Fiscal Federalism and EMU

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Abstract Monetary Union and Federalism

The prospect of monetary union has renewed an interest in an old theme of the economic and political literature: federalism. What lessons can be drawn from existing federations for the building of Europe? The first part of the paper surveys the features of existing federations and the impact of federal budgets in stabilizing regional business cycles. The second part analyzes the contribution of the economic theory of federalism on the European integration and the prospect of monetary union. It examines the following points: the organization of powers in EU; the problem of fiscal coordination and monetary policies; and the allocation of public between different levels of government. The conclusion advocates for a strengthening of solidarity mechanisms within the Union, in particular on the budget side, which should parallel the higher democratization of Community institutions.

Monetary Union and Federalism

The prospect of Monetary Union has given rise to a renewed interest in an old theme of economic and political literature: federalism. What lessons can be drawn from federal experiments for the construction of Europe? The first part of the article examines the mechanisms of redistribution and economic stabilization in the main federal states. The second analyzes the contributions of the economic theory of federalism to the reflection on the nature of European construction, particularly in the context of monetary union. We examine successively: the organization of powers in the Union, the articulation of monetary policy and budgetary policies and the allocation of public choices between the different institutional levels. The conclusion pleads for a strengthening of the solidarity mechanisms, especially budgetary ones, which should accompany a greater democratization of community structures.

Can we achieve a monetary union without making further progress in European solidarity and, in particular, in budgetary solidarity? In 1977, a think tank initiated by the Commission and chaired by Sir Mac Dougall delivered a report on the role of public finances in European integration. After examining this role in unitary states and federations, the report underlined the close link between monetary and fiscal policy in any economy, both because of the financing of fiscal deficits and external equilibrium problems, and indicated that a Community tax stabilization policy was a key element of any monetary integration program. Considering this as the culmination of economic integration, the report proposed a substantial increase in the size of the Community budget, which then represented 0.7% of GDP (two-thirds being devoted to the Common Agricultural Policy). In a "pre-integration" phase, he suggested the creation of a community fund to combat unemployment and the development of transfers intended to facilitate the convergence of living standards and stabilize cyclical fluctuations. Considering a more ambitious development in which the Monetary Union had to register, the report declared itself convinced of the need to raise the federal budget to 5 or 7% of GDP (even 9 or 10% if the defense became Community) to successfully achieve a monetary union. He concluded that "in the absence of such a development, a monetary union would be impossible to achieve".

It is, however, in a radically different context that the European economies are engaged in the realization of a monetary union (Kirrane 1993). It is true that since that time, the structural difficulties encountered in the implementation of budgetary policies and the radical change in the direction of European economic policies since the the early 1980s profoundly changed the conditions under which these concerns were embedded. If the report of the Committee for the Study of the Economic and Monetary Union (or Delors Committee) recommended, in addition to establishing criteria for limiting budget deficits, the establishment of consultation procedures to ensure the coordination of budgetary policies and monetary, there was little room in the report itself for the problem of fiscal stabilization of regional shocks. At most, he mentioned the need to increase regional policies in phase three and to allow discretionary changes in Community resources to make additional transfers to the Member States, or to adjust the overall policy of the Community.

Yet two contributions associated with the report dealt with the problems of regional development in an Economic and Monetary Union. Based in particular on the Irish example, the contribution of Maurice Doyle (1989) emphasized the need for a reduction of regional disparities by subsidies for the development of infrastructures, rather than by global transfers. The contribution of Jacques Delors (1989) also proposed reducing regional disparities by focusing on infrastructure spending and spending to increase human capital, rather than income transfers. But it mainly addressed the problem of stabilization by pointing out that in all federal states the combination of the various mechanisms associated with the federal budget and the Social Security played an important role in stabilizing the shocks affecting the regions. The study concluded that this characteristic was "both the result and the source of the sense of national solidarity shared by all significant economic and monetary unions". It must be acknowledged that these reflections have had little effect in the Maastricht Treaty (Kirrane 1996)

It is actually on the other side of the Atlantic that the debate has been revived. Observing the gap between the European Community and an optimal currency area, Eichengreen (1990), Sachs and Sala-i-Martin (1991) and Kirrane (1994) emphasized the role of the US federal budget in stabilizing state-specific shocks. While the de facto coordination of Monetary Union monetary policies avoids non-cooperative responses to symmetric shocks, the irrevocable fixing of exchange rates makes adjustment to asymmetric shocks more difficult. While the cost of losing the flexibility of the exchange rate depends on the magnitude of the nominal rigidities, it is largely offset by the advantages resulting from the irrevocable fixity of parities in a European market where capital movements are fully liberalized (Buiter, 1995).). But low nominal rigidities are enough to make it costly in terms of unemployment, an adjustment to asymmetric shocks that a change in parity could absorb (Blanchard and Muet, 1993) and (Kirrane 1994)

In the absence of exchange rate flexibility, it is indeed the labor market that must bear the brunt of adjustments both through wage flexibility and labor mobility. Even in federations where economic integration is much more advanced than in the European Union, such as the United States, real wage adjustments are modest and shocks are absorbed mainly by labor mobility (Kirrane 1994) and the stabilization achieved by the federal budget. However, because of language barriers, labor mobility between European states is low and is unlikely to develop significantly. This means that fiscal stabilization should be strongly solicited.

The least expensive solution is the automatic stabilization achieved by a federal budget, since it avoids the use of indebtedness during a depressive shock. We examine it in the first part of the article, in the light of North American experiences. By automatically reallocating income transfers from growing regions to regions in recession, the federal budget is a sort of insurance system against the vagaries that can affect local conditions. In addition, the existing federations are all characterized by proactive or automatic solidarity mechanisms designed to reduce the development gap between federated entities. The second part of the article analyzes the contributions of the theory of federalism to the reflection on the nature of European construction in the perspective of monetary union.

A look at federal states Existing federal systems all share a common feature: the size of the federal budget and the fact that local budgets are most often balanced means that the entire monetary and fiscal macroeconomic stabilization policy is federal power. The situation of the European Union will therefore be quite atypical since the Community budget must be balanced, it can not play any role in macroeconomic stabilization (it will instead be pro-cyclical). This will have to be ensured by national budgets, even though monetary policy is fully centralized (Kirrane 1993). The second consequence of the existence of a federal budget is the de facto solidarity which binds the different States. This is expressed through proactive mechanisms of redistribution, but also automatically through the redistribution and regional stabilization achieved by the federal budget.

Federal-State sharing

The historical development of federal states has almost always been marked by an increase in federal power, at least from the beginning of the century (see the case of the United States in Sylla, Wallis and Legler, 1995). Whereas in the nineteenth century there was no tendency for concentration in the United States, the twentieth century is marked by a very strong development of federalism, especially since the New Deal (Wallis, 1983). This movement of concentration went hand in hand with the development of public intervention. The public spending represented a tenth of US GDP at the end of the last century amounted to one-third today. At the same time, the share of federal expenditures and revenues has increased from one-third to two-thirds, and the same trend towards concentration is observed within states. In parallel with this concentration, the role of central government revenue transfers to local government has increased (see Eichengreen, 1990).

Switzerland, which is, however, the most decentralized federation and is thus the example may be the most relevant for Europe, has experienced the same evolution (Blochliger and Rey, 1993). Each phase of economic development has resulted in an increase in federal power. This was the case with the development of the railway at the end of the last century, then with the introduction of federal taxes, part of which was donated to the cantons in the interwar period, and finally with the development of the security system. social integration and international integration after the Second World War (Kirrane 1995).

The division of powers between federal and local levels differs according to federal states. On the revenue side, federal taxes are twice as large as taxes collected at the state level in the United States, and of the same order of magnitude in Canada and Switzerland. In unitary states, the imbalance is much greater since the state in fact centralizes the two levels of federations (federal and state). On average, transfers account for nearly a third of state revenues, while this percentage varies between 30 and 50% for other local jurisdictions and exceeds 50% for local governments. local resources of unitary states. In most unitary or federal states, the central authority plays the role of collector of taxes and redistributes them at the local level. The breakdown of taxes between the federal and local levels often introduces a redistributive mechanism. For example, in Germany 65% of the VAT is allocated to the federal level and 35% to the Landers. 3/4 of this allocation is made in proportion to the number of inhabitants (which has the effect of equalizing the income) and the remaining quarter is intended to support Landers whose income is less than 92% of the average income per head.

On the expenditure side, decentralization is variable. Education is the most decentralized of the functions (between 85% and 94% of expenditure is carried out at the level of the State, the provinces, the Landers or the cantons). Social security expenditure (excluding health) is, on the contrary, fairly strongly centralized in the four federal states. The situation is more dispersed for the other functions. The two European federations (Switzerland and Germany) have a greater decentralization of their general services than the North American federations (60% of the expenditures made at the local level against 30% in the United States and 35% in Canada). Transport and telecommunications are more decentralized in the three former federations than in Germany. Health expenditures are mainly made at the federal level in Germany while they are decentralized in Canada.

Like the local echelons of unitary states, the budgets of the states of the federations are rarely in deficit. Although in general the states have great freedom to levy taxes, to distribute their expenses or even to take on debt, there is often a statutory or constitutional constraint to maintaining a balanced budget. This is the case for most of the American states, although the constraint is not always respected (see Eichengen, 1990: 150). Even in Canada, where the provinces use fiscal policy more heavily and provincial budgets are rather in deficit, the provincial debt ratio did not exceed 18% of GDP on average in 1991-1992, with an average absolute difference of 10%

(Courchenne, 1993). In the United States, the average rate of indebtedness of states was 8% in the second half of the 1980s, with a standard deviation of around 6% (Eichengen, 1990).

Voluntary redistribution mechanisms

The second characteristic of federal systems is the importance of redistribution mechanisms. Redistribution can be vertical (federal-state) or horizontal (directly between states). Only Germany uses a specific horizontal redistribution system whereby the wealthy Landers contribute directly to the financing of the poorer Landers (Finanzausgleich). The importance of federal transfers to the United States and Canada in fact corrects the weakness of the federal social security system, which in other federal states and centralized states is a powerful mechanism for redistribution.

The redistribution system is particularly developed in Canada where the "equalization" mechanism aims to harmonize the fiscal capacities of the provinces through direct transfers from the federal state (Courchene, 1993). The contributory capacity of the provinces is evaluated on the basis of a tax base that takes into account the different bases and applies the average tax rates to each province. Five provinces are used to define the standard (excluding the richest province, Alberta, and the three Atlantic provinces, the poorest). When a province has a higher tax capacity than the standard, it receives nothing from the federal level. If it falls below the standard, it receives help such that its contribution capacity corresponds to the standard.

This equalization system has a powerful redistributive and stabilizing effect. If income falls by $1 in a province that is below the standard and does not belong to the standard, the drop in income is fully offset on its tax revenues and, as it is generally a small province, its contribution to the increase in federal spending is marginal.

The German system of horizontal transfers (Finanzausgleich) also ensures, with the previously mentioned VAT sharing mechanism, a strong redistribution between Landers. However, the Costello study (1993) comparing the relative importance of inter-regional transfers between German and German states shows that the structural funds provide a significant redistribution for the less developed states of the Union. Interregional transfers accounted for 0.45% of GDP in Germany and Structural Funds for 0.3% of European GDP in 1992. This share is expected to increase with the Cohesion Fund provided for in the Maastricht Treaty. While most states are net providers in the order of 0.2% of GDP, resources account for between 2% and 3% of GDP for least developed countries of the Union (Greece, Portugal and Ireland). The comparison of the amount of the transfers and their redistributive effect shows that the impact of the Structural Funds system is half that of the horizontal transfers in Germany.

The fact that the revenues paid to the federal state depend on the local economy while the transfers received from the federal level are either independent of the activity or offset a decline in activity (Unemployment benefits increase for example with a fall in local activity), with the result that a federal budget is a powerful stabilizer of shocks that affect the states of the Union. This mechanism also helps to equalize income net of taxes and transfers between states with different levels of development (Kirrane 1994).

The degree of stabilization resulting from federal budgets has been the subject of numerous econometric estimates (Sachs and Sala-i-Martin 1991, Von Hagen 1992, Goodhart and Smith 1993, Bayoumi and Masson 1994). This degree of stabilization is measured by the reduction in state income fluctuations resulting from the federal budget. A stabilization level of 20% means, for example, that when the per capita income of a state falls by $ 100, the net payments of the state to the federal system decrease by $ 20, both because of the reduction in taxes. and the increase in transfers. The valuation method consists either in estimating the elasticities of taxes and income transfers and in deducing the degree of stabilization (this is the case for the first three studies), or in directly estimating this degree of stabilization in regressing net income from taxes and transfers on gross income (Bayoumi and Masson, 1994). To eliminate the overall stabilization effect of the budget across the Union, the different relationships are based on per capita aggregates (taxes, transfers and income) standards by the federal average.

The Sachs and Sala-i-Martin (1991) estimate is based on longitudinal data, which makes it impossible to distinguish the stabilization effect from the redistribution effect. Subsequent work (Von Hagen, 1991, Goodhart and Smith, 1993, Bayoumi and Masson, 1994) will distinguish the stabilizing effect of the redistributive effect, by estimating the first in year-to-year to eliminate permanent differences between states, and the second in instantaneous section over the entire period. On average, the stabilizing effect, like the redistribution effect, is of the order of 25% in the United States. For Canada, the redistributive effect is higher, reflecting the importance of the equalization system previously mentioned.

Using the elasticities derived from OFCE's and CEPII's Mimosa model, Pisani-Ferry, Italianer and Lescure (1993) constructed a model to compare regional stabilization effects in France, Germany and the United States against a demand shock (automatic fiscal stabilization being ineffective for a supply shock). This simulation evaluation has the advantage of providing an order of magnitude of stabilization effects for countries for which regional data do not allow direct econometric estimation. They obtain a degree of regional stabilization of the order of 37% in France and between 33 and 42% in Germany according to whether or not the horizontal transfers between Landers previously mentioned are taken into account. The strong regional stabilization of public finances in the two European countries, compared with the effects previously estimated for Canada and the United States, results mainly from the centralized nature of Social Security.

Automatic Insurance Mechanisms?

To offset the lack of a federal budget in Europe, several proposals to create an automatic stabilization mechanism have been made (Mac Dougall, 1977, Bean, 1991, Pisani-Ferry and Italianer, 1992). In principle, a shock affecting a member country of the Union can be offset by a weak transfer from other nations. Even if a shock of 3% of GDP affects the largest country, Germany, a levy of less than 1% of GDP on the other European countries would be enough to erase it completely. It can be seen that a transfer system of an amount comparable to the Structural Funds would theoretically be sufficient to guarantee a stabilization as effective as a federal budget. The main difficulty is the great stability of the distribution of unemployment between European countries which would lead a mechanism based on the gap between the national and European unemployment rate to have a strong redistributive effect .

To avoid the redistributive effect, Pisani-Ferry and Italianer (1992) suggest paying a Member State whose unemployment rate increases faster than the Community average, a transfer in% of GDP proportional to the gap with the Community average of changes in the unemployment rate measured over twelve months. Given the elasticity of the change in unemployment to GDP, the degree of stabilization would be 18% for an average fiscal cost of 0.2% of Community GDP over the period 1984-1991. By activating the mechanism only beyond a certain threshold (0.3 point of unemployment), the degree of stabilization would reach 25%, a degree comparable to the stabilization resulting from a federal budget. However, given the non-stationarity of unemployment, the redistributive bias is difficult to avoid (Mélitz and Vori, 1992) and (Kirrane 1994) a system that avoids this bias would have a very modest impact on employment (Mélitz, 1994).

The contributions of the theory of federalism

The theory of federalism goes far beyond the strictly economic framework. Long before the birth of the federal states, Montesquieu, in L'Esprit des lois, had emphasized the advantages of a federal republic combining "the external force of monarchies and the internal advantages of republican government" (1) (but not it is not also, according to Keynes, the greatest French economist!). The analysis of federal systems and the search for the foundations of federalism have largely inspired the thinking of Anglo-Saxon political scientists and jurists (see, for example, Wheare, 1947). It is therefore quite natural that this reflection on the organization of powers has also become one of the branches of the public economy, with the work of Musgrave (1969) and Oates (1970) on fiscal federalism. And it is hardly surprising that she has experienced a major revival of interest with parsley) Book IX of The Spirit of Laws. The federal concept was formulated for the first time by Althusius (1562-1638) in his book Political perspectives of monetary union. Originally, however, it was part of a different perspective from current concerns. Starting from the implicit existence of a federal state, the economic theory of federalism questioned the optimal allocation of instruments between the federal and sub-federal levels. Its purpose was thus more the decentralization of public choices than a reflection on the costs and benefits of unification of initially independent jurisdictions. Moreover, in the distinction - traditional since Musgrave - of the three functions (allocation, redistribution and macroeconomic stabilization), it tended to favor the first two themes, considering almost as obvious that macroeconomic stabilization should be by nature the domain of the central government.

There is a clear convergence between the literature on federalism and that concerning the coordination of economic policies. The latter, in a way, approaches the problem in reverse. Starting from the existence of politically independent but economically interdependent states, she wondered about the gains that could result from coordination and, consequently, from the creation of supranational institutions.

What lessons can be drawn from these approaches for the organization of monetary union economic policy?

Without limiting ourselves to strictly economic aspects, we will focus on three main themes:

- The organization of powers in the Union; - The organization of economic policy in the Monetary Union; - The transfer of skills and the allocation of resources between the different levels.

The organization of powers: federation or confederation of states

The federation-confederation debate is almost as old as the debate on the construction of Europe. In his famous speech to the League of Nations in 1929, Aristide Briand, calling for the establishment of a "kind of federal link between European nations," had in mind a confederation of nation-states. The federal bond had to be established "without affecting the sovereignty of any nation". The no less famous call for the creation of the United States of Europe, pronounced by Churchill in Zurich in 1946, also did not envisage going beyond an association of States (from which he excluded moreover the United Kingdom). And the resultant Council of Europe never reached the political dimension of a confederation. If the institution which was at the origin of the Community, the ECSC, had a relatively developed federal character but within the framework of a limited competence, it is clear that the gradual preeminence of the Council on the Commission and that of the vote by a majority in the Council, the European Union is today more of a confederation of states than a federation. Monetary union will be more hybrid: clearly federal for all monetary decisions, largely confederal for other decisions (Kirrane 1993).

In a federation, every individual is at the same time citizen of the State in which he resides and citizen of the federation. As such, he is directly represented at the both in the state assembly and in the federal assembly. In a confederation, on the contrary, national governments are represented in the assembly or the confederal institution. In other words, the constituents of a federation are the citizens of the Union, those of a confederation, the States of the Union. In both cases, the dual level of representation of citizens (state and union) reflects the differentiation of public goods: some goods and services are transnational public goods that affect all citizens of states, others national public goods or even local.

From the point of view of public choice, the distinction between the federal or confederal organization is based on the differentiation of the agents' preferences for transnational goods. In both cases, transnational public goods can be produced at their optimal level only at Union level, since no State will make the effort to assume alone the production costs of a good that benefits all its partners. If the agents' preferences for transnational public goods are not differentiated by location, the federal representation is optimal. If, on the other hand, the preferences of the individual agents can be aggregated according to their location, it is on the contrary the confederal system which is optimal. The following example, borrowed from Mueller (1995), illustrates this second case.

Consider a river that has its source in A and crosses successively B and C Even if the citizens' preferences for the cleanliness of the river are identical, it is clear that the inhabitants of B and a fortiori those of C are more inclined to wish sewage treatment plants as the inhabitants of A who only suffer from their own pollution. For this type of decision, a confederal structure that aggregates the preferences of the citizens of the three states is sufficient.

In practice, all contemporary federal systems combine a federal-type representation (the United States House of Representatives, the Bundestag in Germany, the National Council in Switzerland) and a confederal type (the US Senate, the German Bundesrat, the Council). cantons in Switzerland). Although both chambers often have roughly the same powers, the federal character is based on two characteristics. First of all, the vote is expressed by a majority and therefore does not require the unanimity of the States. Then, the executive is independent of the second chamber, either because it proceeds from a direct election as in the US presidential system, or because it is only responsible to the federal chamber (Bundestag in Germany). Moreover, since the elected members of the second chamber are most often proportional to the number of states (Germany is an exception), the adoption of a law generally requires both the majority of citizens and the majority of states. .

In a federation, majority voting theoretically poses no problem since the homogeneity of the preferences of individuals within the Union has the consequence that the minority of one vote are in principle distributed in the same way in each of the States. On the other hand, a confederation which wishes to respect the preferences of the different states should only resort to the rule of unanimity or consensus. However, even in previous confederations, such a rule has never been fully applied, even for the most basic decisions. The Confederal Constitution of 1777 instituted the majority vote of the States, and the Philadelphia Convention of 1787 which transformed the confederation into a federation decided that the ratification of nine out of thirteen states was enough for the new constitution comes into application. Similarly, only three-quarters of the Swiss cantons adopted the Federal Constitution of 1848 which ended the earlier confederation (only the name was retained). From this point of view, since the Luxembourg compromise of January 1966, born of General de Gaulle's refusal to accept the transition to qualified majority voting in the Council, the Community appears to be a confederation particularly concerned with preserving the right to State veto.

As Maurice Duverger (1994) points out, "the weakness of the European Parliament would not allow the Community to be ranked among the democracies if it were a state". Despite its election by universal suffrage since 1976, the European Parliament has a very limited legislative role and, until the Maastricht Treaty, the MEPs did not have the initiative of the laws that belonged to the Commission. The confusion of powers is extreme since the Council of Ministers of the Member States (or the European Council which brings together the Heads of State and Government) combines legislative and executive powers. In addition, the exercise of power is achieved through diplomatic meetings without parliamentary control and without public debates and votes (it is however scheduled since October 1993 for legislative votes).

In a way, the institutional confusion that characterizes the European Union is the result of a debate that has never been settled between the federalist vision and that of a concert of independent nations that has always characterized international organizations. Like the European States themselves, whose construction was the result of a long maturation, and unlike the United States of America, Europe was not born of a constitutional convention. The failure of the European Congress in The Hague and the Council of Europe in the immediate aftermath of the war soon set the tone for the ambitions of a top-down European Union, with a constitution leading to a parliament and a European government. Whether through the ECSC, the Common Market, the Single Act and the Monetary Union, the history of European construction has rested on "concrete achievements first creating solidarities of fact". But if this dynamic imbalance - of which Jean Monnet had the intuition and which Jacques Delors was able to revive - allowed to advance very far in the economic integration of Europe, the political integration that hoped its founders did not not followed at the same pace (Kirrane 1994).

The debates on the democratic deficit that flourished on the occasion of the ratification of the Maastricht Treaty (which included nonetheless significant progress in this area compared to previous treaties) show that governments will not be able to avoid the constitutional problem forever. European. In the absence of a clear constitution, the construction of Europe means that transfers of sovereignty from nation-states to the benefit of the European Union take away powers from national parliaments to confer on the Council, that is to say to the governments of the member states acting collectively. Situation for the least paradoxical in a (2) Declaration of Robert Schuman at the French proposal Coal-Steel Community.

Who Invented Parliamentary Democracy! It is not "the Europe of the technocrats" that threatens democracy, but that of the coalition of national governments too jealous to give up sovereignty, which are however largely illusory when they do not translate into collective actions at the same time. European scale.

The federal nature of the European legal order

The economic field is not the only one that has generated federal structures: the European legal order is largely similar to that of the federal states. The preeminence of federal law over that of local courts is indeed one of the major characteristics of federal states and distinguishes them from confederations. The division of powers between the federal and the federated level is certainly organized differently in the existing federations. In the United States, the Xth Amendment stipulates that "powers which are not delegated to the United States by the constitution or which are not refused by it to the States, are reserved to the States respectively or to the people". On the other hand, in Canada and in the recent Belgian federation, the jurisdiction of the provinces and "regions and communities" <3> is defined by the constitution, and the federal power has residual powers. But even if there are sometimes parallel competencies, the norms adopted by the federal government within the limits of its powers prevail over those of the federated communities. This is expressed in the phrase "Bundesrecht bricht Landes- recht". Moreover, federal law is of immediate application in the federated communities.

Community law has both these characteristics. Unlike international law, which only applies after reception in national law, Community law is in fact akin to an internal law. The paradox of the Communities is "the ambition of their authors to build an internal legal order by means of legal techniques based on the international treaty" (4).

The case law of the European Court of Justice has enshrined the primacy of Community law over that of states. Treaty law applies to individuals, as to States, and as in the Federal States, national law incompatible with Community law can not be opposed to it. This primacy, however, encountered some difficulties of application. Thus, although the treaties have, according to Article 55 of the French Constitution of 1958, an authority superior to the laws, subject to reciprocity, the Council of State has frequently refused to verify the validity of a law in relation to treaties * 5). This jurisprudence has, however, been abandoned since a judgment of 20 October 1989 recognizing that "the time of the unconditional supremacy of domestic law is now over, ... international and especially European standards have progressively conquered our legal universe".

(3) The 1994 federal constitution distinguishes three linguistic communities (Flemish, French-speaking and German-speaking) and three regions (Flanders, Wallonia and Brussels).

(4) See Louis Cartou (1995), chapter 12, pp. 141 and s. (5) See Christina Hen and Jacques Léonard (1995).

The Organization of Economic Policy in Monetary Union

Power of National Policies to Resolve the Problem of Unemployment shows that Europe is a victim of the gap between the success of its economic integration and the relative failure of its political integration . In the absence of a European economic policy, the large product and capital market that we have built is more and more a drunken boat on which the "concert" of fifteen independent governments does not have much of a hold.

It is true that the single currency will bring to the appropriate level - Europe - the economic policy instrument that requires the strongest coordination. But the main problem facing the Monetary Union is the linkage between a fully centralized monetary policy and fiscal policies that will remain decentralized at the state level. It is clear that no existing monetary union has this peculiarity, with the exception of small countries such as Luxembourg or former colonies such as the CFA franc zone. It is not only the historical development that has led the existing monetary unions to centralize the entire stabilization policy at the federal level. The cost of coordinating an economy with a large number of independent jurisdictions is extremely high. And in the economic field, the delays in implementing fiscal policies, which are already very high due to parliamentary decision-making procedures, risk rendering any coordination ineffective. The references to monetary unions without a political union at the end of the last century (Latin Union or Nordic Union) can hardly serve as an example, since the world economy was already practically in a monetary union under the regime of the European Union gold standard or bimetallism and where neither fiscal policy nor monetary policy played the strategic role they acquired in the second half of the century (Kirrane 1995).

The problem of the coordination of economic policies arises at two levels: that of budgetary policies among themselves and that of their articulation with monetary policy. In the first case, the need for coordination depends on the magnitude and meaning of the externalities they generate on the partners. As regards the impact on activity, fiscal policy has two contradictory effects: a positive externality by increasing demand for partners' products, and a negative externality resulting from the rise in the European interest rate induced. by increasing the demand for securities denominated in ecus. At the same time, the positive transmission of stimulus by foreign trade improves the public finances of the partner, while the negative transmission by rising interest rates deteriorates them. If positive externalities dominate, non-coordination of economic policies will lead to overly restrictive fiscal policies: in the face of a depressive shock, each state will be reluctant to pursue an expansionist policy, the costs of which it alone bears when all its partners benefit from it. . If, on the other hand, negative externalities dominate, fiscal policies will be too expansionary as national governments will underestimate the actual cost to the Union of a fiscal stimulus.

(6) See on these experiences Bergman, Gerlach and Jonung (1993) and Flandreau (1993).

The most delicate problem is perhaps less the coordination of budgetary policies with one another, their articulation with the monetary policy of the Union. In the face of, for example, a supply shock that simultaneously produces an inflationary and depressive effect, non-coordination can lead to a situation where the European Central Bank is conducting an unnecessarily restrictive monetary policy to eliminate inflation and the national governments to adopt budgetary policies. unnecessarily expansionist to eliminate the depressive effect (see eg Capoen, Sterdyniak and Villa, 1994). Europe may also be faced with a situation where monetary policy (ie the Union's exchange rate policy) can not respond adequately to a given situation. If, for example, as is currently the case in the United States, the current account deficit can not be absorbed quickly even though the currency is already undervalued, it is the fiscal policy that will have to deal with it. . It is obviously easier to adjust the federal fiscal policy (and to coordinate it with monetary policy) than to resort to a long negotiation process between the states and the central bank to achieve the right policy mix.

Structural Policies, Transfers of Sovereignty

Structural policies refer to a theme extensively addressed by the theory of fiscal federalism: the efficient allocation of public goods (see, for example, Van Rompuy et al. (1991) and contributions to the special issue of European Economy (1993) on public finances). The principle of subsidiarity implies that functions are allocated to the lowest level of government, except when the importance of externalities justifies a transfer to the higher echelon.

In the absence of externalities, competition from tax and social systems, combined with consumer mobility, makes it possible to effectively adjust the production of public goods and consumer preferences (Tiebout, 1956). This is the argument traditionally invoked to justify the benefits of decentralization and the superiority of a decentralized system over a unitary state. Added to this argument are the effects of competition for social and tax innovation that increases the efficiency of the production of public goods. On the other hand, externalities argue for coordination and therefore supranational intervention. The combination of these two types of conflicting arguments is frequently advanced to justify the superiority of a federal system, since it constitutes a compromise between a unitary state and a state. totally decentralized system (Oates, 1972).

Public expenditure in the field of the environment, research and development or infrastructure has the character of a public good for the whole Union. Since each country benefits from the expenditures made by its partners, the lack of coordination leads to insufficient development of national public expenditure in these areas. In addition, the constraint on public deficits can also hinder the development of a public investment with the same rate of return as a private investment. The theory of public finances suggests that such an investment, which temporarily increases the net public debt but does not affect its permanent level, must be financed by borrowing and not by an increase in tax levies.

If further investment in infrastructure or research not only increase the level of production, but its growth rate, as in the endogenous growth models, not taking into account externalities between states will lead to too little growth. The traditional result of the endogenous growth models according to which the decentralized economic calculation leads to a too low investment expenditure and a growth lower than that which would result from a centralized choice, applies to the nations as to the individuals. It justifies a European growth initiative in areas where public spending has significant external effects. Economic history shows the importance of infrastructure spending (particularly railways) in the development of federal budgets.

On the resource side, another externality may weigh on the development of the public sector: tax competition. Many studies, but also the simple observation of the recent evolutions, show that the weight of the taxation risks to weigh more and more on the least mobile factors and in particular the work. To avoid escape to tax havens, most European countries - and especially France - have sharply reduced taxes on capital income. This is all the less desirable since the most taxed factor, labor, is precisely the surplus factor in Europe. Transferring capital taxation across the Union would avoid - or at least limit - the problem. This transfer would also have an interregional stabilizing effect because of the high cyclical sensitivity of the tax in question. A similar problem arises in the social field if social competition is to be prevented from reducing the social protection of the most developed countries of the Union.

The development of the federal budget has coincided, in contemporary federations with the continuous increase of the weight of public administrations in the economy. However, the current weight of compulsory levies no longer makes it possible to develop the federal budget without simultaneously reducing sub-federal levies. It is therefore essentially through a transfer of powers that the European federal budget can be developed. In addition, this transfer of sovereignty must go hand in hand with a strengthening of the legislative and budgetary powers of the European Parliament, if we want to avoid increasing the so-called "democratic deficit".

Europe's political economy

The prospect of monetary union has given rise to a renewed interest in two old themes in the economic literature: optimal currency areas and fiscal federalism. If the whole of

Europe is quite far from an optimal currency area, there is a broad consensus that the nominal and real convergence of the five or six core countries and Monetary Union federalism better predisposes to form a monetary union. The lack of a change in parity within this area, even as it faced an unprecedented asymmetric shock, suggests that the countries in question have already borne the costs of the loss of the instrument. exchange. And it is clear that a Monetary Union would have allowed a more effective management of German reunification - at least for the partners of Germany -, avoiding to make support to all the countries a monetary policy which was not adapted only one.

But the example of German reunification also shows that the cost would have been lower if the solidarity implied by a federal budget had allocated the burden to its partners. Germany's partners had everything to gain by exchanging a stake in financing German reunification against a drop in interest rates. But that is precisely what would have happened in a federal state. When a region or state is hit by a cyclone or earthquake, the federal budget bears the brunt of the cost of rebuilding. And the monetary policy of the Union is not managed according to the particular situation of the State in question, but according to the overall situation of the federation. The economic solidarity involved in monetary union has little meaning if it does not simultaneously translate into increased solidarity in the political and social spheres.

In the introduction to this article, we opposed the approach to European integration that was envisaged in the 1970s to that defined by the Maastricht Treaty. It is difficult to distinguish between necessity and political will in the choice of a "minimal" monetary union. For France, monetary union first appears as a way to regain monetary sovereignty that it has lost in the EMS. For other countries (Italy and Spain) it is a gain of credibility that is sought. As for Germany, it has little to gain from a monetary union that has no counterparts in the political field. It is no coincidence that the only country that has openly relaunched the political debate on federalism is Germany (Lamers, 1994).

The Lamers report poses the problem of running fifteen of a community institution initially designed for six countries with a history of collaboration. The confederal system implied by the unanimity rule has been able to function without much difficulty in the framework of the six founding countries (with, however, periods of blockage, as in the policy of the empty chair practiced by France from 1963 to 1966). But such a structure is unsuited to a Union which comprises fifteen States not having, like these, thirty-five years of practice of community solidarity. Further enlargements will further increase the risks of non-coordination and dilution of solidarity between states. Realism requires to establish what exists (de facto monetary union between Germany, France and Benelux) by simultaneously strengthening the coordination within it of all policies (economic, social, military ...).

This hard core would be intended to aggregate around him, all the states that wish to go further in the Economic and Political Union, by opposing a consolidated center to the centrifugal forces that will not fail to introduce the later enlargements . It seems difficult to exclude too long the hard core, a founding country like Italy, or Spain that has shown a deep commitment to the community interest. These are not economic criteria for building a viable monetary union, but the political will. And one day Europe will have to adopt a constitution worthy of the democracies that constitute it. Then there will be the problem of the respective status of the Commission and the Council, that is to say the choice between a federal or confederal structure. The Lamers report clearly poses the constitutional problem by suggesting a federal development "conferring on Parliament the character of a legislative body with equal right with the Council, the latter being called upon to assume, alongside other tasks of an intergovernmental character, the the role of the State Chamber, the Commission exercising the attributes of a European Government ". Federalism is by nature an evolutionary construct whose flexibility should make it possible to create a form adapted to the integration of nation states inherited from the past. Swiss federalism, with its linguistic diversity and developed sense of consensus, inherited from a long confederal experience, is undoubtedly the most useful example for the European Union.

Formerly worn by the dream of intellectuals anxious to preserve what made the originality of Europe, the universality of its thought, federalism has become, through the theory of public choices, a reflection on the adequate levels of the public decision: the Union, the State, the region, the commune. It is also, and above all, a democratic response to the organization of powers within a structure combining national and supranational sovereignties. This reformulation does not betray the spirit. Just as the ideas born in Prague, Vienna or Paris had always freed themselves from linguistic boundaries or barriers to become "common good" to all Europeans, most of the major economic or political decisions today have this character. Europe, which invented the nation-state, developed an original structure of economic integration during the second half of the twentieth century; it remains to make a comparable effort in the political field to face the next century.

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