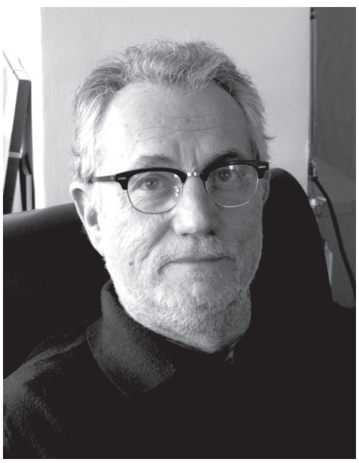
98 EUROPEAN UNION MEMBER STATES?



Jordi Angusto,
ECONOMISTA

Scotland, Veneto, Lombardy, Catalonia... these are all EU regions demanding greater self-government, in some cases including independence from their home states but never from the EU. An apparent paradox given that their demands have increased along with the EU's own growth in power. But there is no contradiction.

The EU has super-imposed a new order that sits uneasily with the previous settlements between regions and nation states, both in political and economic terms. An incompatibility requiring an adjustment at EU level rather than at states' level if we still want "an ever closer union". *(See here)*

Both in Italy and Spain, North to South fiscal transfers were designed as a stabilising mechanism to recycle trade imbalances. It meant the North's trade surplus financing the South's trade deficit fiscally: a closed mechanism that made sense while trade and fiscal flows were symmetrical, as was the case before the EU single market and the euro; but hard to justify once the flows are asymmetrical. As a case in point: before the euro, Catalonia used to have a trade deficit with the rest of the world and a huge trade surplus with the rest of Spain; nowadays, it enjoys a 6% GDP trade surplus with the rest of the world while that with the rest of Spain has been halved. But fiscal transfers to the rest of Spain remain untouched, at 8% of GDP.

As the Catalonia/North Italy demands for lower fiscal transfers have given the impression that they are selfish and opposed to the solidarity required in any society, it's worth analysing those fiscal transfers both under moral and efficiency principles.

RICH TO POOR OR POOR TO POOR?

In moral terms, it's commonly accepted that fiscal transfers between wealthier and poorer regions are fair. And they would be if those regional transfers really were between rich and poor, which is not the case. Post-tax capital yields tend to be equal everywhere in an environment of free movement of capital;

therefore, if there are any extra charges anywhere, those are paid for by labour and not by capital. And they're paid by those with lower salaries, who on top receive less social protection. This means that, at best, those fiscal transfers are intra-class transfers.

In efficiency terms, fiscal transfers are justified as reducing regional disparities. However, the fact is that regional disparities are rather frozen or even increased by this mechanism. Permanent Southern underdevelopment and high unemployment, both in Italy and Spain, after years and years of fiscal transfers, is evidence enough. As a result, fiscal transfers paid by the poor in the rich regions end up subsidizing the unemployed in the less advanced regions, which produces a great result for companies and owners of capital: unemployment in Southern regions encourages lower salaries across the country as a whole and allows companies to be competitive without the need to invest in innovation and good management.

All in all, fiscal transfers between regions are far from fair, do not help to reduce regional disparities and sustain the country's lower productivity and higher unemployment, if they do not bring productive investment designed to improve productivity in the recipient regions. This is akin to what happened with EU cohesion funds: the main recipients before enlargement to the East were Portugal, Ireland, Greece and Spain or precisely the four countries that later on had to be bailed out!

Why has criticism about these mechanisms appeared now and not years ago? Probably, for the asymmetry factor mentioned above. While trade and fiscal flows were symmetrical within countries, however unfair and inefficient, this was a closed circuit mechanism and such transfers returned as a trade surplus. As would be the case if fiscal transfers were Europeanised, by converting the EU into a "transfer union": a prospect strongly rejected by Germany, which would be the main contributor and has its own and much more elaborate fiscal transfer scheme (*Länderfinanzausgleich*) than one that would end up by freezing rather than reducing disparities.

MORE EUROPE

For both reasons, the alternative to fiscal transfers as a trade surplus recycling mechanism is a surplus avoidance mechanism. How could that work? **Bruegel** suggests decentralizing wage bargaining in Italy, because a median wage following median productivity there means lower salaries in the more advanced North and excessive ones in the less developed South, thus giving the competitive advantage to the North that lies behind its trade surplus with the South. Conversely, a different and higher wage in the North, matching its higher productivity, would suppose a competitive gain for the South and a cut in its trade deficit and high unemployment. The same can be said for Spain, where prospective independence in Catalonia might result in higher salaries and a lower surplus, helping the South develop much more than via fiscal transfers.

Alongside wage bargaining decentralization, by reducing their fiscal transfers the surplus regions would and must increase their domestic demand through public expenditure. This would consolidate the higher salaries level and would bring in more demand for the deficit regions. All in all, the lagging regions get more exports, incomes and employment.: a virtuous circle to substitute for the current vicious one.

The euro crisis exposed the flaws of an asymmetric EMU, with a centralized monetary policy and a decentralized fiscal policy. Furthermore, a fiscal policy centralized at nation state level is incompatible with the economic dynamics of regions linked with all EU regions much more than with their domestic regional partners. A deeper subsidiarity scheme is necessary, in both political and fiscal terms. Decisions must be taken closer-to-the-citizens and pass to an upper level if and when the latter proves fairer and more efficient.

How to get such full subsidiarity, whether welcoming to the EU several new states or federalizing current states, is a political issue for debate. As can be said for fiscal policy. Each administrative level must be self-financed with taxes related to the services it provides, which means that corporate taxes must be Europeanised for those companies working across the single market and must serve to assure a full employment-orientated aggregate demand at EU level and to finance a convergence program properly designed to improve the development of the lagging regions, instead of freezing disparities through direct unconditional fiscal transfers.

European Commission President Jean-Claude Juncker expressed recently his fears around **an unmanageable EU of 98 states**. However, with 28 members holding veto rights for main questions, the EU is already unmanageable. The question is not the number of states but the institutional architecture. For policy reasons, the EC is used to working with the **272 existing regions** in the EU and only few of those are ready to assume full self-government. Finding a satisfactory solution for those regions that are ready and willing to do so and reforming the EU's architecture to make it more social, democratic and manageable is a daunting challenge that must be tackled. Anybody willing to take it up? •

Article publicat en el marc del programa d'economia que rep el suport de

Obra Social "la Caixa"