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Guidelines for a Sustainable Development Plan for the European economy

Towards a Federal Fiscal Union

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The Final Report of the Working Group is scheduled to be delivered by the end of 2012 and will include further analysis on the most important issues for the "European Development Plan".

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1) From the debt crisis to a European economic recovery plan

The continuing sovereign debt crisis and the slow recovery of the European economy mean that the Member States of the European Union are caught in an ever tighter stranglehold: to comply with the stricter rules imposed by the fiscal compact they have to quickly apply measures to reduce their deficit and to progressively reduce their debt as a percentage of GDP. At the same time, they have to struggle with increasing costs in benefits to those people who have lost their jobs while the various industries are suffering from a drop in demand and a squeeze on their ability to borrow due to the banks aiming to rebalance their books. All of this is happening in a situation of widely deteriorating public finances due to falling tax receipts resulting from a drop in incomes.

Given the financial difficulties weighing on Eurozone countries that severely restrict the opportunities to launch policies to give an effective kick-start to the economy, the European Union must play a decisive role in any recovery, also to reduce the social tensions that are becoming unsustainable in many countries, and loosen – by means of the automatic expansionary effects on tax receipts – the constraints on national budgets. However, the Union's monetary resources are limited and, in any case, governments seem presently to be focused only on dealing with sovereign debt crises by means of the inevitable bailouts, without thinking about putting a more comprehensive plan in place that would be able to restore development prospects for the whole European economy. To get out of this logjam it is therefore necessary to quickly promote initiatives to begin to create a political project of establishing a Federal fiscal union in Europe by stages, along the lines taken in the past to achieve the single currency. To develop this plan it is first necessary to understand that the current crisis marks the end of a phase in the process of European economic growth, and that there will be no end to the current crisis implementing policies aimed primarily at supporting the demand for consumer goods.

To start this radical change in the concept of growth in Europe it is therefore necessary to promote creating a model of sustainable development at an economic, social and environmental level. The main driver of this new phase of development consists of public investments (and public-private partnerships) for producing not just tangible goods – albeit necessary, such as infrastructures (transport, energy, broadband) – but also intangible assets, particularly investments in basic research and better education aimed at supporting technological innovation, in order to promote an increase in the productivity and competitiveness of European industry which has now reached the threshold of the technological frontier. But it is necessary to also promote the production of public goods to meet the needs of citizens not being covered by the market (environmental protection, conservation of natural resources and cultural heritage, services for people, particularly the underprivileged), with the participation of new players, particularly from the third no-profit sector.

However, this rebooting of public investments and, more generally, of public demand, comes up against the barrier of budgetary constraints in Europe and in its Member States. As a result of the financial restrictions throughout Eurozone countries, from 1980 to 2010 the share of public investment as a percentage of GDP has reduced from over 3.5% to under 2.5%. As was recently argued in a Report of *Notre Europe*[1], re-launching the European economy requires a sharp reversal in this trend, with new public investments amounting to 1% of European GDP, or around €100 billion a year. The size of the EU budget has been stuck at a level of 1% of GDP for a long time, quite inadequate for supporting the production of the goods necessary for achieving this radical transformation in the structure of the European economy.

2) The world market and the globalisation process

Over the last twenty years, management of economic policies in Europe has been dominated by the influence of neo-liberalist thought and the replicating of the USA model. Growth policies in the European framework initially focused on completing the internal market and, thereafter, on supply-side policies. Liberalising the internal market supported growth, but is now able to only marginally promote any further expansion in the European economy. The prevailing view of governments is that the solution to Europe's problems must therefore rely on further action on the supply side (specifically, more flexibility in the labour market and deregulation measures), without taking substantial action on the demand side. This policy is largely illusory, as is shown by the recession that the European economy has become mired

[1] J. Haug, A. Lamassoure, G. Verhofstadt, D. Gros, P. De Grauwe, *Europe for Growth. For a Radical Change in Financing the EU*, Notre Europe, Paris, April 2011

in. However, for properly defining a European economic recovery plan, the first action to take is to thoroughly reconsider the characteristics of the world market after the start of the globalisation process.

In the last two decades, the volume of goods traded has tripled, with emerging economies bursting onto the world stage (particularly the BRIC countries – Brazil, Russia, India and China) and with a growing de-nationalising of production processes. China's weight in the global economy has grown from 2% to 8%, while India's share has risen to 3%. Underlying these changes are clearly the technological innovations, particularly in the areas of transport and communication. But equally important are the changes that have occurred in the production process because the value of the product that end-consumers buy is now calculated from a set of functions that are performed in different countries. This has meant that, between 2000 and 2010, the exchange of intermediate goods i.e. of parts and components that contribute to the producing of final goods, has more than doubled and now accounts for about 18% of world trade.

Also this process of de-nationalising production has its roots in technological innovation. Physical proximity of the various production stages is no longer necessary since technological progress makes it possible to coordinate the various production stages in different places, separating the design stage for a product from the manufacture of some of its components and assembly. This process also directly involves Europe. Trade in intermediate goods in the European Union – used as a proxy of the level of internationalisation of production – amounts to 15% of world trade and has been aimed particularly in the last decade towards Asia and countries formerly part of the Soviet Union. Nonetheless over 60% of this trade in parts and components still remains within the EU, a figure that shows how European firms have developed an important pan-European production network. The completing of the single market and monetary stability guaranteed by the Euro has acted as the engine that has enabled the production systems of the various European countries to gain efficiency through this process of de-nationalisation. As was remarked recently in a Bruegel Report[2], it is now necessary when considering competitiveness to make reference to companies, not countries. The size, productivity and quality of the human capital and ability to innovate, as well the redistribution around the world of production processes, are decisive factors that explain the success of European companies, particularly in the emerging markets, due to competitiveness not in pricing but in quality. These are the factors to be borne in mind when defining a recovery plan for the European economy.

[2] G. Barba Navaretti, M. Bugameli, F. Schivardi, C. Altomonte, D. Horgos, D. Maggioni, *The Global Operations of European Firms. The Second EFIGE Policy Report*, Bruegel, Brussels, 21 July 2011

3) Globalisation and the constraints on economic policy

However, the globalisation process has also introduced important changes to the management of economic policies. The first observation concerns the impossibility of single nations to independently initiate their own measures for re-launching the economy. The size of any European market, including the German market, is no longer able to ensure that the effects of expansionary measures will not mainly occur through the channels of relations with abroad. As a consequence, no country is prepared to spend resources earmarked for national development which will then be largely enjoyed by others outside that country. There is therefore an under-sizing of the countercyclical policies, which can only be overcome if the stabilisation policy is handled in a large enough territorial area to ensure that most of the benefits are not gained externally. In other words, the task of the stabilisation policy has to be attributed to a European Government.

The prevailing view, influenced by the unbending position of the German government that reflects the cultural influences of a mindset which Germans call *Ordoliberalismus*[3] is that, in reality, countercyclical measures are not necessary as long as the automatic stabilisers are working efficiently. If the budgets are balanced, when income decreases, tax revenues decrease and expenses increase: the government budget then has a deficit and thus supports the economic recovery. In practice, even when there are automatic stabilisers, the effects still fall short of those needed to restore equilibrated conditions in the markets. Above all, however, even a good policy of automatic stabilisation is ineffective because it does not promote the structural changes necessary in this new phase of European and world politics.

The second observation starts with the recognition of the fact that globalisation has made environmental constraints a pressing matter. The great change that has occurred in the structure of the world economy requires a thorough repositioning of the economies of the old industrialised countries. As soon as weak signs of recovery appear in the world economy, rising prices of raw materials, foodstuffs and sources of energy are a clear sign of the impossibility to restart a process of development along traditional lines. The compatibility with the ecological balance of an American-style development model, based on a continual growth in demand for consumer goods, is guaranteed up until the start of the globalisation process of the “fortunate” circumstance that, out of six billion inhabitants in the planet, only a sixth of them belong to the industrialised world, enjoying affluent consumption and exerting pressure on the natural and environmental resources available, while the rest of the world remains excluded. In the last twenty years, the situation has radically changed. First the planet must ensure the survival of one billion more people and, above all, of these 7 billion inhabitants of

[3] S. Dullen-U. Guérot, *The Long Shadow of Ordoliberalism: Germany’s Approach to the Euro Crisis*, European Council of Foreign Relations, February 2012

the Earth, roughly six billion have entered the consumer society, and only a billion – mainly located in Africa and some Southern Asian and Latin American countries – have to live with the problems of acute poverty. As a result, the pressure on natural resources and the environment has grown exponentially, with effects that are now becoming very evident and are not limited just to climate change caused by carbon dioxide emissions but are strongly undermining the quality of life, particularly in the more industrialised countries. If there is to be ensured a better quality of life in the most prosperous areas and higher levels of consumption in the poorest countries, it will be necessary to apply austerity measures which reduce demand for natural and environmental resources so as to allow expansion in the poorest countries.

The third observation is founded on the profound remark from Einaudi that "the market will satisfy demand, not needs"[4]. It is a fact that a growing number of consumer goods are now available to families, even those with lower incomes. But the number of needs not satisfied is startling. And these needs are not met because they do not translate into monetary demand and are therefore not guaranteed by the market mechanisms. It is therefore necessary to shift resources for producing tangible goods towards satisfying the needs not guaranteed by the market. The problem that needs to be solved relates to the fact that, to meet these needs, it is necessary to use public resources to a large extent, in a situation where there is a sharp decrease in resources available, or to promote action by the 'third sector', which will require major restructuring of the economic and social sectors.

A last observation comes from the fact that the globalisation process has made competition much tougher in the world market, with the presence of new producers that can take advantage of modern technologies – which have now become an externality easily usable in all countries of the world that have skilled labour and are able to attract investment from more advanced countries – and whose workforces are paid considerably less than those in countries where the industrialisation process is older. The prevailing theory deduces from this that it is inevitable that external competitiveness will in any case prevail over the other objectives of economic policy, strongly limiting the extent of public spending to bring about a concomitant reduction in the tax level, so as to ensure that production costs for companies reduce and the possibilities of selling their products in the world market increase. And the dominant theory also argues that, in the new global distribution of economic power, it is no longer possible in Europe to maintain either the most advanced achievements of the welfare state, or the measures for environmental protection which, in our continent, are much more expensive than in other parts of the world.

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[4] L. Einaudi, *Lezioni di politica sociale*, Einaudi, 1964, p. 23

It is hard to agree with this dominant viewpoint because it overlooks the fact that the competitiveness of European industry is mainly linked to product quality and to the introducing of new technologies in the production processes. To ensure high levels of competitiveness over time it is necessary to increase expenditure on research and higher education – in order to have availability of highly skilled labour at all levels – and for the development of new technologies – in order to ensure the quality upgrading of products and processes. At the same time, the human capital, particularly the asset of a highly qualified workforce, should not be weakened by having people work more and more on temporary contracts that merely lead to their insecurity and continuous instability in employment[5]. If the intention is to introduce greater flexibility in the labour market, it must come with a strengthening of the social safety net and with higher investments for training and professional retraining. To achieve these results it is necessary to strengthen Europe's education, research and social policies, introducing in the system a greater amount of public expenditure aimed at these objectives, and this presumes very strict controls of other areas of expenditures in order to facilitate the structural change needed for starting a new phase in the development process of the European economy.

4) A model of growth based on environmental protection

In recent decades, the rate of growth of the European economy has progressively declined. Even before the recession in the Eurozone following the financial crisis that originated in the USA, the issue was raised of how to put in place an innovative strategy to support a resumption of growth. This led to approving the Lisbon Strategy whereby the European Union must become "*the most dynamic and competitive knowledge-based economy in the world by 2010 capable of sustainable economic growth with more and better jobs and greater social cohesion and respect for the environment*". Underlying this strategy is the recognition that, in order to sustain the living standards achieved and to guarantee the survival of the EU's social model unique in the world, it should increase productivity and thus make its products more competitive, in a world characterised by increasingly fierce global competition, rapid technological developments and the presence of an ageing European population. But the open method of coordination that was to have ensured the success of the community project failed because the EU has neither the financial resources nor the decision-making capacity necessary for bringing about the objectives set.

The Lisbon objectives were reformulated with the approval of the Europe 2020 Strategy in an attempt to take account of the profound structural changes that Europe requires. The key

[5] U. Beck, *The Brave New World of Work*, Oxford, Polity Press, 2000

point to consider, and which was only partially evaluated when formulating the Strategy, is that the problem no longer just relates to low growth rates resulting in higher unemployment, but there must come about a radical transformation of the European development model. Powerful drivers of change began after the introduction of monetary union: while there was increasing pressure towards a further agglomerating of production processes which favoured concentrating industrial activity in the already most industrialised areas located mainly in the North, the dynamic element of demand represented by private consumption progressively dried up, while growth in real estate has been faced with the increasingly expensive use of one of the most scarce resources i.e. urban land.

Whatever the economic factors requiring ad hoc interventions for overcoming the financial crisis and the resultant sovereign debt crisis, the recovery of growth in Europe thus presumes that the first thing to be identified is the dynamic factor that can support a new phase of accelerating the rate of growth (as happened in the past with the mass consumption of motor vehicles and, more recently, with the revolution in communication and information technologies). And, as Michel Aglietta clearly affirms, "*il ne fait pas de doute que l'environnement est la nouvelle frontière technologique [there is no doubt that the environment is the new technological frontier]*"[6].

5) Limitations on debt and the fiscal compact

Faced with the twin challenges of a progressive decline in the rate of economic growth and a continuous ageing of the population, with a consequent increase in costs for old age security and health protection, the European Union applies the traditional diagnosis which adopts the prevailing point of view in Germany: the problem of the European economy is connected with public sector borrowing in countries that are unable to comply with financial discipline. It is therefore necessary to impose stricter rules to avoid behaviours that can generate a further increase in debt which make it impossible to overcome the crisis in sovereign debt.

With the launch of the monetary union, the constraints to fiscal policies defined in the Treaty of Maastricht – of a deficit no higher than 3% of GDP and stock of debt equal to 60% of GDP – were further tightened by approving the Stability (and Growth) Pact which requires that, in the medium-term, the budgetary balance has to be at 'break-even' (or close to it). This rule was taken further by the fiscal compact which emphasised that the structural budget balance – i.e. net of cyclical trends - must not exceed 0.5% of GDP, while the distance between the share of debt as a percentage of GDP and 60% must be reduced by 5% per year. There

[6] M. Aglietta, *Zone Euro. Éclatement ou Fédération*, Michalon, Paris, 2012, p. 134

were then defined, still as part of the fiscal compact, control procedures and penalties to prevent breaches of these rules. The balanced budget law in the Eurozone must be included in the Constitution – or at least have an equivalent legal status – and must therefore acquire a role equal to that recognised in the Treaty of Maastricht to the independence of the European Central Bank.

This basically means applying a sort of strengthened *golden rule* because a largely balanced budget also includes the expense for investments. In the classic theory of public finance, the most widespread version of the *golden rule* requires instead that current spending must be financed from tax revenues, while investment spending can either be financed by the budget surplus or by issuing public bonds. Therefore the balanced budget law is applied to the current budget while the investment spending can be financed by borrowing (with some restrictions to prevent over-indebtedness, such as setting a maximum amount of tax revenue that can be used for covering expenses related to debt). The reason for this classic version of the *golden rule* seems clear because it is considered that coverage of an expenditure that is expected to produce its effects for a long period of time – for decades in some cases – cannot occur in just one financial year but must be spread over several budgets. In any case, if public investments promote growth, this results in increased tax revenues which thus make it possible to cover the costs of that investment.

The underlying assumption of the balanced budget law goes back largely to the Ricardian equivalence, in other words it is presumed that savers are perfectly rational and that the information is perfect. In this case, a deficit today can be expected to result in a tax increase tomorrow to finance the debt. As a consequence, savings must increase to meet future costs, and this leads to a contraction in demand. Conversely, a balanced budget will change the expectations of savers and investors, both domestic and international, and so the interest rates fall with positive effects on the budget balance by reducing the costs for servicing the debt. The fiscal resources freed up can therefore be used for funding the public investments for boosting the economy's rate of growth.

6) Financial stability of the Eurozone and the ESM

However, the basic justification for the fiscal compact goes back to the growing debts of the Member States of the European Union, which led to the sovereign debt crisis and has once and for all shown the limitations of a system of growth based on debt. These days, the Eurozone countries are not only curtailed in quantitative terms, but have lost a large part of their sovereignty regarding forming their budgets which must be submitted for prior opinion by the Eurozone institutions. If the commitments made when forming the budget are subsequently found to have not been met, the rules provide for sanctions and, ultimately, even an appeal to the European Court of Justice. The start of this budgetary union, strongly supported by Germany, is a step towards building a genuine fiscal union but, however important it may be, it is only a starting point, not a final goal. A balanced budget and continued reduction of the stock of debt are not sufficient for guaranteeing a strong re-launching and a structural change in the European economy, nor are they sufficient for ensuring compliance with the institutional rules that should characterised a full democracy.

The sovereign debt crisis, which led to approving the fiscal compact, was accelerated by the attacks from the markets on bonds issued by the Eurozone countries, the key aspects of which are explained by De Grauwe[7]: European states issue debt in a currency, the Euro, over which they have no direct control. They have therefore lost their monetary sovereignty, but do not yet form part of a federation. To permanently escape the European debt crisis it is therefore necessary that the Eurozone countries become members of a federal state. And it is in the direction of fiscal union that the process begun by the fiscal compact is heading since it rigidly governs the budgetary policies of the Member States, providing for control from Europe over fundamental acts of public finances of the Member States and even the competence of the European Court of Justice for overriding any national measures conflicting with the objective of a balanced budget.

However, alongside the fiscal compact, Eurozone countries have begun to create a specialised system for funding the member States that have lost their monetary sovereignty and are heading in the direction of becoming member states of a federation. Already now, the countries continue to be liable for the loans received – at lower rates of interest than those they would have to pay with national issues – from the European Financial Stability Facility (EFSF) for funding the new bond issues necessary to cover maturing bonds, and they must indicate in the forecast budget the amounts earmarked for the EFSF for servicing the debt negotiated. Once having ratified the new Treaty establishing the European Stability Mechanism (ESM), signed on 2 February 2012, it is destined to become the standard system for ensuring the financial stability of the Eurozone countries, gathering together the necessary resources by issuing bonds in return for the loans granted to the Member States (Article 3 of the Treaty). On the other side, the financial assistance from the ESM will be subject to conditions of strict compliance, which may include not only a macro-economic adjustment programme (Article 12) but also more specific guarantees: the founding Treaty gives the ESM a senior creditor status from the Member State funded (point 13 of the Recitals). As a result, in case of insolvency, the ESM will have the right to be reimbursed before private creditors.

[7] P. De Grauwe, *The Governance of a Fragile Eurozone*, University of Leuven and Ceps, April 2011

Lastly, "*the ESM shall establish an appropriate warning system to ensure that it receives any repayments due by the EMS Member under the stability support in a timely manner*" (Article 13.6). Ultimately, by granting loans to Eurozone countries and issuing bonds for providing the necessary financial resources, the ESM will be acting in practice as an embryonic Federal debt agency, while creating European securities attractive to the world and contributing to the development of the Eurozone financial market.

So, while the fiscal compact guarantees the respect of budgetary constraints by Member States of the Eurozone, the ESM is the first step towards starting a common system of financial support to Member States, putting an end to speculation based on a possibility of a debt crisis by a country forced to borrow on the market at excessively high terms which can lead to an unstoppable escalation of debt. The sovereign debt crisis has therefore obliged the Member States in the Euro area to launch the first tangible steps towards fiscal union. The remaining problem is that of growth.

7) Carbon tax and sustainable development

If economic recovery cannot – quite rightly – rely on growing debt, then it is necessary to evaluate, under the new terms coming from the approval of the fiscal compact, how it is possible to restart growth in the Eurozone, identifying: a) the dynamic factor that can start a new phase of development, b) the policies to be applied to activate it, c) the financial instruments for covering the expense. And the most appropriate answers seem to be: a) preservation of the environment, b), policies of innovation and technological development, and c) a carbon tax.

On the first point there is now a broad convergence of opinions, in which the definition of sustainable development not only includes environmental aspects but also economic and social. The key point of the new phase of development seems to be to find other sources of energy than fossil fuels, primarily to address the problem of climate change, but also to reduce Europe's dependence on imported gas and oil and to make available new sources of energy for economically backward countries, particularly in the African continent. Pursuing this objective requires a huge amount of public investment, primarily in research and in the application of research results for producing new sources of clean energy, for saving energy and for a more efficient use of energy.

All great revolutions in the economy and society have occurred with the arrival of new energy regimes, which have marked every stage of Man's progress and civilisation. Today the great technological challenge that humanity faces is to transform the widespread, inexhaustible and free solar energy increasingly efficiently into electricity. The rapid progress in recent years in the field of wind and photovoltaic energy shows that the beginning of an era is close at hand in which every person can become a producer of the energy each consumes, and the countries in the South of the world, up to now afflicted by poverty and underdevelopment, will realise that they are “sun rich”. This finding reveals the democratic content of the new “green” energy regime and its potential for a more equitable redistribution of energy resources and wealth among the peoples of the Earth.

Apart from promoting public investment, European policy should also allocate an increasing level of resources to funding higher education to produce high quality professional staff, and to basic and applied research to start building a new paradigm in energy production that makes production growth compatible with the preservation of environmental quality. Research and technological innovation must also develop the use of new sources of energy to improve the quality of life, particularly in urban areas: for example, the problem of ‘soft mobility’ that does not produce pollution and which frees the city environment from the burden of congestion.

The instrument for facilitating the transition to a new economy of clean energy is the carbon tax, which is a European tax imposed on the various sources on the basis of both the energy content and, more importantly, based on the carbon content[8]. A first portion of the tax – on energy – is designed to encourage energy saving, while the second part – on the carbon content – discourages the use of fossil fuels and encourages turning to new sources of clean energy. A further positive effect of a carbon tax is that the promoting of new sources of energy is done directly through the market and without the need for bureaucratic interventions that promote the production of initially very expensive energy by incentives since they would otherwise be unable to become established on the market without public support. With the carbon tax, the price of fossil fuels increases in proportion to the negative externalities caused by carbon content, thus making it worthwhile turning to alternative energy sources.

8) Objectives of the new model of sustainable development

When pursuing a new model of ecologically sustainable development, European policies should also propose:

[8] A. Majocchi, *Carbon-energy tax e permessi di inquinamento negoziabili nell’Unione europea*, Discussion Paper n. 3, Centro Studi sul Federalismo, Torino, October 2011

- that the circle is ended of extraction, use and restoring of natural resources since humanity now consumes (and often wastes) the natural resources which are scarce by definition and degrades the environmental heritage by a pace of exploitation beyond its ability to regenerate. It is necessary to reconcile the economic pace (growth) with the ecological pace, using the "almost mature" technological solutions in each sector, in the recycling of materials, so that the resources are used and reused indefinitely and, at the end of the production cycle, the product waste obtained is nothing other than the original resource. In this sector, the role of technological innovation can have an impact on economic development and employment comparable to that of the new energy regime,
- that sustainable farming is promoted, since the "green revolution" of the 1990s based on irrigation, mechanisation, high-yield seeds and chemical fertilisers has not produced good results, as already extensively certified by the UN and FAO, and that it is adopted organic farming to affirm "the right to food" in the world, producing good, clean food and in the right quantities for everyone, respecting the quality of the land, local cultures, traditional methods, businesses and local input, and the "short production chain".

But there are other areas where EU policy can promote the development of a green economy:

- sustainable mobility, based on public transport, electric and fuel cell vehicles
- energy storage and hydrogen technology as an energy carrier, generated from renewable sources
- redesign cities to make them less polluted and more liveable
- construct "passive energy" homes
- use the internet and inter-grid for energy distribution.

Ultimately, the "green" revolution can open up a future of economic development that is more democratic, widespread, fair and balanced, driven by the wave of a technological revolution whose effects while certainly deep and long-lasting, are currently still hard to define.

9) The European plan for sustainable development

In a continually changing global scenario, with a growing share of the world population participating in the development process that requires a rational and efficient use of natural resources (food, energy), Europe needs to implement a policy of strict control of resources, transforming its economic and production system fairly and sustainably. The basic choices of Europe are already pointing in the right direction, starting with the objectives indicated in the

Treaty of Lisbon through to the decisions of the European Council with the launch of the Europe 2020 Strategy. The narrow path of budgetary rigour (both for countries and for individuals) and sustainable development is only viable if there is a joint European effort. Development can only be kick-started by investments that make European businesses competitive, reducing power consumption and the cost of energy and raw materials, making full use of information technologies, and promoting and spreading an aware society.

The gradual increase in per capita income of citizens in emerging economies opens up enormous possibilities for Europe to export goods and quality services, thus bringing the European economy into the new world cycle. The ability to produce industrial goods with a high technological component, advanced services and cultural assets is already widespread in many areas, but this can only spread, expand and improve if put in the perspective of a strategic choice that aims at a profound restructuring of the European economy.

Starting with the common market and, subsequently, with the single market, Europe began long cycles of expansion. The challenge now is to promote a similar choice, aimed at fully integrating Europe in the new structure of the world economy. Proposals circulating in this difficult stage of the European economy are often aimed in the right direction but, by being limited to individual national frameworks, they hamper their feasibility, effectiveness and economy. Similarly to the Single Market programme of 1992, also today the solutions most discussed solely propose avoiding the cost of the “non Europe”. The most significant example comes from investments in research – especially in the field of new energy sources – to understand how plans that are only made at national level and not integrated throughout Europe, are a huge waste of resources, no longer permissible due to the necessary austerity policy that should provide guidance to public budgets and private companies.

Today Europe must rapidly launch a *European plan for sustainable development*, of small size but decisive for indicating the directions to take by all the European economic and social operators. It is the prime responsibility of the European Commission to propose the measures necessary to the European Parliament and Council and to present them to Europe’s citizens and to the political, economic and social powers. The Plan must also involve relationships with the areas most strongly associated with the Union, due to their geographic proximity, particularly the Mediterranean countries that have initiated a profound political, economic and social change.

The investment plan proposed at the time with great foresight by President Delors must now be re-proposed and aimed at creating the necessary conditions for competitiveness, sustainability and social cohesion for European recovery. It is the Commission’s task to specify the projects to be supported, ensuring that they are feasible, and guaranteeing a rigorous and transparent management. The European budget should, in the long run, be funded entirely from own resources, whose essential components should be a carbon tax, a financial transaction tax and the new European VAT. The proposals already put forward by the Commission regarding the carbon tax[9] and financial transaction tax[10] constitute essential elements of the Plan and adopting these proposals could secure funding. The carbon tax might also push the economy towards sustainable choices and is compatible with transitional measures in which the tax is payable also on products imported from areas that have not yet adopted similar measures. The financial transaction tax can be used for making the transition of the economic system socially sustainable – significantly refinancing the Globalisation Adjustment Fund and redefining its tasks – and for shifting at least part of the tax burden from unskilled and temporary employment to unearned income.

The launch of the Plan, with its common European taxation measures, should be accompanied by a reduction in the expenditures now budgeted in each of the Member States in those sectors where action can be jointly undertaken. In order to assure the maximum transparency and efficiency in using the resources it is necessary to provide in all cases where possible – and certainly in the field of research for new sources of energy – the activation of specific programmes and, where appropriate, agencies in charge of employing the funds. Since the main objective of the Plan is to re-launch investments, it is necessary to provide substantial financial injections – even if their disbursal is deferred – enabling the issue of project bonds, involving the EIB in the preliminary assessment and management of the operations, to be done through a Trust Fund that retains the ownership of the investments made, for the part financed by the Plan, in order to have (from the income from such investments, albeit deferred) resources for the new generations.

10) Funding the plan

With the financial transaction tax it will be necessary to collect about €30-40 billion of additional resources for the European budget to allow for adequate allocations in the sector of research and for refinancing the Fund set up by the Commission in 2006 to cope with the difficulties brought about by adjusting to the globalising of the labour market. The EU budget would thus be close to the threshold of 1.27% agreed in the past by the Member States. In the previous expansion cycles, Europe was able to create over 15 million new jobs. The Plan

[9] *Proposal for a Council Directive amending Directive 2003/96/EC restructuring the Community framework for the taxation of energy products and electricity*, COM(2011)169 final, Brussels, 13.4.2011
[10] *Proposal for a Council Directive on a common system of financial transaction tax and amending Directive 2008/7/EC*, COM(2011)594 final, Brussels, 28.9.2011

should allow for creating at least 20 million new jobs given that it should particularly make the services sector competitive and thus halve the current unemployment rate[11].

The investments provided for by the Plan should reach at least €300-500 billion, to be disbursed over a period of three to five years. To enable the issue of project bonds – with appropriate guarantees from the EU – it would be necessary to use carbon tax revenues amounting to at least €50 billion annually to repay the bonds issued. The use of the carbon tax to support the investments plan in the start-up stage would be fully justified by the fact that the revenues from this tax will tend to decrease as the European economy – also because of the Plan – begins using sources of energy not generating CO_2.

At the end of the period of implementing the Plan, the EU would have capital whose value could be at least double the size of the investment, thereby ensuring that new generations have adequate support, as already happens for young Norwegians by means of the Pension Fund funded by oil revenues. In this case, the European Capital Fund would be financed by the revenues from new sources of energy brought about by the Plan through the research investments and expenses, and could also support the inclusion of young Europeans in a programme of civil service similar to the Erasmus programme, in self-employed activities, and in projects aimed at eliminating temporary job situations.

If insurmountable difficulties were found for participation by all EU countries in the Plan, it will be necessary to allow the possibility for a group of countries to proceed, activating the enhanced cooperation rules, especially by the Eurogroup and those countries that want to join in the Plan's implementation.

11) Increasing the European budget and the financial transaction tax

To be politically manageable, the European budget should increase over time only moderately, and should not in any case exceed 2% of GDP in the medium term, as was already suggested in 1993 by the commission of experts appointed to study the role of fiscal policy in an economic and monetary union[12]. Increasing the size of the European budget must clearly be accompanied by a reduction in the budgets of Member States, transferring expenditures (for defence, foreign policy and research in particular) to a higher level, based on the subsidarity principle, that can be made with greater efficiency and with considerable

[11] A. Iozzo, *Per un piano europeo di sviluppo sostenibile*, Discussion Paper n. 2, Centro Studi sul Federalismo, Turin, October 2011
[12] *Stable Money - Sound Finances. Community Public Finance in the Perspective of EMU*, in "European Economy", 1993, No. 53

savings by using the economies possible from a greater concentration and, therefore, with very large economies of scale. It is clear that, as the need for investments increase that require financing from Europe – also providing for the future use of Eurobond issues as a means for financing the investments and for strengthening the European financial market –, the necessity to reform the structure of the European budget will also occur, firstly by providing for the return to a system of genuine own resources. The so-called 'fourth resource' is not a real own resource, since it is nothing more than a national contribution as a proportion of GDP, and could be replaced by a European surtax on national income taxes – which would not be affected by the reform – paid directly by citizens to the European budget in such a way as to ensure the greater transparency of the tax while also increasing the responsibility of those who draw on the resources.

A new resource could be secured for the European budget if the proposal recently made by the Commission for a Directive to introduce a carbon/energy tax as of 2013 is approved. In a situation in which the risks connected to climate change are now clearer and the necessity to replace fossil fuels with alternative energy sources is increasingly urgent, a tax proportionate to the content of carbon in the energy sources seems to a method appropriate for starting a virtuous cycle of energy saving and fuel switching towards renewable sources of energy, reducing the negative environmental impact of energy consumption and supporting the introduction of less energy-intensive production processes. Applying the rate proposed by the Commission of €20 per ton of CO_2 and with total emissions throughout the EU estimated by the European Environmental Agency as being slightly below 5 billion tons, the revenue for the EU budget could be around €95-100 billion. A part of this revenue could be used to finance the production of global public goods by means of a European contribution for promoting the establishment – in agreement with the United States and other G20 countries – of a world fund for sustainable development.

In this context of reforming the budget, a significant instrument could be to introduce a financial transaction tax, as was recently proposed by the Commission. According to this proposal, the tax becomes payable for each financial transaction taking place at a rate no lower than 0.1% and 0.01% for financial transactions relating to derivative contracts. The revenues from this, estimated by the Commission at €57 billion, could be shared among the EU budget and the Member States. In the current economic situation, a tax placed on operations of a speculative nature could be more acceptable to public opinion than other forms of taxation, while also encouraging a greater use of savings for funding investments rather than financial transactions.

12) The European Treasury and fiscal federalism

In the last phase, aimed at building a real federal fiscal union, the budget funded by the EU's own resources could be managed by a European Treasury of a federal nature, in charge of implementing the Sustainable development plan and for coordinating the economic policies of Member countries. In this way, also the attractiveness of debt instruments issued by the EU would increase, guaranteed by taxation revenues going straight to the federal coffers. Once this institutional transformation has been achieved, it therefore appears entirely realistic to expect a European Treasury Ministry to be set up, a first fundamental pillar of a European economic government.

The plan aimed at building a federal financial union and for establishing a European Treasury should be the subject of a decision of the European Council, which immediately sets the timeframe for the various stages and, above all, the deadline which will mark the beginning of the Fiscal Union's operations. But although a decision of this nature is important, it is not sufficient. There is an underlying difference between fiscal union and monetary union. The Central Bank is a constitutional body whose independence is enshrined in the Treaty of Maastricht, with the important but limited task of ensuring stability in prices by means of fully independent decisive actions. The Treasury is a different type of constitutional body because it is a fundamental principle of democracy that there is No Taxation without Representation. The Treasury can only operate effectively if there is agreement and must therefore be subject to the democratic control of the Parliament and act as part of a government that is representative of the will of the people. The decision to proceed with building a fiscal union, with a Treasury and a federal finance, must therefore be accompanied by a simultaneous decision that sets the date for starting a full Federation, which will also include being tasked with foreign policy and European defence.

Ultimately, the launch of a European plan for sustainable development should be included in a project involving the evolution by stages from monetary union to a real economic and fiscal union, which would then result in a fully complete Federation. With this view, approving the fiscal compact can be seen as the first step towards fiscal union, with the defining of a process that must lead to the consolidating of public budgets of the Member States, starting with those in the Eurozone. However, the rebalancing of the budget is a necessary part, but not sufficient. In a second stage, the restructuring should be accompanied by policies that favour growth, by defining a European plan for sustainable development. The fiscal compact has introduced new principles for the governance of the European economy, with control of budgets and of the macroeconomic performance of Member States, but without guaranteeing the development and a democratic control of the choices made at European level. The definition of the Plan and, above all, its practical implementation, require taking a further step forward on the institutional terrain, with closer cooperation between the Commission and the national treasuries, which can be institutionalised by creating a European Fiscal Institute – along lines similar to those provided when setting up the European Monetary Institute for creating the Central Bank.

Lastly, the third phase must lead to creating a Treasury, responsible to the European Parliament and to the Council, and put in charge of managing the economic and fiscal policies. The economic and monetary union would thus be finally completed, with a democratic government of the European economy, with a view to completing the federation by recognising new competencies in the sector of foreign policy and defence.

13) From fiscal union to a European Federation

From the foregoing, a concluding observation can be made. The sacrifices required to meet the terms imposed by the Treaty of Maastricht for entry into the monetary union appeared viable considering the benefits deriving from using a single currency. But, after a short while of expansion, the financial crisis arrived which, in turn, fuelled the crisis in sovereign debt, forcing Eurozone countries to impose new sacrifices. As a result, Europe is increasingly seen as being not only foreign to the daily lives of citizens but even hostile, imposing constraints and sacrifices without guaranteeing a better and safer future. It is therefore time to change, by setting up a development plan, starting with the Euro area, for reviving the European economy and employment. If the growth prospects change and the problems connected to the sovereign debt crisis are resolved, the confidence of citizens can be restored, thereby helping the transition towards a federal result of the European unification process by creating a Federal Treasury responsible for managing the budget and coordinating European economic policies to promote sustainable development. After the new currency, this would lead to creating the second arm of a federal state, with a view to completing the process by attributing the EU with decision-making powers also in the areas of foreign policy and defence. As regards the perimeter within which it is possible to start this process, the starting point is certainly by the Eurozone where there has already been seen an ever growing interdependence and where it is possible to foresee further developments in a Federal direction.

In the current situation, with the continuation of the sovereign debt crisis, it needs to be clearly stated that the decisive point is essentially political: it means transferring the power to independently handle the fundamental decisions of economic policies to Europe – which have so far been jealously guarded by the Member States –, thus completing the building of the economic and monetary union by creating a Federal Treasury and with the possibility of guaranteeing an effective coordination of the national policies through the power (limited but real) attributed to a European government. *Hic Rhodus, hic salta*. The sovereign debt crisis has shown that the modest institutional progress achieved by the Lisbon Treaty is entirely insufficient and that it now requires achieving the construction of a federal state in Europe, with responsibilities currently limited to the sector of managing the economy and currency, within the framework of the group of countries in the EU where the degree of integration is most advanced, particularly within the Eurozone.