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THE IDEA

The idea to complement European Monetary Union with some form of fiscal federalism is not new. In 1992, the MacDougall report suggested

at the time of the MacDougall report, the idea was to have a central government, local governments cover municipalities and, in federal countries, states or regions.

At the country level, the notion of 'general government' covers the central government, local governments and social security institutions. Local 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 10 percent of total expenditure. As for the euro area, it has no budget except the lending capacity of the ESM (€ 500 billion in 2012, equal to about 10 percent of euro-area member states' combined budgets).

Following the conventional classification of public intervention (Musgrave and Musgrave, 1980), 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 long-run 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 questions. 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?

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

FISCAL STABILISATION

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-

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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 pulse.

. See Blanchard *et al*
{ [B] }.

. See Independent Annual
Growth Survey Consortium
{ [B] }.

[B] This was already the
conclusion of Barvas and
Vihriä { [B] } *enq* 44

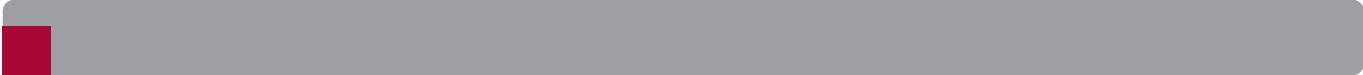
restructuring procedure, as some scholars have
proposed (see e.g. Wijnbergen and Wijnbergen, 2011; Wijnbergen and Wijnbergen, 2012; Wijnbergen and Wijnbergen, 2013; Wijnbergen and Wijnbergen, 2014; Wijnbergen and Wijnbergen, 2015; Wijnbergen and Wijnbergen, 2016; Wijnbergen and Wijnbergen, 2017; Wijnbergen and Wijnbergen, 2018; Wijnbergen and Wijnbergen, 2019; Wijnbergen and Wijnbergen, 2020; Wijnbergen and Wijnbergen, 2021; Wijnbergen and Wijnbergen, 2022; Wijnbergen and Wijnbergen, 2023; Wijnbergen and Wijnbergen, 2024; Wijnbergen and Wijnbergen, 2025).

. See Committee on International Economic Policy and Reform (2017). The report proposes further adjustments to C Cs to make them more effective.

stance (European Commission Policy Brief 2012)

Article 125 of the Treaty on the Functioning of the European Union imposes fiscal discipline, not fiscal stabilisation.

cycles (Besson, 2011), discretion does not necessarily produce a counter-cyclical policy. The



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