DE GRUYTER OLDENBOURG Journal of Economics and Statistics 2017; 237(3): 159–162

Editorial

Thiess Büttner* and Friedrich Heinemann

Fiscal Equalization in Europe – Introduction

https://doi.org/10.1515/jbnst-2017-1104

The euro crisis has revealed fundamental deficiencies of the European Monetary Union (EMU). Although the acute crisis has been contained for the time being by a substantial and controversial involvement of the European Central Bank the euro area remains in an inherently fragile shape. The crisis has led to substantial reforms of European institutions. This includes the establishment of the European Stability Mechanism (ESM), the amendments to the Stability and Growth Pact, an additional surveillance on macroeconomic imbalances, the signature of the Fiscal Compact and the establishment of the Banking Union.

In spite of these reforms, a common view holds that the EMU still resembles a “half-built house” (Fred 2012) where important elements of the construction are still missing. Recently, the European Commission (2017) has provided suggestions for additional measures required to build a “European Fiscal Union”. Suggestions range from the potential role of new stabilization instruments (euro area fiscal capacity) over new financing instruments for both the EU budget or the Member States to new approaches to fiscal policy decision making in Europe (e. g. through the establishment of an euro area Treasury). These reform ideas raise many complicated questions. What are effective tools to stabilize the euro area against common or asymmetric shocks? What is the role of the EU budget and how could and should the EU budget be developed as to complement and strengthen the institutional architecture of the EU? How large are the moral hazard effects arising from new stabilization tools and how can the disincentives be contained? What do we know about the political economy of fiscal policy decision making in Europe?

Against this background, this special issue presents contributions to this ongoing debate. All articles had been presented at the ZEW Public Finance conference in spring 2016. They offer important insights relating to potential

***Corresponding author: Thiess Büttner,** Friedrich-Alexander-Universität Erlangen-Nürnberg, 90403 Nürnberg, Germany, E-mail: thiess.buettner@fau.de
Friedrich Heinemann, Zentrum für Europäische Wirtschaftsforschung, L7,1, 68161 Mannheim, Germany

new financing tools for the European budget, the political economy of EU spending, the link between inequality and fiscal decentralization and the stabilizing impact of a fiscal European capacity used to provide automatic horizontal transfers.

Marian Dobransch, Alexander Krenek, Danuše Nerudová and Margit Schratzenstaller provide a comprehensive view on potential new revenue sources for the EU budget. This debate has a long tradition but remains highly topical. As a contribution to the ongoing reflections, the High Level Group on Own Resources (2016) has recently published its report with new suggestions for the future financing of the EU. An influential argument in favor of EU taxes is based on the analogy between national and the European budget. If central budgets of federal countries are mainly financed from autonomous taxation the conclusion seems to be that also the European central budget should have access to tax resources. The authors contribute in two respects to this debate. First, they provide a comprehensive survey on the pro and con arguments in the existing literature which makes extensive use of fiscal federalism and political economy considerations. This survey indicates that the traditional debate remains largely undecided and that the status quo of the contribution system has both weaknesses and merits. The paper's second contribution is that it puts this debate into an innovative context by taking an encompassing "sustainability perspective". With this reappraisal of the debate, the authors conclude that EU taxes have a potential of fostering environmental, social and economic sustainability.

Monika Banaszewska and Ivo Bischoff look into the political economy of cohesion spending in Poland. This Member State is currently by far the largest recipient of regional transfers. The political economy of spending allocation is an important aspect often missing in the considerations of a European Fiscal Union. In most reflections on optimum fiscal stabilization tools it is taken for granted that the direction of spending will follow actual stabilization needs. Indeed, empirical analyses like the one by Banaszewska and Bischoff demonstrate that political self-interests of national or sub-national politicians have a measurable impact. While some insights on regional allocation do exist in the literature, this study makes use of municipal data. And also for this lowest tier of government standard political-economic hypotheses are supported. Municipalities whose voters are politically more aligned with the regional government receive more funds. Moreover, those municipalities benefit above average that are "swing-districts", i. e. where the vote-share differentials between both leading parties are small. Implicitly, this study points to an important trade-off which has to be taken into consideration in all future reforms of European fiscal instruments: A strong role of local voters and politicians in spending decisions has the advantage of a higher consistency with preferences. The disadvantage is that this decentral discretion will then also be (ab)used for the own selfish agenda of regional and local representatives.

The relationship between fiscal decentralization and income inequality is explored by Sibylle Stossberg and Hansjörg Blöchliger. Given concerns about fiscal competition leading to a race to the bottom among decentralized governments, this is a topic of particular interest in Europe, where mobility of households and firms has already affected tax and transfer policies of the EU Member States. Yet, as the authors note, existing empirical evidence is mixed. The paper employs a dataset of about 20 OECD countries and explores whether any effects can be discerned using various indicators of fiscal decentralization and income inequality. Using the standard Gini coefficient no strong relationship is found in the data, but if the analysis takes account of differential effects for the lower and the upper parts of the income distribution, stronger relationships emerge in the data. They suggest that the effects of fiscal decentralization varies along the income distribution. In particular, middle income earners seem to benefit from fiscal decentralization. This is an interesting finding that should stimulate further research into the effects of fiscal decentralization also from political economy perspective.

Werner Roeger and Lucas Vogel focus on the role of fiscal transfers in mitigating the effects of asymmetric shocks in a monetary union. This topic has recently gained much interest due to the weak economic performance in the Eurozone after the financial crisis and is one of the key issues addressed in the EU Commission's attempt to push for a European Fiscal Union. The paper uses a DSGE model for two countries with a common monetary policy calibrated to the euro area. The model is augmented with a fiscal capacity which provides budgetary support in the case of adverse cyclical shocks. To assess the contribution of these automated transfers the paper employs a decomposition of total consumption smoothing following Asdrubali et al. (1996). While horizontal transfers are found to enhance the fiscal space of the governments, as emphasized by proponents of a European Fiscal Union, the results point to a significant crowding-out of alternative risk sharing channels. As a consequence the net contribution to stabilization is small. As disincentive effects on national policies are not modelled this suggests that the enthusiasm that the political debate is devoting to the implementation of an own fiscal capacity at a supra-national level is somewhat exaggerated.

We would like to thank the authors for their contributions and the referees for their constructive hints. We thank the editor of the Journal of Economics and Statistics, Peter Winker, for his patience and the excellent cooperation.

Nürnberg and Mannheim, July 2017
Thiess Büttner and Friedrich Heinemann

References

Asdrubali, P., B.E. Sørensen, O. Yosha (1996), Channels of Interstate Risk Sharing: United States 1963–1990. The Quarterly Journal of Economics 111 (4): 1081–1110.

European Commission (2017), Completing Europe's Economic and Monetary Union, Brussels.

Fred, B.C. (2012), Why the Euro Will Survive, Completing the Continent's Half-Built House. Foreign Affairs 91 (5): 16–22.

High Level Group on Own Resources (2016), Future Financing of the EU. High Level Group on Own Resources, Brussels.