



WORKING PAPERS

LAW 2015/12
Department of Law

A Myopic Economic Constitution?
Controlling the Debt and the Deficit without Fiscal
Integration

Violeta Ruiz Almendral

European University Institute
Department of Law

**A MYOPIC ECONOMIC CONSTITUTION?
CONTROLLING THE DEBT AND THE DEFICIT WITHOUT FISCAL
INTEGRATION**

Violeta Ruiz Almendral

EUI Working Paper **LAW** 2015/12

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ISSN 1725-6739

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Printed in Italy
European University Institute
Badia Fiesolana
I-50014 San Domenico di Fiesole (FI)
Italy
www.eui.eu
cadmus.eui.eu

Constitutional Change through Euro-Crisis Law

This paper was first delivered at a conference held at the European University Institute in October 2014 presenting some initial results of the project on Constitutional Change through Euro Crisis Law. This project is a study of the impact of Euro Crisis Law (by which is meant the legal instruments adopted at European or international level in reaction to the Eurozone crisis) on the national legal and constitutional structures of the 28 Member States of the European Union with the aim of investigating the impact of Euro Crisis law on the constitutional balance of powers and the protection of fundamental and social rights at national level. An open-access research tool (eurocrisislaw.eui.eu) has been created, based on a set of reports for each Member State, that constitutes an excellent resource for further, especially comparative, studies of the legal status and implementation of Euro Crisis law at national level, the interactions between national legal systems and Euro Crisis law and the constitutional challenges that have been faced. The project is based at the EUI Law Department and is funded by the EUI Research Council (2013-2015).

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Abstract

This paper assesses the actual implications that the current budgetary supervision legal framework (both in the EU Law and Member States) has had on the Economic Constitution. Although there are tangible implications for all EU Member States, and the EU as a whole, in this paper I will mainly focus in the Euro Area, where budgetary discipline rules have greater consequences. Budgetary discipline rules do not automatically entail austerity measures or undermine the powers of Parliaments, at least in theory. They have however probably had a crowding-out effect for the construction of a (real) economic union, in that measures to construct fiscal capacity and tax integration to discuss public spending or to attain a real banking union (to name just a few) have been watered down if not abandoned outright.

Keywords

Economic constitution, Budgetary stability, budgetary supervision, monetary union, public debt, cost of rights

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Introduction¹

The underlying logic of reinforcing budgetary supervision is that closed coordination of this sort is necessary in the absence of a real economic (political) and monetary union. In the long term, agreeing on a given set of fiscal rules is regarded as a fundamental building block of an economic union.

The rationale is relatively straightforward: in monetary unions there must be stronger budgetary discipline than in the absence of such an union, partly because there may be moral hazard issues, in the sense that governments may feel protected by the rest of the union and incur in higher debt than otherwise, or be it because member states “fish from the same pool of financial capital”².

The idea of introducing budgetary supervision or discipline rules is part of a larger world trend however, as a recent IMF report shows³. In the European Union, fiscal constraints have been first linked to the adoption of the common currency and, since 2010, to the bail-out mechanisms set up in the wake of the financial crisis.

Of course this does not automatically predetermine a given model of budgetary discipline, or even the mere existence of written and well detailed fiscal rules, as the comparative examples show (neither Canada nor the United States have a centralized system to ensure budgetary discipline).

In the last five years (2010-2014) there has been, at least formally, a partial transformation in the Economic and Monetary Union and, as a result, of the very Economic Constitution in the European Union. Most of this transformation has implied building up the Constitution in a disorderly progression, seemly without a plan and partly through the back door of financial assistance to some EU Member States. An Economic Constitution by instalments.

The development of the financial and subsequent economic crisis in 2007-2009 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, which clearly do mirror the German’s idea of stability and frugality (in the form of austerity even), undermine powers of Parliaments vis à vis the budget, may curb growth and substantially change the economic constitution, endangering the very survival of what is left of the European welfare system. In this regard, there is a very powerful and widespread narrative, according to which the new economic governance and specifically the “budgetary discipline rules” have transformed the European social model, as they are deemed directly responsible for budgetary cuts (“austericide” measures), for limiting democratic leeway for Parliaments and overall for helping or making more visible the north/south, indebted/debt free, divide.

This persuasive narrative is not new but is currently more widespread. There is of course truth in this general explanation of budgetary rules, but it leaves out the lion’s share of the fundamental problems that the stability legal framework presents. By focusing on the harm inflicted by *austericide* policies, this narrative minimizes the arguments for balancing budgets (not necessarily in a centralized manner) and may to a certain extent actually misunderstand what the current rules actually entail, by confusing their mandatory provisions to the actual policy decisions undertaken “in the name of” such provisions.

Furthermore, 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. Austerity may have slowed or stopped the implementation of substantial reforms, just as focusing on budgetary limits has crowded

¹ Comments are welcome (violetaruizalmendral@gmail.com)

² See on the basic models, P. De Grauwe, *Economics of Monetary Union*. Oxford University Press, 2012, pp. 218 et seq.

³ Tidiane KINDA, Christina KOLERUS, Priscilla MUTHOORA, and Anke WEBER, IMF Working Paper, “Fiscal Rules at a Glance”, October 2013. The report includes four types of rules: budget balance rules, debt rules, expenditure rules, and revenue rules. It is accompanied by a electronic database:

<http://www.imf.org/external/datamapper/FiscalRules/map/map.htm>

out further economic integration in the EU. Overall, budgetary discipline rules should not necessarily entail austerity measures or undermine the powers of Parliaments, at least in theory. They have however probably had a crowding-out effect for the construction of a (real) economic union, in that measures to construct fiscal capacity and tax integration (see the CCCTB project, currently on hold)⁴, to discuss public spending or to attain a real banking union (to name just a few) have been watered down if not abandoned outright.

The process is still unfinished and it is thus too early to fully assess its implications. However, even at this point it is doubtful that the changes in economic governance, albeit substantial, have actually implied a mutation of the Constitution, as some commentators have argued. Somewhat paradoxically, the changes may be precluding real fiscal integration. In this regard, my objective in this paper is to assess the actual implications that the current legal framework (both in the EU Law and Member States) has had on the Economic Constitution. Although there are tangible implications for all EU Member States, and the EU as a whole, in this paper I will mainly focus in the Euro Area, where budgetary discipline rules have greater consequences.

The current fiscal consolidation legal framework (insufficient or myopic?)

The unique experiment of uniting monetary policy without sufficiently coordinating economic policy needed a clear warrant that the Union would save its currency whatever it took, 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.

This link between budgetary rules and the credibility of the currency is biased, and it has evidently permeated the Member States' internal debates; thus for example, the reform of Article 135 of the Spanish Constitution or of Austria's Stability pact of 2012 was fundamentally motivated by a need to reassure financial markets⁵.

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 others the European Council Madrid meeting of December 1995. The 1997 Stability Pact (Protocol n. 12 on the excessive deficit procedure) and the two Council Regulations⁶ 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" then became 3 per cent of deficit and 60 per cent of public debt, a strict threshold whose rationale has been repeatedly criticized, 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

⁴ The Common Consolidated Corporate Tax Base (CCCTB) Commission project has been on stand-by since January 2013. According to some news sources, the recent "Lux leaks" scandal may spur further movement on the tax harmonization of the Corporation Income Tax, probably together with or in the framework of adopting measures to curb "Base erosion and profit sharing" (see BEPS project, at the OECD.org, as well as an outline of the Commissions' initiative thus far:

<http://taxinstitute.ie/TaxPolicyandPractice/RevenuePracticeandRepresentations/EUandInternationalTaxPolicy/EUActionPlan.aspx>

⁵ In the case of Austria, the motivation was not to lose the triple "A" rating on its debt. In the case of Spain the situation was much more dire with bond yields eventually hitting close to 10 per cent in 2012.

⁶ 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).

Courts Maastricht Opinion, the Waigel Plan⁷ 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 policy⁸. It also had a lot to do with the particular institutional architecture of stability price supervision, and the mono-mandate of the European Central Bank⁹.

The current legal framework has been substantially transformed after the crisis, and in direct relation to the assistance programmes. Assistance and oversight are two sides of the same coin of budgetary governance, in that the former has reinforced the second; they are, as has been pointed out, “joined at the hip”¹⁰.

I will leave out the specifics of the assistance programs put in place¹¹, as well as the substantial reform of the legal framework governing financial institutions¹².

As has been repeatedly pointed out, the current framework is a myriad of normative instruments, including the relative novelty of an international treaty that actually rests on European Union institutions. There are currently 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 Law¹³.

⁷ “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.

⁸ 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.; See also, by F. SNYDER: “EMU –integration and differentiation: metaphor for European Union”, at *The evolution of EU Law*. Oxford: Oxford University Press, 2011, pp. 690 et seq. STRATH, B.: “The Monetary issue and European Economic Policy in historical perspective”, at 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.

⁹ 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 Specialized 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?”, at BREUSS, F.; FINK, G.; GRILLER, S. (Eds.): *Institutional, Legal and Economic Aspects of EMU*. Vienna/Nueva York: Springer, 2003, pp. 5 et seq.

¹⁰ CRAIG, Paul. “Economic Governance and the Euro Crisis: Constitutional Architecture and Constitutional Implications”. at ADAMS, Maurice; FABBRINI, Federico and LAROUCHE, Pierre (Eds.). *The Constitutionalization of European Budget constraints*. Hart Publishing, 2014, p. 23.

¹¹ On the financial assistance mechanisms: A. DE GREGORIO MERINO, “Legal developments in the economic and monetary union during the debt crisis: the mechanisms of Financial Assistance”. *Common Market Law Review* (2012), p. 1613, at p. 1615. CRAIG, P. “Economic Governance and the Euro Crisis: Constitutional Architecture and Constitutional Implications”, at ADAMS, Maurice; FABBRINI, Federico and LAROUCHE, Pierre (Eds.). *The Constitutionalization of European Budget constraints*. Hart Publishing, 2014, pp. 19 et seq.

¹² Specifically on securitization regulatory changes see: RAMOS MUÑOZ, David, *Living on the Edge: Securitization Supervision and Characterization Problems* (October 1, 2009). EUROPEAN COMPANY LAW, 2009, VOLUME 6, ISSUE 5. Available at SSRN: <http://ssrn.com/abstract=2397167>

¹³ See DE WITTE, B.: “Using International Law in the Euro Crisis. Causes and Consequences”. ARENA Working Paper, 4/June 2013, in particular pp. 22 et seq, on the implications of the system. The author argues, in response to K. Tuori’s submission that the institutional designs of the rescue mechanism are hard to control democratically, that “when the Euro area countries wanted to set up a major rescue fund in order to preserve the stability of the euro area (a decision which, itself, seems very reasonable), EU law did not provide them with sufficient legal and financial resources, so that “going outside” and setting up a separate international organisation was the only available solution” (p. 22).

Legal instruments to establish financing (bail-out) mechanisms [the European Financial Stability Facility (EFSF) and the European Financial Stability Mechanism (EFSM)] are thus intertwined with the fiscal consolidation legal framework (article 126 of the TFEU, one Directive, and seven Regulations - the Six Pack, and Two Pack).

In 2011, the Stability and Growth Pact, regulated in the 1997 Protocol and two Rulings¹⁴ was modified and enhanced by way of the “Six Pack”, five Regulations and a Directive adopted on November 2011. In 2013 two further Regulations were adopted (the “Two Pack”).

Among other things, the system entails the following:

First, there has been a substantial rearming of the SGP, at least from a formal perspective, as there are more control procedures and more elements under control.

Specifically, the SGP has been reinforced by Regulation No 1175/2011 of the European Parliament amending Council Regulation (EC) No 1466/97 on the strengthening of the surveillance of budgetary positions and the surveillance and coordination of economic policies; thus, Regulation 1466/97, as updated, establishes the “European Semester”, defined as a “framework” for “economic policy coordination”. Regulation 1177/2011 amending Regulation (EC) No 1467/97 on speeding up and clarifying the implementation of the excessive deficit procedure, also enhances coordination by means of including the European Parliament (art 2a), as well as establishing new communication avenues to ensure a permanent coordination process (i.e., “permanent dialogue”, article 10a).

Second, budgetary coordination, with the possibility of (further) sanctions, is set in Regulation 1173/2011 on the effective enforcement of budgetary surveillance in the euro area.

Regulation 1174/2011 on enforcement measures to correct excessive macroeconomic imbalances in the euro further strengthens the prevention phase by way of looking into the whole cycle. The Regulation establishes a sanction system specifically for failing to comply with the recommendations, or “corrective action recommended by the Council” directed at correcting said imbalances (Art. 5)

Council Directive 2011/85/EU of 8 Nov 2011 on requirements for budgetary frameworks of the Member States establishes the need for independent bodies or bodies endowed with functional autonomy that would ensure and monitor compliance country-specific numerical fiscal rules (the debt and deficit thresholds among other). The main aim of the Directive is to substantially coordinate budgetary frameworks, so that all Member States speak the same (budgetary) language.

Finally, the Two Pack further harmonizes surveillance of the whole budgetary process, which will be substantially more intense should the Member State be either experiencing or threatened with serious financial difficulties, as laid out in Regulation 472/2013 of the European Parliament and of the Council of 21 May 2013 on the strengthening of economic and budgetary surveillance of Member States in the euro area experiencing or threatened with serious difficulties with respect to their financial stability; for regular situations Regulation 473/2013 of the European Parliament and of the Council of 21 May 2013 on common provisions for monitoring and assessing draft budgetary plans and ensuring the correction of excessive deficit of the Member States in the euro area, establishes a common budgetary timeline (Art. 4) and intends, among other things, to prevent Member States from

(Contd.) _____

The paper can be retrieved at:

<http://www.sv.uio.no/arena/english/research/publications/arena-publications/workingpapers/working-papers2013/wp4-13.pdf>. Accessed 11.1.2015.

DE WITTE, B.: “The European Treaty Amendment for the Creation of a Financial Stability Mechanism”. Sieps, European Policy Analysis (2011: 6epa).

¹⁴ Council Regulations (EC) 1466/97 on the strengthening of the surveillance of budgetary positions and the surveillance and coordination of economic policies; and 1467/97 on speeding up and clarifying the implementation of the excessive deficit procedure.

adopting their budgets based on “biased and unrealistic macroeconomic and budgetary forecasts”, partially with the help of “Independent bodies monitoring compliance with fiscal rules” (Art. 5).

The Six Pack, Fiscal Treaty and Two Pack form a set of layers of fiscal surveillance. The system works in parallel with direct connections to the bail-out mechanism. As a result, the 1997 Stability and Growth Pact is now a full-fledged budgetary and economic policy coordination system that no longer merely focuses on the end result of Member States budgets (public debt and deficit figures) but rather encompasses the full budgetary cycle as well as (increasingly) the economic policy.

The basis of the system: numeric deficit and debt thresholds

Now, as before, general government deficit may not exceed 3 per cent of Gross Domestic Product (GDP), while public debt must not exceed 60 per cent of GDP or be in a diminishing path. These figures are debatable and have been questioned since the first SGP¹⁵, in that regard the current framework has been improved in that it pays substantially more attention to the overall sustainability position of the Member States’ finances by means of the structural deficit.

The 3 and 60 per cent threshold are still in place but by paying attention to the overall economic cycle Member States should try to attain surpluses in good times, and save the deficit for downturns.

This was introduced in 2005, by reinforcing the so-called preventive arm, by way of setting medium term objectives.

From a purely legal perspective there is certainly room for improvement in some aspects of the design. For instance, there is no legal definition of how exactly the notion of “structural deficit” should be calculated. In fact the actual method of calculating it is obscure and has not been subject to public debate, which will prove problematic, especially if sanctions are imposed.

Preventing imbalances: fiscal surveillance

The traditional “preventive arm”, (including the “country-specific medium-term objective) remains in place with the following tweaks:

First, there is now a quantitative definition of what exactly will be considered a “significant deviation” of the country-specific medium-term objective (“MTO”).

Second, this micromanaging of the consolidation path is completed with the existing medium-term budgetary frameworks (or “MTBFs”), which is part of the budgetary coordination and basically obliges the country to place its budget in a multi-year context. The Commission has been monitoring the MTBFs with a set of questionnaires since 2006¹⁶.

This complex system entails a way of monitoring the budget that is largely only formal, not substantial. Specifically what the MTBFs analyse is the formal framing of budgetary decisions, not the decisions themselves. Thus, there is for instance no information on exactly how health spending (to name a substantial area of public spending in the EU) is allocated and distributed over time. The focus is (again) on the big numbers: budget balance, overall expenditure and its projection on different spending areas.

¹⁵ Early on see: EICHENGREEN, B.: “Should the Maastricht Treaty be Saved?” (Princeton studies in international finance no. 74), Princeton, NJ 1992; by the same author: “Institutions for Fiscal Stability”, 2-3 May, 2003. See also MAJONE, G.: *Dilemmas of European Integration. The Amiguities & Pitfalls of Integration by Stealth*. Oxford: Oxford University Press, 2005, p. 169; 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*. Viena/Nueva York: Springer, 2003, p. 111.

¹⁶ There is currently data available for the years 2006, 2008, 2009, 2010, 2011 and 2012; at:

http://ec.europa.eu/economy_finance/db_indicators/fiscal_governance/framework/index_en.htm (accessed 3.1.2015)

However, by forcing Member States to outline specifically how decisions are adopted in the construction of the budget and how MTBFs are allocated (what time-frame, etc.), or when they can be revised and how, the framework “prods” Member States to both provide information and (maybe) reflect on their own budgetary processes and possibly improve accountability.

See, for example, question 3.10:

“In terms of the revision of budgetary objectives/targets, please select which of the following applies:

- *The MTBF can be revised at any time*
- *The MTBF can be revised once per year*
- *The MTBF cannot be revised*
- *The government has to publicly justify why the budgetary objectives/targets are revised*
- *An independent fiscal institution has to be consulted/has to endorse any revision*
- *Other”*

By asking such specific questions the Member State are forced to provide an x-ray of the budgetary decision-making process, as well as to the core of the democratic quality of the process; for instance question 6.15 addresses media coverage of the Stability/Convergence Programme (SCP) in place, and its changes. Other questions refer to the coordination of the different surveillance/benchmark mechanisms in place, such as question 6.6.: *“How are the fiscal objectives specified in the SCP related to the fiscal targets established by the medium-term budgetary framework?”*

Overall, the legal framework is tilted towards prevention, by way of analysing two areas: general outcomes (deficit as a percentage of GDP, general spending areas and their percentage equivalences) and budgetary procedures. But the control is mostly formal: what the numbers are and what explains them, what the plans are and how they are planned (time-framed). There is virtually no coordination on basic spending and revenue decisions, which in practice substantially limits the actual impact that these Regulations actually have on the role of Member States when designing their budgets, as I argue below.

Fiscal correction

The “corrective arm”, also known as “excessive deficit procedure”, is reinforced following the existing rationale of strict thresholds. The sanctions have never been credible but the current framework introduces a new form of sanctions by linking compliance with the financial rescue mechanisms. In this regard, there is a whole new system of sanctions building upon and substantially expanding the traditional stability pact. Sanctions may be imposed in the prevention phase as well as in the correction phase.

Overall, the correction phase has a wider scope, as the debt criterion is now also taken into account for the eventual launching of an EDP. Also, sanctions are at least in theory easier to impose by way of the reverse qualified majority voting (RQMV) introduced in the Six Pack for most sanctions. As a consequence of the RQMV any recommendation by the Commission will be deemed adopted in the Council unless a qualified majority of Member States votes against it.

Regulation 1173/2011 on the effective enforcement of budgetary surveillance in the euro area establishes sanctions “for enhancing the enforcement of the preventive and corrective parts of the Stability and Growth Pact in the euro area”. Sanctions include not only infractions regarding the preventive and corrective phase (arts. 4 to 7), but also manipulation of statistics (Art. 8), done “intentionally or by serious negligence” with the result of misrepresenting deficit and debt data.

The eventual fines and interest paid would accrue to the EU budget and will, in principle, be assigned to the to the European Financial Stability Facility, unless Eurozone Member States decide to create

“another stability mechanism to provide financial assistance in order to safeguard the stability of the euro area as a whole”, in which case said revenue shall be assigned to that mechanism. The sanctioning procedure is directed by the Commission (which “shall fully respect the rights of defence of the Member State concerned during the investigations”, Art. 8.3, last par.) and is subject to review by the European Court of Justice (Art. 8.5).

A fundamental question still is whether sanctions actually work. It is too early to assess this although sanctions have never been imposed in the past. Of course in general sanctions are an attempt to make coordination credible, but they are a risky bet, for if sanctions are not credible themselves this substantially undermines the logic of the system. Even with reverse majority, sanctions are unlikely to be imposed and lack credibility, as has been often pointed out¹⁷.

Coordinating budgetary policies

One distinctive element of the current legal framework is the establishment of so-called “budgetary coordination procedure”, in the framework of the “European Semester”, actually established in 2010 but legally developed in the Six Pack, and substantially reinforced¹⁸ by the Two Pack, which entered into force in May 2013. For countries in a dire situation, the monitoring will be particularly intense, as laid out in Regulation 472/2013 of the European Parliament and of the Council of 21 May 2013 on the strengthening of economic and budgetary surveillance of Member States in the euro area experiencing or threatened with serious difficulties with respect to their financial stability. This specifically means that more information will need to be provided, and more recommendations will be received for the Member State to implement. In this scenario, the sovereignty of the Member State will be substantially limited, at least from a legal perspective. Economically of course, dire situations de facto undermine the actual sovereignty of the country, so the comparison terms should be chosen carefully.

Regulation 473/2013 of the European Parliament and of the Council of 21 May 2013 on common provisions for monitoring and assessing draft budgetary plans and ensuring the correction of excessive deficit of the Member States in the euro area is applicable to all.

The departing point of budgetary coordination is, of course, that “The Treaty on the Functioning of the European Union (TFEU) requires that Member States regard their economic policies as a matter of common concern, that their budgetary policies are guided by the need for sound public finances and that their economic policies do not risk jeopardising the proper functioning of economic and monetary union” [Whereas (1)].

This regulation sets common budgetary rules as a way to harmonize the process. It also deals specifically with the problem of unrealistic economic forecasts in the budget¹⁹. Moreover, the Regulation is game changing with regard to the very meaning of “national” budgets. In order to avoid spill-over effects Member States must consult “the Commission and each other before adopting any

¹⁷ IMF Staff [Céline Allard, Petya Koeva Brooks, John C. Bluedorn, Fabian Bornhorst, Katharine Christopherson, Franziska Ohnsorge, Tigran Poghosyan, and an IMF Staff Team] discussion note “Toward a Fiscal Union for the Euro Area”, p 11 (available on their site).

¹⁸ According to the explanatory in the Commission website:

(http://ec.europa.eu/economy_finance/economic_governance/sgp/convergence/index_en.htm, accessed 16.12.2014)

¹⁹ Council Regulation (EU) No. 473/2013 of the European Parliament and of the Council of 21 May 2013 on common provisions for monitoring and assessing draft budgetary plans and ensuring the correction of excessive deficit of the Member States in the euro area, para. 10: “Biased and unrealistic macroeconomic and budgetary forecasts can considerably hamper the effectiveness of budgetary planning and, consequently, impair commitment to budgetary discipline. Unbiased and realistic macroeconomic forecasts can be provided by independent bodies or bodies endowed with functional autonomy vis-à-vis the budgetary authorities of a Member State and which are underpinned by national legal provisions ensuring a high degree of functional autonomy and accountability. Such forecasts should be used throughout the budgetary procedure”.

major fiscal policy reform plans with potential spill-over effects”, allowing assessment of the possible impact that such a reform may have.

The Regulation does not provide examples but the general terms in which it is explained practically allows for any major policy change to need to be consulted. It establishes, because budgetary plans are to be “of common concern”, that they must be submitted to the Commission “for monitoring purposes” before they are sent to Parliament, following the procedure set out in article 7. This submission may have consequences, for should the Commission identify “particularly serious non-compliance with the budgetary policy obligations laid down in the SGP”, it will request a revised draft of the budgetary plan, in particular “where the implementation of the draft budgetary plan would put at risk the financial stability of the Member State concerned or risk jeopardising the proper functioning of the economic and monetary union, or where the implementation of the draft budgetary plan would entail an obvious significant violation of the recommendations adopted by the Council under the SGP”. The Commission’s opinion on the plan must be adopted in November at the latest. The National Parliament is then given an opportunity to request that the Commission presents its opinion directly in the Chamber, once such opinion has been made public (Art. 7.3).

In this regard, the game change is primarily directed to the Executive power. It can be argued that, in a way, the Regulation may actually strengthen the role of National Parliament, at least not in comparison with their ideal role but with the actual role in the context of complicated documents that are difficult to fully discuss.

Finally, the partnership programme outlined in article 9 is designed to help bring forward “structural reforms necessary to ensure an effective and durable correction of the EDP”. Should the Member State be part of an EDP the reporting requirements will be of much greater scope (Art. 10), which basically consists of substantially enhanced reporting obligations, outlining all the different elements of the budget.

The current legal framework has been self-evaluated in the Commission reports of February and November 2014. The evaluation does not provide much information on the actual functioning of the system, which is consistent with the fact that it is quite new.

The Commission’s own assessment is mildly optimistic despite the fact that most of the Regulation has so far not been applied:

- “The Commission is of the opinion that Regulation (EU) No 472/2013 has so far proven an adequate framework for a strengthened monitoring and surveillance of the euro-area Member States experiencing or threatened with serious difficulties with respect to their financial stability”²⁰.
- “However, as explained in this Communication, the short timeframe during which this Regulation has been in force provides limited evidence on which to base this evaluation. Enhanced surveillance, for example, remains to be tested, but the Regulation establishes a framework which should enable closer monitoring of euro-area Member States either threatened with, or experiencing, financial difficulties. Post-programme surveillance also remains to be tested.”²¹

It is too soon to determine the real effect that the Two Pack has had on how national budgets are designed. However, given the actual regulation, the impact is, again, mostly formal. The Two Pack addresses how the information, the budgetary decisions, has to be reflected on the budget.

²⁰ European Commission. “Communication from the Commission to the European Parliament and the Council on the application of Regulation (EU) No 472/2013”. COM (2014) 61 final, 6.2.2014, p. 7.

²¹ European Commission. “Communication from the Commission to the European Parliament and the Council on the application of Regulation (EU) No 472/2013”. COM(2014) 61 final, 6.2.2014, p. 7.

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)²². 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. The revenue side (taxes and other public resources), as well as the fundamental elements of public spending cannot be a mere side-effect of fiscal restraints but the departing point.

In a nutshell: what the legal framework entails (and what it does not)

The original sin, or structural design failure, of the 1997 legal framework was that fiscal rules were established without real economic coordination. The failure of the current system is the logic-defying link established between budgetary constraints or fiscal rules, bail-out mechanisms and the sovereign debt market situation.

The need for some form of budgetary discipline (with this model or another) in a monetary union may seem self-evident, at least in theory. But so is the fact that looseness of fiscal policy did not cause the sovereign debt crisis²³.

Furthermore, the very design of the monetary union, and in practice the process by which member states have lost their stabilizers, namely, the Central Bank's roles as lender of last resort, has very likely aggravated the crisis, with a solvency crisis which was followed by austerity policies that in turn further worsened the situation²⁴. To exclude this element from the equation makes the whole construction dangerously myopic.

In this regard, democratic deficit has been often named as the main structural problem with the current supervision/prevention legal framework²⁵. However, the system is not that different from the existing one, at least in its logic, which can be argued that it was faulty before and it is now. The general idea is that Member States are still free to design their budgetary processes, and fundamentally, to tax and to spend, but they do need to convey structured detailed information on the process.

In a way, the current system is more flexible, or realistic. Rather than examining rote compliance with the 3-60 thresholds, the new legal system intends to control the process, including the possible danger zones (prevention phases). This is a formalization of the existing loose Commission recommendations,

²² 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.

²³ See a critic at Paul DE GRAUWE, Yuemei JI, "How much fiscal discipline in a monetary union?". Special Conference paper, May 23-24, 2013 (available here:

www.bankofgreece.gr/BogEkdoseis/SCP201321.pdf). The author makes an exception for Greece.

²⁴ Paul DE GRAUWE explains how "we found out that financial markets acquire great power in a monetary union: they can force countries into a bad equilibrium characterized by increasing interest rates that trigger excessive austerity measures, which in turn lead to a deflationary spiral that aggravates the fiscal crisis. Countries pushed into such a bad equilibrium now face long periods of economic recession that will test the political and social acceptability of a monetary system that had been presented as heaven but is now perceived to be a hell for millions of people". DE GRAUWE, Paul, "Design Failures in the Eurozone - can they be fixed?", European Commission, Economic Papers 491 | April 2013, p. 9.

²⁵ Paul De Grauwe has harshly criticized the Two Pack and spoken of "the danger of a new governance of the budgetary process that decides top down on budgetary manners without clearly defining the political responsibilities for these decisions". DE GRAUWE, P.: "Design Failures in the Eurozone - can they be fixed?", European Commission, Economic Papers 491, April 2013, p. 25.

which will now adopt different forms (macroeconomic imbalances reports, different shades of early warning system).

The process (or rather, the cycle) 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:

Budgetary cycle	
Phase	Participating institutions
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) Commission/Council (end results). European Court of Justice
5. Controlling the results	Deficit/debt: - Commission/Council - ECJ

According to an oft repeated rant against the legal framework, it would undermine the principle of “no taxation without representation”, or rather; misalign the decision to tax and to spend, in the sense that the Commission may eventually force spending cuts or the raising of taxes without bearing its political costs²⁶. This is however only true in the bail-out procedures, which at the same time do leave some leeway for adjustment.

²⁶ “However, the moves towards political unification should not come at the cost of a loss of democratic legitimacy. I have argued that this is the case with the recent introduction of the “two-pack” legislation. The latter transfers considerable power to the Commission without this power being checked by political control. The European Commission, which now obtains de facto power to force national governments to impose additional taxes or to cut spending, escapes the political accountability for these decisions. Such a model of integration should be rejected now. If not, it will lead to great conflicts in the future and a slow but steady further erosion of the willingness of the European populations to move forward into a political union.” DE GRAUWE, Paul, “Design Failures in the Eurozone - can they be fixed?”, op.cit. pp. 29-30.

This general outline of the current legal framework does pose different legal issues²⁷.

First, there is no legal definition on how structural deficit is to be defined. This is problematic as the numerical value of such deficit has direct and clear consequences, which can ultimately entail the imposition of sanctions, possibly without sufficient legal certainty²⁸.

Second, there is also some doubt as to what the “contracts” or Memorandum of Understanding signed by Member States recipients of financial assistance actually are. The contracts are envisaged in art. 13 of the ESM and are formally a possibility under the Lisbon Treaty, but some of the recommendations nonetheless pose doubts as to their legal anchorage.

Finally, there is much to be said about the legal technique employed, consisting of approving a set of different Regulations (a total of seven) with cross referencing among them which, even excluding their complicated relation with the Fiscal Treaty and the Directive, makes it very difficult to have a general idea of what the current legal framework entails and what the general principles are. Without principles, a theological and systematic interpretation of their provision is made harder.

The need for fiscal “discipline”, “surveillance” or the adoption of “automatic” measures and correction paths derives from the legal framework in a very obvious way. The patched-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. But the enhanced permanent supervision adds significant complexity to the budgetary cycle. It also gives the impression of an automatic process, of complicated machinery where every step of building the budget is (formally) monitored.

This sense of control is misleading. There is only external control, albeit substantially centralized²⁹. But the content of the budget is left unsupervised, except for the general recommendations provided by the Commission (bailed out/non-bailed out countries). This by itself may create perverse incentives: the feeling of control fosters moral hazard. Because the budget cycle is being monitored externally, there may seem no need to internally monitor it, for instance by substantially revising the expenditure/revenue structure of the country. As long as a Member State is complying, or in the process of complying with the external framework, there will be less pressure to fully revise its spending structure, which is problematic in particular in the European Union.³⁰

From a purely psychological perspective the abuse of terms that convey a sense of control reveals the intrinsic difficulty of actually coordinating Member States budgetary policies.

Another question of course is whether budgets in the EU can actually be harmonized. The short answer is no, so that budgetary coordination cannot be anything more than large-numbers coordination or general frameworks coordination (time-frames, and such), but without real internal coordination. This is of course reasonable as that type of coordination would not be feasible even in a more integrated Union, which would in any event be some form of Federation, which means Member States would keep at least the budgetary powers currently held by federal States. In the words of Paul De Grauwe “the euro is a currency without a country. To make the euro sustainable a country will have to

²⁷ See CRAIG, Paul. “Economic Governance and the Euro Crisis: Constitutional Architecture and Constitutional Implications”, p. 26.

²⁸ The method has been recently amended; see G. MOURRE, G. ISBASOIU, D. PATERNOSTER and M. SALTO: “The cyclically-adjusted budget balance used in the EU fiscal framework: an update”. *Economic Papers* 478 | March 2013.

²⁹ FABBRINI, F.: “The Fiscal Compact, the ‘Golden Rule’ and the Paradox of European Federalism.” *Boston College International & Comparative Law Review* 36 (2013).

³⁰ In particular due to the looming demographic crisis the cost of Health care and Public pensions would need to be substantially overhauled (see a summary at: <http://www.economist.com/node/3243014>; see also the 2013 Annual Growth Survey and the Commissions recommendations).

be created”³¹. Ultimately, the fundamental design failure remains the same as in the first set of fiscal rules: the impossibility of enforcing budgetary coordination in the absence of political integration. The system is also inefficiently centralized, as C. WYPLOSZ has very rightly pointed out³².

In hindsight, it can be argued again, and indeed often has, that leapfrogging to a fully-fledged coordination of the budgetary frameworks was too fast, reckless even. The current “hybrid governance model”³³ was not part of the plan. Until 1985 Europe was 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 States³⁴. The Delors *White Paper on Completion of the Internal Market*³⁵ is a tipping point that will be reflected in the Maastricht treaty and consolidated, at least in part, through the monetary union³⁶. Of course the Maastricht Treaty only partly followed the Delors proposal, which also entailed a political union³⁷. The step towards monetary union was taken without fulfilling the necessary economic coordination prerequisites. Thus, the current and, 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 out³⁸.

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. 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-fits-all rules, so to speak, that in some cases may end up substituting policy initiatives³⁹. More worryingly, the legal framework is seemingly easy to comply with in the very short term by means of budgetary cuts that will then increase the public debt in the mid-term, as has already happened.

³¹ DE GRAUWE, Paul, “Design Failures in the Eurozone - can they be fixed?”, European Commission, Economic Papers 491, April 2013, p. 25.

³² WYPLOSZ, C. “Europe’s Quest for Fiscal Discipline”, Economic Papers 498, April 2013, p. 31.

³³ MAHER, I.: “Economic governance: hybridity, accountability and control”. *Columbia Journal of European Law*, vol. 13/2007, p. 682. See a critic at: 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. 322-323.

³⁴ See JOERGES, C.: “The Market without a State? The “Economic Constitution” of the European Community and the Rebirth of Regulatory Politics”. *European Integration Online Papers (EioP)*, Vol. 1, n. 019/1997.

³⁵ 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.

³⁶ 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.

³⁷ On the different proposals see: SNYDER, F.: “EMU Revisited: Are We Making a Constitution? What Constitution Are We Making?”, op.cit. pp. 421 et seq.

³⁸ 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. 322-323. SNYDER, F.: “EMU Revisited: Are We Making a Constitution? What Constitution Are We Making?”, at: AA.VV. (Eds.: CRAIG, P.; BÜRCA, G. De.): *The evolution of EU Law*. Oxford: Oxford University Press, 1999, pp. 434 et seq.

³⁹ JOERGES, C.: “What is Left of the European Economic Constitution? A Melancholic Eulogy...cit. pp. 14 et seq.

The introduction of fiscal constraints in Eurozone Member States' legal frameworks: appropriation of rules in substance or only in form?

This time is different for budgetary rules as well. 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.

At this point, only three years after the Fiscal Compact made it mandatory for Member States to establish their own budgetary discipline provisions, the only analysis that can be undertaken on national rules is purely descriptive. There is substantial information on which countries have adopted which rule, on what timeframe and with what after what type of public debate. There is also information (in the press) on what type of public debate, if any, has surrounded the adoption of the rules. Tellingly, the public debates seem similar; in the bailed-out countries, formal or informal budgetary rules were a pre-condition for help to be received. Overall, the debate focused mainly on austerity measures necessary to meet the deficit and debt thresholds.

But there is a further restriction for a full assessment of the constitutional or legal internal rules, which is their own legal set of concepts. A mere transplant of a debt brake into a legal system with no procedures or even tradition of assessing the budget will be nothing more than a rare exotic plant that may or may not take root in the legal environment to which it is transplanted. It quite evidently follows that the actual consequences of the constitutional reforms will depend on the existing culture⁴⁰, as migration of constitutional concepts does occur, but it is questionable whether forcing such migration in a centralized manner attains the same result.

This of course defeats the very rationale behind urging Member States to adopt constitutional or otherwise binding rules: that they internalize the stability rules. The idea is that Member States internalize the stability “culture”. The desired effect being that such rules will no longer be regarded as outside rules.

For that purpose, Member States do not need to change their constitutional rules, but do have to substantially change their system by introducing hard-to-reform rules (such as organic laws, whose approval requires an absolute majority). So far, however, four members of the Eurozone have modified their Constitutions: Italy, Spain, Slovakia, Germany and Slovenia⁴¹. In the case of Germany and Spain (which partially follows the German reform⁴²), the reforms took place before the Fiscal Compact required them to. Spain was then one of the early adopters, for well-known specific reasons, which is the substantial increase of the bond yields in the summer of 2011 (which actually paled in comparison with 2012 skyrocketing bond yields, *after* the reform). On September 27th 2011 Article 135 of the Constitution was amended for the purpose of introducing deficit and debt rules.

⁴⁰ 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>

⁴¹ See: FABBRINI, F.: “The Fiscal Compact, the ‘Golden Rule’ and the Paradox of European Federalism”, 2012, (SSRN: <http://ssrn.com/abstract=2096227>); later published at *Boston College International & Comparative Law Review* 36 (2013). CUENCA, Alain; RUIZ ALMENDRAL, V. “Budgetary stability in the autonomous regions: Beyond constitutional reform”. *Spanish Economic and Financial Outlook*, vol. 3, n. 4 (July 2014).

⁴² See CORDERO GONZÁLEZ, E.: “La reforma de la constitución financiera alemana en particular, el nuevo límite al endeudamiento de la federación y los *Länder*” [The reform of the financial Constitution in Germany], *Teoría y Realidad Constitucional*, n. 29, 2012, p. 289 at pp. 325-326.

The provision is further developed in Organic Law 2/2012 (Law on Budgetary Stability and Financial Sustainability)⁴³.

After that, 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.

For some EU Member States, the Six Pack/Two Pack legal framework has substantially altered the budgetary legal framework. For others, it has promoted a reform or further sophistication of an existing system. For some EU Member States, there already was a culture of controlling budgetary stability, be it by having already some form of debt and the deficit rule in the Constitution or because their legal system provided for it.

Austria⁴⁴ has a balanced budget rule (based on the German model), which was adopted in 2011. It has established a new budgetary framework, including the fixed spending limits for specific programmes or the adoption of the “output orientation” of the administration. The existing internal stability pact directly deals with the distribution of the burden (debt and deficit limits, between the centre and the subnational entities, which will entail a modification of the territorial financial system (Finanzausgleichsgesetz). This internal pact was not legally binding but in practice forced Länder to comply with it or be punished by losing part of the revenue from shared taxes. The Austrian Constitutional Court ruled on the constitutionality of the TSCG on October 3, 2013. Belgium already had a constitutional provision for regions, while Cyprus, on the other hand, had neither fiscal rules, binding medium-term budgetary framework (MTBF), or any type of fiscal council. Estonia has adopted a new budget law, as of 2014. France has also adopted its own rule. Germany has an extensive experience with fiscal constraints, having introduced a form of legal rule in 1967⁴⁵. Currently the German rule is embedded in article 109⁴⁶, and as is well known, it has served as a blueprint for the Fiscal Compact. Germany’s regions (Länder) are not allowed to run a deficit after 2020. One salient element of Germany’s model is the creation, directly in the Constitution, of a Stability Council. Italy modified, through Constitutional Law 1/2012, articles 81, 97, 117 and 119. Article 119 specifically provides a no bail out for the regions. The 1/2012 Law also creates a Fiscal Council. In Italy the harmonization of public budgets is now an exclusive competence of the centre (Article 117). Portugal enacted an organic law (*Budgetary Framework Law*)

What have these reforms achieved?

General deficit has improved while debt has substantially increased, as it is normal after a recession. But causality should not be mistaken with correlation. The situation may or may not have been improved because of the adjustment paths adopted (i.e., austerity measures) and budgetary discipline rules.

⁴³ See RUIZ ALMENDRAL, V., 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>. See a comparison of the ‘golden rule’ in different EU Constitutions at: F. Fabbrini, ‘The Fiscal Compact, the ‘Golden Rule’ and the Paradox of European Federalism’, (SSRN: <http://ssrn.com/abstract=2096227>).

⁴⁴ I follow the report by Daniela Jaros (eurocrisislaw.eu.eu/austria).

⁴⁵ Gesetz zur Förderung der Stabilität und des Wachstums der Wirtschaft, June 1967, codified then in Art. 115 of the German Constitution.

⁴⁶ See Federal Ministry of Finance, Economics Department: “Reforming the constitutional Budget rules in Germany”. September 2009

(at:

http://www.google.es/url?sa=t&rct=j&q=&esrc=s&source=web&cd=1&cad=rja&uact=8&ved=0CCIQFjAA&url=http%3A%2F%2Fwww.kas.de%2Fwf%2Fdoc%2Fkas_21127-1522-4-30.pdf%3F101116013053&ei=7DcRVYiNN8PTUfuzgtAO&usq=AFQjCNF0hGQUWfON6AL5EZN85jx09ZGbWA&sig2=nyY-Y2JPCbYpq0xECEhA&bvm=bv.89184060,d.d24, accessed: 23. March 2015).

There are currently a total of eleven countries with on-going excessive deficit procedures, of which eight are Eurozone members:

Overview of ongoing excessive deficit procedures⁴⁷			
Country	Date of the Commission report (Art.104.3/126.3)	Council Decision on existence of excessive deficit (Art.104.6/126.6)	Current deadline for correction
Malta	21 May 2013	21 June 2013	2014
Cyprus	12 May 2010	13 July 2010	2016
Portugal	7 October 2009	2 December 2009	2015
Slovenia	7 October 2009	2 December 2009	2015
France	18 February 2009	27 April 2009	2015
Ireland	18 February 2009	27 April 2009	2015
Greece	18 February 2009	27 April 2009	2016
Spain	18 February 2009	27 April 2009	2016

As for complying with structural balance rule, it is harder to determine causality as there are no historical numbers.

Structural balance of general government: Adjustment based on potential GDP Excessive deficit procedure⁴⁸						
Country	2010	2011	2012	2013	2014	2015
Austria	-2.9520	-2.4845	-1.8423	-1.2706	-1.1082	-0.9997
Belgium	-3.7085	-3.6419	-3.1232	-2.6918	-2.6345	-2.2410
Cyprus	-5.2408	-5.7004	-5.4915	-2.1247	-0.8434	-1.3259

⁴⁷ Accessed 23.3.2015:

http://ec.europa.eu/economy_finance/economic_governance/sgp/corrective_arm/index_en.htm

⁴⁸ Unit: Percentage of potential GDP at current prices. Source: AMECO database.

http://ec.europa.eu/economy_finance/ameco/Include/Query.cfm?serie=UBLGAPS&trn=1&agg=0&unite=319&ref=0&nomserie=Structural+balance+of+general+government+%3A-+Adjustment+based+on+potential+GDP+Excessive+deficit+procedure (accessed 9.1.2015).

Structural balance of general government: Adjustment based on potential GDP Excessive deficit procedure⁴⁸						
Country	2010	2011	2012	2013	2014	2015
Estonia	0.2861	-0.2396	-0.3736	-1.1395	-0.7755	-0.6899
Finland	-1.0681	-0.7950	-1.0537	-0.7280	-1.0986	-1.1049
France	-5.8488	-5.0014	-4.2732	-3.2815	-3.0293	-2.9268
Germany	-2.0712	-1.2735	0.0384	0.5936	0.7122	0.6078
Greece	-9.4646	-5.6974	0.0517	3.1418	2.0182	1.6300
Ireland	-8.7719	-8.0105	-7.0844	-4.7644	-3.7702	-3.3343
Italy	-3.2499	-3.3045	-1.6409	-0.8026	-0.9012	-0.8052
Latvia	-2.2457	-1.0722	-0.0534	-1.0295	-1.4737	-1.6443
Lithuania	-3.3885	-3.7723	-2.8222	-2.1957	-1.7598	-1.5608
Luxembourg	0.1809	0.7903	1.5429	2.0241	1.1075	0.4009
Malta	-4.3075	-3.0837	-3.8402	-2.7080	-2.7495	-2.9216
Netherlands	-3.7930	-3.8002	-2.2340	-0.5951	-0.5403	-0.8062
Portugal	-7.5120	-5.4465	-2.3100	-1.9409	-1.3495	-1.6693
Slovakia	-7.2884	-4.0532	-3.3929	-1.3643	-2.1020	-1.2810
Slovenia	-4.5597	-4.4539	-1.8164	-1.8102	-2.5084	-2.1898
Spain	-7.0214	-6.2631	-3.6156	-2.3293	-2.1644	-2.3400
Euro area (18 countries) ⁴⁹	-4.2477	-3.5547	-2.1116	-1.1898	-1.0928	-1.0990
European Union (28 countries)	-4.6133	-3.7849	-2.7211	-1.6887	-1.7949	-1.7569

These numbers are hard to link effectively to the legal reforms, and they hide what by far is should be a major concern, which is debt sustainability. This should open a different scenario, looming long

⁴⁹ This database does not include Lithuania yet (a Eurozone member since 1 January 2015).

since 2010 and which possibly will have to be dealt with sooner or later: the possibility of orderly debt restructuring, or partial controlled default.

No public debate or legal provision regarding insolvency

The possibility of sovereign insolvency in the Eurozone has been largely ignored both by investors and the legal system⁵⁰. To date, no system to deal with the insolvency of a Member State has been put in place, except for the limited-scope approach adopted through the European Stability Mechanism (ESM), which is in a way a contractual solution.

There are however different options to tackle possible insolvencies, which can be largely divided into two groups: the statutory (public law) systems, and the contractual systems⁵¹. In this regard, there have been different proposals to adopt a long-term solvency procedure that are worth assessing.

One of them, put forward by C. G. PAULUS and I. TIRADO⁵², includes the setting up of a special court-like institution (such as the Sovereign Debt Tribunal proposed by the IMF) and partly mimics the US Bankruptcy Code Chapter 11 proceeding. The proposal departs from and builds on the existing ESM, which would need to be reformulated.

The recent “PADRE” and “PADRE 2.0” proposals by Pierre PÂRIS and Charles WYPLOSZ propose not a debt restructuring but a debt rescheduling scheme, which ends up implying a reduction via rollover. PADRE is based on the purchase of public bonds on the secondary market by the ECB. PADRE 2.0 is a similar scheme without involving the ECB⁵³. The proposals start by clearly outlining exactly how unsustainable public debts currently are; a Member State with a debt nearing 95 per cent (like Spain) would need to grow at an annual rate of 3.5 % for thirty five years for its debt to fit the 60 per cent threshold if it intends to apply the Commission’s rule of reducing debt by 0.5 per cent of GDP annually. The opportunity costs of such a debt reduction programme would be huge and may also substantially reduce the possibility of dealing with other shocks, as of yet unforeseen.

All proposals tackle the moral hazard problem by tying the debt restructuring or rescheduling (respectively) to imposing actual enforceable fiscal discipline.

The rationale for dealing with the debt is clear: “bringing indebtedness down is unlikely to be achieved through growth because high debts stunt growth. Debt restructuring can be the magic bullet that erases the legacy and opens the space needed to bring austerity policies to an end”⁵⁴. At the same time, some authors have pointed out the impossibility of continuing with the current system of debtor/creditor, north/south, rich/poor (take your pick) divide. Recently, Jürgen Habermas⁵⁵:

⁵⁰ And not for lack of examples, as C. G. PAULUS and I. TIRADO show; see “Sweet and lowdown: a resolvency process and the Eurozone’s crisis management framework”, pp. 3 et seq; at <http://ssrn.com/abstract=2330423>.

⁵¹ See ROGOFF/ZETTELMEYER, “Bankruptcy Procedures for Sovereigns: A History of Ideas, 1976-2001”, IMF Staff Papers 49, n. 3, 2002; PAULUS, C. G.; TIRADO, I.: “Sweet and lowdown: a resolvency process and the Eurozone’s crisis management framework, pp. 4 et seq.

⁵² PAULUS, C. G.; TIRADO, I.: “Sweet and lowdown: a resolvency process and the Eurozone’s crisis management framework, op.cit. pp. 8 et seq.

⁵³ See P. PÂRIS; C. WYPLOSZ: “PADRE: Politically Acceptable Debt Resolution in the Eurozone”, *Geneva Report on the World Economy*, Special No3, CEPR, London, 2014; and : “PADRE 2.0: Politically Acceptable Debt Restructuring in the Eurozone”, May 2014

(available at: http://graduateinstitute.ch/files/live/sites/iheid/files/sites/international_economics/shared/international_economics/prof_w_bsites/wyplosz/Papers/PADRE%202.pdf/.; accessed 24.3.2015)

⁵⁴ WYPLOSZ, C.: “Europe’s Quest for Fiscal Discipline”, *Economic Papers* 498, April 2013, p. 41.

⁵⁵ “Democracy, Solidarity and the European Crisis”, Lecture delivered by Professor Jürgen HABERMAS on 26 April 2013 in Leuven.

“This time, the uncontrolled systemic contingencies of a form of capitalism driven by unrestrained financial markets are transformed into tensions between the member states of the European Monetary Union. If one wants to preserve the Monetary Union, it is no longer enough, given the structural imbalances between the national economies, to provide loans to over-indebted states so that each should improve its competitiveness by its own efforts. What is required is solidarity instead, a cooperative effort *from a shared political perspective* to promote growth and competitiveness in the euro zone as a whole. Such an effort would require Germany and several other countries to accept short- and medium-term negative redistribution effects in its own longer-term self-interest — a classic example of solidarity, at least on the conceptual analysis I have presented”.

The above critics support the proposals for common Eurobonds, and more recently, debt restructuring (such as the PADRE proposal). In this scenario, not studying debt restructuring or rescheduling options may actually be the more reckless option. But it should come hand in hand with analyzing the structure of public spending (what to finance and how) and the revenue system (taxations systems and compliance levels). There are different estimations on the level of tax fraud and evasion in Spain, which can be place at around 7.5 per cent of GDP (11.6 in the case of Italy and 4.86 in the case of the UK)⁵⁶.

Democracy: Parliaments and the budget; distribution of authority in multinational States

The actual role of Parliaments in the budget

Budgets have a double nature; they are, so to speak a “hybrid” document, legal form and political action.

The double nature of the budget is clearly seen in its life cycle, which traditionally (before EU coordination) went like this:

- 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.
- Phase 3: Execution. Budgets are a document designed for the Executive, who must then apply it (i.e., spend the monies).
- 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.

This double nature has many implications:

First and foremost, the way budgets are structured, approved and executed depends directly from the political structure of the country as well as, directly, from the specific procedure to approve laws. Some countries do not have a written Constitution, while others have the whole budgetary process perfectly outlined in the Constitution (such as Article 134 of the Spanish Constitution, or, more impressively as to its detail, Articles 110 et seq. of the German Constitution). Other countries, such as

⁵⁶ There is no official data for Spain. The numbers above can be found here: The Guardian (“Tax evasion: how much does it cost?”) <http://www.theguardian.com/news/datablog/2013/sep/27/tax-evasion-how-much-does-it-cost-a-country> Accessed on 24.3.2015

The actual tax fraud is difficult to assess, as well as the size of the informal economy.

See in this regard: Schneider, F.: “The Shadow Economy and Work in the Shadow: What Do We (Not) Know?”, March 2012 (IZA DP No. 6423), Which estimates a size of 19.3 for the Spanish Shadow Economy (25.1 for Greece, and 22.3 for Italy) –at <http://ftp.iza.org/dp6423.pdf>. (accessed 24.3.2015)

the USA, do not even have “a budget”, but many different laws covering aspects of the budget⁵⁷. This by itself translates into Parliaments having wildly different powers in the budgetary process to start with.

Budgets are also and fundamentally political action in numbers, in that they mirror the Executives’ plan. For this reason, and despite country differences, budgets are by and large a product of Governments, not a product of Parliaments. A Government outlines and directs economic policy mainly through the budget.

One of the consequences of this double nature of budgets is quite tangible: failing to have the budget approved is one way of losing confidence in Parliament. In most countries, Governments remain the masters of Budgets, not Parliaments.

The current EU budgetary coordination legal framework has a myriad of implications⁵⁸, but it does not substantially change the way Parliaments deal with the budget. The consequences will more directly be felt by the Executive power.

The general idea that Parliaments get to allocate and control the public money is one of the oldest principles in democracy, rooted in the separation of powers. It has however acquired a substantial amount of complexity overtime. It was during Rationalism that the Budget rules or “principles” were set. These principles shaped the Budget as both a fundamental political document and an Act of Parliament. One of these principles was the notion of equilibrium. Thus, the idea of balancing the Budget, i.e., 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 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, and subsequent increase of public spending that took place mainly after the Second World War (New Deal, Welfare State) transformed public budgets into documents both difficult to manage and to discuss in a public forum such as the Parliament. The chambers still approved the document, but they were growingly incapable of fully discussing its complicated content. To a certain extent, there is a trade-off between the size of the public sector, and the possibility that the budget that encapsulates its financing can be democratically discussed. In fact, the very size of the budget fostered a certain re-allocation of spending decisions. Thus, to ease the management of public funds, new techniques such as the creation of independent agencies resulted into chunks of public funds being decided and controls completely outside the Parliament, whose role was limited to approving their overall budget.

Because budget laws were no longer democratically debated laws, but executive documents that flew through Parliament, and precisely 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 134⁵⁹ of the Spanish Constitution 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,

⁵⁷ See OECD. *The Legal Framework for Budget Systems. An International Comparison*. OECD Journal on Budgeting, Vol. 4-No. 3. Special Issue, 2004, pp. 28-30.

⁵⁸ See P. CRAIG “Economic Governance and the Euro Crisis: Constitutional Architecture and Constitutional Implications”, in particular pp. 26 et seq.

⁵⁹ 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 conflict 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, accessed 24.3.2015.

whenever a tax law of a substantive nature so provides”; Art. 134.7⁶⁰). 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 Spanish Constitutional Court, with a large amount of Budget laws being challenged for containing provisions not directly linked to the Budget⁶¹. 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. Ultimately most political decisions can be linked to an expenditure decision. How weak that link is will determine if that provision is constitutional.

So, in fact, when analysing the democratic impact of the current EU legal framework, it should be borne in mind that Parliaments in practice have a very limited role in the budget. The crisis of Parliaments vis-à-vis the Budget has existed long before the “golden rules”. Among other elements, growing public spending made it very hard to actually control the budget (both its approval and the after-life). Furthermore, the role of Parliaments is severely limited due to other circumstances, for instance the possibility to alter the effective impact of the budget or parts of it by way of Royal Decrees⁶².

This does not minimize the democratic deficit that the current EU legal framework entails, as argued by many commentators⁶³. But the deficit lies fundamentally in the imposition of general measures in a one-size-fit-all mode, and is of a structural nature. There is no longer such thing as a “national” budget in a monetary union.

On the other hand, it could be argued in fact that the MTBF do pose a real opportunity to enhance the participation of Parliaments in the budget⁶⁴, as does the MTO. Both soft governance instruments actually require Member States to outline their policy measures and place them in the economic context. This in itself is not new; it is part of the Parliament’s role when assessing the budget. But really shows that the actual power of Parliament is diminished as it is virtually impossible to fully assess such a complex document. From that perspective, MTBFs may actually provide a very useful “navigation tool” for Parliaments.

In fact, one of the dimensions assessed in the MTBFs database is the actual involvement of the national parliament in the preparation of the medium term budgetary plans⁶⁵.

For the fiscal year 2012, the assessment showed the following results:

In most cases (16 out of 28), there was no vote (score 1). Finally, in 3 cases there was no formal presentation of the objectives to the national parliament. In 9 cases, there was a vote of the parliament on the main medium-term objectives (in the context of a national MTBF or of the Stability and Convergence Programmes (SCP) (score 2).

⁶⁰ Spanish Constitution, official translation.

⁶¹ There are many examples. Recent cases include SSTC 9/2013, 28 January, FJ 2; 86/2013, 11 April, FJ 2, or 206/2013, 5 December. Every year there are at least three cases where the question is posed.

⁶² In Spain there were 29 Royal Decrees in 2012, 17 in 2013 and so far in 2014, 12.

⁶³ CLOSA MONTERO, Carlos, “La Gobernanza Fiscal y Macroeconómica Europea y Sus Limitaciones Democráticas” *Revista Aranzadi Unión Europea XXXVIII*, 12/2012, pp. 51–65.

⁶⁴ One of the elements surveyed for the MTBF database is in fact

(Database –in an excel document- can be found here:
http://ec.europa.eu/economy_finance/db_indicators/fiscal_governance/framework/index_en.htm)

⁶⁵ See Database, Box 2 “Scores...”, Dimension 2.

Country	Involvement of National Parliaments in the preparation of MTBF
Austria	No vote but formal presentation of the objectives to the national parliament
Belgium	No vote but formal presentation of the objectives to the national parliament
Bulgaria	No formal presentation of the objectives to the national parliament
Cyprus	No vote but formal presentation of the objectives to the national parliament
Czech Republic	Vote of the parliament on the main medium-term objectives (in the context of a national MTBF or of the SCP)
Germany	No vote but formal presentation of the objectives to the national parliament
Denmark	Vote of the parliament on the main medium-term objectives (in the context of a national MTBF or of the SCP)
Estonia	No vote but formal presentation of the objectives to the national parliament
Greece	No vote but formal presentation of the objectives to the national parliament
Spain	Vote of the parliament on the main medium-term objectives (in the context of a national MTBF or of the SCP)
Finland	No vote but formal presentation of the objectives to the national parliament
France	Vote of the parliament on the main medium-term objectives (in the context of a national MTBF or of the SCP)
Croatia	Vote of the parliament on the main medium-term objectives (in the context of a national MTBF or of the SCP)
Hungary	No vote but formal presentation of the objectives to the national parliament
Ireland	No formal presentation of the objectives to the national parliament
Italy	No vote but formal presentation of the objectives to the national parliament
Lithuania	No vote but formal presentation of the objectives to the national parliament
Luxembourg	No vote but formal presentation of the objectives to the national parliament
Latvia	No vote but formal presentation of the objectives to the national parliament
Malta	No vote but formal presentation of the objectives to the national parliament

Country	Involvement of National Parliaments in the preparation of MTBF
Netherlands	Vote of the parliament on the main medium-term objectives (in the context of a national MTBF or of the SCP)
Poland	No formal presentation of the objectives to the national parliament
Portugal	Vote of the parliament on the main medium-term objectives (in the context of a national MTBF or of the SCP)
Romania	Vote of the parliament on the main medium-term objectives (in the context of a national MTBF or of the SCP)
Sweden	No vote but formal presentation of the objectives to the national parliament
Slovenia	No vote but formal presentation of the objectives to the national parliament
Slovakia	No vote but formal presentation of the objectives to the national parliament
United Kingdom	Vote of the parliament on the main medium-term objectives (in the context of a national MTBF or of the SCP)

Fiscal constraints in multinational (Federal) states

A different issue that is directly linked to the democratic deficit discussion is whether and to what extent the current legal regime may shape the internal distribution of powers.

The Union is far from blind to the internal distribution of powers between the centre and subnational entities in the Member States⁶⁶. From a territorial perspective, the internal stability pact mirrors the German model⁶⁷, and has thus entailed a substantial amount of centralization. There has been a substantial revision of decentralization, as the Austrian, Italian, Portuguese⁶⁸ and Spanish cases show⁶⁹.

From a purely theoretical perspective, establishing some form of fiscal constraints or budgetary discipline rules for subnational governments will be needed, especially if the market-pressure mechanisms (i.e., more expensive financing as a mechanism to borrow less) do not work. One of the situations where they may not work is when there is a reasonable expectation that the centre will bail

⁶⁶ The Spanish Constitutional Court has repeatedly stated that EU Law is blind and does not directly affect distribution of authority. In fact the opposite can be concluded by examining the case law. See also, in this WP series, the paper by N. Skoutaris (“State-region dimensions of Euro-crisis law”), the Euro-crisis law evidently has direct impact on the balance of powers between the centre and the regions.

⁶⁷ See in this series, Nikos SKOUTARIS, “State-region dimensions of Euro-crisis law” (2015) Constitutional Change Through Euro Crisis Law Workshop, European University Institute, 17-18 October 2014 (forthcoming).

⁶⁸ See the report by the Conselho das Finanças Públicas (Portuguese Public Finance Council) 1/2013, titled “Analysis of the Legal Proposals for New Subnational Finance Laws”, pp. 20 et seq.

⁶⁹ See N. Skoutaris “State-region dimensions of Euro-crisis law”, Constitutional Change Through Euro Crisis Law Workshop, European University Institute, 17-18 October 2014 (forthcoming).

out Communities. From this perspective, merely stating, in a law or agreement, that there will be no bail outs does not suffice, there needs to be a history of no bailouts⁷⁰.

Internal fiscal rules may be procedural (analysing and benchmarking budgets) and numerical (debt and deficit limits, spending caps). An obvious difficulty with simple numerical rules is that they can be bypassed through accounting tricks or by cutting spending in an inefficient manner (i.e., investing less)⁷¹.

Ideally, internal fiscal rules should allow for cyclical flexibility, but because it is difficult to accurately determine local cycles, a rainy day fund may be more effective.

In any event, fiscal rules will not foster fiscal discipline in the absence of real political commitment, or when the system of intergovernmental relations or of subnational financing is inefficient.

Spain's internal pact is a good example of all the inefficiencies described. Although it was implemented in 2001, it has not been able to avoid fiscal gimmickry schemes; for example, the building of a now empty airport in Ciudad Real which was "privately" financed, that is, paid for by Savings banks (Cajas de Ahorros) with obvious links to the Community's Government (Castilla-La Mancha). At the same time, there have been substantial, across the board budget cuts in the provision of Health and Education services, which amount to about 70 per cent of Communities' budget. The system has been substantially centralized, as Communities do not have much say in the way budgetary rules are applied to them. The system of intergovernmental relations envisaged in the LOFCA and institutionalized in the "Consejo Fiscal de Política Fiscal y Financiera" (CPFF) is in practice a way to convey Autonomous Communities decisions made by the centre. The CPFF has a very limited role in the internal fiscal pact which, according to some, is in breach of Article 135 of the Constitution, which clearly called for a larger role for the CPFF or any other similar institution. Strikingly, Cataluña has not challenged it⁷². Finally, the system is in itself not credible. There have been successive bail outs and there are bound to be more⁷³. The financing system itself is hardly transparent and there coexists both a "common" system and the foral regimes, whose arrangements are also obscure and probably count as a privilege in the actual implementation formula⁷⁴.

The current EU legal system says little about internal powers. It is naturally (formally) left to Member States. The very design of the system is, however, hardly compatible with a decentralized system, which is partly why the evidence shows progressive centralization (as the Italian, Spanish or Portuguese cases show), following the German model, which is highly centralized for a decentralized state, taking into account the legal framework to force Länder to comply with the debt and deficit

⁷⁰ TER-MINASSIAN, T.: "Fiscal Rules for Subnational Governments: Can They Promote Fiscal Discipline?". OECD Journal on Budgeting, Volume 6 – No. 3, 2007, p. 4.

⁷¹ TER-MINASSIAN, T.: "Fiscal Rules for Subnational Governments: Can They Promote Fiscal Discipline?". OECD Journal on Budgeting, Volume 6 – No. 3, 2007, pp. 6 et seq.

⁷² One possible explanation is that Cataluña approved its own Stability law which may not comply with the Constitution, as some definitions divert from the States' organic law, which operates as an umbrella of concepts that must be followed by Communities. The Centre and this Community met under the bilateral conflict-resolution commission, an ad-hoc organ designed to avoid bringing conflicts before the Constitutional Court and, most likely, both parties decided not to challenge each other's laws. Another explanation is that Cataluña is one of the main recipients of the Liquidity Fund.

⁷³ CUENCA, A.; RUIZ ALMENDRAL, V., "Budgetary stability in the autonomous regions: Beyond constitutional reform". Spanish Economic and Financial Outlook, vol. 3, n. 4 (July 2014); See a critic and proposals for a real transparent subnational debt restructuring at: TIRADO, I.: "At the core of the sovereign crisis in Spain: restructuring subnational debt versus internal bailout". Capital Markets Law Journal, Vol. 9, No. 1, pp. 76 et seq.

⁷⁴ See in this regard: ZABALZA, A.; and LÓPEZ-LABORDA, J.: "The Uneasy Coexistence of the Spanish Foral and Common Regional Finance Systems". Wp-ec 2014-02, Instituto Valenciano de Investigaciones Económicas, 2014, p. 31.

brakes. The “Germanization of the governance of the euro”⁷⁵ has other consequences, as pointed out, but the impact on fiscal federalism is currently being felt, but it is probably too soon (again) to fully assess the impact⁷⁶.

Constitutional fiscal constraints and public spending

The case for fiscal constraints

The economic wisdom behind the need to balance the budget in the mid and long-term is well known and the basic idea is largely uncontested, namely, that high public debt levels do curb growth⁷⁷ and eventually endanger sustainability; hence the rationale for hard-bound rules.

The establishment of legally binding fiscal rules, loosely defined as rules that impose a constraint on fiscal policy (by controlling debt and/or public deficit) is a relatively new phenomenon. According to the IMF database⁷⁸, in 1985-86, only Austria, Germany, Indonesia, Japan, Malaysia, Singapore and the United States had some form of Fiscal Rules. In 2013, only a few countries do not have one (Argentina, Canada, Iceland, India, and Maldives).

In the current EU context in particular, the establishment of such rules must be understood in the context of an older and larger debate, namely, and roughly, the debate on public spending as a motor (or “multiplier”, as Keynes put it) of growth, versus monetary policy. The (relative) crisis of Keynesian policies contributed to the sophisticated analysis of the consequences of a public deficit.

It is a structural element of democracies, to a certain extent at least, that when public deficits consolidate they may indeed burden growth, as well as establish a sort of ghost tax upon future generations. Budgeting methods as well as lobby groups facilitate the resilience to change public spending (once budgeted, it will never move)⁷⁹. Budgetary allocations reflect the power of the organs in charge of their management. In many instances, it will be hard to avoid political incentives to increase public spending and finance it with debt operations, rather than with new taxes⁸⁰, thus giving rise to a possible democratic deficit for future generations⁸¹. In this regard, as C. WYPLOSZ puts it, “fiscal indiscipline, the tendency to run deficits year in-year out, is the result of a “commons

⁷⁵ 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).

⁷⁶ The re-centralization trend in Spain is particularly clear, as the setting up of a centrally managed liquidity fund is in practice entailing a centralization via spending power.

⁷⁷ This not contested in the literature, although disagreement does remain as to where the growth deterrent figure lies; see REINHART, C. M. AND KENNETH S. ROGOFF: “Growth in a Time of Debt”, *American Economic Review: Papers and Proceedings*, 100(2), 2010, pp. 573-578. De Grauwe, P.: “The Governance of a Fragile Eurozone”, *Australian Economic Review* 45(3), 2012, pp. 255 et seq.. See a critic at: PANIZZA, U. AND A. F. PRESBITERO: “Public Debt and Economic Growth: Is There a Causal Effect?”, MoFiR working paper No. 65/2012. The actual dangerous rate has not been established, and depends on many variables, as the “excelgate” debate came to show in 2013 (see Carmen Reinhart/Kenneth Rogoff).

⁷⁸ See T. KINDA, C. KOLERUS, P. MUTHOORA, and A. WEBER: “Fiscal Rules at a Glance”, International Monetary Fund, October 2013, and the accompanying Fiscal Rules Dataset (1985-2013), all available here:

<http://www.imf.org/external/datamapper/fiscalrules/matrix/matrix.htm> (accessed 12.12.2014).

⁷⁹ ELLIOTT, E. D.: “Constitutional Conventions and the Deficit”. *Duke Law Journal*, n. 6 (december), 1985, pp. 1089-1090.

⁸⁰ 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.

⁸¹ 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”.

problem”, the need for democratic governments to spend to cater to pressure groups while avoiding to upset taxpayers”⁸².

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 indebtedness will finance is a fundamental element of the intergenerational analysis⁸³. 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 spending⁸⁴. 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 controversial⁸⁵. Among other reasons not to enshrine it in a binding rule (constitutional or similar) is that once established there will be accounting *gimmickry* practices in order to conveniently “repackage” current spending as investment⁸⁶.

Of course the problem lies in correctly defining investment and current spending, much harder than it may seem. Furthermore, exactly which type of expenditures can pass the intergenerational equity test and which not will largely depend on political, fungible, decisions is debatable. Building a highway may seem like a good investment today 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 depend on the marginal utility of that asset through its lifetime, which can only be roughly estimated.

Ultimately, the equity test becomes more complicated, because more elements will need to be thrown into 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)⁸⁷. The traditional golden rule, which limited deficit spending to financing investment, has usually entailed infrastructures (roads, airports). However, current spending also may have an intergenerational impact, as will be the case of research and education investment, which may facilitate a change in the economic model (as the South Korea and Singapore cases show).

The phenomena grew substantially in the final decades of the last century. 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.

The second phenomenon was a 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

⁸² WYPLOSZ, C. “Europe’s Quest for Fiscal Discipline”, *Economic Papers* 498, April 2013, p. 24.

⁸³ SHAVIRO, D.: *Do Deficits Matter?* Chicago/London: The University of Chicago Press, 1997, pp. 114 et seq.

⁸⁴ 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.

⁸⁵ 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 et seq.

⁸⁶ KOEN, V.; VAN DEN NOORD, P.: “Fiscal Gimmickry in Europe: One-off measures and creative accounting”. OCDE, Economics Department Working Papers, n. 417, OECD Publishing. <http://dx.doi.org/10.1787/237714513517>, pp. 13 et seq. BUTI, M.; FRANCO, D.: *Fiscal Policy in Economic and Monetary Union. Theory, Evidence and Institutions...cit. p. 35.*

⁸⁷ SHAVIRO, D.: *Do Deficits Matter?... pp. 153 et seq.*

well as globalization, which foster “legal” tax avoidance by making delocalization easier⁸⁸. As controversial as the economic effects of deficits is what contributes more to its creation. As has also been pointed out, diminishing tax returns are at least as responsible⁸⁹ 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 board⁹⁰. 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, lobby groups and the like, that help constitute a powerful set of entitlements⁹¹. An overview of the State Aid Commission decisions gives a rough but accurate idea of the types of tax incentives that some corporations receive⁹².

Enough to enshrine the rules in a Constitution?

From this perspective, fiscal constraints or budgetary discipline rules may, as a side-effect at least, have the virtuous consequence of changing the debate in tax law. Resources are intrinsically scarce, but fiscal rules reinforce that view and may at least indirectly help redesign a tax system. Thus enshrining fiscal constraints, together with a culture of budgetary discipline, may help end the perverse (political) separation between the revenue and the expenditure sides⁹³.

Of course the debate on whether or not and how to enact budgetary constraints rules in the Constitution acquires a different character in the EU. 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”, spill over effects derived from uncoordinated economic and fiscal policies. 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 mechanisms⁹⁴, which will doom the rules from the beginning.

There is then a case for introducing such rules in the Constitution. Of course the design of such rules is highly debatable. The stress should be put on exactly how much leeway do the rules leave. It has been

⁸⁸ RUIZ ALMENDRAL, V.: “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).

⁸⁹ 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.

⁹⁰ ELLIOTT, E. D.: “Constitutional Conventions and the Deficit...cit. p. 1080, “if one assumes that large structural deficits are a problem, they should be understood as symptoms of fundamental diseases in our political institutions that are unlikely to be cured short of a constitutional convention”.

⁹¹ See the short piece by James SUROWIECKI “Corporate Welfare Queens”, *The New Yorker*, October 8th, 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].

⁹² http://ec.europa.eu/competition/elojade/state_aid/

⁹³ ELLIOTT, E. D.: “Regulating the Deficit after *Bowsher v. Synar*...cit. p. 352. CAMERON, D. R.: “On the Limits of the Public Economy...cit. pp. 50 et seq.

⁹⁴ EICHENGREEN, B.; WYPLOSZ, C.: “The Stability Pact: More than a Minor Nuisance...cit. pp. 78 et seq.

argued that the more flexible the rules, the greater the probability that they will be respected⁹⁵, but experience shows otherwise. Ultimately for the rules to be credible they must first be internalized as part of the rationale of public revenue/expending. And they have to be part of the culture, which entails, among other things, electorates supporting a debate on what to finance and how.

Quite evidently, the fact that there are reasons to introduce these rules as constitutionally binding rules is not enough. Enshrining debt-deficit control rules in the Constitution is mired with problems in the best of scenarios⁹⁶. It is possible to think of many other policy areas that may have spill over effects, such as the labour market or the tax system⁹⁷, or climate change. 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.

Back to basics: taxes vs. debt and the cost of rights

Recently, in Opinion 49/2015, 5 March, the Spanish Constitutional Court has declared that the Government decision not to fully index public pensions was in accordance with Art. 50 of the Constitution, which states that “The public authorities shall guarantee, through adequate and periodically updated pensions, a sufficient income for citizens in old age”. The Opinion has been highly contested and there were four Justices dissenting from it (out of twelve).

The underlying debate was whether some social rights were irreversible or not, so that even though the Constitution enshrined them in ample terms, once old age pensions are indexed to inflation they cannot be removed.

This issue, and the way it has been reasoned (by the dissenting opinion and part of the public) further proves that there is no real debate on the opportunity costs of financing some social programmes against other social expenditures. Taking into account the looming demographic crisis such opportunity cost is only going to grow.

The fiscal rules legal framework has not been accompanied by a real debate on the cost of rights. There has been a very limited and largely biased debate on the cost of bail-outs for creditor countries, although this debate has left out the (probably larger) cost of a euro-breakup.

Any sensible debate on budgetary discipline must departure from a simple public finance handbook idea: the fact that all rights cost money and that (especially public) money is scarce. Budgeting is a way to structure and monetize opportunity costs. A given country may be able to finance public universities but most likely not all of them, if so, then less money will need to be allocated, for instance, for early years education⁹⁸.

⁹⁵ SCHELKLE, W.: “EU Fiscal Governance: Hard Law in the Shadow of Soft Law?”. *Columbia Journal of European Law*, vol. 13/2007, pp. 707 et seq.

⁹⁶ As the USA case shows; see ELLIOTT, E. D.: “Regulating the Deficit after *Bowsher v. Synar*...cit. pp. 349 et seq, on the *Gramm-Rudman-Hollings Act*, struck down by *Bwosher v. Synar*.

⁹⁷ CLOSA, Carlos, “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).

⁹⁸ One current debate in Spain is the cost of higher education. This debate can be had in theory –should we finance public education? Or, more usefully, in practice: should we finance every law student on the country? Spain has 56 Law schools, so a sophisticated cost debate should start by questioning whether it makes sense to have a law school in virtually every province (the author, born in 1975, is well aware that sophisticated debate will have her generation of law school professors unemployed).

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 system⁹⁹. From this perspective, third generation rights (such as health, education, pension funds) are no costlier than fundamental rights (due process, the right to property, freedom of speech)¹⁰⁰. The cost of rights debate must be the centre of any public debate on fiscal restrictions. 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)¹⁰¹. It naturally follows that enshrining rights in a Constitution already determines how the budget should be spent.

And scarcity is not a contingency but the essential element of the public purse. No right can be absolutely guaranteed as no right can be fully financed. Spending should be analysed on a regular basis. This can be done by means of budgeting techniques (such as “zero budgeting”). In the mid-term at least the current social model of the European Union will need to be evaluated. The shortest (and also the most unfair) way is across the board cuts to social programmes, given the obvious fact that an ageing population together with soaring health costs make meeting the current demands of the system next to impossible. On the other hand, substantial revision of the current spending programmes (which roughly represent 50 per cent of EU member states budgets) should be revised following an evidence-based approach¹⁰².

Evaluating the cost of rights is often welcomed with a great amount of suspicion, as it is usually identified with restricting such rights. Quite surprisingly, no Constitutional Law handbook mentions this issue (to the best of my knowledge). This is part of the reason why a debate on the cost remains partly hidden even though there are daily, tangible examples that show how some things are financed and others are not. Budgetary cuts receive wildly different public responses depending on the sector that is affected by them. The budgetary cuts of civil servants pay in Spain have resulted in more than fifty cases pending before the Court, either by Courts or Autonomous Communities challenging the pay cuts. The substantial budgetary cuts that have ended or reduced school-lunch programmes, also decided by laws (budgetary laws) have not been challenged and have had a much smaller impact in the media¹⁰³. Civil servants are an organized group. Impoverished (or rather their parents) children are not¹⁰⁴.

On the other hand, and despite common political (and academic) discourse, there is in practice no such thing as red lines that cannot be trespassed in the guarantee of rights. There are many examples to

⁹⁹ 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.

¹⁰⁰ 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.

¹⁰¹ Eurostat (Tax trends in the EU).

Specifically with data on the German tax system: 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]

¹⁰² See R. HASKINS, “Social Programs That Work”, New York Times, December 31 2014 (at: http://www.nytimes.com/2015/01/01/opinion/social-programs-that-work.html?smid=fb-nytimes&smtyp=cur&bicmp=AD&biclup=WT.mc_id&bicmst=1409232722000&bicmet=1419773522000&r=3). Accessed: 9.1.2015.

See also the book, by HASKINS, R.; G. MARGOLIS, *Show Me the Evidence: Obama's Fight for Rigor and Results in Social Policy*. Brookings Institution Press, 2014.

(a webcast: <http://www.brookings.edu/events/2014/12/01-show-me-evidence-social-policy>)

¹⁰³ The author knows of no challenge of this reduction before any Court.

¹⁰⁴ One in three Spanish children live under the poverty line: http://www.unicef.org/media/media_76447.html

illustrate this point. Take the above mentioned article 50¹⁰⁵ of the Spanish Constitution (a “positive” right), which guarantees that retirement pensions must be adequate and periodically updated so that 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 (and challenged before the Constitutional Court) 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. A harder to see but just as obvious example is the protection of fundamental rights. With a judicial system that sometimes takes 10 years to answer citizens claims it is hard to argue that the right to a due process is sufficiently guaranteed *in practice*.

In a limited patched-up way, there is of course a Europe wide debate on the cost of Euro-crisis law, but it has mainly focused on what bail-outs actually cost (although with little debate of the cost of not financing bail-outs). Of course the financing of the assistance mechanisms represent a substantial percentage of the Member States budgets cannot be ignored¹⁰⁶.

Specifically, the current European Stability Mechanism (ESM) has a potential maximum lending capability of €700 billion, distributed among Member States in relation to their GDP. Of that amount, only 80 billion must be paid in directly, while the remaining 620 operates as a guarantee¹⁰⁷. The Capital subscriptions (callable capital) represent a substantial percentage of their national budget. Much less is of course the size of the paid-in capital.

The participation in the ESM depends on the size of GDP¹⁰⁸. Thus, for the top financing Member State, Germany (27.1464%), this will represent €22bn of paid-in capital and €168bn of callable capital (in total, €190 billion). Taking into account, for the sake of comparison, the 2012¹⁰⁹ budget, it would represent 16 per cent (190,024 /1,191,490 x 100). For Spain, the ESM total callable capital represents roughly 16.9 per cent of the annual budget (83,325/491,414 x 100). For France, about 12.39 per cent (142,701/1,151,257 x 100); for Italy, 15.82 per cent (125,395/792,583 x 100); finally, for Finland, it would represent about 11.54 per cent (total expenditure in 2012: 12,581/108,927 x 100). So far, only Finland and Germany have raised the concern of the cost, discussion whether approval of a sum of money that may jeopardize the sustainability of the Parliament¹¹⁰.

Any obligation to spend implies a restriction of the budget. The conundrum is expressed very well by the German constitutional Court’s Opinion of 18 March 2014 [BVerfG, 2 BvR 1390/12]¹¹¹, (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. BVerfG 129, 124 <170>). Even if such a commitment restricts democratic

¹⁰⁵ Official translation source:

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”

¹⁰⁶ As K. TUORI AND P. CRAIG have, among others, pointed out in the papers I quote in this.

¹⁰⁷ In fact, of that amount, €200 billion is overcollateral, so that the effective lending capacity of the ESM amounts to € 500 billion.

¹⁰⁸ Thus: Germany (27.1464%) France (20.3859%) Italy (17.9137%) Spain (11.9037%) Netherlands (5.7170%) Belgium (3.4771%) Greece (2.8167%) Austria (2.7834%) Portugal (2.5092%) Finland (1.7974%) Ireland (1.5922%) Slovakia (0.8240%) Slovenia (0.4276%) Luxemburg (0.2504%) Cyprus (0.1962%)

¹⁰⁹ All data derived from Eurostat, Government Finance statistics, Summary tables — 2/2013.

¹¹⁰ Finland Constitutional Committee report PeVL 13/2012; and BverfG, 2 BvR 1390/12, 12 September 2012.

¹¹¹ See English version:

http://www.bverfg.de/entscheidungen/rs20140318_2bvr139012en.html (accessed 19.3.2014)

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. BVerfG 119, 96 <147>). To avoid such a constriction is a legitimate aim of the (constitutional) legislature (BVerfG 132, 195 <245>, n. 120)".

But the debate has only focused on the cost of bail-outs, which is high, but more limited and time constraints than the makeup of public spending.

Clearly, the figures show that Member States have enough skin in the game to worry about moral hazard issues. However, the response to the ESM has been asymmetrical, with Germany (by far the main contributor) but also Finland contesting it on constitutional grounds, while in other countries there has not been much debate. The explanation for this cannot be oversimplified as it depends on the current culture of budgetary control as a whole. In Spain, despite the substantial percentage that the contribution represents, it has not received much public attention, and it has certainly not raised any constitutional concerns. In my opinion, this is explained not by a higher sense of solidarity but because Spain's culture of budgetary control is relatively new, and it does not yet actually have and public debates on the cost of government programs or otherwise social expenditure are not a substantial part of public debate as a whole.

The fundamental (pending) question is whether the budgetary discipline legal framework is a gate towards greater integration in substance, the actual distribution of public spending within the Union. The answer now is no. The four building blocks of the blueprint for further EMU integration named in the December 2012 report are: financial integration, integrated budgetary framework, an integrated economic policy framework and democratic legitimacy and accountability of decision-making within the European Monetary Union¹¹². What to spend the money on is of course not mentioned in this document, which also only en passant refers to where the money should come from (taxation) and how. The report does, however, point in the direction of a deeper economic and political integration. The current debate on greater integration makes more salient the fact that there still is a crucial missing element: what to finance (the cost of rights debate) and how to finance it (the design of the tax system). Taxation is only mentioned en passant¹¹³ (p. 5) and, more worryingly, there seems to be an intention to leave Member States' systems untouched; thus, in page 11, when discussing the options for the development of the EU's fiscal capacity, it is argued that "it will be important to ensure that, irrespective of the approach that is followed, establishing this function does not affect the overall level of public expenditure and tax pressure in the euro area"¹¹⁴.

Provisional conclusions

There is, in my opinion, 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 for Member States. Of course enshrining constitutional rules limiting the debt and deficit implies a petrification of political options (Carlos Closa), but so does enshrining fundamental rights, which can then evolve as all constitutional options do (the Constitution as a living tree). In fact, the case for fiscal constraints and its introduction in the Constitution is not so different from the case for

¹¹² President Van Rompuy together with J. M. Barroso, J-C Juncker and M. Draghi: "Towards a Genuine European Monetary Union", December 2012.

¹¹³ President Van Rompuy together with J. M. Barroso, J-C Juncker and M. Draghi: "Towards a Genuine European Monetary Union", December 2012.

¹¹⁴ It is stressed also in the summary, p. 12, "The design of the fiscal capacity should be consistent with the principle of subsidiarity, and its operations transparent and subject to appropriate democratic control and accountability. Equally, it should be cost-effective and not lead to the undue development of costly administrative procedures or unnecessary centralisation. It should not lead to an increase in expenditure or taxation levels".

establishing the building blocks of a revenue system. In fact Western constitutions have a preference for a revenue system based on taxes.

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, where general principles have transformed into one size fits all strict rules, whose sanctions are neither clear nor credible.

The design of the fiscal rules should avoid reductions in spending without sufficient assessment. Senseless austerity with across the board cuts may be just as harmful for long term growth as fiscal profligacy. When specific rules are established, deficit and debt will be reduced at all costs to avoid breaching them. Some of the measures will or may entail reducing investment¹¹⁵. 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). To the extent that deficit and debt thresholds matter more than the route taken to achieve them, there is a powerful incentive to introduce austerity measures, which then crowd out real reform measures. Budget cuts across the board do 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 an EU BEPS initiative to curb tax evasion).

The existing legal framework has not brought about a substantial change in the EU Economic constitution. It has also not substantially diminished, if anything the opposite, the powers of Parliaments with regard to the budget.

There have been, however, fundamental missed opportunities. One is to design a credible monetary system that permits decoupling the currency with the fiscal situation of member states. Excess deficit and debt does not pre-determine default. Markets will reward any definition of sustainability. By focusing on big numbers the message sent is that those should be rewarded. Markets are not sophisticated, but they are based on confidence and confidence alone, which helps explain why a country with such large public debt as the USA does not have sustainability issues (measured as the cost of bond yields): the market believes on the capacity of paying that debt. Precisely the problem with the current debt levels in the EU is not their levels per se, but the possibility of a long stagnation period.

There are other causes for concern in the current design. For example, what the role of constitutional courts should be. As rules become part of constitutional systems, Courts will need to make sense of them and ultimately declare, when necessary, that a given provision has breached the rule. The theory is, again, easy to understand, create a rule, enforce it and control its application. In practice, it will be very difficult to narrow exactly what legal provision constitutes a breach of the rule.

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¹¹⁵ This is exactly what has happened with Spanish regions in Spain.

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