

FISCAL AND BUDGETARY INTEGRATION: TOOL OR OBJECTIVE FOR THE EURO AREA ?

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Abstract:

This paper presents a theoretical and practical approach to fiscal policy seen as an instrumental variable in the Euro Area. It tries to highlight specific aspects of the mechanism of tax tools, ways of transmission towards industry and its influence.

It also presents the new approach to European construction, based on benchmarks provided by the doctrinaire and reaching today's reality (offered by the institutions with competence in this area), subject to the decisions actually included in the specifications or protocols, but also to strategies both at the European level and in each European Union member state.

Key words: optimum currency area, the euro area, fiscal policy, taxation

JEL Classification: E62, E63, H61, H87, O23

Introduction

As the Reuters reports, the European Commission taken into account developing a plan on the restructuring Euro Zone, including the prospect of creating a common budget for all Euro Area countries and a unique debt of following years. Thus, European Commission President, Jose Manuel Barroso, said that "the 17 Member States of the Euro Area should be allowed to integrate faster and more than the rest of the other EU countries"¹. He also stated that it is

¹ European Commission, Press Release, *Project for Economic and Monetary Union deep and true: launching a debate at European level*, November 28, 2011

necessary to more careful supervision of the economies: "In a real economic and monetary Union, all major economic and fiscal policies of the Member States will be a subject for a deeper coordination, supervision and support at European level. The Euro Zone must be able to integrate quickly and better in EU, in its totality".

Also, in the Report of the President of the European Council, Herman Van Rompuy, entitled "*Towards a true economic and monetary Union*" is raises the issue of need to create an economic Union, with a deeper integration of the single market and a political union, with more democracy if the EU wants to form a more stable economic bloc and a strong currency. In this report are included the contributions, of the European Commission President, the European Central Bank President, Mario Draghi, and President of Euro Area Finance Ministers, Jean-Claude Juncker.

In this context, the paper proposes a theoretical presentation of fiscal policy seen as an instrumental variable for the Euro Area, by highlighting specific aspects of the mechanism of tax tools, ways of transmission towards industry and its influence.

1. Theoretical approaches of fiscal policy as instrumental variable Euro Area

From specialized literature, the idea of fiscal and budgetary integration can be summarized that, through this process the Member countries of European Union creates an complex and unique ensemble fiscal – budget, consisting of processes and economic methods of help, stabilization and development, aiming thereby to create a European tax entity with a stable and strong economy.

The evolution of budgetary policy of the European Union has demonstrated these issues since the emergence of the concept of "budget of the European Union". But, it should be noted that, this budget is discrepant from Member States' national budget. Member States shall cover expenditure on public services and consequently, the institutions that manage these services from the state budget. From the EU budget are financed only those expenditures pertaining to the Community institutions, therefore, the most significant share of expenditure is allocated for European funds. These will be allocated, later, of certain economic and social community interest sectors.

Also, there are differences in terms of training of budget revenues. Thus, if at national level to the formation of government revenues contributing for the most part the application of fiscal instruments, i.e. taxes, excise or obligatory contributions of the economic entity or individual (social security revenues and social health insurance budget), at EU level, the budget revenues come from the amounts "collected by the Member States and poured to European budget, according to the revenue they create (value added) and their trade volume (imports) with the rest of the world"¹. The basis of budget elaboration and execution is given by the compliance of the budgetary principles, which are the same as those at the national level, namely: annuality principle, unity, universality and budget specialized. To these are added: the principle of balance, a principle that is not found any European country and that implies that the revenues for a particular period must, necessarily, to be equal to the expenditure of the same period.

In this context, it should be noted that, since the beginning of the European Communities, strengthening the financial system and European budget has been a priority of the European authorities with responsibilities in this area, being followed by three main directions of action:

1. Unification of budgetary instruments;
2. Increased of financial autonomy;
3. Perfection of the institutional balance; clarification of this aspect being dedicated along with the 3rd wave of integration and adoption of the Single European Act.

Finding an adequate response to this challenge "fiscal and budgetary integration" requires knowledge the history of the optimum currency area, its evolution, and recent theoretical approaches of optimum currency areas

The economic area consists of two or more states that have a stable economy in the long run, apply the same monetary policy, use the same instrument rate, may represent an optimal currency area, often considered to be an ideal currency area as they tend to a homogenous structure and possess all the tools of common economic policies. From the point of view of classical theory, optimal currency area was approached in different works of economists.

Thus, R. Mundell has developed a series of studies and analyses of optimum currency areas, with respect to monetary and fiscal policies under the influence of different factors, such as: different rates - thus showing that a course

¹ Coșea M., (2004), *Economics of European Integration*, Economic Tribune Publishing House, Bucharest, 2004, pg.295;

floating exchange corresponds to a strong monetary policy and poor fiscal policy, the opposite was obtained only in conditions of existence of a fixed exchange rate, introducing foreign trade and capital movements in the IS-LM model - thus justifying the fact that the effects of policy stabilization depends on the degree of capital mobility.

He also studied the dynamics of money by customizing how the two instruments - monetary policy and fiscal policy - would be coordinated and directed by objectives (internal and external equilibrium), underlying the responsibilities of the two authorities (government and Central Bank) on their own instrument stabilization policy.

One of its conclusions is the fact that “to prevent instability of an economy there should be made the connection to relative effectiveness of the instruments”, and for this it is necessary that the monetary policy maintains external balance, internal balance remaining to be done within fiscal policy.

Therefore, the classical theory does not provide economic justification for an optimum currency area, but recent approaches accompanied by numerous critics argue the theory of optimal currency area (OCA). The most important opinion on the optimal currency area can be summarized as follows (Table 1).

Table no. 1 *Opinions on the theory optimal currency areas*

AUTHOR	OPINION
FRANKEL	Region with optimum climate for unique currency and monetary policy;
MONGELLI	Existence of an optimum geographic area for unique currency, where: <ul style="list-style-type: none"> ❖ the sovereign states have adopted the unique currency; ❖ fixed exchange rates are established; ❖ there are conditions and criteria to be fulfilled for full monetary integration.
FRANKEL AND ROSE	Support the theory of endogeneity (OCA), thus: <ul style="list-style-type: none"> ❖ Monetary unification leads to economic cycles synchronization; ❖ Possible advantages for the countries adhering to monetary union (elimination of exchange risks and transaction costs)¹.

Source: realized by authors

¹ Sebea M., Ioneșcu A., (2006), *Achieving Economic and Monetary Union and the Need to Converge*, Collection EIR Studies, no. 18, Bucharest;

Analysis of these opinions emphasizes a growth in durability of the monetary union in time, even if there are differences in the economy and society development. Nevertheless, from the OCA endogeneity point of view the euro will not represent the “key” of structural transformations. As a result, the Economic and Monetary Union represents only an “advantageous monetary area” for some economies and for others it is a restraint in the way of internal economic adjustments¹.

The most economists agree essentially with the need for a common monetary policy and that they also support the importance of coordinating national tax policies. Nevertheless, the position and objective of the euro area can lead to ideological disputes, completely contrary to ideas on economic policy objectives of the state, determining priority between them and the degree of intensity of intervention.

Therefore, the fiscal criteria laid down in the Maastricht Treaty offers the possibilities for:

- Goal setting;
- Setting / choosing appropriate means and methods;
- Existence of certain features (of a way to unfold)
- There is certain finality,

with regard to fiscal integration and discipline, within budgetary equilibrium. Thus, it is possible to utilize fiscal stabilizers in case of recession periods and it represents one of the present concerns in case of fiscal decentralization.

The multiplicity and complexity of functions performed by the fiscal and budgetary policy in the euro area context involve multiple perspectives approaches. In this respect, it is needed to harmonize the operating mechanism with the mechanism of the national community, marked by the relationship between national policy of each state and the budget and fiscal policy of the community and coordination with the existing tax system in Europe, taking into account the concrete economic and social situation, measured in terms of achieving long term sustainable growth².

All these measures are necessary to promote equity in the sphere of public revenues, tax simplification techniques, prevention where possible within taxpayers’ subjectivism and the reduction of "fiscal sacrifice." In other words, eliminate "tax pressure" and encourage "fiscal competition" without generating the emergence of "tax havens".

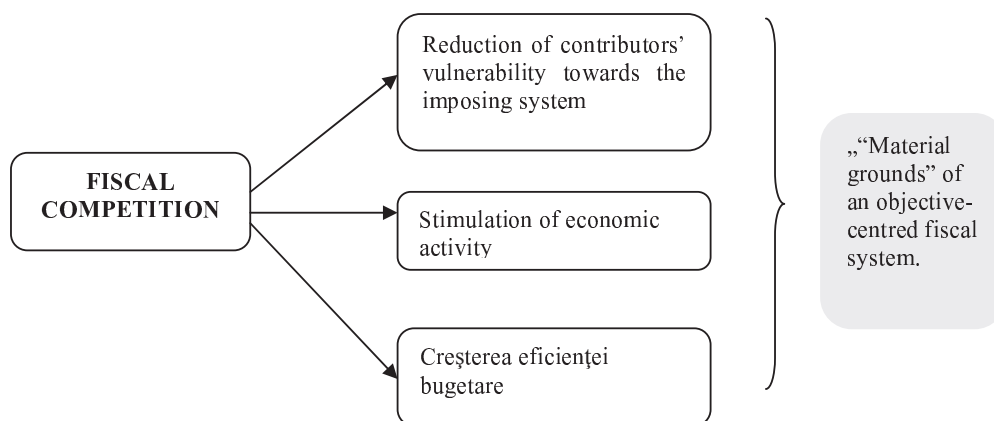
¹ Marinaş M. C. *Macroeconomic modelling of relationship of asymmetric shocks, business cycles convergence and economic adjustment mechanisms within the context of Romania's adhesion to the Euro area*, Postdoctoral research project, No. 78/03.08.2010;

² Duca A. (2007), *Miraculous triangle taxes*, ASE Publish House, Bucharest, pp. 286;

The tax competition on the one hand seeks to attract direct foreign investment in order to create new jobs in the euro area member states and in those outside this area, with implications in increasing living standards for citizens with beneficial effects visible over time, as evidenced by rising consumption and important reduction of migration, on the other hand, mobile financial capital necessary to create strong financial markets, stable and internationally competitive, and not least to attract financial flows for companies subordinated to their tax jurisdictions.

As a result, at first sight the fiscal competition cannot generate but a series of beneficial effects for the European Union. These advantages can be represented as follows:

Figure 1 Fiscal competition. Advantages in different segments



Source: realized by authors

In the current conjecture the question whether "tax competition" is an objective of the Euro Zone, which can be achieved by the "tool" called fiscal policy.

To answer this question, the European Parliament issued Resolution from 10 February 2012, on promoting good governance in fiscal issues, making a number of judgments, among which may be mentioned:

- Good governance in tax matters is equivalent to transparency, exchange of information and fair tax competition;
- Lack of good governance encourages to fraud and tax evasion, with serious consequences for national budgets of the Member States and for the European Union system resources;

- Infringement of the principle of fair competition and corporate responsibility by applying some strategies (creating tax havens, offshore centers) to avoid imposing.

For this purpose, the European Parliament aims achieve a real policy of good fiscal governance "without prejudice to the competence of Member States", and aimed at:

- Cross-border tax recovery;
- Recovery of claims relating to taxes;
- Adoption of measures to prevent the abuse of application "the residence principle";
- Coordination of policies to strengthen the implementation of anti-avoidance rules;
- Introduction of a common consolidated tax base;
- Introduction of Standards in the field of prudential supervision, Taxation, Money Laundering, Combating terrorism etc.

But, any change attract some unfavorable aspects: fiscal integration deficiencies will affect the national tax systems, due to the risk of erosion and mobility of tax bases, the procedures for calculating and collecting fees.

The phenomenon called "tax integration" regarded from bases of imposing or mobility raises a number of problems and effects on the incidence of the tax due. Quantifying the impact is difficult as the factors involved in this process are multiple, based on the interdependence of tax and individual behavior and ending with "placing" their exact environment in the economic, political and social context.

In terms of methods of calculation and collection of withholding taxes on worldwide tax there can be applied two criteria: the criterion of residence and the criterion of nationality and in-territory using the territorial revenue. The application of these "concepts", leads to double taxation. Therefore, to avoid this, as well as conflict of interests and tax, it is necessary to adopt a European tax system based on efficiency and fiscal equity.

Therefore, the importance and necessity of adopting a European fiscal and budgetary system should be linked to risk assessment, and the balance of economic and social stability, influenced by the shortcomings listed above and the trends analyzed the evolution of public revenues in the short run (due to economic slippages), medium run (through the influence of fiscal pressures on economic behavior).

Aiming to achieve this goal it is necessary to harmonize the tax system. In this sense, the aim is to regulate direct taxes (mainly income and capital tax) - so far covered by the fiscal policy of each Member State- and indirect taxes, especially VAT. However, in the same context, there has been developed a series of amendments that have followed duty.

Located at the "border" between theory and practice of taxation, a test example of tax harmonization is the Fiscals program in 2013, a Community Action Programme starting January 1st 2008 and ending December 31st 2013, aimed at improvement of the functioning of global taxation domestic market by increasing cooperation between participating countries, and their clerks.

Decision no. 1482/2007/EC of the European Parliament and of the Council¹ provides that *"on the domestic market, effective, uniform and efficient implementation of Community law is essential for the functioning of taxation systems, in particular to protect national financial interests by combating tax fraud and tax evasion avoid distortions of competition and reducing burdens on administrations and taxpayers"*.

For this purpose, the main objectives of this program are:

- ❖ VAT and excise duties;
- ❖ Taxes on income and capital, by providing administrative cooperation, exchange of information and understanding and implementation of Community legislation in the field;
- ❖ Taxes on insurance premiums.

Another aspect of tax harmonization proposed by the European Commission is that of introducing a single formula for calculating taxable profits, applied in Europe. This system is known as "Common Consolidated Corporate Tax Base."

Basic common consolidated corporate tax is to operate in parallel with existing methods for calculating each member state, economic entities having the opportunity to adopt the pan - European system and continue to apply national rules.

The advantage of this method is the facility of management corporation tax payment owed by businesses operating in the EU, in that tax base would be calculated using a single method, and not separately, as currently calculated for each country.

¹ Decision no. 1482/2007/EC of the European Parliament and the Council, 11 December 2007 establishing a Community program to improve the operation of taxation systems on the domestic market (Fiscalis 2013) and repealing Decision no. 2235/2002/EC;

Another issue related to the European Commission is the introduction of a flat income tax. This hypothesis is rejected, however, because a flat tax in the European Union would generate negative effects for countries with more relaxed taxation sector operators. "The fiscal relaxation" represents an element of attraction for foreign investment.

Therefore, harmonization of the taxation system in space or customization of the European euro area as a whole can significantly increase the tax rate and perhaps a return to a progressive system.

In the current fiscal situation, this assumption can not be applied yet, because existence of national tax policies, which determine the method to calculate the taxable profit and the tax system used, attract development and adoption of common legislation. To achieve a common fiscal policy, which remove all these barriers, in the present context were established Euro Plus Pact and its complement Tax Treaty.

In an economic approach, objectives and means of achieving fiscal and budgetary integration rely on the analysis:

- Quantitative and qualitative system which means setting and collecting of taxes;
- Cause-effect relationships;
- Interaction between tax and business decisions

Therefore, the "engine" of Europe towards integration submission must include a credible path implemented in order to obtain a continuous modernization process, attainable through reforms of monetary and fiscal budget for each economic sector (implies further measures at micro and macroeconomic levels) correlated with the establishment of a rigorous discipline.

This means that the tax law is possible and is often not only supportive but also concerned with the economic condition of the instruments that make the complex features of economic life.

Apparently a political advantage both for the politicians and citizens alike, it can turn into a disappointment ... because of the illusion created. We shall all find it hard to understand and adapt to the conditions and "unwritten rules" imposed by this "integrated system of the euro area", which can not lead to prosperity, but a negative influence over the economic interest.

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