

Renationalising fiscal policy would help rebuild support for the EU

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*How should EU policymakers respond to growing Euroscepticism and the challenge posed to the EU's future by Brexit? **Harald Sander** writes that while there have often been calls for more integration in the aftermath of crises that have hit the EU in the past, what is required now is a rebalancing of the desire of many citizens for more national autonomy with the need for centralising the few essential functions that are required for providing stability.*



The impact of Brexit on the future of the EU lies in the hands of European policymakers. In a best case scenario, Brexit will serve as a forceful push toward [reforming European governance](#). The British vote has highlighted the political limits of ever-deeper economic integration and challenged the view that an ever-closer European Union is the best answer to it. However, the concept of national sovereignty [is illusive](#) in the presence of (financial) globalisation. Rather than simply opting out of integration, policymakers should focus instead on rebalancing European governance and national sovereignty.

Unfortunately, the willingness of European leaders to pursue serious reform has been extremely low in the past and might remain minimal as they now face a referendum in Italy and major elections in Germany and France in 2017. Moreover, the immediate economic effects of Brexit on the EU have been relatively mild so far. Thus, there seems to be the idea in Brussels that a combination of 'making exits costly' and granting some relief to member countries by [bending European rules](#), for example by exempting Spain and Portugal from charges for violating fiscal deficit limits, will be sufficient to contain the populists. This is potentially a [highly dangerous](#) strategy.

While Brexit might be costly but manageable for Europe, this will be not the case if a Eurozone member tries to exit. Serious economists have already warned several years ago that a break-up of the Eurozone will trigger "[the mother of all financial crises](#)", but for this very reason, they argue that a voluntary exit is highly unlikely. Regrettably, today's populists do not listen to rational arguments. If France or Italy would opt for exit from the EU, the impact could be catastrophic. Policymakers should therefore be aware of large long-term risks that could arise from a strategy of muddling through.

Explaining the rise of Euroscepticism

To understand what needs to be done, a brief review of the main reasons underpinning the growth in Euroscepticism is helpful. The various analyses that have been produced on this subject in recent years have highlighted at least three key factors that have shaped the rise of Euroscepticism.

First, there are arguments which are motivated by a desire to restore sovereignty to the political institutions operating at the level of national politics. This argument has two distinct variants. On the one hand, there are critiques of the general [distribution of competences](#) between the EU and national levels. On the other, there are critiques of the specific (overly intrusive) involvement of the [Eurogroup](#) in Eurozone countries. In essence the argument here is that the common currency architecture has turned the larger part of Europe into an [asymmetric union](#) in which lenders dominate borrowers, thus contradicting the original idea of a Europe of equals.

Second, there is the economic stagnation that has emerged in Europe and especially in the Eurozone. Imposed austerity, which has been put forward without alternatives by the Eurogroup, has damaged not only the economies of many countries, but also the [political legitimacy of European governance](#). Finally, there are the [distributional consequences of globalisation](#) and European economic integration, which have led to job and income losses via

trade, the relocation of industries, and migration for the [losers of globalisation](#).

How to prevent the break-up of the EU

Opinions differ on the relative importance of these issues, but it is clear that without addressing them a break-up of Europe is no longer just a theoretical possibility. Traditional European integrationists typically respond by arguing for “more Europe”, e.g. by creating a fiscal union. There are indeed strong arguments in favour of centralisation, especially with respect to the European Monetary Union. It can provide stability and a better insurance mechanism against the imperatives of global markets. However, more centralisation is exactly what the EU-critics are voting against.

Instead it is imperative to rebalance the wish for more national autonomy with the need for centralising the few essential functions for providing stability. Barry Eichengreen and Charles Wyplosz have formulated [minimal conditions for the survival of the euro](#) in which *renationalisation of fiscal policy* plays a major role. It is worthwhile promoting these ideas after Brexit, as they also address the concerns of Eurosceptics in a productive manner.

For the common currency, two centralised structures are crucial for providing financial and economic stability: a central bank that can effectively backstop financial crises, and a banking union that complements the single currency with its core elements: single supervision, single resolution mechanism and single deposit insurance. In both areas, the Eurozone is already on the way, though the banking union is still incomplete. This is largely because of resistance against the single deposit insurance, which especially in Germany is seen as a form of debt mutualisation. Such issues can, however, be overcome by a good design, for example by addressing moral hazard concerns. But it is evident that such concerns are not those of the “take-back-control” camp, but rather those of industry lobby groups.

However, where divergences in national preferences are strong and/or local expertise is superior for solving problems, decisions are best taken at the national level. A renationalisation of fiscal policy is therefore at the core of a sustainable European reform process.

Why? First, because decisions about taxation and how to spend taxes are the heart of national sovereignty. This is exactly what people vote about in elections. Second, because countries can and should use fiscal policy to protect their economies against idiosyncratic shocks (though [better incentives](#) to really do it are needed). Third, the rule-based control of fiscal deficits by the stability and growth pact and its various follow-ups has clearly failed and damaged the reputation of Europe in general and the EU Commission in particular. Finally, the renationalisation of fiscal policies does not impede joint actions, e.g. to engage in European-wide stimulus programmes, if need be. However, they should have the character of a voluntarily agreed “[compact](#)”. A similar argument can be made for [joint European infrastructure projects](#).

Yet, the devil is in the details. For most countries sovereign debts are still at record-high levels. To regain control of fiscal policy a substantial debt consolidation is necessary. Clearly, this is the most difficult point to agree upon. “Moral concerns” are voiced in some countries to oppose smart schemes, which show feasible ways for debt restructuring without debt mutualisation or realising losses. And returning the responsibility for fiscal discipline to the national level requires adhering to a strict no-bailout rule.

These concerns constitute serious, though not insurmountable obstacles. A careful rebalancing can address the major concerns against the current European governance structure. Some reforms can be done easily, some require overcoming vested interests and wrong-headed moral considerations, while others may even necessitate rewriting the European rulebook, the *acquis communautaire*, which should not be considered as sacrosanct [as suggested by Charles Wyplosz](#). However, taking the most necessary steps now with courage can make Europe attractive again and provide a convincing alternative to the false and dangerous promises of anti-European populists.

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