budget, significantly lower than other fiscal federations (table 2). In principle, the Commission should use this particular heading of the AGS to stimulate the setting-up of extra funding outside of the Multiannual Financial Framework. As highlighted, among others, by the High Level Group on Own Resources (HLGOR) headed by Mr. Monti, the EMU lacks currently both a Treaty Basis, and political willingness, to implement a full-fledged system of genuine own resources (Monti, 2014). Therefore, the 2016 MFF reform cannot be expected to provide either a boost in the total MFF funding or a strengthening of the European Parliament's capacity of raising resources

It follows that any strengthening of the European Union's capacity of enacting expenditure has to be channelled, for the time being, through intergovernmental decision making. Hence, a standardised format for extra-MFF projects would be of great help in preparing the ground for the establishment of a Euro Area Treasury in the middle of the next decade. Depending on the issue, these might be based on pure inter-governmental agreements or enhanced cooperation. The goal of having a separate heading in the AGS is to provide a comprehensive framework and a common structure for a practice that already exists as a mosaic of unrelated decisions, examples are: the ESM, the EFSI or the extra-funds being gathered to deal with the refugee crisis. By streamlining proposals in this field into the AGS, the Commission would, on the one hand, stimulate the practice of pooling together resources, which might constitute the foundations of a Euro Area Treasury envisioned by 2025; on the other hand, it would informally (but substantially) provide an arena for the involvement of the European Parliament, nowadays excluded by any intergovernmental agreement on special-purpose vehicles.

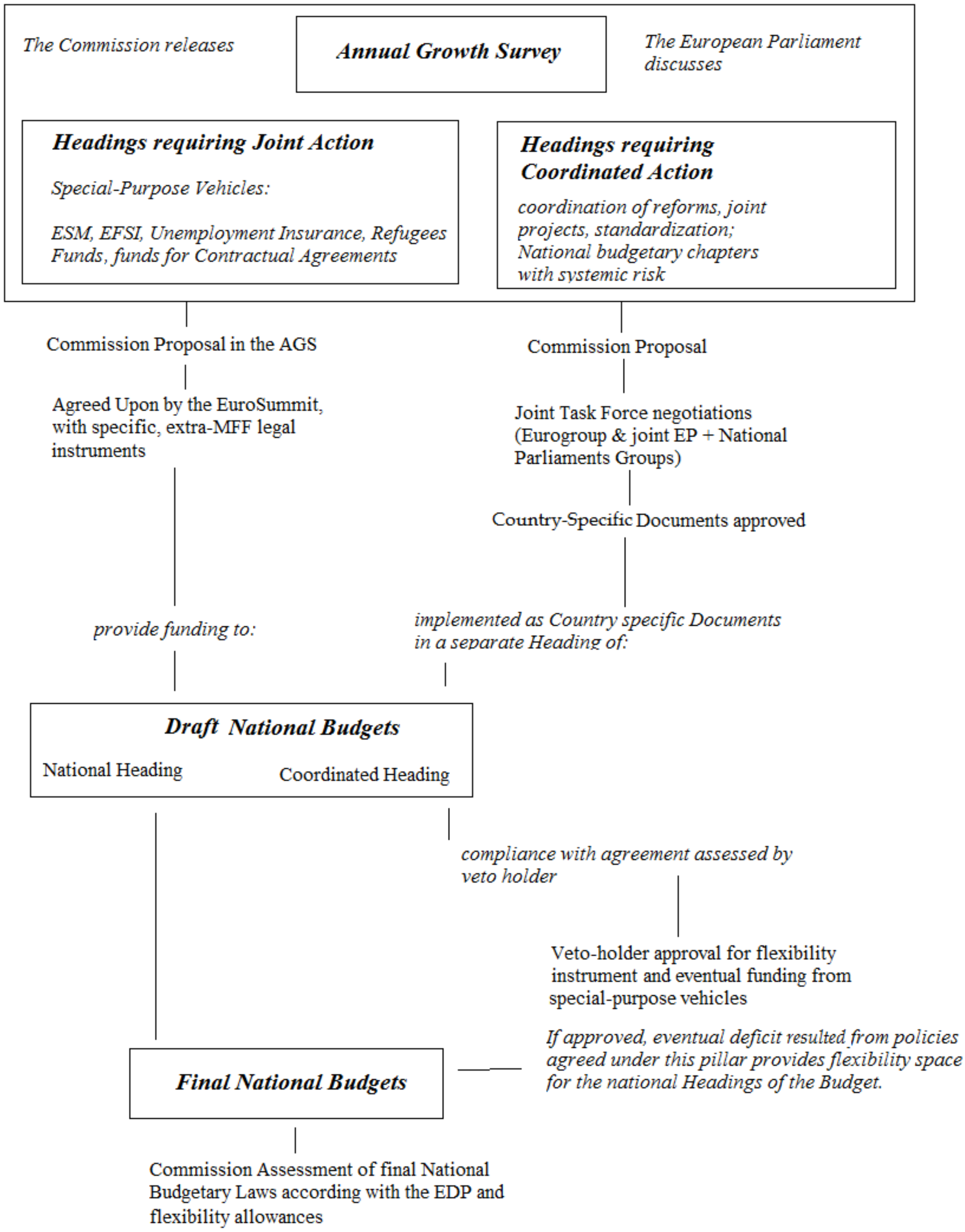
3.2.2. Coordinated Action: streamlining reforms

The second pillar of a JBP concerns the strengthened coordination of national budgets. Strengthened coordination begins with an appropriate heading of the AGS identifying, by policy area, and (group of) countries, actions requiring enhanced coordination. Following the AGS, the Eurogroup would establish sectoral working groups covering each of the policy areas that are the object of strengthened coordination. Depending on the matter, only some countries may be required to join the working groups. Similarly, the European Parliament, through its existing powers of consultation with national parliaments (art. 13 TSCG), would invite the chairs of the competent committees of each parliament of the Eurozone to create a working group hosted by the EP, to work along the Eurogroup's own ministerial working group in each of the policy areas. The resulting inter-institutional task force would be led by a Commission representative. Each task force would aim to propose concrete actions for each member-state involved in a particular policy area, with the goal of achieving the desired degree of policy coordination. Strictly speaking, this is procedurally different from a process of policy harmonization because it is neither grounded on a legislative document nor requires member-states to abide by the same regulation. Moreover, the task force may propose that member-states adopt a divergent course in certain policy areas in order to achieve a particular coordination objective- it might be the case, for example, of labour policy or public expenditure, where Eurozone-wide objectives are better achieved by a different composition of divergence rather than pure convergence among member states (IMF, 2012). This joint task force would constitute an iterative process of negotiations leading to both a working-group and country-specific, detailed policy documents aimed at informing July's country-specific recommendations. Finalised recommendations would be directed to countries individually, and to working groups of countries, and would require the application of the specific content of the country-specific report in the yearly national budget. Both the working-group and the country-specific policy documents would include expenditure targets for specific areas, for both participating countries as a whole, and individual countries. As a general fiscal rule, the overall expenditure limit agreed within the coordinated Headings should not push the Euro Area as a whole above the 3% deficit/GDP target; it might, however, lead individual countries to temporarily over-shoot the target, as long as they implement their coordinated Headings in the national budgets as agreed in the Joint Task Force. The overall package of actions under the country-specific documents would constitute, for each given country, the coordinated pillar of its yearly budget, presented as a separate heading in national budgetary law; such to be presented annually to the Commission by October 15th in line with the existing European Semester timetable. Overall, coordinated budgetary headings constitute the coordinated budgetary pillar of the monetary union, while budgetary headings not included in the coordination process would constitute the national pillar of the monetary union budget. At the concluding stage, the European Commission, in accordance with the criteria laid down in the SGP, would assess the application of fiscal rules in the overall budgetary law. However, as discussed in the next section, different fiscal rules would apply to the coordinated heading of national draft budgetary laws.

Until there is an enactment of treaty change, member-states retain full sovereignty over their national budgets, as such, incentive mechanisms should be put in place to ensure compliance with the agreed package of measures coordinated through the second pillar of the JBP. Fiscal Rules would continue to characterize the boundaries of fiscal freedom of member states under the JBP; in particular, the overall budget of a country would remain subject to the existing fiscal rules, with particular reference to the 3% deficit/GDP target and the 0.5% improvement towards MTO. However, the Commission would have an assessment role in judging that the Coordinated Headings of the national budgetary laws were both in line with what agreed in the Joint Task Forces, and reproduce the recommendations as detailed in the agreed country-specific reports. In such a case, the eventual deficit agreed in the Joint Task Force to finance the Coordinated Headings would not be considered in the computation of the deficit threshold. The 3% fiscal rule would apply, however, to the coordinated budgets when assessing the Euro Area deficit/GDP ratio as a whole. Suggested originally by the Dutch Finance Minister De Jager in 2011 (Karagiannis and Guidi, 2014), endorsed by Barroso (2011) and by the German Financial Minster Mr. Schäuble (Spiegel, 2012) and by several authors (see, for instance, Enderlain and Haas, 2015) a "European Financial Minister", with powers of veto, would enhance the incentive strategy. Of course, no formal veto powers on national budgets could be envisaged, as it would require a degree of sovereignty transfer not envisioned in the current treaty setting.

Figure 2

The Joint Budgetary Procedure



Instead, this authority could apply the veto to flexibility and financial measures adopted under the Coordinated Headings of national budget. This would have no legal consequences and would not require formal legislation: the country subjected to the veto would still be able to approve its national budget including the vetoed measures. However, the veto would prevent the Commission from using either of the two incentivisation instruments presented above: flexibility and contractual financing. Failure in coordination, therefore, would be associated with a high cost for a country, because its overall budgetary position would need further adjustment to comply with the deficit/GDP ratio.

When, by 2025, Treaty change has been accomplished and a Euro Area Treasury established, instruments such as Union Bonds could be emitted to finance parts of the expenditure enacted under the Coordinated Headings. Moreover, the ESM could be used to introduce a modified form of the "red/blue bond proposal" (Depla and Weizsäcker, 2010); pending approval of the veto-holder, debt enacted under the coordinate pillar would enjoy seniority and guarantee from the ESM, while in contrast debt enacted under the national pillar would have neither seniority nor guarantees. This would provide a strong incentive to keep the books balanced in the national pillar, increasing coordination and ensuring both the application of EU fiscal rules, and the strengthening of reciprocal trust.

4. Conclusions

The formal and informal strengthening of Economic Governance (and of its master, the European Commission), analysed in the first part of this paper, suffers from two essential limitations: first, it is still not sufficient in providing a permanent setting for the EMU; and second, it lacks the democratic legitimacy to do so. Against this background, scheduled changes to governance, expected to be incrementally introduced in the next ten years, appear insufficient. Given the absence of Treaty Change, not expected before 2025, in the second part of the paper we have put together, elaborating from existing policy proposals, two alternatives to the current and expected setting which would be substantially more efficient. In the absence of Treaty change, no reform can be expected that increases the formal powers of the European Parliament, provides further limitation of budgetary sovereignty, or expands the small federal budget the EU is currently endowed with as MFF. Both proposals, therefore, rely on intergovernmental protocols, inspired by the informal agreement behind the first European Semester in 2010 (before its codification in December 2011). Both proposals would enhance Parliamentary scrutiny because they are anchored into the AGS, which is expected to be voted upon by the EP.

The contractual agreements' proposal had been widely discussed in the literature and by policy-makers in the lead up to the December 2014 European Council. Its major strength is its limited range of action and the flexibility that characterizes its functioning. However, it has three major drawbacks. First, its capacity of influencing policy-making is asymmetric; countries with limited need of reforms would be unaffected and would lack incentives to coordination. Second, it would imply "putting a price-tag on reforms" to countries thus creating a precedent in fields for which a case for financing does not exist. Third, the system would not provide a suitable basis for a smooth transition towards a Euro Area Treasury expected for 2025, which is not likely to be anchored into contractualism. Therefore, while a limited contractual agreements scheme might work in fostering reforms in weak countries, it would not provide a suitable basis for smoothing the 10-year long transition towards a common Treasury. The JBP analysed in this paper merges several existing proposals, from the "Euro-Area Commissioner" to the "threefold model of fiscal union". The core element is to allow the Commission, through the AGS, to stimulate member-states, on the one hand, to set up ad-hoc, extra-MFF instruments to deal with specific functions, and, on the other hand, to proceed with strengthened coordination of certain economic policies. This approach differs from the Contractual Agreements' Mechanism, as the JBP is more suited as a transition instrument because it provides better coordination of the overall policies of EMU countries, decreasing divergence in view of the 2025 leap (which, accordingly with the Five Presidents' Report, will be conditional to successful convergence). Moreover, the two pillars of the procedure are designed to evolve, respectively, into a Euro Area budget and into forms of Eurobonds that guarantee enhanced coordination once Treaty change allows for it. Strengthened coordination in the form of a JBP, therefore, is to be preferred to a contractual agreements proposal in view of a smooth transition ahead of 2025.

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[1] In fact, fiscal integration is a condition for the EMU to survive. This can be done explicitly and democratically, or implicitly through monetary backstop. De Grauwe and Ji (2013), Sinn and Wollmerahausen (2012), and Schelkle (2012) argue – from quite different perspectives- that the ECB'OMT and QE policies have achieved precisely this goal.

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Conventional Direction to Unconventional Measures: Using Quantitative Easing to shape Eurozone Fiscal Capacity

by

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Abstract

Eight years after the outbreak of the crisis, the Eurozone (EZ) fiscal policy remains fragmented at the national level. This paper fills the structural gap between the monetary and fiscal dimensions of EZ economic policy by suggesting a 'conventional' direction to the unconventional Quantitative Easing (QE) policy of the European Central Bank (ECB). We propose an evolution for QE to tackle the shortcomings of the current 'decentralized' fiscal policy in the EZ. In a nutshell, we suggest a change in the composition of QE asset purchases, focusing on buying European Investment Bank (EIB) bonds that, in turn, would be used to finance real investments through the Juncker Plan programme. The rationale of our proposal is legitimised by an overview of the gloomy macroeconomic conditions of the EZ, and the situation in ongoing policies. The mechanism is described in detail, with a discussion of both its strengths and possible limitations.

Key-words

Quantitative Easing, Eurozone, Juncker Plan, European Investment Bank, Fiscal Capacity, Euro Treasury

1. Introduction

The idea of fiscal capacity in the EZ is not new, and has often emerged in the European debate; it was presented in the 2012 Four Presidents' report (Van Rompuy, 2012) which refers to two kinds of mechanism: contractual arrangements, and an insurance-type unemployment scheme.[1] Both mechanisms have limited scope, given that European unemployment insurance would be a temporary tool, while contractual arrangements regard a restricted number of key micro-economic, sectorial and institutional weaknesses which hinder growth, employment and, in general, the smooth functioning of the EZ (Rubio, 2013).

Although Europe has been facing the consequences of a demand shock *par excellence*, caused by the deleveraging process of both public and private sectors after the bursting of the bank lending bubble (De Grauwe, 2014), the possibility of an EZ fiscal capacity focused on bridging the investment gap and the shortfall in overall aggregate demand has been neglected since 2012. The Investment Plan for Europe, widely referred to as the Juncker Plan (EC, 2014), is a good starting point to deal with the European shortage of investments and demand, but relies too much on private capital being forthcoming for its success. The idea behind the Plan is that using limited public funds is the best way to attract other investors – i.e. public intervention has to be limited enough to induce crowding-in, rather than crowding-out, of private investments. However, since the 1970s, financial deregulation and financial innovation have determined a move of private capital from long term investment in the real economy towards speculative investment in financial assets (Wray, 2011). Further, it is hard to reconcile the financial system's short-termism with the need for patient capital to nurture long term capital development projects that are too risky to be financed by the private sector (Mazzucato, 2013). The point here is not just the ability of the Juncker Plan to mobilize capital from a mere quantitative viewpoint (a point already subject to critical debate), but rather the nature of the financing and the role that the Investment Plan could have in the transition from setting individual national fiscal policies constrained by budget rules to one featuring a common fiscal policy supported by supranational tools.

The recent Five Presidents' report (Juncker, 2015) has revived the debate, with the proposal of an EU financed macroeconomic stabilization function, as an initial step towards a larger European budget. The report recommends that various additional sources of financing should be considered beyond the measures set out in the Juncker Plan. These additional sources of financing should neither lead to permanent transfers between countries, nor undermine the incentives for sound fiscal policy-making at the national level. In this perspective, a different approach to the way monetary policy and fiscal policy cooperate could be useful to provide the fiscal stimulus that Europe needs. With an expansive monetary policy by the ECB but neutral fiscal stance at the aggregate level, the EZ economic policy is not effective, given that growth remains weak, deflation is still a concern and unemployment is at record highs in some periphery countries.

In this paper we propose an unconventional evolution for the European Central Bank (ECB) asset purchasing programme (also known as Quantitative Easing – QE) to tackle the shortcomings of the current 'decentralized' fiscal policy in the EZ. While some authors (e.g. Turner, 2013) suggest complementing QE with forms of overt monetary finance, we propose to direct a significant share of QE asset purchases towards European institution-issued bonds, thus indirectly setting up the framework for the establishment of a truly supranational fiscal capacity. The additional public financial resources gained by the EZ from this proposal will increase the capacity to back ambitious Investment Plans where they are most needed. By establishing a link between monetary instruments, the fiscal dimension and interventions on the real economy, our proposal jointly contributes to several ongoing debates: discussing the interplay between monetary and fiscal solutions to the current state of recession, mainly focused on QE; and the Juncker Plan and the EZ's fiscal capacity (High level Group on Own Resources, 2014). The Juncker Plan could be the link between those countries that need more solidarity and public investments in order to ensure employment-friendly growth and other member states whose priority is fiscal discipline. In this paper we try to design an effective way to bring together these two positions, by making the Juncker Plan a supportive and distributive tool in the broader perspective of the ongoing European integration crisis. In a nutshell, we are taking a first step in what Berg et al. (2015) call the necessary alignment of the three 'policy stars' of Europe: the Capital Market Union, the Juncker Plan, and the QE. We focus on the alignment of the last two elements, providing a mechanism to ensure the channelling of

QE resources to the real economy through the Juncker Plan, with the help of the European Investment Bank (EIB).

The paper proceeds as follows. Section One offers a snapshot of the current EZ economic framework, analyzing the macroeconomic conditions under which our proposal is formulated. Section Two discusses the coordination problems emerging from the mismatch between monetary and fiscal policies and the ongoing measures undertaken at the central level from both sides. Section Three outlines our proposal, offering a discussion of its critical aspects, before we offer our concluding comments in the final section.

2. Current economic situation in the EZ

2.1. Macroeconomic conditions and fiscal consolidation

Since 2010, fiscal consolidation in the EU and especially in the EZ has been the preferred response to the growing risk of sovereign default. Theoretically, policies aimed at imposing consolidation (otherwise known as 'austerity'), derive their rationale from the Expansionary Fiscal Contraction hypothesis (Giavazzi and Pagano, 1990) according to which a belt-tightening in government deficit will correct biases introduced by an oversized public debt, namely: i) the displacement of capital by debt, and ii) the distortions implied by the higher taxes needed to service the debt (Blanchard and Leigh, 2013). When the risk of being drawn into 'bad equilibria', whereby expectations of debt default lead to rises in debt interest rates premia, which in turn reinforce expectations of default, are added to the picture, there seems to be a good case for the implementation of austerity policies.

The Fiscal Compact, together with the EC packages (Two-pack, Six-pack) have been the main vehicles of fiscal consolidation, now enshrined in most European countries' Constitutions, inspired by the 'debt brake' rule that Germany introduced in 2009. The new criteria on fiscal consolidation update those of Maastricht; while the latter were an indirect substitute for the lack of a European fiscal policy (read economic government), the new framework does not change the rules of the game: the levers of fiscal fine-tuning remain at the national level.

Unfortunately, expansionary contractions have performed quite poorly in the EZ, with results acutely overbalanced towards costs rather than benefits, especially for periphery countries. Figs. 1-2 show the trends in real GPD growth and in public debt stock as a share of GDP for the EZ and the averages when countries are clustered by broad geographical group (labelled 'North', 'South', and 'East').[II] While growth seems to have gained momentum, especially for the countries in the 'South' group, and the dynamics of debt seems to have reached a peak in the period 2013-2014, one has to consider that part of the positive dynamics is either driven by the East block (which mostly experienced the effects of the financial crisis in 2009 and recovered faster afterwards) or is affected in GDP growth averages by some well-performing outliers (e.g. Cyprus, for the Mediterranean countries), and that the magnitude of the change in the direction of the macroeconomic trends is still far from impressive. The effect of austerity measures seems to slowly align with expectations, however years after the outbreak of the crisis and at high social (see below for unemployment) and political costs, the latter exemplified by the perceived drop in trust among EZ countries in particular (Eurobarometer, 2015).

Fig. 1 Real GDP growth

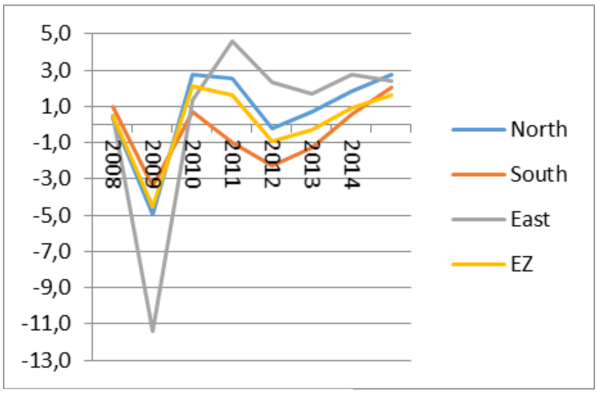
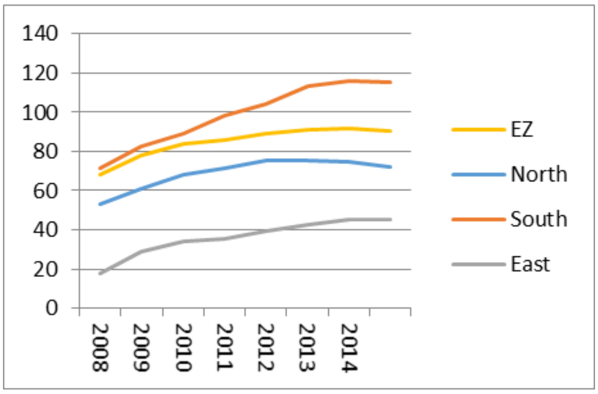


Fig. 2 Government debt % of GDP



Source: Eurostat

Beyond this picture, two further important aspects hamper growth in Europe. In 2015, the EZ unemployment rate stood at 10.9% while the youth unemployment rate (under 25) was 22.4% (figs.3-4). Among the member states, the highest unemployment and youth unemployment rates were recorded in Greece (24.9 and 49.8 per cent) and Spain (22.1 and 48.3 per cent). This has been accompanied by a rise in the rates of long-term unemployment (people not working for more than a year) (fig.5). All these people are more likely to become discouraged and leave the labour market resulting in an erosion of skills, a decline of capacity and a lower, if any, probability to find a new job when the labour market begins to recover. Therefore, a less productive workforce will limit the economy's ability to grow its way out of a recession, which ends up lasting longer (Banerji, 2015).

Fig. 3 Unemployment rate (year average)

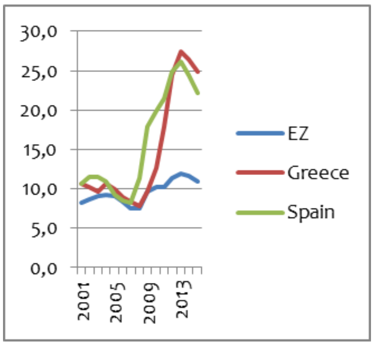


Fig. 4 Youth unemployment rate (% of youth)

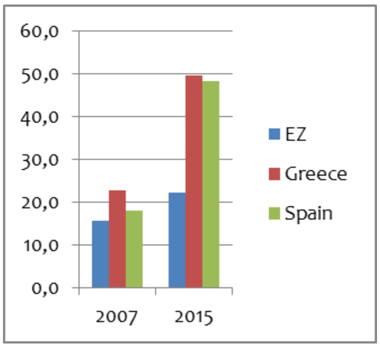
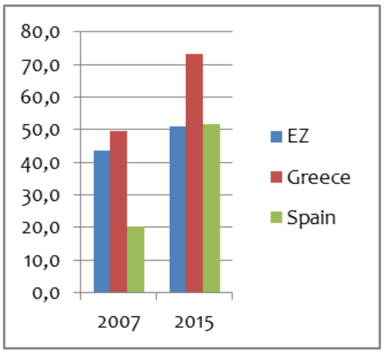


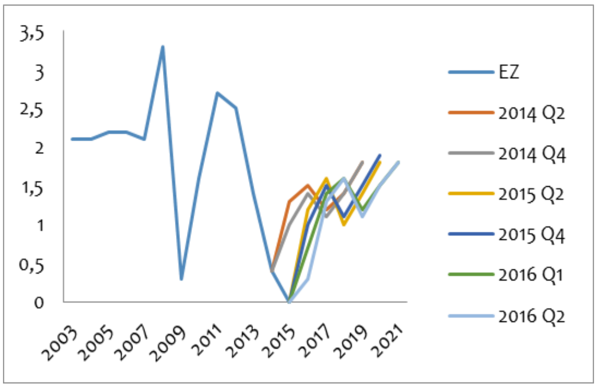
Fig. 5 Long Term unemployment rate (% of total unemployment)



Source: Eurostat

The gloomy prospects for the EZ economy are also reflected in the trends of inflation, whose trajectory towards deflation seems to persist more than was expected by inflation forecasts, which have been systematically revised downwards over the years (Wolff, 2015).

Fig. 6 EZ Inflation and ECB inflation forecasts



Source: ECB inflation forecast

The persistence of low inflation, despite a return of economic growth, has shaped the debate on recent monetary policies and on the best action to be taken by Central Banks. In the most advanced economies, monetary authorities have reacted by pursuing unconventional policies of asset purchases, with the aim of enlarging the monetary base and encouraging some heating-up of the economy.[III] QE policies have been introduced in recent years by the Bank of England, the Bank of Japan, the Federal Reserve), and later by the ECB.[IV]

The way major Central Banks have managed the crisis suggests two main lessons can be learned. Firstly, monetary policy makers have been endowed with the capacity to make hard choices, sometimes adopting exceptional measures required by the presence of a liquidity trap rather than only by the need to achieve price stability, in order to sustain growth and employment (Saraceno, 2015). Secondly, the creation of money by itself is not enough; new money must be spent by sectors of the real economy able to create inflation. In this respect, the very recent debate on 'helicopter money', is nothing but part of the search for the most effective way to channel financial resources to the real economy.[V]

2.2. Public and private investment

Since the outbreak of the financial and sovereign crisis, the trend for both public and private investment has been decreasing in the EZ and similar patterns are also seen in other major countries (figs. 7-8). Before the crisis, public investment was fairly constant with a peak in 2005 at 3.5% of GDP, while private investment fluctuated between 18% and 19%. After the crisis, both public and private investment have been in decline. Neither has yet returned to its pre-crisis level, indicating that fixed capital formation in Europe may be in a low level trap, reinforcing the arguments suggesting 'secular stagnation' as the new normal for advanced economies.

Fig. 7 Public investment (% of GDP)

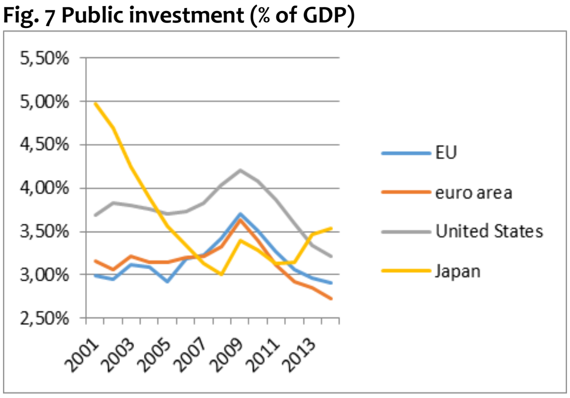
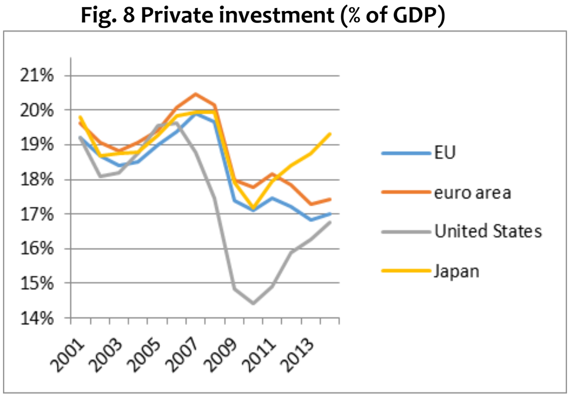


Fig. 8 Private investment (% of GDP)

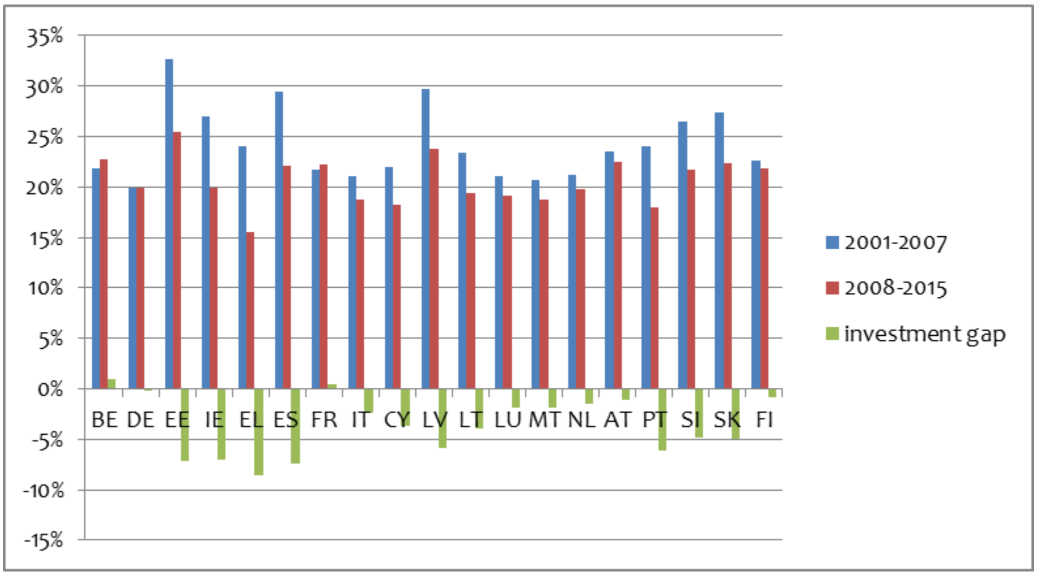


Source: Ameco

The reasons for an investment gap, despite the favourable borrowing conditions created by QE, can be found in the inefficiencies of the capital market and banking system, and in the uncertainty and negative expectations produced by the crisis (BMfWFW, 2015). Different estimates quantify such a gap in a range between €190 billion for the EZ and €330 billion for the EU as a whole per year (Rubio et al., 2016). Whether the existence of such an investment gap should be a guiding principle for policy, and the actual composition of the gap have both been matters of debate. According to Gros (2014), the argument in favour of a return to pre-crisis levels is inappropriate since investment evolves according to the financial cycle. Before the crisis, some countries experienced excessive investments in sectors like real estate that rarely create conditions for sustainable growth while, during the 'bust', investment fell below pre-crisis levels. In any case, we consider a rise in capital formation as a necessary condition for economic recovery. What matters for our proposal is the following: if the investment gap is to be considered as the measure of the boost required for the European economy, then the initiatives underway at the moment are insufficient to bring the current investment levels up to the level potentially required.

When looking at the composition of the investment gap, a more thorough picture emerges when countries are analysed around different axes. We can first of all distinguish between those countries experiencing a large drop in investments (e.g. Greece, Spain), those with a smaller drop (e.g. Netherlands, Austria, Slovakia), and those that have experienced a slight growth in gross capital formation (e.g. Belgium, Germany). Secondly, following Rubio et al. (2016) and disaggregating expenditure by sector (in this case, construction, infrastructures and machinery), we find countries that have reduced all types of expenditures, and other countries subject to specific drops or increases. Such a constellation of differences has to be taken into account in order not to provide a 'one-size-fits-all' policy recipe that may underperform or fail.

Fig. 9 Investment (% GDP) pre and post crisis, investment gap (change 2001-2007 to 2008-2015)



Source: Ameco

3. (Lack of) Coordination between Monetary and Fiscal Policy

In macroeconomics, policy-makers can combine two kinds of tools to achieve sustainable economic growth in a context of price stability: fiscal policy, and monetary policy. Needless to say, within the EZ, the problem of coordinating macro policies is very complicated because the creation of the EZ constitutes a policy-making framework that is unique in history; for while monetary policy is oriented towards a Union-wide objective, fiscal policy remains the competence of national governments. There exists therefore a structural gap between the two sides, since the ECB has no federal treasury partner at all (Bibow, 2015). On the contrary, the idea has prevailed in the EZ that setting coordinated common fiscal rules is enough 'to go a long way towards providing favourable conditions for economic growth and employment' (Issing, 2002). The assignment of responsibilities has been clearly defined, where the maintenance of price stability is the primary objective of monetary policy (art. 127.1 of the Treaty on the Functioning of the EU) and pursuing sound public finances is the aim of the Stability and Growth Pact (SGP), which represents an 'indirect' surrogate for fiscal policy.

The opinion that, in the long run, there is no trade-off between price stability and economic growth, in accordance with the lines of the 'New Consensus' in macroeconomics (Arestis and Sawyer, 2005), has fuelled the independence of the ECB while reducing its potential to inflation targeting, especially in comparison with the Federal Reserve in the United States (US).[VI] The ECB is considered one of the most independent Central Banks, even more than the *Bundesbank*, not only because 'neither the European Central Bank, nor a national central bank, nor any member of their decision-making bodies shall seek or take instructions from Union institutions, bodies, offices or agencies, from any government of a Member State or from any other body' (art. 130 TFUE), but also because its Statute can only be modified by revising the Treaties, which requires unanimous approval from all member states. Conversely, the German Parliament and the US Congress can amend their respective Statutes of the *Bundesbank* and the Federal Reserve by a simple majority (De Grauwe, 2007). Thus, despite its high degree of independence, the ECB does not have an equivalent level of political accountability. Indeed, the EZ organization is based more on an exchange of information than on identifying lines of actions for coordinating activities. This leads to uncooperative attitudes between the ECB, which gives priority to defending its freedom of action, and national governments that are unwilling to accept further reductions in their fiscal sovereignty (Von Hagen and Mundschenk, 2003).

The consequences of this lack of cooperation became evident in occasion of the euro crisis management. The slower economic recovery of the EZ compared to the US is explained by an insufficient macroeconomic response to a severe macroeconomic crisis (Bofinger, 2015; Watt, 2015). While the US tried to stimulate their economy by increasing the deficit and adopting a timely zero lower-bound interest rate policy, the EZ member states were subjected to restrictive fiscal measures along with a much more cautious approach to the monetary policy.

In this context, the ECB took actions that were considered to almost breach its mandate and which have been the object of political and legal scrutiny to assess their compatibility with the ECB mandate, with the European Treaties, and with member states' sovereignty. In general, such actions represent attempts by the monetary institution of the EZ to signal the absence of the fiscal side of economic policy.

The optimal currency area theory suggests that whenever a union faces an asymmetric demand shock, the only two feasible fiscal initiatives are a national fiscal policy free to accommodate budget deficits or a centralized budget able to provide automatic fiscal transfers among states (Kenen, 1969). Notwithstanding the preference of the latter option with a view to an 'ever closer union', none of the possibilities is or seems to be achievable in the very short term unless strong political determination makes an appearance in the EZ capital cities. An alternative, intermediate third solution must therefore be found. Given the nature of the crisis and the present political conditions, such a solution could be sought in a more cooperative attitude between existing institutions, focused on EZ macroeconomic policy. What we mean by coordination is the set of arrangements and activities aimed at creating a unified framework for monetary and fiscal policies and introducing commitments on policy decisions at national and supranational level (Panico and Vàzquez Suàrez, 2007). Such a path is not desirable *per se*, but could be functional to the development of a fiscal capacity in the long run.

3.1. On the monetary side: the ECB's unconventional measures and the EZ financial structure

Any initiative to mobilize finance to increase investment in Europe requires first of all a good understanding of Europe's financial structure, which is also important for evaluating the way the ECB has faced the crisis.

In response to the crisis, all the major central banks resorted to various measures, whose nature, more or less conventional, differs substantially, depending on their internal structural and legal conditions. While the ECB and the Bank of Japan generously lent money to banks, the Fed and the Bank of England injected reserves into their respective economies by purchasing bonds. In normal times, the ECB passively accommodates any demand for liquidity, given the policy of interest rates being the decision of the governing council. In exceptional times, when the ECB can no longer control the transmission mechanism from lower interest rate to higher aggregate demand for investment and consumption, the ECB goes beyond the quantity demanded and tries to stimulate growth through a higher supply of liquidity to banks. The ECB has always considered unconventional monetary policies as complementary to, and not a substitute for, its usual inflation targeting strategy (Cour-Thimann and Winkler, 2013).

The problem observed during this unconventional phase was that money created by the ECB did not translate into credit demand. The large refinancing operation by the ECB in the 2008-2012 period helped compensate for the liquidity leakage from the periphery towards the core, inverting the direction prevailing in the period before the crisis. In practice, although not a direct aim of the ECB, its monetary policy provides funds to finance current account balances (Cour-Thimann, 2013). In fact, since the launch of the Euro, demand booms associated with capital inflows from the core to the periphery, as well as the loss of export competitiveness in the periphery, contributed to the accumulation of large foreign debt in these countries, while the core accumulated sizeable surpluses. The external funding of a demand boom in the periphery almost exclusively relied on debt flowing through interbank lending from the core.

The specific bank-based financial structure of the EZ, where bank lending provides 70% of total financing to the non-financial sector, with financial markets providing the remaining 30%, is one reason explaining why the ECB's early crisis management approach was aimed at supporting the banking system, rather than providing a direct monetary stimulus to the economy (Cour-Thimann and Winkler, 2013). The fact, now officially recognized by economists (Baldwin et a., 2015), that the real causes of the EZ crisis were the large intra EZ capital flows from the core to the periphery, is another motive behind the unconventional ECB policy measures.

The financing through debt of non-financial corporations in Europe is dominated by bank lending. Loans to non-financial corporations have decreased since the crisis, and even more so since 2013, suggesting the ineffectiveness of the transmission mechanism of the ECB (Losch, 2015). This is explained by the deleveraging process of both the banking and the non-financial sectors, since European banks are reluctant to finance high-risk investment, and households and firms cut their consumption and investment decisions, giving priority to repairing their balance sheets. In addition, capital market financing has not been able to offset reduced bank lending whereas, in the US, corporate bond issuance is more developed and increased during the financial crisis, making up for the fall in bank loans (Berg et al., 2015).

Another important reason behind the ECB technique of intervention regards the EU legal framework[VII] that explicitly prohibits the ECB from buying sovereign bonds on the primary market. However, the behaviour of the ECB changed during the crisis and, in retrospect, it was the only player capable of acting beyond its instruments and operations as envisaged by the Treaties (Micossi, 2015). As Lavoie (2015) observes, although outright transactions on secondary markets are allowed within the Statute of the Eurosystem and the ECB, it was understood that the ECB would never conduct such operations. However, the prolonged crisis changed this convention when the ECB resorted to a progressive programme of assets purchasing.[VIII] The ECB has extended its role of lender of last resort from supporting only commercial banks to making unlimited advances to also provide a backstop to government debt.

3.1.1. The state of play of the QE

In March 2015 the ECB started its QE, the Public Sector Purchase Programme (PSPP) of €50 billion per month, to be added to private sector Asset-Backed Securities and Covered Bonds Purchase Programmes (ABSPP and CBPP3) of €10 billion, originally launched in September 2014. Two types of securities can take part in the PSPP: bonds issued by EZ governments and national agencies (88% of PSPP), and securities issued by European institutions (12%), among which is the EIB. The purchases are funded by central bank money, which the institutions can use to buy other assets and extend credit to the real economy. In setting the PSPP, the ECB Governing Council established a quantity limit on top of the eligibility criteria,[IX] ensuring that the ECB does not breach the prohibition on monetary financing.

With regard to sharing hypothetical losses, the Governing Council decided that securities issued by European institutions (12%) will be bought by National Central Banks (NCBs), not the ECB, although they will be under a regime of full risk sharing, a sort of debt pooling. As regards central government and agencies securities, only a small fraction of them (8%) will be placed under the same sharing regime, for a total of 20%. The rest (80%) will be excluded by risk pooling (ECB, 2015).

Table 1. The allocation of securities within the PSPP (original version, March 2015)

Type of security	Security holder	Monthly purchase (bn €)	Annual purchase (bn €)	% of total PSPP	Risk regime
European Institutions	NCBs	6	72	12	Full sharing Risk on ECB
EZ governments and agencies	ECB	4	48	8	Full sharing Risk on ECB
	NCBs	40	480	80	Not full sharing Risk on NCBs
Total		50	600	100	

Source: ECB

The programme was expanded in March 2016, and will last until at least March 2017. Total purchases have been increased from an initial €60 billion to €80 billion, and the allocation between types of securities has changed, with an increase of purchases of government bonds and those from recognized agencies from 88% to 90% of the total, and a decrease of purchases of securities issued by international organizations from 12% to 10% (ECB, 2016).

The effects of QE monetary policies are hard to estimate, but many scholars agree that QE produces positive effects. Nonetheless, the long run effects of extending such unconventional policies have to be better understood, especially as regards the potentially deleterious effects on economic incentives and the decreasing returns over protracted periods of intervention (Joyce et al., 2012) and with respect to the international dimension, where countries compete to have the lowest interest rates, and potential spill-over effects may reverberate through trade and financial linkages (Georgiadis, 2015).

The effectiveness of the ECB's QE in solving the deflation problem is clearly questionable. The macroeconomic context in which QE policies are implemented matters, because the effect of deflation on debt may reduce the room for policy action (OFCE/IMK/ECLM, 2016).[X] Other aspects are debated, in particular the fact that the Euro has been slowly appreciating since the beginning of QE, thus reducing demand stimulus from the external channel. There is also a risk of underutilization of the programme, caused by a clause of issue share limits. The ECB cannot buy more than 25% (increased to 33% in January 2016) of the total eligible debt securities of a country.[XI] This rule, even with the later changes to the original design to expand the scope of the QE, will restrain the full potential of the program, with the risk that the primary mandate of price stability might not be fulfilled because of self-imposed limits (Claeys and Leandro, 2016).[XII] Therefore the rule of allocation of asset purchases between countries based on the ECB capital keys forces the QE to be scaled up in order to seriously support small countries, like Greece and Portugal, that currently receive one tenth of what is due to Germany, which gets more than 20% of total purchases.

3.2. On the fiscal side: the Juncker Plan

The main question of the policy debate about investment in Europe is how to ensure the crowding in of the private sector in an exceptional moment of historically low interest rates and weak euro exchange rates (BMfWFW, 2015). In this situation, the main driver for investment is (expectations of) growth, while interest rates play a secondary role; therefore monetary policy cannot be effective in stimulating investment. However, growth is endogenously driven by investment. The result, as supported by the figures in section 1.2, is a vicious circle between sluggish growth and weak investment which needs to be broken.

The Juncker Plan is supposed to bridge the gap between abundant savings, on one hand, and lack on investment, on the other.[XIII] The financing of the Juncker Plan's investment projects critically depends on the degree to which the private sector matches the limited resources allocated by public institutions, the EC and the EIB, through the creation of a guarantee fund, the European Fund for Strategic Investments (EFSI). The existence of €21 billion public resources of the EFSI should stimulate additional financing from markets. It is explicit that the Juncker Plan is a purely private sector demand-driven mechanism, with no sectorial or geographical pre-allocation. The EIB makes risk-absorbing financing available but it cannot make the projects happen. Leaving the task to the private sector alone could lead to a suboptimal level of investment.

To sum up, liquidity is available, also thanks to the ECB's accommodating attitude, but a lack of risk-taking capacity and a general uncertainty about the economic outlook prevents it from being translated into aggregate demand. The initiative by the EC remains a private sector dominated mechanism, interested in financing more secure projects that probably could have been financed in any case by normal EIB operations. This vicious circle reminds us of what Draghi said in 2014, when he recognized that 'the risks of doing too little outweigh those of doing too much' (Draghi, 2014). Introducing a limited guarantee in the hope of leveraging additional funding from the private sector is not enough to ensure that additional riskier projects are started, and is certainly not enough to bridge the EZ investment gap. The Juncker Plan should be put at the centre of the European crisis management strategy, but linked with the ECB's current expansionary monetary policy. Instead of devoting all QE liquidity issuance to the purchasing of sovereign bonds, the ECB could directly link its programme with the Investment Plan, to better serve the needs of the European economy, as Valla et al. (2015) clearly suggest.

3.2.1. The state of play of the Juncker Plan

When discussing investment, it is usually assumed that 'more is always better', regardless of the quality of the investment. In our view, the challenge for Europe and the EZ is not just the quantity of investment (the gap), but also the 'quality' of investments in terms of geographical allocation and targeted sectors. In this respect, one of the crucial points of the existing Juncker Plan is the 'additionality principle', according to which the selection committee should be able to identify new projects that would not have happened without the subsidy of the EFSI.

The results of the Juncker Plan are regularly published by the Commission. The latest data (April 2016, tab. 2) show that there is a total of 222 projects approved (or under assessment) by the EIB Management Committee and the EFSI Investment Committee which, on the basis of €11.2 billion provided under the EFSI, will receive additional funding of €82.1 billion.

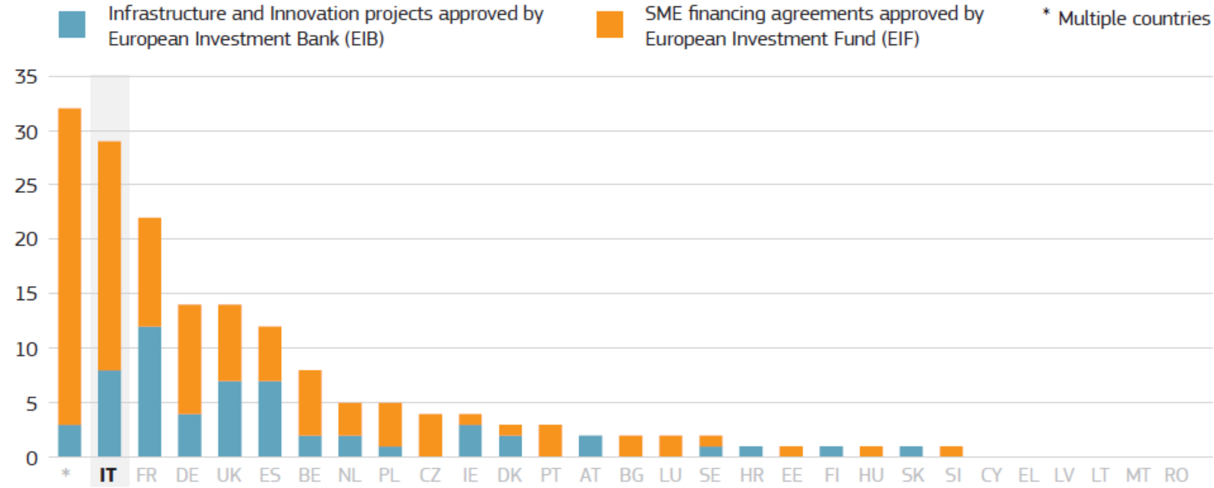
Tab. 2 Current situation of the Juncker Plan (April 2016)

	Number	Financing under the EFSI	Total expected investment triggered
Infrastructure and innovation projects	57	€7.8 billion	€82.1 billion
SME financing agreements	165	€3.4 billion	

Source: ec.europa.eu

The Commission also provides further details about the main beneficiaries of the EFSI guarantee (fig. 10) and the state of play of projects in the main countries (tab. 3). Data shows that the main recipients are Italy, France, Germany and the United Kingdom, proving that the geographical distribution of funding is not coherent with the major drops of investment across Europe, as shown in fig. 9.

Fig. 10 Distribution of project and SME agreements within Europe (March 2016)



Source: ec.europa.eu

Tab. 3 Details of progress in projects (by selected countries)

	INFRASTRUCTURAL PROJECTS						SMEs		
	total	signed	approved	under assessment	EFSI financing	private sector	total	EFSI financing	private sector
BE	2	1		1	100	653	6	58	685
DK	2	1		1	75	2,000	1	4	68
FR	12	4	7		465	2,005	10	286	3,600
DE	4		3		455	1,100	21	274	5,100
IT	8	3	2	3	1,400	4,800	21	318	7,300
NE	2	1	1		100	200	3	28	279
PL	1			1	n.a.	n.a.	4	19	658
ES	7	3	1	3	615	2,500	5	114	3,400
UK	7	3	2	2	1,400	6,700	7	214	2,900
	45	16	16	11	4,610	19,958	78	1,315	23,990

Source: ec.europa.eu

According to Rubio et al. (2016), different reasons may lead to a geographical concentration under the EFSI regime, to the detriment of periphery countries: i) the tendency of the EIB to approve projects ready and complete in order to easily prove itself consistent with the '315 billion target'; ii) the specific political and economic uncertainty affecting some countries; iii) having developed National Promotional Banks strongly involved in the EFSI scheme; and iv) the possibility to co-finance the EFSI and at the same time deviate temporarily from fiscal consolidation rules only applying to countries in the preventive arm of the Stability and Growth Pact. The last point is exacerbated by the fact that the contribution to EFSI announced by nine countries[XIV] will be in the form of co-financing to EFSI projects, not contributions to set up the EFSI (ECB, 2016). This means that such contributions will only support investment projects in their own countries and not flows to the common pool or resources of the EFSI. This highlights the difficulty to overcome the 'juste retour' principle which prevails in discussions on the EU budget.

To sum up, the Juncker Plan and the EFSI institution rightly enter the territory of European fiscal policy and allocation of resources to the real economy. However, the size of the mobilized resources is not enough to compensate for the EZ investment gap. Hence, a more systemic way to mobilize resources has to be introduced. The proposal that follows, by combining QE purchases with EIB/EFSI investment capacity, goes in this direction.

4. The Proposal

The principle element of our proposal is to substantially increase the amount of QE asset purchases by the ECB from the EIB in order to finance supranational investments. In this way, an unconventional monetary policy will produce conventional fiscal effects and prepare the ground for the establishment of a fiscal union. The proposal is inspired by previous contributions, from both academia (Stiglitz et al.,2014; Varoufakis et al., 2013; Watt, 2015; Wolff, 2014; Bibow, 2015) and political impetus. Recent proposals in this direction include the debated 'People's Quantitative Easing' that the leader of the Labour Party Jeremy Corbyn has promoted for UK (Skidelsky, 2015). The justification for our proposal builds on two pillars. On the one hand, the direction and size of the ECB QE seems to not be producing the expected effects on inflation or to have put the EZ back on track as regards the other main macroeconomic indicators. On the other hand, QE is unable to provide the necessary boost to the EZ, but neither can the quantity of the Juncker Plan that, even in the best scenarios of additionality and crowding-in effects, won't cover Europe's investment gap. A combination of the two policies may achieve the desired investment threshold and produce the inflationary pressure that QE is currently seeking to produce.

4.1. Conditions and Features

The overall picture that emerges from the analysis conducted up to now can be summarized in the following remarks.

1. *Ease the original sin of the EMU*. The ability of the EZ to achieve an optimal policy is severely constrained by its structural deficiencies. The ECB lacks a federal treasury partner, thus missing the crucial Treasury-Central Bank combination that forms the basis of power in sovereign states.
2. *Macroeconomic conditions have changed*. The main challenge today arises from the deflationary effect of private sector deleveraging, as households and corporations seek to restore their balance sheets, resulting in a collapse in credit demand. In this context, a zero lower-bound interest rate situation has very limited ability to stimulate credit creation, since spending and investment decisions are driven by balance sheet considerations.
3. *There is an alternative*. European growth-oriented public finance is seen as alternative to austerity policies, as is a Europe-wide fiscal stimulus to national initiatives under fiscal constraint. A recent study (Rannenberg et al., 2015) argues that the fiscal consolidation over the 2011-2013 period is responsible for between one third and one half of the decline of the EZ output gap. A different approach to the crisis – had it been acknowledged that low growth determines high debt and not the contrary – would have avoided the depressing consequences on growth and unemployment many countries are facing.
4. *'Agli stati l'austerità, all'Europa lo sviluppo'*. This famous statement by Tommaso Padoa-Schioppa (roughly translated as 'national governments have to deal with austerity, while Europe has to deal with growth') establishes the compromise between budgetary rules compulsory for EU member states on one side, and a European investment plan, on the other. If the objective of strict debt sustainability is to hold, an investment-led growth path must only be initiated at central level, since national governments are constrained by fiscal rules.
5. *Debt is not bad in itself*. What makes the difference are the nature and the aim of debt, rather than such debt's absolute or relative size. Notwithstanding that, our proposal does not consider a mutualisation of pre-existing national government debts (as in the case of 'Eurobonds') but features a pooling of forward-looking debt, with *new*

common debt funding *new* public investments that serves the common interest of the Union. Unlike with other proposals, in this case member states would continue to be responsible for their level of earlier debt.

6. *A gradual transition towards fiscal union***.** The current political environment in the EZ makes an acceleration of the process towards the realization of a true fiscal union quite complicated. While a political will to proceed in the direction of an 'ever closer union' is taking shape, a ready-to-implement proposal, based on existing institutions and coherent with the Treaties, would be effective and acceptable in the short term.
7. *Investments plan must be Europeanized***.** European wide investment projects encompassing education, health, and renewable energy must be labelled as European public goods, embodying a high value added. As a consequence, part of the borrowing for investment planned at national level could be converted into European borrowing.

4.2. Operational Details

4.2.1. Phase one

The first phase of the proposal regards a mechanism based on existing institutions (the ECB and the EIB) and ongoing policies (the QE and the Juncker Plan). The scheme is largely inspired by the contribution of Watt (2015), who proposes a conditional monetary financing of public investment for the EZ. We apply a similar programme to specifically address the flaws in current tools, one year after their launch. The scheme can be better understood through a stock-flow consistent visualization, which uses sector-based balance sheets in order to trace monetary transactions between sectors (Godley and Lavoie, 2007). Fig.11 shows the mechanism.

1. The EIB issues new bonds (i.e. 'investment bonds') and sells them on the markets. At present, the EIB issues additional bonds to the extent of three times the guarantee of the EFSI (from €21 to €60 billion), while the remainder (up to €315 billion) is collected through private financing. Our proposal involves increasing this 'internal multiplier' well beyond 3, and reducing the external multiplier, since the private sector will be attracted by secure projects that do not require additionality. The private sector buys them on the basis that

this new issuance is guaranteed within a specific programme of the ECB, which could be a new design of the present QE. Therefore, no speculation would emerge to undermine the rating on EIB bonds.

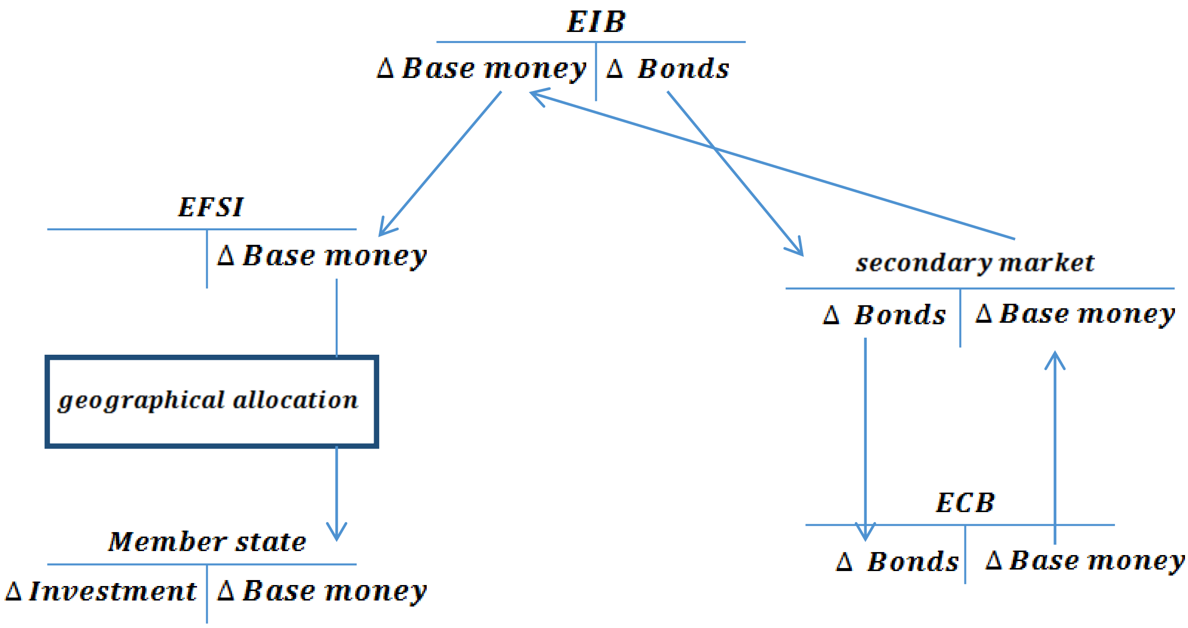
2. The ECB is ready to buy 'investment bonds' on the secondary markets within a QE2.0. The purchasing of bonds is financed through an increase of base money on the liabilities side of the ECB's balance sheet. This operation changes the essence of debt, from debt – that carries an interest rate and has a default risk, – to base money – that is default free but is subject to inflation risk. A risk, however, set aside by present deflationary forces. Liabilities still exist in the ECB's balance sheet, but 'now they do so in the form of money' (Watt, 2015).
3. Funds made available in circulation are then passed on the EFSI, which should expand, going beyond a basic guarantee fund to a 'distributional fund' giving support to states according to certain equity criteria (see section 3.3.2).
4. Both on bonds issued by the EIB and on grants received by national governments, an interest rate flow is generated. The ECB will receive interest payments from the EIB on bonds, while national governments will bear debt service on grants provided by the EIB.

The distributions of grants to national governments would not be a 'free lunch', as criticized by Tober (2015), as various conditionalities could be applied in order to balance the agreed financial support with investment.

Firstly, in order to avoid behaviour of moral hazards by national governments, a strict conditionality could be attached to the scheme, similar to that required by the European Stability Mechanism in order to obtain emergency financial assistance. Thus, the investment grants are bound to compliance with the EZ fiscal regime, meaning that they will be automatically withheld whenever structural budget rules still effective for current spending are not fulfilled. Such a conditionality would ensure a Fiscal Union that delivers 'both fiscal sustainability and fiscal stabilization' as the Five Presidents' report recommends.

Secondly, the risk that the ECB would overshoot its target of inflation, close to 2%, could be avoided through an explicit heuristic or 'rule of thumb' process that would scale up or down purchases of 'investment bonds'. In a sense, we suggest a sort of Taylor rule for the purchase of investment-boosting bonds. In a period of deflation, instead of looking to real GDP (nominal GDP/price level), as Central Banks normally do, it would be better to monitor the nominal GDP (Varoufakis, 2016). When prices are falling faster than nominal GDP – a situation found in some periphery countries – the resulting real GDP would seem to rise, a 'statistical illusion', underestimating the fact that money income is decreasing. A 'rule of thumb' appropriate to a deflationary period would require an expansionary policy which adjusts to the effective monetary capacity, since the latter is what really matters when indebted actors heavily involved in a deleveraging process have to repay their debts.

Fig. 11 A stock-flow configuration of the proposal



As regards the size of the programme, different proposals have been suggested. Wolff (2014) states that a ECB-EIB bond buying programme of €400 billion for a period of two years would be the best way to overcome the crisis. Bibow (2015) suggests an increasing scale, with 3% of GDP (€300 billion) as the initial volume of public investment to be increased to a 5% rate in the following years. On the contrary, Watt (2015) considers a decreasing scale, with a five-year programme where a starting issue of €250 billion in the first year is followed by €50 billion each year.

We suggest that, in the first instance, the size and duration of the scheme should be adjusted in order to meet actual investment needs, namely the investment gap discussed earlier in the paper. This amount could be collected within the existing QE framework.

For the purpose of our proposal, in order to be of significant magnitude, the purchasing of EIB bonds which are part of the investment programme should be: i) held by the ECB, not NCBs; and ii) increased within the 20% risk sharing regime, which is possible – *ceteris paribus* the amount of monthly asset purchase – through a corresponding decrease of the share of other European institutions securities and government and agencies bonds.

4.2.2. Phase two

Both the Juncker Plan and the QE should last until 2017 (excepting further extensions), while 'stage two' of the Five Presidents' Report for a common macroeconomic stabilization function built on the EFSI is expected to begin after June 2017.Therefore, it makes sense to think of the EFSI as the starting tool for change. In fact, the EFSI should perform the function of provision of public goods, and not only be focused on short-term interventions in favour of growth, as envisaged by Rubio et al. (2016).

In this second phase the EFSI should become a sort of Euro Treasury, like the one proposed by Bibow (2015).[XV] In his proposal, new common debt is devoted exclusively to grant public investment to governments. Thanks to the golden rule of public finance (Musgrave, 1959), while governments still obey EZ fiscal rules only for current public expenditures, capital expenditure is financed through common debt. The EFSI, once equipped with enough funding, could start issuing investment bonds by itself on the market, improving its scope from a mere guarantee fund. It would thus provide the safe assets the financial system needs, while the ECB continues to plays its role of lender of last resort, thus maintaining low interest rates. After the scheme has taken off, the EFSI could be changed by regulation into a Euro Treasury on the basis of two strict rules: first, the above mentioned golden rule on investment; and second, the no discretion rule in spending decision-making. Thus, the Euro Treasury will only finance capital spending and will not undertake investment spending itself, but will give grants to member states according to a distributional criterion, delegating the political decision on spending to national governments.

In the future, the scheme could be further extended with a shift in spending decision-making from national governments to European institutions or agencies in charge of the

EU's 'missing policies' i.e. industrial policy. As Pianta (2015) observes, in the longer term there will be the need for a dedicated institution coherent with the mandate of reshaping economic activity in Europe, accountable to the European Parliament and engaged in consultation with European political, economic and social actors, avoiding the 'revolving door' between the institution and the private and banking sectors. Such an institution could be the EIB itself, but this would change its nature from an intermediary tool between those who have money and those with a project to becoming a more proactive player.

4.3. Discussion of critical aspects

4.3.1. Fear of fiscal transfers

When talking about EZ fiscal capacity the main source of concern regards the possibility that it would mix monetary and fiscal policy and ultimately imply fiscal transfers between member states. Such concerns have emerged with both the Outright Monetary Transaction (OMT) programme and with the QE (see, among others, Sinn, 2014, who criticizes the ECB's decision). However, a deeper analysis of the way bond-buying programmes work reveals that such a fear is not economically justified, and the same reasoning applies to our proposal.

As De Grauwe and Ji (2015) explain, the misunderstanding is based on considering central banks as private agents. First, central banks and governments are two branches of the same public sector. Therefore, their balance sheets could be consolidated. In our scheme the EIB, the ECB and national governments are branches of the same public sector. This means that bonds issued by the EIB and held by ECB are just a claim of one branch of the public sector (ECB) against another branch of the public sector (national governments). Second, central banks are not-for-profit agents because, at the end of the year, they distribute profits to governments. Basically, what walks out the door of national government re-enters through the window.

Let's suppose that the ECB buys €1,o00 of 'investment bonds' on the secondary market (tab.4). and this amount is distributed to national governments according to a given distribution criterion ('shares'). On such bonds held by the ECB each government will pay the same interest rate (3% for example). At the end of the year, the ECB will return the interest payment to national governments using the same distribution criteria. This way, there will be no fiscal transfer between governments, since the amount received ('investment grants' and 'interest rate redistribution') and paid ('interest rate payment') are in the same proportion.

Tab. 4 An example of the neutrality result

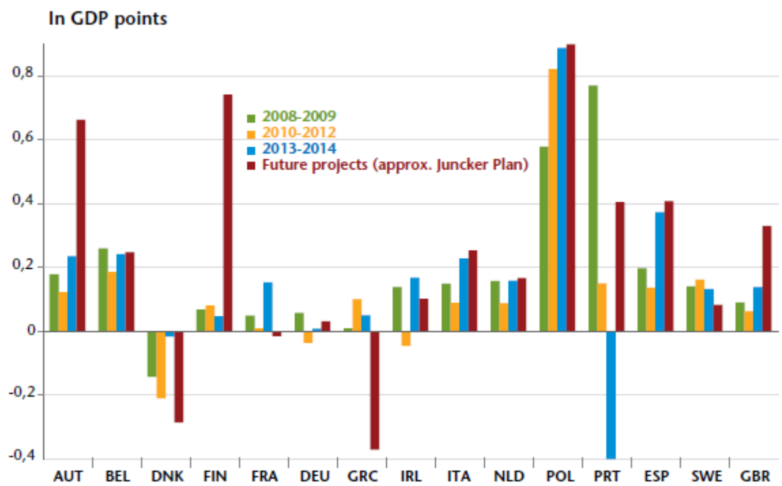
	DE	FR	IT	SP	others	TOT
shares	30%	25%	20%	15%	0.1	1
investment grants	300	250	200	150	100	1000
interest rate payment	9	7.5	6	4.5	3	30
interest rate redistribution	9	7.5	6	4.5	3	30

What Germany pays as interest service on its grant is what Germany receives at the end of the year, as with other countries. Tab. 4 shows this neutrality result, which represents a crucial aspect when designing a distribution tool. That said, the choice of one distribution criterion or another is a separate aspect, which does not affect the neutrality result.

4.3.2. Distribution criteria

One of the main aspects of the Juncker Plan that attracts criticism regards the risk of geographical concentration away from countries where the investment gap is pronounced. For those countries, the capacity to attract financing may also the lack of advanced financial markets and on unfavourable political and economic situations. Further, an analysis of the activity of the EIB since the beginning of the crisis reveals that, in spite of two previous increases in the Bank's subscribed capital in 2009 and 2012, the lending activity has slightly missed the EIB's stated goals, and such activity has not necessarily targeted countries most in need of resources (OFCE/IMK/ECLM, 2016).

Fig. 12 Increase in EIB's lending since pre-crisis period



Source: OFCE/IMK/ECLM (2016)

The EFSI regulation consider the possibility of adjustment in the mix of projects as regards countries 'on the basis of an ongoing monitoring of the developments of market conditions in the Member States and of the investment environment to help overcome market failures and sub-optimal investment situations' and, in any case, 'when carrying out that adjustment, the Steering Board shall avoid an approach which would be riskier than necessary'.[XVI] Such criteria to mitigate the risk of concentration ends up corresponding to the definition of 'additionality', which is the eligibility criterion in order to activate the EFSI, defined as 'the support by the EFSI of operations which address market failures or sub-optimal investment situations'. The regulator has not provided for a clear recognition of the potential problem of geographical concentration, while the latest data related to the Juncker Plan shows the risk that, without a strong correction mechanism, it could amplify existing gaps.

The QE programme allocates purchasing of bonds according to the ECB capital keys,[XVII] which gives more per capita to countries with higher income. However, an alternative (read 'fairer') way to allocate ECB funding is possible. Of course, the precise definition of distribution criteria has to meet both economic and political rationales. But given that fiscal neutrality will depend on whether or not the same criteria are applied to both the distribution of grants and redistribution of profits, regardless of the precise definition of the criteria, ideally any rule could be implemented. In practice, however, if this scheme were to meet opposition by some EU countries, a 'variable geometry' approach could be envisaged, excluding those countries that do not wish to participate, or an 'opt-in' basis could be followed in line with countries' specific needs.

In his proposal for a basket-Eurobond, Bofinger (2015) promotes a GDP weight, defined as the GDP share of each member state in the EZ GDP or a debt weight, deriving from the debt share of each member state in the EZ consolidated debt, as distributional keys, recommending also that a large German share would be beneficial for the credibility of the programme. On the one hand, we partly agree with Bofinger (2015) in that a 'fair reward' for the EZ's most important economies is a condition to ease the acceptance of any proposal that directly or indirectly introduces fiscal elements at supranational level.

However, the purpose of our proposal – and, in general, of any fiscally-inspired policy – is to guarantee sound resources to those countries that need them most, in line with the solidarity principle. We suggest that a parameter of distribution taking into account the fair reward of the most important and the neediest economies may include (alone, or as a part of a more complex weighting scheme) *national* investment-to-national GDP (I/GDP) share; this would be more consistent with the spirit of the proposal and actually fairer, because countries will be granted resources in proportion to their 'capability' to invest. Countries with a lower I/GDP ratio will be receiving higher shares of resources, if one assumes that a lower national I/GPD share measures a country's 'difficulty' to engage in capital investments.[XVIII]

4.3.3. Contravening the ECB mandate

The political independence of the ECB is affirmed twice in the TFEU. Firstly, it is affirmed by the explicit prohibition on conducting any type of credit facility in favour of (art. 123) and to seek or take instructions from (art. 130) any political institution or body at any level, thus eliminating any risk of direct financing of public sector deficit. Secondly, it is guaranteed by the establishment of a primary single mandate of price stability, without any connection to budgetary policy (art. 127). These premises derive from considering monetary policy as a *technical* function, where inflation is the only variable that a central bank can fix since, in the long run, money is neutral for the real economy (Micossi, 2015). However, the crisis and the following period of recession have stressed the importance of endowing monetary policy with the capacity to also fulfil a *political* function, especially given the reluctant reactions of national governments that called for more resolute action by the central bank. Indeed, this was acknowledged with interventions in the sovereign bonds market in 2010 with the Securities Market Programme (SMP) and in 2012 with the OMT, both directed to intervene in order to lower the spreads on bonds. With the OMT announcement, the ECB, ready to buy unlimited amount of sovereign bonds in the secondary market, *de facto* sets itself as a lender of last resort for the EZ.

In ascertaining whether our proposal could contravene the Treaties, we refer to a recent judgment by the European Court of Justice (ECJ) on the OMT programme. In 2014 the legality of the OMT programme was questioned by the Federal Constitutional Court of Germany (*Bundesverfassungsgericht*), claiming that OMT exceeds the ECB's monetary policy mandate and asking the European Court of Justice (ECJ) to strike down the measures as *ultra vires*. The ECJ roundly rejected this view, asserting once and for all the principle of the supremacy of EU law (Fabbrini, 2015). In considering whether the ECB violated the prohibition on direct financing (art.123 and art.130), the ECJ maintained that the OMT programme fell within the scope of the ECB. In more detail, the ECJ, in an historical interpretation of the Treaties, acknowledged that 'it is apparent from the preparatory work relating to the Treaty of Maastricht that the aim of Article 123 TFEU is to encourage Member States to follow a sound budgetary policy' (ECJ, 2015). Thus, the features of the OMT 'exclude the possibility of that programme being considered of such a kind as to lessen the impetus of the Member States to follow a sound budgetary policy' (ECJ, 2015). The fact that OMT intervention is accompanied by the condition that a country concerned has to sign up to a memorandum of understanding on adjustment measures 'precludes the possibility of a programme […] acting as an incentive to those States to dispense with fiscal consolidation' (ECJ, 2015).

By analogy, our proposal could be judged the same way as OMT when considering the ECJ's interpretation of art.123. Since ECB purchases are directed to newly issued EIB bonds supporting real investment, there would be no incentives for member states to elude fiscal consolidation. On the contrary, while national governments would remain responsible for their respective national debt, European institutions would embark on a programme that, if anything, will put a virtuous cycle in place where an increase in growth will reduce the burden of fiscal consolidation. The debt originally issued by EIB is bought and kept by the ECB. What governments receive from the EIB is a grant on which they have to pay an interest flow, which will eventually return. In principle, member states are indebted to the ECB but, in practice, this debt is not relevant as the ECB can always finance its debt with zero cost money base (Watt, 2015). The only side effect would be inflation which – as discussed before – is the aim of the programme (as a consequence of economic growth).

5. Conclusions

The outlook of the EZ economy, eight years after the beginning of the economic crisis and after five years of macroeconomic consolidation, looks quite gloomy. The story of the crisis however is not a boring one; the highest expectations from expansionary fiscal contraction policies turned into a depressive incapacity to restart growth and boost aggregate demand. The binding constraints on the actions of the monetary authority led to sympathizing with unconventional policies. Intervening in what is the real European moral hazard – the one between the few institutions that try to maximize European welfare and national governments slow to engage in reforms and cessions of sovereignty – the ECB has launched its QE and the EC has started its Investment Plan.

Despite such institutional innovations, not much has changed yet. The EZ has a unique, single monetary policy, while fiscal policy remains fragmented at national level. In the short run, the proposal outlined in this paper fills the structural gap between the monetary and fiscal dimensions of European economic policy. In the long run, instead, it builds the basis of a true Euro Treasury endowed with fiscal capacity.

In the paper we have discussed the feasibility and the limits of the proposal. Many of the potential critiques can be easily overcome. In particular, risks of accelerating inflation, fears of fiscal transfers and concerns on the financial sustainability of the proposal and on its legal standing with respect to the contents of the treaties do not hold up after an in-depth analysis.

In addition to that, the current situation offsets any possible fear regarding unintended effects of the proposed policy. The prospects for the EZ economy – given the evolution of the main macro prices and of inflation expectations – and for the world economy – with the end of the BRICS dream and the slowdown in Chinese growth – call for direct intervention by the public sphere to lift economic activities from a situation of stagnation and recession. Cracks are already appearing in the current model of salary cap and push towards export activities – well represented by Germany – while coordination failures put at risk the entire European construction.

Our proposal does not represent a new model per se, but a contribution to the establishment of a fully-fledged European fiscal policy. Many issues remain to be explored, for example the targeting of resources for investments on sectors/projects with high expected multiplier effects. In any case, as often happens in European integration, it is only as a result of temporary dis-equilibria that new policies and powers are invented and assigned at the supranational level of government. By giving a new scope to QE, we hope to have contributed to a new disequilibrium.

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[I] Contractual arrangements are a conditional aid policy to be agreed between the individual EZ countries and the European Commission (EC), in which the member states would commit to various structural reforms while receiving financial support; they are embedded in the European Semester and serve to implement the Country Specific Recommendations, mainly in case of a Macroeconomic Imbalances Procedure; their rationale is that if all EZ members develop reforms, a convergence process within the euro area will follow. The European unemployment insurance scheme is an absorption mechanism involving unemployment subsidies and transfers between member states.

[II] 'North' countries are Belgium, Germany, Ireland, Finland, Luxembourg, Netherlands, Austria. 'South' countries are Greece, Spain, France, Italy, Cyprus, Malta, Portugal; 'East' countries are Slovenia, Slovakia, Latvia, Lithuania, Estonia.

[III] The reduction of interest rate on government bonds produced by purchases by the central bank increases returns on other assets. This should stimulate investors towards riskier assets linked to the real economy (portfolio effect) and should induce households holding assets with increased value to consume more (wealth effect).

[IV] See Gros et al., 2015 for a comparison and for a description of the type and size of the interventions

[V] See Baldwin (2016) for a review. The idea has been touched upon even by European policy makers, not least Mario Draghi, although he considers direct printing and distribution of money to citizens a measure too difficult to be implemented.

[VI] Of course, the different monetary approach between the ECB and the Federal Reserve is explained by the nature of the mandate of the two institutions, where only the Federal Reserve has been endowed with a 'dual mandate' that comprises the pursuit of price stability and full employment.

[VII] These provisions include, in particular, the prohibition of monetary financing by the central bank (art. 123 of TFUE), the prohibition on privileged access by public institutions or governments to financial institutions (art. 124), the 'no-bailout' clause (art. 125), the fiscal provisions for avoiding excessive government deficits (art. 126).

[VIII] Lavoie (2015) also stresses that art. 123 of the TFUE mentioned by the German Federal Constitutional Court to oppose the OMT programme has no reference at all to secondary market purchases. This makes a 'constitutional challenge' hard to see, where the OMT is a purchasing programme of government securities on the secondary market for EZ countries after precise conditions set by the ECB have been accepted.

[IX] To be eligible a bond must i) have a remaining maturity of 2 to 30 years, ii) be denominated in euro, iii) be eligible as collateral for ECB monetary policy operations, iv) yield more than the deposit rate (-0.4% in March 2016).

[X] Under deflation, like in Japan, real debt increases and this encourages the government to resume more fiscal consolidation, reducing the possibilities to resort to a mixed (not only monetary, but also fiscal) policy response.

[XI] This clause has been imposed to prevent the ECB from having a block minority in a debt restructuring involving collective action clauses, applied to the procedure for restructuring public debt. This means that the ECB does not want to be in a position in which it has the power to block a potential vote on the restructuring of debt of EZ countries, because not blocking such a procedure could be considered as a monetary financing of a EZ country, since the ECB will not recover the money used to buy bonds.

[XII] The total amount of EZ sovereign debts purchased between March 2015 and September 2016 will be € 799.71 billion, significantly less than the potential € 836 billion that the ECB could have bought without predefined limits (Claeys et al., 2015).

[XIII] As a result of the economic crisis, investments have decreased in most European countries, down by as much as 20% between 2008 and 2009 and, after briefly stabilising in 2010, reduced by another 6% in the period 2011-2013. However, this situation has been going on for far longer; over the last thirty years, both private and public investment has shown a disturbing trend. Calculating the estimated trend of total investments in the EZ in the period 1970-2014 at 2014 prices, there can currently be seen a difference of about €260 billion (Claeys et al., 2014).

XIV Bulgaria, Germany, Spain, France, Italy, Luxembourg, Poland, Slovakia and the United Kingdom.

XV Recently the French and German governors of central banks jointly proposed a Euro Treasury, under the control of the European Parliament (Weidmann and Villeroy de Galhau, 2016).

XVI Regulation (EU) 2015/1017 of the European Parliament and of the Council of 25 June 2015 on the European Fund for Strategic Investments, the European Investment Advisory Hub and the European Investment Project Portal and amending Regulations (EU) No 1291/2013 and (EU) No 1316/2013 - the European Fund for Strategic Investments.

XVII The capital keys reflect the respective country's share in the total population and GDP of the European Union.

XVIII The criteria suggested above will fraction the financial resources collected by the EIB in a quite even manner, given that the distribution of national shares of investment on GDP is not very much dispersed. If this allocation rule is considered not fully able to satisfy the need for a fair reward of bigger contributors to the EZ economy and to ECB equity, more complex allocation criteria can be created combining different indices, the investment gap included (calculations are available on request from the authors). However, for the scope of our paper, what matters is that the distribution of the funds obtained from the implementation of our proposal has to respect the needs of the member states that contribute the most and of those that need the most.

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