COORDINATION OF FISCAL POLICIES AT EUROPEAN LEVEL

Ionuţ-Cătălin CROITORU, PhD student
University of Craiova

1. Introduction

The concept of fiscal policy is often presented in different ways, usually highlighting its feature regarding the fiscal system promoted by a specific country. In fact, fiscal policy cannot be conceived different from a mixture between the methods of acquiring the resources for the state and those regarding the destinations given to those resources, to accomplish the assigned functions and tasks.

For that reason, we will define fiscal policy as representing the ensemble of decisions through which is accomplished structural molding of fiscal system, ensuring its functionality for obtaining the desired economic results by public decision-makers.

Fiscal policy of contemporary countries is oriented, usually, towards microeconomic and macroeconomic targets and, it is determined by the role that the state must accomplish in economy[1]:

- allocation role, aimed at correcting market failures in such a way that the functioning of economy leads to an efficient allocation of resources;
- distributive role, aimed at influencing the revenue and wealth distribution in society;
- regulatory role, aimed at ensuring the smooth functioning of markets;
- stabilizing role, aimed at reducing unemployment, inflation and deficit of current account, through the creation and implementation of macroeconomic fiscal and monetary policies.

Thus, fiscal policy is a component of state financial policy, which includes, both the ensemble of regulations on establishing and collecting taxes and applying the state options regarding taxes and, the decisions on public expenditures that are being financed. But, its components have to be concerted with those of budgetary or monetary policy, respectively, with price policy and employment etc. to fit the general policy.

European Union's fiscal policy is subject to the Treaty establishing the European Community, which provides:

- elimination of custom duties between member countries and any other measures with equivalent effect;
- ensure free competition within the common market.

EU policy on tax has two major components: direct taxation – which is the responsibility of Member States and indirect taxation, which affects the free movement of goods and services. In this respect, especially considering indirect taxes (VAT and excise). Direct taxes are only subordinate to the goal to not affect free market competition, but it is recommended to the members the conclusion of agreements under international double taxation. Moreover, the Treaty from Maastricht (1992) requires to monetary union members to limit budget deficits to 3% of GDP, non-participant members to monetary union are being recommended to avoid substantial deficits.

[1] Ocnean, A. – Empirical study on fiscal policy connection – economic development, Theoretical and Applied Economics, no. 9 / 2006 (504), p.3-8, Bucharest

In the EU, the responsibility for fiscal policy is mainly in the hands of the Member States which may delegate part of those competences to regional or local levels according to the constitutional or administrative structure of public power[2].

Given these issues we analyze the spatial dimension of European fiscal policy on three levels of reference:

- the local level, which we will characterize in that the right to establish taxes is limited because the fiscal burden is to prevent the concentration of population in some areas for fiscal reasons. We support the idea that fiscal policy should aim to mitigate the socio-economic differences between different areas and must ensure that horizontal equity between communities.
- the national level, where we consider the cost of fiscal administration, assessment criteria, assessment techniques and redistribution of taxes imposed among various levels of public administration. Such a redistribution of taxes has to be made, in our definition, without creating distortions between different levels, and without altering their degree of financial autonomy.
- international level, where we consider the independence among national fiscal pressures, avoidance of double taxation through international legal fiscal decisions, fiscal heavens, structural fiscal decisions on the harmonization of national fiscal policies.

Creating single internal market required the implementation of a consumption fiscal system as neutral as possible[3]. Fiscal coordination could be achieved by fiscal harmonization (a single fiscal system), but also by removing all barriers to free movement within the single market of goods and services, labor and capital[4].

In order to achieve the common market and monetary union there were entailed changes in taxation. Eliminating restrictions on capital movements caused fears that national fiscal bases could be eroded by fiscal competition, this leading to a shift in the fiscal burden from capital to labor, with adverse consequences for employment[5]. Here have been shaped the fiscal policy objectives:

- a long term goal is to remove the differences in the rates and application methods of indirect taxes. The objective aims VAT and excise.
- an objective in direct taxation aimed at minimizing the opportunities for evasion avoidance of double taxation on the basis of bilateral agreements between Member States.
- harmonization measures of fiscal policy which is to avoid the negative effects of competition between Member States, in particular, avoiding transfer of fiscal base through migration to the firms seeking the most favorable fiscal regime.
- limiting the power of governments to finance public expenditure by increasing public debt. Through The Stability and Growth Pact, Member States participating in the Eurozone should not run budget deficits above 3% of GDP. The overall aim of the pact is to maintain balanced budgets at the economic cycle. Thus, the increase of public spending can be financed only by increasing public revenue receipts in the economic cycle.

2. The Stability and Growth Pact I – instrument of fiscal convergence

The Stability and Growth Pact, foundation of the third stage of EMU, which started on January 1st, 1999, with the introduction of the euro, had as main objective a sustainable and durable convergence of economies from Member

[2] Profiroiu, M. - European policies, Economic Publishing House, Bucharest, 2003, p. 123
[3] Profiroiu, M. - Idem, p. 121
[4] Cincă, Mădălin – Fiscal harmonization within the frame of Romanian integration in the EU, Finances – Challenges of the future, Vth year, no.5/2006, p. 215-221, Craiova
[5] Profiroiu, M. - Idem, p. 122

States participating in the Eurozone, had preventive character for the emergence of excessive budgetary deficits and in assuring economic stability. Another objective was that of sound management of public finances of the Eurozone countries to ensure that fiscal policy does not allow a Member state to damage another. Thus, they sought to stabilize prices and maintain sustainable and durable economic growth.

The Stability and Growth Pact was and remains one of the most controversial issues of the current EU and, consequently we intend to do an overview of its main features. Conceived in 1997, the Pact would be a very effective invention for establishing fiscal discipline to launch the single currency.

Fiscal discipline is important because in a monetary union there are two constraints on national fiscal policy:

- on the one hand, Member States may no longer use the exchange rate adjustment as a tool for asymmetric shocks, which means that macroeconomic stabilization to national level is possible entirely because of fiscal policy. Practically, fiscal policy has to assume the role of instrument to attain flexibility, making the necessary adjustments, in condition of rigidity of the other instruments.
- on the other hand there have to be avoided the risks of possible effects caused by the increase of public debt and budgetary deficits. The expansion and the sustainability issues of public debt in a country can cause difficulties to other Member State.

The Economic Monetary Union is based on a complex frame of economic politics, made of single monetary policy and 16 national fiscal policies, applied in a decentralized and independent way. Such state of affairs requires the coordination of fiscal policies to ensure macroeconomic stability of the whole, mainly by observing the first objective of the European Central Bank, price stability. This is because fiscal policy affects the allocation of resources between public and private sectors, affecting consumer behavior, savings and investment and thus production level and evolution of economic cycles.

Recently, European Institute of Romania issued a work[6] under the coordination of univ. prof. Dr. Moisă Altăr where are briefly described the characteristics of the pact. There are highlighted here two components that characterized the first form of the pact: a preventive component and a corrective one. The preventive feature of the pact consists in making a fiscal policy that guarantees economic stability and proper fulfillment of medium-term budgetary objectives. The corrective feature consists in simple rules which will lead to a minimum of fiscal discipline.

We consider necessary to underline that the first form of The Stability and Growth Pact does not ensure enough flexibility to face the cyclical crises, for that it could not be a substitute for economic policy coordination, objective that had to be achieved through harmonization of national fiscal policies. Furthermore, referring only to the limits of deficits, the Stability and Growth Pact omitted the structure and causes of those.

Also we consider that the role of the Stability and Growth Pact was to ensure further protection of the European Central Bank in case of any political pressure for excessive debt with inflationary effect. Another positive aspect is that the agreement eliminates the risk of growth rate in the Eurozone as a result of excessive borrowing, a phenomenon that can influence the evolution of the euro exchange rate.

Difficulties encountered in the operation pact led to its reform; reform adopted by Heads of State and Government in March 2005 Spring

[6] Altăr, M. – Studies of Strategy and Politics (SPOS 2009), European Institute of Romania, Bucharest, 2010

Council. Following this reform, on the one hand, the pact rules were relaxed considerably, and on the other hand, countries such as Austria and the Netherlands supported the introduction of enhanced control procedures between Member States.[7]

The Stability and Growth Pact has undergone reforms in four directions[8]:

- greater focus on public debt and its sustainability;
- redefining the medium-term country -specific;
- consideration of several factors and circumstances;
- early preventive action.

3. The Stability and Growth Pact II – a new philosophy

The new pact allows the imposition of more realistic deadlines, allowing Member States to correct excessive budget deficits. Deadlines are extended to two or three years for Member States with a high initial deficit and weak growth prospects. Member States with low excessive budget deficit as the UK will have shorter deadlines. Another positive result is the enhanced structural recommendations. Fiscal adjustments required for Member States that were having procedures to reduce excessive deficits were higher than those recommended before the pact was updated.

Another objective envisaged by the new pact is the public debt level. There is required closer monitoring of budget transactions that could have a negative impact on public debt levels, even if Member States with debt levels above 60% of GDP are not subject to infringement proceedings of the provisions in this regard.

Reform changes relate specifically to[9]:

- triggering the excessive deficit procedure (EDP) – this procedure cannot be initiated against a country undergoing a period of negative growth or a prolonged period of slow growth.
- “relevant factors” that allow a state to not be subjected to EDP – if benchmarks are temporarily exceeded, the concerned Member States may request that certain “relevant factors” are taken into consideration, so that they are no longer submitted to excessive deficit procedure. Among these factors there are structural reforms (e.g. reforms of pension or social security systems), adoption of programs to support research and development and application of budgetary rehabilitation measures (reduction of debt levels, budgetary reserve accumulation).
- extensions of time before the excessive deficit procedure to be implemented. Member States shall have two years to reduce the deficit if it is considered to be excessive. This period may be extended in case any unexpected economic events happen and have serious consequences on the budget. To qualify for the extension, the concerned states must provide evidence that they took recommended steps to correct the deficit. Doing so, they pledged to use unforeseeable fiscal revenues from periods of strong economic growth.
- medium-term objectives specific to each state – these objectives will be defined taking into account the indebtedness and growth potential.
- reliability of the statistics provided by Member States – for this, the Council wishes to strengthen the position of Eurostat.
- stability and Convergence Programms – the Eurozone Member States prepare annual stability programs and, the other EU Member States also prepare annual convergence programs.

We believe that the new approach sets as priority the economic

[7] http://www.euractiv.ro
[8] Altăr, M. – Idem

[9] http://www.euractiv.ro

growth and not the stability as the first variant of the pact did. Extremely slow growth, high and chronical unemployment determined the removal of the straitjacket represented by the Stability and Growth Pact, which imposed harsh restrictions on budgetary discipline.

Only a strengthened coordination of national fiscal policies may allow finding a balance between fiscal systems and social diversity, on the other hand, full exercise of freedoms of establishment and movement in the EU[10].

In support of this idea we believe that for small states, as for the new Member States which are preparing to adopt the euro, the adjustment benefits of the Stability and Growth Pact are overshadowed by the risks that poor budgetary discipline could have on inflation and the euro exchange rate. The economic impetus of several European countries given by the removal of budgetary barriers may have medium-term repercussions by increasing interest rates, inflation and depreciation of the euro. A concrete example is Poland, which once it joined the EU received assurances that it will be supported in its efforts to adopt the single currency which would allow it to benefit from a easier trade in that area.

Recent experience has shown how quickly the budgetary situation may deteriorate in adverse cyclical circumstances, special problems occurring when the initial situation is not quite strong. (See table no.1)

4. New Perspectives on European Fiscal Policy

The financial crisis that included Europe set the emergence of a new report of forces to Union level and, at the same time provided the guidelines for future European strategy for economic policy coordination, mainly for budgetary policies. From this perspective we need to consider the German government idea of a "*European economic government*"[11]. It is considered that the existence of such a body would be necessary for two reasons:

- occurrence, in crisis situation, of some vulnerable states of the union as Greece, Spain and Ireland and the inefficiency of the coordination mechanism of national economic policies within the context of manifestation of some strong interests and excessively oriented towards the interest of national markets of some states as France, Germany and the UK.
- the need to create the conditions and framework necessary to achieve balance and stability of Eurozone and for achieving consolidation and development of the Union within the difficult conditions of global competition in the period after the crisis.

We believe that this body should be thought of as a suitable tool to improve fiscal policy coordination mechanism, but not outside general principles of Community policies, made by Pierre Werner in the late 60s. For this reason we underline that a main principle that should underpin such an institutional building is the convergence, because we consider the idea that a common European economic policy will be more effective if national laws and rules will be reduced both conceptually and operationally. Other important principles in this regard are: the principle of solidarity, given the need to strengthen European mechanism in situation of economic contraction or recession, principle of effectiveness and transparency of the decision act, both to eliminate bureaucratic barriers and the democratization of relations between European institutions and citizens.

Although in terms of European fiscal-budgetary unification policy this approach is able to establish single fiscal rules for the Member States yet, the most

---

[10] Profiroiu, M. - Idem, p. 140

[11] http://www.euractiv.ro

difficult issue in creating such institution remains that of inter-institutional and inter-state framework where it could work. Even though the European Leaders state that such body to European level will not have prerogatives as the state authorities nor federal autonomy, we have to underline the fact that there is the possibility to subordinate national economic policies to a super-state forum and, this super-state forum submitted to the will of a single Member State or a group of Member States especially after the role France and Germany play in the case of Greece.

Discussions at the European Council led to a possible structure of the body on four pillars of organization and functioning:

- first pillar would consist of creating a European fund for the safe management of crisis situations.
- the second pillar would consist of strengthening the role and responsibilities of the European Council towards increasing its power of analysis, monitoring, programming and foreign representation.
- the third pillar would be the increase to community and national level of investments in education, innovation, and infrastructure and in the so called "common property" (energy infrastructure, environmental programs, development of border facilities, academic cultural and educational goals, with European status).
- the fourth pillar would be a political agreement on convergence strategy, focusing on strengthening local market mechanisms by increasing the coordination degree of the fiscal – budgetary policies, as well as increasing the efficiency to use structural funds accessed by different member countries.

5. Conclusions

History of the European economy has shown that the economic impact of a country depends, above all, on the degree of mobilization and increasing use of its own resources (human, material and financial). In order to maintain a balanced economy it is necessary to ensure the conditions for stable long term economic growth. Among the many tools and levers of influence to maintain economic equilibrium there are the financial ones and, in particular, the fiscal ones.

In the EU there are a variety of related fiscal systems of each Member State, with different importance, depending on the fiscal policy pursued by each state in particular. Depending on the objectives to respond, fiscal policies have been controversial subjects, but the Member States managed to find a common set of objectives. Given these realities, we express our belief that in order to achieve these goals there should be reduced the overall level of taxation in the EU and also is required a balance between the reduction and consolidation of financial support by reducing public debt and investing in basic public services. We consider it is essential that the stability program of each Eurozone country to clearly establish strategies for disengagement and fiscal consolidation for the next period. In this regard, we consider that are needed sustained efforts, particularly from countries which record high levels of deficit and public debt.

Under the Stability and Growth Pact, excessive deficit procedure is the main instrument of coercion of Member States to meet the convergence criteria. However the reform carried out in 2005 increase the risk of relaxation in relation to budgetary adjustments during economic growth, fully demonstrated by the financial crisis in the EU instituted in 2008, when states' budgets were caught with serious imbalances, although it came after a period of economic boom and the crisis of the '90s.

However we believe that the reform of the Stability and Growth Pact has served also to remind the European

States that national laws and institutions can play a more important role than hypothetical financial sanctions contained in the pact, in terms of budgetary control.

Application of the Stability and Growth Pact is based mainly on two pillars: basis for multilateral control of the budgetary situation and excessive deficit procedures. With regard to multilateral control, to coordinate economic and financial situation, Euro Zone Member States have a stability program, which includes medium-term objectives of government accounts, updated annually. Member States which have not yet been part of the Eurozone develop convergence programs.

These serve as the basis for multilateral control of the Council of Ministers. Thus, any diversion of public finances may be a recommendation of the Council of Ministers.

The prospect of euro adoption by Romania, but rather as a basis for reporting to the Eurozone economy, we find it appropriate to analyze the provisions and effects planed and particularly those actually produced by the Stability and Growth Pact.

Although Romania is not yet part of the Eurozone, we believe that the provisions of the pact provide background elements of the main lines of action to fulfill some measures adopted at European level. We conclude that in the case of our country there should be developed a long –term fiscal strategy, the moving to a multi-annual budgetary programming by implementing a medium-term budgetary framework and the introduction of strict fiscal rules.

Table 1. Excessive deficit procedures in process

Country	Date of Commission report	Council's decision on the existence of excessive deficit	Deadline for correcting the excessive deficit
Poland	May 13th 2009	July 7th 2009	2012
Romania	May 13th 2009	July 7th 2009	2011
Lithuania	May 13th 2009	July 7th 2009	2011
Malta	May 13th 2009	July 7th 2009	2010
France	Feb. 18th 2009	April 27th 2009	2012
Latvia	Feb. 18th 2009	July 7th 2009	2012
Ireland	Feb. 18th 2009	April 27th 2009	2013
Greece	Feb. 18th 2009	April 27th 2009	2010
Spain	Feb. 18th 2009	April 27th 2009	2012
UK	June 11th 2008	July 8th 2008	Financial year 2013/14
Hungary	May 12th 2004	July 5th 2004	2011

Source: European Commission, Directorate General for Economic and Financial Affairs: http://ec.europa.eu/economy_finance/sg_pact_fiscal_policy/excessive_deficit9109_en.htm

REFERENCES

Altăr, Moisă	*Studies of Strategy and Politics (SPOS 2009)*, European Institute of Romania, Bucharest, 2010;
Cincă, Mădălin	*Fiscal harmonization within the frame of Romanian integration in the EU*, Finances – Challenges of the future, Vth year, no.5/2006, p. 215-221, Craiova;
Dodescu, Anca Otilia	*European monetary integration from the Werner Plan to the Stability and Growth Pact*, University of Oradea Annals, p. 166-172, 2004;
Ocnean, Alexandru Sergiu	*Empirical study on fiscal policy connection – economic development*, Theoretical and Applied Economics, no. 9 / 2006 (504), p.3-8, Bucharest;

Profiroiu, Marius	*European policies*, Economic Publishing House, Bucharest, 2003;
Văcărel, Iulian şi colectiv	*Public Finances*, Didactic and Pedagogic Publishing House, IV[th] edition, Bucharest, 2003;
European Commission	*Challenges ahead for new Stability and Growth Pact* – Bulletin Quotidien Europe no 9217, 23 June 2006, Brussels;
Banca Central Europeana	http://www.ecb.int;
*****	http://www.mfinante.ro;
*****	http://www.cadranpolitic.ro;
*****	http://ro.euabc.com;
*****	http://www.euractiv.ro;
*****	http://www.europa.eu.int.