Designing a European Fiscal Union: Lessons from the Experiences of Fiscal Federations
13 federations: Argentina, Australia, Austria, Belgium, Brazil, Canada, Germany, India, Mexico, South Africa, Spain, Switzerland, USA
Three Questions

① What is the role of centralized fiscal policies in federations, and hence what is the relative size of centralized taxes and outlays?
② What are the institutional arrangements between central and subnational budget authorities?
③ What are the financial links between federal and subnational governments, and how have subnational crises been handled, when they occurred?
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Central budgets are large in federations, including in decentralized ones...

**Revenue of the Central Government**
(in percent of GG revenue)

**Spending of the Central Government**
(in percent of GG spending)
The EU budget is very small...

- Only 1 percent of GDP, 2 percent of public spending
- Mostly financed by transfers from member states
- Transfers account for two thirds of spending, yet too small to have a stabilizing impact
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Rules are most commonly used as fiscal constraint on subnational governments in federations.

Number of countries in the sample

- Budget balance rules: 12
- Borrowing caps: 8
- Debt rules: 7
- Expenditure rules: 7
- Cooperative approaches: 2
- Direct controls: 2

*Fiscal rules*
Fiscal constraints on EU Members are complex, yet enforcement mechanisms are relatively less stringent.

- A multi step approach
- Several instances of coordination, yet still incomplete harmonization

Multiple rules: 5 rules vs. 2 on average in federations

- 3 percent deficit rule
- Medium term objective
- 60 percent debt rule
  - Breach
  - Insufficient effort
  - Structural effort of 0.5 percent of GDP per year
  - Structural effort of 0.5 percent of GDP per year
  - Reduction of gap by 1/20th per year
  - Financial sanction, closer surveillance
  - Financial sanction
  - Financial sanction, EDP

Number of constraints

Number of federations
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In most federations, the central government holds the lion’s share of the public debt.
## Experiences of Subnational Debt Crises

<table>
<thead>
<tr>
<th>Country</th>
<th>Year</th>
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<tbody>
<tr>
<td>Argentina</td>
<td>1992-94</td>
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<tr>
<td></td>
<td>2001-02</td>
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<tr>
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<td>2003-04</td>
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<tr>
<td>Australia</td>
<td>2009-10</td>
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<tr>
<td>Brazil</td>
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<td>1997</td>
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<tr>
<td>Germany</td>
<td>1994-2004</td>
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<td>India</td>
<td>1980-2012</td>
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<tr>
<td>Mexico</td>
<td>1995</td>
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<td>United States</td>
<td>1975</td>
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<td>2006</td>
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- 16 episodes
- Rare cases of defaults and restructurings to private creditors
- Permanent crisis resolution framework even less common
- Ad hoc interventions are the norm
- Use of conditionality is frequent
The EU setup

- Financial links were minimal before the crisis
  - Transfers: structural funds (½ percent GDP)
  - Indirect financing: EIB

- They have intensified since then
  - Direct support: EFSM, EFSF, ESM (permanent)
  - Indirect support: ECB

- Proposals for shared financial instruments:
  - Direct financing: issuance of common European bonds (euro-bills, red-blue bonds, ESBies)
  - Rainy day funds: cyclical adjustment insurance funds financed by national budget contributions
Four critical issues for Europe

• Can the EU remain without a central fiscal risk sharing instrument?
• How to make the fiscal governance framework “binding”?
• Is there scope for shared debt instruments?
• Will the crisis resolution lead to closer, or looser, fiscal integration?
Thank You!