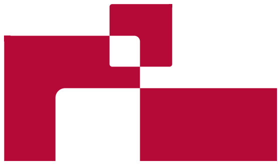

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WHAT KIND OF FISCAL UNION?

by

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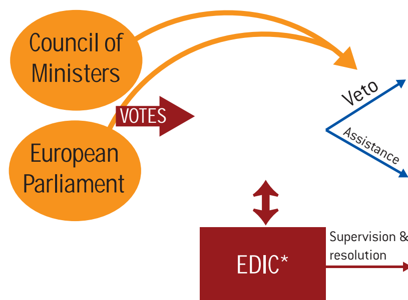

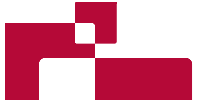

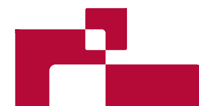

The reaction of euro-area policy-makers to the crisis falls short on a number of grounds.

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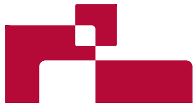
The introduction of the euro typically was not accompanied by structural reform to provide countries with instruments to contain their internal and external imbalances. To address this, a new Euro Plus Pact commits members to competitiveness-enhancing structural reforms (eg

4. See Hallerberg, Marzinotto and Wolff (2011).

5. Marzinotto, Pisani-Ferry and Sapir (2010).



blueprint for the EFSM. By contrast, other crisis instruments, from the Greek loan facility to the European Financial Stabilisation

8. Gianviti *et al* (2010) have made proposals to this effect.

9. Italian financing needs until the end of 2012 do not exceed €500 billion. At a current rate of seven percent, a payment of €15 billion (€500 billion x three percent) would bring the actual budget impact down to a *de-facto* interest rate of four percent.

the insolvencies of banks that are too large to be saved by national taxpayers, even if this capacity were in the interest of the euro area as a whole. The very high level of financial integration in the euro area should be matched by an equally integrated banking supervision and resolution authority. The euro-area finance ministry should help establish such an authority. It should have sole supervisory authority over all systemic banks, with complete and direct access to all information for the relevant institutions. In addition all euro-area banks that accept deposits should contribute an

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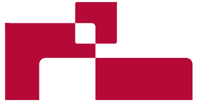
We note that all successful currency areas have a sizeable federal budget; our proposal involves a smaller one. We argue that the euro-area finance ministry would need a taxing capacity of perhaps two percent of euro-area GDP in case loans provided to an illiquid country were to turn bad or bank recapitalisation needs were to exceed the funds available in the EDIC insurance. Euro-area GDP is around €9,000 billion. With a permanent income stream of €90 billion annually (ie one percent), one could borrow up to €2250 billion at a hypothetical interest rate of four percent. This borrowing capacity would be large enough to take Italy and Spain from the market for several years. Alternatively, a payment mechanism that would guarantee that liquidity crises do not become self-fulfilling by reducing the budgetary impact of spreads could be established with limited tax resources[12]. Until



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