FISCAL STABILITY RULES IN EUROPEAN CONSTITUTIONS

by Marek Antoš

LL.M. SHORT THESIS

COURSE: Constitutions and Constitution-making in Europe

PROFESSOR: Renáta Uitz

Central European University

1051 Budapest, Nador utca 9.

Hungary

Table of contents

Abstract

The so-called Fiscal Compact signed in March 2012 by 25 out of 27 EU member states requires the states to transpose the treaty's rules that limit the annual structural deficit and the general government debt "through provisions of binding force and permanent character, preferably constitutional" (Art. 3, §2). While the goal is set, the means are up to respective states, and thus an extraordinary wave of constitutional engineering has been triggered. This thesis deals with four countries in Central Europe which have already adopted fiscal stability rules in their law (Germany, Hungary, Poland and Slovakia). It describes the rules adopted and demonstrates that despite some similarities, four wholly distinct models of regulation have been used in these countries. These models are further examined and compared, in particular with respect to their substance (numerical, or institutional fiscal rules), criteria used (state debt, state budget deficit, or structural deficit) and enforcement mechanisms created (automatic cut of expenses, vote of non-confidence in the government, veto power of an independent fiscal council, judicial review, etc.). The models are evaluated both from the perspective of their democratic legitimacy and from the perspective of their expected efficiency. The paper argues that the proper solution should support rather than replace the political process, and therefore it advocates a solution which combines a structural deficit based numerical fiscal rule with an independent fiscal council overseeing how the rule is fulfilled. Only the German rules fully complies with these criteria, whereas the constitutional provisions in other three countries are less appropriate in terms of effectiveness (Poland, Slovakia) or also of legitimacy (Hungary).

Introduction

The "power of the purse" is one the basic powers of legislatures. It includes not only the exclusive power to impose taxes, but also the power to assign money to particular purposes: the power to spend. Furthermore, it is a right and a duty of the legislature to take the general decision on how much money should be spent and whether the state budget should be balanced, in surplus or deficit.

Many countries have, nevertheless, introduced various legal restrictions of the budgetary process. One possibility is to enact numerical fiscal rules which limit the maximum deficit, debt or another indicator of overall fiscal performance. Another possibility is to establish independent fiscal institutions which are supposed to review budget proposals, to give advice on fiscal policy matters or even to take independent decisions on fiscal policy. The aim of both is the same: to restrict the budgetary discretion of legislatures. Such constraints are often adopted by states which went through some fiscal problems, in order to stabilize their public finance and regain the credibility they lost.

The recent sovereign debt crisis is the reason why the balanced budget rule has become an important issue also in Europe. The Treaty on Stability, Coordination and Governance in the Economic and Monetary Union (the so-called "Fiscal Compact"), signed by all member states of the European Union except the United Kingdom and the Czech Republic, sets down certain numeric fiscal rules. The most important among them stipulates that the structural deficit of the annual budget should not exceed 0.5 % of GDP. Those signatories which are members of the Eurozone have to transpose these rules into their national law "through provisions of binding force and permanent character, preferably constitutional" (Art. 3, §2).[1]

[1] According to the original proposal, the constitutional character should be mandatory, but this was refused by some member states which led to the compromise phrasing (see Martin Kusák and Lenka Pítrová, "Právní aspekty Smlouvy o stabilitě, koordinaci a správě v hospodářské a měnové unii [Legal Aspects of the Treaty on

This obligation shall be fulfilled within one year after the treaty enters into force[2] and may be subject to review by the Court of Justice of the European Union. Some states have done it already (e.g., Germany, Spain, Italy, Hungary), while in other states the process of amending the constitution has not started yet or is underway. Interestingly, the amendments adopted up to date reveal that the general goal set by the Treaty may be implemented by a number of means and there is a significant difference in approach between the states.

Some observers may applaud the Fiscal Compact as a viable way to overcome the deficit bias of democracy. Recalling the Jon Elster's famous theory of pre-commitment, illustrated by the story of Ulysses, the Sirens and the mast,[3] they may argue that the rules will secure more sustainable public finances. However, there is also room for skepticism. As the rules are largely imposed and enforced by the European Union, it may be seen as an infringement of national sovereignty. They may are also be criticized for undermining the traditional role that parliament has in democracy, operating pro-cyclically which is not a sound economic policy[4] and/or not being effective whatsoever. In this paper I deal with the latter three objections.

I argue that the fiscal stability rules, if properly designed, are both reconcilable with democratic parliamentarianism and likely to achieve their goals. In the first chapter, I discuss the budgetary powers of parliament: how they have emerged, what their rationale is, whether they meet it and to what extent they may be subject to limitations. Then I move to fiscal

Stability, Coordination and Governance in the Economic and Monetary Union]," *Acta Universitatis Carolinae – Iuridica* no. 1 (2012): 51). Additional explanation of this shift offer Besselink and Reestman who suggest that it might be caused by specific rigidity of some constitutions, which would have required either lengthy procedure of adoption (Belgium, the Netherlands, Denmark) or even a referendum (Ireland), while neither was desired by the states (see Leonard E.M. Besselink and Jan-Herman Reestman, "The Fiscal Compact and the European Constitutions: 'Europe Speaking German'," *European Constitutional Law Review* no. 8 (2012): 3).

[2] The Treaty entered into force on 1 January 2013 and thus the deadline for the states which had ratified it before this date expires on 1 January 2014.

[3] Jon Elster, *Ulysses and the Sirens: Studies in Rationality and Irrationality* (Cambridge: Cambridge University Press, 1979), 36.

[4] Based on the Keynesian theory, which is pre-dominant in current economics, the government should intervene by increased spending during economic recession in order to stabilize output over the business cycle, whereas during expansion the government spending may be lower thanks to the increased activity of private actors.

stability rules: in the second chapter I explain various types and specific features thereof, such as various fiscal performance indicators (e.g. debt, deficit, current expenses) which may be used as the criterion and the methods of enforcement. Besides, I discuss their effectiveness, based on past empirical studies. In the third chapter I summarize the constitutional fiscal rules which have been adopted in Germany, Poland, Hungary and Slovakia, using these countries as examples of four distinct models of regulation. I analyze their key features and assess them on the basis of the two major evaluating criteria, i.e. whether they are democratic enough and likely to be effective. Finally, I conclude that some of the constitutional provisions adopted meet the requirements, but others do not.

1 Budgetary powers of parliament: history and limits

Before we start to look closer at fiscal stability rules, we need to examine the nature of budgetary powers of parliaments. In this chapter I will focus on their historical origin and the rationale behind, and demonstrate the flaws they have. Using a historical example from the U.S., I will argue that certain limitations of parliament may actually be not against, but rather in favor of democracy.

1.1 Parliamentary oversight: origin, rationale and flaws

The outset of the power to adopt state budget dates back to 1215 when John, King of England, issued his famous Magna Carta Libertatum as a concession to the nobility. In Article 12 and 14 it ordained that:

> 12. No scutage not aid shall be imposed on our kingdom, unless by common counsel of our kingdom, except for ransoming our person, for making our eldest son a knight, and for once marrying our eldest daughter; and for these there shall not be levied more than a reasonable aid…
>
> 14. And for obtaining the common counsel of the kingdom anent the assessing of an aid (except in the three cases aforesaid) or of a scutage, we will cause to be summoned the archbishops, bishops, abbots, earls, and greater barons, severally by our letters; and we will moreover cause to be summoned generally, through our sheriffs and bailiffs, and others who hold of us in chief, for a fixed date, namely, after the expiry of at least forty days, and at a fixed place; and in all letters of such summons we will specify the reason of the summons.[5]

At that time, it was a revolutionary provision which required the King to collect taxes only with consent of Parliament. However, it was not sufficient, as it only covered the income part of the budget. As Wehner notes, the kings learned how to go around this requirement by making debts for their expenses relying on the fact that parliament would eventually have to agree with taxes to pay them back. It took centuries before parliament gained also the power to approve expenses, which was finally confirmed by the Bill of Rights of 1689.[6] The

[5] "Magna Carta Libertatum," 1215, http://www.constitution.org/eng/magnacar.htm.

[6] Joachim Wehner, *Legislatures and the Budget Process: The Myth of Fiscal Control* (London: Palgrave Macmillan, 2010), 3.

budgetary powers not only shifted towards parliament, but they were also democratized as the non-elected House of Lords lost its veto power over money bills. At first only as a custom, but after a struggle with the House of Commons it was formally enacted by Parliamentary Act of 1911.[7]

Given these origins, we may argue that the parliamentary oversight of the budget has had two historical rationales. First, it provides a democratic control of how much public money should be collected and to what purposes the money should be spent, i.e. the implementation of the "no taxation without representation" principle. And second, it is a safeguard against making unsound debts or, put more generally, a guarantee of sound fiscal policy of the state.

The latter function had been successfully fulfilled by the end of World War Two, largely thanks to the fact that deficits were – except for extraordinary periods, such as wars – considered immoral. This view has been abandoned, however; not only under the influence of Keynesianism, but also due to the Neoclassic economic theory which urges stable tax rates even at the cost of temporary deficits.[8] Shortly after the old moral paradigm had been left, government debts in developed countries started to increase rapidly in 1970s[9] and running a deficit has become a new standard.

The reason for this behavior is the so-called *deficit bias* which is "a tendency to run fiscal deficits that are not consistent with medium-term fiscal sustainability".[10] Above all, this is caused by the fact that governments often prefer short-term objectives, such as to be re-

[7] Ibid., 6.

[8] Ralph M. Wrobel, "Balanced Budget Rules in Europe: A Comparative Institutional Analysis," *International Area Studies Review* no. 1 (2008): 156.

[9] According to OECD, „[g]ross general government debt as a share of GDP for the OECD area has been gradually on the rise since the 1970s, reaching a record level of nearly 100% in 2010." (OECD, "Government Debt," in *OECD Factbook 2011-2012: Economic, Environmental and Social Statistics* (OECD Publishing, 2011), http://dx.doi.org/10.1787/factbook-2011-91-en).

[10] Ana Corbacho and Gerd Schwartz, "Fiscal Responsibility Laws," in *Promoting Fiscal Discipline*, ed. Manmohan S. Kumar and Teresa Ter-Minassian (Washington, D.C.: International Monetary Fund, 2007), 59.

elected, to long-term ones like sustainable public finances.[11] Moreover, public finances suffer from a "common pool" problem which causes that not only the government, but rather each individual or interest group in the society tries to maximize their own benefit regardless of the common costs, especially as they are only to be revealed in a long-term perspective.[12] And on the top, the fiscal policy is often pro-cyclical, which means that it is loose in good times and tight in bad times, whereas economic theory recommends quite the opposite.[13]

1.2 First constitutional restraints of borrowing in 19th century

The first efforts to constitutionally restrain the power of parliaments to run deficit were made already in the mid-19th century in the USA, at the states' level. It was a response to a series of debt crises which occurred due to public overspending on large infrastructure projects, such as railways and canals. The states believed that the debts would be paid back by tolls and other usage fees, but this did not happen, partly due to a financial crisis and subsequent economic downturn.[14] Contrary to previous similar cases, Congress refused to cover their obligations, with the consequence that nine states defaulted in 1841 and 1842.[15] As a response, ten states changed their constitutions and added various versions of debt brakes, procedural or substantive.[16] As this trend continued, a recent survey shows that 41 out of 50 states nowadays have a legal requirement that the legislature must pass a balanced budget while in 37 states the governor is required to sign a balanced budget: only 4 states have

[11] Joaquim Ayuso-i-Casals et al., "Beyond the SGP – Features and Effects of EU National-Level Fiscal Rules," in *Fiscal Policy: Current Issues and Challenges: Papers Presented at the Banca d'Italia Workshop Held in Perugia, 29-31 March, 2007* (Rome: Banca d'Italia, 2007), 655.

[12] Alta Fölscher, "A Balancing Act: Fiscal Responsibility, Accountability and the Power of the Purse," *OECD Journal on Budgeting* no. 2 (2006): 139.

[13] See Fabrizio Balassone and Manmohan S. Kumar, "Cyclicality of Fiscal Policy," in *Promoting Fiscal Discipline*, ed. Manmohan S. Kumar and Teresa Ter-Minassian (Washington, D.C.: International Monetary Fund, 2007), 19–35.

[14] C. Randal Henning and Martin Kessler, *Fiscal Federalism: US History for Architects of Europe's Fiscal Union*, Working Paper WP 12-1 (Washington, D.C.: Peterson Institute for International Economics, 2012), 6.

[15] Richard C. Schragger, "Democracy and Debt," *The Yale Law Journal* 121 (2012): 861.

[16] John Joseph Wallis, "Constitutions, Corporations, and Corruption: American States and Constitutional Change, 1842-1852," *Journal of Economic History* 65, no. 1 (2005): 234.

neither of these. Moreover, in 39 states these requirements are enacted at the constitutional level.[17]

It is remarkable that these provisions were not mandated or promoted by the federal government.[18] It was the voters themselves who asked for these amendments, largely because they believed that this is a way how to improve the political process and prevent its distortions.[19] In this view, the restraint of legislatures which followed was in favor of democratic political process.

Conclusion

Both empirical data on the rate of indebtedness of developed countries and the theoretical consideration of deficit bias show that the current state of parliamentary control of budget clearly fails to meet one of its two rationales. While it keeps providing the budget with democratic legitimacy, it is no longer a guarantee of sound fiscal policy. Therefore I believe, and this is a standpoint for the following parts of the paper, that it is legitimate to examine other possibilities to achieve this aim. I ague, that even though this amounts to a certain restriction on the discretion exercised by the democratically elected parliament, this restriction is not an infringement, but rather a support of democratic political process. However, a question of the means, in particular how to strike a proper balance between the democratic legitimacy and sustainability of public finances which both must be preserved, still remains.

[17] National Association of State Budget Officers, *Budget Processes in the States*, Summer 2008 (Washington, D.C.: National Association of State Budget Officers, 2008), 40.

[18] Henning and Kessler, *Fiscal Federalism: US History for Architects of Europe's Fiscal Union*, 10.

[19] Wallis, "Constitutions, Corporations, and Corruption: American States and Constitutional Change, 1842-1852," 248.

2 Fiscal stability rules, their types and effectiveness

From the constitutional point of view, two basic ways how to eliminate or at least reduce the deficit bias can be imagined. First, we may enact a constitutional provision stipulating certain substantial limits which parliament (and government) must obey when passing a budget and managing public finances. A ban on deficits, such as the one being used in many U.S. states, may serve as an example. And second, we may cure the shortcomings of parliament by delegating budgetary power, or a part of it, to an independent and non-elected authority which would pursue more long-term objectives. These two possibilities give rise to what is called *numerical fiscal rules* and *independent fiscal institutions (fiscal councils).* In this chapter I will discuss their modalities, effectiveness and enforcement.

2.1 Independent fiscal institutions

The idea of employing independent fiscal institutions draws on the undeniable success of the concept of independent central banks. The fact that monetary policy, including issuing money, was taken away from the government has secured monetary stability for a long period of time. In a way it is striking: the combination of the very strong powers and weak electoral legitimacy is not very common in democracy, yet it is not being challenged here. We may say that it is simply because the concept is so old that no one even thinks about it. In my view the explanation is rather that this institutional design is acknowledged as a convincing and functional solution to a social problem which could not be solved appropriately within the framework of direct rule of popular will.[20]

So if independent bodies have managed to solve the problem with unsound monetary policy and still no one seriously questions their reconcilability with democracy, should we not use

[20] For a thorough analysis of independent authorities, their functions and constitutional position see András Sajó, "Independent Regulatory Authorities as Constitutional Actors: A Comparative Perspective," *Annales Universitatis Scientiarum Budapestinensis De Rolando Eötvös Nominatae Sectio Iuridica* 48 (2007): 5–52.

the same cure for fiscal policy? Quite a few economists argue for stepping forward this way, at least up to a certain extent which respects that unlike monetary policy, fiscal policy has a strong redistributive character.[21] Debrun et al. recall four criteria given by economic theory which determine whether a certain policy should be delegated to an independent body. There must be

> [1.] socially harmful distortions in policymaking undertaken by political representatives…
> [2.] a broad consensus on what constitutes 'sound policy'…
> [3.] delegated mandates should not be primarily distributive or have major distributive consequence…
> [4.] delegation should not give rise to major policy coordination problems.[22]

They observe that while monetary policy fits well in these criteria, it is not that clear-cut with the fiscal policy. Nonetheless, similarly to other authors promoting this idea, they find a solution that only the deciding on the fiscal balance should be delegated, whereas all other fiscal areas of fiscal policy would stay with the parliament.[23] Put differently: the parliament would keep full discretion on how much – and in which manner – money should be raised and spent, but it should not overstep the overall balance of the budget set bindingly by the independent fiscal authority.

I am not wholly satisfied with this conclusion. Redistribution in society is one of the key issues which need to be decided on by the political process: if the political branches could not decide on how much money should be raised and spend anymore, what else would remain in the domain of politics? Therefore I agree that this part of fiscal policy must stay with

[21] Most notably Charles Wyplosz, *Fiscal Policy: Institutions vs. Rules*, HEI Working Paper 03/2002 (Geneva: The Graduate Institute of International Studies, 2002). See also literature review and further reasoning in Adam Geršl, "Political Economy of Public Deficit: Perspectives for Constitutional Reform," *Czech Economic Review: Acta Universitatis Carolinae Oeconomica* 1, no. 1 (2007): 67–86.

[22] Xavier Debrun, David Hauner, and Manmohan S. Kumar, "The Role for Fiscal Agencies," in *Promoting Fiscal Discipline*, ed. Manmohan S. Kumar and Teresa Ter-Minassian (Washington, D.C.: International Monetary Fund, 2007), 108–112.

[23] Ibid.

parliament. But is that enough? I do not believe that the two parts, as designed by Debrun et al. and others, are easily separable. Budgeting processes are very complicated as they affect many areas of public policy. In fact, most of both revenues and expenses are prescribed by law which means that even if a change is seen as desirable, it takes time and negotiations. Stringent limit, i.e. the balance of budget set by the independent fiscal authority, could easily cause an institutional deadlock. Hence I might agree that this design complies with the first three out of four criteria mentioned above, but I am not convinced it complies with the fourth.

Nonetheless, there is another – and non-problematic – option which Wyplosz refers to as a "soft solution",[24] and this is the so-called wise persons or fiscal councils. The main difference from the independent fiscal authorities is that the fiscal councils do not have any decisive powers. Instead they may provide analysis of the fiscal situation and predictions, or even assess "the appropriateness of fiscal policy in a given macroeconomic environment".[25] There is not delegation of powers and their findings are not formally binding, but this does not mean they would be impotent. They enjoy an independent status, credibility and "expert nimbus", altogether creating a great potential to influence the public opinion, which in fact makes them powerful. This may be supported even further by certain formal procedures. In Germany, e.g., the government has to publicly explain why it did not respect a recommendation given by the Council of Economic Experts which bears some reputational costs.[26]

---

[24] Wyplosz, *Fiscal Policy: Institutions vs. Rules*, 81.

[25] Debrun, Hauner, and Kumar, "The Role for Fiscal Agencies," 115.

[26] Ondřej Schneider, *Rozpočtové instituce - evropské zkušenosti a aplikace na Českou republiku [Fiscal Institutions – European Experiences and their Application on the Czech Republic]*, Studie IDEA 1/2012 (Praha: Národohospodářský ústav AV ČR, 2012), 7.

2.2 Numerical fiscal rules

The second kind of fiscal stability rules, numerical fiscal rules, can be defined as "a permanent constraint on fiscal policy, typically defined in terms of an indicator of overall fiscal performance".[27] Depending on what variable is used as the "indicator" we may further distinguish three major types of rules: debt rules, expenditure rules and deficit rules.

The debt rules are typically formulated as a maximal permissible level of state's indebtedness in relation to GDP. At first sight this is a sound idea as it goes to the core of the problem: the state budget may be in deficit time to time, especially during economic downturns, but the overall debt should be kept within some reasonable limits. There are two problems, however. The first one is that as there is no universal or scientific view on what an appropriate level of debt is, it inevitably calls for arbitrariness. This is particularly well illustrated by the 60 % of GDP debt limit set by Maastricht Treaty which was not a result of any expert assessment, but rather a matter of co-incidence as it simply corresponds to the average level of debt in European countries on the day the Treaty was finalized.[28] It is not only the case of the European Union: as we will see later, even when the limit is set domestically, it is largely influenced by the present situation which is aimed to be either preserved or improved. Constitutional provisions, however, should be designed on a more abstract basis with the view that they will persist for a long time.

The second problem is that the debt rule does not work properly. In good times, when the actual debt is well below the limit, it does not restrain the governments at all. Actually, given the method of calculation, when the GDP grows, the government may run deficit and still the ratio of debt remains the same. This is illustrated by the Table 1: if we assume the debt level

[27] George Kopits and Steven Symansky, *Fiscal Policy Rules* (Washington, D.C.: International Monetary Fund, 1998), 2.

[28] Wyplosz, *Fiscal Policy: Institutions vs. Rules*, 79.

at 60 % and the economic growth at, e.g., 5 %, then the budget deficit may be up to almost 3 % GDP and still the level of indebtedness remains the same. But it works both ways: in bad times of economic recession the level of debt grows automatically even if the budget is balanced which means that if government wanted to comply with the rule, it would actually need to run a surplus. Governments do not need rules to be motivated to spend during expansion and save during recession, they can do it themselves: but it is exactly against the objective to be achieved.

	GDP growth	GDP	Debt	Deficit	% Deficit
Year - 1		1000	600	0	
Year	5%	1050	630	-30	-2,9%
	4%	1040	624	-24	-2,3%
	3%	1030	618	-18	-1,7%
	2%	1020	612	-12	-1,2%
	1%	1010	606	-6	-0,6%
	0%	1000	600	0	0,0%
	-1%	990	594	6	0,6%
	-2%	980	588	12	1,2%
	-3%	970	582	18	1,9%
	-4%	960	576	24	2,5%
	-5%	950	570	30	3,2%

Table 1: Simulation of debt-neutral deficit depending on level of GDP-growth

The expenditure rules seem to be a more powerful tool, although on their face they point at a different target. Instead of dealing with deficit or debt, they simply forbid the budget expenditures to be increased by more than certain percentage points or value from year to year. This is a smart idea which limits the pork-barreling in good years: when the economy is growing, the additional income (e.g., from taxes) should be used rather for paying back the debt than for additional expenses. On the other hand, it seems to be too restrictive to be constitutionalized: one cannot reasonably foresee all possible future circumstances. Furthermore, if constitutionalized, this rule would fix the current level of redistribution in the society, which is not desirable – and maybe even permissible – in democracy. The level of taxation and public spending needs to be subject of political process and ideological competition between proponents of higher and lower redistribution, and thus it should not be petrified forever. Hence, although this tool may be beneficial, it should rather be used on the basis of political consensus and not law.

The deficit rules, the third type of numerical fiscal rules, are concerned with the budget balance. The basic form of this rule simply ordains that any budget approved must be either surplus or balanced (*balanced budget rule*). Nonetheless, in this form it suffers from a similar deficiency like debt rules: too loose during good times when it fails to force the governments to discipline and too strict during the bad times. In fact, it is not only pro-cyclical, but also impracticable due to automatic stabilizers[29] which are triggered during economic downturns. It is true that the balance budget rules are used in many US states as we discussed above, but that confirms rather than refutes this assessment. Henning and Kessler rightfully argue that the US system is functional just because state and municipal budgets account only for a smaller part of government spending. The remaining 60 percent is spent at the federal level which is not bound by these rules, and thus it plays the stabilizing role during recessions.[30]

Another form is the so-called golden rule which allows for some deficit, but only to cover capital and not current expenditures. Its perhaps the best well-known instance was the former Article 115 of the German Constitution, which prescribed that "revenue obtained by borrowing should not exceed the total of investment expenditures provided for in the

[29] This term stands for certain features of public budget policy which help to smooth out the economic cycle. Since taxes are generally set as a fixed percentage of income, profit or sales, often even progressively, the tax revenues decrease during economic downturns, which means that the money remains with households and companies and support their economic activity. At the same time, more people get entitled for unemployment and welfare benefits, and thus again more money is transferred to the economy. Altogether this means that even if the government remains inactive during a recession, automatic stabilizers help the economy, with an obvious consequence of worsening the budget balance as a trade-off.

[30] Henning and Kessler, *Fiscal Federalism: US History for Architects of Europe's Fiscal Union*, 14–15 and 20.

budget."[31] The underlying logic is that although the present generation shall not live on the expenses of its successors, it does not seem to be unfair to share the burden of costs for long-term investments with them. Nevertheless, regardless how just and fair this rule may be perceived, it is in fact even less practical than the basic balanced budget rule as it allows the government to spend even more during good times.[32]

The third form is a response to the flaws of the former two. The main difference is the time horizon: it does not work primarily with one fiscal year, but rather with the whole business cycle. Its goal is a balanced budget over the cycle: during the economic expansion the budget should be in surplus which is used to cover the budget deficits during recession. Another way to express this concept is that the budget shall not be in a *structural deficit.* It really solves the two main objections: it is strict enough to enforce fiscal discipline but flexible enough to work counter-cyclically during economic downturns. Therefore I believe this is the optimal solution.

Nothing is perfect, though. The difficulty here is how to determine the phase of the economic cycle and in particular the structural deficit. Wyplosz notes that "business cycles are of varying duration and amplitudes; cyclical adjustments are open to a large degree of arbitrariness."[33] It is certainly not a simple operation with an obvious result, but rather a matter of interpretation, assessment and estimation. If we left this task solely to parliament or the minister of finance, the restraint might easily become somewhat less restraining; which brings us to the issue of effectiveness.

[31] "Basic Law for the Federal Republic of Germany (Grundgesetz, GG)," accessed March 21, 2013, http://www.iuscomp.org/gla/statutes/GG.htm#115.

[32] For a detailed study of reasons which led to abandoning of the golden rule in Germany see Elke Baumann and Christian Kastrop, "A New Budget Rule for Germany," in *Fiscal Policy: Current Issues and Challenges: Papers Presented at the Banca d'Italia Workshop Held in Perugia, 29-31 March, 2007* (Rome: Banca d'Italia, 2007), 595–612.

[33] Wyplosz, *Fiscal Policy: Institutions vs. Rules*, 83.

2.3 Effectiveness of fiscal rules

There is quite an extensive literature on the effectiveness of fiscal rules; however, it is somewhat inconclusive. Generally, authors tend to conclude that the rules have certain impact: there have been many empirical studies finding a positive correlation between an introduction of fiscal rules and a betterment of fiscal performance of the countries.[34] The numerical fiscal rules are usually not the only explanation, though. For instance, a significant positive correlation has been found between the strong position of the finance minister both in preparatory and execution phase of the budget process and sound fiscal outcomes.[35]

Furthermore, there is an endogeneity problem: even if the correlation is established, is there also causality? Put differently, does the introduction of fiscal rules cause bigger responsibility of governments and therefore better fiscal management, or is rather the introduction of fiscal rules one of the consequences of the fact that the governments decide for such responsibility? If the latter was true, the rules themselves would actually be of a little significance. Indeed, there is evidence supporting the view rather political commitment is decisive. Examining the fiscal rules introduced in 25 EU member states over the 1990-2005 period, Ayuso-i-Casals et al. discovered that shortly after the rules had been enacted, government spending decreased on average, suggesting a shift towards a more sound fiscal policy. However, this effect was only short-term: in 5-years perspective there was no more a significant difference between countries that had enacted the rules and which had not.[36] Moreover, Corbacho and Schwartz

[34] See, for instance, a review of literature in Corbacho and Schwartz, "Fiscal Responsibility Laws," 61.

[35] See Carlos Mulas-Granados, Jorge Onrubia, and Javier Salinas-Jimenéz, "Do Budget Institutions Matter? Fiscal Consolidation in the New EU Member States," in *Fiscal Policy: Current Issues and Challenges: Papers Presented at the Banca d'Italia Workshop Held in Perugia, 29-31 March, 2007* (Rome: Banca d'Italia, 2007), 613–650, or Leif Helland, "Fiscal Constitutions, Fiscal Preferences, Information and Deficits: An Evaluation of 13 West-European Countries 1978-95.," in *Institutions, Politics and Fiscal Policy*, ed. Rolf R. Strauch and Jürgen von Hagen, ZEI Studies in European Economics and Law 2 (Boston: Kluwer Academic, 2000), 107–138.

[36] Ayuso-i-Casals et al., "Beyond the SGP – Features and Effects of EU National-Level Fiscal Rules," 679–680.

observed that in countries where the rules have had the highest impact, the change in trend in fact started already before they were enacted.[37]

Both these findings support the view that political consensus on the balanced budgeting is in fact the most important factor.[38] As Debrun and Kumar put it:

> [Fiscal] rules are primarily the manifestation of an implicit contract with the electorate, a public signal of the commitment to maintain mutually agreed standards of fiscal discipline. The adoption of rules reflects a conscious commitment to fiscal discipline rather than an attempt to suppress discretion and reduce its potentially injudicious use.[39]

However, albeit political consensus or "implicit contract with the electorate" may be the most important factors, it is not enough to rely solely on them. As Madison famously said, "If men were angels, no government would be necessary. If angles were to govern men, neither external nor internal controls government would be necessary."[40] Men are not angles, though, and thus they adopt constitutions and constitutional constraints which ensure that the current consensus on fundamental will be maintained also in the future. To serve this purpose, the rules need to be enforced.

2.4 Enforcement of fiscal rules

If we ask who should be in charge of enforcement of constitutional norms, the answer seems to be obvious. It is the task of the judiciary, in the European context particularly of constitutional courts. But when constitutional fiscal stability rules are concerned, it becomes somewhat less obvious. The main reason is that the rules are very closely linked with the political process, and therefore courts traditionally approach them with a great degree of self-

[37] Corbacho and Schwartz, "Fiscal Responsibility Laws," 71.

[38] Wrobel, "Balanced Budget Rules in Europe: A Comparative Institutional Analysis."

[39] Xavier Debrun and Manmohan S. Kumar, "Fiscal Rules, Fiscal Councils and All That: Commitment Devices, Signaling Tools or Smokescreens?," in *Fiscal Policy: Current Issues and Challenges: Papers Presented at the Banca d'Italia Workshop Held in Perugia, 29-31 March, 2007* (Rome: Banca d'Italia, 2007), 506.

[40] James Madison, "The Federalist #51," 1788, http://www.constitution.org/fed/federa51.htm.

restraint. The most striking is the US example: Kelemen and Teo observe that although there is an extensive case-law on various fiscal provisions (e.g. of procedural nature), there are only few cases concerning the balanced budget rules. And furthermore, the courts have "show[n] political branches considerable deference in this field" with the consequence that these rules are hardly ever enforced by courts.[41] But there may be also other good explanations, such as a lack of expertise: great lawyers, not economists usually become (constitutional) judges.

Moreover, greater activity of constitutional courts in this field is limited by their nature of "negative legislators". Even if they decided to annul the budget overstepping, e.g., the maximal deficit, what would follow? Not much, in fact, except for the chaos it would cause. Should be the fiscal policy improved and deficit reduced, an extensive activity by both legislature and executive is necessary. But this is exactly at the heart of political decisions which cannot be effectively prescribed by a constitutional court. I believe that although the courts will probably start to treat economic questions in a more active way once the rules are enacted to constitutions, still they cannot be relied on to be the primary way of enforcement.

Another alternative would be an independent fiscal authority empowered to veto the budget if it did not meet the binding criteria the authority had set. We have already excluded this option, however, because of the high risk of institutional deadlock and questionable legitimacy.

In the European Union context, distinctively, also international enforcement comes into the picture. Already the original version of Stability and Growth Pact adopted in 1997 contained a "corrective arm" which was supposed to be used if any state ran an excessive deficit, i.e. more than 3 % of GDP. The Council, on a proposal of the Commission, was supposed to

[41] R. Daniel Kelemen and Terence K. Teo, *Law and Eurozone Crisis*, Paper Prepared for American Political Science Association Annual Convention, August 30-September 2, 2012, 5 and 10.

issue recommendations to the state and set a deadline for effective action to be taken. If this had not been fulfilled, various sanctions could be imposed, including fines.[42] In practice, however, these provisions were never used, mainly due to the complicated procedure which could be blocked both at the Commission and the Council. The most striking example happened in 2003 when the Commission proposed to step further in sanctions procedure. It was rejected in the Council, also by France and Germany which themselves were in breach of the threshold for deficit at that time.[43]

This past failure may suggest that international enforcement is not very effective, especially when larger states are involved. Nonetheless, the procedural shortcomings were substantially improved by the Fiscal Compact. The main change is that the qualified majority of the Council is not required for imposition of sanctions, but rather for the opposite. If the Council remains silent, the Commission may impose them in its own capacity.[44] Taking into consideration all the bitter experiences the European and Euro area countries have come through during last few years of financial crisis, it seems that the willingness to enforce the rules has increased substantially and the peer pressure can really become more effective.

In the past, economists thought that the best solution would be provided by the market. If government runs deficit, it must acquire the missing funds somewhere. One possibility would be to borrow from the central bank, but as it comes with a high risk of moral hazard, this is forbidden in most of the countries. The second possibility is to turn to the markets and borrow there, e.g. by issuing state bonds. Investors should assess the risk then, based on the state's fiscal policy. If its public finances are not sustainable, the investors, banks etc. should

[42] See *Council Regulation (EC) No 1467/97 of 7 July 1997 on Speeding up and Clarifying the Implementation of the Excessive Deficit Procedure*, 1997.

[43] Ludger Schuknecht et al., *The Stability and Growth Pact: Crisis and Reform*, Occasional Paper Series (Frankfurt: European Central Bank, September 2011), 9–10.

[44] Johannes Holler and Lukas Reiss, "What to Expect from the Latest Reform of the Stability and Growth Pact," *Monetary Policy & The Economy* no. Q4/11 (2011): 89–91.

not buy its bonds, or at least they require a risk premium, which both motivates the government to make some reforms. Unfortunately, it has been demonstrated that this theory does not work in practice. During economic expansions, the market actors actually encourage the states to make debts as this is the source of their profit, while during downturns financial sources suddenly become unavailable.[45] Once again, it is not an effective constraint and it is pro-cyclical.

Drawing on these findings, Kelemen and Teo come with another theory. They assume that the failure of market enforcement of sustainable fiscal policy is partly based also on the variety of market participants who "often hold different views which makes coordination challenging and decentralized punishment difficult."[46] In this setting, fiscal rules can serve as a unifying focal point that gives a clear guidance to the market, and the market itself can enforce them then. According to them, the most important attribute of fiscal rules is thus their clarity, and therefore they dislike the Fiscal Compact's adherence to *structurally* balanced budget which needs to be, as we have discussed already, a matter of assessment and interpretation.[47]

I find the idea of collective enforcement very persuasive: we have just recently experienced falls of Italian and Greek governments which were primarily caused by market turbulences. Also, we should not underestimate the citizens and voters: similarly like in the mid-19th century in the US, they have realized that a sustainable fiscal policy is necessary and they are now more demanding in this respect. Both them and the markets need a lighthouse, though, to signalize whether the fiscal policy is actually sustainable or not. Nevertheless, I believe that the criterion of a structurally balanced budget is not, as such, unsuitable for this purpose. The

45 Schragger, "Democracy and Debt," 864.

46 Kelemen and Teo, *Law and Eurozone Crisis*, 12.

47 Ibid., 21–22.

solution I would promote is a combination of this rule with an independent fiscal council overseeing the steps of the government and legislature and providing the public are being fulfilled, including market participants, with an independent and expert assessment how the rules. In this way the lower clarity of the rule, compared to the basic balanced budget rule, would be compensated while retaining its counter-cyclical character.

Conclusion

In this chapter we have discussed various alternatives which may overcome the deficit bias of governments and ensure a responsible fiscal policy. Delegation of budgetary powers, or a part of it, proved to be an inappropriate solution, both because of the lack of democratic legitimacy and because of the risk of institutional deadlock. Instead, I have argued in favor of a "soft solution" which would strengthen the commitment to sustainable fiscal management and support, but not replace the political process. This solution counts on an independent fiscal council authorized to issue expert recommendations and assessments of fiscal policy issues, but not decisions or vetoes. At the same time, a numeric fiscal rule should be incorporated into the constitution to set a fiscal goal both the council and political branches. A careful design of the rule is essential. It must be strict enough during good times and loose enough in bad times, in order to work counter-cyclically. Therefore the rule should be based on structural deficit rather than actual annual deficit or overall debt. The adherence to the rule would be a result of enforcement by interplay between the fiscal council, markets and voters.

3 Constitutionalizing of the rules in EU member states

Having established what the rules ought to be, it is time to see what they really are. After preliminary research, I decided to further explore four countries which may serve as a perfect example of four distinct approaches to the problem: Germany, Poland, Hungary and Slovakia. In this chapter, I will describe the main features of the rules which have been adopted in these countries and evaluate them on the basis of the conclusions made in previous parts.

3.1 Germany

"Once again German will be spoken in Europe," the then prepared Fiscal Compact was to be evaluated by one of the leaders of the German governmental party CDU.[48] The final version of the treaty confirms his statement: despite there are some differences within the partial parameters, Germany has basically managed to get through its own constitutional arrangement which was adopted with effect from August 1, 2009.

Its core is a new wording of Article 109 paragraph 3 of the Basic Law, according to which the federal budget as well as states' budgets shall "in principle be balanced without revenue from credits".[49] In particular, in the case of federal budget a deficit in a maximum amount of 0.35% GDP is admissible. However, it is a structural deficit: if economy deviates from normal development, Article 115 provides for that also the maximum deficit is adjusted accordingly, in both directions. The debts which have arisen in this way must be settled in the course of the economic cycle. Exceptions are allowed also in the case of "natural catastrophes or unusual emergency situations beyond governmental control and substantially harmful to the state's financial capacity". There has been established so-called Stability Council

[48] Besselink and Reestman, "The Fiscal Compact and the European Constitutions: 'Europe Speaking German'," 2.

[49] Christian Tomuschat and David P. Currie, trans., "Basic Law for the Federal Republic of Germany," 2012, http://www.gesetze-im-internet.de/englisch_gg/englisch_gg.html.

composed of both federal and state governments' representatives whose task is to continuously supervise the budgetary management and to prevent budget crises (Article 109a).[50] In addition the Economic Expert Council (so called "Wise Persons Council") is still functioning. It has only advisory vote but if the government decides to ignore its recommendation, it must give a public explanation.[51] The constitutional anchoring of the budget rules also comes with the possibility for the budget to be reviewed by the Federal Constitutional Court.

The effectiveness of the new rules has been postponed so that both the federal budget and the state budgets can adapt to them gradually. Under the temporary provision in Article 143d, they become fully effective in regards to the federation only as of January 1, 2016 and in regards to the states even as of January 1, 2020.

3.2 Poland

Poland is among 25 EU membership states which have signed the Fiscal Compact, however it has not completed the ratification process yet.[52] The duty to meet the fiscal rules and to transpose them into its legal order shall not apply to it until it becomes a member of the Euro area or decides for a voluntary opt-in. Yet, the Polish Constitution contains budgetary limitation, already since its adoption in 1997. Under Article 216, it is "neither permissible to contract loans nor provide guarantees and financial sureties which would engender a national public debt exceeding three-fifths of the value of the annual gross domestic product."[53] The constitution contains also a procedural limitation: solely the government has the right to

[50] For more details see Frank Zipfel, *Stability Council: Financial Inspector of Germany's Länder* (Frankfurt: Deutsche Bank Research, 2011).

[51] Schneider, *Rozpočtové instituce - evropské zkušenosti a aplikace na Českou republiku*, 7.

[52] European Parliament, "Table on the Ratification Process of Amendment of Art. 136 TFEU, ESM Treaty and the Fiscal Compact" (European Parliament, February 21, 2013), http://www.europarl.europa.eu/webnp/webdav/site/myjahiasite/users/fboschi/public/esm%20tscg/art.%20136%20ESM%20fiscal%20compact%20ratprocess.pdf.

[53] "The Constitution of the Republic of Poland," 1997, http://www.sejm.gov.pl/prawo/konst/angielski/kon1.htm.

propose the state budget (Article 221) and the Sejm (the first chamber of parliament) shall not perform such changes which would lead to an increase of the budget deficit (Article 220). If the budget is not approved during four months after it has been presented, the President of the Republic can dismiss the Sejm. The President of the Republic shall also have the right to submit the adopted budget to be reviewed by the Constitutional Court (Article 224).

The Public Finance Act setting out two state debt safety limits follows the constitutional arrangement.[54] If the state debt gets into the interval between 50 and 55 % of GDP, the government shall not submit a state budget proposal with a higher deficit than in the previous year. If the debt reaches an interval between 55 and 60 % of GDP, the state budget is to be proposed in such a way that the debt ratio to GDP is not increased. And finally, if the debt exceeds 60 %, the constitutional rule, according to which the state budget must be balanced or in surplus, shall be applied. Moreover, legal limits (so called Belka's rule)[55] has been adopted in 2011, according to which non-mandatory and newly approved state budget expenses shall not increase year-on-year more than by 1 % in real prices (cleansed of inflation).[56]

According to OECD methodology, the total level of state debt reached 57 % in 2011 which means that the 55 % threshold triggering the debt increase prohibition has been exceeded and certain measures should have been activated. In fact this did not happen since the government has transferred the infrastructural project financing to BGK, a state owned development bank,

[54] See Aleksander Rutkowski, "Ceilings and Anchors: Fiscal Rules for Poland," *ECFIN Country Focus* 4, no. 4 (2007): 1–6.

[55] The rule is named according to former vice-premier Marek Belka who proposed it already in 2001, but it was not adopted at that time.

[56] Andrea Schaechter et al., *Fiscal Rules in Response to the Crisis - Toward the "Next-Generation" Rules. A New Dataset*, IMF Working Paper (International Monetary Fund, July 2012), 43.

the obligations of which they do not count into the state debt, which means a decline of about 3,5 %.[57]

3.3 Hungary

In terms of the Fiscal Compact, Hungary is in a similar situation as Poland: it has signed it but not ratified it yet,[58] and in any case the fiscal rules anchored in it do not apply to Hungary until they enter the Euro area or unless they decide for a voluntary opt-in. The new Hungarian constitution adopted in March 2011 and effective as of January 1, 2012, thus still before the completion of the Fiscal Compact, contains, however, strict fiscal stability rules. The starting point is Article N in basic provisions of the Constitution, according to which

> Hungary shall enforce the principle of balanced, transparent and sustainable budget management. Parliament and the Government shall have the primary responsibility… [However,] in the course of performing their duties, the Constitutional Court, courts, local governments and other state organs shall [also] be bound to respect the principle.[59]

This principle is followed by Article 37, which stipulates the debt ceiling in amount of 50 % GDP, i.e. about 35 percentage points less than what the current state is.[60] No state budget can increase the state indebtedness level over this limit (Article 36, paragraph 4); and as long as the debt level is over the 50% limit it is even required that each state budget reduces the relative indebtedness in relation to GDP (paragraph 5). Exceptions are admissible only in case of a “special legal order” or during “a significant and enduring national economic recession, to the extent necessary to restore the balance of the national economy“ (paragraph 6).

[57] OECD, *Poland*, OECD Economic Surveys, March 2012, 13.

[58] European Parliament, “Table on the Ratification Process of Amendment of Art. 136 TFEU, ESM Treaty and the Fiscal Compact.”

[59] “The Fundamental Law of Hungary,” 2011, http://mkab.hu/rules/fundamental-law.

[60] OECD, *Hungary*, OECD Economic Surveys, March 2012, 4.

In order to enforce these rules, the Constitution has established the Budget Council (Article 44) consisting of the President of the Budget Council appointed by the President of the Republic (without countersignature) for the period of six years, and of two *ex officio* members. These are the Governor of the National Bank of Hungary appointed by the President of the Republic – with countersignature of a member of the Government – for a 6 years term, and the President of the State Audit Office elected by the Parliament by two-thirds majority for a 12-year term. At first sight, the Council has predominantly advisory character: it is a body "supporting the legislative activity of the Parliament; it shall examine whether the central budget is well-founded… [and] …take part in the preparation of the Act on the central budget" (Article 44). In fact, however, its position is extraordinarily strong since its previous approval that the balanced or surplus budget requirement has been fulfilled is required for the adoption of the state budget: it has thus the right of absolute veto. If the Parliament passes the budget despite, it can be cancelled by the Constitutional Court for the breach of procedural rules (Article 37, paragraph 4).

This provision can lead in practice to an essential conflict of institutions and result in early elections: under Article 3 paragraph 3, if the state budget is not approved by March 31 of the given year, the President of the Republic can dissolve the Parliament. Moreover, one can imagine, theoretically, the situation that not even the newly elected Parliament finds an agreement with the Budget Council, and thus the constitutional crises will be pro-longed. This constitutional provision is subject of justified criticism not only for the conflict with democratic values (the three member council appointed for a long term can block the functioning of the parliament with much bigger democratic legitimacy) but also for imprudence (such a crisis can have a worse impact on the state economy than a budget deficit).[61]

3.4 Slovakia

Slovakia is a member of the Euro area and it ratified the Fiscal Compact on January 17, 2013 which means that the fiscal rules set out should be implemented at the latest by February 1, 2014. In reality, the constitutional Act on Budget Responsibility, effective as of March 1, 2012 (in some parts as of January 1, 2015) was passed already on December 8, 2011, thus before signature of the Final Compact.[62] A debt ceiling in an amount of 50 % of GDP, i.e. about 7 percentage points under the current level,[63] was set by this constitutional act. The basis for the debt's assessment shall be European Commission or Eurostat official statistics rather than domestic statistics (Article 5, paragraph 2). At the same time, it in a great detail lays down the gradually escalating provisions leading to the decrease of debt which are triggered automatically at the moment when the debt exceeds 40 %. If the debt is in an interval between 40 and 43 % GDP, the Ministry of Finance should submit to the National Council (which is the parliament) a written justification and a proposal for measures to decrease it. Further, in the interval of 43-45 % the salaries of the members of the government are lowered to the level in the previous year if there has been an increase in the meantime.

If the debt reaches the interval of 45-47 %, the measures continue in such a way that the Ministry of Finance is obliged to bind 3 % of the state budget expenses in the given year, except for the debt-servicing expenses, means from the EU and means intended for co-financing, pays to the EU budget, Social Insurance Company expenses and expenses for the

[61] Márton Varju, "Governance, Accountability, and the Market," in *Constitution for a Disunited Nation: On Hungary's 2011 Fundamental Law*, ed. Gábor Attila Tóth (Budapest, New York: Central European University Press, 2012), 316.

[62] *Ústavný zákon č. 493/2011 Zb., o rozpočtovej odpovědnosti [Constitutional Act on Budget Responsibility]*, 2011.

[63] OECD, *Slovakia*, OECD Economic Surveys, December 2012, 6.

liquidation of damages incurred by disasters. Moreover, an expense ceiling is applied which means that the government must not propose a state budget which would contain – in nominal expression – expenses higher than the previous state budget, with the exception of the above-mentioned chapters. Local and regional self-governing units are required to manage with balanced budget, and the government shall not draw from its budgetary reserve. The measures escalate even further: in the interval of 47-50 %, the government must not submit a deficit state budget, and if the threshold of 50 % is exceeded, it must ask for vote of confidence. However, the measures described in this paragraph apply neither during "the period of 24 months … after the day when the governmental program declaration has been approved and the government has won the vote of confidence" (Article 5, paragraph 10) nor during the period of serious economic recession which is defined by change of the GDP development by more than 12 % (paragraph 11).[64] Neither shall it be applied when there are increased governmental expenses exceeding 3 % of GDP, necessary because of bank crises, disasters or international obligations, as well in the time of war (paragraphs 11 and 12).

Furthermore, these rules will not be fully applicable until the budgetary year of 2028, i.e. 16 years after the constitutional act has been passed. Until then, there is time left for gradual adapting, which is demonstrated by a gradual decline of the debt ceiling. The debt ceiling from now till the end of 2017 amounts to 60 % of GDP, i.e. ten percentage points more, and other intervals for the measures to be taken are adjusted in the same way. In the period from 2018 till 2027, all the limits will be gradually decreased by one percentage point per year.

The Council for Budgetary Responsibility has been established by the constitutional act. All three members thereof are elected and removed by the parliament: one upon the proposal of

[64] Article 5, paragraph 11, item a) is somewhat less understandable for a lawyer in this aspect. It seems that the crucial criterion is not directly an expression of GDP decline but a change of trend. It is better to be illustrated by an example: GDP growths by 7 % in the first year while it decreases by 6 per cent in the second year. The total difference amounts to 7-(-6) = 13 percentage points, the constitutional condition has been met therefore.

the Government by a three-fifths majority of the members of parliament, the second upon the proposal of the President of the Republic by a simple majority and the third one upon the proposal of the Governor of the National Bank of Slovakia also by a simple majority. The competences of the Council, as specified in the Constitutional Act, have an advisory character: it prepares a report on long-term sustainability and report on the fulfillment of the budgetary responsibility rules, on its own indicative or at a request of a parliamentary political group expresses its opinion on the presented draft laws etc. However, it does not have any power of decision neither it can block the adaptation of the state budget.

3.5 Analysis

Despite a lot of distinctions, the four described countries have something in common: their debt brakes combine both institutional and procedural rules. However, they differ in terms of emphasis: all of them rely on numerical rules, but Slovakia and Poland rely enough on themselves while Germany combines them more with procedural rules and Hungary with institutional enforcement. Taking into consideration the conclusions we arrived at in the previous chapter, the attitude of the latter two countries can be considered far more suitable in terms of effectiveness.

A substantial difference can be observed in the selection of the central criterion. While in Germany it is the structural deficit, in all other countries it is primarily total state indebtedness expressed relatively to GDP. Only once this debt ceiling has been broken or when it is approaching, the budget deficit comes to the picture. Slovakia is then required to have a balanced or surplus budget, i.e. the sum of expenses has to be at the most at the level of incomes. In the case of Poland and Hungary, the construction is more complex since the constitution requires the state budget not to increase (or rather decrease) the level of indebtedness relatively to GDP. As we have seen above, if GDP growths, this condition may be met even in case of a (slight) deficit while if it declines, even a (slight) surplus may not meet the condition. Apart from that, neither of these countries – unlike Germany –monitors the amount of structural deficit which takes into account the phase of economic cycle. In Slovakia there are some exceptions possible, for instance in case of economic recession, which are, however, not much explicit and can tempt for abuse or disputes in terms of their interpretation which would limit their effectiveness. Polish constitution does not provide for any exceptions.

The fact that the central criterion in Hungary, Poland and Slovak is the debt and not the deficit comes with the deficiency discussed above. The situation may appear fine for a long period of time and the governments and parliaments are not forced to fiscal discipline.[65] In the time of recession there is jump deterioration (expenses increase due to social benefits while GDP declines), but it is already too late at this moment for effective savings. Not to mention the fact that if they are really introduced, they contribute to a further deepening of the recession. In other words, in this way constructed brakes are less effective and in addition pro-cyclical, therefore the very opposite of what they ought to be.

The Polish “Belka’s rule“ which, in addition, limits the state budgetary expenditure by allowing year-on-year increase of expenses maximum by 1 % might be more effective. If Poland manages to keep it, it will obviously have positive influence on the state budget development from a long term point of view. Therefore, it could be evaluated positively in terms of effectiveness but I have doubts about its enforcement since it is not anchored at the constitutional level. And even if it got anchored in the future, one could doubt whether it was not a too big infringement of the democratic parliamentarianism when the state reallocation

[65] It can be easily demonstrated on the example of the Czech Republic: it ranked 4 out 34 countries in the OECD list with only 13 % indebtedness in 2000, however ten years later it was already 13th place and 37 % of GDP. The “German type” debt brake would have been effective much earlier and would have limited the deficit economy while the brakes used in other countries would have been still waiting to approach to 40, 50 or 60 % of GDP and only after then they would have started a swift braking.

level which should be a subject of political process would become petrified. One thing is to concur that the states can be constitutionally prevented from expending more than they collect, but another thing is to say that parliament must not considerably increase the expenses even if it gets additional incomes to cover them, for instance from higher taxes.

As regards the enforcement, the constitutional arrangements in Germany and in Poland are based predominantly on the presumption that the political consensus and the pressure of public opinion are sufficient to enforce the rules. They set a certain goal and emphasise transparency and public control rather than detail ways how to achieve them. In case of Germany this is further supported by the institution of independent experts' council, opinions of which have a strong influence on the public opinion and the government is obliged to express its stand to them. To a considerable extent, this fits with the view I have advocated as it is more a support, not a replacement of political process.

In contrast, the Slovak arrangement is much more specific in terms of particular steps which needs to be taken (especially) by the government in case of negative development. But if we look closer we see that in fact these are relatively harmless and not very effective tools as is the duty of the government to ask for a vote of confidence for instance. If the government has a majority in the parliament it is not an obstacle for it. But even if we assume that this may not always be the case, it is a sanction without much sense, since it does not affect the governments which run the state into debt continuously but only the one which has the bad luck of being in power at the moment when the debt has exceeded the set limit, e.g. as a consequence of economic recession. And if it turns out that it does not have the majority for the vote of confidence, in addition to indebtedness and economic recession the state gets also a constitutional crisis which can hardly be considered to be the best tool for enhancement of the situation. This solution thus does not stand in terms of effectiveness. Furthermore, it has the pro-cyclical effect based on the fact that the possible governmental crisis creates uncertainty on financial markets and thereby deepens the economic recession even further.

In terms of enforceability, the strongest is the Hungarian arrangement, which gives the independent Budget Council the right of absolute veto against the budget which does not meet the numerical rules stipulated in the constitution. However, albeit it may be effective, the democratic legitimacy of such setting is doubtful and the potential for an institutional deadlock even worrisome.

Conclusion

The approach of the four countries differs in degree which perhaps may be found surprising, especially given the fact that – except for Poland – all the constitutional provisions were enacted recently, as a consequence of the global financial crisis. They differ both in terms of the criterion they use and the means employed to improve the fiscal situation.

With regards to the former, in three out of four cases the provisions concern mostly indebtedness. Although I agree that the ultimate *goal* of all fiscal rules is to prevent the debt from becoming unsustainable, I have shown that it should not be used as the *criterion*, as it makes the rules ineffective and pro-cyclical. When the latter is concerned, the picture is more complex. Hungary adheres to a strict enforcement, but it suffers from lack of democratic legitimacy and makes an institutional deadlock possible. The Slovak rules are very specific in terms of consequences which should follow when a threshold is hit, but in fact they are not effective enough. In Poland, the potential enforcement relies largely on the constitutional court acting on an initiative of the president of the republic, which is unsuitable.

Altogether, only the German rules meet the requirements I have set in the previous chapter, as they are counter-cyclical and rely on the "soft enforcement" by interplay between an independent council of experts, markets and voters which is both effective and democratic.

Conclusion

From the historical point of view, as we have seen, the parliamentary power of purse had two functions: it provided the budget with democratic legitimacy and it served as a safeguard against an irresponsible fiscal policy of the executive. However, the latter is no longer fulfilled, as the empirical data on the developed countries' indebtedness show. The explanation is the deficit bias of legislatures and governments. Searching for other possibilities how to achieve a sound fiscal policy is thus not only in compliance with the concept of democratic parliamentarianism, but it even supports the concept.

The two options to overcome the deficit bias we have discussed are the establishment of independent fiscal institutions and enactment of numerical fiscal rules. With regards the former, two different approaches are possible. A delegation of budgetary powers, or a part of it, is not appropriate, both because of the lack of democratic legitimacy and because of the risk of institutional deadlock. Instead, I advocate a "soft solution", strengthening a commitment to sustainable fiscal management and supporting, but not replacing political process. This solution counts on an independent fiscal council authorized to issue expert recommendations and assessments of fiscal policy issues, but not decisions or vetoes. Also a numeric fiscal rule should be incorporated into the constitution to set a clear fiscal goal. It must be strict enough during good times and loose enough in bad times, in order to work counter-cyclically. Therefore it should be based on structural deficit rather than actual annual deficit or overall debt. The adherence to the rule would be a result of enforcement by interplay between the fiscal council, markets and voters.

From the four countries analyzed, only the German constitutional provisions meet these criteria; they are counter-cyclical, likely to be effective and still democratic. The design of the constitutional provisions in the other three countries is somewhat less satisfactory. The most problematic is that they use debt rather than deficit as the central criterion, which makes the rules ineffective and pro-cyclical. Furthermore, the means of enforcement are either insufficient (Poland, Slovakia) or not legitimate enough (Hungary).

Recalling the above mentioned statement of a German MP, one cannot resist the impression that even though there might be more melodic languages, it would be better if more European countries “spoke German” when drafting their constitutional fiscal rules.

Bibliography

Ayuso-i-Casals, Joaquim, Diana González-Hernández, Laurent Moulin, and Alessandro Turrini. "Beyond the SGP – Features and Effects of EU National-Level Fiscal Rules." In *Fiscal Policy: Current Issues and Challenges: Papers Presented at the Banca d'Italia Workshop Held in Perugia, 29-31 March, 2007*, 651–702. Rome: Banca d'Italia, 2007.

Balassone, Fabrizio, and Manmohan S. Kumar. "Cyclicality of Fiscal Policy." In *Promoting Fiscal Discipline*, edited by Manmohan S. Kumar and Teresa Ter-Minassian, 19–35. Washington, D.C.: International Monetary Fund, 2007.

"Basic Law for the Federal Republic of Germany (Grundgesetz, GG)." Accessed March 21, 2013. http://www.iuscomp.org/gla/statutes/GG.htm#115.

Baumann, Elke, and Christian Kastrop. "A New Budget Rule for Germany." In *Fiscal Policy: Current Issues and Challenges: Papers Presented at the Banca d'Italia Workshop Held in Perugia, 29-31 March, 2007*, 595–612. Rome: Banca d'Italia, 2007.

Besselink, Leonard E.M., and Jan-Herman Reestman. "The Fiscal Compact and the European Constitutions: 'Europe Speaking German'." *European Constitutional Law Review* no. 8 (2012): 1–8.

Corbacho, Ana, and Gerd Schwartz. "Fiscal Responsibility Laws." In *Promoting Fiscal Discipline*, edited by Manmohan S. Kumar and Teresa Ter-Minassian, 58–105. Washington, D.C.: International Monetary Fund, 2007.

Council Regulation (EC) No 1467/97 of 7 July 1997 on Speeding up and Clarifying the Implementation of the Excessive Deficit Procedure, 1997.

Debrun, Xavier, David Hauner, and Manmohan S. Kumar. "The Role for Fiscal Agencies." In *Promoting Fiscal Discipline*, edited by Manmohan S. Kumar and Teresa Ter-Minassian, 106–134. Washington, D.C.: International Monetary Fund, 2007.

Debrun, Xavier, and Manmohan S. Kumar. "Fiscal Rules, Fiscal Councils and All That: Commitment Devices, Signaling Tools or Smokescreens?" In *Fiscal Policy: Current Issues and Challenges: Papers Presented at the Banca d'Italia Workshop Held in Perugia, 29-31 March, 2007*, 479–512. Rome: Banca d'Italia, 2007.

Elster, Jon. *Ulysses and the Sirens: Studies in Rationality and Irrationality*. Cambridge: Cambridge University Press, 1979.

European Parliament. "Table on the Ratification Process of Amendment of Art. 136 TFEU, ESM Treaty and the Fiscal Compact." European Parliament, February 21, 2013. http://www.europarl.europa.eu/webnp/webdav/site/myjahiasite/users/fboschi/public/esm%20tscg/art.%20136%20ESM%20fiscal%20compact%20ratprocess.pdf.

Fölscher, Alta. "A Balancing Act: Fiscal Responsibility, Accountability and the Power of the Purse." *OECD Journal on Budgeting* no. 2 (2006): 133–152.

Geršl, Adam. "Political Economy of Public Deficit: Perspectives for Constitutional Reform." *Czech Economic Review: Acta Universitatis Carolinae Oeconomica* 1, no. 1 (2007): 67–86.

Helland, Leif. "Fiscal Constitutions, Fiscal Preferences, Information and Deficits: An Evaluation of 13 West-European Countries 1978-95." In *Institutions, Politics and*

Fiscal Policy, edited by Rolf R. Strauch and Jürgen von Hagen, 107–138. ZEI Studies in European Economics and Law 2. Boston: Kluwer Academic, 2000.

Henning, C. Randal, and Martin Kessler. *Fiscal Federalism: US History for Architects of Europe's Fiscal Union*. Working Paper WP 12-1. Washington, D.C.: Peterson Institute for International Economics, 2012.

Holler, Johannes, and Lukas Reiss. "What to Expect from the Latest Reform of the Stability and Growth Pact." *Monetary Policy & The Economy* no. Q4/11 (2011): 85–98.

Kelemen, R. Daniel, and Terence K. Teo. *Law and Eurozone Crisis*. Paper Prepared for American Political Science Association Annual Convention, August 30-September 2, 2012.

Kopits, George, and Steven Symansky. *Fiscal Policy Rules*. Washington, D.C.: International Monetary Fund, 1998.

Kusák, Martin, and Lenka Pítrová. "Právní aspekty Smlouvy o stabilitě, koordinaci a správě v hospodářské a měnové unii [Legal Aspects of the Treaty on Stability, Coordination and Governance in the Economic and Monetary Union]." *Acta Universitatis Carolinae – Iuridica* no. 1 (2012).

Madison, James. "The Federalist #51," 1788. http://www.constitution.org/fed/federa51.htm.

"Magna Carta Libertatum," 1215. http://www.constitution.org/eng/magnacar.htm.

Mulas-Granados, Carlos, Jorge Onrubia, and Javier Salinas-Jimenéz. "Do Budget Institutions Matter? Fiscal Consolidation in the New EU Member States." In *Fiscal Policy: Current Issues and Challenges: Papers Presented at the Banca d'Italia Workshop Held in Perugia, 29-31 March, 2007*, 613–650. Rome: Banca d'Italia, 2007.

National Association of State Budget Officers. *Budget Processes in the States*. Summer 2008. Washington, D.C.: National Association of State Budget Officers, 2008.

OECD. "Government Debt." In *OECD Factbook 2011-2012: Economic, Environmental and Social Statistics*. OECD Publishing, 2011. http://dx.doi.org/10.1787/factbook-2011-91-en.

———. *Hungary*. OECD Economic Surveys, March 2012.

———. *Poland*. OECD Economic Surveys, March 2012.

———. *Slovakia*. OECD Economic Surveys, December 2012.

Rutkowski, Aleksander. "Ceilings and Anchors: Fiscal Rules for Poland." *ECFIN Country Focus* 4, no. 4 (2007): 1–6.

Sajó, András. "Independent Regulatory Authorities as Constitutional Actors: A Comparative Perspective." *Annales Universitatis Scientiarum Budapestinensis De Rolando Eötvös Nominatae Sectio Iuridica* 48 (2007): 5–52.

Schaechter, Andrea, Tidiane Kinda, Nina Budina, and Anke Weber. *Fiscal Rules in Response to the Crisis - Toward the "Next-Generation" Rules. A New Dataset*. IMF Working Paper. International Monetary Fund, July 2012.

Schneider, Ondřej. *Rozpočtové instituce - evropské zkušenosti a aplikace na Českou republiku [Fiscal Institutions – European Experiences and their Application on the Czech Republic]*. Studie IDEA 1/2012. Praha: Národohospodářský ústav AV ČR, 2012.

Schragger, Richard C. “Democracy and Debt.” *The Yale Law Journal* 121 (2012): 860.

Schuknecht, Ludger, Philippe Moutot, Philipp Rother, and Jürgen Stark. *The Stability and Growth Pact: Crisis and Reform*. Occasional Paper Series. Frankfurt: European Central Bank, September 2011.

“The Constitution of the Republic of Poland,” 1997. http://www.sejm.gov.pl/prawo/konst/angielski/kon1.htm.

“The Fundamental Law of Hungary,” 2011. http://mkab.hu/rules/fundamental-law.

Tomuschat, Christian, and David P. Currie, trans. “Basic Law for the Federal Republic of Germany,” 2012. http://www.gesetze-im-internet.de/englisch_gg/englisch_gg.html.

Ústavný zákon Č. 493/2011 Zb., o rozpočtovej odpovědnosti [Constitutional Act on Budget Responsibility], 2011.

Varju, Márton. “Governance, Accountability, and the Market.” In *Constitution for a Disunited Nation: On Hungary’s 2011 Fundamental Law*, edited by Gábor Attila Tóth, 301–331. Budapest, New York: Central European University Press, 2012.

Wallis, John Joseph. “Constitutions, Corporations, and Corruption: American States and Constitutional Change, 1842-1852.” *Journal of Economic History* 65, no. 1 (2005): 211–256.

Wehner, Joachim. *Legislatures and the Budget Process: The Myth of Fiscal Control*. London: Palgrave Macmillan, 2010.

Wrobel, Ralph M. “Balanced Budget Rules in Europe: A Comparative Institutional Analysis.” *International Area Studies Review* no. 1 (2008): 153–168.

Wyplosz, Charles. *Fiscal Policy: Institutions vs. Rules*. HEI Working Paper 03/2002. Geneva: The Graduate Institute of International Studies, 2002.

Zipfel, Frank. *Stability Council: Financial Inspector of Germany’s Länder*. Frankfurt: Deutsche Bank Research, 2011.