

Does the European Union Have its own System of Fiscal Federalism?

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ABSTRACT

There has been a lively debate among scholars about the feasibility and desirability of fiscal federalism in the European Union (EU). The paper addresses the question of whether ‘conventional fiscal federalism’ is feasible in the EU, considering the distinctiveness of European integration and the political-economic template of Economic and Monetary Union (EMU). It is an attempt to bridge the gap between economics and political science by adding the political conditions that might create difficulties to the economics’ rationale.

Starting from the conceptual instruments used (fiscal federalism, centralisation and decentralisation) the paper highlights how fiscal federalism is multi-faceted concept embracing both a centralisation and a decentralisation outcome. Borrowing the Musgravian classification of allocation-equity-stabilisation, the EU is examined as far as *redistribution* and *macroeconomic stabilisation* are concerned. The aim is to conclude whether centralisation or decentralisation is the prevailing outcome for both functions.

Considering that in the EU: i) the current distribution of fiscal competences is favourable to member states; ii) the overall outcome for the aforementioned fiscal functions is decentralisation; iii) despite monetary policy is the main tool for macroeconomic stabilisation, and this is a policy arena where centralisation prevails; iv) the diminished scope for inter-state solidarity averts more centralisation in redistribution; and v) the absent political willingness from national governments to increase the EU budget; all this suggests that ‘conventional fiscal federalism’ is ruled out as a feasible solution for the EU.

Notwithstanding this doesn’t imply that fiscal federalism is absent from the EU. A distinct, decentralised modality of fiscal federalism already exists, coping with the ‘*sui generis*’ nature of European integration.

Introduction

Following the inception of Economic and Monetary Union (EMU), there has been a lively discussion about the desirability and feasibility of fiscal federalism in the European Union (EU). EMU brought the European integration process into an advanced stage of economic integration that is very similar to other federations: a single currency, with a single monetary policy assigned to a supranational body (the European Central Bank, ECB).

Fiscal federalism is the missing piece in this jigsaw. ‘Conventional fiscal federalism’ is understood as a constitutional system assigning fiscal powers among different tiers of government, with a noticeable centralisation bias. From the Musgravian distinction between allocation, equity and stabilisation (Musgrave and Musgrave 1989), the debate around European integration and ‘conventional fiscal federalism’ pays considerably more attention to the equity and stabilisation dimensions. In the context of European ‘conventional fiscal federalism’ can be more problematic due to the distinctive nature of the EU, where member states play an influential role.

Another important aspect is the usefulness of federal countries as benchmarks against which the evolution of the EU can be assessed. Despite the distinctiveness that characterises European integration, the mere possibility that EMU installed a ‘de facto’ federalism in the EU (Buiter 1999, Burgess 2000, and McKay 2001) acts as a catalyst for examining other cases of monetary integration in federal countries. To claim that the EU is a distinct form of federalism does not rule out any comparison with existing federations. It is possible that the EU already shares some elements of existing federalisms. The basic question is this: *what lessons can be captured from these federal countries, and where (and why) does the EU deviate from them?*

1. Redistribution and European integration

1.1. The emphasis on decentralisation

It might be problematic to achieve the pattern of interpersonal redistribution of mature federations in the EU, because citizens’ loyalties are focused in member states. Centralised inter-personal redistribution is far away from meeting the necessary political conditions to achieve it: not least because the degree of inter-state solidarity is low, but also (and mainly) because such modality of redistribution requires an instrument (income taxes) that is not

available in the supranational catalogue of competences. Without the appropriate tool at the supranational level, it is unthinkable to envisage a system of supranational transfers.

The emphasis on decentralisation is not very different from the general pattern observed in three of the federations under assessment. Assuming a differentiated nature between two groups of federal countries – Canada and the US, on the one hand, and Australia, Switzerland and Germany, on the other hand – the perception is that redistribution doesn't follow a uniform path. For those where vertical transfers and the tax system are the main tools available (Canada and the US), centralisation is the keyword. Conversely, decentralisation prevails in those federations where horizontal transfers play the leading role (Australia and Germany, mainly; and Switzerland to a lesser extent). There is also some centralised redistribution in this second group of federal countries. Nevertheless the decentralised aspects of redistribution are more visible.

Taken from this perspective, it is inaccurate to conclude that EMU sustainability depends of 'conventional fiscal federalism' in order to perform, among other functions, redistribution. The reasoning behind those who support 'conventional fiscal federalism' is that redistribution is largely centralised. However it is clear that such idea doesn't fit well with the differentiation that characterises fiscal federalism. Taking for granted that a decentralised solution for implementing redistribution also exists in mature federations, one might ask whether the EU already fits into this tendency.

The assessment of the functional distribution of competences among all tiers of government provides indisputable evidence that the EU is a case of strong dominance of decentralised redistribution. True, the role played by the supranational budget is negligible, notably when the EU budget is geared towards explicit redistribution (structural funds seeking the goal of economic and social cohesion) (Laffan 1997), but less when implicit redistribution comes to the surface (mainly through the thorny effects of Common Agricultural Policy) (Penketh 1999, and Levitt and Lord 2000). Therefore, the EU approximates to the parameters of 'conventional fiscal federalism' of those countries where decentralisation prevails.

It is nevertheless important to realise that the EU stands at the extreme of decentralisation when compared with the other federations. For this purpose it is important to measure the extent to which the redistribution function is mainly performed at the national level and not so much by the EU budget. By this token, the EU is even more decentralised than the most decentralised system of redistribution among the five federal countries under inspection.

Table 1 *The regions of the EU with the lowest/highest GDP per capita, 2000 (in PPS)*

	2000	
	Region	Average % of the EU
3 poorer	Ipeiros (Greece)	47
	Réunion (France)	50
	Dytiki Ellada (Greece)	51
Average		49.3
3 wealthier	Inner London (UK)	241
	Brussels (Belgium)	218
	Luxembourg	195
Average		218

Source: Eurostat (2003).

The table reveals the accentuated differences between the three poorer and the three wealthier EU regions (by their unweighed average), especially when the EU is compared with the other five federal countries.

The difference between the average index of higher and lower income regions reaches 168.7 percentage points in the EU, almost the double of that country (Switzerland) where the income inequality index is the highest (85.8 percentage points, see Figure 1 below). This is consistent with the rationale used by the proponents of ‘conventional fiscal federalism’ when they claim that redistribution must work at a more centralised level in the EU to correct the imbalances that might prevent the coherent run up of EMU.

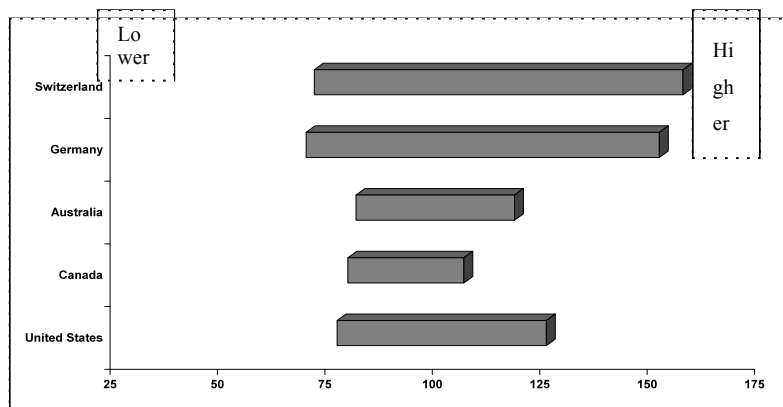


Figure 1 *Comparison of income differentials in the five federal countries*

Source: Author’s estimations based on official statistical data from the five federal countries.

There is, however, a sizeable difference of degree when the EU and those three federations are enmeshed in the same categorisation of decentralisation. While decentralised redistribution in Australia, Germany and Switzerland entangles states in directly reciprocal transfers through horizontal redistribution, no such mechanism is available in the EU.

Thus, *the presumption that redistribution is also flanked by decentralisation in the EU cannot be understood as a similarity with those three federal countries.* In the EU the awareness of a

largely decentralised redistribution function means that redistribution is mostly run up at the national level, but the beneficiaries are not regions located in other member states but instead all the regions included in that member state who designs and implements redistribution. What is missing in the EU decentralist dimension of redistribution is horizontal transfers. In the specific context of European integration, decentralised redistribution only means that this function operates *within* each member state, and *not among them*.

1.2. Are there conditions for enhanced centralisation?

This question resonates with another one: *is it feasible that the EU comes more comparable to those cases of 'conventional fiscal federalism' where centralisation is the keyword in the operation of redistribution?* It is important to realise that the question imprint a huge normative analysis. Nevertheless there are also some positive insights stemming from the observation of current conditions in European integration. In other words, the answer to the crucial question provides a contrasting perception if one relies on normative beliefs or if the examination is driven by positive analysis. I find four crucial motivations for underestimating the plea for centralisation in the EU as far as redistribution is concerned. Two of them are located in the pure political domain, and the other two emphasise political-economic aspects.

1.2.1. The absence of political conditions

To begin with, it is important to reflect once again on the implications of European integration distinctiveness. Among them is the recognition that the *finalité* of European integration is not statehood. Despite some of the crucial developments within European integration are familiar with nation-states (crucially, a monetary union comprising a single currency), and notwithstanding more elements of federalism are acknowledged in European integration, the pathway towards a European super-state seems outvoted for the moment.

In this context caution must be used when it is claimed that redistribution must be more centralised in the EU as an inevitable parallel with those federal states where redistribution follows this path. There are two problems with this reasoning: on the one hand, it assumes that centralisation is the dominant tendency in all federations, when the previous section already showed that some of the federal countries examined chose decentralised redistribution; secondly, the problem with this doctrine is that the outcome of European integration necessarily resonates with a statehood dimension.

From the previous reasoning, my claim is that – as I am writing – it is not *feasible* that more redistribution becomes attached to the supranational level. It might become *desirable* to certain schools of thought. Those who believe that the supranational budget should be

reinforced in order to perform a stronger role in redistribution also show a preference towards more centralisation within the EU context.

The inevitable consequence of such predilection is the assignment of an autonomous taxing power to the EU, the enhancement of supranational budget's outlays and revenues, and more attention to the asymmetries between member states and their regions. In other words, something more must be done at the supranational level in order to offset the depth of the asymmetries that currently characterise the EU. This solution is reasonable to the extent that other relevant aspects beneath European integration were neglected – again the core elements that make the EU a template of distinctiveness, of something that is located on the antipodes of statehood.

The absence of intense inter-state solidarity within the EU is one of these important aspects that act as an obstacle to centralised redistribution in the EU (Korkman 2001, and Wincott 2002). Several evidences show how member states, and the peoples of the EU, don't witness that measure of solidarity. First, centralised redistribution calls for vertical transfers. The implementation of vertical transfers calls for a stronger supranational budget, asking member states to allow an autonomous taxing power for the Union or/and to enable solutions enhancing its revenue capacity. One way or the other, the expected outcome is a larger net contribution by the wealthier member states.

Past evidence suggests that these member states are politically unwilling to make an additional contribution fuelling a stronger and visible EU budget (Gramlich and Wood 2000, and Jones 2002). They were not willing to do that in the eve of the prospective enlargement. National governments recognised that this enlargement creates a huge challenge for the homogeneity of the European economy due to the incorporation of the incoming member states. Notwithstanding, the political unwillingness to enhance the EU budget resources was deeper.

This behaviour dominated the Agenda 2000 negotiations. The same outcome was reflected by the fratricidal discussions held in the Nice IGC in December 2000, where national governments were furiously trying to win the battle for having more relative power in the distribution of voting power in the Council for qualified majority voting purposes (Galloway 2001). Taking member states as a relevant actor in European integration, and accepting the insight from liberal intergovernmentalism that state actors strongly shape the agenda of European integration and use the bargaining process within the supranational polity to achieve certain goals that they could hardly accomplish alone at a domestic base (Moravcsik 1993),

the conclusion is that national governments are dominated by egocentrism and opportunistic behaviour.

Another strain cannot be neglected: different traditions among the member states in what concerns the means and ends attached to redistribution heighten the difficulties of centralised redistribution in the EU. Furthermore there is a sharp division between donor and recipient member states that could be increased in the event of supranational redistribution aiming at offsetting regional inequalities. The likely result would be the fragmentation of EU member states into two different, hostile clubs, jeopardising the climate of salutary relationships within the EU (Person, Roland and Tabellini 1996).

An alternative method confirms how inter-state solidarity is largely absent in the EU. Now the focus shifts from governments' behaviour towards citizens' perceptions of European integration, notably how they react when solidarity between different member states is at stake. People are more concerned with their own problems, turning their attention to the regional or national level of decision-making to solve these problems. Their neighbours' problems are not a reason of worry. It is not surprising that European integration developments were not complemented by a common civic identity (Chrysochoou 2003: 380).

Table 2 *Feeling attached to a place (1991 and 1995)*

Member State	Region 1991/1995	Country 1991/1995	The EC 1991/1995
Austria	---/3.7	---/3.5	/2.3
Belgium	3.2/3.5	3.0/3.2	2.4/2.5
Denmark	3.6/3.4	3.8/3.7	2.3/2.1
Finland	---/3.2	---/3.6	/2.0
France	3.3/3.4	3.4/3.4	2.6/2.6
Germany	3.6/3.6	3.4/3.3	2.4/2.3
Greece	3.8/3.9	3.8/3.9	2.5/2.4
Ireland	3.6/3.6	3.7/3.7	2.2/2.5
Italy	3.4/3.4	3.4/3.5	2.7/2.7
Netherlands	3.0/3.1	3.2/3.1	2.1/2.1
Portugal	3.7/3.7	3.7/3.7	2.5/2.5
Spain	3.7/3.6	3.5/3.5	2.7/2.4
Sweden	---/3.4	---/3.6	/1.9
United Kingdom	3.4/3.3	3.5/3.4	2.2/2.1
EC/EU unweighed average	3.5/3.5	3.5/3.4	2.5/2.4

Source: Adapted from Hooghe and Marks (2001: 55), Table 3.1.

Question: People may feel different degrees of attachment to their region, to their country, or to the EC. Please tell how attached do you feel to...? The data were adjusted from a larger survey where different answers were envisaged for measuring how attached people felt to these three hypothesis: 'very attached' (code 4), 'fairly attached (code 3)', 'not very attached' (code 2), and 'not at all attached' (code 1)'.

Deductively, one could guess that the EU 'medium citizen' doesn't encourage a solution endowing the supranational level with extensive competences related with redistribution. It is infeasible that this (absent) European identity among the peoples of the EU triggers the

acceptance of vertical transfers analogous to those of federal countries where redistribution is dominated by centralisation. Moreover Eurobarometer surveys show how citizens drive their loyalties to a national (if not sub-national) level. Table 3 corroborates the aforementioned reasoning.

Table 3 *European versus national identity 1992 to 2002, EC12/EU15*

	EB 37 (Spring 1992)	EB 44 (Spring 1995)	EB 49 (Spring 1998)	EB 57 (Spring 2002)
Only nationality	38	40	44	38
Nationality and European	48	46	41	48
European and nationality	7	6	6	7
Only European	4	5	5	4

Sources: Data from Eurobarometer 37, 44, and 49 in McKay (1999: 167).
Data for 2002 in European Commission (2002), Table 4.5.

Some interesting insights emerge from interviews made with national governments (both Foreign Affairs and Finance Ministries) of nine member states, as well as with European Commission and ECB officials. Almost 64% of the respondents (at both governmental and EU institutions' levels) gave the unequivocal answer that the EU doesn't need 'conventional fiscal federalism'. Not even for the representatives of supranational institutions (60 % at this level), to whom it would be easy to accept fiscal federalism, the prospect of 'conventional fiscal federalism' seems reasonable. On a grading scale of eagerness for federally oriented outcomes member states usually stand behind supranational institutions. Thus it was without surprise that the majority of representatives from member states' governments (almost 65%) argued that 'conventional fiscal federalism' is not a panacea for the likely disruptions EMU might face in the future.

Among the justifications that the majority of practitioners provided for rebutting the evolution towards 'conventional fiscal federalism' was the awareness that a strong political willingness among member states' politicians is required. Nowadays this condition is far from being accomplished, as it is revealed by the huge resistance member states offer about the transfer of tax competences towards the supranational level. An extrapolation was made by these officials: that 'conventional fiscal federalism', a far-reaching outcome when compared with the transfer of some tax competences, is far from being feasible in the European integration context.

1.2.2. The absence of economic conditions

The first argument emphasises that *asymmetric shocks are less likely after the start of EMU*, and even less likely as long as the operation of the monetary union becomes consolidated throughout time (Artis and Buti 2000: 573). Other scholars have a different perception, claiming that asymmetric shocks are a real prospect for the Euro-zone economy for the deep imbalances that member states still show (Krugman 1993, Fitoussi and Creel 2002, and Boyer 2002), and for the structural differentiation between national economies (Begg 1998, and Fátas 1998).

An interesting view accepts that asymmetric shocks within the Euro-zone are likely to occur, but interprets it as a call for fiscal policy decentralisation (Gramlich and Wood 2000: 11). Gramlich and Wood believe that asymmetric shocks might be offset through enhanced room of manoeuvre for national governments' fiscal policy. The idea can be summarised as follows: the differentiation between national economies is the reason for these shocks; it makes sense to entrust national governments with the means available to offset these shocks for a twofold reason. On the one hand, they possess better information about the sources behind the asymmetric shock. On the other hand, it is expected that national governments possess better skills to correct that negative scenario. This approach is, however, somewhat flawed: one cannot neglect the imbalance between centralised (and prioritised) monetary policy and decentralised (and constrained) fiscal policies as a powerful obstacle that prevents fiscal policy from fighting asymmetric shocks (Cameron 1998).

On the opposite side stands the opinion that EMU has the potential to internalise member states' differentiated business cycles. It thus creates space for *synchronisation between national economies* (Buti and Sapir 1998: 154-63). This effect is expected as a consequence of two interconnected aspects of EMU's political-economic architecture:

- i) The transition period before the launching of monetary union, when a significant measure of economic convergence among member states was already achieved (Eijffinger and de Haan 2000: 130);
- ii) The expected greater credibility of the single monetary policy implemented by the ECB. To this extent, monetary policy is powerful enough to act as a shock absorber against the negative effects arising from a crisis. Consequently, the *stabilisation* effects of monetary policy eliminate fiscal policy activism. (Dyson 2000: 160).

If asymmetric shocks are ruled out, there are fewer arguments in favour of income redistribution being implemented at the supranational level.

A final justification for rejecting centralised redistribution in the EU borrows from *the expected effects of macroeconomic stabilisation* as an ideal outcome of EMU's political economy. The clear distribution of functional competences between the supranational and the national levels is instructive of the reasons that separate EMU from centralised redistribution, and thereby deprive European integration from any connotation with 'conventional fiscal federalism' (Kletzer 1999, and Maillet 2002). Two correlated motivations explain this causality: the dominance of supranational monetary policy in the overall architecture of economic policy, and the extent to which fiscal policy is still largely decentralised (albeit facing some quantitative constraints due to the Stability and Growth Pact, SGP).

Firstly, EMU's political economy is based on the monetarist belief that monetary policy is powerful enough to weaken the disturbances the Euro-zone economy faces. Despite the claims that the 'one-size-fits-all' monetary policy is a reason of concern for being numb to cases where a group of member states requires a different policy stance, the fact is that the winning model puts its faith in the stabilisation potential that the ECB monetary policy is supposed to have.

The logic embedded in EMU's orthodoxy puts the emphasis on monetary policy, relegating fiscal policy to a secondary place. All this suggests that *in the EU the priority is stabilisation, not redistribution*. In other words, if there is a centralisation window opened by EMU, that window is not redistribution but instead stabilisation through the operation of monetary policy.

More relevant to the ongoing discussion is the awareness that the tool available to perform the redistribution function remains in the hands of national governments (Italianer and Pisani-Ferry 1994, and Majocchi 1999). For this reason redistribution has today an immense leeway for decentralisation. Therefore it is important to ask whether the conditions are met for a substantial transfer of competences from national governments towards supranational institutions. This is an important object of inquiry in order to understand whether redistribution is plausibly a room for centralisation, thus bringing the EU closer to 'conventional fiscal federalism'.

The rejection of this ambition starts from the acknowledgement that automatic stabilisers operate better when they are manipulated at the national level. The need for 'conventional fiscal federalism' is negatively co-related with the possibility that automatic stabilisers operate at the national level, since

(...) there is no need for a European system of fiscal federalism so long as member states' automatic stabilizers are allowed to operate. But if these are disabled, there may arise pressure for fiscal federalism, as national governments plump for a union-

wide system to provide the stabilization they are prevented from providing themselves
(Eichengreen 1998: 30).

In this context the SGP is an important device, particularly because one of the core arguments that support the existence of the pact is the leverage for national governments using automatic stabilisers more efficiently (Artis and Winkler 1998). Pegging on Eichengreen's reasoning, the feasibility of 'conventional fiscal federalism' in the EU depends from an incompetent behaviour of national fiscal authorities. Only then automatic stabilisers are unlikely to be operational at the national level. As long as the SGP survives and proves to be consistent with its aims, notably by enabling national automatic stabilisers when they are most need – when economic downturn hits the ground – then the centralisation of redistribution is infeasible.

2. Macroeconomic stabilisation and European integration

2.1. A mixed picture of centralisation and decentralisation

The assessment of macroeconomic stabilisation in the EU highlights the framework that was chosen after EMU was launched. Behind this template of economic policy lies the goal (Treaty on European Union, article 4, 2nd and 3rd paragraphs) of non-inflationary sustainable growth coupled with sound finance and money. The macroeconomic orthodoxy underpinning EMU is a mixed system of functional and territorial competences: while monetary and exchange rate policies were transferred towards the supranational level, fiscal policy remains within national governments' powers, albeit facing some constraints due to the SGP.

It is interesting to realise that this allocation of competences to the national level has some hidden consequences. By making use of the principle of subsidiarity in fiscal policy, EMU was simultaneously recognising two interrelated facts. Firstly, the dominance of monetary policy over fiscal policy as the major tool for performing the stabilisation function. Indeed monetary policy was supranationalised without specifically mentioning the principle of subsidiarity as the motivation for this crucial option beneath EMU.

Notwithstanding no formal recognition came to the surface, the question is whether there is an *implicit justification*, maybe to avoid some national-based resentment. By the implicit reference to the principle of subsidiarity the EU admitted that monetary policy was supranationalised for a twofold reason: first, this is the most important device to accomplish the stability goals included in the Treaty, according to the normative beliefs that inspired the political-economic orthodoxy of EMU; second, if member states remained the masters of monetary policy the required uniformity in the Euro-zone would be jeopardised and stability harmfully affected.

Importantly, on the other hand, by explicitly using the principle of subsidiarity to explain why fiscal policy remains within the hands of national governments, the EU signalled the decentralisation mantle that is anchored to the principle of subsidiarity. This strategy was intended to show how member states are important players in the macroeconomic stabilisation effort in the Euro-zone, although this effort is confined to their own territorial jurisdictions and facing the specific economic needs and different public finance traditions they have.

It would be unthinkable, and unwanted, to foresee centralised fiscal policy where so accentuated differences among member states still remain (von Hagen 1993, and Dyson 2002). And since monetary policy was already supranationalised, this intensified the necessary decentralisation of fiscal policy (Oates 2001). Such solution is the open gate enabling national governments to accommodate asymmetric shocks, if and when they happen. If one sees the supranational level as something similar to centralisation, then an analogy between stabilisation in the EU and in the federal countries is plausible. This is especially true in those countries where the emphasis on stabilisation is focused on monetary policy, while fiscal policy is used as a complementary device (Switzerland and Germany). Even for those federations where centralised fiscal policy is an important stabilisation tool there is a certain similarity: if it is true that fiscal policy is not as decentralised as in the other two federal countries, it is indisputable that monetary policy is focused in the federal central bank.

Being aware of this limited similarity between the EU and some of the federal countries, the conclusion is that the EU fits with the characteristics of those cases of ‘conventional fiscal federalism’ where decentralisation prevails. Hence, it is possible to ascertain that the EU is not far away from the features of *decentralised fiscal federalism* as far as stabilisation is concerned, and especially when the analysis is focused on the extent to which fiscal policy remains within national governments’ competences and monetary policy is assigned to the supranational level.

2.2. Is there space for more centralisation?

The answer to this question depends on the following assumptions:

- i) Standing on the perspective that monetary policy illustrates soft centralisation, enhanced centralised stabilisation would call for a different political-economic template for EMU, notably a diminished prominence for monetary policy and a greater visibility for fiscal policy;
- ii) But considering that the Euro-zone needs some uniformity, and remembering the assumption that the single monetary policy should have been downgraded, the only solution available requires the centralisation of fiscal policy. This would in

turn deprive national governments' say in fiscal policy, and eventually lead to a kind of supranational economic government to perform that function at the supranational level (Cameron 1998, and Collignon 2003).

Monetary policy would no longer be the sacred instrument, since fiscal policy would replace it as the most important instrument to perform macroeconomic stabilisation. The problem with this proposal is the existing set of ideational beliefs that are dominant among key policy-makers (at the ECB, in the Commission, and in national governments – albeit among these the majority of opinions that was favourable to the macroeconomic orthodoxy of EMU has been declining). There is no consensus among these actors about a changing pattern that paves the road ahead for centralised fiscal policy and the relegation of supranational monetary policy to a second-order instrument attached to stabilisation.

When the attention shifts towards the academic community, the conclusion is different. On the one hand, scholars encourage more centralisation in fiscal policy as a necessary counterpart to the supranationalised monetary policy, requiring a proxy of supranational economic government (Verdun and Christiansen 2000), pointing at a window of opportunity for changing EMU's established macroeconomic orthodoxy (Begg 1998, and McKay 2000). On the other hand, others maintain that a single monetary policy is detrimental of the structural differences that still differentiate national economies. The 'one-size-fits-all' monetary policy can produce harmful effects for some national economies that require a different monetary strategy (Boyer 2000).

Despite these arguments, the conditions for changing the current status of monetary policy prominence and national fiscal discipline are far from being met. For that reason the conclusion is straightforward: *EMU still depends of a macroeconomic framework that puts European integration in close contact with those federal countries where stabilisation is a mix of centralisation and decentralisation.* Furthermore, there are strong reasons to believe that fiscal policy must remain decentralised. The motivations behind this judgement are the differences that still characterise the Euro-zone member states, and the perception that automatic stabilisers are much powerful at the national level. Strong empirical evidence suggests that the stabilisation effect of national automatic stabilisers in EU member states is greater than the one provided by those federal countries (and their federal budgets) where centralisation is dominant in macroeconomic stabilisation (Italianer and Pisani-Ferry 1994, Radaelli 1996, and Kletzer and von Hagen 1999).

Conclusions

The inquiry was to investigate whether ‘conventional fiscal federalism’ is feasible in the EU. But maybe the discussion is focused on accessory details and misses the crucial point: that *eventually European integration is already an arena for a distinct modality of fiscal federalism*. The merit of the comparative method was to emphasise that European integration is replete with distinctiveness rejecting the statehood dimension. For these reasons it is difficult to find consistent linkages between the EU and the five federal countries assessed. European integration is a world of its own, and doesn’t fit with the features deployed in all the five federations studied.

This conclusion is furthermore supported by the recognition that ‘conventional fiscal federalism’ is not one-dimensional. There isn’t fiscal federalism *per se*, but instead different modalities of fiscal federalism. This conclusion paves the way for a vivid rejection of the claims that point to a certain model of fiscal federalism as the yardstick for a coherent development of the European monetary union – the US case. This choice is arbitrary for the ample divergences that explain the foundations of the North-American federation and the ongoing development of European integration (Börzel and Risse 2000, Elazar 2001, and Bermann and Nicolaidis 2001).

The problem with the strictly comparative method is the scientific autism it unravels: looking at the *abstract conditions* that must be met in order to make a monetary union operational, but only depicting the lessons of the optimum currency area theory. The method reflects an austerity of means that unpacks its great weakness: *such method leaves behind the real characteristics that influence the developments of European integration and, consequently, misses the very essence that is typical of EMU*. Put it differently, those who argue that EMU must replicate the features of the US model of ‘conventional fiscal federalism’ ignore that what works well in the US must not be the predestined panacea for solving what is envisaged as a major shortcoming in the operation of EMU.

In order to dismantle the truisms of the strict comparative method, it is also important to remember that ‘conventional fiscal federalism’ is made of an uneven mixture of centralisation and decentralisation. The conclusion is that *fiscal federalism is not a necessary synonymous of centralisation*. Thus, a valuable insight arises from the rejection of that axiomatic truth: decentralisation lives together with some of the examples of ‘conventional fiscal federalism’ studied. The specificities surrounding European integration suggest that, for the time being, it

is not feasible that the EU meets centralisation, especially in those domains where ‘conventional fiscal federalism’ operates (allocation, equity, and stabilisation).

The corollary of this conclusion is a window of opportunity *to accept an alternative dimension of fiscal federalism in the EU – one where decentralisation is the dominant feature.*

The fact is that students of fiscal federalism emphasise how fiscal decentralisation is the best solution for mature federations, for the positive effects stemming from vertical and horizontal governmental competition (Oates 1999, 2001). Assuming this is the desirable pathway for mature federations, here is another powerful argument for the infeasibility of centralised fiscal federalism in the EU.

On the other side of the comparative analysis some instructive findings were brought out. The constructive lessons coming out from that method unveil those elements that already enable a residency for European integration in the context of fiscal federalism. I remember those aspects revealing a similarity between some of the federal countries and the solutions that characterise the EU, with variable degrees of resemblance for redistribution and stabilisation.

It isn’t by accident that when the analysis falls within the conceptual traps of the comparative method, Switzerland bestows the stepping-stone for envisaging the EU in line with fiscal federalism. Obviously the EU doesn’t replicate the characteristics of the Swiss fiscal federalism, as there are many instances where the differentiation is remarkable. The same happens with the comparison made between the EU and Germany’s fiscal federalism. Some of the features embedded in this model of fiscal federalism are already emulated in European integration. Nevertheless, there are other elements where the dissimilarity is markedly palpable.

All in all, even if one gets trapped into the tricky aspects of the comparative method, the EU shows some resemblance with those cases of ‘conventional fiscal federalism’ where decentralisation dominates. It is nevertheless dissimilar from the other federations where centralisation is more prominent. This insight is powerful enough to show the weakness of the sectors that try to build a bridge between the EU and ‘conventional fiscal federalism’.

The plea is, hence, *whether the EU is already a system of fiscal federalism on its own.* One modality of fiscal federalism that is dominated by decentralisation, for the constraints that the EU budget faces preventing it from promoting the same goals, and with the equivalent depth, as it is typical of all the other federal countries. But yet fiscal federalism: if I get back to the introduction, fiscal federalism is a system of constitutional distribution of powers between different tiers of government for the traditional fiscal functions. The image that stands out from European integration is the existence of different budget layers, different competences as

far as the performance of the mentioned fiscal functions is concerned, and an outcome that is mapped to accentuated decentralisation.

Thus, it seems clear that *fiscal federalism already exists in the EU*. Not ‘conventional fiscal federalism’ – far from it – but a distinct modality of fiscal federalism for the fact that in the EU the member states still play a prominent role. This conclusion is deepened by the recognition that member states are still the main actors in the fiscal arena, for the following reasons: they refuse to transfer tax competences to the supranational level; citizens still direct their loyalties towards the national, rather the supranational level; and the political-economic template that is the bread and butter of EMU, namely the policy mix of supranational (and prominent) monetary policy together with decentralised fiscal policy, where national governments still play an influential role.

Summing up, my finding is that fiscal federalism is at the moment one of the characteristics embodied in European integration. This is a timid, even a hidden feature, as a consequence of the juxtaposition of different understandings: those who reveal a misconception about fiscal federalism – those who link fiscal federalism to centralisation, and those who provide an evidence of intellectual autism – the proponents of ‘conventional fiscal federalism’ as a value added for EMU; and those who raise obstacles to this prospect for their behavioural scepticism towards far-reaching developments in European integration. Although a timid dimension encapsulates the EU fiscal federalism, it exists indeed. A fiscal federalism of its own, matching the structural attributes that make European integration full of distinctiveness. Fiscal federalism in the EU is like something that exists but is hard to clearly distinguish when it stands in the front of our eyes. For this reason fiscal federalism hides a *metaphysic dimension: one can hardly see it, but it exists anyway*.

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