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Blueprint for the European Fiscal Union: State of knowledge and Challenges

Amélie BARBIER-GAUCHARD[1]

Summary :
Almost 30 years after the launch of the European Economic and Monetary Union (EMU) project in the Maastricht Treaty (1992), budgetary and fiscal union now appears to be the next milestone for the European integration process. In other words, what kind of European Fiscal Union project should decision-makers spearhead? This paper proposes to define precisely what fiscal integration consists of and to draw up a survey of the fiscal federalism theory. The next step is to compare the different possible models of fiscal federalism that exist in practice in the world, and then identify the threats and challenges for the European model in order to be able to describe the main features the future European fiscal union will have to check. Thus, it would be desirable for the future European fiscal union to be characterized by a substantial transfer of "allocative" public spending, particularly in the area of support for growth and employment, and in the area of external relations, by the creation of a fiscal capacity for the euro zone allowing the introduction of automatic European budgetary stabilizers and to replace the current rule of fiscal discipline by a rule that is smarter and more credible in terms of sanctions.

Keywords : fiscal union, fiscal federalism, monetary union, European integration

JEL classification : E 62, E 63, H11, H61, H62, H 77

Almost 30 years after the launch of the European Economic and Monetary Union (EMU) project in the Maastricht Treaty (1992), budgetary and fiscal union now appears to be the next milestone for the European integration process. Since the end of the 2000s, the various recent crises that have shaken the economies of European Union (EU) (2008 financial crisis, 2009 debt crisis, the Great Recession that followed, COVID-19 pandemic crisis since the beginning of 2020) have revealed the limits and weaknesses of the European economic model as it stands.

What should be the future for the EU and EMU? This question covers different dimensions in addition to the economic, budgetary, fiscal and financial dimensions, there is also the political dimension to consider[2]. This paper focuses exclusively on European budgetary and fiscal integration by analyzing what might be the future European Fiscal Union (EFU) which could be entrusted to a European Central Government (ECG) of the EU (the budgetary and fiscal counterpart of the ECB for monetary policy in the EMU).

From the fiscal integration point of view, at a time when there are more and more proposals for a budget for the EU and the euro zone, the first question to ask is: what do the EU and EMU really need? In other words, what is really missing to complete the economic governance of the

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[2] For political economy concerns, see, for instance, Fidrmuc (2013).

EU and the euro area? More generally, the question asked is: What kind of fiscal union project should decision-makers spearhead ?

To answer this question, this paper proposes a five-step approach: it is first necessary to define precisely what fiscal integration consists of (section 1) and to draw up a survey of the fiscal federalism theory (section 2). The next step is to compare the different possible models of fiscal federalism that exist in practice in the world (section 3), and then identify the threats and challenges for the European model (section 4) in order to be able to describe the main features the future European fiscal union will have to check (section 5).

Section 1 - Fiscal union and fiscal federalism in a nutshell

Fiscal integration is one of the stages of economic integration. Economic integration is indeed a multiple dimensions process (commercial, monetary, banking, financial, fiscal, budgetary, etc.) where the partners (regions, countries …) are closely linked. While commercial integration or even monetary integration are widely known processes, fiscal integration remains largely unknown. For instance, among the stages of commercial integration, different stages of free trade area step differ from customs union step, the latter being the most complete form of commercial integration. In the same vein, for monetary integration, different stages of integration also exist like the peg of currencies, and the most complete stage of monetary integration takes the form of monetary union with a single currency for all partners of the integrated economic zone and a single central bank which decides monetary policy for all member countries. But what about fiscal integration? Fiscal integration takes place initially in an integrated economic zone where different levels of public power coexist, as is the case with monetary integration. As highlighted by the table below, these different forms of fiscal integration differ in the number of fiscal power levels, their degree of autonomy and the intensity of financial transfers between these different levels (whether horizontally or vertically).

Table - Different steps of fiscal integration

	Stage 0	Stage 1	Stage 2	Stage 3
Kind of fiscal integration	No coordination	Coordination	Fiscal federalism/ Fiscal union	Total centralization
number of fiscal power levels	sub-central levels only	sub-central levels only	a central level and sub-central levels	a central level only
Intensity of fiscal functions sharing with the central level	Not applicable	Not applicable	Low/High	Not applicable
Degree of autonomy	Complete	Constrained	Constrained	Not applicable
Intensity of financial transfers	Not applicable	Not applicable	Low/High	Not applicable

Source : Author

The initial situation is characterized by total decentralization of fiscal policy where there are only national fiscal policies in the hands of the member-country governments of the integrated zone. These countries are free to implement the fiscal policy they wish, regardless of the policies pursued by neighboring countries and the spillover effects their policy may cause in other countries. This situation is therefore characterized by no coordination of the fiscal policies conducted. In this framework, there is no central fiscal power and no financial transfers between national governments, or between national governments and central government.

The first step in fiscal integration consists of the fiscal policies coordination. In this context, fiscal power is always in the hands of national governments, but in a coordinated manner between national governments, or even between national governments and monetary policy (policy mix). Coordinating economic policies means determining ones optimal policy, taking into account other economic policy actors in the integrated zone. Free rider and moral hazard problems may appear. This stage of fiscal integration could not be a long term option. In opposition to this, total centralization of fiscal policy leads to removing fiscal power to national governments in favor of a single central government. In the same logic as monetary policy, a single central fiscal policy, defined for the entire zone, is led by a single central government.

Fiscal federalism appears at an intermediate level, most often in a political federation[3]. More commonly, fiscal federalism refers to fiscal union. Thus, fiscal federalism can be defined as a particular mode of public finance organization in which there are different levels of fiscal power which share fiscal functions. In this system, the lower levels of power (sub-central levels) benefit from some degree of autonomy and are linked by financial transfers determined at the highest level of fiscal power (central level). Fiscal discipline rules are introduced at sub-central and central level. In this case, there is multi-level governance of public finance. The following box summarizes the main features of fiscal federalism. In this context, the EU already appears as a *de facto* fiscal federation, as will be described in more detail latter.

Box – Main features of fiscal federalism/fiscal union

Kind of public finance organization in an integrated zone characterized by :
- different levels of fiscal power which share fiscal functions
- lower levels of power (sub-central levels) benefit from a certain degree of autonomy
- the lower levels of power (sub-central levels) are linked to each other by horizontal and/or vertical financial transfers
- Fiscal discipline rules are introduced at sub-central and central level.

Source : Author

Section 2 - Main lessons from the fiscal federalism theory

[3] Federalism is a particularly widespread form of political organization. Among the federal states that currently exist are the most powerful and largest States (such as the United States, Russia, India, Canada, Australia, Brazil and Argentina). However, the federative phenomenon does not only concern the very large States: in Europe, Switzerland and Austria are, with Germany and Belgium, federations. From one country to another, federalism presents very different characteristics. There are practically as many federalisms as there are federal states.

The theory of fiscal federalism attempts to determine an optimal distribution of fiscal functions between the different levels of fiscal power. The question asked is : At what level of power the responsibility for a particular fiscal function should be more efficient ?

This theory was built around the seminal work of Oates (1972) and is closely linked to the definition of fiscal functions of Musgrave (1959). Musgrave identifies three main functions for public finance. The first function is the "allocation" function, which consists in providing public goods and services to citizens (education, health, safety, defence, transport, etc.). The second one is the “redistribution” function which consists in intervening to make the distribution of income between individuals fairer by redistributing income from the richest to the poorest with a view to social justice (especially with unemployment benefit, family allowances, minimum income, etc...). The last one is the “stabilization” function which aims at cushioning the effects of cyclical economic shocks on activity, employment and inflation (through automatic fiscal stabilizers or discretionary stimulus measures). This is the only function performed both by monetary and fiscal policy. These fiscal functions are in reality closely interconnected. However, this typology makes it possible to structure the analysis around the crucial question of the optimal way to share fiscal functions in a framework with several levels of fiscal power (i.e. a federal system).

The central thesis supported by the traditional theory of fiscal federalism is therefore that, in a federal system, it is recommended that the redistribution and stabilization functions be performed at the most centralized level possible (due in particular to the mobility of production factors and of economic agents between sub-central levels and the intensity of externalities between sub-central levels). Conversely, it is better for the allocation function to be performed at a more decentralized level (in order to better take into account citizens’preferences). Nonetheless, for some particular kind of public goods and services whose production offers economies of scale, centralization could be preferred.

Other studies have attempted to introduce strategic interactions between the different fiscal actors, or considered the existence of information asymmetries, still others have studied the case of developing countries. Oates (1999), Boadway (2000) or even Wellish (2000) present the main outlines of these works. However, results remain unchanged. The box below summarizes the main lessons of the fiscal federalism theory, which indicates the criteria to be taken into account in deciding the degree of centralization/decentralization for each fiscal functions. Many subsequent works, reported in a very abundant literature, have focused more on the implementation of each of these fiscal functions rather than on questioning this analytical grid initiated by Oates (1972) as will be detailed below.

Box - Main lessons from the fiscal federalism theory

Fiscal functions	Allocation	Redistribution	Stabilization
Areas of public action / public policies concerned	Provision of public goods and services (education, training, R&D, innovation, competitiveness, health, security, defence, culture, justice, transport networks, energy networks, communication networks, etc.)	Social transfers / social policy	Automatic budget stabilization
Criteria to be considered in choosing the degree of centralization / decentralization	Citizens' preferences Knowledge of the territory Economies of scale Externalities	Production factors mobility	Spillover effects

Source : Author

Section 3 – The various forms of fiscal federalism in practice

Fiscal federalism appears to be a very flexible method of public finance governance. Indeed, significant possible margins as to the degree of centralization / decentralization of fiscal functions targeted by public decision-makers could coexist. Ter-Minassian (1997), Badriott, Fornasini and Vaneecloo (2006), or even more recently Cottarelli and Guerguil (2014) offer an extensive overview of what fiscal federalism could comprise in several countries in the world, although Boadway and Shah (2007) mainly focus on intergovernmental transfers. Bordo, Jonung and Markiewicz (2013) offer a historical perspective of fiscal unions.

Among the features common to all fiscal federations, some of them could be highlighted:

- the size of the federal budget (between 10 and 25% of GDP depending on the federation considered),
- the weight of financial transfers between the central level and the sub-central levels (these transfers can represent more than 20% of the public revenues of the sub-central levels),
- strong federal intervention both in terms of redistribution of wealth between the sub-central levels (power of redistribution which makes it possible to reduce between 10 and 40% of income inequalities) as well as cyclical stabilization of activity and employment within the federation (stabilization power between 15 and 40% of the impact of the regional shock),
- the existence of fiscal discipline rules at the federal level as well as at the sub-central levels, these rules being most often self-imposed by the sub-central levels themselves.

The main difference between fiscal federations lies in the sharing of some fiscal functions between the federal and sub-central levels, both in terms of the degree of centralization and in terms of the nature of the powers attributed to each level of power, as highlighted in particular by Barbier-Gauchard (2014) for United States and Canada and illustrated by the table below. All models of fiscal federalism are therefore possible between highly centralized models (as in the United States) and less centralized models (such as Switzerland or Canada), especially for some fiscal functions. In this analysis, the EU model is simply introduced for comparison's sake, to analyze to what extent this one is or is not far removed from the practice in official fiscal federations. This study reveals some regularities in the allocation of fiscal functions but also the fiscal functions for which different models of task sharing are possible. The United States and Canada were chosen to illustrate the extreme diversity of fiscal federation models. First of all, the first table reveals that the American model of fiscal federalism appears to be an extremely centralized model, unlike the Canadian one: 64% of total public spending is provided at the federal state level in the United States against only 37% in Canada (and only 2% at the EU level).

Some "allocative" public expenditure appears to be highly decentralized everywhere (due in particular to the proximity of citizens' preferences by the more decentralized levels): transport (maintenance spending mainly here), education (however, the case of higher education should be isolated), freedom, security, justice, citizenship. Likewise, other "allocative" public expenditure seem to be largely centralized everywhere (due in particular to economies of scale linked to production on larger scales): R&D, competitivity and innovation, defence, public aid to development, humanitarian aid.

For "redistributive" and "stabilizing" public expenditure, it's much more difficult. Indeed, this kind of public expenditure is mainly found in social public spending, whose allocation to a particular fiscal decision level and the generosity of the system also depends on the social choices made by the country concerned. Moreover, this analysis does not take into account the level of coverage of the social policy applied. In this case, the comparison is extremely delicate and dangerous.

However, for intersectoral and interregional "redistributive" public expenditure, it is possible to highlight few lessons. The regional cohesion policy seems quite strongly centralized in Canada (in the same proportions as in the EU). The United States do not appear because this kind of interregional equalization policy does not exist. For support to fishing and agriculture, these public expenditures are also largely centralized (and the European model appears to be an intermediate model between the American model -more centralized-, and the Canadian one -more decentralized-).

Table - Allocation of total public expenditure by level of administration as a percentage of total public expenditure (2011)

	EUROPEAN UNION		USA*		CANADA**	
	COMMUNITY LEVEL	NATIONAL LEVEL	CENTRALIZED LEVEL	DECENTRALIZED LEVEL	CENTRALIZED LEVEL	DECENTRALIZED LEVEL
Total public expenditure	2	98	63.9	36.1	37.2	62.8
Total public expenditure excluding social protection and health	4	96	51.1	48.9	34.8	65.2

* reference year: 2010 ** reference year: 2009

Table - Allocation of total public expenditure by area of intervention and by level of administration as a percentage of total public expenditure (2011)

	EUROPEAN UNION		USA*		CANADA**	
	COMMUNITY LEVEL	NATIONAL LEVEL	CENTRALIZED LEVEL	DECENTRALIZED LEVEL	CENTRALIZED LEVEL	DECENTRALIZED LEVEL
1a. Competitiveness for growth and employment						
R&D	6.8	93.2	89.6	10.4	85.5	14.5
Energy	7.1	92.9	100	0	na	na
Transport	1	99	24.5	75.5	10.7	89.3
Communication	13.1	86.9	na	na	na	na
Education	0.3	99.7	16.4	83.6	5.9	94.1
Competitiveness and innovation	1.3	98.7	58.3	41.7	41.5	58.5
1b. Cohesion for growth and employment						
Regional cohesion	40.6	59.4	na	na	37.1	62.9
Housing	0	100	87.8	12.2	29.3	70.7
Social protection	0.4	99.6	88.5	11.5	58.2	41.8
Health	0.1	99.9	66.7	33.3	18.3	81.7
2. Conservation and management of natural resources						
Agriculture, fishing and rural development	61.4	38.6	81.4	18.6	41.5	58.5
Environment	0.9	99.1	56.3	43.7	15.5	84.5
3. Freedom security and justice, citizenship and culture						
Freedom security and justice	0.4	99.6	17.1	82.9	55	45
Citizenship and culture	0.2	99.8	18.7	81.3	25.6	74.4
4. External relations						
Defence	0	100	100	0	100	0
Official development assistance	0	100	100	0	100	0
Humanitarian aid	32.5	67.5	100	0	100	0
5. Administration						
Operating expenses	1.6	98.4	40.1	59.9	71.8	28.2
Public debt servicing	0	100	70.2	29.8	40.9	59.1

* reference year: 2010 ** reference year: 2009

Source : Barbier-Gauchard (2014)

Section 4 – Main challenges for the EU and "fiscal trilemma" for the EMU

Understanding the monetary policy in the euro zone is relatively straightforward: there is only one actor who manages the monetary policy, national monetary policies having disappeared in favor of the single monetary policy of the European Central Bank (ECB). The application scope of the monetary policy is clearly delimited to the monetary union to which it applies, the EMU only.

In contrast, analyzing fiscal policy in the EU and in the euro zone is an extremely complex task for at least three reasons: (1) there are more than one fiscal policy actors (local level, national level, institutional triangle at community/central level), (2) some fiscal functions concern the EU as a whole while some others only concern the euro area, (3) the exercise of these fiscal functions could be under constraint if the country belongs to the EMU.

Indeed, the whole originality of the European model lies in the coexistence of different stages of economic integration. Out of the 28 member states of the European Union (which will be down to 27 from December 31th, 2020, when the United Kingdom will have left the EU), only 19 have taken the monetary integration step by integrating the EMU. Out of the 9 EU Member States not belonging to the euro zone: 3 of them are out by choice (this is the case of Denmark, Sweden and the United Kingdom), the 6 others wish to integrate, one day, the monetary union.

Thus, on the one hand, some countries are involved in the monetary union, while others have not taken this step towards economic integration. Therefore, some challenges are specific to the euro area while others concern the EU as a whole. It is in this very particular framework that the reflection on the future European fiscal union should take place.

The EU and the euro zone must maintain a delicate tightrope between the Subsidiarity Principle, challenges at European/Eurozone level, and a tiny community budget without eurozone budget.

In this context, two major challenges for European fiscal integration can be identified as also suggested by Fuest and Peichl (2012) or also Cotarelli (2016):

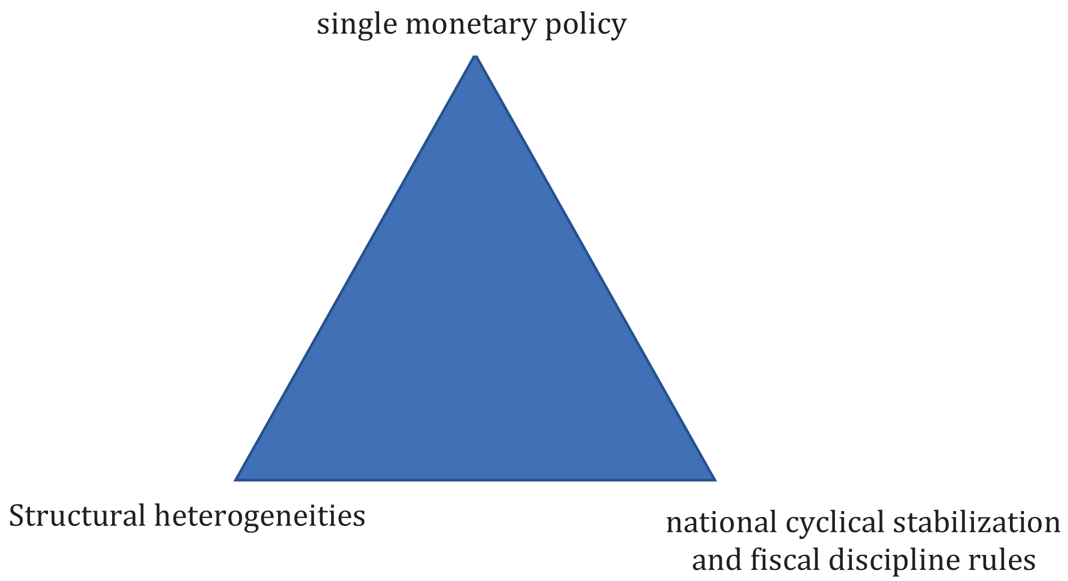
The first challenge concerns the EU as a whole. At the EU level, support for growth and employment suffers from a lack of an ambitious project able to involve positive spillover effects for the European economy, in the spirit of what was started with the Juncker Plan. Indeed, for 20 years now, the EU has been developing official strategies to support growth and employment (the Europe 2020 Strategy succeeded the Lisbon Strategy[4]). These strategies systematically end in failure for lack of financial instruments, without sufficient national policies in this area.

The second challenge relates more specifically to the EMU. At the euro zone level, the monetary union is facing a "fiscal trilemma", in the same spirit as the famous "incompatibility triangle" derived from the Mundell-Fleming model of the 1960's, also known as the "impossible trinity" or the "trilemma". This triangle has been used to argue that it is impossible to reconcile fixed exchange rates, full capital mobility and national autonomy of monetary policy. As illustrated by the figure below, in a non-optimal monetary union, the "fiscal trilemma" could illustrate the incompatibility between having a single monetary policy, structural heterogeneities between countries and only national cyclical stabilization entrusted to Member States limited in their capacity to intervene by fiscal discipline rules. Indeed, the

[4] The Lisbon Strategy (2000-2010) aim to make the EU "the most competitive knowledge economy in the world" was succeeded by the Europe 2020 Strategy (2010-2020) intended to support "smart growth, sustainable and inclusive "in the EU.

monetary union created is far from being an optimal monetary currency area[5] in the spirit of the work initiated by Mundell (1961). The euro zone has partially answered the question of economic stabilization since the ECB is already de facto managing symmetrical shocks. But it is asymmetric shocks (or symmetrical shocks with asymmetric effects) that pose the problem, all the more so in an environment where member countries are structurally very different (in the functioning of their labor and financial markets, etc.) and subject to fiscal discipline rules with undeniable limits. Many studies suggest that the strengthening of fiscal surveillance and fiscal discipline rules have reduced the national capacity to stabilize asymmetric shocks. As such, since the Bohn and Inman (1996) paper, many studies have focused on the effectiveness of fiscal rules in terms of fiscal discipline and on the implementation of national fiscal policies, especially Debrun and alii (2008), Afonso and Hauptmeier (2009, Marneffe and alii (2010),Escolano and alii (2012), De Grauwe and Foresti (2016) or also Caselli and Reynaud (2019).

Figure – Fiscal trilemma in a non optimal currency area



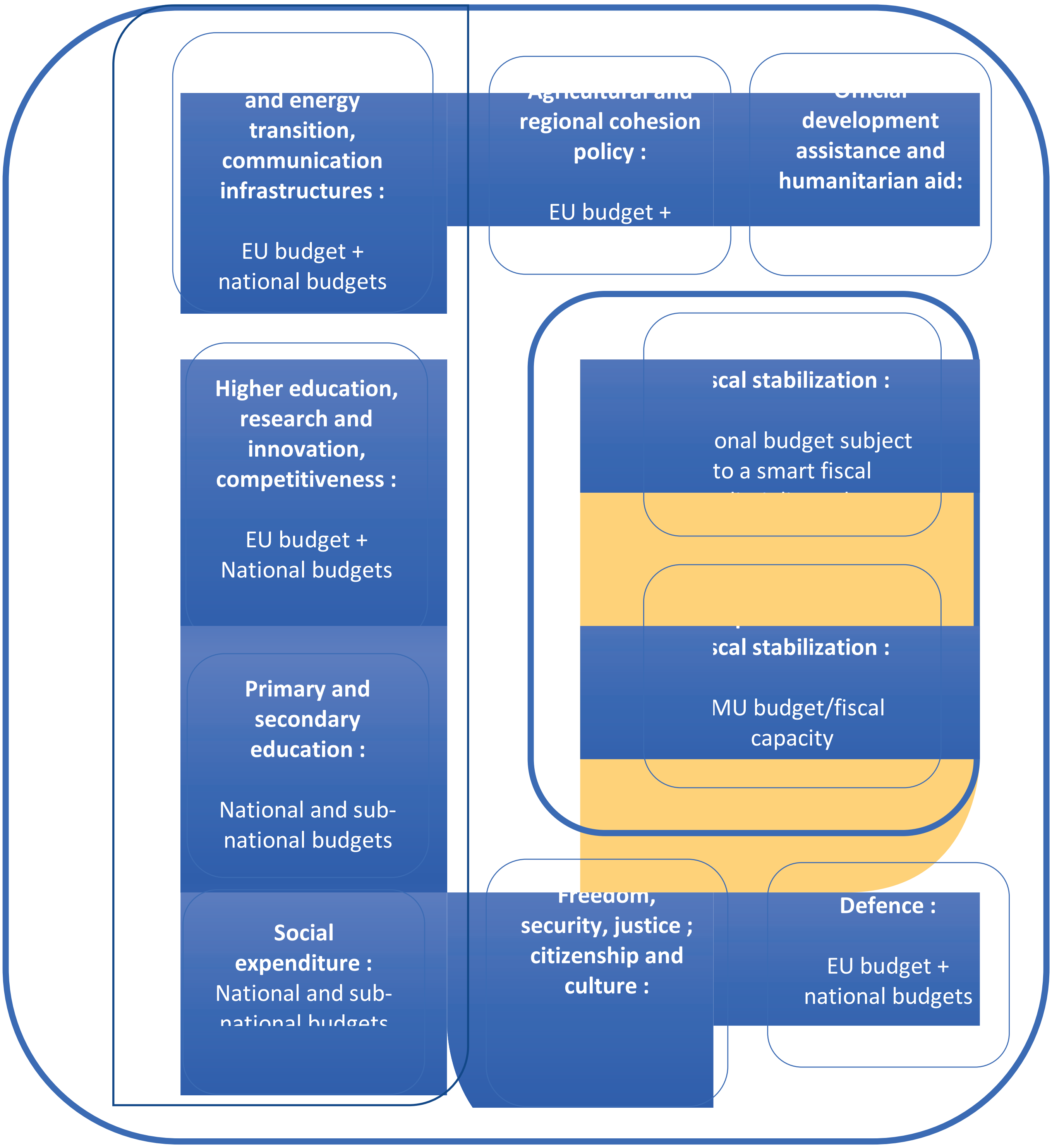
Source : Author

Section 5 - What should the future European Fiscal Union look like ?

In this context, in order to deepen European fiscal integration, to go further, it is first necessary to question the optimal sharing of fiscal functions, drawing inspiration from the lessons of the fiscal federalism theory, from the great diversity of fiscal federation models that exist in practice, without forgetting to take into account the specificities of the European model (especially, no political union and a union of countries with strong structural heterogeneities). The following figure illustrates what could be the design of the future European Fiscal Union.

[5] An optimal currency area is a geographical area within which it is optimal (particularly in terms of cyclical stabilization of shocks) to adopt the same currency. In other words, in this monetary area, the loss of the use of the monetary instrument by the members of this area is compensated by the existence of sufficient alternative mechanisms to take over from the cyclical stabilization (labor and capital mobility, wage flexibility, production specialization, financial integration, fiscal federalism, etc.).

Figure - Illustration of the future European Fiscal Union (EFU)



Source : Barbier-Gauchard, Sidiropoulos, Varoudakis (2018)

More public expenditure to support growth and employment at the EU level

For the EU as a whole, a much more radical transfer of "allocative" fiscal fonctions from the national level to the Community level should be considered in two main fields of public expenditure: support to growth and employment; and external relations. Indeed, several studies analyze the "added value of European spending", as highlighted by Garriga Polledo (2010), Rubio (2011) or Weiss (2013). Thus, for higher education, R&D, competitiveness and innovation, energy transition; but also official development aid, humanitarian aid and defence (in particular for border security) as suggested by Barbier-Gauchard and Bertoncini (2007) or even Barbier-Gauchard and Rubio (2012).

In the field of higher education, research and innovation, Ritzen and Soete (2011) put forward four major measures for a more effective European knowledge policy, paying particular attention to the benefits that could be derived from "smart" specialization between the various levels of budget decision-making. In terms of trans-European energy infrastructure, von Hirschhausen (2011) insists on the challenges of energy policy at the EU level and the huge cost of the energy transition towards renewable energies. In the same spirit, Douillard and Janin (2014) focus on infrastructures in the broad sense, in particular in the field of energy but also transport and communication which they identify as "three target sectors for a European strategy of investment". In the area of defence, Liberti (2011) highlights the obstacles and difficulties which have slowed down further European integration in this sector. In terms of official development assistance, Munoz Galvez (2012) proposes four main avenues for improving the coherence and effectiveness of external aid without, however, placing more strain on public finance.

In other words, to deal with the problems of supporting growth and employment which concern the EU as a whole, a consequent transfer of competences in favor of the Community level would be desirable (thereby reducing the burden of this expenditure to be borne at the national level). In the areas of official development assistance and defence, a partial transfer of skills is also desirable.

To finance these new prerogatives, a reformed VAT resource replacing the existing VAT own resource and / or a EU corporate tax would have the advantage to contribute to a better functioning of the single market, to promote more fairly taxation and to help fight tax fraud or tax evasion, in addition to finance the EU budget as underlined by numerous reports and studies since the beginning of the 2000s, like the European Commission (2004), Lamassoure (2006) and then the High Level Group on Own Resources (2016) and European Commission (2017)[6]. The obligation to ensure sufficient financing of Community expenditure and the need to distribute the burden of this financing equitably between Member States appear historically to be the bone of contention in European negotiations. In addition, the European Investment Bank could also be a significant source of financing through its ability to raise substantial financing from private investors to finance private as well as public investments.

A common fiscal capacity for the EMU

For the Eurozone specifically, a common fiscal capacity for cyclical stabilization at the EMU level and smart fiscal rules at the national level constitute the most effective solution to strengthen the resilience to shocks of the euro area, to internalize fiscal policy spillover effects and to promote a better policy mix. As suggested by Allard and alii (2013), Trichet (2013), Juncker (2015), Bénassy-Quéré and alii (2016), European Commission (2017b) or, more recently, Burriel and alii (2020). As far as the spillover effects of fiscal policies are concerned,

[6] Other resources are also been suggested, like CO2 tax/carbon pricing, tax resulting from the auctioning of emission rights (Inclusion of the EU Emission Trading), motor fuel tax, electricity tax, plastic bag tax, Financial Transaction Tax, Direct debit (Bank levy), Seigniorage receipt

the operation of the various channels of transmission of a national budget shock to foreign economies has been the subject of numerous studies with mixed results, as illustrated by the work of Gros and Hobza (2001), Auerbach and Gorodnichenko (2013), Hebous and Zimmermann (2013) or Belke and Osowski (2016), Attinasi, Lalik, and Vetlov (2017), Barbier-Gauchard and Betti (2020)

Many proposals have been put forward since the seminal report of Mac Dougall (1977) to enable cyclical stabilization mechanisms in the monetary union. In this case, establishing a specific budget for the euro area would stabilize the shocks in addition to the automatic fiscal stabilizers already at work at the national level.

The first generation of work on the fiscal capacity of the euro area provides general principles for the operation of such a mechanism and considers an insurance-transfer scheme between Member States as a mechanism for financial transfers between Member States (frequently referred to as cyclical shock insurance) which would play as an insurance mechanism allowing risk sharing in the EMU. In the first papers on the subject, such a mechanism remains an *ad hoc* scheme with in particular the contributions of van der Ploeg (1991), Majocchi and Rey (1993), Italianer and Vanheukelen (1993), Mélitz and Vori (1993), Hammond and von Hagen (1995) or also Bajo-Rubio and Diaz-Roldan (2003). At the beginning of the 2000s, the analysis was enriched with the introduction of the strategic game between economic policies (monetary and fiscal policy) and the endogenization of the level of cyclical transfer with in particular the work of Dogonowski (1998), Beetsma and Bovenberg (2001), Van Aarle (2001) or Sanguinetti and Tommasi (2004) and Barbier-Gauchard (2005). In the mid-2000s, macroeconomic models based on microeconomics foundations then appears with the work of Evers (2012), Engler and Voigts (2013), Bargain and alii (2013), Hefeker and Neugart (2015), D'Imperio (2015) or also Fahri and Werning (2017). This cyclical transfer mechanism to member countries nevertheless has a certain number of limitations linked to the nature of transfers between governments (financing methods, risk of moral hazard, less efficiency than in the case of direct transfers to economic agents, etc.).

The second generation of work on the fiscal capacity of the euro area considers, on the contrary, an automatic European fiscal automatic stabilization mechanism which could operate through direct transfers to individuals, often considered in the form of European unemployment insurance. Indeed, the most effective tool for fiscal automatic stabilization is unemployment insurance. It means considering a European Unemployment Benefits Scheme (EUBS) or European Unemployment Insurance (EUI) as proposed by the European Parliament (2013), Claeys, Darvas et Wolff (2014), Alcidi et Thirion (2016) or also Beblavy et Lenaerts (2017). In this context, the most realistic solution seems to be that of a common basis for unemployment insurance. Part of the unemployment insurance received by the unemployed would therefore be pooled at the euro zone level, in the form of a common compensation base. This harmonized European unemployment insurance system would partially replace or add to existing national systems. European citizens would be the direct beneficiaries of this insurance. In this case, national mechanisms would be added, depending on the choices made by States in terms of social model.

For a "smart" fiscal rule in the eurozone

The origins of fiscal discipline in the euro area date back to the Maastricht Treaty (1992). This Treaty sets out the steps to be taken and the conditions to be met for a country to be eligible for the single currency. Among these conditions, called "convergence criteria", two criteria relate to public finance stability. Two indicators have been retained: national public debt must not exceed 60% of GDP (threshold set at 60% which corresponds to the average public debt/GDP ratio in the EU-15 at the end of the 90's), national public deficit must not exceed 3% of GDP (threshold set at 3% with reference to the debt dynamic equation which gives the level of public deficit which allows public debt to be stabilized around 60% for a real activity growth rate at 3% and an inflation rate at 2%).

If the candidate country meets all these convergence criteria, it is then allowed to join the euro zone. Any country belonging to the EMU is then subject to a fiscal rule introduced by the Stability and Growth Pact (1996) which came into force on January 1, 1999 with the birth of the euro zone. This fiscal rule could be qualified as the supranational fiscal rule, in contrast to the national fiscal rules also in force in most of the member countries of the euro zone.

The Pact has two complementary objectives: the "stability" of public finance on the one hand, while obliging eurozone countries to pursue sound management of public finance, "economic growth" in the EMU on the other hand, ensuring that national governments have enough leeway to intervene if necessary (more especially if a cyclical shock occurs).To achieve these two complementary objectives, the Pact has two types of instruments: the "dissuasive" arm (public deficit ceiling to be respected, with sanctions provided otherwise and exceptions to the rule in very specific economic circumstances) and the "preventive" arm (multilateral surveillance procedure with "stability programs", multi-annual programs setting fiscal guidelines over 3 years and making it possible to have visibility on public finance for the next 3 years to come to reach budget balance in the medium term).

Despite this fiscal rule, the euro zone experienced several periods of turbulence (first crisis in 2004, Great Recession from 2007 to 2009, Covid 19 crisis since the end of 2019) which constituted so many crises for fiscal discipline in the euro zone. Each time, the fiscal rule was reformed, considering that it was the rule which was imperfect ... These successive reforms led to a stack of indicators to be respected without in-depth reflection on the real reasons for the failures of fiscal discipline in the euro area. Following the reforms of 2005, 2011 and 2013, the fiscal rule in force in the eurozone has turned into a catalogue of indicators to monitor, allowing neither real coercive disciplinary power over the member states, nor a real monitoring of the efficient management of national public finance.

In order to better understand the strengths and weaknesses of fiscal discipline in the euro area, it is interesting to refer to the seminal paper of Kopits and Symansky (1998) on the characteristics of an ideal fiscal rule. They identify eight properties that must be checked by the fiscal rule to be a "good" fiscal rule. Even if this typology do not explicitly use the term of "fiscal rule effectiveness", their contribution nevertheless constitutes the initial cornerstone in the "good" fiscal rule debate. Moreover, Barbier-Gauchard, Baret and Debrun (2021) are interested in the link between fiscal rule and government efficiency to fuel useful debate on fiscal rule performance. Moreover, Wyplosz (2013) offers a very interesting survey on theoretical issues and experiments with fiscal rules.

In the light of this analytical grid, the current fiscal rule in the EMU suffers from three major weaknesses : (1) the current rule now considers too many (and sometimes redundant) indicators simultaneously (total public balance, structural balance, public debt, growth of public expenditure, multiannual public finance program) to be able to make a clear and unequivocal diagnosis on the current state of public finance management in a country; (2) the current indicators of fiscal rule do not really take into account the fiscal functions identified by Musgrave (1959). In this context, in addition to measures which could be taken at Community level for the EU as a whole, the fiscal rule must also allow countries to provide quality public services and ensure economic stabilization. The current rule has already planned to leave sufficient room for maneuver to countries in the event of a cyclical shock. Nevertheless, in order to meet the Maastricht convergence criteria, some countries had to put in place drastic reduction measures for some public spending, sometimes to the detriment of the quality of public services (education, health, security, etc.) and long-term growth public expenditure. (3) the current rule suffers from a cruel lack of credibility of the sanction for several reasons. Imposing a financial penalty on a country already in financial difficulty is nonsense. In addition, the procedure for imposing the sanction is too complex, and not automatic, so that all countries well know that they will never be sanctioned. Moreover, the most efficient fiscal rule is the one the country has imposed on itself. This is the reason why, in the Eurozone, the national fiscal rules seem more effective than the supranational fiscal rule as underlined by Barbier-Gauchard, Baret and Minéa (2019).

Several non-mutually exclusive options are possible to address the weaknesses of the current fiscal rule in EMU:
- to monitor only the structural public balance, excluding public investment, to free up financial leeway at the national level to ensure economic stabilization and support for long-term growth,
- to consider the "quality" of fundamental public goods and services to the well-being of citizens (education, health, security) in the assessment of the sound management (or not) of national public finance,
- to replace the financial fine to be paid in the event of non-compliance with the rule by an automatic cut in all or part of the Community funding granted to the offending country, the sanction being applied automatically (no political decision to be taken).

Of course, all this is only feasible when heavily indebted countries debt will have reduced the level of their public debt, or if specific measures are taken for countries in financial difficulty, insolvent or uncooperative. Dolls and alli (2016) offer a solution for these kind of euro countries.

Nevertheless, much remains to be done on this topic from an academic point of view because it means decision makers should be able:
- to accurately measure net public investment and its long-term impact on growth and employment;
- to assess the "quality" of fundamental public goods and services and define a minimum "quality" standards to be ensured;
- to take courageous decisions to sanction a country that does not respect the rule

Main features of the future "smart" fiscal rule for the euro and Community measures to be taken

(To enforce after public debt stabilization for heavily indebted countries)

- main focus on the structural public balance excluding public investment
- cuts all or part of the Community funding from which the country which does not comply with the fiscal rule + automatic sanctioning mechanism (no political decision to be taken)
- to consider the "quality" of fundamental public goods and services to the well-being of citizens (education, health, security) in the assessment of the sound management (or not) of national public finance

Source : Author

Conclusion

What kind of blueprint for the future European fiscal union? The scientific literature strongly encourages us to deal with this question by taking into account the typology of fiscal functions of Musgrave (1959) as well as the lessons of the fiscal federalism theory initiated by Oates (1972). In addition, the practice of fiscal federalism in a large number of OECD countries combined with specificities linked to the European model make it possible to draw some lessons and guidelines for the future European fiscal union.

Thus, it would be desirable for the future European fiscal union to be characterized:
- by a substantial transfer of "allocative" public spending, particularly in the area of support for growth and employment, and in the area of external relations
- through new own resources (in particular a reformed VAT resource replacing the existing VAT own resource and / or a corporate tax at EU level and potentially other additional resources) combined with the substantial financing to which the EIB provides access thanks to its strike force on the financial markets
- by a status quo for inter-sectoral redistribution expenditure in favor of agriculture and fisheries and for public regional cohesion expenditure
- by the creation of a fiscal capacity for the euro zone allowing the introduction of automatic European budgetary stabilizers thanks to a European unemployment insurance, complementary to the national unemployment insurance systems
- the replacement of the current rule of fiscal discipline by a rule that is smarter and more credible in terms of sanctions

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