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PAUL MASSON: FISCAL POLICY COORDINATION IN EMU

November 2002

HM Treasury invited Paul Masson to revisit his 1996 paper 'Fiscal dimensions of EMU'[1], with particular reference to the quotation: "Though the question of whether the Maastricht criteria are appropriate entrance requirements for monetary union will eventually go away, the issue of how EU countries' fiscal policies will interact in EMU will not. As I have argued above, the use of fiscal policies for stabilisation purposes will be limited in coming decades, by the size of existing debt stocks, by demographic trends, and, to some extent, by the Maastricht debt and deficit criteria themselves. This, and evidence about its greater effectiveness when spread over a wider economic area, suggest that an EU-wide stabilisation policy acting as insurance for regional shocks may be desirable if a number of questions can be resolved. To my mind, it seems inevitable in any case that there will be pressure to move away from independent fiscal policies toward some system where national sovereignty in this area is more limited." (p1003).

1. I have not changed my views concerning the need to harmonize and coordinate fiscal policies within a monetary union like EMU, but I now think that what is more likely to occur in the next few decades is harmonization of tax and benefit policies and increased spending on education, research and infrastructure in the EU budget. EU-wide externalities argue for changes in this direction. For instance, harmonization of tax and benefit policies and EU involvement in education will be desirable to support other aspects of European integration such as the Single Market, which aims to eliminate barriers to the mobility of goods and factors of production, including labor. As for stabilization policies, changes are likely to lead to greater coordination, rather than the mechanical convergence embodied in the Stability and Growth Pact.

2. My recent views are expressed in a chapter of a book, "Fiscal Policy and Growth in the Context of European Integration"[2]. I review the various aspects of fiscal policy, and assess whether they are likely to be taken over by community-level institutions or lead to greater coordination among countries. The size of government spending by governments makes any expansion of the role of government by introducing EU-wide spending programs undesirable (unless national programs are reduced), but a case can be made for a supranational role where there are externalities that cannot be corrected or exploited by national fiscal policies. As an example of the latter, I argue that pressures will increasingly develop for standardizing social programs, in particular pensions, to facilitate mobility. In my view, increasing numbers of Europeans will take advantage of their right to migrate among European countries, but the fact that this reduces their retirement income by forcing them to participate in at least two incompatible national plans will be viewed as increasingly unjust and inefficient. Hence, there will be pressures on their governments to harmonize. While the principle of subsidiarity has been invoked to argue that social policies are, and should remain, the province of national governments, since not coordinating them has harmful effects on other aspects of European integration, they will be viewed as increasingly a shared responsibility and some limited role for the European Commission will, in my view, be accepted.

[1] Masson, P. (1996) 'Fiscal dimensions of EMU', *The Economic Journal* 106 (July) pp. 996-1004.

[2] In *How to Promote Economic Growth in the Euro Area*, eds. Jan Smets and Michel Dombrecht (Aldershot: Edward Elgar, 2001), pp. 112-141.

3. Another area where there are cross-border externalities is education, since with factor mobility the gains to education will not necessarily accrue to the country undertaking the spending. In addition, there are advantages to creating common curricula so that students can more easily transfer to other countries' systems, use degrees to gain professional qualifications, and to facilitate the mobility of university teachers. This may lead to some community involvement in spending on education and in providing norms for countries' schools, but the case is more compelling at the post-secondary level, and EU involvement is likely to be restricted to this.

4. Education is closely allied to research, and as the new theories of endogenous growth argue convincingly, there are externalities in research (those doing innovations cannot completely appropriate the gains that result) which also may argue for a supranational role within Europe. Already the EU has some joint efforts (CERN, etc.) and provides subsidies for research activities. This may expand, but the literature on innovation suggests that the public sector should be cautious in getting involved, and support private sector efforts rather than dictating a line of research.

5. A final area in which cross-border externalities exist is communication and transportation infrastructure, to which the EU budget already devotes some funds, and this may increase.

6. What is the experience of other regions that have labor mobility, in particular, the federations constituted by the United States and Canada? These countries, it is true, do not have completely harmonized social programs. The United States, on the one hand, does not have a national health plan, and private pensions constitute a larger part of pension saving than in continental Europe, and private pensions are typically not portable. But there is a national public plan for retirement saving, and national medicare for the poor. Canada, moreover, has a national health plan as well as the public retirement saving plan; even though Quebec (alone among the provinces) has its own plan, it is fully transferable to or from the Canada Pension Plan. Education is typically decided at the state or local level, though the federal government in each country does provide subsidies and imposes standards. The involvement is typically greater at the university level, and includes subsidies for research.

7. Pension plans are standardized precisely to facilitate the mobility of workers. This is less of an issue for health care. Instead, the Canadian health care plan was launched by the federal government to ensure that Canadians had access to a minimum of services across the country. Provincial health care plans are not uniform, nor are they portable (but they do not have to be). So among social programs, retirement saving would seem the most important program to facilitate mobility.

8. As for the use of fiscal policy for stabilization purposes, the experience of the Growth and Stability Pact suggests to me that standard rules that aim to apply the same ceilings on fiscal deficits to all countries, and in all circumstances (except for exceptional circumstances defined in terms of a particular decline in GDP) are not going to work effectively. What I think will emerge is a closer coordination of national policies, on the basis of greater attention to the circumstances facing individual countries and the impact of those policies on other countries. Such coordination would be both more flexible than the current excessive deficits procedures and more constraining for a particular country than the current system, because it would allow the EU to assess the appropriateness of detailed policy measures rather than just their overall deficit impact.

9. In conclusion, I think coordination and harmonization of fiscal policies will continue to develop in the EU. To quote my recent views as expressed in the chapter cited above:

> "Coordination of fiscal policies will be a major issue within the euro zone and the EU for the foreseeable future. In the absence of coordination, there will be pressures from tax competition to limit the level of services provided by governments… Stable systems that can dependably rule out the worst outcomes from uncoordinated polices are likely to involve the development of EU-wide fiscal policies... Endogenous growth theory points to a few areas where externalities might suggest that EU-wide policies would be desirable, in particular to stimulate knowledge-creating activities and factor mobility… Over time, there may be some gradual increase in the taxing power at the EU level, accompanied by reductions in fiscal responsibilities of national government." (p. 136).