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„Fiscal rules: Identifying key issues and problems“

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The refugee crisis adds another dimension to the already **existing European crisis**. The prior crises – with their economic, political and social dimensions – have already revealed existing **shortcomings in the social security systems** of many EU members and have further **undermined social justice in Europe.**

The European crisis poses the **threat that the established parties** – social democratic parties in particular – in the member states could be further weakened in the face of growing nationalist and populist forces. This is true for populists both from the right (e.g. Front National in France, AfD and PiS) and the left of the political spectrum – be it Podemos in Spain or Syriza in Greece.

The economic debate about the right response to the crisis is often falsely **framed along wrong the headline: either austerity or growth**.

The issue is much more complicated. Therefore, I am going to go deeper into three interconnected topics that have to be addressed in a discussion about the future of Europe:

- an undeniable **lack of investment**,
- growing **inequality**,
- and **structural problems** such as corruption, clientelism, bad governance, inefficient/unjust education systems, legal uncertainty even in simple issues as well as an underperforming justice.

That is the reality in many countries!

1. Lack of Investment

Of course, we cannot deny a lack of investment in Europe. The driving force behind **private investment** in Europe is currently the **ECB** with its policy of **low interest rates**. This investment-friendly policy – besides other measures – led to positive but fragile developments in some of the crisis countries. However, the induced investment activity can hardly be

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controlled by governments or EU institutions. In this regard, a particular threat is the risk of **bad and underperforming investments** made by private as well as public investors due to the need to invest in anything that might promise positive interests.

Therefore, a lot of money raised due to the ECB's policy goes to countries and regions that are – so to say – not in desperate need of investments. Additionally, total investment is still far from sufficient.

The ECB as a "secret" (or not-so-secret) economic government of the Euro zone cannot do much about this, of course. It is the responsibility of the member states and particularly **the political European institutions to regain control** over that issue by raising public and facilitating private investment. This will make them able to direct investments to certain regions. A so called Golden Rule might be a useful instrument regarding this isolated issue.

2. Inequality

Government-directed investments can also be an effective measure to steer the economy in poorer regions – addressing the second major problem: **inequality**. This is a problem not only from an ethical and social point of view, but also in economic terms. I am sure that you are all aware of the OSCE study that confirms the negative effects of inequality on growth. However, not only inequality between individuals is problematic.

Generally speaking, we have two broader kinds of inequality in Europe: inequality between nations and between regions. Both are equally harmful.

Inequality between nations within a monetary union and its negative effects have been discussed extensively in recent years. However, Northern Italy and Catalonia, for example, are far over average in terms of GDP per capita while Sicily and Andalusia are among the poorest regions in West Europe. Therefore, inequality within countries has to be taken into account as well. This can be done by redirecting investments to weaker regions. Some measures have been taken in this matter, but not enough – obviously.

3. Structural Reforms

However, for sustainable investments and a working Economic and Monetary Union we need **a policy mix** that does not only consist of investment but **also aims for structural reforms and appropriate, growth-friendly consolidation.** These aspects are equally important when it comes to addressing the current economic crisis and we must not forget those issues by focusing too much on so called austerity.

For example, it took too much time until most of the six billion Euros that were meant to **fight youth unemployment** in the crisis countries have been transferred into projects. (Current status: 100% of the money is projected, but nobody knows whether all of it is going to be used)

Therefore, a measure that could have **induced growth and employment did not work** as it should. This was mainly caused by **domestic disputes and inefficient administrations** – and that was not an isolated case. Therefore, it is not enough to simply invest more money – be it due to a Golden Rule or other fiscal measures. **The structural environment** has to support investment – namely by supplying efficient administration bodies, low corruption and a reliable, fair tax system.

My overall example today is going to be **Italy**. That is not because I think that Italy is an exceptionally difficult and messy country, but due to my belief that Italy is **one of the most important countries in the Eurozone**. Italy’s potential in economic terms is tremendous, but a lot of problems that EU states face today can be observed in Italy. To some extent they were revealed because of recent reforms and efforts to fight corruption, but some of them have been known for a long time.

How is EU investment supposed to have crucial impacts in a country like Italy that ranges in **Transparency International’s corruption index** on place 69 behind countries like Cuba and Saudi-Arabia? How can the EU help to develop Sicily when a significant share of the money that is meant for new streets goes directly to construction firms controlled by the **Mafia**?

This not only true for Italy, of course, but also for a lot of other countries. And how can European investment projects work when even basic standards of **Good Governance** are not respected in the country’s administration?

Italy and most other crisis countries made some efforts in order to build up Good Governance structures. Nevertheless, there is still a long way to go.

In this respect, **those who primarily demand structural reforms** are right to some extent. However, one **must not be as biased** and one-eyed in this regard as the **German finance minister Schäuble**. Structural reforms can only be part of a big picture and have to facilitate growth and equality. We need **strong and efficient administrations** that are able to deliver both a **just tax regime** and **efficient implementation** of economic policies. We need investment plans in **education and infrastructure**. We need legal certainty and a well-functioning justice.

Only wealthy citizens can afford a weak state.

Therefore, a Golden Rule for investment and other fiscal reforms or revisions of the fiscal compact will not help much as long as the structural environment does not support these approaches.

4. Revenue Side

However, we must not only look at issues of spending and investment when talking about inequality. We also have to look at the **revenue side**.

I do not want to go into too much detail about this here, but issues of **Base Erosion and Profit Shifting** (BEPS), the recently revealed Panama Papers, and other ways of avoiding taxes by companies or wealthy individuals are major problems when it comes to fighting inequality. Even among EU members, some states **lack of solidarity** when it comes to fighting tax evasion.

The **Panama Papers**, for example, reveal a wide range of ways how an international group of corrupt and kleptocratic leaders, weapon dealers, tax dodgers and other dubious actors hid its money, sometimes legally, but often with illegal intentions at least. This was possible due to **rampant liberalizations** that created the basis for such a **tax evasion system**.

Tax havens help to undermine fiscal justice by supporting large companies and rich individuals in avoiding to pay their fair share. As we all know, this money is **missing** when it comes to **investments** in education, employment opportunities, and other measures that are necessary for social justice. Thus, such a system of tax havens is a contribution to growing inequality and harms the states‘ ability to address economic and social problems.

Additionally, it is not necessary to cross the sea to find tax havens. It is not even necessary to leave the EU: **Belgium, the Netherlands, and Luxemburg** still are tax havens, particularly for large multinationals – in contrast to all their assurances and promises.

We have to hope that after the **revelations a new consensus will emerge to fight harmful tax practices**. That is not only true for the BeNeLux-States and Germany. Also for the well-known tax havens in Great Britain and its British Virgin Islands and Channel Islands and also for the US and its tax haven states Delaware, Nevada and Wyoming. That is why it is necessary to act internationally.

This would be the only way to fight this **shadow empire** of kleptocrats, arms dealers, money launderers and tax evaders. **States need these misappropriated funds to spend it for education, infrastructure and the welfare state.**

5. Conclusion

Therefore, we have to achieve both **more efficient spending** that helps reducing inequality and a **fairer de facto taxation system**. Consolidating the **spending and the revenue side** is equally important and should be considered together, not separately.

Additionally, right and some left wing populist combat the process of reforming the EU. The populist favor a nationalist approach in dealing with the European crisis. Instead of a more integrated Europe or Eurozone, they want separate currencies and floating exchange rates in Europe. As Oskar Lafontaine, Stefano Fassina und Fabio De Masi stated in an article with the title Europe before the crash.

I think this would be the most dangerous perspective for the European economy and its societies. Unemployment and poverty would be the first result of such a policy.