

Working Paper

Re-Booting Europe: What kind of Fiscal Union - What kind of Social Union?

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Abstract

Doomsday scenarios about the survival of the Euro and the European Union have gained prominence since Brexit. While we cannot deny the endogenous and exogenous challenges to the EU, these challenges can also function as an opportunity to think about how to achieve a European social market economy. Given the deficit in EMU's institutional design, many experts believe that the next building block should be a fiscal and social union to improve fiscal policy coordination and foster social cohesion. This paper discusses the institutional requirements for fiscal capacity building and the introduction of a Eurozone Treasury. In the final section, the ideas of a European social market economy are spelled out, arguing that a modernized version of the concept of the German social market economy, as introduced by the economist Alfred Müller-Armack, may function as a starting point to ensure a fairer balance between markets and social cohesion.

I. Introduction

There is a wide-spread attack on the single European currency, ranging from the rise of anti-European parties to Nobel Prize laureates such as Joseph Stiglitz (2016) with his claim that the Euro Area is an unsustainable currency union. Such criticisms are not new, having been raised by several American economists who predicted the Euro's failure from its very start.

While Stiglitz is right in criticizing many of the policy failures of European leaders during the sovereign debt crisis, his proposed solution of abandoning the single currency is not very helpful. Europe would have to go through a valley of tears, in precarious times, with quite uncertain outcomes. Rather than engage in such scenarios, we will address in this paper both the challenges to the European Monetary Union (EMU) and the larger European Union, suggesting that the single currency is a European public good worth the political and intellectual effort to be 'rescued'.

Since the financial crisis, the EU has seen, due to the existence of an EMU, a very active monetary authority, and thus quite an independent central bank taking strong monetary and financial measures against the crisis.

The EU has also taken important institutional steps to reduce the so-called sovereign/bank nexus, and has completed two legs of the Banking Union with a European oversight function (the Single Supervisory Mechanism or SSM), and a common framework for winding up failing banks with a (currently underfunded) Single Resolution Fund (SRF). Missing is the third leg of a European Deposit Insurance (EDIS) which would provide risk-sharing across the euro-area banking system.

Many argue that the next building block should be to focus on the fiscal union and social union, in particular after Brexit, where a re-booting of the EU is important to improve fiscal and economic policy coordination and foster social cohesion in the Euro Area.

As for the Fiscal Union, one is tempted to compare EU fiscal institutions and fiscal policy to US fiscal federalism, but this is not an appropriate model. In the US, there are clear obligations and responsibilities with federal tax revenue expenditures historically shared between the federal state and the individual states. In addition, the monetary policy of the US Federal Reserve provides fiscal stabilization measures for the states in times of crisis. This type of fiscal integration has not been reached in the EU and may be too ambitious.

As compared to the US, the EU member states have a long tradition of controlling their own fiscal decisions, manifested in national parliaments' power over taxes and expenditures against an Absolute State, monarch or ruling aristocracy. National sovereignty gave parliaments the power to make budgetary decisions on raising state revenues and expenditures, and issuing debts. Designing a workable European form of fiscal federalism thus means that national parliaments are likely to retain some sovereignty on tax, expenditure, and fiscal decisions. In other words, the challenge is how to obtain fiscal federalism within a loose fiscal union, where there is still a dominance of member states in economic, social and fiscal affairs (Semmler/Young 2016).

Given these specific conditions, any EU Fiscal Union is likely to work only if a two-track system is established where there is some form of federal treasury while, at the same time, sovereign national parliamentary decisions are preserved, or at least partially preserved. Going too far in one or the other direction would endanger the EU project as a whole. As a first step to creating full EU fiscal federalism with tax-and-spend powers, the art is to find a middle ground between federal fiscal institutions and preserving some national parliamentary budgetary decision-making.

In our contribution, we want to argue that fiscal stabilization policies should be planned at two levels—the central level dealing with aggregate macroeconomic instabilities, or instabilities arising from external effects at local or regional level, and in addition fiscal stabilization at member state level (i.e., national parliaments and ministries). This scenario would embrace both fiscal consolidations as well as fiscal expansions during times of economic downturns.

This presupposes that central fiscal institutions are important. Richard Musgrave, who developed the path-breaking theory of modern fiscal federalism, identified in principle three important goals of the fiscal authorities: a) providing public goods, b) ensuring macroeconomic stabilization, and c) re-distributional measures counterbalancing market failures. The first function would provide fiscal capacity to fund European public goods so as to provide solutions to common problems that can no longer be resolved at local or national level. The second function of macroeconomic stabilization is based on Keynesian insights and complements the ECB in its monetary policy.

The final goal is re-distributionist policies that are supposed to correct market failures generating an uneven primary income distribution, an important pillar that was included in the post-war German social market. Until now, re-distributionist policies have been restricted to the domain of member state governments. In line with subsidiarity, these are primarily responsible for employment and social policies. However, after Brexit and the large populist revolt in many EU countries against free market policies and growing social inequality, it is in the EU's long-term interest to create more of a Social Europe.

Since the social policy agenda has been neglected in the EU, we will thus focus in the latter part of the paper on the social market economy tradition and ask whether the new Pillar of Social Rights introduced by the European Commission President, Jean-Claude Juncker in 2015 is the start of a

European New Deal for a more socially cohesive Europe. In other words, is there the prospect of a European social market economy that puts fundamental social rights above the freedom of untrammelled competition policy, providing hope for those who have been left behind in trying to cope with neoliberal market forces that have dominated the Single Market since its inception.

II. Major Recent Challenges

One also needs to think about the challenges facing the EU that need to be managed when it comes to fiscal institutions. The EU is a monetary (and incomplete banking) union, but not yet a fiscal union. There is a central monetary authority but a variety of fiscal policies/cultures. Undoubtedly, there have been some achievements since the start of the EMU but challenges remain.

1) *Convergence/non-convergence*: There was an initial convergence process in terms of human capital, infrastructure and productivity across countries (see Mongelli et al., 2015), but since the great recession starting in 2007/8 one can observe processes of divergence. Discussions centred on whether Germany created the imbalance and divergent trends by itself. In particular, the argument put forward suggests that the productivity of the German labour force grew faster than wages from the mid-1990s until 2007/8 and then started catching up again. On the other hand, nominal wages in some Southern countries moved up more quickly (see also other contributions in this volume). For Germany, this created high current account surpluses and external imbalances in the euro area. There were also capital flows from the North to the South through the respective banking systems, with financial engineering taking place, by pushing credit into low-income segments of the population in the South (Kumhof et al. (2012)). Although the chains of causality for the imbalances are unclear, imbalances and non-convergence or divergence have been distinctly obvious.

2) *Fiscal Policy Failures*: A particular driver of divergence has been the fiscal consolidation policy imposed on the South. There have been failures of fiscal consolidations since 2008/9. This has been recognized by official representatives of the IMF since 2013 (see Blanchard et al. 2013; also Semmler and Semmler 2013, and Semmler and Haider 2017) as the perils of fiscal austerity during recessions. Important in this context are the new studies on the regime dependent multiplier. Evidence from non-linear VAR (MRVAR) is given in Mittnik and Semmler (2012). An IMF Study (Batini et al. (2013: 24) states: “In all countries a fiscal consolidation is substantially more contractionary if made during a recession than during an expansion” (see also Blanchard and Leigh 2013). This has had adverse effects, since the fiscal austerity under pursuit has increased financial stress in all EU countries (see Schleer and Semmler, 2015).

3) *Debt-deflation*: What is more, there has been a trend toward debt-deflation in the South. Inflation rates were negative after 2008/9 and then again after 2014. With negative inflation rates, expenditure by households and firms declines, since the price of future goods is even lower, and agents postpone spending. This is the Tobin effect whereby an expected decline in prices slows down spending. On the other hand, with deflation, real interest rates rise and real debt increases (Fisher effect). Moreover, with deflation and low or negative growth rates, there is a rising insolvency risk among banks, since households and businesses cannot repay loans and risk premia for loans rise (Minsky effect) (Ernst et al. (2016).

4) *Banking Vulnerability and Banking Union*: Though a Banking Union has been put in place, numerous banking problems remain in the EU. Banks show rising debt levels since roughly 2000, actual bank debt has risen even higher since 2004 (see Schleer, Semmler and Illner 2017). The

Banking Union started with: 1) ECB supervision, 2) stress tests, 3) single resolution mechanism, and 4) the regulatory policy of bail-in (asset and bond holders of banks made liable in case of bank insolvency). Yet overall, bank vulnerabilities and perils (due to debt deflation, low interest rates inducing low spreads between long and short interest rates) remain, particularly in Italy.

5) Future sovereign debt: At the same time, we can expect at some point the ECB to gradually wind down unconventional monetary policy. The ending of Quantitative Easing (QE) and the Asset Purchasing Program (APP), possibly in 2017, will raise nominal interest rates and real rates might rise too if the inflation rate remains low. This is likely to recreate fiscal debt problems in the most fragile EMU member states, which will once more pose a crucial challenge for Euro-area stability --- and create great perils for the Euro's continued existence.

6) Divergent political trends: Furthermore, there are/have been crucial elections in the Euro Area in 2017 (in the Netherlands, France and Germany) that may boost anti-European parties. These may mean further divergent trends in terms of EU fiscal policies, if politically populist/nationalistic governments come to power. The absence of or presence of merely weak social buffers in some countries will magnify this process.

In sum, the above challenges require careful consideration in terms of what can realistically be built, what type of interaction is needed between monetary and fiscal union/policies, and what proposals are necessary for fiscal arrangements and fiscal capacity building at federal EU level that, at the same time, accepts some kind of retained sovereignty by national fiscal authorities.

III. Stabilizing a Loose Fiscal Union

Current Institutions

The original construction under the Maastricht Treaty was a central monetary union and member states pursuing many different fiscal policies. The deficiencies of the Maastricht arrangements have received much attention in academia. We want to make only a few points:

- The ECB was given a mandate for price stability alone, with autonomy in pursuing this goal
- The Stability and Growth Pact relies solely on automatic stabilizers; national budgets should be balanced over the business cycle
- The Maastricht Treaty gives the Commission a strong mandate for conducting single market policies, favouring structural reforms but handing over no stabilization role.

Given these shortcomings, resulting in only limited room in the Euro Area for expansionary fiscal policy in recessions, it is not surprising that after the crisis of 2008/9, and the new challenges arising from Brexit and the election of Donald Trump as President of the United States, many politicians, academics and practitioners from industry, financial markets, and trade unions look to re-booting Europe, particularly on the fiscal front.

Need for broader fiscal tasks

As the many crises starting in areas of finance, banking and debt have demonstrated, local or national solutions are no longer adequate for global and regional problems. There are eminent public goods problems which need a common solution at the federal EU level such as: investment in

European infrastructure; European research and development tasks; policies concerning transportation, climate, energy, immigration and migration; internal and external security; and harmonization and standardization across product lines. Providing such funding would have the added value of contributing to cyclical stabilization across member states during times of recessions (Demertzis and Wolff 2016).

Fair risk sharing needs new institutions

From the start of the EMU, there were two concepts as to how to balance the upcoming risks in a monetary union: one from Robert Mundell on the optimum currency area required high mobility of capital and labour, the other – adhered to also by McKinnon from the start in 2000 -- is that a union will have lower capital costs and can be held together through risk-sharing. It has become apparent that the uneven performance of the European macroeconomy in the light of the many fiscal policies within a central monetary union is possibly generating greater risks and instabilities than foreseen. Given the current arrangements, and the above-mentioned possible phasing out of unconventional monetary policy in the near future, likely scenarios can be sketched out in a game theory set-up (see Canofari et al., 2016).

How is risk-sharing taking place to stabilize the Euro if there is a significant rise in sovereign debt and the risk of sovereign insolvency, as well as a threat to the Euro's survival? There are two ways of responding and consolidating the public debt of member states:

- Non-cooperative game and indirect risk-sharing through debt reduction strategies, namely differential inflation rates—higher inflation rate in the North and lower in the South—and possibly Quantitative Easing (QE). The first one might be ambivalent, since higher inflation in the North through QE may reduce real interest rates there and raise them in the South, but deflation in the South – so some argue --may increase competitiveness and allow for debt repayment, though real interest rates may rise due to deflation. On the other hand, some QE reduces risk premia in the South and allows for easier borrowing and debt repayments. In addition, there would be a need for debt relief/restructuring through multiple escape routes, reducing perils for the Euro Area (see Semmler and Proano, 2015).
- Cooperative game and direct risk-sharing arrangements through cooperation and interaction of monetary and fiscal policy -- with the goal of stabilizing the Euro Area through more highly coordinated fiscal policy, as well as monetary and fiscal policy cooperation to make debt sustainable. Low interest rates and QE and APP policies, for example, allow for relaxation in sovereign debt markets, low cost refinancing, and reducing sovereign default risk. As Canofari et al. (2016) argue, this might also allow the Southern countries to pursue an expansionary fiscal policy if required.

Whereas the first strategy needs less institution building but a higher adaptation cost due to sovereign default threats and the peril of the Euro Area falling apart, the second requires more cooperation and institution building, and in particular this strategy would require extensive cooperation from Germany and other Northern countries. But, under the threat of the break-up of the Euro, the cooperative solution might be a preferable strategy.

Building fiscal capacity

Some experts argue that the plan of a Eurozone treasury seems premature because one needs first some fiscal capacity building, as Demertzis and Wolff (2016) suggest. They propose a sequence of three steps: First, completing the Banking Union, second, building fiscal capacity for the Eurozone in the area of public goods (dealing with environment/climate policy, migration, defence, fiscal stabilization), and building a social Europe (social security for buffering risk). And third, starting a fiscal federation by suggesting a centralized social security system with 20% of total government spending allocated to it.

Yet here, as with the widely discussed Eurozone treasury, unresolved issues remain such as the funding sources, checks and balances, as well as legitimization and accountability problems.

Moreover, additional EU emergency programmes are required. One could, for example, think of the Golden Rule of fiscal policy (see Saraceno 2016, Truger in this volume), where public investments are undertaken in a private-public partnership that issues development and green bonds that would, in turn, stem further divergence in growth and employment and promote convergence. This is, however, designed to be a partnership where the public ensures itself a stake in its success.

Eurozone Treasury

The proposal for coordinated behaviour in the EU requires further institution building. Many scholars and practitioners have proposed a Eurozone treasury. In fact, both the presidents of the German and French Central Banks, Jens Weidmann and Francois Villeroy de Galhau, have suggested a Euro-treasury (Süddeutsche Zeitung 8.2.2017). They argue that the EU faces a stark choice: either more decentralization within the EMU and less solidarity, or a substantial reform of the EMU with the creation of a finance ministry, a more efficient and less fragmented European bureaucracy, as well as creating a stronger political board subject to parliamentary control. This would ensure the required balance between liability and control. (For further detailed discussion of a Eurozone treasury, see Semmler/Young 2016).

The difficulty is how to achieve fiscal federalism in a loose fiscal union. Goals such as macro stabilization, public goods and redistribution should be pursued, but it is unclear which specified revenues, taxes and bond issuings should be assigned to the federal and member state levels – and how. The dominance of some member states over fiscal policy and their unwillingness to give up some sovereignty is a major obstacle that is hard to resolve. At the same time, monitoring the performance of member states' fiscal policy must be part of the design of a Eurozone treasury. Unresolved is also the question about the democratic legitimacy and accountability of such an acting executive of a Eurozone treasury.

We will now turn to Musgrave's third pillar of correcting distortions in income distribution and analyse whether a Social Union is a feasible project for further EU integration. Can the idea of a European social market economy, mentioned as a specific goal in the Lisbon Treaty, provide a framework for combining policies promoting social protection and equality and those promoting market efficiency?

IV. The New EU Pillar of Social Rights of 2015

The European Commission has started to emphasize EMU's social dimension as a way to regaining some of the legitimacy the EU has lost since the financial and sovereign debt crises. Commission President, Jean-Claude Juncker, launched a new European Pillar of Social Rights on assuming office. He told the European Parliament that "I want Europe to be dedicated to being triple-A on social issues, as much as it is to being triple A in the financial and economic sense" (EU Press release, 22.6.2015). In spring 2016, the Commission launched a consultation paper on such a Pillar, which emphasized better functioning of labour markets and welfare systems as well as social cohesion as the core of the new process of "upward convergence" within the Euro Area. Other EU member states can join the Social Union if so desired at a subsequent time (European Commission 2016). In consultation with the other presidents of the EU institutions, the Commission will present a White Paper in spring 2017 and set completion of the EMU by 2025.

Many scholars agree that this new European Pillar of Social Rights is a step in the right direction, but the document (containing 34 social principles) is rather vague in terms of providing definitions of "adequate" income, "fairer EMU", "well-functioning and fair labour markets and welfare systems", and "reliable balance of rights and obligations between workers and employers". While it speaks about the role, scope and legal nature of the Pillar, it does not provide indicators to measure and compare member states' social performance and has little to say about compliance. Neither does it address the different legal competences between the EU and the member states, *inter alia*, on labour markets. For instance, Article 153 of the Treaty on the Functioning of the European Union (TFEU) clearly does not provide any Union competence in matters of "pay". It remains unclear how national and EU competences are to be shared in the Social Union (Sanden/Schlüter 2016).

The Four Presidents' Report of 2012 (*Towards a Genuine Economic and Monetary Union*) and Five Presidents' Report from 2015 (*Completing Europe's Economic and Monetary Union*) already raise the prospect of a fiscal policy framework. Yet there is little mention of creating a discretionary fiscal policy or enabling an EU unemployment insurance¹ scheme as an automatic stabilizer to counter economic divergences across Eurozone countries since the financial crisis, or allowing permanent cross-border transfers. Experts have also criticized the fact that Jean-Claude Juncker has made no further reference to the Social Pillar since announcing it. This may indicate a divided Commission with strong internal opposition to establishing a Social Europe. There may also be strong headwinds on two further fronts: "The EU is blocking social advances in certain areas at member states level and the member states are blocking social progress at European levels" (Höpner and Weiss 2017).

V. Social Europe Embedded within a European social market economy

Creating new institutions for a socially fair Fiscal Union with a European treasury with its own budget, economic and tax coordination, and a common unemployment insurance scheme requires a comprehensive framework in the form of a European social market economy. This is not a new idea.

¹ A good beginning for an EU unemployment insurance has been made by Andors (2016), an EU Commission document (EU Commission 2015) and Dullien (2014) who suggests a two-pillar system: A minimum EU unemployment insurance (50 %, 1 year), topped up by national unemployment insurance (60 % and of longer duration).

Art. 3 of the Lisbon Treaty has already spelled out the goal of a social market economy, meaning that social concerns should be taken into account throughout the decision-making process. However, it did not provide details about the institutional structures required for a competitive social market economy. Building such structures at EU level is all the more difficult, since the social partners are not key players in this process. The Single European Act of 1986 and the Maastricht Treaty of 1992 were concerned with economic and monetary matters and left the social dimension to be dealt with at member state level. The major obstacle in EU social integration is the multi-layered institutional mismatch between EU market structures and nationally fragmented institutional arrangements. An added difficulty is the rise of virulent nationalism as witnessed in the form of Brexit and populism in many member states. As a result, national governments continue to insist that social and labour policies are "their" competences, demanding national priority over common EU solutions.

Given these national preferences, social policy has been a stepchild in European integration, creating a constitutional asymmetry between policies promoting market efficiencies and policies promoting social protection and equality (Scharpf 2002). The European Court of Justice (ECJ) further sanctioned the subordination of social rights in the legal disputes between Viking, Laval, Ruffert and Commission versus Luxembourg. The ECJ ruled that freedom of competition took precedence over fundamental social rights. Its judgment meant that national social rights, such as the right to strike, make collective agreements or pursue wage policies were not allowed to interfere 'excessively' with the freedom of competition. In response, Mario Monti in 2010 warned that the subordination of social rights had the potential to alienate large portions of the workers' movement and trade unions from the European project (Bosch 2017).

This alienation has become reality among the European populace, including many citizens bearing the brunt of austerity measures in the Southern periphery, and among members of the populist right-wing movements on the European continent. Yet a reform programme that would make monetary union sustainable and acceptable to ordinary people must be premised on the idea that the stability and integrity of financial markets, free trade, and free movement of labour depend upon a fairer balance between markets and social cohesion. Money and banking, trade, capital flows, movement of labour are not just technical issues reserved for experts, they also have important social, cultural and political dimensions and may have negative externalities across member state territorial boundaries.

A European social market economy?

Can the ideas of the social market economy offer some guidance on how to institutionalize a fairer compromise between competitive markets and social solidarity? The origins of the social market economy go back to the German economist Alfred Müller-Armack who coined the term *Soziale Marktwirtschaft* after World War II to rebuild with Ludwig Erhard (first as Economics Minister, and then as Chancellor) a war-torn German economy. Müller-Armack belonged to a group of economists and lawyers in the 1930s, the so-called neoliberals, who opposed Anglo-Saxon laissez-faire liberalism and its notion of self-regulating markets. Rejecting the market fundamentalism that led to the Great Depression, post-war Germany faced the challenge of setting up a constitutional framework to establish both political and economic democracy within a federal system that did not rely on a strong centralized state. Business was free to operate within a market economy that was explicitly competitive. The social market economy also contained a major social element, since there were millions of refugees, war widows, orphans, war veterans, poor pensioners who could not be left

exposed to market forces and had to be integrated into the new market economy. What matters most for our argument is that the social market economy was not the outcome of a strict technocratic ordo-liberal rules-based concept but rather of political leaders entering into concessions and compromises with existing socio-political forces.

Ludwig Erhard had to take into account the interests of the American occupation forces, demands of the Social Democrats and the impoverished working class, the war destitute, West German big business, especially in the Ruhr region as well as the *mittelständische* firms of Southern Germany (Berghahn 2015). This pragmatism in creating a new federal economic system with weak centralization but a strong federal component institutionalized in the second chamber of the German Parliament (Bundesrat) may hold out some promise for building a European social market economy despite the fragmented and centrifugal tendencies among EU member states.

Of course, the ideas of Müller-Armack must be updated, they are overly normative and are a top-down paternalistic approach to achieving a balance between market freedom and social security. They must also be adopted to a Post-Westfalian (non-nation-state centered) political environment. However, his core concepts still hold today. Thus, the overriding essence of the social market economy for Müller-Armack is a “peace order” (Müller-Armack 1972/1981). Unlike his ordo-liberal colleagues of the Freiburg School, he insisted on a second pillar of social politics to the constitutional economic order. He defined social politics as an arena that should not be subordinated to economics in case of any conflict between economic and social concerns.

As early as the 1920s, Müller-Armack championed – before John Maynard Keynes - an active business cycle policy of state intervention. It is the duty of the state, he said, to ensure reconciliation between different interests. Müller-Armack goes beyond suggesting interventions in the economic order. For him, the social praxis implies shaping the entire scope of social life (Gesellschaftspolitik). Politics is thus not the result of a rules-oriented constitutional order, but is outcome-oriented and requires discretionary intervention. Interpreting market failures as integral to free markets, Müller-Armack stipulated that since the constant adaptation of the market economy imposes high social hardships which individuals are forced to bear in their helpless and anonymous role, it is important to reduce justified and unjustified fears arising from the (otherwise unfettered) mechanism of free markets (cited in Vanberg 2002; Lane-von Kulesa/Renner 1998).

Understandably, given the compliance failure of the Stability and Growth Pact, the Maastricht Treaty, Two and Six Packs as well as the Fiscal Compact, some macroeconomists argue that fiscal capacities for countercyclical policies as advocated in the Five Presidents’ Report are illusory at EMU level. Thus, fiscal policies are best left to the nation state (see Priewe in this volume).

However, it is not clear why social policies underpinned by unemployment insurance at EMU level fail as a regional public good benefitting the citizens of the member states. That social policies are prone to higher implementation problems, are more vulnerable to distributional conflicts and to moral hazard makes these policies no different from agricultural policies, nuclear, climate and energy policies, creating a Banking Union with a European Stability Mechanism as a redemption fund for banking liquidity crisis, or fighting terrorism.

In all these examples, collective tasks are resolved at the European level when they can no longer be resolved at the individual member state level. In other words, there is cooperation at the EU level to ensure that public goods are provided to all the citizenry. That in the process some national

sovereignty is transferred to the EU level has been accepted as long as people feel it is in their common interest.

A Second Chamber for the European Union?

To make fiscal policy work at EMU level it may be more acceptable to include national parliaments in a hybrid decision-making process with the European Parliament. Again, this is not a new idea. Already the two EU Presidents' Reports of 2012 and 2015 have championed a hybrid model to increase legitimacy and accountability in cases of negotiating on politically fraught decisions. Again, little progress has been made on this front. A hybrid model may stipulate that fiscal decision-making will largely be made at federal EU level, but coordinated and controlled by national parliaments. Alternatively, as Bénassy-Quéré et al. (2016) suggest, national fiscal policies remain largely in nation state hands but decision-making over that policy is shared with the federal level. Such a hybrid model of power-sharing presupposes a new EU Parliament with two chambers.

This reform may be easier in the light of Brexit. The first chamber would comprise elected EU nationals and the second members of national parliaments and civil society. This would ensure that national parliaments and the voices of civil society are an intrinsic part of the EU fiscal decision-making process. Such an EU parliamentary reform should not be a top-down process. Instead, new innovative ideas should come from a European-wide competition conducted within a public assembly in which a broad spectrum of society are able to formulate ideas for such a hybrid model designed by the members of the EU for the members of EU.

VI. Conclusion

Doomsday scenarios about the survival of the Euro, and the EU itself have gained prominence since Brexit. The uncertainty has further increased since President Trump applauded the decision of the British people to leave the EU and expressed his open hostility to it. While we cannot deny the endogenous and exogenous challenges to the European Union, and especially to the European Monetary Union, these challenges can also function as an opportunity and incentive to think about how we can achieve a European social market economy that does not subordinate issues of fairness and equality to market competition. This was the intent of this paper.

In the first section, we enumerated the many challenges facing the EU that need to be taken into account when thinking about new fiscal institutions. EMU weaknesses became evident during the financial and subsequent sovereign debt crisis in the Eurozone. Since that financial turmoil, many institutional novelties have been implemented to stabilize the Eurozone. At the same time, the major challenge remains between a central monetary union and divergent fiscal policies in the member states. Originally, it was believed that a monetary union with an independent European Central Bank would eventually lead to a convergence of the various national fiscal policies. This is and remains the Achilles heel and biggest stumbling block in building a more integrated EMU.

Given the deficits in EMU institutional design, many experts believe that the next building block should be to focus on a Fiscal Union and Social Union to improve fiscal and economic policy coordination and foster social cohesion in the Euro Area. The next section of the paper discussed the institutional requirements for fiscal capacity building and the introduction of a Eurozone treasury. In the final section, the focus shifted to the ideas of a European social market economy and argued that a modernized version of the original concept of the German social market economy, as initiated by

the economist Alfred Müller-Armack, may function as a starting point to ensure a fairer balance between markets and social cohesion. Social policy for Müller-Armack is a “peace order” and, unlike his ordo-liberal colleagues of the Freiburg School, he insisted on discretionary intervention to reduce justified and unjustified fears among people arising from market failures.

In contrast to other scholars, we argue that fiscal policy capacity building should be both at the federal EU level with input and control from national parliaments. Such a hybrid model of power-sharing assumes a parliamentary structure with two chambers. The first chamber would comprise the citizens of the EU, and the second representatives of national parliaments and civil society.

Creating a Fiscal Union and Social Union should not be a top-down project from European experts and economists. Instead, there should be citizen involvement in the form of a public assembly (including activists, entrepreneurs, political leaders, economists, business managers) to design and create such a new hybrid institutional structures for a digitalized 21st century.

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