Ireland Proposal for Stronger Fiscal Unity

Motivation:

For better or worse, we all agreed to a monetary union. We've taken large steps toward creating a single market, but the stability of the single market depends upon increased fiscal unity. Our economies have become so intertwined that regional instability can spill over into other countries, but the EU does not provide any automatic stabilizers to reduce the severity of regional shocks. More importantly, the EU is not allowed to stimulate aggregate demand through deficit spending. The EU can only borrow to finance loans for three programs: EFSM, BoP assistance, and Macro-Financial Assistance. The EU is not allowed to borrow for its own expenditures.

We propose building automatic stabilizers into the EU budget and allowing the EU to finance a budget deficit through selling bonds (EU has a AAA rating). In the short run, the EU could provide stimulus (e.g. public works programs, etc.) for indebted countries while they continue the austerity measures to fix their long-run structural deficits. If other countries are opposed to giving so much power to the EU, we hope they will at least consider our weaker proposal for just automatic stabilizers. It won't have much of an effect in the short run, but it will provide greater stability in the long run by reducing the effects of country-specific shocks.

Weak plan:

Build automatic stabilizers into the EU budget.

- Determine a baseline of welfare programs to be guaranteed to all Eurozone citizens.
- EU taxes EZ citizens directly. (income tax)

- EU provides welfare programs to all EZ countries.

Preferred Embodiment:

We're leaving tax rates and amount of welfare open to negotiation. However, our general idea is that we would all agree upon an amount of welfare and then look at how much fiscally responsible countries (like Germany) spend on these programs. Then, we could estimate the necessary EU budget increase and negotiate the tax rates needed to fund it. Allowing the EU to tax citizens won't necessarily raise taxes on all EZ citizens. Some governments might be able to cut taxes proportional to the EZ tax without increasing their deficits. We don't want anyone to give up more fiscal autonomy than necessary, so we would allow countries with above average welfare programs to supplement EU programs with their own resources. For example, we don't think it would be that inconvenient to receive two unemployment checks instead of one check for an equal amount.

Implementation:

One major obstacle will be building the necessary bureaucratic infrastructure for tax collection and welfare programs at the EZ level. The first step will be establishing head offices for tax collection and welfare. A new EU agency will have to be formed for dealing with tax collection and tax evasion. The administration of welfare programs could be built into an existing agency, such as the European Foundation for the Improvement of Living and Working Conditions. These agencies will also need offices at the country level. For the most part, we think this can be handled like an acquisition in the business world. Certain national offices would become EU offices and would be reformed under the discretion of the head offices. There is no hurry for implementing this policy as it won't help much in the short run, but the EZ will benefit if we can get past the recognition and decision lags before the next crisis.

Consequences:

In the long run, automatic stabilizers would help when future individual country shocks are not strongly correlated with each other. Dampening country-specific shocks will reduce their spillover effects on the EZ. Also, this policy constitutes a regime change that could have some medium-run benefits. First, tax dodgers in Southern Europe might see the EU as a credible tax collector. Additionally, the EU and national agencies could work together to find and punish tax evasion. Furthermore, the EU having a more direct role in national governments could increase transparency in national governments and boost investors’ confidence in fiscally irresponsible countries. Unfortunately, this policy won’t really stimulate aggregate demand without EU deficit spending.