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# **No Eurozone without Euro-dividend<sup>1</sup>**

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**Corrections, suggestions and remarks most welcome**

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### **Abstract**

*The vulnerability of the European currency union is ultimately rooted in the extreme weakness of two major buffering mechanisms that have proved crucial to the sustainability of the currency union formed by the United States: inter-state mobility and inter-state solidarity. As little hope can reasonably be staked in increased mobility between member states of the European Union, it is of crucial importance to explore the way in which a far higher level of solidarity could be institutionalized between member states. After having considered and rejected a number of options, the paper ends up focusing on a universal euro-dividend paid to every resident of the European Union (or of the Eurozone) and funded exclusively or mainly by a Value Added Tax. Taking for illustrative purposes a monthly euro-dividend of 200 euros funded by a 20% EU-wide VAT, it explores some of the key consequences of such a set up and the conditions of its political feasibility.*

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We cannot say that we were not warned. Years before the euro was launched, there was no lack of economists, admittedly mainly American, who were telling us that giving the European Union a common currency was economic nonsense. Europe would not listen to them, no doubt in part because it saw only too well that it was not exactly in the Americans' interest to see the emergence of a euro that would rival the dollar as a reserve currency and thereby challenge the United States' exclusive ability to get away, year after year, with huge budget deficits. So, the general response was: "Please, mind your own business, and stop telling us that we cannot do for (a subset of) our twenty seven member states what you have been happily doing for your fifty states." But however self-serving, perhaps the American economists' argument against the sustainability of the euro was right. And if it is right, I shall argue, the euro will only prove sustainable if it is backed up by a universal euro-dividend.

## **1. Four missing features for a sustainable currency area**

The substance of the argument goes back to the origins of the theory on optimal currency areas, which was precisely prompted by the first suggestions that European integration should involve monetary integration.<sup>2</sup> Drawing on the classic formulation by Robert Mundell (1961), it has been repeatedly argued that the obvious advantages of a common currency are the more likely to prevail over its disadvantages, the more the area concerned possesses four characteristics — homogeneity, flexibility, mobility and solidarity — none of which is likely to be present at a sufficiently high level in the European Union. The argument can be schematically summarized as follows.

Joining a currency union has several advantages beyond those flowing from the common currency being adopted by other countries as a reserve currency. In addition, economic efficiency can be expected to benefit from the reduction of the transaction costs associated with international operations and from the removal of the uncertainty associated with exchange rate fluctuations. These advantages, however, come at the cost of greater rigidity. If one country with its own distinct currency becomes less competitive relative to its trading partners, it can adjust smoothly by letting its currency devalue relative to that of its trading partners, thereby making it easier for its products to compete with foreign products both at home and abroad, while spreading the cost of the adjustment throughout the population in the form of higher prices for foreign goods (including trips abroad, for example) and any other goods whose production includes foreign goods. By contrast, with the fixed exchange rates entailed by a common currency, no such option is available, and the trade imbalance induced by the divergence in competitiveness is reflected in increased unemployment and its various unwelcome consequences.

As exemplified by the United States, this difficulty inherent in fixed exchanged rates can be contained if the various components of the currency area display at high enough a level one or more of the following four features. The first one is *homogeneity*. If the various components are replicas of each other, they will be affected symmetrically by any economic shock or trend, and the monetary policy appropriate for any component will be appropriate for all. However, the very existence of a single market, for many decennia in the US,

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<sup>2</sup> For a didactic critical presentation of the relevant literature, see De Grauwe (2012).

for less long in the EU, can be expected to gradually deepen the industrial specialization of each state, through the joint action of comparative advantage and economies of scale. Homogeneity, in this sense, is therefore not high in either the US or the EU and can be expected to decrease further in the latter as a result of the single market deploying its full effects. Moreover, formal and informal socio-economic institutions vary significantly from one EU member state to another — far more than from US state to another. Hence, even if member states happened to have the same pattern of industrial specialization, they are likely to react quite differently to the same external shocks.<sup>3</sup>

The second feature is *flexibility*, more specifically the downward flexibility of prices and wages. If the negative employment impact of lower competitiveness cannot be averted through devaluation, it could just as well be counteracted through swift decreases in wages and social protection in order to keep the local products competitive on both domestic and foreign markets. Flexibility in this sense is not huge in the US, and it is even more modest in most EU countries, owing to stronger Trade Unions, more constraining labour legislations, and more developed social protection systems.

The third feature is *mobility*, more specifically the propensity to move from one state to another in response to employment opportunities. The proportion of US residents who move from one state to another in the course of one calendar year is about 2.2%, to be compared with 0.3% of EU residents moving from one member state to another.<sup>4</sup> This is partly a reflection of the fact that the proportion of American residents who change residence every year — whether or not in the same state — is about three times the proportion of European citizens who do so, which in turn can probably be ascribed to differences in the fluidity of the labour and housing markets but also to a lesser attachment to a particular *Heimat* by a population of immigrants and descendants of immigrants. However, the fact that inter-state migration is seven times less frequent in the EU than in the US is also to a significant extent a reflection of the fact that the EU's linguistic diversity and, to a lesser extent, its far greater cultural differentiation, generally make moving from one EU member state to another far less promising in professional terms and far more costly in personal terms than moving from one state to another in the US.<sup>5</sup>

The fourth feature is *solidarity*, more specifically the extent to which taxes and transfers at the level of the currency area offset contrasting economic shocks and trends in the various member states. In the United States, the bulk of interpersonal transfers is funded at the level of the federal state — Social Security and Medicare (i.e. pensions and health care for the elderly), unemployment insurance, Earned Income Tax Credit (i.e. subsidies to the low-paid workers) and Temporary Assistance to Needy Families, Food Stamps and Medicaid (i.e. means-tested assistance in cash and in kind). As a result,

<sup>3</sup> This last point is stressed by Carlin (2011).

<sup>4</sup> These are estimates provided by European migration expert Michel Poulain on the basis of Eurostat data for 2008 and US census data for 2010.

<sup>5</sup> As Feldstein (1997: 36) puts it: « But although the legal barriers to labor mobility within the European Union have been eliminated, language and custom impede both temporary and long-term movement within Europe. As long as Europeans speak ten different languages, cross-border movement in response to job availability will be far less than movement among American regions. » Or Milton Friedman (1998) : "The characteristics that make Australia and the United States favourable for a common currency are that the populations all speak the same language or some approximation to it; there's free movement of people from one part of the country to the other part, so there's considerable mobility."

whenever the economic situation of one state worsens relative to others, there is some automatic compensation in the form of increased transfers and reduced taxes paid by households and firms located in the state. Early estimates used by American economists to explain why the dollar was sustainable whereas the euro would not be suggested that each loss of one dollar of GDP in one state was partly offset by an increase in net transfers of about 40 cents. By contrast, they noted, the compensation provided by EU-wide transfer systems fell short of 1 cent per euro of GDP lost.<sup>6</sup>

## 2. Can the euro be made viable?

The bottom line of this quick overview of the four characteristics stressed by the theory of optimal currency areas is that the EU seems poorly equipped to deal with the disadvantages of abandoning flexible exchange rates. A couple of years before the launch of the euro, Milton Friedman (1998) described it as a "big gamble", because "the Common Market does not have the features that are required for a common currency area": "You have countries with people all of whom speak different languages. There's very little mobility of people from one part of the Common Market to another. The local governments are very large compared to the central government in Brussels. Prices and wages are subject to all sorts of restrictions and control." Along the same lines, Martin Feldstein (2012) recently seemed to take some understandable pleasure in recalling the warnings he had formulated in the nineties (Feldstein 1992, 1997). And this view is by no means not restricted to one side of the conservative/liberal divide among US economists. However much they may diverge on the right solution to the financial crisis, Joseph Stiglitz and Paul Krugman, for example, do not say anything fundamentally different on what is wrong with the euro.<sup>7</sup> Nor does Amartya Sen (2012): "A unified currency in a politically united federal country (such as in the United States of America) survives through means (such as substantial population movements and significant transfers) that are not available to a politically disunited Europe. Sooner or later the difficult question of the long-run viability of the euro would have to be addressed, even if the rescue plans are completely successful in preventing a breakdown of the euro in the short run."

This amounts to a pretty strong challenge, which cannot be dismissed as a self-serving attempt to sabotage the euro by an American establishment only too keen to keep for the dollar the enormous privileges linked to its status as the top reserve currency. One response to it would be to recognize the mistake and go back to the separate currencies. However, even abstracting from the bruised pride, there would be a heavy immediate price to be paid by all

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<sup>6</sup> Feldstein (1997) used a study by Sala-i-Martin and Sachs (1991), whose conclusion reads as follows: "Some economists may want to argue that this regional insurance scheme provided by the federal government is one of the key reasons why the system of fixed exchange rates within the United States has survived without major problems. And this is a lesson to be learnt by the proponents of a unified European currency: the creation of a unified currency without a federal insurance scheme, could very well lead the project to an eventual failure. »

<sup>7</sup> For example: "The truth is that Europe's march toward a common currency was, from the beginning, a dubious project on any objective economic analysis. The continent's economies were too disparate to function smoothly with one-size-fits-all monetary policy, too likely to experience "asymmetric shocks" in which some countries slumped while others boomed. And unlike U.S. states, European countries weren't part of a single nation with a unified budget and a labor market tied together by a common language. » (Krugman (2011)).

countries involved in the stormy transition: as some analysts put it, once the omelette is made, good luck to you if you try to get your eggs back. Moreover, a currency union remains a meaningful long-term objective. James Meade (1957: 388), for example, the British forerunner of the theory of optimal currency areas, argued on the eve of the creation of the European Economic Community that the time was not ripe for the sort of European government required for a viable European currency union, but that it is "ultimately desirable".<sup>8</sup> As John Stuart Mill (1848: 372) famously wrote, distinct currencies are nothing but an element of "barbarism" that subsists "in the transactions of the most civilized nations", "to their own inconvenience and that of their neighbours".<sup>9</sup>

I shall therefore take for granted that we want to keep the euro. But to make it sustainable, we need dramatic improvements along one or more of the four dimensions listed above. Once the relevant sense of "homogeneity" is clearly distinguished from convergence in price and wage levels or in levels of development, there is not much to expect along this first dimension, given the country specialization structurally induced by the single market.

Flexibility is another matter, no doubt appealing to those, like Milton Friedman, who would not mind getting rid of "all sorts of restrictions and control". But of course much of our European rigidities are closely linked to the development of our national welfare states, far greater on average than the American one. There may be some room for acceptable increases of flexibility,<sup>10</sup> but if this were to be the main strategy for making the common currency sustainable, it would mean a shrinking of our social protection and labour legislation far below the American level, in order to compensate for the main differences with the US, which relate to the last two characteristics. Compared to the EU's new ultra-neo-liberal capitalism, even the post-Reagan US would then look like a social-democratic paradise. Some of the advocates of the euro may have anticipated this pressure, now tangible enough, and may have advocated it for precisely this reason.<sup>11</sup> But once understood in all its

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<sup>8</sup> Meade's (1957: 387-8) crucial passage is worth quoting in full: "The integration approach thus involves-in addition to the formation of a common market for goods and for factors of production and the provision of much greater international liquidity for European monetary authorities-a very extensive range of powers for what would amount to a single European government. Such a government would have to be able to control central-bank monetary policy and governmental budgetary policy throughout Europe, to determine a single European commercial and exchange-rate policy vis-a-vis third countries, and to carry out an effective special-area policy for depressed regions in Europe. This is in my opinion ultimately desirable; let us hope that it will prove ultimately practicable; but it is not a starter at the moment, and it would be a great shame to sacrifice the present real political possibilities of building a commercial free-trade area to this ideal of simultaneous monetary and budgetary integration."

<sup>9</sup> "Let us suppose that all countries had the same currency, as in the progress of political improvement they one day will have. [...] So much of barbarism, however, still remains in the transactions of the most civilized nations, that almost all independent countries choose to assert their nationality by having, to their own inconvenience and that of their neighbours, a peculiar currency of their own." (Mill 1848: Book III, Chapter XX).

<sup>10</sup> To one of which I return in section 6 below.

<sup>11</sup> As suggested by Fritz Scharpf (2011: 35) on the basis of quotations by the ECB's former chief economist Otmar Issing (2009). See also my response (Van Parijs 2012) to Gerhard Schröder's apology of his Agenda 2010 (or Harz IV) reform. The crisis of the euro did not need the world financial crisis to be triggered: it is enough for significant competitiveness-improving (and inequality-increasing) reforms to be implemented in one major component of the single currency area for trade balances deficits to arise in other components and force these to slash in turn in their social protection in order to regain their own competitiveness — until Germany fears once

consequences, one can safely assume that this is not a path we would be proud of treading.

A massive increase in inter-state mobility may seem to be a less gruesome alternative. But moving from Greece to Bavaria is not quite the same as moving from Nebraska to Texas. This difference shows in the current gap between frequencies of inter-state moves in the US and in the EU. But it also impacts what: can be expected in the future. The deepest obstacle to making inter-state migration as smooth and frequent in the EU as in the US is linguistic. Learning other EU languages is a way to overcome it, and it is on the rise, at least as far as English is concerned.<sup>12</sup> But as long as administrative, economic, political and social life happens in twenty two or more distinct languages, the reluctance to move to another state and the average cost of integration in that other state will remain considerably higher in the EU than it is in the US. And there are good reasons to expect — and also arguably to wish — that this linguistic distinctiveness will persist.<sup>13</sup> Admittedly, greater reluctance and greater cost may not inhibit a dramatic increase in inter-state migration if the welfare states are dismantled to such an extent that workers will be massively driven into expatriation. If the dismantling is radical enough, inter-state mobility will be driven up despite the linguistic and cultural obstacles. But it will really need to be driven very far for intra-EU inter-state migration to start approaching the US level, and even then with less economic benefits and more social suffering, owing to greater difficulty of economic and social integration. Thus, unless one wants to go very far in the direction of linguistic unification and/or welfare state dismantlement — i.e. in the direction of drastically reduced cultural solidarity and/or material solidarity —, there is little to be hoped along the mobility dimension either. The equivalent of big cities like Detroit or St Louis losing huge chunks of their populations to other states would be far more nightmarish in Europe than in the US. And it would moreover need to happen at a far higher level in the absence of the fourth and last feature, which is also far more developed in the US.

### **3. No sustainable Eurozone without trans-national transfers**

This fourth dimension is inter-state solidarity. As mentioned before, whereas inter-state mobility is about seven times higher in the US than in the EU, inter-state solidarity is, depending on the estimates, up to forty times higher in the US than in the EU. Along with mobility, solidarity operates as a major buffer when a state, unable to devalue its currency, sees its competitiveness decline relative to other states in the same currency union. The fact that the American welfare state operates at the federal level means that the impact of growing unemployment on both the revenue and the expenditure side of a state's budget is far less than if it were operating at the state level, and it is therefore at far less risk of triggering a vicious spiral of increasing budget deficits, swelling public debts, worsening ratings, higher interest rates and even deeper deficits. Moreover, higher net transfers mean an injection of effective demand which helps sustain the local economy. These impacts do not suffice to cancel a decline, nor therefore to make the other main buffer —

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more that it may become "the sick man of Europe" and undertakes another round of reforms.

<sup>12</sup> See the age decomposition of the 2012 Eurobarometer data at [www.languageknowledge.eu](http://www.languageknowledge.eu).

<sup>13</sup> See chapters 5 and 6 of Van Parijs (2012) on why the preservation of this linguistic distinctiveness, though not desirable in itself, is nonetheless justified.

inters-state migration — redundant, but they make it possible to have smooth, permanent and automatic adjustments, instead of leaping from one acute crisis to another.

The picture is totally different in the Eurozone. The main inter-state transfer system is the subsidy component of the common agricultural policy, and quite apart from not being exactly designed as an optimal buffer for falls in competitiveness, it represents only a tiny proportion of GDP. When hit, for whatever reason (from decreases in the foreign demand for some of its main traded products to competitiveness-boosting reforms in other member-states), by economic shocks or steady declines, a member-state of the Eurozone is not helped by the transfer system operating within its borders. On the contrary, the more developed its welfare state, the heavier the impact on its public budget of the unemployment generated by its lower competitiveness. And whether it takes the form of higher taxes or less generous benefits or both the effort to keep the deficit under control will depress the local effective demand, without any noteworthy compensation from an increase in net transfers from the rest of the Union.

Is this fourth dimension — the development of a so-called “fiscal union” or *Transferunion* — any more promising than the other three? There are now many hints in that direction, generally quite vague.<sup>14</sup> But there are also forceful expressions of scepticism. It is precisely because he rules out this option that Martin Feldstein (2012: 111) believes that the euro, in contrast to the dollar, is unavoidably in deep trouble. As a result of the current crisis, he says, “the euro has thus caused tensions and conflicts within Europe that would not otherwise have existed. Further steps toward a permanent fiscal union would only exacerbate these tensions.” And there is no lack of support for this view on the European side too. Thus, on the occasion of a lecture he gave in Oxford, Jean-Claude Trichet (2012), former head of the European Central Bank, dismissed this option on the ground that “a fiscal union does not belong to the DNA of the European Union”. Along the same line, in his illuminating analysis of the various ways in which the European Union has been trying to legitimize itself through what it does for European people (what he calls the “Roman” strategy of gaining legitimacy through consumer satisfaction), Luuk van Middelaar (2012: 399) asserts that an EU-wide transfer system “would intrude into national economies and shake their populations’ horizon of expectations. A European welfare state is unthinkable.”

If what we are talking about is something like Europe’s most developed welfare states blown up to EU scale or even something comparable to the US welfare state, then this is indeed something that can be regarded as being forever out of reach: the EU member states’ elaborate pension, health care, child benefit, unemployment, disability and wage subsidy schemes are very

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<sup>14</sup> For a typical example from the political side: “Die gegenwärtige Krise macht jedoch klar, dass man nicht einen gemeinsamen Währungsraum haben kann ohne eine gemeinsame Finanz-, Wirtschafts- und Sozialpolitik.» (Schröder, 2012). Some opinion leaders dare to be somewhat more explicit, for example Ben Chu, the economic editor of *The Independent*: “In the US, the majority of taxes are raised by the centre and spent by the centre. This means that when an American state is hit hard by an economic shock, it does not collapse because it automatically gets extra payments from the federal government. [...] The central design flaw in the eurozone, then, is that it is a currency without a country behind it. Can this half-built structure survive the violent storm? That is likely to depend on how rapidly it can develop the monetary institutions, fiscal transfer mechanisms and sense of common political purpose that define those currency unions that have stood the test of time.” (Chu 2012: 19).

different from each other in both design and funding, and they are the path-dependent income of tough struggles, lengthy debates and laborious compromises. Merging them all into a single EU-wide uniform system may be thinkable, but is definitely not doable, if only because of the chaos created in the transition period. Moreover, even abstracting from the transition difficulties, there is nothing intrinsically desirable about a uniform welfare state across Europe: many aspects of institutionalized solidarity — such as the definition of “involuntary” unemployment or the scope, form and extent of universal health insurance — are better left to country-level discussions and procedures, conducted in the local languages against the background of the local cultures. So, let us forget the idea of an EU-wide mega welfare state.

But this is not the end of the story. I shall now consider a number of more modest options that may claim to do at least part of the job. I shall explore them as options for the whole of the European Union, because of their potential of being part of the background conditions for making membership of the Eurozone a safe bet for countries that stuck to their national currencies. Each of these options, however, could also be envisaged in a restrictive version limited to member states of the Eurozone.

In the first instance, one might think of a pure insurance scheme between member states, following a pure actuarial logic and hence involving no ex ante redistribution. To buffer downward fluctuations in employment or GDP, revenues would be collected in countries doing better (relative to their initial position) and transferred to the governments of the countries doing worse.<sup>15</sup> To address the standard moral hazard problem, the compensation afforded by the insurance scheme must of course fall far short of full neutralization of the downturns. But this is also the case for the compensation generated by the American welfare state. This scheme may look attractive in terms of abstract economic reasoning. But inherent in it is the likelihood that poor member states will be required to transfer considerable sums from their taxpayers to the budget of other member states far richer than them. The acceptance of such a scheme would not last long.

More plausible, therefore is a *Finanzausgleich* scheme of the sort that exists between German *Länder*, i.e. a system of transfers between member states linked to their respective levels of prosperity, that would automatically reduce the contribution paid or increase the transfers received by any member state whose economic position is deteriorating. If the buffering is to pass the test of legitimacy, it must be a by-product of some form of solidarity — not sheer insurance — between richer and poorer member states. But another legitimacy problem will then quickly come up. If part of the revenues that are being raised in one state and could be used for good purposes in that state are being transferred to the budget of another state, the taxpayers and governments of the former will keep claiming a right to interfere with the use made of “their” money by the government of the latter.<sup>16</sup> Especially with distinct public opinions separated by language divides, one can easily foresee the recurrent tensions which this is bound to generate. This risk can be cosmetically attenuated if the transfers are “vertical” rather than “horizontal”, i.e. if the taxes are levied by the federation and distributed to the state’s

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<sup>15</sup> For proposals along these lines in a different context, see Drèze (1993, 2009).

<sup>16</sup> This problem is less acute in the case of an insurance scheme without ex ante redistribution, because each member state can then more easily imagine itself on the receiving side.

government according to some demographic or needs criterion that diverges significantly from proportionality to the tax levied in the various states. The net transfers across states may be exactly the same as under a horizontal transfer of revenues levied by one state to fund the expenditures of another, but the perception may be sufficiently different to make the transfer seem less problematic to the net contributors. In any case, the vertical option is most unlikely to be an option for the EU: it is hard to imagine the governments of the member states transferring taxing powers to the EU in order for the latter to transfer the money back to them. Hence, it is horizontal transfers we must be thinking of, with the tensions they would unavoidably trigger. The scheme may nevertheless be sustainable for relatively small transfers, but not for the level required to guarantee the sustainability of a common currency. Whether within federal Germany, or within the US, a common currency has been not made viable by the comparatively small transfers (horizontal or vertical) to the states' budgets, but through a huge system of interpersonal transfers that crosses state borders.

#### 4. The euro-dividend

Are we then back to the unfeasible and undesirable common welfare state? Not necessarily. For one could leave the structure of each national welfare state essentially intact, while introducing a significant level of transnational interpersonal redistribution. One proposal along these lines is Philippe Schmitter and Michael Bauer's (2000) *euro-stipendium*. It consists in a means-tested minimum income scheme funded at the level of the European Union: any EU household whose income is lower than a stipulated threshold will receive a lump-sum benefit directly from the Union. There are various defects with this proposal, some of which can be mended but two of which are both serious and intrinsic to it. Firstly, the scheme requires a uniform specification of what incomes (and possibly other assets) need to be taken into account and a uniform enforcement of this specification by national officials who will have little incentive to be very thorough. (The more narrowly income is defined and the less scrupulously it is detected, the more European money will flow into the country.) Secondly, the scheme necessarily creates a perverse incentive for each country to organize its labour market and welfare state so as to maximize pre-EU-transfer poverty (with a given GDP). Among two member states with an equal per capita national income, the one whose institutions produce the higher degree of inequality will be rewarded by higher transfers from the EU.<sup>17</sup>

However, this defect is avoided by an alternative to this proposal which could be called a *euro-dividend*. Instead of targeting poor households, it is paid to every legal resident on an individual basis without any income test. Obviously, this does not prevent it from redistributing from the rich to the poor, providing the rich contribute to its funding more than the poor (in absolute terms, not necessarily in relative terms). But it by-passes the big administrative and political problem of implementing the income test in a uniform way in all member states. And secondly, it stops rewarding inegalitarian policies. The scheme simply consists in fitting an income floor under the nationally generated distribution of income, whether from labour, capital or transfers. Above the floor provided by the dividend, the structure of the diverse existing national welfare

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<sup>17</sup> See the discussion in Van Parijs & Vanderborght (2001) and Bauer & Schmitter (2001).

states can remain essentially unchanged. Indeed, the presence of the floor will strengthen the national welfare states and help preserve their diversity.

Before speculating about possible positive and negative effects, however, it is important to specify how an EU-wide (or Eurozone-wide) euro-dividend could be funded. We might as well leave aside from the start the two main sources of funding of national welfare states. Social security contributions consist in principles in subtracting from a worker's cash wage a portion that will take the form of an indirect wage paid differentially according to the circumstances of the worker's life. It is therefore best not to use them for a universal benefit and rather reserve them for the funding of social insurance schemes. Personal income taxation, on the other hand, cannot be ruled out for this reason. But in order to operate at EU level, it would require a uniform definition of taxable income across member states and therefore raise a problem analogous to the one mentioned above in connection with the means-test. For this definition varies significantly from member state to member state and is extremely sensitive politically: how is home ownership taken into account, for example, or household composition, or the nature of the income (from labour, capital or social transfer), or occupation-related costs which? Reaching an agreement on a uniform tax base is essential to avoid legitimate reproaches of "tax evasion" between countries with different definitions of the income tax base. And it is bound to be so contentious and laborious that it would be most unwise to count on it. The same comment applies to the idea of an EU-wide wealth tax. Of course, in the end the funding of a euro-dividend must amount to a different distribution of income and wealth, but there may be more promising ways of achieving this by focusing, in a workable and defensible way, on specific types of income and wealth, or by taxing these indirectly.

As an alternative, we may therefore first think of some taxes which are most naturally organized at the European level. One of them is the prospective financial transaction tax (or Tobin tax). A recent study by the European Commission estimates its yield at about 57 billion euros annually.<sup>18</sup> With half a billion EU residents, this amounts to 114 euros per person annually, or about 10 euros per month. This is not exactly a large amount. It is one, moreover, that can be expected to fluctuate widely with speculative movements, and it is likely to be significantly overestimated, as the tax elasticity of the tax base may be much larger than assumed once speculators find loopholes or shift to more lucrative endeavours.

Another possibility worth considering is the carbon tax, or rather the fee to be paid for the right to use some of the carbon quotas allocated to the EU. To assess the potential of this source of funding, it makes sense to start by asking how high an income would be generated if all the carbon emission permits allocated to the EU were auctioned off to the highest bidder. This is arguably the best way of handling the EU emission limit in a simple, efficient and fair way, providing the proceeds are redistributed equally among all EU citizens. The

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<sup>18</sup> See the documents on "The Financial Transaction Tax » released by the European Commission in May 2012 ([http://ec.europa.eu/taxation\\_customs/taxation/other\\_taxes/financial\\_sector/index\\_en.htm](http://ec.europa.eu/taxation_customs/taxation/other_taxes/financial_sector/index_en.htm)). The estimate is based on a tax rate of 0.1% for securities and of 0.01% of the notional value for derivatives agreements, payable by each side of a transaction. « About one third of this revenue is expected to be generated by taxing trading, borrowing and lending in securities (bonds and shares), and two thirds are expected to come from taxing derivatives », in particular (half of the total) from taxing interest rate linked derivatives such as interest-rate swaps.

price of the permits will be reflected differentially in the price of all goods and services whose production requires them directly or indirectly, and on average the equal per-capita lump-sum compensation will overcompensate low-income households and undercompensate high-income households.<sup>19</sup> The sale of the permits currently covered by the Emission Trading System is estimated to yield 21 bn euros annually by 2020.<sup>20</sup> This is not much (it would fund a monthly euro-dividend of about 3.5 euros). Moreover, some experts believe that the unit price assumed in the exercise (16.5 euros) is overoptimistic. However, most of the carbon emissions are not subjected to the trading system. If all were, the yield would be much higher. How much is a matter of speculation, as the equilibrium price that would emerge depends on the ceiling chosen (which may go down) and the rate of economic growth (which keeps fluctuating). With 4 to 5 Bn ton of CO<sub>2</sub>-equivalent and a price of 20 euros per ton, this could yield up to 100 Bn euros and hence fund a euro-dividend of up to 17 euros per month.<sup>21</sup> Consequently, even under very favourable assumptions — 100% of the permits auctioned, 100% of the proceeds allocated to the euro-dividend —, the level of the dividend that could be funded in this way remains very modest, subjected to fluctuations that affect the market-clearing price of the permits and, moreover exposed to the long-term downward impact of the fee on the demand curve for the permits. The amount that can be expected from this source is larger and more reliable than what can be expected from a financial transaction tax, but if the euro-dividend could count on nothing else, it could not be given a significant role in helping secure the sustainability of the euro.

## 5. A VAT-funded euro-dividend

All this does not sound very encouraging. Social contributions and income taxes yield large revenues but are out of the question at EU level. Financial transaction and carbon taxes make a lot of sense at EU level, but their per capita yield is very modest. Is there anything else one can turn to? Certainly: the most Europeanized of all existing taxes, the Value Added Tax.<sup>22</sup> The VAT part of the funding of the EU's current budget can be sketchily presented as

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<sup>19</sup> The market-clearing cost of the permit could also be implemented in the form of a carbon tax at an equivalent level. The same logic governs the universal benefit introduced in Iran by way of compensation for the gradual alignment of the domestic price of oil on the international price (see Tabatabai 2001).

<sup>20</sup> European Commission 2012: 24, table 7.

<sup>21</sup> Thanks to Vincent Van Steenberghe for these well-informed guesses based on the assumption that all permits are allocated through the auction (instead of a percentage rising gradually from 20% in 2013 to 70% in 2070, as currently decided at EU level.) Estimates for Germany taken separately yield higher levels of dividend (250 euros per year or over 20 euros per month) because they take as their point of departure Germany's current quota, which is largely determined on the basis of the historically given level of emissions and hence larger than its per capita share of the EU quota (Schachtschneider 2012). Similarly, estimates for the US (for 2020, assuming a unit price of 25 dollars) lead to a dividend of nearly 400 dollars per year, or over 30 euros per month, mainly because of the reduction called for by the Kyoto Protocol leaving the US with a share of worldwide emissions much higher than its share in the world population (see Boyce and Riddle 2012; Howard 2012).

<sup>22</sup> Other possibilities that are probably worth exploring more than I can do here are an EU-wide corporate income tax (which raises at least some of the problems of a personal income tax) and more innovative options such as a funding by money creation made possible by the re-socialization of seniorage privileges (the level of which would be limited to and fluctuate with the rate of real growth: see Huber 1998; Huber and Robertson, 2000), or an EU-wide automated payment transaction tax (which would not have these drawbacks but, if introduced at a high rate, would have massive consequences: see Feige 2000).

follows. Starting from the VAT revenues in each member state and the pattern of tax rates on different categories of goods and services, one calculates for each member state a harmonized VAT base by dividing the VAT revenues by a weighted sum of the VAT rates. Abstracting from lower rates that apply temporarily to some countries, 0.3% of this tax base is collected by the EU in every member state.<sup>23</sup> The result of applying these rates to the harmonized tax base is an expected yield of 15 bn euros in the EU's budget for 2012.<sup>24</sup> This suggests that each per cent of VAT applied to the harmonized tax base of all member states (including those benefitting currently from reduced rates) would yield annual revenues in the order of 60 Bn, or 10 euros per month per capita.<sup>25</sup>

This figure gives us a good grip on the orders of magnitude involved.<sup>26</sup> Let us focus for illustrative purposes on a EU-wide VAT of 20%. In the light of the above, this would yield a euro-dividend of 200 euros per month if every European, whatever his or her circumstances, were to receive it at the same level. I sketched above the decisive objection against means-tested trans-national transfers, i.e. against differentiation or restriction along the income dimension. But there is another dimension along which one could differentiate or restrict without facing similar objections: age. The amount could be lower for children for example, or higher for those over seventy. Or the funds could be entirely allocated to the 10% of the EU population below 10 or to the 12% of the population older than 70. A 1% VAT, for example, would give every European child below 10 a monthly child benefit of 100 euros, while a 6% VAT would give every European aged over 70 an unconditional basic pension of 500 euros.<sup>27</sup> There could be good reasons, at least in a transitional period, to target the euro-dividend in this way: it could be justified for example on the ground that the EU has a special responsibility to help countries cope with the ageing of their populations or instead to slow down this ageing by making life easier for families with children. Of course, as the age structure varies considerably from one member state to another, the choice between these various versions of the euro-dividend is far from being distributively neutral. Let us leave these possibilities aside, however, and concentrate for illustrative purposes on a very simple variant: a universal basic income of 200 euros per month from birth for every legal resident, funded by VAT, either entirely or only predominantly (if up to one tenth of it were to be funded by a transaction tax and/or a carbon tax).

I am not offering this as a well-thought-through, duly fine-tuned proposal, but as a baseline for serious thinking about an option to which one is led

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<sup>23</sup> With the temporary exception of four countries enjoying a lower "call rate" (0.1% for the Netherlands and Sweden, 0.15 for Germany, 0.225 for Austria until 2013) and subject to the tax base not exceeding 50% of GDP (a ceiling imposed to prevent the poorest countries from contributing at a higher rate than the richer countries).

<sup>24</sup> This is to be compared with 19 bn from customs duties and 97 bn from GDP-based contributions from member states at a 0.74% rate. See European Union (2011) for the amounts, and European Union (2008: 234) for the structure.

<sup>25</sup> The EU's GDP was 12629 Bn in 2011 (about 2200 euros per capita and per month), somewhat above twice the harmonized VAT base. Note that the 1% tax increase on the harmonized tax base need not be linear: each member state would be at liberty to distribute it among the various categories of goods.

<sup>26</sup> This is again just meant to give an order of magnitude. More refined estimates would need to take into account some complexities related to the capping clause mentioned in an earlier footnote and to the implications of the UK's tax rebate, and also the possible impact an an increase in the tax rate on the size of the tax base.

<sup>27</sup> Population data are based on

<http://epp.eurostat.ec.europa.eu/portal/page/portal/population/data/database>.

through the exploration of a whole series of other options that might, at first sight, have seemed far more straightforward or more realistic but turned out to be dead ends. Once you have checked all the doors and realized that, if not sealed, they all open either into a cupboard or into a precipice, it makes sense to take notice of a window that may be harder to climb to but offers the only chance of salvation. Before engaging on the climb, however, it is wise to ask a few crucial questions about what can really be expected and reasonably feared from taking the direction just sketched

First of all, how will the tax-and-transfer systems adjust? Neither the new tax nor the new benefit will simply be piled on top of the existing taxes and benefits. On the benefit side, the dividend will form the bottom part of all existing benefits, with the rest subsisting, if their current level is higher, in the form of a conditional top up. The direct effect would be to free the national revenues previously used to fund this bottom layer of 200 euros. At the same time, just as the euro-dividend is not meant to swell automatically the total benefit level of all benefit claimants, it is not meant to swell automatically the net earnings of all workers. For these, it could be viewed as equivalent to a uniform tax credit that would replace the standard tax exemptions and reduced rates on the lower income tranches of every income tax payer. The direct effect would be a considerable increase in the revenues from the income tax, with the profile of the income tax becoming more linear.

The savings made on the benefit side (through substitution of the euro-dividend for the lower part of every benefit) and the revenue increase on the income tax side (through substitution of the euro-dividend for the standard income tax exemptions) make it possible to reduce national taxation. The most straightforward option is to lower the national component of the VAT.<sup>28</sup> However, the specific tax and benefit structure of each member state may suggest other choices, as fitting the euro-dividend at the bottom of the structure may provide a welcome opportunity for rationalizing and simplifying what is often the unwieldy outcome of countless ad hoc accretions. These adjustments can be made so as to avoid big shocks in the distribution of incomes. However, whatever the form taken by the adjustments, the measure cannot be distributively neutral and is not meant to be. It will necessarily benefit a minority of households whose combined benefits and tax exemptions amount to less than 200 euros per capita, with the burden of the corresponding tax increase spread over the other households. And it will necessarily entail a net transfer from member states in which value added per capita is higher than the EU average to member states where it is lower.<sup>29</sup>

## 6. How strong a buffer ?

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<sup>28</sup> Note, however, that the lower the national component and the higher the EU component, the less incentive there is for each country to trace value added rigorously — perhaps to the point of having less confidence than now in the way in which the harmonized tax base is currently determined.

<sup>29</sup> Working out the redistributive impact of a specific combination of Euro-dividend, EU-wide VAT increase and readjustment of national tax-and-transfer schemes would need to be done using the European tax and benefit simulation model EUROMOD, along the lines of what Bargain & al. (2012) did for a full and partial replacement of the member states's income-tax-and-cash-benefit systems by a European one. However, the impact of changes in VAT rates on the real incomes of various types of households is more difficult to simulate, for obvious reasons, than the impact of changes in income tax rates.

This provides an essential background for answering a second question: how much of a buffering effect can be expected from a VAT-funded euro-dividend?<sup>30</sup> Take the case of a member state that is suddenly hit by a sustained increase in its rate of unemployment. Under present circumstances, the whole of the decrease in tax revenues and the full cost of the unemployed person's replacement income will need to be borne by the budget of the country concerned. In the absence of high mobility and/or high flexibility and without the possibility of devaluation, the impact on the public deficit and debt can catch the country in a risky spiral. A VAT-funded euro-dividend does not cancel this impact, but it attenuates it in two ways. The fall in revenues is reduced because part of the reduction of the yield of the country's VAT is spread all over the EU. And the increase in expenditure is reduced because part of the unemployment benefit takes the form of a euro-dividend funded at EU level. In most countries, the level of the unemployment benefit is sensitive to family composition. A family of four would receive a euro-dividend of four times 200 euros, and the unemployment benefit to be paid out of national funds could be correspondingly reduced.

How strong this buffering effect would be compared to the buffering effect of the US federal welfare state is an arduous question that raises many methodological questions. It is clear that with 20% of value added, which is itself in the order of half of GDP, one is unlikely to match the joint effect of all components of the US tax and transfer system. It is therefore worth exploring variants of the particular proposal made here by way of simple illustration. Obviously, one could consider a higher level of the euro-dividend, or a differentiation of its level that would favour the population of working age, or a progressive EU-wide VAT with a rate rising with the per capital GDP.<sup>31</sup> Assessing the simple version discussed above and each of these variants in terms of their direct impact on public finance would be instructive. However, it is important to bear in mind that the buffering effect has a further dimension: the fact that henceforth part of the transfer system is transnational entails that the purchasing power within a country affected by a downturn is higher than it would otherwise have been, thereby sustaining local effective demand and local economic activity.

Even in the best feasible variant, it is unlikely that the buffering effect of inter-state solidarity will reach, let alone far exceed, the level achieved in the US. It follows from the analysis above that, for the euro to be sustainable, some improvement should also be attempted on the mobility and flexibility side. The euro-dividend itself is not irrelevant to these dimensions. The very existence of a transfer system can be viewed as a brake on mobility. Indeed, the development of a such a system has sometimes been advocated, for example in the Brazilian context, to check the tendency of rural populations to flock into overcrowded cities. And the fact that there are more Poles or Turks than Walloons working in (now) prosperous Flanders — whereas Flemings moved to (then) more prosperous Wallonia *en masse* in pre-welfare state times — has something to do with the existence of a developed Belgian welfare state

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<sup>30</sup> Again, my purpose is not to answer this complex empirical question with any precision, as Bargain & al. (2012) did for a European tax-and-benefit system applying to 11 member states, but to identify its various dimensions and point to the directions in which answers need to be looked for.

<sup>31</sup> As is the case with the current EU-wide VAT, owing to the tax base being capped at 50% of GNP, as explained in an earlier footnote.

covering both Flanders and Wallonia. This holds also for an EU-wide transfer system, but only if the relevant counterfactual is the absence of such transfers, not the exclusive organization of all transfers at the national level. Once the relevant counterfactual is used, one can instead expect the introduction of the euro-dividend to favour transnational mobility. Currently many social rights are narrowly linked to national systems and can often only be maintained, if at all, through complicated and uncertain procedures after moving to another country. The euro-dividend would provide a modest yet secure basis on which one could keep counting wherever one moves to within the EU. Had it been introduced in the absence of country-level social transfers, it would have reduced trans-national mobility. But against the background of existing country-level systems, it would facilitate it.

What about flexibility? One of the main economic arguments invoked in favour of a universal-basic-income type of social protection, in contrast to a means-tested safety net, is that it opens the way for a more productive combination of security and flexibility.<sup>32</sup> The firm floor on which one can rely in all circumstances will facilitate voluntary working time reduction and career interruption, and thereby a smoother back-and-forth between employment, education and care. Relatedly, against the background of this floor, downward fluctuations in the supply of decently paid full-time jobs will not trap as many people in a dependency trap as would otherwise be the case. Of course, with a basic income pitched at 200 euros, members states will not be able to dispense with supplementary means-tested social assistance (and even less with unemployment insurance), and the euro-dividend will therefore not suffice to get rid of the trap the latter creates, but it will attenuate it to some extent and may, once the distributive set up is in place, encourage some countries to supplement the euro-dividend with a national dividend, thereby further reducing the trap inherent in long-term means-tested assistance and unemployment benefits. When unemployment hits a component of a single currency area and cannot be sufficiently defused by emigration to other components or mitigated by transfers from other components, there is a pressure to avoid protracted unemployment through greater flexibility by reducing the level or duration of replacement incomes that exceed what the unemployed could earn if at work. The presence of an unconditional floor makes it easier to adjust more smoothly through forms of work sharing that avoid trapping people out of the labour market. As in the case of mobility, the argument is not that flexibility would be improved relative to the absence of any transfer — it would not, and fortunately so: any form of social protection is a brake on the maximal exploitability of the labour force. The argument is rather that against the background of the existing pattern of social protection, a modest EU-wide universal floor would make room for more flexibility of an acceptable sort.

## 7. Political feasibility

Let us sum up. If the analysis proposed here is correct, the euro-dividend would equip the Eurozone with an essential transfer-based stabilization mechanism analogous to the one supplied to the dollar zone by the far more complex and extensive American welfare state. In addition, the euro-dividend

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<sup>32</sup> See Standing (1986) for an early formulation of this argument.

would not make things worse but, if anything, significantly better in terms of two other features whose presence contributes to the sustainability of a currency area. Bearing this in mind, we can now turn to a final question. Suppose one is convinced by the need for a euro-dividend, how is it to become politically feasible.

Firstly, perception is of the greatest importance. There is little prospect for a euro-dividend if it is successfully depicted as a mega-bureaucratic machine that threatens the valuable democratically shaped diversity of national social protection systems and ends up channelling masses of money from countries well run to countries sloppily run, thereby perpetuating the latter's sloppiness. It is important that European citizens should understand that a euro-dividend is not a threat to the diversity of European welfare state, but instead, for the reasons explained above, an essential tool to prevent the constraints of the single market and the single currency from gradually forcing all of them to trim down and converge to a minimalist form of social protection.<sup>33</sup> Even more important, the euro-dividend should at the same time be viewed as a way of making as sure as possible that every European citizen should share in the material benefits of European integration. How high these benefits are is impossible to assess with any precision. To imagine the relevant counterfactual, one must find some inspiration in the contrast between the aftermath of World War I and that of World War II. The very fact that it is hard to think of a military build up and armed conflict between European countries, let alone to estimate what they would cost us, is not a reason to ignore them in the assessment of the material benefits every European derives from the creation and perpetuation of the European Union. They must on the contrary be taken into account as a bulky and lasting component of what the EU keeps doing for us.

There are, in addition, the considerable material benefits of a common market in terms of breaking monopolies, stimulating innovation, facilitating specialization, etc., mostly reflected in the difference between the prices Europeans pay for the goods and services they consume and the prices they would have paid had the trade and investment barriers remained what they were prior to the European Economic Community. Arguably, this type of benefit is directly shared by all, but it is so to various extents, as the bundle of goods consumed by rich and poor is not the same. Moreover, greater transnational competition also makes many jobs and many regions more vulnerable. For the reasons discussed above, this vulnerability has been further increased by monetary unification. Lower prices than would otherwise be the case are therefore no guarantee of universal gain. In this context, the euro-dividend would not prevent some people and regions from gaining a lot from European integration nor some others from losing out. But it would give everyone a tangible share in part of the overall material gain that can be safely attributed to the very existence of the EU. Indexing the level of the dividend on the EU-wide per capita level of value added (or GDP) — or its average over the last five years or so to make it less bumpy — would make this link more explicit: the prosperity of the whole would then be clearly seen to benefit each of its parts — member states, regions and households.

There are no doubt also background institutional conditions that will favour this perception of the euro-dividend and thereby its acceptability by the

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<sup>33</sup> The common currency only amplifies the downward homogenizing pressure of the single market on the more generous welfare states. See Scharpf (2000) and Van Parijs (2000).

population, rather than a perception in terms of immediate country-level net losses and net gains. As long as key decisions are taken by politicians who are accountable exclusively to the electorate of a single country, it will be very difficult to prevent electoral competition from getting the issue framed in terms of net gainer and net loosing countries.<sup>34</sup> This is the case to the extent that the key decisions are taken by heads of government gathered in the European Council. But it does not need to be different if more power is exercised by the European Parliament, meant to emanate from the EU population as a whole rather than from its member states. As things stand, MEPs are also electorally accountable only to the citizens of their own country. In the US and in European nations, an inclusive rhetoric and policy orientation is facilitated by direct presidential elections or centralized political parties. At EU level, there are good reasons to believe that we shall never have either. The next best option is the development of strong pan-EU federations of national parties, which itself will remain a pipe dream in the absence of an EU-wide constituency for part of the seats of the European Parliament, coupled with a direct link between the composition of the EU executive and the electoral results in this constituency.<sup>35</sup>

More broadly still, the political achievability and sustainability of a euro-dividend — and of any other major redistributive scheme at EU level — requires the existence and liveliness of an EU-wide democratic forum. An EU-wide parliamentary constituency should help, but will not suffice. Institutional innovations such as the European Citizens' Initiatives should also help, because of the opportunities and incentives they create to meet, argue and mobilize across national borders. The most fundamental obstacle, however, is the EU's linguistic diversity. National welfare states were not born out of the blue through some top-down decree. They were the laborious outcomes of long struggles. Such struggles could only be successful because of efficient communication, trust building, coordination and mobilization across the nation made possible by a shared national language. The wonderful yet expensive and stiffening services of translators and interpreters will never supply an adequate alternative to a shared language. As mentioned before, competence in English is spreading rapidly among the younger cohorts of the European population. But this lingua franca should not and will not replace national languages. It will not therefore be able to play quite the same role as national languages in cementing trust and fostering solidarity. Nonetheless a minimal condition for the political sustainability of institutionalized solidarity is that the people among whom this solidarity operates should be able to address and understand each other. The democratization and appropriation of English as a lingua franca throughout Europe is therefore at least as crucial to the political feasibility of EU-wide redistribution as institutional engineering.<sup>36</sup>

What follows from this brief discussion of political feasibility is not that we might as well give up. It is rather that it is not enough to spell out blueprints of what is needed to get to the roots of our present problems, submit them to critical scrutiny and advocate what emerges as the most robust version. At the same time, one must fight and progress on many different, seemingly unconnected fronts. Banning the dubbing of films may be no less crucial to the

<sup>34</sup> See, along the same lines, Chu's (2012: 19) analysis of what is missing to make the euro sustainable: "These politicians then, inevitably go into negotiation with each other with their national interest, rather than the wider European interest, uppermost in their minds."

<sup>35</sup> See Van Parijs (2011a: ch.5 and 7)

<sup>36</sup> See Van Parijs (2011b: ch.1).

sustainability of an EU-wide transfer system than removing the cap on the EU's taxing powers.

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