EU Institutional Framework for a Common Currency

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Executive summary

1. Europe is confronted with three major crises at the same time: the immigration crisis, the euro-crisis and Brexit. Although the euro-crisis is not daily front page news it could return any day with a vengeance. The solution for maintaining the euro is a substantial transfer of taxing and spending power and economic decision making power from the Member States, to a central governing body exercising these powers under democratic control. At this stage it is clear that there is no majority political support in Europe for such a fundamental reform and even the staunchest defenders of European economic (not political) integration don't dare to spell out the consequences of such reform to their voters. Therefore it is necessary to take on this reform in two stages: (1) a fundamental reform in the legal structure putting in place the necessary legal machinery for decision making and (2) a budgetary reform that minimises the impact of this legal reform by implementing its fiscal and budgetary content in an incremental and gradual way so as not to rock the voter's boat.

The immigration crisis and the euro-crisis have made it clear that the transfer of power to the European level to resolve these crises means a quantum leap from the transfer of power that is adequate to operate the internal market. It is no longer possible to maintain the two totally different ways of decision making within the single and same European legal construction. After almost 60 years Member States should be put before their responsibilities and make a choice between either an internal market or an Economic and Monetary Union with a common currency. At the same time they should also decide whether to accept either one common and single external border the defence of which is the common responsibility of all Member States, or a national border for each Member State to guard its own.

That choice is in a certain way facilitated by the demand of the UK to be relieved from the obligation to an ever closer union of the peoples of Europe. The UK has made a clear choice not to participate in the euro and

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not to adhere to the obligations under the Schengen agreement. The European Union should accommodate this choice and allow the UK and others to go this road which stops with the completion of the internal market, but at the same time these EU Member States, which don't want further economic integration, should allow those fellow Member States which strive to realise Economic and Monetary Union, the important second objective of the European treaties, to achieve their goals without blocking their progress. Europe is diverse and therefore should take diverse forms of political organisation. The outcome will not be a European federal superstate, but a sui generis political construction that precisely reflects the essence of Europe: a sui generis continent.

1. Introduction

2. After agreement was reached with Greece in the summer of 2015 on the conditions for the aid package, the euro-crisis seemed to subside. Immigration and free movement of people jumped to the top of the EU agenda and interest rates for government bonds for all euro-states in crisis, except for Greece, went down considerably. However, in spite of these reassuring facts, since the establishment of the European Stability Mechanism (ESM) that started operations in October 2012, nothing has changed in the decision making mechanism for running the common currency. The existing machinery has proved to be slow, cumbersome and subject to pressure by individual Member States. If a new crisis would blow up in a bigger Member State like Spain or Italy we would witness even more hair raising scenes than during the last crisis. That crisis did not originate in Europe but in the US, but today there are threats to financial markets outside Europe, in China and emerging economies, that could trigger crisis that would spill over to the EU.

Therefore it is important to make the decision making mechanisms for operating the common currency more effective and at the same time also more democratic. This contribution deals with the institutional questions that need to be answered in the EU to achieve this objective from a fiscal and budgetary viewpoint. To that effect we will make a brief analysis of (1) the legal framework of decision making for operating the internal market and the Economic and Monetary Union (EMU) with a common currency, and (2) the economic framework for operating the internal market and the EMU.

Art. 3 TEU lists the two major and distinct economic objectives of the EU: (1) the Union shall establish an internal market and (2) the Union shall establish an economic and monetary union whose currency is the euro. The

conditions for achieving these objectives from a fiscal and budgetary viewpoint are totally different. It is our proposition in this contribution that the fiscal and budgetary conditions laid down in the European treaties for achieving the internal market are perhaps not ideal, but by and large adequate, with the exception of the unanimity rule for deciding tax matters that relate to the internal market. With respect to the objective of achieving EMU and operating a common currency the fiscal and budgetary conditions laid down in the European treaties are inadequate to prevent another currency crisis. If this new crisis would be bigger than the previous one the current decision making mechanisms are not capable of preventing a total disintegration of the common currency.

In a last part we will discuss the minimal reforms that are necessary in the institutional framework for the EMU and the procedural ways to realise such a minimal institutional reform within the existing TEU and TFEU.

2. The fiscal and budgetary requirements for the internal market

2.1 The concept of the internal market

3. The internal market is defined in art. 26 TFEU as an area without internal frontiers in which the free movement of goods, persons, and capital as well as the right of establishment is ensured. Within that internal market competition is to be free and fair, as guaranteed by the competition and the state aid rules in the TFEU.

2.2 Abolition of internal borders and national treatment for foreigners

4. Such a market requires abolition of all obstacles to cross-border movements of persons, goods and services, capital and business establishments and at the same time equal treatment between domestic and foreign products, persons, capital and enterprises. It also requires the abolition of all internal tax obstacles at internal borders within the Union in indirect taxation (customs duties, levies having an equivalent effect, excises, turn over and sale taxes) but also in direct taxes (income and capital taxes and gift and inheritance taxes). Because of the abolition of all tax obstacles at the internal borders, it also requires the same customs duties and levies having an equivalent effect at the external borders of the Union.

2.3 No Union taxing power, no general harmonisation

5. The internal market does not require however the exclusive levying of European or national taxes for a European budget. The European budget for operating the internal market can perfectly be financed by the annual transfer of national taxes as it is the case today. It also does not require full uniformity or harmonisation of all income taxes and social security charges and in particular not the full equalisation of rates of income taxes and mandatory social contributions, although some mild form of coordination is desirable in order to avoid extreme distortions of competition. With respect to indirect taxes on consumption full harmonisation is not necessary, in particular not with respect to tax rates, but equalisation of tax rules and tax burdens within each national jurisdiction of final consumption is imperative. That has largely been achieved by the system of VAT, but is still unfinished business in the area of excises and some other forms of indirect taxation such as environmental levies.

2.4 No large Union budget

6. In order to operate the internal market it is not necessary for the Union to have control over large volumes of the budget to steer demand or employment or to determine interest rates. A rather limited budget to allow the Union to conduct its regional policy, the common agricultural policy and further to run its administration is sufficient. That is by and large the situation with the current budget which represents about 1% of the GDP of the whole European Union. Member States continue to exercise their own national economic and budgetary policies in a sovereign way with emphasis on national and economic preferences, backed up by national taxing and spending powers.

2.5 Free competition between different social and fiscal systems

7. This situation results in nearly unrestricted freedom for cross-border movements of persons, services, capital and businesses where the inbound competitive positions are more or less the same, for foreign and domestic economic agents, but there are still differences in the competitive positions determined by national economic and social preferences reflected in the national tax policies of the countries of origin of these foreign agents. In this situation private enterprises and Member States are in competition with each other with substantial differences in income tax systems, systems of social security contributions and tax rates in indirect taxation.

3. The fiscal and budgetary requirements for EMU with a common currency

8. EMU and a common currency impose a more general economic and legal framework, which does have fiscal and budgetary consequences.

3.1 A central bank

9. A common currency needs of course a central bank which has the power (1) to determine the interest rate and (2) the volume of money, (3) to intervene in the financial markets and (4) to act as a lender of last resort for private and public financial institutions and governments. In order to fulfil these functions the central banks need unlimited access to money from the public treasury. This back up can take the form of a special fund, but most often it is the national treasury with the pool of all taxes and other public revenue that constitutes this back up.

3.2 A government for the EMU with a common currency

10. An EMU with a common currency also needs a central governing entity that not only coordinates but also decides and implements the economic policy of the EMU and has the power to take action to address the economic unbalances within the EMU. The decisions of this entity must have priority over all subordinate levels of government. The central entity must dispose of an adequate budget in order to enable it to steer the macro-economic factors determining supply and demand and employment throughout the whole territory of the common currency.

3.3 Fiscal and budgetary requirements for EMU

11. The conditions mentioned above do have important fiscal and budgetary consequences. These conditions first require that the central governing entity has the power to levy taxes directly and independently from any other level of government. The taxes levied by the central entity must flow directly and automatically to its central treasury. In the European context these taxes could be national taxes of the Member States provided these taxes are assigned unconditionally to the central treasury, but preferably they would be European taxes levied on a uniform basis and at uniform rates throughout the common currency zone. EU members not participating in the common currency zone would of course not be concerned by these taxes, neither at the European nor at the national level.

Even in the EMU with a common currency there would still be considerable room for substantial national taxes with different tax base and rates. However there also will be an overarching economic and social policy of the EMU as a whole, coordinating in a commanding way the economic policies of the Member States participating in the common currency and compensating the unbalances within the currency union. The degree of independence of the Member States participating in the currency union will be determined by its regulatory framework, but also to a large extent by the relative importance of the budgetary volumes available respectively at the level of the central entity and the participating Member States.

4. The legal and economic framework of the internal market

4.1 Adequate distribution of competences

12. The legal framework for the internal market is well established in the European treaties and a vast area of secondary legislation including many directives and regulations in indirect taxation and some directives regarding direct taxation and cross-border tax cooperation. Art. 3 TFEU determines that the EU has exclusive competences for the customs union, the competition rules in the internal market and the common commercial policy. Art. 4 TFEU determines that there are shared competences between the Union and the Member States with regard to the internal market, economic, social and territorial cohesion, agriculture and fisheries, environment, consumer protection, trans-EU networks, transport and energy.

The EU does not have the power to levy taxes (except for the common customs tariff), but art. 113 TFEU provides for the direct power to harmonise indirect taxes if necessary for the establishment of the internal market and art. 115 TFEU contains a general provision permitting the harmonisation of legislation if necessary to establish the internal market and this implicitly also includes direct taxation.

4.2 Enforcement by national administrations and ECJ

13. The enforcement of the European treaties and the secondary EU legislation is implemented by national and Union administrations, while all litigation in the end is controlled by the European Court of Justice. The

Court is also the final guardian of the enforcement of the European treaties.

4.3 Veto power as a stumbling block to progress

14. This legal framework functions rather well in such a wide spread territory with many sometimes very different national habits, cultures and languages. From a tax perspective there is only one anomaly that constitutes a serious stumbling block towards the achievement of the internal market and that is the unanimous voting rule for tax matters, which requires all 28 Member States to agree for any advance in secondary EU tax legislation. This veto power on tax legislation is a major legal impediment, because it allows an individual Member State to block on its own any progress that is essential for the internal market and that has the support of the large majority of Member States representing the overwhelming majority of the population in the EU.

4.4 Economic framework

15. Free and fair competition is the economic essence of the internal market. The design and enforcement of the competition rules and the bureaucratic machinery to operate the internal market require only a modest budget that can be financed from contributions from Member States, that are approved annually by the European parliament. The Union may want more money to run its programmes and administration and in particular more money for the subsidies in its regional policy, but this a question of budgetary volume rather than a question about the method on how to finance that budget. The conclusion is that from a tax point of view the economic framework is by and large satisfactory.

5. The legal and economic framework of the EMU with a common currency

5.1 Political reality does not correspond to distribution of competences

16. Art. 3.1. TFEU clearly states that "The Union shall have exclusive competence in the following areas: [...] c) monetary policy for the Member States whose currency is the euro." That rule, which has been agreed by all Member States does not correspond to reality. At many times during the euro-crisis we have witnessed individual Member States take command and

national parliaments have the last word in the approval of rescue plans for other individual Member States. One advantage however is that the TFEU does not need to be amended to provide full decision making power to the EU on monetary matters.

The TFEU then contains a number of provisions that are common for the economic and monetary policy of all Member States (art. 120-135 TFEU), regardless whether or not they participate in the common currency. There are also a few articles (art. 136-138 TFEU) that are specific to Member States whose currency is the euro. It is typical that the rules with respect to economic policy, budgetary discipline and the control measures, as well as the rules with respect to financial support for the Member States are identical, regardless whether or not a Member State participates in the common currency. From the discussion below it will follow that these rules are first and foremost designed for Member States that are not participating in common currency, and as a consequence are inadequate for Member States participating in a common currency.

5.2 RULES COMMON TO EURO AND NON-EURO MEMBER STATES

5.2.1 Coordinating economic policies in the EU

17. Art. 119 TFEU provides for activities that include "a single currency, the euro, and the definition and conduct of a single monetary policy and exchange-rate policy" with as primary objectives "to maintain price stability, and without prejudice to this objective, to support the general economic policies in[1] the Union". This introductory article refers to the economic policies, plural, in the Union, and not to the economic policy of the Union supporting the common currency. This wording is repeated in art. 127 TFEU on monetary policy.

5.2.2 Multilateral surveillance and excessive deficit procedures for all Member States

18. The art. 120-121 and 126 TFEU describe the procedures of multilateral surveillance and excessive deficit designed to maintain budgetary discipline among all Member States inside or outside the common currency zone . The basic parameters for this budgetary discipline are to be found in the European Stability and Growth Pact: (1) an annual budgetary deficit of maximum 3% of GDP and (2) a total government debt not exceeding 60% of GDP. These multilateral surveillance and excessive deficit measures are intended to put pressure by Commission recommendations and public

[1] Emphasis by the author.

statements on non-complying Member States. The maximum pressure for euro-Member States is a fine, but there is no imperative obligation for euro-Member States to follow the recommendations of the Commission or the Council. That means that within the EMU there is no binding instrument to impose an economic policy upon a Member State participating in the common currency against its will. This point has been eminently illustrated by the saga of the Greek budgetary crisis.

5.2.3 No financial solidarity

19. The rules with respect to the financial solidarity between the euro-Member States can be found in art. 122-126. They prohibit for all practical purposes any fiscal or budgetary union among the EU and the Member States participating in the common currency, or among the Member States themselves. They also prohibit the EU or a Member State to become liable or to assume any commitment by any level of government within the Union or within a Member State, effectively excluding any bail-out of a Member State of the euro-zone on the basis of TFEU rules. Art. 122 TFEU allows some aid "in a spirit of solidarity" if a Member State is in severe difficulties, but this article was not designed to organise the solidarity between Member States participating in the common currency. Art. 123 TFEU prohibits any overdraft or credit facility by the European Central bank (ECB) to any level of government within the EU or within a Member State. It also prohibits any direct purchase by the ECB of debt instruments issued by a Member State. That's why the ECB waited so long before taking the step of buying Member States government bonds on the secondary market, because it considered that such purchases could be held to constitute an indirect way to circumvent the prohibition of a direct purchase in the treaty.

5.2.4 Full independence for the ECB

20. Finally the rules on monetary policy are to be found in art. 127 to 133. These rules deal at the same time with the organisation of the European System of Central Banks (ESCB) in which non-euro Member States participate and of the ECB which deals exclusively with euro-Member States. The ECB shall be consulted on any Union act and on any national draft legislation of the Member States within the areas of its competence. Art. 128 determines that the ECB has the exclusive right to authorise the issue of euro bank notes. Finally and very importantly art. 130 TFEU guarantees the absolute independence of the ECB from any interference or influence by the Member States. The EU institutions are bound to respect this independence. However there are no express provisions in the treaty

on the competence of the ECB neither to determine interest rates, nor to act as a lender of last resort for the euro-Member States.

5.3 Rules specific to euro-Member states

5.3.1 Economic policy guidelines that are compatible for the whole Union

21. Fortunately the TFEU also contains some provisions that are specific to euro-Member States. Art. 136 TFEU allows the Council of Ministers within the framework of the multilateral surveillance and the excessive deficit procedure that applies to all EU Member States to adopt measures that are specific exclusively for euro-Member States in order to “strengthen the coordination and surveillance of their budgetary discipline” and “to set out economic policy guidelines” for euro-Member States only, provided “that they are compatible with those adopted for the whole of the Union[2]...” When issuing these specific measures and guidelines only the Council members representing euro-Member States shall take part in the vote, thereby excluding non-euro Member States. On the basis of this article indeed specific procedures have been elaborated such as the Six Pack and the European semester procedures, which have been applied to all EU Member States including Member States that are not members of the EMU and do not participate in the common currency.

5.3.2 The protocol for the euro-group

22. Art. 137 provides for a separate internal structure for the euro-States, members of the EMU. A protocol was established for the euro-group. Within this group the policy discussion on the euro take place. The whole protocol contains only two articles: one article providing for informal meetings with a standing invitation for the ECB and the Commission and another stating that the meeting elects a president for two years and a half. There are no rules for agenda setting, decision making. All decisions are taken “by consensus” of all the Member States.

5.3.3 Unified international representation of the euro

23. There is also an article 138 TFEU which provides that the Council, on a proposal by the Commission can after consulting with the ECB decide to take common positions on EMU and the common currency at international conferences and to provide for a unified representation with international

[2] Emphasis by the author.

financial institutions like the IMF, the IBRD and the BIS. So far this article has not had any significant implementation.

5.3.4 The European Stability Mechanism

24. In the midst of the euro-crisis, after a shaky start with the European Financial Stability Facility, the TFEU was amended on March 25 2011 with approval of all EU Member States, including the non-euro Member States. A third paragraph was added to art. 136 TFEU, allowing the euro-Member States to set up the European Stability Mechanism (ESM) that can be activated to guarantee the stability of the euro-zone as a whole and to intervene to stabilise individual Member States. The treaty of the ESM was signed by the then 17 euro-Member States on 2 February 2012 and after a positive vote in the German Bundestag in September 2012, the ESM became operational and was instrumental in the bailout of several euro-Member States in distress and in particular Greece.

5.4 The economic framework of EMU

5.4.1 Distribution of taxing and spending power between EU and Member States

25. Looking at the budget of the EU and the Member States it is clear that fiscal sovereignty with all taxing and spending power in the whole EU rests squarely with the Member States. Of all taxes levied and all revenue spent in the EU, more than 97% is under the full control of the Member States. The spending budget of all the Member States in 2014 amounted to 48,1% of total GDP of the Union, while the spending budget for the EU amounted to 1,04% of total GDP of the Union. Total national spending power of the Member States exceeded by more than 45 times the total spending power of the Union.

5.4.2 Economic discrepancies in the euro-zone

26. In spite of the huge increase in intra-community trade in the internal market, Member States in the euro-zone maintained their different national taxing and spending patterns and their different models of social protection. This is illustrated by the statistics in the table below showing differences in social security contributions, and the implicit tax rates on labour and capital in 2010.

Economic discrepancies in the euro-zone

Social security contributions as % of GDP (2010)[3]

BE	DE	FR	IR	IT	LV	NL	PT	SP
14,2	15,5	16,7	5,9	8,9	8,4	14,1	9	12,3

Implicit tax rates on labour (2010)

BE	DE	FR	IR	IT	LV	NL	PT	SP
42,5	37,4	41	26,1	42,6	32,5	36,9	23,4	33

Implicit tax rates on capital (2010)

BE	DE	FR	IR	IT	LV	NL	PT	SP
29,5	20,7	37,2	14	34,9	7,4	12,5	30,7	28,4[4]

Implicit tax rates on consumption (2010)

BE	DE	FR	IR	IT	LV	NL	PT	SP
21,4	19,8	19,3	21,6	16,8	17,3	27	17,4	14,6

From this table it is clear that the tax burdens on the macro-economic aggregates of labour, capital and consumption are unevenly distributed among the budget of the euro-Member States. Statistics below of trade balances, budget deficits and unemployment rates also show similar considerable discrepancies.

[3] Source: Eurostat 2012, Taxation trends in the European Union.
[4] 2009.

Unemployment rates (end 2015)[5]

AT	BE	DE	EL	FR	IT	NL	SP
5,8	7,8	6,3	24,5	10,1	11,3	8,3	21,4

Current account balance as % of GDP (2015)

AT	BE	DE	EL	FR	IT	NL	SP
+2	+0,4	+8,1	+2,5	-0,3	+1,9	+10,6	+1

Budget balance as % of GDP (2015)

AT	BE	DE	EL	FR	IT	NL	SP
-2,1	-2,6	+0,7	-4,1	-4,1	-2,9	-1,8	-4,4

These statistics show that with respect to policies on employment and balanced budgets the economic guidance for individual Member States should be quite different. But above all these statistics raise the question whether it is possible to eliminate the unbalances in some Member States, by addressing some other unbalances in other Member States, e.g. by using some pluses in some Member States to compensate some minuses in other Member States. That does not necessarily mean the direct transfer of surplus funds from one Member State to another, but it raises the question about the utility of a governing entity having the power to take the macro-economic decisions to address these unbalances at a European level that does not represent the immediate national interest of surplus and deficit states, but the interest of the currency union as a whole.

5.4.3 The European Stability Mechanism

27. So far the ESM has been successful with its interventions for euro-Member States in crisis, because in relation to its capabilities the demands have been limited. It disposes of a total capital of 700 billion €, with a maximum intervention ceiling of 500 billion €. It has disbursed so far 220 billion € in loans. Total interventions of all EU funds for the euro-zone so far have amounted to a little over 400 billion €. However the states appealing to the aid of the ESM have been the rather small economies of Greece, Ireland and Portugal.

[5] Source: The Economist, Economic and Financial indicators 23.01.2016.

5.4.4 Adequacy of the legal framework for the EMU?

a. No common treasury

28. This short overview of the legal framework for determining and implementing the rules of the economic and monetary policy in the TFEU shows that those rules were clearly not conceived for the functioning of an EMU with a common currency, because some essential elements of this functioning are lacking. Within the currency union there is no common treasury to back up the ESM or the monetary policy of the ECB. The absence of a common treasury has to do with the absence of any power to levy euro-taxes, or to transfer some part of the national taxes independently to a common euro-treasury.

b. National parliaments have the final decision on ESM spending

29. The power to spend the ESM money still rests with the national parliaments of some Member States (Germany, Finland, the Netherlands and Sovakia) and these national parliamentary procedures are too slow to permit quick action in case of an emergency. In addition these national procedures are subject to national constitutional challenges before the courts, as has been the case in Germany.

c. No structure for decision making in the euro-group

30. The euro-group so far has failed to decide on procedures for agenda setting or decision making. The consensus model is too slow in times of crisis and decisions are sometimes determined by national political priorities, not by European priorities.

d. Overlap of competences between the Commission and the eurio-group

31. There is no clear delimitation of powers between the euro-group and the Commission as to the enforcement of budgetary discipline and formulating economic guidelines. The Commission is still in charge of enforcing budgetary discipline of the individual Member States, while the euro-zone in addition to this national enforcement, needs an economic policy for the whole currency zone in which the interaction between the Member States directed by a European (euro-zone) institution. Although the euro-group has played an important role in many decisions, its

competences are not well defined. Within the European Council voting procedures on euro-matters and general EU matters are clearly separated, but this is less obvious for the discussions on those matters preparing the decisions.

e. Disconnect in decision making power between EU and national parliaments

32. Finally there is a disconnect between the fiscal and budgetary competences and the general competences of the Member States and the EU. The national parliaments of the Member States are competent to approve national budgets and raise taxes, which constitute the bulk of taxing and spending power in Europe, but formulating en enforcing economic guidelines for the currency-zone and monetary policy is a competence which the treaties reserve to the EU. These are areas in which the EU parliament is competent, but it does not have the taxing and spending power to back up its general policy recommendations.

f. Conclusion: the legal framework is inadequate

33. The conclusion is that the legal framework of the currency union lacks a central decision making body that would be in charge of (1) formulating and enforcing the economic and budgetary policy framework for the Member States of the currency-union, (2) formulating and enforcing the economic policy for the currency-union as a whole and the interaction between the Member States in the currency-union, (3) deciding independently form the Member States which and how much taxes to raise for an independent treasury under its control and (4) spending the money of such treasury to support the common economic and monetary policy within the currency-union. The common economic and monetary policy should cover all aspects including employment, European wide public investment and regional unbalances within the currency-union.

5.4.5 The economic framework of EM

a. ESM capital is too small to rescue big Member States

34. In economic terms it is a miracle that the EMU has survived the financial crisis, largely thanks to the rescue mechanism of the ESM. The budgetary mass at the disposal of the currency-union is too small to come to the rescue in case of a crisis in the bigger Member States. The budgetary

mass of a common treasury to conduct a common economic policy is totally inexistent.

b. No central organ coordinating economic policy for euro-zone as a whole

35. The necessary coordination of economic and social policies of the Member States is only effectuated partially and indirectly through the budget control of the national budgets of the Member States and not directly through direct intervention and spending decisions at the level of the EMU as a whole. The wide divergence in macro-economic aggregates of the euro-Member States show that addressing the unbalances is a major task in the currency union. The state aid programmes within the current framework of the regional economic policy are to small to address these macro-economic unbalances.

6. Which changes to make to EMU and the common currency function

6.1 Strengthening the ESM

36. A first priority is to strengthen the ESM that is already available as an instrument in case of emergency. That means increasing the capital available of the ESM and streamlining its decision making process. The Board of governors of the ESM has the obligation to review periodically the adequacy of the authorised capital and at least every five years. That means that the question of review of the authorised capital of 700 billion € will be soon on the agenda. Because of the present voting majority requirement of 80%, Germany and France have veto-power on almost all decisions, but each member state, however small, has also veto-power on all the most important decisions in the so called mutual agreement procedure which is decided by unanimity voting. The unanimous voting requirement and the impact of the national constitutional rules in Member States like Germany are a major hurdle in the decision to increase the capacity of the ESM.

6.2 ESM and European treasury

37. A decision should be made on the ultimate guarantee of the euro-debt of the Member States. The ESM could be used as a core for this debt guarantee, but this would require a considerable increase of its capital. The guarantee could also take the form of a separate and independent euro-

treasury in which the ESM could be merged. In the end the establishment of such a treasury will be inevitable to support a common economic policy, because in the long run such common policy cannot be financed by capital contributions, but should be financed by raising taxes. Because the financing would be done by taxing at the euro level its decision making structure should take a more political form of a body that would be politically accountable. Such a treasury should have a sufficient budgetary mass for effective interventions, but this mass would probably be insufficient as the ultimate guarantee for the total outstanding public debt of all Member States. I.e. certainly in an initial faze a mechanism should stay in place as a rescue mechanism to support the public debt of single euro-Member States.

6.3 Strengthening the position of the ECB

38. The powers of the ECB should be extended to allow it to act as the lender of last resort for any Member State of the currency-union. One important remaining question is whether the mandate of the ECB should be extended to take into account other macro-economic factors than only price-stability. That may not be necessary on the condition that a central governing entity is established in the EMU that is competent for employment and regional policy throughout the currency union, but, failing that, including employment in the ECB mandate would be advisable so as to allow the ECB to act as an all-round player in the EMU.

6.4 The establishment of a central policy organ in the EMU

6.4.1 Central policy organ inside the Commission?

39. The most crucial question is the choice of the entity that will be charged with conducting an effective economic policy for the whole EMU. Can we entrust this vital task to a member of the Commission, or to all the members of the Commission appointed by euro-Member States, or to the national ministers representing the euro-Member States in the Council of Ministers? Or should we create a new central organ for the euro-zone, or could the euro-group act as such an organ?

Part of the common economic policy in the form of the budgetary discipline currently already belongs to the competences of the Commission. The question then is which commissioners and which departments will have the competences to fulfil these tasks. The essential task will be to formulate and to enforce an economic policy for the whole of the EMU, which will not affect all Member States in the same way. The main question

is whether the Commissioners charged with this task can at the same time act as Commissioner for non-euro Member States. In some cases there may be a conflict of interest between the interest of the currency-union as a whole and the non-euro Member States. Such a conflict of interest may occur in several areas of competence, because several areas in which the Commission is already active also belong to the common economic policy. An example of such a potential conflict was the project of the banking union. Other potential areas of conflict may be CCCTB or FFT, when such taxes would be used by the euro-Member States to finance their common treasury.

6.4.2 Central policy organ outside the Commission?

40. The alternative is to establish a new organ outside the existing Commission. That raises delicate questions, because today part of the common economic policy that consists of budgetary surveillance of the Member States is already implemented by directorates of the Commission. However it is not unthinkable to concentrate all the activities related to the common economic and monetary policy of the EMU in a separate administration, under the supervision of the euro-group. The euro-group with all the Ministers of finance and economics could act as the Council of Ministers of the euro-Member States. The euro-group itself could function under the chairmanship of the president of the European Union. The full Council of Ministers representing all the Member States of the Union could serve as a forum for discussion where the two central organs, the Commission and the new euro-entity could meet, discuss and make recommendations.

6.5 Political accountability of the central policy organ in the EMU

6.5.1 Accountability to national parliaments?

41. Since the common economic policy presupposes raising taxes for a European treasury there is a need for a democratic organ controlling the common euro-budget and the taxing and spending by the central entity in the conduct of that common policy. There are several possibilities to make the central entity politically accountable: control by national parliaments, control by the euro-Council of Ministers and control by the European parliament or a combination of these instances. Control by national parliaments does not seem desirable because the experience during the financial crisis has shown that it is not possible for national parliaments to take into account the interest of the euro-zone as a whole including the

interests of all its Member States. The role of national parliaments is to defend the national interest of the individual Member States, not to defend the common European interest.

6.5.2 Accountability to the European parliament?

42. The most democratic way of controlling taxing and spending at the European level is debate and voting in the European parliament, with the power to dismiss the central governing body if it does not meet the expectations of the euro-zone as a whole. Today that is already the case for the structure government structure for the internal market. The new Commission needs the approval of the parliament and the Commission's budget is subject to approval by the same parliament. There is no reason why this structure of decision making could not be extended to the central body in charge of EMU and the common currency, regardless whether that body would operate inside or outside the Commission.

The votes on euro-policy questions in the European parliament should be limited to those members of parliament representing euro-Member States. That rule is already observed today in the Council of Ministers. However as in the new constellation the Council could be used as a platform for general debate among all EU Member States, there could be special sessions in the European parliament for such a general debate in which all members of parliaments can participate and vote for (non-binding) recommendations to both the Commission and the central instance in charge of the EMU.

6.5.3 Additional accountability to the euro-Council of Ministers?

43. Because the central euro-body would be in competition for euro-tax money with the national taxes of the Member States it may be advisable to install a double control by the Council of Ministers of the euro-group. That would provide a guarantee to the smaller Member States against complete dominance of the bigger Member States. In that case however the unanimity or consensus rule which currently prevails in the euro-group meetings should be abandoned and replaced by a system of qualified majority voting to prevent that one or two small Member States could block euro-wide measures that the large majority of the population would consider to be absolutely necessary.

7. The procedure for achieving the reforms

7.1 Achieving reform inside or outside the framework of EU treaties

7.1.1 Intergovernmental cooperation outside the treaties

44. As important as the question which institutional reforms are necessary to provide a stable functioning framework for the euro, is the question how to achieve those reforms. Member States are free to conclude treaties outside the framework of the treaties of the European Union and they have done so in the past.[6] However the most important of those separate treaties, the Schengen agreement, was in 1990 integrated in the European treaties. That same procedure may be followed for the new structure of the EMU, but there are some problems.

When an agreement outside the framework of the European treaties is reached, the decision making process under such an agreement is mostly that of intergovernmental cooperation, requiring consensus of all participants, i.e. granting veto power to any participating Member State. The experience during the financial crisis has demonstrated that this unanimity requirement with veto power is precisely the Achilles heel of the current euro-construction. This means that in this agreement from the start, qualified majority voting should be the rule. Intergovernmental agreements are also not subject to the jurisdiction of the European Court of Justice, which means that in case of conflict there is no impartial judicial instance to decide the conflict, unless the contracting parties agree in advance that conflicts and questions of interpretation would be mandatorily submitted to the European Court of Justice.

7.1.2 Reform by amending the treaty

45. When the Commission or a special directorate of the Commission would become the central governing entity in charge of EMU and the common currency, it would be almost impossible to achieve an adequate reform of the Commission, without touching the TEU and the TFEU, because the organisation of the Commission is ingrained in both treaties. If that road is chosen an amendment of the European treaties becomes inevitable and the question is how to go about it, because experience has shown how difficult it is to amend the European treaties.with the consent of all Member States.

[6] For example: Schengen agreement of 14 June 1985. However the Schengen agreement was later incorporated in the European treaties.

One way of achieving this would be to make use of the chapter 4 of title VIII on Economic and Monetary Policy allowing for provisions specific to Member States whose currency is the euro. The amendment of art. 136.3 TFEU establishing the ESM was achieved on that basis. Art. 137 already provides for the existence of the euro-group. The protocol of the euro-group could be enhanced and within that protocol a central entity could be established in charge of formulating and implementing the common economic policy guidelines for the currency-union. That central entity should also have the power to propose euro-taxes to be levied on the territory of the euro-zone for a common treasury. That central entity should also be made accountable to the European parliament. The discussing and voting arrangements in the European parliament with respect to euro-matters could be established in its Rules of Procedure. The amendments to the TEU and the TFEU necessary for this reform would be rather limited.

The most important principle would be that all EU Member States agree to extend the separate voting arrangement for euro-matters that is already in force in the Council of Ministers in art. 136.2 TFEU: "For those measures set out in paragraph 1 (the proper functioning of economic and monetary union), only members of the Council representing Member States whose currency is the euro shall take part in the vote." That principle should be extended to all amendments of the TEU and TFEU that are necessary to make the euro function and to all discussing and voting arrangements on euro-matters in the European parliament. That principle can only be accepted of course in a political compromise between non euro- and euro-Member States.

The occasion for such a political compromise are the negotiations with the UK on a EU reform. In exchange of relieving the UK and other Member States wishing to follow its example, of the obligation in art. 1, second paragraph TEU of "creating an ever closer union among the peoples of Europe", the euro-Member States should obtain the right in the TEU to amend and enhance the TFEU provisions from art. 136 to 138 that are specific and limited to the Member States whose currency is the euro. It is clear that this would result in a "Europe at two speeds", but this is the inevitable result of an irrevocable choice between an internal market and a full Economic Union with a common currency. It should be noted that the choice is only irrevocable for those countries choosing for the currency union. Those countries which stay out of the currency union are always free to join at a later date, provided they agree to all the conditions that make that currency union function successfully.

7.2 No big bang, but gradual reform

7.2.1 Big bang: federal EU

46. In the discussion between the euro proponents and opponents of the euro, it is often pointed out that a common currency inevitably results into a political union and that a currency union without a full political union is an economic nightmare. It is because the UK does not want such a political union that it does not want the euro and with it, elsewhere in Europe there are many opponents to the idea of a full fledged European federal state. From a theoretical point of view a full political union would of course resolve most if not all the legal and economic problems that now exist in maintaining the currency union. Yet a full fledged European federal state is out of the question, it is not feasible, not desirable and also not necessary to run the euro.

In a federal state the common economic and monetary policy is determined by the budgetary mass which the federation has at its disposal to steer that policy. Even in very decentralised states the minimal budgetary mass to steer economic and monetary policy successfully stands minimum at about 25% of total revenue raised in a country. Increasing total taxing and spending power in the EU up to that level would be tantamount to a revolution. It would require a massive transfer not only of the budget but also of competences to spend that budget from the Member States to the Union and would destroy the political and administrative structures of the Member States.

A political union in a federal state is much more than an economic union with a common currency. The historic and cultural discrepancies and traditions in the Member States of the EU are such that a certain form of separation is preferable to political union. The century old examples of countries like Belgium and regions like Catalonia and Scotland are there to prove this point.

7.2.2 The gradual approach

a. Fundamental legal reform, incremental budgetary reform

47. The gradual approach consists in realising a fundamental legal reform in the decision making process, whereby the euro-zone acquires the power to raise and spend revenue independently from the Member States and the rules of the EMU clearly have priority in economic and monetary matters that concern the Euro-union as a whole. But in budgetary terms these reforms should be implemented in a minimal and incremental way. A first

change would be to increase the capital of the ESM and gradually (over a transition period of 10 to 15 years) changing its financing by contributions of the Member States into a system of financing by European taxes that would flow directly to the ESM. It would gradually provide an increasing budget for the new central entity in charge of economic and monetary policy and endow it with a critical budgetary mass for economic intervention that during a transitional period would increase by 0,5% to 1% per year from zero to a maximum of 10 to 15 percent of the GDP of the whole euro-zone. During this transitional period formulas of integrating the ESM into the euro-treasury should be looked into. The central entity or the department of the Commission in charge of the economic and monetary policy of the euro-zone should gradually become accountable to the euro-Council of Minsters and the European parliament in accordance with democratic rules.

b. Reform treaty as a final choice to stay in to leave the euro

48. The gradual process of institutional development should be incorporated into a new treaty that would be submitted for approval according to the constitutional rules of each euro-Member State. Rejection of the treaty would mean leaving the euro-zone because approval to the treaty would over time amount to a gradual but significant transfer and budgetary sovereignty of the Member States to the Union. However the mechanism of a central governing entity competent for a common economic and regional policy in the euro-zone, would be a far cry from a full fledged national government. Competition and international trade would still be within the competences of the Commission. There would be no competence for defence, justice and foreign policy with the exception of international monetary matters. The largest share of public revenue would still remain under the control of the Member States in the form of personal income taxes, social security contributions and rate setting in value added tax. But at last there would be one single authority keeping an eye on the overall economic balances and unbalances in the euro-Member States with the competence of dictating action if necessary in the interest of the EMU and the common currency as a whole.