THE BALANCE BETWEEN FISCAL INTEGRATION, A FISCAL UNION AND FISCAL COMPETITION

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Abstract

The aim of this paper is to review the major driving points towards a fiscal union and its effects on fiscal integration and competition. Although the European Union is considered the pinnacle of economic, monetary and social unions, this is partially true. Even though the formation of a monetary union was a breaking point in the European integration process, the lack of a genuine fiscal integration seems to have a negative impact, especially when facing an economic crisis. Since the establishment of EMU the need to achieve a fully integrated union, including fiscal and budgetary policies has been remarked. Even if the Stability and Growth Pact and the Fiscal Compact are important steps, they do not offer enough support in maintaining sound public finances and in taking to the next level the fiscal integration degree. According to the literature, an enhanced fiscal integration leads towards a lack of fiscal competition, between the member states of EU. The pinnacle of the fiscal integration process in the European Union leans towards a single direction: the creation of a fiscal union. We believe that only by enhancing the EU through the fiscal integration, the European economy will reach new heights in economic growth, stability and resilience towards crises

Key words: European Union, fiscal integration, fiscal union, fiscal competition Indexes

The vast process of European integration started in 1950 and it is still undergoing today. Starting from an economic union, Europeans have accomplished the formation of a monetary union and are now moving towards a fiscal union. Anticipating the time required to complete the fiscal integration process seems to be a task without any chance of success. However, until the appropriate time, we can point our attention and channel our energy towards assessing the past and present issues regarding the integration process and implicit on the manifestation of tax competition.

Implementing a monetary union, a series of national mechanisms need to be ceded to supranational institutions as the European Central Bank, noting two key elements: exchange rates and monetary policies. To achieve fiscal union, the key elements that should be assigned are fiscal and budgetary policies. In this regard, there are many opinions that campaign to defend national independence and democracy, opposing such a measure, disadvantage noted by IMF experts (Allart, et al., 2012)

Through this paper we capture the main aspects of the fiscal integration process, the fiscal advantages and disadvantages of a fiscal union, and to define a series of specific terms. We also take into consideration the fiscal competition debate, because fiscal competition seems to undergo important changes due to external factors such as the degree of fiscal integration.

The current debate around the effectiveness of tax harmonization has raised numerous opinions such as (Garcia, et al., 2013), who demands a closer cooperation regarding tax issues, even if a number of important steps (VAT and excise duties) have been taken in terms of tax harmonization.

De Grauwe and Wolf (2013) believe that a monetary union does not necessarily need a support a fiscal union to function. However, they appreciate that the implementation of some form of fiscal federalism, or the implementation of supranational fiscal policies tends to take shape and gain support.

While analyzing the literature on subject, we noted that, the push for a fiscal union in the EU, and especially in EMU, it's demanded and required by the current economic context. Although it diminishes fiscal competition on the European continent, it's needed for empowering the European integration process in order to obtain sound public finances in all states. Although it presents some disadvantages, a future fiscal union seems a fair solution to current European economic problems. One thing is clear: developing a fiscal union implies a deeper fiscal integration, with

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negative effects on tax competition, and policy makers need to, carefully examine what are advantages and disadvantages, of fiscal integration and tax competition.

Considering our objectives and chosen topic, we organized our paper as follows. Section 1 marks our introduction. Section 2 marks methodology while Section 3 presents results and discussions. We offer new insight into the mechanism behind the fiscal integration with its advantages and disadvantage, that ultimately hurt tax competition. The last Section marks our conclusions.

MATERIAL AND METHOD

Since it one of our objectives was to approach most of the literature which addresses the topics of fiscal integration, tax completion and fiscal unions, we've done our analyses by identifying the key definitions, approaches, advantages and disadvantages of each of the topics, found in the literature regarding analyzed topics. We synthesized in this paper some of the key points of view and results found in the literature, in order to present our readers with a lager view on the subject. The papers used for our study on the literature are found in international databases and know journals.

RESULTS AND DISCUSSIONS

THE FISCAL INTEGRATION AND THE CREATION OF A FISCAL UNION

In terms of macroeconomic policies, a recent study done by Dosi et. al. (2015) offers a new perspective to approach the subject. Their results indicate that the choice of a macroeconomic policies mix or another has significant implications on the dynamics of an economy.

If policy-makers aim to stabilize a series of fundamentals macroeconomic variables (GDP growth, volatility of production, unemployment and inflation), public finances should opt essentially for a relaxed fiscal policy combined with a series of measures monetary policy. Together, the two policies seem to guarantee economic stability, a low unemployment rate and a low level of public debt, elements especially necessary when the adhering to a fiscal union desire exists. Continuing on this macroeconomic study side, Claire Reicher (2014) indicate that tax revenues and tax rates respond strongly to changes in public debt ratio to GDP. According to the author, tax revenues seem to be influenced more by the chosen tax bases, and less from tax rates.

Since the creation of the European Economic Community, there has been a perpetual debate beside the need for a tax harmonization and cooperation in Europe. In this respect, as stated by (Garcia, et al., 2013), it is required a closer cooperation in the issues of taxation, both on direct and indirect taxes, cooperation that should accompany the current integration process registered in the European Union. In this regard, note the authors, a number of advances were made on the line of the Value Added Tax and excise duties. Also, the authors noted that tax fraud tends to be a problem more and more important, that seems to create concerns among European representative institutions. Tax harmonization, according to the mentioned authors, is a policy that has developed along the history of the European Union. The most important problem is closely linked to the fact that tax systems are based on outdated pillars, designed in a divided world, in which countries were indifferent to what happened in other states. Even so, many discussions focus on harmonization and coordination of fiscal policies (see the Delors report). Establishing general acting directions, of rules, seem to be an easy issue to realize. On the other hand, cooperation in establishing common fiscal and budgetary policies is completely and totally different, at least in terms of the difficulty of implementation, especially when countries tend not to cooperate.

An important aspect of fiscal integration are the systemic shocks that may occur, especially in a monetary union that accede to form a fiscal union. Benetrix and Lane (2013) see in national fiscal policy the main instrument of stabilization that can cope with shocks specific to each country member of a monetary union. The consistency of a monetary union, as the authors mention, depends on the cyclical behavior of fiscal policies applied by Member States, which should in principle contribute to maintaining macroeconomic stability. They concluded that by stating from the implementation of the Maastricht Treaty a fiscal reform was possible, and that the institutional environment can come up with an important contribution in promoting better fiscal results.

In order to form a European Monetary Union, the European Union members agreed on ceasing their independence on monetary policies and exchange rates. The Member States agreed on the fact that fiscal policies should remain in the hands of national governments. But, in order to achieve a fiscal union, further efforts are needed. In this regard, Vitor Castro (2011) proved that it is needed a decade to halve the differences that occur between EU countries on key aspects such as the GDP per capita. According to him, as new data becomes available, his survey can be extended to an analyze on how EU countries face a reformed Stability and Growth Pact, and on the implications that the SGP has on economic growth and fiscal competition. Creating a fiscal union also implies a closer collaboration of the states in this regard, but there is a possibility of a deficit in terms of tax competition appearing, many states encouraging the creation of gross domestic product through relaxed fiscal policies, while fiscal integration could lead to an increase taxation levels and a decrease in tax competition.

Some authors focused on the formation of a monetary union without the benefits of a fiscal union. Luque, Morelli and Tavares (2014) argue that the decision of forming a fiscal union without going further with a higher level of integration can be rationalized if the volatility of shocks on tax revenue is low, as considered when creating ECB. They proved how the relative incomes and increasing population, and the correlation of shocks on inter-state income interacts with fiscal policies in forming the feasibility of reforms. Their perspective allows taking into consideration issues related to economic and political speeches, in a broader context by demonstrating how negotiations can lead to policies that support the sustainability of a fiscal union.

Ben Heijdra and Jenny Ligthart (2007) consider that the recent recession in Europe and the United States has revived the long debate on the role of fiscal policies in stimulating economic activity. In their paper, "Fiscal Policy, monopolistic competition and finished Lives", they claim that it is required a number of additional studies, particularly regarding the effects of anticipated tax shocks and other forms of financing the fiscal impulses. Christophe Schalk (2014) on the other hand, has focused on analyzing fiscal behavior in Member States of the Economic and Monetary Union. By pinpointing their analysis to a more recent timeline, is needed because economic conditions were reflected in a state of constant flux. The model constructed by the author analyzes fiscal behaviors as a parameter that varies over time.

Some works examine how regional incentives differ from the national (or central), situation in which states choose to implement a supranational fiscal arrangement. Essentially, two types of fiscal agreements were suitable for most of the analyzes: a union of nations and a federation of nations. According to the authors Ignacio Ortuno-Ortin and Jaume Sempere (2006), in a union of states there exist full fiscal integration, and in a federation of states there exist only partial fiscal integration and a partial insurance against local risks. In this regard, as the authors mention, regions tend to have stronger incentives than the nations to form a supranational union.

Other authors have focused on the relationship between discretionary fiscal policies and macroeconomic stability. Agnese Sacchi and Simone Salotti (2015) conducted a study on the mentioned subject, with a sample composed of 21 OECD member countries, the chosen timeline for the study being the years 1985-2012. They argue that the aggressive use of discretionary fiscal policies by governments while it leads to a high volatility of the national output, it has a small influence over inflation. Their results also suggest that the aggressive use of fiscal policies has destabilizing effects on both the national output and inflation, although the evidence for inflation is somewhat less convincing. Also, it seems that the introduction of fiscal rules significantly affects the stabilization function of fiscal policies. According to the authors, the rules relating to balanced budgets enjoy a higher degree of efficiency than those related tax revenues who register a lower degree of efficiency. On the other hand, fiscal rules seem not to be able to mitigate the destabilizing effects of inflation due to discretionary fiscal policies, regardless of the type or degree of stringency.

Other authors wondered what are the effects of cyclical fiscal policies on industrial growth. In this regard, Agion et. al., (2014) showed that industries that rely heavily on external funding or that have less tangible assets tend to grow faster (both in terms of added value and increasing labor productivity) in countries that implement mainly countercyclical fiscal policies. According to the same authors, a number of questions may raise regarding the determinants of countercyclical fiscal policies, especially on features or institutional arrangements that encourage or prevent anti-cyclical actions.

In another point of view, fiscal policy can be seen as an instrumental variable in the Eurozone. Mariana Balan (2012) tried to highlight specific aspects of the mechanism composed of fiscal instruments, ways of transmission of the effects of the industry and influence over it, while trying to present a new approach to European integration, based on benchmarks set in doctrine approaches or based on today's reality. The harmonization of the tax system in the European space or the customization the Eurozone as a whole, can lead to a significant increase in taxation, and finally even a return to progressive tax rates systems. In the current context however, as notated by Mariana Balan, this hypothesis is difficult to apply because of the applied national fiscal policies, which determine the method of calculating taxable profits, but which also leaves its mark on the used tax system.

Specialists such as Koenig and Zeyneloglu (2010) focused their attention on indicating the financial integration degree of the influence that fiscal policies have on welfare. Their results show how the effects of a stronger financial integration on fiscal policies can be amplified. Moreover, according to them, the degree of financial integration seems to have no effect on the effectiveness of fiscal policies in increasing welfare.

Europe's sovereign debt crisis triggered a series of debates about the lack of integration of the components found in the architecture of the European Union and the Economic and Monetary Union. There are many opinions that argue that a common currency needs and a deeper fiscal and political integration, as a condition for its survival. This view is not necessarily supported by the experience of other monetary unions, particularly those created by sovereign states. On the other hand, as stated by Marek Dabrowski (2013), the current architecture of EU integration it already contains many elements of a fiscal union. Moreover, several important policy areas such as financial supervision, defense, security, etc. centralization of resources at EU level, could provide a deeper level of integration and the chance to address pan-European externalities. However, fiscal integration itself depends on political decisions being taken at European level. Sin (1994) believes that politicians have their own logic, following their own interests. They are driven by the pressures of the political system, whose vision is generally a short-term one and that doesn't always have rational economic arguments.

A popular view among economists, politicians and the media is that the Maastricht Treaty, and later the Stability and Growth Pact, have significantly impaired the ability of governments of EU Member States to implement fiscal policy stabilizers and provide an adequate level of public infrastructure. Jordi Gali and Roberto Perotti (2003) investigated these issues, assessing the effects of discretionary fiscal rules on budget deficits; the study was conducted during 1980-2002, based on data composed of the member countries of the Economic and Monetary Union and other OECD Member States. Thus, as they mentioned, discretionary fiscal policies in EMU Member States have become more cyclical, trend evident at first only for industrialized countries. Moreover, the decline in public investments (as a percentage of GDP) observed over the past years cannot be attributed to constraints retained in the Stability and Growth Pact or the Maastricht Treaty.

PROS AND CONS FOR A FISCAL UNION

Since the 1970s, and especially in the last decade, in many industrialized countries the public sector has undergone a process of decentralization, while the integration of the global economy has rapidly advanced. Oates (2011) considers that while explaining the differences between countries in terms of government structures, the fiscal federalism theory fails to give an adequate explanation on the recent trend of decentralization. In his study, Dan Stegarescu (2012) concluded that contrary to theoretical predictions and previous cross-sectional analyzes, regressions indicate a negative effect of urbanization and population size on expenditures regarding decentralization. In another point of view, we could say that a particular impact on decentralization it may come from the creation of a fiscal union in the Eurozone.

Although a monetary union does not necessarily need the support of a fiscal union, we notice a number of pros and cons in achieving full fiscal integration. Some authors, as for example De Grauwe (2006) and Wolff (2012), suggested implementing a supranational fiscal policy, based on a form of fiscal federalism, this function being itself required to implement at a federal level. On the other hand, given the diversity of political, economic, social and cultural of the EU, the optimal degree of fiscal centralization may be lower than in other more "mature" and more homogeneous federal states, as stated by Marek Dabrowski (2013).

In the opinion of IMF experts Allard et.al., (2013), the benefits of fiscal integration could accumulate in both the short and long term. In a steady state of the European economy, the probability future crises manifesting can be reduced, and when they would occur, their effects would be less severe (and in case of fiscal integration). IMF expert also appreciate that the confidence degree in the viability of the Union would increase, bringing with it mutual support that would be given regarding the crisis management, as a determined and more effective coordination of fiscal policies and an extension of cyclical tools available would be available. Disadvantages on the formation of a fiscal union presented by Celine Allard et.al (2013) refer to:

a) *Political costs*. The transfer fiscal policies would require intense public debates, and it may even require changes to existing treaties. Politicians that will assume such a measure will shoulder a very high responsibility;

b) *Operational challenges*. A number of mechanisms that will be implemented will involve high financial and time costs, plus other difficulties that may arise in the implementation process;

c) *The increase in costs*. Implementation of a shared risks system will require a number of additional costs, particularly for developed countries.

An effective vision over a fiscal union must confront long-term challenges Economic and Monetary Union is facing. The euro area is diverse and policy planning at national level is the most effective method for a multitude of decisions. However, national policies cannot be decided in isolation, especially when taking into consideration the fact that their effects would rapidly spread in other member states of the union. The main advantages of a fiscal union noted by Herman von Rompuy (2012) are: a more competitive European economy, more effective coordination of fiscal policies that ensure sustainable development without major imbalances, a more efficient framework in ensuring stability financial. It would also be necessary in order to achieve those objectives a supranational institution that would deal with supervision and monitoring of implemented fiscal and budgetary policies, an independent institution politically safeguarded.

As main drawbacks noted by the same author, we could mention the manifestation of moral hazard in terms of taxation and public expenditure of some countries, that taking into consideration the aspect of risk sharing may implement inefficient and uneconomic policies, which eventually would lead to financial costs for other countries, that would have to contribute (financially) to maintain stability.

TAX COMPETITION

The last two decades have seen a sharp increase in foreign direct investment in the most of developing countries. This growth was accompanied by an increase in competition among developing countries in attracting foreign direct investment, resulting in many more tax incentives in order to attract foreign investors in those countries.

Tax competition is likely to occur not only between countries but also between local authorities within developing countries, especially in those who have applied for decentralization policies. It can be expected from such a phenomenon that the fiscal autonomy of local authorities to increase, growing at the same time the possibility of a larger competition between them on the side of tax levels and incentives.

Tax competition intensity may vary according to the tax base mobility, with implications on the fiscal decisions of governments. In their analysis, Carlsen, Langset and Rattso (2005) focused on enterprise mobility, which is a key concern of local politicians. They investigated the relationship between the level of taxation and the conditions for mobility within local governments. Their results confirm that local taxes are influenced by the degree of mobility of enterprises. Local governments who have in their geographical area businesses that present high levels of mobility tend to have lower tax rates.

Tax competition can take many forms. Governments can compete in income tax, or more generally in business taxation. Within developing countries, the taxation of profits is a central government decision, local governments and authorities having at their disposal a series of measures with much weaker effects. Justam, Thisse and Ypersele (2005) see the competition between regions for potential investors as one less direct, that enables them to benefit from higher foreign investors. However, as the authors mention, the globalization of trade and investments has increased competition among regions in order to attract foreign investment and to create jobs, increasing local revenues and properties value from the involved geographical area, regions being after all practically forced to compete with each other, even at a cross-country level. Each region will seek to differentiate itself from the other, seeking new niches that may allow it to that attract investments.

David Wildasin (2011) while analyzing the applied fiscal policies to one of the two elements that influence the mobility of production factors, noticed that integration affects the allocation of resources in terms of general equilibrium. According to him, if the process of adjustment to a higher level of taxation is slower, the yield factors can be substantially reduced, especially in the case of factors such as capital or labor.

Authors such as Bock et. al (2006) preferred to consider tax competition between a different dozen jurisdictions. Their work expands the issues discussed in the literature in two directions. First, the emphasis was placed on the inclusion of two types of labor: qualified and unqualified. In addition, the authors began their analysis on the assumption that labor mobility benefits form the mobility factor, and the unqualified no. The fiscal competition among local governments for production factors can in this sense explain the effects of strategic interactions identified by authors.

David Wildasin (2000) preferred to consider tax competition between several spatially separated jurisdictions in a dynamic explicit framework. The degree of mobility between different jurisdictions is imperfect because it basically involves a series of time-consuming financial costs. Although it is harmful long-term, residents of jurisdictions may benefit in the short term from levied taxes on non-mobile factors of production (referring here specifically to production units located in the geographical area corresponding to jurisdictions). In this regard, the noted author states that anticipated local taxes are less beneficial than those that are imposed unexpectedly. The analysis conducted by Wildasin showed how a given level of endogenous factor mobility responds to changes in fiscal policies, indicating a number of opportunities arising from the application of alternative policies, concluding with the idea that his results do not represent a complete rupture static or temporal analyzes. Rather, as he argues, the dynamic analysis results appear as direct generalities derived from the standard models.

Daniel Becker and Michael Rauscher (2013) wonder whether tax competition is good for economic development? To answer this question, they used a simple model of endogenous growth. According to the published results, not all results obtained by tax competition can be translated to economic growth in an endogenous framework. Thus, the formation of a balance of tax competition is not always possible, especially when facing high costs and a sharp depreciation of capital.

Tax competition not only affects indicators such as foreign investment or local tax revenues, but it may also influence a number of other factors such as public expenditures. In his paper, Hannes Winner (2012) investigated whether tax competition affects the structure of public expenditure in the context of a theory involving a change of public goods production from residential to industrial public goods. Thus, he proposed an empirical model to test the special strategic character and endogeneity of tax competition in 18 OECD member countries, the considered timeline being the years 1980-2000. From the empirical standpoint, he considered tax competition as being endogenous, applying an approach from the perspective of an instrumental variable. In essence, he concludes, the results tend to be similar, regardless of the extent of the tax burden.

The European Union makes us think not only about tax competition, but also about tax harmonization. Vuta Mariana, Lazar Paula and Vuta Mihai (2012) wondered if there is possible a harmonization of the tax systems of all 28 EU member states? For now, at European level it was possible only the harmonization in indirect taxes, excise duties and value added tax. In addition, according to the fiscal policy strategy a fully tax harmonization would not be required. Member States are free to have their own tax system, but only within the framework of European policies. However, the European Union insists on the subject of eliminating tax barriers for transnational activities, and on intensifying the fight against harmful tax competition and tax fraud. These objectives are supported by the Europe 2020 strategy. The previous mentioned authors, while analyzing this topic, conclude that there is sufficient reduction of the tax burden in order to increase investment flows, both domestic and foreign. Accordingly, other factors are equally important, such as for example infrastructure, education and labor market, especially in achieving and maintain a sustainable development. An interesting study was also conducted by Thierry Madies and Jean-Jacques Dethier (2012), that reveals the impact of integration on competition. They suggest that tax competition among governments in attracting foreign investments may take the form of a very small tax burden on businesses, accelerated depreciation or reporting losses in the future (carry-forward). Their analysis also involved verifying the influence of tax incentives on the flows of foreign direct investments, and there is empirical evidence of a strategic behavior in developing countries in attracting foreign direct investment. Both developing countries examined by them were characterized over last two decades by two phenomena with impact on tax competition: deepening economic integration and achieving a deeper decentralization. Thus, it would seem that there are some deep doubts on the manifestation of tax competition among local governments in developing countries, given that even the wave of decentralization that has been experienced in the last twenty years, they do not enjoy a high degree of fiscal autonomy.

Tax competition between governments, which involves the use of fiscal and regulatory policies, it is a very debated subject on both sides of the Atlantic, as the well know author Wallace Oates (2011) states. The working point of this author was the concept of "race to the bottom", which mainly implies a strong reduction of tax rates. It considers tax competition as a problem "pretty intriguing." W. Oates also considers that the literature on tax competition puts us at some distance from understanding the circumstances in which such a competition would influence the functioning of the public sector, being in this respect far from conclusive. But returning to the subject of tax competition itself, it seems that it may have a beneficial impact, as the author states: provides incentives for adopting best decisions regarding tax revenues and public expenditures.

John Arthur Spry (2005) on the other hand, has analyzed tax competition in a more detailed environment. For example, he analyzed the motivation of local authorities in relying heavily on property taxes, even in those instances where they have access to other sources of income. He wondered why local governments continue to form their budgets on a structure in which property taxes play an important role, although some criticism occurred and still occurs on such a construction. According to Spry, the continued use of propriety taxes is based on two reasons: first, these taxes are an important local source of incom and, secondly, there are nonresidents who have real-estate in several geographic areas and which are not considered to be indigenous.

Our results indicate that the best solution to today's European public finance problems is the formation of a fiscal union, with all its risks, among we can mention political costs, operational challenges, costs for the companies and population of some countries. But with all these risks, the fiscal integration must go on, in order to obtain sound public finances, and stability, solutions that the literature presents ranging from a multinational transfer mechanism to the harmonization of the tax systems and legislation.

But, tax competition has its own advantages, the most important being the "race to the bottom", which implies a strong reduction of tax rates, with positives effects on firm's profitability and investments. Unfortunately, extremely low tax rates leave few space for fiscal adjustments in the case of economic crisis, or in the face of a powerful financial disturbance.

We suggest our readers as future research directions, analyzing what are the best methods to quantify the fiscal integration process, the degree of integration, and the degree of tax competition, topics rarely debated in the literature, and only mentioned as an alternative.

CONCLUSIONS

The aim of this paper was to analyze the literature on fiscal integration, fiscal unions and tax competition, as a literature survey. In this regard, we've selected some key papers and analyzed and synthesized what are key ideas and results portrayed in the literature. Our key, results indicate that while for the EU, including EMU, fiscal integration and the formation of a fiscal union seems to be the best path to take, for developing countries, that aren't bounded by treaties or by a monetary union, tax completion is a better alternative.

The literature provides a wealth of answers about the process of fiscal integration and creating a fiscal union, including also a number of alternatives. Although the points of view are essentially divided, many of them tend to converge under a number of issues, of which we could mention the importance of deepening fiscal integration, the need to create a fiscal union and the advantages and disadvantages of mentioned aspects.

The efficiency of anti-cyclical measures and economic recovery appears to be closely correlated with achieved the level of fiscal and budgetary integration. In this regard, we note that very few authors have managed to capture in their undertaken work the differences between fiscal policy and budgetary policy, and the differences between the fiscal integration process and the formation of a fiscal union.

Through this literature review we provide a more complete and relevant point of view with regards to some key issues discussed, in an attempt point out what are the main topics which prevail in the related literature.

As limitation, we can mention the fact that we haven't reviewed all existing articles on subject, and the fact that we didn't provide empirical data, data that is found in most of our analyzed studies.

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