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[illegible]

The idea to complement European Monetary nion with some form of fiscal federalism is not new. In , the Mac ougall report suggested [illegible]

. t the country level, the notion of 'general government' covers the central government, local governments and social security institutions. ocal governments cover municipalities and, in federal countries, states or regions.

the E as a federation, it would be a complete outlier, with 'local' (ie member state) budgets representing percent of total expenditure. s for the euro area, it has no budget except the lending capacity of the ESM (- billion in , e ual to about percent of euro-area member states' combined budgets).

Following the conventional classification of public intervention (Musgrave and Musgrave,), the purpose of a federal budget is threefold. First, it should finance those public goods that are common to all regions, such as research, infrastructure, diplomacy and defence. Second, it may carry out transfers between regions to correct geographical or historical disadvantages and maintain national cohesion. Third, it ensures macroeconomic stabilisation, ie smoothing out business fluctuations in line with the P trend at national level and across the regions, local budgets being generally constrained by tight balanced-budget rules .

The small E budget has so far been entirely devoted to the first two objectives. This raises three uestions. First, should the E budget be expanded and or re-purposed Second, does E and national spending need to be complemented with spending at other levels of government, such as the euro area or Schengen area Third, does the euro area need federal resources for fiscal stabilisation

n the first uestion, we agree with those who argue that the E budget needs to become more efficient and future-oriented . The second uestion is related

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Fiscal stabilisation is the use of fiscal policy to support the economy through higher spending or lower taxes in a downturn, and to eliminate the budget deficit in an upturn. Fiscal policy is im

BOX 1: PRO-CYCLICAL FISCAL POLICY AT AGGREGATE LEVEL

The orientation of aggregate fiscal policy in the euro area can be captured by the *fiscal impulse*, ie the variation in the ratio of the general government balance to GDP. A rise in the budget balance means fiscal tightening, whereas a fall means loosening. These variations are deemed counter-cyclical if they go in the same direction as the economic cycle (eg fiscal tightening when GDP grows faster than potential growth) and pro-cyclical in the opposite case.

The fiscal impulse can be decomposed into an 'automatic' variation related to the economic cycle, and a discretionary p [illegible]

. See Blanchard *et al* ( ).

. See Independent nnual Growth Survey Consortium ( ).

. This was already the conclusion of arvas and ihri ( )

restructuring procedure, as some scholars have
[illegible]

. See Committee on International Economic Policy and eform ([illegible]). The report proposes further adjustments to C Cs to make them more effective.

stance (European Comm[illegible]

. rticle of the Treaty on the Functioning of the European nion imposes fiscal discipline, not fiscal stabilisation.

cycles (Besson, [illegible]), discretion does not necessarily produce a counter-cyclical policy. The [illegible]