# As Europe's fiscal union marches on, it is time for the centre-left to debate what it can do to make the eurozone more progressive

Blog Admin

*While the EU edges ever closer to fiscal federalism, it still lacks a federal budget, which would be able to assist areas of the eurozone that are in economic difficulty.* **Dan Corry** *argues that in the absence of a eurozone-wide federal budget, Europe's centre left must begin to consider and debate measures that would help struggling regions, such as more progressive taxes and an EU-wide unemployment benefit scheme.*

Slowly, slowly, bit by bit and sometimes in big leaps, the EU – or at least the Eurozone – is moving towards a stronger fiscal union. This has always been inevitable to some degree; monetary unions, where the currency is shared and there is only one interest rate, almost always need firm fiscal discipline to be enforced. If you don't have it then you have all sorts of perverse incentives playing out with strong, surplus countries feeling they are paying for the 'free-riding' of the weaker countries who no longer have currency risk and can borrow at lower rates due to being 'enveloped' by the stronger countries. The infamous Maastricht condition of 3% budget deficit policed by various forms of multi-lateral surveillance and fines was an early attempt to bring some elements of a fiscal union to the table. But when it came to the crunch its set of exhortations backed up by fines and penalties turned out to be too little.

The great banking crash and the subsequent Great Recession have forced the pace of what might otherwise have been a gradual move over time to something closer to fiscal federalism. Now the screw is being tightened. Countries in the Eurozone will have less freedom. Banks will be supervised at an EU level; Eurobonds of some form or another will emerge; and the so called 6 pack of new regulations will constrain countries much more in how much they can operate an independent fiscal policy.

For the centre left this raises some big problems. Within most currency unions (be that the USA or Germany, the UK or France) there is an ability through a strong national or federal budget and other policy measures to help particular parts of the monetary union area in economic difficulty. However, the EU looks unlikely to have a federal budget of anything like the scale needed to ensure some sort of equity, not least in response to shocks (known as asymmetric shocks) that hit one part of the monetary union far more than others.

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There are of course limited measures in place already, like the Structural Funds, that financially support areas of lower prosperity in an effort to get them onto a path to higher productivity and thus higher incomes. But these are limited and are not flexible enough instruments to help deal with things like the economic cycle. In any case their scale is limited by the political realities.

So if we cannot achieve a larger federal budget then perhaps we need to look at some of the other things that are used in monetary unions to help out in this way. Clearly one is a progressive tax system. Progressive taxation does a lot of the work in most countries in helping the worst off and individuals and areas hit by a particular downturn in the economy: those on low incomes have money 'given' to them through tax on those better off. But anything like this remains a pipe dream (or nightmare) for the EU or Eurozone. So too does some sort of overall common social security system.

More promising might be another measure normally present in monetary unions which is unemployment compensation. This idea is currently being given a push in the EU – including by the Employment Commissioner Laszlo Andor who has talked about it as serving as an automatic stabiliser and argued that "We need and must study the possible set-up of such a European unemployment benefit scheme as we develop the next phase of Economic and Monetary Union". Such an idea deserves a good look.

The basic concept arises from the observation that if a member state is affected by slower growth for a period then it is likely to have higher unemployment. If the funding of the compensation paid to unemployed workers is EU or Eurozone wide then it is more likely that in effect it comes from the more prosperous areas and better off citizens. It is thus a redistributive tool, even if one slightly hidden (although hardly a 'stealth' measure). Surely this is something the left should be pushing for.

Well, like any idea it will have massive political problems in getting those likely to have to be net contributors to agree to it. Some – including the European Commission – have tried to argue that since it will be designed only to help with the economic cycle which all member state face if at different times, there will be no net redistribution over time across countries. But, we should put these problems aside for the moment and decide whether it is worth fighting for.

The technical issues are great. It is hard to imagine that it could be a fixed amount in every country – it will somehow have to relate to average wages in the relevant country. The same would go for contributions. There are also major issues as to whether it can operate when there are such very varied rules about the basis on which unemployment compensation is paid across the EU and even what labour market institutions they have. To take the most obvious example, different countries pay unemployment compensation for different lengths of time and have different systems of incentives and sanctions to get people off benefits. Without harmonising this across the EU/Eurozone there are severe problems (although trying to harmonise them would cause even more!). But perhaps to side step all this, the EU/Eurozone wide scheme could pay a certain minimum amount for a fixed, short(ish) period given certain minimum conditions: in effect it would be the bedrock scheme which member states then added to and supplemented.

Others would argue that the way a country organises it's labour market matters too. So if a country had a higher minimum wage than another, or more restrictions on hiring, then it could be stoking up unemployment in some circumstances (although this too is contested of course). Again the minimum idea seems the only way forward.

Finding a way to fund such an EU/Eurozone wide unemployment compensation scheme is another challenge. Some suggest taxes on labour or a supplement to VAT. Others find yet another use for the bonanza that a Financial Transaction Tax might bring.

Would any of this have an impact on the things we are trying to tackle?

This is hard to tell. A recent Bruegel paper (See Box 1) reviewed recent evidence for the impact of unemployment compensation across monetary unions in addressing regional shocks, including the US. From one angle the findings are disappointing: the effects were pretty small. But they were clearly positive and were at least a small contribution to equalising things up when the ability to devalue and set your own interest rate has been removed. None of this could do much about the severe shocks – asymmetrically felt – that the banking crisis caused. That is way too big for such a gentle mechanism.

Perhaps more important than this though is that it is a recognition that the EU owes it's citizens these sort of mechanisms if it is to ask them to participate in a tight monetary and fiscal union. If a helpful (albeit small) payment came from Europe it could only help citizens develop a more concrete understanding of the gains from EU membership than the harder to grasp gains from trade and the internal market. And it is something that the countries who will end up paying should and might accept as a small 'payment' for the benefits that the single currency gives them and the problems a fiscal union causes for weaker countries.

At this point, as the fiscal union marches on, the centre-left has been pretty quiet on suggesting what it might do to make it a fiscal union that is in some sense progressive. Here at least is something to debate – seriously. We should get on with it.

*This article first appeared as a contribution to Policy Network's work on The politics of European integration.*

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