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Why Would Eurozone Need an Own Budget?

- It is needed to re-think and redesign fiscal stabilization mechanisms in the Eurozone. Individual member states fail to run successful stabilization policies themselves. Fiscal stabilization tools have to be organized at supranational level in monetary union.
- The budget of the European Union is not big enough (robust) to perform stabilization function (just 1 % of EU GNI). Eurozone budget has not been established yet.
- Eurozone established stabilization mechanism – outside the EU budgetary framework and the EU Treaties.
- Policy paper proposes Eurozone unemployment scheme that would form a milestone of the future Eurozone budget.
- It is necessary to ensure that proposed system will not establish any permanent transfers from net contributors to net gainers of the proposed scheme.

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Why would the Eurozone need an own budget?

Common monetary policy of the EMU does not fit specific needs of all member countries (no "one size fits all policy"). EU budget is too small to provide a stabilization function and not flexible enough. Therefore, the only tool left to fight asymmetric shocks is national fiscal policies. Economic shock leads to increased deficits of national budget that could further endanger the country in terms of higher interest rate on debt service.

Currently, the budget of the EU is clearly insufficient and unable to deal with asymmetric shocks mainly due to its small size, rigid planning and completely different focus.

As a response to the recent economic crisis, ad-hoc stabilization mechanisms out of the scope of the EU treaties have been developed and financial aid from such mechanisms has been triggered for the member states in need.

Aim of the proposed Eurozone budget is to partly decrease a burden borne by the member states when encountering a negative asymmetric shock and provide temporary transfers to help country decrease impact of the shock on national budgets.

How to finance Eurozone budget?

In our proposal, the stabilization function would be performed by means of the Eurozone unemployment scheme. The reason behind this is that unemployment is one of the basic and easy-to-measure indicators of deviation of the economy from long-term equilibrium. In other words, Eurozone budget would practically have a function of common unemployment scheme for Eurozone. It means that Eurozone citizens (since Maastricht Treaty, each citizen of one of the EU member states is also a citizen of the EU) would pay a common Eurozone payroll tax into the budget. In case a Eurozone citizen got unemployed, he or she would receive unemployment benefits from a Eurozone budget for a limited period (according to the suggestions of authors for 4 months). By collecting payroll taxes and paying unemployment benefits, the budget would ensure transfers from member states that are not severely hit by the crisis to states with bigger economic downturn. The unemployment scheme is not meant to fully replace the existing national unemployment schemes.

Proposed scheme should just partly decrease the burden of unemployment support paid out by the member states. From this reason, the unemployment benefits would be set up only for a limited period and unemployed people with exactly defined profiles.

Arguments for Eurozone budget

In the following section, arguments for Eurozone budget are summarized.

1. *Missing stabilization function on a European level.*

Recent economic crisis proved that European budgetary structures have not been designed to perform a stabilization function. Eurozone was therefore not prepared to help member countries adjust to asymmetric shocks in the early stage of the crisis. This issue was addressed by Eurozone crisis management actions through creating stabilization mechanisms that did not have a form of a budget (EFSM, EFSF, ESM, and redemption fund – one pillar of banking union). The above-mentioned development reveals a need to re-think and redesign fiscal stabilization mechanisms in the Eurozone since individual member states fail to run successful stabilization policies. *Furthermore, unemployment levels in southern Eurozone countries rose dramatically during the crisis to levels that are not sustainable in the long-run and this problem has to be addressed urgently. Permanent insurance mechanism at supranational level has to be designed as soon as possible.* [1], [2], [3], [4]

2. *EU budget is not the federal one.*

All federations and at the same time monetary unions depicted in Figure 1 have substantially bigger federal spending than the European Union where only 2 % of public spending is done on a supranational level. Ratios in analyzed federations reach from 35 % in Canada to 67 % in Germany of total social security spending.

Figure 2 shows a share of regional and federal budgets on spending on social welfare. In the US and Canada, social welfare is predominantly financed from federal budgets. On the other hand, in case of the EU it is entirely financed from the national budgets. [6]

Furthermore, the design of the EU budget is too rigid to perform a stabilization function. The budget is planned for a period of 7 years in advance. Deficits are not allowed. In other words, current EU budget is not flexible at all and flexibility is one of the characteristics a budget performing stabilization function should have. Asymmetric economic shocks are hard to estimate in advance and therefore a budget with fixed financial ceilings for a period of seven years would hardly perform stabilization function in case of big and/or unexpected asymmetric shocks like Eurozone crisis.

3. *Central Fiscal Authority – Eurozone Ministry of Finance is missing.*

Paul de Grauwe stated that "Eurozone without a common budget is like a house without a roof". [7] In order to bring stability into the Eurozone, a central authority that is able to collect taxes and use financial resources for spending in the scope of the whole union should be established (so called "Eurozone Treasury" or "Federal ministry of finance"). [7], [8]

In contrast to above-mentioned central authority, ESM provides support by means of a financial help to Eurozone member states that are hit by substantial financial problems. The ESM is able to collect funds by two ways. They can either issue financial instruments or conclude agreements with its members, financial institutions and/or other third parties. The ESM can provide loans to countries in need, buy member state bonds on both primary and secondary markets and engage in financing recapitalizations of financial institutions.

> Proposed unemployment scheme has potential to decrease a burden borne by the member states when encountering a negative asymmetric shock and provide temporary transfers to help country decrease impact of the shock on public budgets.

Figure 1: Breakdown of public spending on social security by level of government in 2010.
Source: [5].

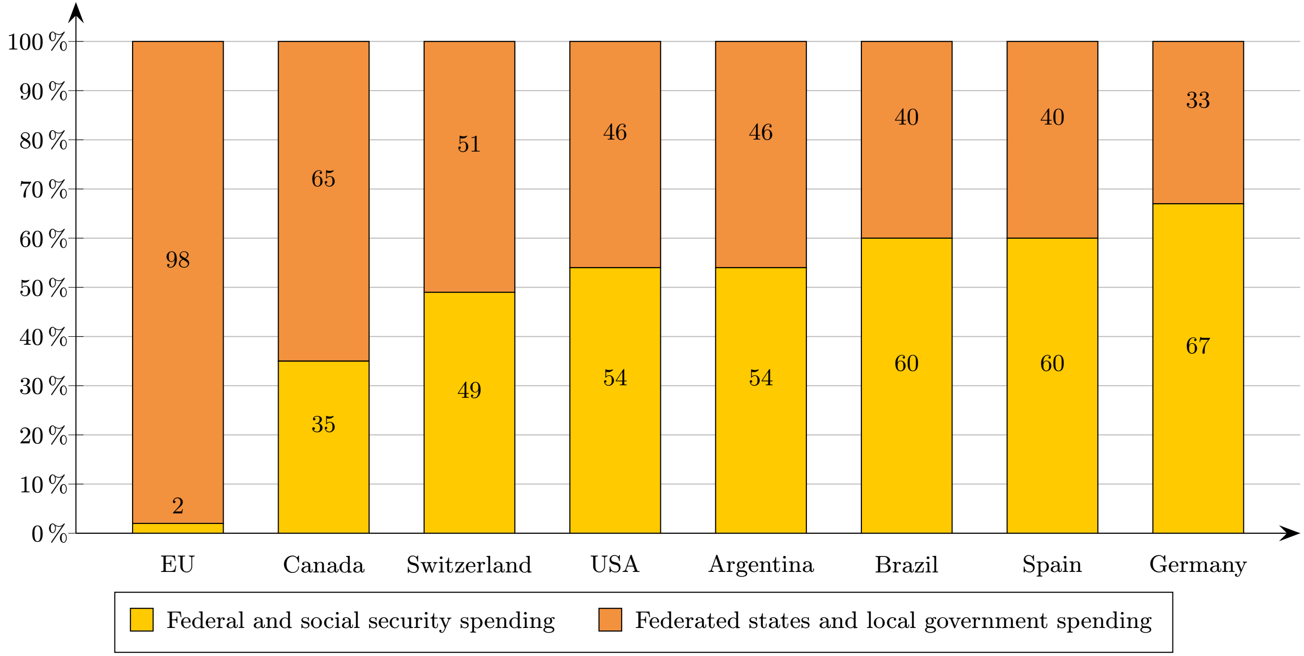
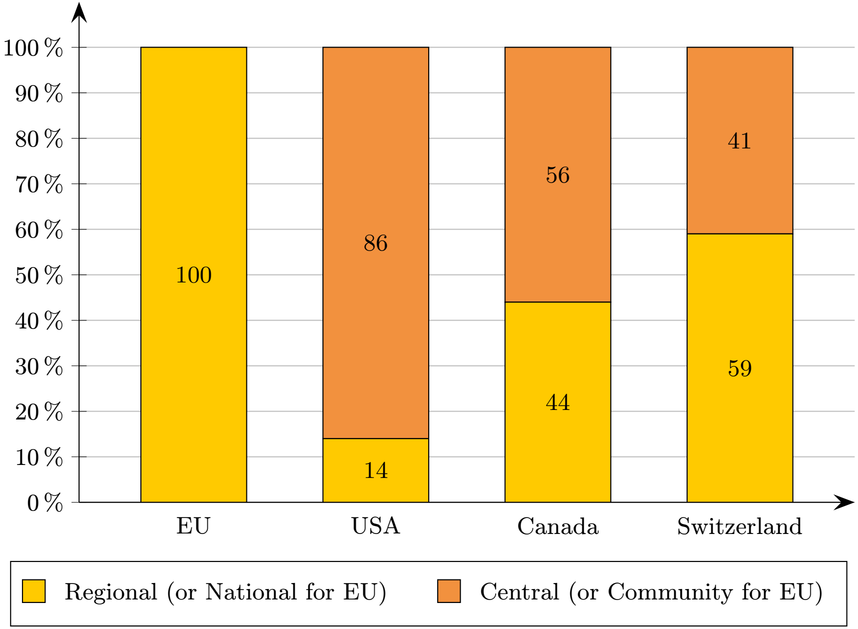


Figure 2: Distribution of spending for social welfare
in 2008 as a % of total public spending.
Source: Eurostat, OECD, [6].



Arguments against Eurozone budget

In this part, authors state most significant arguments against the Eurozone budget and common Eurozone unemployment scheme.

1. *Large differences among national unemployment schemes.*

   One of the biggest obstacle in creating the common unemployment scheme are the large differences among unemployment schemes in individual member states. National schemes differ substantially in all characteristics such as size of the scheme relative to GDP as it can be seen in Figure 3, duration of unemployment support, replacement rate etc. Given these facts, it would be very difficult to agree upon a common characteristics of the Eurozone unemployment scheme and its relation to the national ones. Due to the large differences in national systems, no attempt has been made in the past to reach a level of harmonization in this field and therefore it is probable than no consensus on the Eurozone scheme would be reached. [9]

2. *Net gainers versus net contributors of Eurozone budget.*

   Figure 4 shows the net gainers and net contributors of the Eurozone unemployment scheme. Negative values in the figure mean that given member state collects more money from the payroll tax then amount of money needed for unemployment benefits. These countries can be called net contributors to the Eurozone unemployment scheme. By analogy, the positive values in Figure 4 mean that the country consumes more money for unemployment benefits than amount of money collected by the payroll tax. The model is done based on the 2012 data.

   It can be seen that many Eurozone countries (Slovakia, Malta, Luxembourg, Latvia, Italy etc.) do not have a substantial positive or negative balance in the unemployment scheme. On the other hand, Germany and Spain have the most unbalanced figures, Germany being the biggest net contributor with 23.6 billion EUR and Spain being the biggest net gainer with 26.4 billion EUR.

   Another important fact to be mentioned is that all countries except Italy often called PIIGS (Portugal, Ireland, Italy, Greece, and Spain) are practically the only net gainers of the unemployment scheme. This is also a proof that unemployment scheme designed in this working paper is in fact able to decrease the costs and deficits of member states that are severely hit by an economic crisis and effectively transfer financial resources from countries not suffering so much from the crisis to countries that are really badly affected by an economic downturn.

3. *Eurozone versus EU budget.*

   Third argument against Eurozone budget is that the stabilization function and unemployment scheme could be embedded into the existing budget of the EU. In such a case, it would be probably easier and quicker to adjust some part of the EU budget than establishing an entirely new budget of the Eurozone. One fund of the EU budget already plays role when it comes to labor market, namely European Social Fund (ESF). The ESF represents more than 10 % of the total EU budget (approximately 0.1 % of the EU GDP). The ESF supports a number of actions to enhance access to employment and might be therefore adjusted to work as a common unemployment scheme. However, due to its small size and characteristics of the EU budget described above, authors are convinced that this fund would not be able to work as a necessary stabilizer against asymmetric shocks. [9] There is also so called globalization fund with limited stabilization power.

4. *Permanent transfers and moral hazard.*

   Last but not least, permanent transfers and moral hazard belong to arguments against the Eurozone budget as well. This issue can be resolved by precise design of the unemployment scheme that would disable moral hazard and decrease permanent transfers. In other words, net balances of member states should be monitored and relevant measures triggered accordingly.

Figure 3: Unemployment support as % of GDP (average for years 2005–2011).
Source: [9], Eurostat.

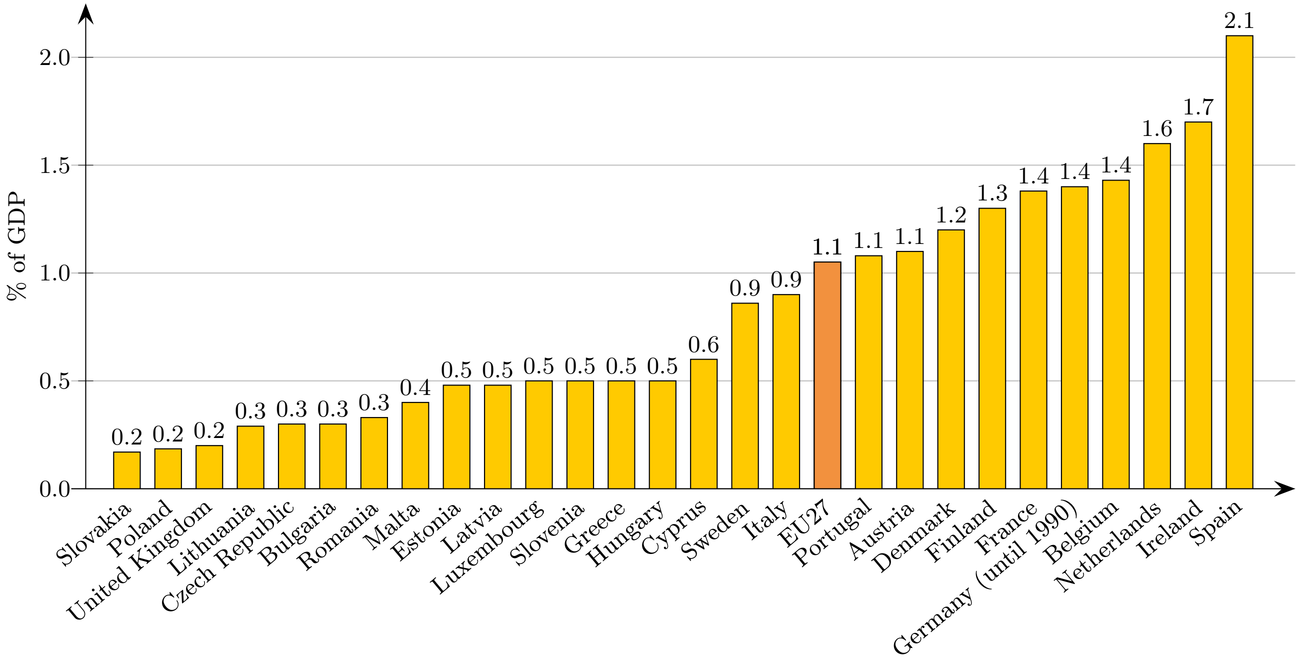
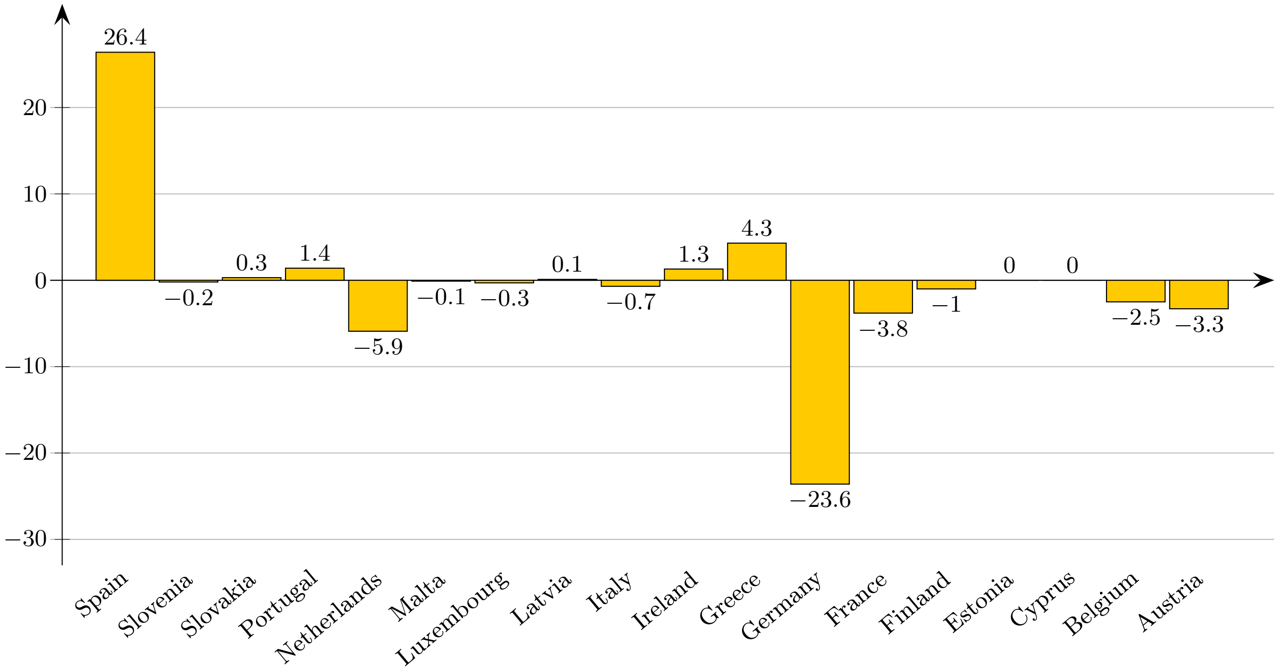


Figure 4: Difference between unemployment benefits received and payroll tax paid per member state in EUR billions. *Source:* own elaboration.



How to make Eurozone budget politically acceptable?

> The issue of political acceptability is crucial step in making the Eurozone budget a reality.

In order to make the Eurozone budget as politically acceptable as possible, the authors suggest following characteristics of the budget:

1. *The size of the budget should be as small as possible but still with potential of providing stabilization function.* It is clear that a fully federal type of budget would not be politically acceptable for national representatives since it would mean transferring substantial fiscal powers from national onto the European level. According to the MacDougall report, the size of the common federal budget should be at least 2 % of the GDP in order to be able to play some role in the stabilization policy. In comparison to fully functioning federations as United States and Germany where the size of public expenditures on the community level were around 25 % of the GDP, it is obvious that common European budget with size of just 2 % of GDP could not fully and solely perform stabilization function itself and should be accompanied by stabilization functions of the national budgets. The report suggests that the largest component of the budget would be used for equalization mechanisms between the weaker member states and richer member states and there would be mechanism for supporting fight against unemployment. For the sake of this mechanism, EU support of lagging EU regions could be decreased. [9], [10], [11]

2. As it was already stated above, the budget is not going to replace the national unemployment schemes. It is going to provide unemployment support for a limited period to help the member states in crisis carry part of the costs connected with an increasing unemployment. This characteristic should also make the Eurozone budget more acceptable since the member state will not feel like losing their own unemployment schemes. *The intended Eurozone unemployment scheme would absorb just unemployment that is higher than long-term average so that it would decrease the burden on a member states at the beginning of the crisis when the unemployment rises and terminate when the economy returns to the long-term trend.*

3. *Design of a Eurozone budget should prohibit permanent and long-term transfers from net contributors of the Eu-*

rozone unemployment scheme to net gainers of such scheme. Eurozone is not a fully integrated federation, the German voters would not appreciate permanent transfers for example from Germany to Spain, and therefore they would make the Eurozone budget politically unacceptable. This issue can be resolved by following precautions. Net balances of the unemployment scheme would be monitored and certain ceilings for both positive and negative balance would be defined. Once such ceiling would be reached, the contribution of the particular member state would be increased in case of a negative ceiling and decreased in case of a positive ceiling. This would ensure an ongoing balancing mechanism of the scheme so that member states would become neither an extreme gainers, nor extreme contributors. The support from the Eurozone scheme would be provided only if the member state realized reforms of labor market and supported the labor mobility. [12]

4. Last but not least, *benefits of common Eurozone unemployment scheme should be duly explained to Eurozone citizens* so that they understand what common Eurozone unemployment scheme is good for and why the financial transfers from one member state to another exist. Such scheme decreases political instability in the states affected by the crisis, prevents member states from high debts and also prevents the spillover effect of the crisis into the rest of Eurozone.

Policy recommendation

Proposed unemployment scheme (a milestone for future Eurozone budget) is a better framework for the stabilization function than the EU budget since the member states are bound by one currency, do not dispose of their own monetary and exchange rate policies and therefore share a similar need of a stabilization function at supranational level to be able to cope with asymmetric shocks. In addition, member states have limited possibilities of their fiscal policies since they are bound by rules of Stability and growth pact, Six pack, Two pack etc. that require primary surpluses of the national budgets.

The necessary steps for implementation of the Eurozone unemployment scheme are following.

- *The member states have to agree on the characteristics of the scheme such as replacement rate, duration of unemployment support, eligibility criteria and relation of Eurozone unemployment scheme to the national schemes. Based on the relation with national schemes, the revenues would be realized either by a separate payroll tax or by a contribution from the existing national schemes. Our proposal suggests replacement rate of 60 % of their wage, duration of up to 4 months maximum and eligibility of all employees who are registered at an unemployment office. Based on the defined criteria, the payroll tax rate should be defined in order to ensure a balanced unemployment scheme.*
- The authors are convinced that political representation of the Eurozone member states would be able to agree on a minimal size of the Eurozone unemployment scheme that would be able to perform stabilization function against asymmetric shocks.
- The proposed scheme could become a milestone for the real federal budget of the whole EU.
- Finally, the Eurozone budget should be made for all Euro countries plus all countries with fixed Euro exchange rate and countries that are in the process of preparation for Euro acceptance. In order to fight substantial and wide economic shocks and stabilize the economy, Eurozone should be able to borrow money on the capital markets. However, a possible misuse of federal financing could lead to increasing federal debt without any boundaries and problem of misusing. From this reason, strict limits on federal borrowing should be introduced. *One possibility to do this is to impose a rule of structural balanced budget or to establish an independent institution controlling the new budget and federal borrowing: Federal Ministry of Finance.* [9]

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Vignette
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Think tank – Mendel European Centre
About the Project: Objectives and Mission

Foundation of Think tank – Mendel European Centre has a direct link to realisation of the European Commison project Jean Monnet Centre of Excellence at Mendel University in Brno, Czech Republic. The main objective of the think tank is to contribute to the discussion about advantages and disadvantages of membership in EU and Eurozone. Activities of the think tank also provide suggestions for futher process of deepening of integration towards fiscal and political union.

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