EUROPEAN FISCAL UNION. A SOLUTION TO SAVE THE EURO?

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A monetary union with strong connections among banking systems but without a fiscal union may pose problems because the national governments may be tempted to increase inefficiently their public debts, which, in case of contagion, may have serious repercussions on other economies.
This article analyses the idea - widespread among specialists - of the integration of fiscal policies in the Euro Area as a solution to overcome the sovereign debt crisis. The situation has become critical for countries such as Greece, Portugal, Ireland, Spain.
Key words: fiscal union, Euro Area, fiscal policies, sovereign debt crisis, fiscal treaty
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Introduction

The current economic and financial crisis highlighted the fact that the institutional regimes and the EU common policies, more precisely, of the Euro Area, are not adequate. Even before the crisis, the economic growth in the European Union was low, pointing at deep structural problems in the EU Member states. The macroeconomic imbalance created a European Union with divergences in productivity and competitiveness.

The response of the involved countries to the sovereign debt crisis in the Euro Area was slow and weak because of the supranational character of the European Union and of its budget, limited to 1,24% of the community GNI. In the opinion of several specialists, to which I equally subscribe, in order to try to overcome this crisis, it is necessary to promote as soon as possible an initiative to start a political project envisaging the creation of a European Fiscal Union, just like the Economic and Monetary Union was created.

In this scientific research, my objective is to analyze the idea of the European Fiscal Union, mentioned as a long-term solution for the Euro Area to overcome the sovereign debt crisis. I chose to realize this analysis of the idea of a fiscal union because it is a topical issue, taking into account that at the beginning of March 2012 the Fiscal Treaty was signed, introducing new rules concerning the budgetary discipline.

Analyze of the economic literature

For two years, the Euro Area has been confronting with a debts crisis, its long term viability being under question mark. The problem is that the Euro Area doesn't have adequate institutional arrangements to help it manage a major crisis, nor mechanisms for amortizing the asymmetrical shocks and for burden-sharing. The fiscal reactions of the member stated differ according to the level of debt, of budgetary expenditures and of the budgetary revenues as percentage of the GDP (EIR, 2011: 21).

This Monetary Union possesses that € ***440*** billion **European Financial Stability Facility, *created in 2010, and the*** € ***800*** billion *European Stability Mechanism*, created in February 2010. The declared purpose of the ***European Financial Stability Facility is to save the Euro Area countries if they cannot solve their economic problems, each country being allowed to borrow up to*** € ***440*** billion. The European Stability Mechanism, which will enter into force in July 2012 aims to contribute to the amelioration of confidence and to guarantee the financial stability of the Euro Area.

The Euro Area doesn't yet have a framework for the political cooperation between the European Central Bank and the national governments, even though the single currency creates the need of a tighter cooperation. The absence of a place where a common position for monetary and budgetary policies can be defined makes the institutional organization of the Euro Area more

oriented towards knowledge exchange than towards the identification of guidelines for the coordination of activities.
The European Central Bank, lacking trust concerning the budgetary decisions of the national governments, tends to protect its freedom of action in order to be able, if necessary, to counter-attack their tendencies toward governmental deficits. The national governments, unable to convince the European Central Bank to pay more attention to the specific conditions of their economies and not knowing the budgetary conduct of the other governments are reticent about cooperation, ready to counter-attack any restrictive position of the monetary policy and stubborn in accepting the additional diminishment of their fiscal sovereignty (Panico Carlo &Vazquez Suarez Marta, 2008:16).
But economic theory**,** based on the *optimum currency area model***,** shows that the single currency benefits outweigh its costs only when economic integration – under the form of commercial exchanges, similar conditions and economic cycles - is strong enough.
The German Chancellor Angela Merkel, one of the most appreciated political personalities leading the European Union, publicly specified, more than once, that there is a concord regarding a possible step towards a fiscal union, towards a coordinate approach of the fiscal and economic policies, but on medium or long-term. For the beginning, the basis of the fiscal union must be set up from political and legal point of view. A fiscal union would imply a single ministry of finance and a single treasury, an idea agreed by Germany, France, Holland, Belgium, Luxemburg, but less wanted by countries like Portugal, Italy, Finland and Greece, which face financial difficulties. A viable monetary union supposes the use of tools which amortize the asymmetric shocks and the creation of a federal budget in the Euro Area, which proves to be more than necessary.
In the opinion of several specialists, to which I equally subscribe, in order to try to overcome this sovereign debt crisis, it is necessary to promote as soon as possible an initiative to start a political project envisaging the creation of a European Fiscal Union, just like the Economic and Monetary Union was created.
The first stage, according to Alberto Majocchi (2011) should be the *creation of a European Fiscal Institute*, whose main task should be to save those countries that risk being swept away by the sovereign-debt crisis and to pave the way for the subsequent institutional move toward a Federal Fiscal Union and the institution of a European Treasury.
During a second phase, *an issue of Eurobonds* would be necessary to supply the UE the financial means needed to support the setting up of a recovery plan of the European economy, to favour a productivity and competitiveness increase. The European budget should return to a system of real resources, substituting what is known as the fourth resource, based on member states' GNI, with a European surtax on the national income taxes paid directly by the citizens and the limited liability companies to the European Treasury. Thus, the European Union budget, based on own resources, would be managed by a Federal European Treasury, responsible for the coordination of the EU economic policy and the transition to a sustainable economy. (Alberto Majocchi, 2011: 79).
Therefore, the European Union could and should have a *federal budget,* able to play a counter-cyclical role in case of conjectural "asymmetric" shock. This is the role of the federal budget within a federation: in case of a shock which affects only a part of the federation, the resources originating from this region diminish, while the transfers in its favour increase. In a Union in which the labour-factor is characterized by a low mobility, possessing a federal budget could be a precious advantage, but requires a radical evolution of the budgetary expenditures and revenues: the Union's revenues should be activity-based taxes and its expenditures should be, at least partly, related to conjecture. In these circumstances, in order to have a microeconomic impact, the EU budget should highly exceed the current ceiling of its own resources, in order to represent about 7-8% of the Union GDP. (Sabău-Popa Diana, 2010: 11).

Fiscal implications of the Treaty on Stability, Coordination and Governance in the Economic and Monetary Union

In order to overcome to sovereign debt crisis in the Euro Area, 25 Member states of the European Union signed in Brussels, on the 2nd of March 2012 the *Treaty on Stability, Coordination and Governance in the Economic and Monetary Union*, which introduces a set of golden rules concerning the budgetary discipline. Only two countries of the European Union refused to sign the Treaty: the United Kingdom and the Czech Republic.

Some of the most important provisions of the Treaty on Stability, Coordination and Governance in the Economic and Monetary Union, also called the *Fiscal Treaty* are:

- *The annual structural deficit must not exceed 0.5% of the GDP*; the annual structural deficit of the public administration means the annual cyclically adjusted deficit net one-off and temporary measures.
- *Non-Eurozone countries join the Eurosummits* whenever are discussed issues of general interest with regard to the single market, competitiveness or the modification of the Euro Area strategy.
- Where *the ratio of public debt to GDP is significantly below 60 %* and where risks in terms of long-term sustainability of public finances are low, *the structural deficit can reach at most 1.0 % of the GDP.*
- In the event of significant observed deviations from the maximum ceiling of the structural deficit or the adjustment path towards it, a *correction mechanism* shall be triggered automatically.
- When in one of the 25 Member states which signed the Treaty *the ratio of public debt to GDP exceeds 60%* the state *shall reduce it* at an average rate of *one twentieth per year* as a benchmark.
- *Financial sanctions can be imposed –which may not exceed 0.1% of GDP of the Member State in question* – if, based on its own observations or on the European Commission report, one of the 25 Member states which signed the Treaty concludes that another state failed to comply with the above-mentioned ceilings and brings the matter to the European Court of Justice.

The treaty mentions the necessity to develop ever-closer coordination of economic policies within the Euro Area, therefore it tries to push the governance of the Union toward more integration, going thus beyond the scope of a fiscal treaty. It specifies a very true and important issue – that if a monetary union which doesn't rely on the disciplining of the actual budgetary executions has a very precarious way of functioning.

Actual government deficit has two components: a cyclical one, based on automatic stabilizers and a structural one, based on discretionary policies. Structural government deficit, mentioned in the treaty represents the fiscal position when the GDP is at its potential level, that is the economy is halfway between economic expansion and recession. The annual modification of the structural deficit is due to the effect of discretionary decisions of fiscal policy.

But structural governmental deficit is an indicator lacking transparency and inaccessible to the population, difficult to understand and to verify. Its formula is: Structural deficit=Structural expenditures-Structural revenues=Expenditures*GAP^{ec}-Expenditures*GAP^{ev}. GAP represents the production differential calculated as ratio between the potential GDP (normal rhythm of economic growth in a neutral year, form a cyclical perspective) and the actual GDP.

The new 0.5% of GDP limit of the structural deficit will impose a very strict control on the public finances of the 25 countries, which may have advantages and disadvantages. For Romania, which in the past had a discretionary procyclical fiscal policy, it will make impossible to practice a procyclical fiscal policy, that could be a significant advantage (Ionuţ Dumitru, 2012: 5).

The major disadvantage of the treaty is linked to its reduced capacity to stimulate the economy, especially in recession periods. The automatic stabilizers are the most effective in countries such as Denmark, Holland, Sweden and Finland, their size being closely related to the tax system and the size of the governmental expenditures. In Romania, like in the other Member states of Eastern Europe, the size of the automatic stabilizers is significantly smaller, which requires the possibility to apply some discretionary fiscal stimulus (higher structural deficit), stronger in recession periods (Ionuţ Dumitru, 2012: 8).
Some specialists, such as Joseph Stiglitz, recipient of the Nobel Prize in Economic Sciences, strongly criticize this Fiscal Treaty, considering that the strictening of the fiscal policy in the European Union is a wrong way of solving the debt crisis and might lead to a totally opposite result.

Possible stages in the creation of the European Fiscal Union

The purposes of my own research are the analyze of the concept of fiscal union and then the presentation of the possible stages in the creation of the European Fiscal Union.
If we analyze the concept of fiscal union, it refers to the integration of the fiscal policies of the states. In a fiscal union, the decisions concerning the tax collection and spending public money are taken by institutions common to the governments of the participating states. For example, in federal states, such as the USA, the fiscal policy is largely decided by the central government, empowered to increase the taxes, to make public borrowings and to spend public money.
A monetary union with strong connections among banking systems but without a fiscal union may pose problems because the national governments may be tempted to increase inefficiently their public debts, which, in case of contagion, may have serious repercussions on other economies.
The sovereign debt crisis in the Euro Area is due to the breach between the common monetary policy and the national economic and fiscal policies of each Member state. 17 EU Member States are part of the Monetary and Economic Union, based on the Euro currency, but most of the decisions regarding the taxes and public expenditures are taken on a national level, because the fiscal policy belongs to each democratic state as the expression of its sovereignty. But direct taxes, as well as the indirect ones distort the four main freedoms of the single community market.
The European Union has limited fiscal powers. The majority of the European Union Directives refer to VAT, customs duty and excises. The VAT is harmonized at community level, the taxation principle of the VAT is that of the destination of goods; the tax is levied on the delivery of goods and the provisioning of services in the state where they are consumed. Member states can apply the following types of VAT quotas: a normal tax and one or two reduced taxes. The normal VAT tax must not be smaller than 15% and the reduced taxes must not be smaller than 5%. The products to which the harmonized excises are being applied are alcohol and alcohol products, tobacco and tobacco products, energetic products, electricity; the community legislation mentions the existence of a minimum excise applied to each category of products. Starting with 1968 no customs duties are levied on the goods transported within the territories of the European Union Member states, and for the goods entering these states, the common external tariff of the EU is applied. With regard to direct taxes, the community acquis targets the income tax and the tax on capital and less the tax on the natural person income. Most of the provisions concerning the direct taxes are left up to each Member state, as an expression of their sovereignty.
We can identify two possible stages in the creation of the European Fiscal Union.The first stage should be the creation of a European Fiscal Institute, whose main task should be to save those countries that risk being swept away by the sovereign-debt crisis and to pave the way for the subsequent institutional move toward a Federal Fiscal Union and the institution of a European Treasury. The Fiscal Institute could play the role, in the realization of the Fiscal Union, that had been entrusted to the European Monetary Institution as a prerequisite for the start of the

Monetary Union. (Alberto Majocchi, 2011: 91). An important step in this direction was the creation, in February 2012, of a € ***800*** billion European Stability Mechanism. This European Stability Mechanism aims to contribute to the amelioration of trust and to ensure the financial stability of the Euro Area.

In a second phase it is necessary to start the issue of Eurobonds to contribute to the provision of the necessary financial means to support the realization of the plan for the recovery of the European economy. By issuing Eurobonds, The European Investment Bank could provide the financing of the European public investments (secondary education, research and innovation, new technologies, environmental conservation, renewable energies) that represent a *conditio sine qua non* to guarantee a long term sustainable growth of the European economy (Alberto Majocchi, 2011: 92).

Then, the fourth resource of the European Union budget, based on the GNI of the Member states (representing more than 60% of the EU budget), which is not real own resource, could be substituted by a European surtax on the national income taxes paid directly by the citizens and the limited liability companies to the European Treasury. The European surtax on the national income tax of the natural persons, paid directly by the citizens to the European Treasury would guarantee a greater transparency of the levy and would strengthen the responsibility of those who use the public financial resources. The European surtax on the companies' income would have the effect of neutralizing a little the impact of the company relocations within the European Union and of reducing the fiscal competition among the Member States.

From 2013, the European Union budget could benefit from a new resource from a carbon/energy tax. In a situation where the risks connected to the climate changes are by now more and more clear and the need of replacing the fossil fuels with alternative energy sources is becoming more and more pressing, a tax also in line with the carbon content of the energy sources appears as an adequate instrument to start up the processes of energy-saving and of fuel-switching to renewable energy sources, thus reducing the negative impact of the energy consumption on the environment.

The policy-makers could also consider the European Commission proposal regarding the introduction of tax on the financial operations of a speculative nature, in order to increase the resources of the European Union budget and to guarantee a more orderly development of the international financial system. The financial transaction tax should have a large application field and it would be preferable to be applied to the national markets as well as to the international exchanges. The Financial, Economic and Social Crisis Committee of the European Parliament debated upon the advantages and disadvantages of a possible financial transactions tax, estimating that such a tax, of only 0,05% could eliminate the short-term financial transactions, ensuring a greater stability and contributing with € ***300*** billion to the European Union revenues (Sabău-Popa Diana, 2010:152).

During the last phase, aimed at creating a real Federal Fiscal Union, the budget, based on own resources, would be managed by a federal European Treasury, responsible for the coordination of the EU economic policy and the transition to a sustainable economy. The European Treasury should be the subject of a decision of the European Council, establishing the deadlines for the different phases and, most of all, the final date that will mark the beginning of Fiscal Union operations.

There is a basic difference between the Fiscal Union and the Monetary Union. The ECB is a constitutional organ whose independence is ratified by the Treaty of Maastricht and whose task – important but limited – is to guarantee price stability. The Treasury would be a constitutional organ of a different nature and should be be subject to the democratic control of the European Parliament (Alberto Majocchi, 2011: 94).

In conclusion, the decision to go ahead with the construction of the Fiscal Union, with a European Treasury, must be backed by a contextual decision fixing the date for the start of the

transformation of the European Union – a supranational organization – into a European Federation.

Conclusions

For a good functioning of the Euro Area, it is necessary that at least the common monetary policy and the common fiscal policy work together. Therefore, in order to avoid the collapse of the Euro Area and eventually the collapse of the European Union, it is extremely necessary to realize as soon as possible the integration of the fiscal policies of the European Union Member states and the creation of a European Treasury. If need be, the common defence policy and the foreign policy of the European Union can wait until the conditions are favourable.

Therefore, the decision-makers of the European Union Member states must understand that they must yield to the Union some of their budgetary and economic powers is order to complete the construction of the Economic and Monetary Union, with the creation of a Federal European Treasury which should guarantee an effective coordination of the national economic and especially fiscal policies.

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