

***An Economic Constitution by installments***  
***(Balanced Budgets and Public Finance Legal Reforms)***

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**[draft, do not quote]**

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**I. Introduction.**

At the outset, the legal framework to control public debt and deficit has been linked to the construction of the monetary union. The unique experiment of uniting monetary policy without sufficiently coordinating economic policy need a clear warrant that the

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Union would save its currency *whatever it takes*<sup>2</sup> and that it was ready to introduce hard bound rules that would force Member States to maintain a certain fiscal balance. Investors believed it, as they believed that ultimately the no-bail out clause would not be enforced.

The development of the financial and subsequent economic crisis and in particular the measures adopted (and not adopted) to fight it, have contributed to reinforce a narrative, present since the adoption of the first budgetary control rules (the 1997 Stability and Growth Pact), that maintains that such rules mirror German's idea of stability and frugality (in the form of austerity even), that they may curb growth and that they substantially change the economic constitution, as well as endangering the very survival of what is left of the European welfare system.

This persuasive narrative is not new but is currently more widespread and well founded on tangible elements, such as the wording itself of the current legal framework and its comparison to the German, or the BVerfG case law, as well as the own declaration of some high profile German politicians, referring to the deficit spending addiction, even gluttony, of the "southern" countries, the PIGS (Portugal, Italy, Greece and Spain, where the author is from).

As attractive as this point of view is, I submit it leaves out the lion's share of the fundamental problems that the stability legal framework presents. It also minimizes the arguments for balancing budgets and may misunderstand what the current rules actually entail, by confusing their mandatory provisions to the actual policy decisions undertaken in the name of such provisions. In many instances, austerity has been more a shortcut to avoid harder policy measures than a solution imposed upon Member States by the said legal provisions.

In this (currently unfinished) paper I will deal with these first (part II); assess both the impact of the current legal framework and its potential to attain the objectives outlined in the same framework (part III); and determine whether this is in fact a new economic constitutional framework or rather a small limited-effects installment.

## **II. The case for balancing budgets in the European Union.**

The economic wisdom behind the need to balance the budget in the mid long run is well known, at least the basics. Only it is not unidirectional or coherent.

Public spending as a motor (or "multiplier", as Keynes put it) of growth, versus monetary policy, form part of a decades-old debate. The (relative) crisis of Keynesian policies contributed to the sophisticated analysis of the consequences of public deficit. Albeit a structural element of democracies, to a certain extent at least, when public deficits consolidate they may indeed burden growth<sup>3</sup>, as well as establish a sort of ghost tax upon future generations. Budgeting methods as well as lobby groups facilitate the

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<sup>2</sup> To mimic Mario Draghi's July 2012 words, which contributed to a turning point in the crisis.

<sup>3</sup> The actual dangerous rate has not been established, and depends on many variables, as the "excegate" debate came to show in 2013 (see Carmen Reinhart/Kenneth Rogoff). [SHAVIRO 1997](#).

resilience to change of public spending (once budgeted, it will never move)<sup>4</sup>. Budgetary allocations reflect the power of the organisms in charge of its management

There is a political incentive to increase public spending and finance it with debt operations, rather than with new taxes<sup>5</sup>, as there is a perfect incentive system that to some extent also creates a democratic deficit for future generations<sup>6</sup>.

### - The equity argument.

Intergenerational equity is one of the most persuasive arguments to curb deficit and public debt. But analysing the normative criteria to establish inequities is complex and not usually part of the debate. Roughly put, what the indebtedness is for is a fundamental element of the intergenerational analysis<sup>7</sup>. This idea is encapsulated in the so-called golden rule of deficit spending, according to which public debt shall only be incurred for investment, but not current spending<sup>8</sup>.

The idea is relatively simple but harder to execute; typical handbook examples of investment are infrastructures (a highway), while an example of current spending would be salaries of public servants. However, in practice the golden rule (debt for investment only) is controversial<sup>9</sup>. Among other reasons not to enshrine it in a binding rule (constitutional or similar) is that once established there will be accounting gimmick practices in order to conveniently “repackage” current spending as investment<sup>10</sup>. Article 115 of the German Constitution is an example of the opposite tendency or economic wisdom, in that it directly enshrines the golden rule.

In any event, what can pass the intergenerational equity test and what not will largely depend on political, fungible, decisions. Building a highway may seem today like a good investment as it constitutes an asset that may be enjoyed by future generations, so that there is a (future) correlation between that expenditure projected in the future (through debt) and its cost. But this will ultimately depend on the marginal utility of that asset through its lifetime, which can only be roughly estimated. At the same time, the equity test becomes more complicated, almost unmanageable because more elements

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<sup>4</sup> ELLIOTT, E. D.: “Constitutional Conventions and the Deficit”. *Duke Law Journal*, n. 6 (december), 1985, pp. 1089-1090.

<sup>5</sup> As the main critics of Keynesianism point out; BUCHANAN, J.; WAGNER, R.: *Democracy in Deficit: the Political Legacy of Lord Keynes*. 1977, pp. 93-154. See online edition <http://www.econlib.org/library/Buchanan/buchCv8c1.html>; con paragraphs 8.7.2 et seq.

<sup>6</sup> ELLIOTT, E. D.: “Constitutional Conventions and the Deficit...cit. pp. 1091 a 1092; “future generations are truly subject to “taxation without representation”, because today’s politicians can vote to implement programs to benefit today’s voters but to be paid for in part by tomorrow’s tax payers”.

<sup>7</sup> SHAVIRO, D.: *Do Deficits Matter?* Chicago/London: The University of Chicago Press, 1997, pp. 114 et seq.

<sup>8</sup> ZSOLT DE SOUSA, H.: “The Future of the Stability and Growth Pact as a Tool for Economic Policy Coordination...cit. pp. 22 et seq. ARTIS, M. J.: “The Stability and Growth Pact: Fiscal Policy in the EMU”, at BREUSS, F.; FINK, G.; GRILLER, S. (Eds.): *Institutional, Legal and Economic Aspects of EMU*, Springer, 2003, pp. 111 et seq.; BUTI, M.; FRANCO, D.: *Fiscal Policy in Economic and Monetary Union. Theory, Evidence and Institutions*. Cheltenham/Northampton: Edward Elgar, 2005, pp. 6 et seq.

<sup>9</sup> BIRD, R. M.: “Evaluating Public Expenditures: Does it Matter How They are Financed?”, *International Tax Program*, University of Toronto, ITP Paper 0506, pp. 9 y 10; EICHENGREEN, B.: “Institutions for Fiscal Stability”, pp. 9 y ss.

<sup>10</sup> BUTI, M.; FRANCO, D.: *Fiscal Policy in Economic and Monetary Union. Theory, Evidence and Institutions...cit. p. 35.*

will need to be thrown in the formula; such as what public deficit is depending on who generates it (the Government, its agency, a strictly regulated public-private corporation...), the time frame taken as a reference point, what elements integrate it or the causes for it (structural or not)<sup>11</sup>.

### **- Taxes versus debt: perverse political incentives.**

In the seventies, and well through the nineties, two unrelated phenomena contributed to stressing the importance of establishing some type of rules to tip the balance towards controlling the deficit.

One, the relative deregulation of financial markets, whose consequences on the current financial crisis have been well studied, contributed to facilitating emissions of public debt; and two, the growing decrease in tax revenues, in particular deriving from income taxes. This was the consequences of different elements, among them the sophistication of tax avoidance as well as to globalization, which foster “legal” tax avoidance by making delocalization easier<sup>12</sup>.

As controversial as the economic effects of deficits is what contributes more to its creation. Diminishing tax returns are at least as responsible<sup>13</sup> as the tendency to increase public spending.

There is a further rationale to introduce specific limits in the analysis of the logic of public spending allocations and the democratic process. There are political incentives to spend more across the board. Focus is often centred on entitlements, old transfer payments directly or indirectly related to entitlements (pension payments, unemployment, public health system, specific transfer payments such as child allocation, etc.).

But there are also vested interests that constitute a powerful set of entitlements (corporate welfare queens<sup>14</sup>). An overview of the State Aid Commission decisions gives a rough but accurate idea of the types of tax incentives that some corporations receive<sup>15</sup>

Rules may also contribute to changing the debate in tax law. Resources are intrinsically scarce, but the rules reinforce that view and may at least indirectly help redesign a tax system.

Rights have costs. Not only transfer based rights (such as employment benefits), but fundamental rights, as well as the cost of Government<sup>16</sup>.

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<sup>11</sup> SHAVIRO, D.: *Do Deficits Matter?*... pp. 153 et seq.

<sup>12</sup> RUIZ ALMENDRAL, Violeta, “Tax Avoidance, the ‘Balanced Allocation of Taxing Powers’ and the Arm’s Length Standard: an odd threesome in need of clarification”, at *Allocating Taxing Powers within the European Union*. Series: MPI Studies in Tax Law and Public Finance, Vol. 2., at Richelle, Isabelle; Schön, Wolfgang; Traversa, Edoardo (Eds.) Springer; 2013 edition, (pp. 131-170).

<sup>13</sup> CAMERON, D. R.: “Taxes, Spending and Deficits: Does Government Cause Inflation?”. LINDBERG, L. & MAIER, C. (Eds): *The Politics of Inflation and Recession*. Washington D. C.: Brookings Institution, 1985, pp. 234-239, and pp. 252-259. See a critic at: WOLFE, D. A.: “Politics, the Deficit and Tax Reform”. *Osgoode Hal Law Journal*, vol. 26, n. 2/1988, pp. 351 et seq.

<sup>14</sup> See the short piece by James SUROWIECKI “Corporate Welfare Queens”, *The New Yorker*, October 8<sup>th</sup>, 2012, describing what the author calls the “the corporate welfare state” [<http://www.newyorker.com/magazine/2012/10/08/corporate-welfare-queens>, accessed 10.10.2014].

<sup>15</sup> [http://ec.europa.eu/competition/elojade/state\\_aid/](http://ec.europa.eu/competition/elojade/state_aid/)

There is a spending ceiling, but there is also a revenue floor which is harder to fulfil in light of declining tax revenues (a fiscal crisis of the welfare state, as James O'Connor put it)<sup>17</sup>.

### **- Designing budgetary rules to fill coordination gaps in a monetary union.**

The case for controlling debt and the deficit in a Monetary Union has been well established, at least to the extent that it may minimize “inflationary debt bail-outs”, spillovers effects derived from an uncoordinated economic and fiscal policies<sup>18</sup>. However, this rationale works in two different directions, as at the same time, this may also be a reason not to limit beforehand all room for manoeuvre, since the more limited and myopic the rules are, the less possible it would be for member states to develop their own cooperation mechanisms<sup>19</sup>, which will doom the rules from the beginning.

On the other hand, the fact that there are reasons to introduce these rules as constitutionally binding rules is not enough. It is possible to think of many other policy areas that may have spillover effects, such as the labour market or the tax system<sup>20</sup>, or many other. But then again, none of them is bound to have a hard impact on the credibility of the currency, which is the ultimate reason for the adoption of budgetary constraints.

With hindsight, it can be argued, and indeed often has, that leapfrogging to a full-fledged coordination of the budgetary frameworks was too fast, reckless even. Until 1985 Europe is a dual political entity, with integration mostly limited to the construction of the common market, and ordoliberal rationalism that coexisted with decisions on public spending left entirely to Member States<sup>21</sup>. The Delors *White Paper on Completion of the Internal Market*<sup>22</sup> is a tipping point that will be reflected in the Maastricht treaty and consolidated, at least in part, through the monetary union<sup>23</sup>. Of course the Maastricht Treaty only partly followed the Delors proposal, which entailed

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<sup>16</sup> All rights are positive; see on this S. HOLMES and C. S. SUSTEIN, *The Cost of Rights. Why Liberty Depends on Taxes*. W. W. Norton & Company, 1999, pp. 37 et seq., on the futility of the dichotomy between positive and negative rights.

<sup>17</sup> **EUROSTAT DATA**. On the falling revenues see:

CORNEO, G., “The Rise and Likely Fall of the German Income Tax, 1958-2005”. [WP, accessed 10.10.2014

[http://www.wiwiss.fu-berlin.de/bibliothek/diskussionsbeitraege/diskussionsbeitraege-wiwiss/files-diskussionsbeitraege-wiwiss/discpaper18\\_04.pdf](http://www.wiwiss.fu-berlin.de/bibliothek/diskussionsbeitraege/diskussionsbeitraege-wiwiss/files-diskussionsbeitraege-wiwiss/discpaper18_04.pdf)

Specifically with data on the German tax system:

<sup>18</sup> EICHENGREEN, B.; WYPLOSZ, C.: “The Stability Pact: More than a Minor Nuisance?...cit. pp. 75 et seq.

<sup>19</sup> EICHENGREEN, B.; WYPLOSZ, C.: “The Stability Pact: More than a Minor Nuisance...cit. pp. 78 et seq.

<sup>20</sup> CLOSA, Carlos, “The Transformation...

<sup>21</sup> JOERGES, C.: “What is Left of the European Economic Constitution? A Melancholic Eulogy...cit. pp. 7 et seq.

<sup>22</sup> Commission of the EC, “Commission White Paper to the European Council on Completion of the Internal Market”, COM(85) 310 final of 14 June 1985.

<sup>23</sup> JOERGES, C.: “What is Left of the European Economic Constitution? A Melancholic Eulogy...cit. pp. 16 et seq. *Vid* SNYDER, F.: “EMU Revisited: Are We Making a Constitution? What Constitution Are We Making?”, at (Eds.: CRAIG, P.; BÜRCA, G. De.): *The evolution of EU Law*. Oxford: Oxford University Press, 1999, pp. 433 et seq.

also a political union<sup>24</sup>. The step towards monetary union was taken without fulfilling the necessary economic coordination prerequisites. Thus, the current, to a certain extent unforeseen design of the EMU is a unique experiment, which separates economic and monetary union *contra natura*, as has also been often been pointed out<sup>25</sup>.

The laxity of the economic policy coordination criteria is offset by strict debt/deficit rules that end up substantially restricting the leeway of Member States in the face of an economic crisis, a limitation that may end up contributing to further non-compliance situations, as has also been often pointed out<sup>26</sup>. This is all the more dangerous inasmuch as there is an obvious loophole as there is an institution in control of monetary policy (ECB) but no corresponding institution in economic policy.

The dysfunctions of the previous and the current fiscal framework are only a consequence of that, and they become worse because the rules are predetermined for all, drone-like one size fit all rules so to speak that in some cases may end up substituting policy initiatives<sup>27</sup>.

### **- The cost of rights as a rationale for deficit/debt reduction.**

Deficit and debt control makes sense for the different reasons, some of them mentioned above.

There is generally a case for introducing such budgetary constraints in the Constitution. At least if we have already agreed that there is a case for introducing the guarantee of certain rights, be it third generation rights (such as health, education, pension funds), or fundamental rights (due process, the right to property<sup>28</sup>, freedom of speech). All rights have costs, if only because all of them must be enforced at one time or another, and this will need, at least, establishing a publicly financed court system<sup>29</sup>.

Fiscal constraints, when rational, introduce clarity in the financing of rights. It does not make much sense to insert the one without the other: the principles and fundamental elements without a general outline of how it is that those rights are going to be financed to begin with. Departing from the scarcity of resources, there is no absolute right to finance all rights inasmuch as it would entirely negate the financing of others. Despite common political discourse, there is no such thing as red lines that cannot be trespassed in the guarantee of rights.

There are many examples to illustrate this point. Take article 50<sup>30</sup> of the Spanish Constitution (a “positive” right), which guarantees that retirement pensions must be

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<sup>24</sup> On the different proposals see: SNYDER, F.: “EMU Revisited: Are We Making a Constitution? What Constitution Are We Making?...cit. pp. 421 et seq.

<sup>25</sup> MAHER, I.: “Economic governance: hybridity, accountability and control”. *Columbia Journal of European Law*, vol. 13/2007, p. 682. HATZOPOULOS, V.: “Why the Open Method of Coordination Is Bad for You: a Letter to the EU”. *European Law Journal*, vol. 13, n. 3/2007, pp. 322 y 323.

<sup>26</sup> SNYDER, F.: “EMU Revisited: Are We Making a Constitution? What Constitution Are We Making?...cit. p. 449.

<sup>27</sup> JOERGES, C.: “What is Left of the European Economic Constitution? A Melancholic Eulogy...cit. pp. 14 et seq.

<sup>28</sup> Fundamental in some Constitutions, like the German.

<sup>29</sup> Constitutional lawyers and scholars have an intriguing tendency to ignore this, beautifully explained, with US examples, by S. HOLMES and C. S. SUSTEIN, *The Cost of Rights. Why Liberty Depends on Taxes*. W. W. Norton & Company, 1999; see in particular pp. 87 et seq.

<sup>30</sup> Official translation:

adequate and periodically updated so they do not lose spending potential. The current President (Mr. Rajoy), as well as the former (Mr. Zapatero) have at one time or another publicly stated that indexing pensions to inflation is a red line that cannot be trespassed.

It has, of course, already been trespassed but the relevant discussion is exactly against what other public expenditures this guarantee should be maintained, in view of the rapidly ageing population and the unbearably high unemployment rate in Spain<sup>31</sup>.

The case for fiscal constraints and its introduction in the Constitution is not so different from the case for a revenue system. An entirely different matter is just what the specific wording of the constitutional clause should be.

It can be argued the way the legal framework has adopted, and adapted, the existing economic wisdom is suboptimal but is the result of a sketchy unorganized process<sup>32</sup>, where general principles have transformed into one size fit all strict rules, whose sanctions are neither clear, nor credible.

From the old monetary policy vs. spending policy debate (Buchanan, Friedman, Keynes), to the 70s Waigel Plan, the inflationary caution, the ECB late creation with its monomandate, the 1997 coordination of general results (see the numbers, ignore the cycle), that failed when France and Germany failed to comply with it, to the 2005 semi-flexibilization of the numbers (result of the cycle, not year to year; the golden rule – deficit for investment- seems to be back in play).

The bottom line is that there is a case for constitutionalizing such rules in an imperfect monetary union, but it should be done as a result of a Convention and with careful wording so as to not restrict the necessary leeway. The ultimate reason is that there is no prevailing tradition of budgetary stability and it is sensible its introduction.

Of course enshrining constitutional rules limiting the debt and deficit implies a petrification of political options (Closa). This effect is produced in a very strict way, by introducing rules to control debt and deficit that are much stricter than those found for instance in the US Constitution. The paradox is that the EU is averse to the construction of a federal system in the political arena, but fiscal governance, as created by the TSCG, establishes a federal fiscal model that is much stronger than the one in the U.S. Constitution<sup>33</sup>.

There is also a moral hazard issue to be considered. If specific rules are established, deficit and debt will be reduced at all costs to avoid breaching them. Some of the

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Section 50, The public authorities shall guarantee, through adequate and periodically updated pensions, a sufficient income for citizens in old age. Likewise, and without prejudice to the obligations of the families, they shall promote their welfare through a system of social services that provides for their specific problems of health, housing, culture and leisure”

<sup>31</sup> **Data** (fertility data; health care cost data, unemployment data).

<sup>32</sup> C. Closa points out in his paper the deficiencies of the constitutionalization process

“In addition to the aforementioned prevalence of the German and preference for petrification, the constitutionalizing process is also low-quality. The new Fiscal Pact has been elaborated without the intervention of the Convention anticipated in article 48 of the TEU (not to mention the formality that it is not a EU Treaty). In addition, the agenda (contrary to previous EU reforms) has been strictly restricted to measures of fiscal discipline and oversight. Finally, the entire process has been completed with unusual haste, especially given the importance of the agreement”

<sup>33</sup> FABBRINI, Federico, “The Fiscal Compact, the ‘Golden Rule’ and the Paradox of European Federalism.” *Boston College International & Comparative Law Review* 36 (2013).

measures will or may entail reducing investment<sup>34</sup>. Therefore, a provision such as fiscal discipline that intends to force policy makers to think long-term is complied with by adopting short term measures that endanger long term sustainability (across the board budgetary cuts in science and technology in Spain are a good example).

Furthermore, to the extent that deficit and debt thresholds matter more than the route to achieve them, there is a powerful incentive to introduce austerity measures which then crowd out real reform measures. Budget cuts across the board, such as cutting public servants pay or pensions, have immediate effects on the budget and are politically very useful when working on ever shorter election terms. However, it is real reforms that have the only possibility to be game changing (measures to tackle an ageing population -drastic immigration reform, pension and health system reforms-, to curb diminishing of tax reforms –such as a EU BEPS initiative).

### **III. The fiscal consolidation legal framework: insufficient or myopic?**

#### **- An (external) fiscal supervision system.**

The stability legal framework was initially agreed in the Resolution of the European Council on the Stability and Growth Pact Amsterdam, (17 June 1997), following among other the European Council Madrid meeting of December 1995.

The initial 1997 Stability Pact (Protocol n. 12 on the excessive deficit procedure) and the two Council Regulations<sup>35</sup>, gave a very specific shape to the loose principle that “*Member States shall avoid excessive government deficits*” (enshrined in former art. 104 TEC; current art. 126 TFEU).

“Excessive” became 3 per cent of deficit and 60 per cent of public debt, strict threshold whose rationale has been repeatedly criticised, deemed as arbitrary even.

The introduction of budgetary stability rules was shaped by the previous (to a certain extent failed) attempts to introduce stricter coordination rules in the economic area. The final result cannot be understood without paying special attention to the debate previous to the German Constitutional Courts Maastricht Opinion, the Waigel Plan<sup>36</sup> and, further back, the Werner Plan, an attempt to establish the fundamental elements of a monetary union, much more ambitious than the current form and that entailed a more fundamental coordination of economic policy<sup>37</sup>.

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<sup>34</sup> This is exactly what has happened with Spanish regions in Spain (**add data**).

<sup>35</sup> Council Regulation (EC) 1466/97: On the strengthening of the surveillance of budgetary positions and the surveillance and coordination of economic policies (which entered into force 1 July 1998).

Council Regulation (EC) 1467/97: On speeding up and clarifying the implementation of the excessive deficit procedure (which entered into force 1 January 1999).

<sup>36</sup> “Stabilitätspakt für Europa: Finanzpolitik in der dritten Stufe der WWU”. Pressemitteilung des Bundesministerium der Finanzen, Bonn, 10 Nov. 1995, at: *Deutsche Bundesbank/Auszüge aus Presseartikeln* no. 77, 13 Nov. 1995, pp. 6-9. *Vid* the summary at HAHN, H. J.: “The Stability Pact for European Monetary Union –Compliance with deficit limit as constant legal duty”. *Common Market Law Review*, n. 35/1998, pp. 80 et seq. BUTI, M.; FRANCO, D.: *Fiscal Policy in Economic and Monetary Union. Theory, Evidence and Institutions*...cit. pp. 19-20.

<sup>37</sup> A summary at RUIZ ALMENDRAL, Violeta, *Estabilidad presupuestaria y gasto público en España*. Madrid, La Ley-Wolters Kluwer España, 2008, pp. 33 et seq. *Vid*. SNYDER, F.: “EMU Revisited: Are We Making a Constitution? What Constitution Are We Making?”, at (Eds.: CRAIG, P.; BÜRCA, G. De.): *The evolution of EU Law*. Oxford: Oxford University Press, 1999, pp. 426 et seq.; STRATH, B.: “The Monetary issue and European

It also had a lot to do with the particular institutional architecture of stability price supervision, and the mono-mandate of the European Central Bank<sup>38</sup>.

The current legal framework is formed by very different legal instruments.

There are two treaties; Treaty on Stability, Cooperation and Governance (TSCG, known as the “Fiscal Compact”); the Treaty of the European Stability Mechanism (TESM) with specific, and complicated, links to European Law (Bruno De Witte).

Legal instruments directed as financing mechanisms: the European Financial Stability Facility (EFSF) and the European Financial Stability Mechanism (EFSM)

The core of the fiscal consolidation legal framework is formed by article 126 of the TFEU and the following Regulations (Directive, seven Regulations –five from the Six Pack, and Two Pack).

(...)

The parched up legal system builds on the previous legal framework in that it established specific debt and deficit ratio thresholds, as well as an institutional design to control compliance levels.

There are however fundamental differences:

1) This time, Member States are expected to appropriate the rules. In particular, Eurozone member states must implement budgetary constraints by means of establishing rules of “binding force and permanent character, preferably constitutional” (Fiscal Compact).

The idea is for Member States to have skin in the game, and to acquire a stability culture and control it through its legal system.

2) Controlling the full cycle (the European Semester).

Rather than examining rote compliance with the 3-60 thresholds, the new legal system intends to control the process, including the possible danger zones.

This is a formalization of the existing loose Commission recommendations, which will now adopt different forms (macroeconomic imbalances reports, different shades of early warning system).

This is encapsulated in the so-called European Semester, in which Member States’ budgetary cycles become European budgetary cycles by means of permanent connection with the EU institutions.

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Economic Policy in historical perspective”, en JOERGES, C.; STRATH, B.; WAGNER, P. (Eds.): *The Economy as a Polity. The Political Constitution of Contemporary Capitalism*. UCL Press, 2005, pp. 63 et seq.

<sup>38</sup> ZILIOLI, C.; SELMAYR, M.: “The European Central Bank: An Independent Specialized Organization of Community Law”. *Common Market Law Review*, n. 37/2000, pp. 592 et seq.; TORRENT, R.: “To Whom is the Central Bank the Central Bank of: Reaction to Zilioli and Selmayr”, *Common Market Law Review*, n. 36/1999, 1232 et seq.; AMTENBRINK, F.; DE HAAN, J.: “The European Central Bank: An Independent Specialised Organization of Community Law –A Comment”, *Common Market Law Review*, n. 39/2002, pp. 68 et seq.; DUTZLER, B.: “Institutional Framework of the EMU –Is the ECB a Fourth Pillar?”, en BREUSS, F.; FINK, G.; GRILLER, S. (Eds.): *Institutional, Legal and Economic Aspects of EMU*. Viena/Nueva York: Springer, 2003, pp. 5 et seq.

<b>Budgetary cycle</b>	
<b>Phase</b>	<b>Participating institutions</b>
Phase 0: Pre-budgeting	National Governments / Commission
1. Elaboration (law project)	National Governments / supervision by Independent Councils
2. Approval	National Parliaments
3. Execution (Spending phase)	National Governments
4. Control	National Government (internal control mechanisms) National Parliaments (Fiscal Councils) Comission/Council (end results). European Court of Justice
Phase 5: controlling the results	Deficit/debt: - Comission/Council - ECJ

This enhanced permanent supervision adds significant complexity to the budgetary cycle. It also gives the impression of an automatic process, a complicated machinery where every step of building the budget is monitored.

This sense of control is misleading. There is only external control; the content of the budget is left unsupervised, except for the general recommendations provided by the Commission (bail out/not bail out countries)

Different cycle depending on financial assistance mechanism.

Perverse incentives: the feeling of control fosters moral hazard

**- The changes on the budgetary powers: less powers for Parliaments or different powers?**

Democratic deficit revisited, as argued (CLOSA, FASONE, FABRRINI)<sup>39</sup>

This is not so simple.

**i) The real traditional budgetary role of Parliaments (sheer idealization).**

The idea of balancing the Budget, ie, controlling the resulting debt and deficit during the budget cycle and establishing some predetermined rules to be legally binding is far from new. It was during Rationalism that the Budget rules, or “principles” were set.

<sup>39</sup> CLOSA MONTERO, Carlos, “La Gobernanza Fiscal y Macroeconómica Europea y Sus Limitaciones Democráticas” *Revista Aranzadi Unión Europea* XXXVIII, 12/2012, pp. 51–65.

These principles shaped the Budget as both a fundamental political document and an Act of Parliament. This double nature, -a political instrument and a law-, persists today and permeates any legal analysis on the budget. To a certain extent, failing to understand this double nature jeopardizes any effort to coordinate budgetary frameworks.

It was not until the mid XX century that budgets acquired its present form, that of lengthy complicated documents summarizing all public economic policy. The game change (New Deal, Welfare State), and subsequent increase of public spending that took place after the Second World War transformed public budgets into documents both difficult to manage and to discuss in a public forum such as the Parliament. The chambers approved the document but were no longer able to fully discuss its content.

Furthermore, and to ease the management of public funds, new techniques such as creation of independent agencies resulted into chunks of public funds being decided and controls completely outside the Parliament, whose role was limited to approving its overall budget.

In order to partially minimize the democratic deficit some areas were excluded of budget laws, such as those not directly related to the estimation of revenues and the authorization of expenditures. This was embedded in some constitutions or became part of the rules governing the budget. Article 134<sup>40</sup> of the Spanish Constitutions limits the possible content of the budget to “the entire expenditure and income of the State public sector and a specific mention shall be made of the amount of the fiscal benefits affecting State taxes” (art. 134.2) and specifically precludes the budget from creating taxes (“The Budget Act may not establish new taxes. It may modify them, whenever a tax law of a substantive nature so provides”; art. 134.7<sup>1</sup>). In any event, the objective to avoid extra budgetary matters, also known as “*cavaliers budgétaires*” is usually linked to maintaining the rule of law and the democratic principle; because budgets are complicated documents discussed in Parliament during a very limited time including other non-directly related matters contributes to the discussion losing its focus and therefore undermines the role of Parliament of controlling the Budget.

These limits to the possible content of the Budget have been the source of numerous conflicts before the Constitutional Court, with a large amount of Budget laws being challenged for containing provisions not directly linked to the Budget<sup>41</sup>. Of course taking into account that the Budget is like an x-ray of public action, it is very difficult to establish the red line separating Budget matters and material regulation.

The double nature of the budget is clearly seen in its life cycle.

Phase 1. Elaboration. Budgets are elaborated by the Executive power, the Government, which normally will have the sole legislative initiative in this matter.

Phase 2. Approval. Budgets are discussed and eventually approved by Parliament.

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<sup>40</sup> See article 34.19 of the French Constitutions (and art. 1 of the *Loi organique relative aux lois de finances*). This has also been the subject of much conflictivity in France; see DÉCHAUX, Raphaël “L’évolution de la jurisprudence constitutionnelle en matière de “cavaliers” entre 1996 et 2006”; at: [http://www.conseil-constitutionnel.fr/conseil-constitutionnel/root/bank\\_mm/pdf/Conseil/cavaliers.pdf](http://www.conseil-constitutionnel.fr/conseil-constitutionnel/root/bank_mm/pdf/Conseil/cavaliers.pdf)

<sup>41</sup> Examples include (*cita*).

Phase 3. Execution. Budgets are a document designed for the Executive, who must then apply it.

Phase 4. Control. Budgets, or rather their execution, will be ex post facto controlled by Parliament, through a Court of Auditors. There are other forms of control, such as internal Government base control mechanisms as well as by specific budgetary offices.

A very limited role on the budget: crisis of Parliaments vis a vis the Budget (long before the “golden rules”): growing public spending made it very hard to actually control the budget (both its approval and the after-life); technicity over democracy

Also, the role of Parliaments is severely limited due to other circumstances (Soft law; legislating by Royal Decree There were 29 Royal Decrees in 2012, 17 in 2013 and so far, in 2014, 9).

## ii) So...are Parliamentary powers more limited than before?

Yes and no

There are 2 different issues that are too often mixed up:

- Deficit and debt rules as they apply to the budgetary documents
- What those rules imply for the economic policies of Member States (the famous budgetary cuts, tax increase, etc.); in other words, what is done “*in the name of...*”
- Restriction of democracy...or widening of democracy (restrict spending to save future generations).
- Alternative narrative: democracy, but only for the German Parliament?

German Constitutional Court Opinion of 18 March 2014 [BVerfG, 2 BvR 1390/12]<sup>42</sup>, (par. 169):

“a constitutional commitment on the part of the Parliaments and thus a palpable restriction of their budgetary power to act may be necessary precisely in order to preserve the democratic power to shape affairs in the long term (cf. BVerfGE 129, 124 <170>). Even if such a commitment restricts democratic legislative discretion in the present, it guarantees it for the future. Admittedly, even a worrisome long-term development of the level of debt is not a constitutionally relevant impairment of the legislature’s power to decide on fiscal policy at its discretion, and dependent on the situation. Nevertheless, this results in a *de facto* constriction of discretion (cf. BVerfGE 119, 96 <147>). To avoid such a constriction is a legitimate aim of the (constitutional) legislature (BVerfGE 132, 195 <245>, n. 120)”.

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<sup>42</sup> See English version:

[http://www.bverfg.de/entscheidungen/rs20140318\\_2bvr139012en.html](http://www.bverfg.de/entscheidungen/rs20140318_2bvr139012en.html) (accessed 19.3.2014)

**iii) In short: it is all about the continent, nothing about the content (coordinating budgets and ignoring the revenue/spending logic).**

The budgetary stability legal framework does not directly refer to public spending but rather to the final macro result of the budget (deficit or surplus).

And yet it has been on public spending that the (public) debate has been mostly focused. This is not new as it is quite common to confuse public spending with budgetary procedures and techniques. Simply put, the current legal framework has all to do with the second, and virtually nothing with the former.

How budgets are approved, controlled and how the public purse is allocated has been the major focus of the stability framework and most of the public debate. But budgetary stability, at least in the long run, cannot be achieved by adopting such a myopic view and leaving aside the revenue side (taxes and other public resources), as well as leaving aside the fundamental elements of public spending.

It follows that budgetary stability does not entail austerity or the limitation of Parliaments' budgetary powers. That is, unless it is monolithically identified with a one sided economic wisdom<sup>43</sup>.

Content, however, matters more (banking supervision model, tax harmonization model, etc.)

#### **IV. Are Member States Constitutional reforms “paper tigers”?**

The rationale behind urging Member States to adopt constitutional or otherwise binding rules was for them to internalize the stability rules. Member States must have “skin in the game”; internalize the stability culture.

The effect being that such rules will no longer be regarded as outside rules.

Not compulsory; Member States do not need to change their constitutional rules. So far, four members of the Eurozone have done so (Germany, Slovenia, Spain and Italy)<sup>44</sup>.

The first European Member States to adopt such a constitutional provision was Poland, which limited public debt to 60 per cent, inserting an early warning requirement to adopt special actions when the limit hit 60 per cent. Hungary adopted a similar system, granting special supervisory powers to its Constitutional Court.

In the Eurozone, after Germany, Spain was also one of the early adopters (for specific reasons: bond yield hitting 10%). On September 27<sup>th</sup> 2011 article 135 of the Constitution was amended for the purpose of introducing deficit and debt rules. The provision is further developed in Organic Law 2/2012 (*Law on Budgetary Stability and Financial Sustainability*)<sup>45</sup>.

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<sup>43</sup> HERDEGEN, M. J.: “Price Stability and Budgetary Restraints in the Economic and Monetary Union: The Law as Guardian of Economic Wisdom”. *Common Market Law Review*, vol. 35, n. 1/1998, pp. 9 et seq.

<sup>44</sup> FABRINI (2013 and 2014)

CUENCA, Alain; RUIZ ALMENDRAL, Violeta, “Budgetary stability in the autonomous regions: Beyond constitutional reform”. *Spanish Economic and Financial Outlook*, vol. 3, n. 4 (July 2014).

<sup>45</sup> See RUIZ ALMENDRAL, Violeta, *The Spanish Legal Framework for Curbing the Public Debt and the Deficit* (January 1, 2014). *European Constitutional Law Review*, 9: 189–204, 2013. Available at SSRN: <http://ssrn.com/abstract=2412010>

The actual consequences of the constitutional reforms will depend however on the previous culture<sup>46</sup>.

## V. A new Constitution? (Is the legal system imperfect, unfinished or impossible?)

The new legal framework has had different institutional consequences. From the model of Economic governance, to the transformation, or “enriching” of the existing institutional framework related to the budgetary process.

It has been argued that the current budgetary stability legal framework means the “Europeanization of German preferences in macroeconomic and fiscal matters”, or even the “Germanization of the governance of the euro”<sup>47</sup>. This is clearly the case if we compare the content of art. 115 and the debt brake mechanism (see Eva CORDERO). It has also been argued that such a model entails an implicit constitutional transformation (mutation) in that it limits the development of the “social constitution”, that is, the financing of the welfare state. Finally, the current system would explicitly limit parliamentary powers<sup>48</sup>, as well as implicitly by increasingly assigning responsibilities to agencies<sup>49</sup>.

The most tangible consequence is the establishment of strict threshold as well as mechanism for its correction. A look at the different levels of compliance, and its comparison with the historical (un)compliance undermines the credibility of the rules. Rules impossible to comply with end up being ignored.

- An imperfect constitution (no revenue side, no banking supervision system; (Wyplosz 2013), substantial elements are absent:

- No economic union

- divorce *contra natura*
- still no skin in the game?
- Myopic view?

- Not enough debate on the cost of rights (what to finance, how to finance it)

All rights cost money (positive, negative, and systematic; ie, bail-outs)

First generation rights cost as much as second generation rights. There is a welfare state, but there is also a “corporate welfare state”.

Austerity means nothing by itself;

- the role of automatic stabilizers (unemployment payments, income taxes)

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<sup>46</sup> 15 October 2014; the first report of the newly minted Autoridad Independiente de Responsabilidad Fiscal exposes the consequences of not having a credible fiscal stability culture; the presented budgets, analyzed by this institution, are incomplete and difficult to assess (see p. 15 et seq. of the “*Informe sobre los Proyectos y Líneas Fundamentales de los Presupuestos de las Administraciones Públicas*”, available only in Spanish, here:

<http://www.airef.es/es/contenidos/informes/66-informe-sobre-los-presupuestos-de-las-administraciones-publicas>

<sup>47</sup> Carlos CLOSA, “The Transformation of Macroeconomic and Fiscal Governance in the EU”, at Serge Champeau; Carlos Closa; Daniel Innerarity and Miguel Poiars Maduro (Eds) *The Future of Europe Democracy, Legitimacy and Justice After the Euro Crisis*. Forthcoming (november 2014).

<sup>48</sup> FASONE; CLOSA, Carlos

<sup>49</sup> “ ‘agency-itis’ in the model of governance”, as CLOSA puts it (cit).

- budget cuts are meaningless per se (zero budgeting is not however)
- unexplored possibilities to benchmark budgeting techniques
- No assessment of revenue problems; no European BEPS initiative.
  - It is hard to establish taxes (politically), and even once establish it is hard(er) to obtain revenue from them
  - Increase of public spending is not a problem by itself. The lack of assessment is.
    - Vast differences
    - A boom in borrowing after the 70s after the financing schemes
    - A boom of progressivity taxes after the 70s, high tax avoidance and off shore finance
    - It was politically easier to borrow than to increase taxes. This created an intergenerational equity problem that had to be address (i.e. see climate change)
- Still outside rule, no real incentives
  - No effective control over economic policy; no control over substance, so we control the form (budget elaboration; the numbers).
  - No real incentives to comply with the rules
  - And Member States did not really “own” the rule (it was an external rule. A rule imposed by “Europe”)
  - With the financial crisis a process that was more for Governments (controlling debt/deficit) has now entered Parliaments. Maybe giving them back part of the power that had already been lost.
  - If you look at the legal framework before the Six Pack & co., this was a Commission/Council thing
- But, elements for a better Constitution/debate
  - The legal framework may be better designed
  - Governments are limited: spending, sanctions
    - There are now political sanctions that were not there before
    - Control of spending
    - Peer reviewed numbers
    - It is part of the debate now, it was not before!
  - Parliaments now have more participation in the budget: Phase zero

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<sup>1</sup> Spanish Constitution, official translation.