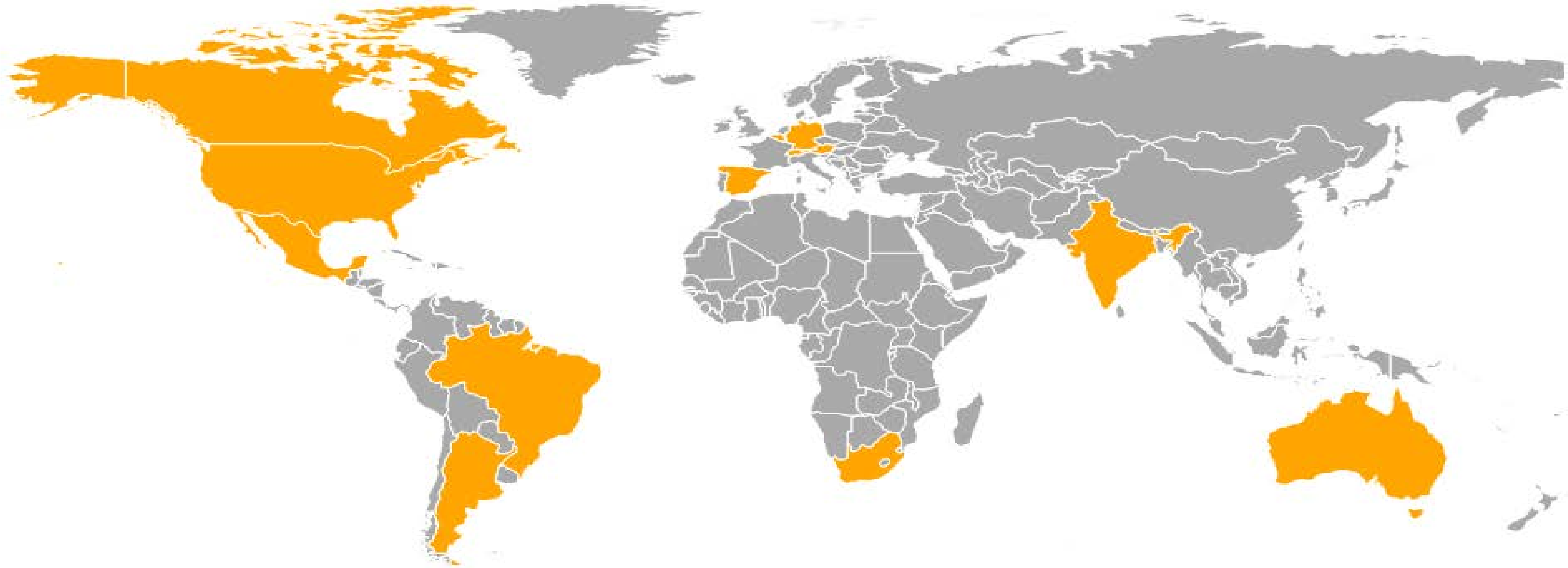
Designing a European Fiscal Union: Lessons from the Experiences of Fiscal Federations

The Sample

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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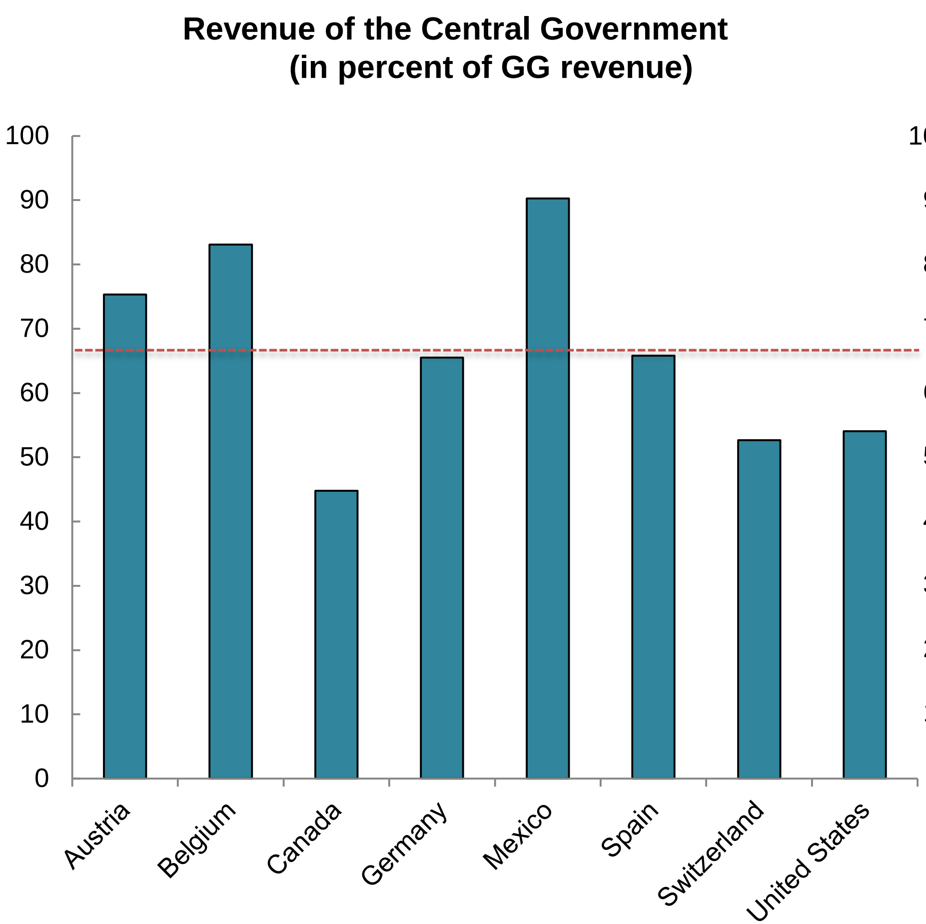
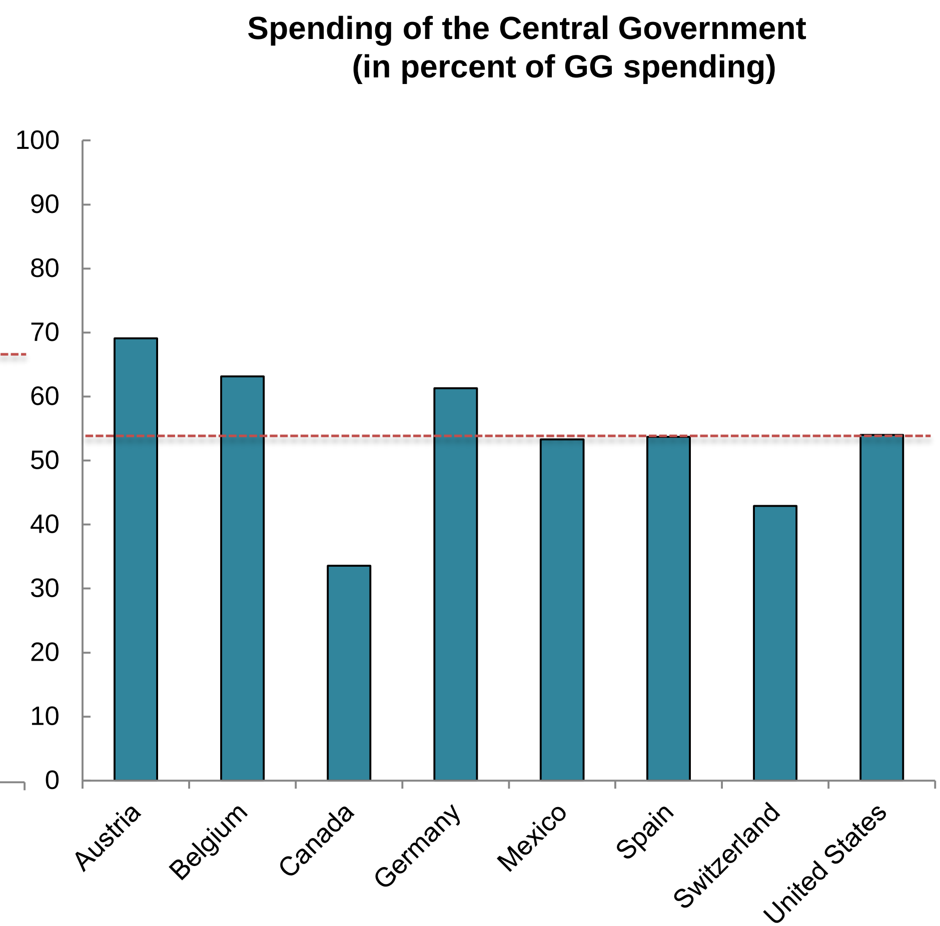
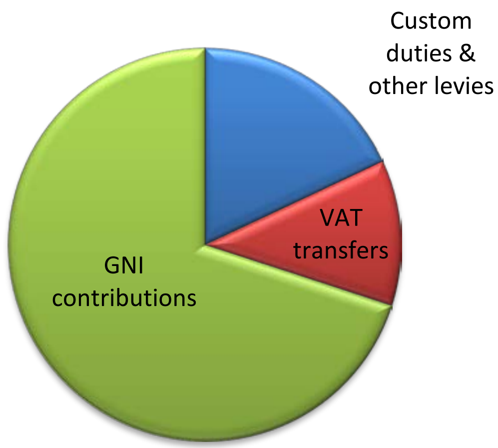
Central budgets are large in federations, including in decentralized ones…



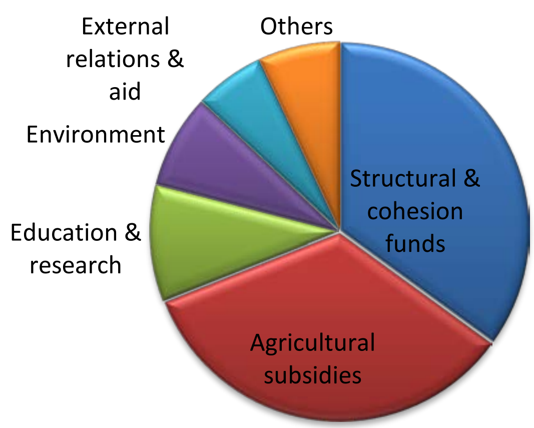


The EU budget is very small…

Sources of revenues



Main spending categories



- 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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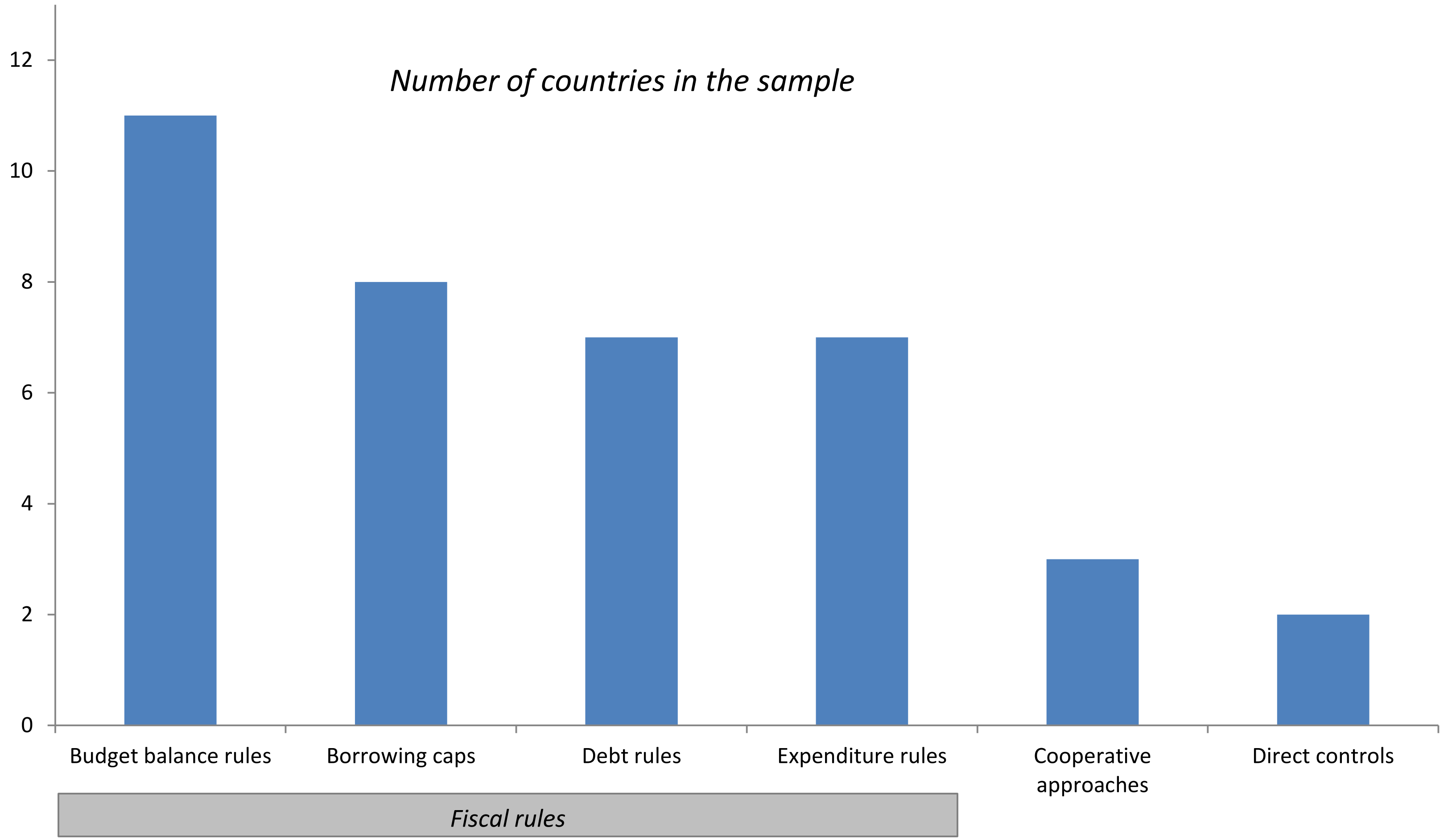
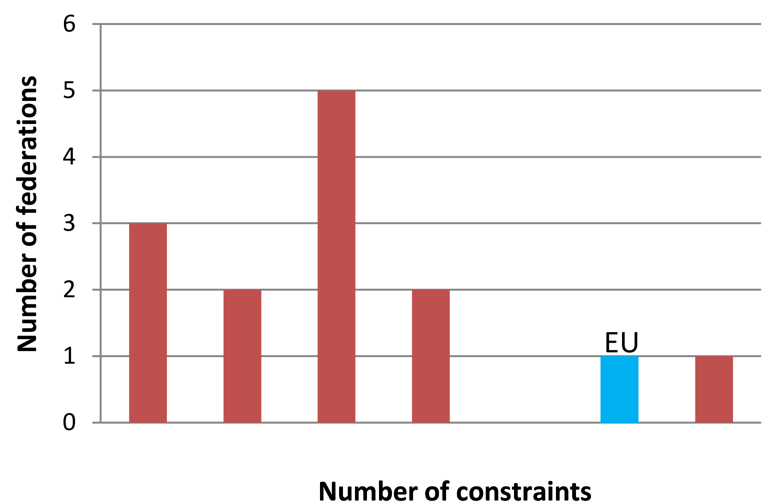
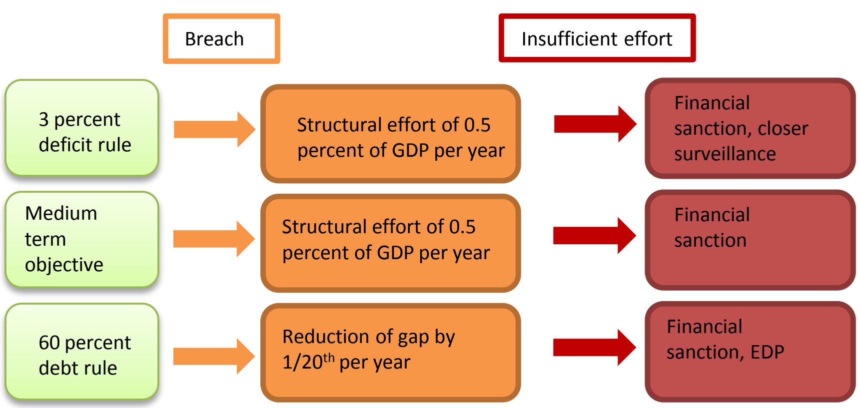
Rules are most commonly used as fiscal constraint on subnational governments in federations



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

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





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

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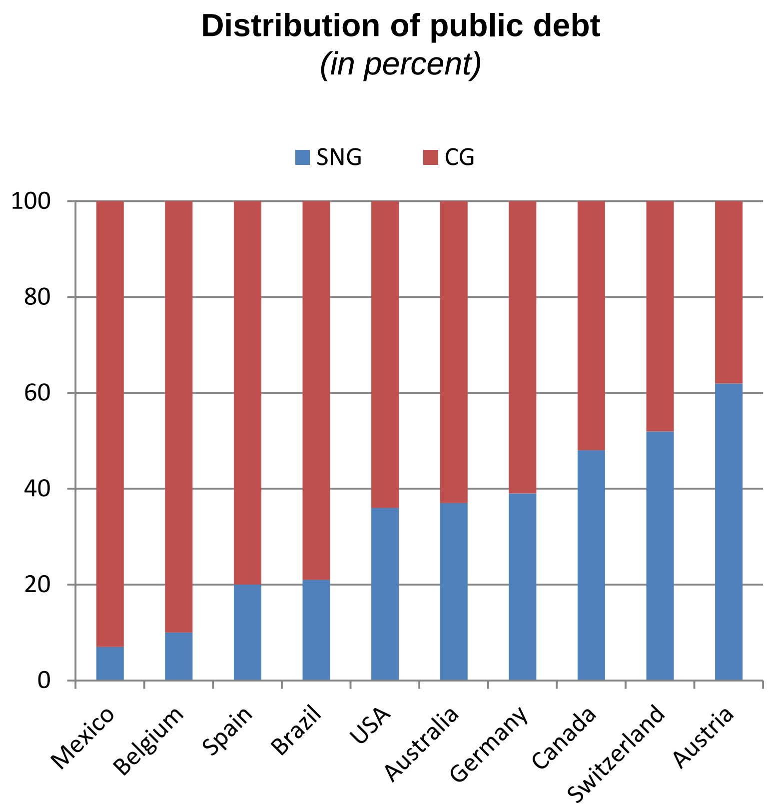
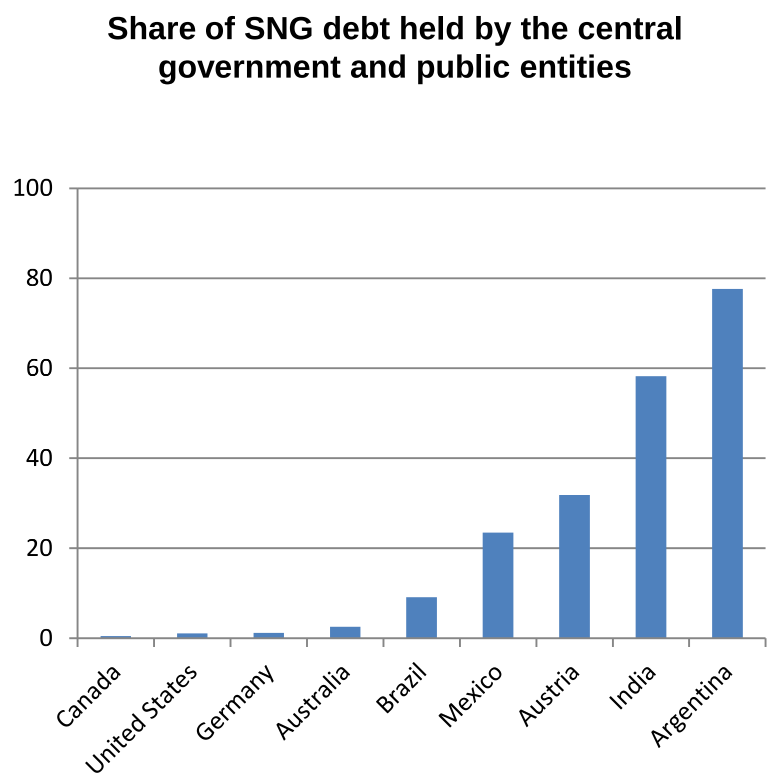
In most federations, the central government holds the lion's share of the public debt





Experiences of Subnational Debt Crises

Country	Year
Argentina	1992-94 2001-02 2003-04
Australia	2009-10
Brazil	1989 1993 1997
Germany	1994-2004
India	1980-2012
Mexico	1995 2004-06
Spain	2012-
South Africa	1997-98 2011-12
United States	1975 2006

- 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!