Part I
Methods and Introduction

The European Union (EU) has struggled with the meaning of fiscal federalism in Europe since the Treaty on European Union and the creation of the Economic and Monetary Union (EMU). The model of fiscal federalism inscribed in the Treaty at Maastricht conceived of national governments as distinct, miniature sovereign borrowers which retained the necessary fiscal competencies to manage sovereign economies. Central to the Maastricht model is a prohibition on financial assistance (Article 125 TFEU, ex Article 103 TEC) that enshrines a constitutional consensus on fiscal sovereignty and exposes Member States to market discipline and hard budget constraints. This follows a formula for federal equilibrium that is well-established in theory and well-evidenced in history, visible in the autonomous credit ratings of Swiss cantons, Canadian provinces and American states. That model has been vitiated by the (now-realized) sovereign bailout expectation. The European bailouts, the (now permanent) European Stability Mechanism (ESM), and a new Article 136(3) TFEU have

1 On these concepts, see below, at nn 62–63 and Chapter 2, Sections 2.2.4 and 2.3.
2 See Sections 8.2.2, 8.2.3, 8.2.4 for Switzerland, the United States and Canada. As Jens Weidmann, ‘Crisis Management’ (Walter Eucken Lecture, Freiburg, 2 November 2013), observes, ‘The framework of monetary union was quite coherent, it reflected well-established regulatory policy principles, and the attempt was made to learn the lessons and not to repeat the errors of the past.’ See also Jürgen Stark, ‘Lessons from the European Crisis’ (2013) 33 Cato J 541, 544–545, ‘Historical examples show that the aforementioned principles and rules are essential for the smooth functioning of a monetary union.’
institutionalized a joint liability group. In the wake of the sovereign debt crisis, successive reforms have incrementally supplanted the decentralized architecture of fiscal federalism in the Treaties with mechanisms more commonly seen in unitary states: financial transfers and centralized governance of Member State fiscal policy. Fiscal federalism in the EU is now the subject of piecemeal renegotiation that increasingly exceeds the limits of the Maastricht model: a European Monetary Fund, direct tax harmonization, binding budget contracts and a concomitant power to rewrite national budgets were all the objects of recent EU initiatives. A new model is emerging, yet there is no consensus on what elements of ‘fiscal union’ are necessary to achieve equilibrium in the new model, and no consensus on what is permissible within the constitutional boundaries of the EU legal order. Where individual measures have inched beyond the boundaries of fiscal sovereignty contemplated by national legal orders, the result has been stirrings of legal revolt and revolution: legal challenges, political upheaval and divergent national appetites to deepen or repatriate European powers.

The EU must not only redefine its model of fiscal federalism, but ensure that it is anchored within deeper constitutional boundaries underlying the European legal order as a whole.

In order to remain stable and permanent as a matter of law and economics, the model chosen for EU fiscal federalism must do two things: it must, first, be compatible with the constitutional boundaries of the EU legal order; and, second, it must ‘work’ – that is, it must not be economically unstable. In that respect, the EMU has now spent over half its life in a state of crisis. Some economists estimate that Europe’s GDP

---

4 On the problem of EU joint liability, see Chapter 3 Sections 3.1.1–3.1.2 (and sources cited).
8 See Chapter 3, nn 2, 4.
is now as much as 18% lower than if the EMU had never been invented at all.\textsuperscript{9} From its inception, the EMU precipitated unthinkable macroeconomic imbalances that were unprecedented in over thirty years of economic data.\textsuperscript{10} Now over a decade since the European sovereign debt crisis emerged, the cycle of macroeconomic imbalances which led to the crisis in the first place is repeating: EMU current account imbalances are widening, not narrowing,\textsuperscript{11} interest rate spreads on sovereign bonds are near non-existent\textsuperscript{12} and general government debt ratios remain far above those levels which triggered the sovereign debt crisis in the first place.\textsuperscript{13} And yet, a glance at the fiscal federalism literature should give pause. Comparative federations such as the United States, Switzerland and Canada – with no federal oversight of state budgets and no economic coordination whatsoever – have long since recovered from the global financial crisis. The United States, the very progenitor of the 2008 global financial crisis, declared its ‘Great Recession’ over in June 2009.\textsuperscript{14} Its largest trading partner, Canada – another decentralized federation with comparable debt dispersion characteristics to the EU – suffered just seven months of recession.\textsuperscript{15} The Swiss Confederation, whose two

\textsuperscript{9} EMU GDP is 18\% lower than if it had continued to grow at the modest pace before the euro was created: Joseph Stiglitz, \textit{The Euro: How a Common Currency Threatens the Future of Europe} (Norton 2016), 72–73. It provided no boost to growth when it was supposedly working well: Stefan Kawalec, Ernest Pytlarczyk and Kamil Kamiński, \textit{The Economic Consequences of the Euro} (Routledge 2020), 25–27; Paul De Grauwe, \textit{Economics of Monetary Union} (13th ed., Oxford University Press, 2020), 64–65.

\textsuperscript{10} See Chapter 3, Section 3.2.2, Figure 3.10.

\textsuperscript{11} IMF, ‘Current Account Balance, % GDP’ (IMF WEO Database, 2020) www.imf.org/external/datamapper/BCA_NGDPD@WEO/OECD/ADVEC/WEOWORLD accessed 10 September 2020. EMU current account imbalances narrowed as a result of the crisis between 2008 and 2015, and have been growing again since 2016.


\textsuperscript{13} EMU debt as a percentage of GDP in 2019 was 84.1\%, compared with 70\% in 2008. Among periphery countries, it was 117\% (2019) compared to 74.7\% (2008). Eurostat, ‘Government Consolidated Gross Debt (gov_1odd_3dpt1)’ (Eurostat, 2020) http://epp.eurostat.ec.europa.eu accessed 2 January 2020.


The European Union now faces a choice between two well-worn paths in the history of constitutional law and economics in federal states: centralization under a single fiscal authority, or decentralization to the level of national constitutional authority. At stake in this debate is nothing less than the economic welfare of millions of people and the integrity of the EU legal order as a whole.

This book is intended to bridge the study of European constitutionalism and the study of ‘fiscal federalism’ – the subfield of public economics concerned with the structuring of public finance incentives in federal states. On one axis, this book delves deeply into European constitutional law in order to identify permanent boundaries integral to the stability of the European legal order as a whole. On the second axis, it engages fiscal federalism to determine which models known to that field remain theoretically and empirically implementable within the European legal order. This approach is vital because the incumbent political prescriptions for ‘fiscal union’ set out in the EU Five Presidents’ Report and Commission proposals enunciate blueprints that are, by their own admission, manifestly beyond the limits of the EU Treaties. Furthermore, as Wyplosz points out, these catalogues of proposals to establish federal fiscal union ‘do not even mention at all fiscal federalism principles [...] It is worrying to note that they seem unaware of the principles of fiscal federalism.’

The central argument of this book is that the limits of the EU legal order in fiscal policy are circumscribed by unconferrable constitutional principles typically referred to as the limits of ‘constitutional

16 OECD, ‘Quarterly GDP’. 
17 Unless otherwise specified, in this book the term ‘European legal order’ encompasses both Member State and EU legal orders as a contiguous interacting whole, including the constitutional bases for conferral outside the EU legal order, and national implementations of EU law within the EU legal order: ‘EU legal order’ refers to that part of the European legal order that is derived from the EU Treaties and that applies within the EU legal order. ‘Member State’ or ‘national’ legal orders and constitutional law refer to that part of the European legal order that does not derive from the EU Treaties and is Member State law.
identity’ – inviolable, immutable powers or principles so integral to the twenty-seven constitutional democracies at the basis of the European legal order that they can never be impinged or disposed-of without abrogating the constitutive identity of the state. This book examines how this curtails the selection of available models of fiscal federalism in the EU and, among those remaining, which would result in a stable economic equilibrium based on available economic data. The thesis of this book is as follows.

First, Member State fiscal sovereignty is a permanent constitutional constraint upon the application of fiscal federalism theory in the EU. That constraint is implicitly but plainly impressed upon the allocation of competences in economic policy (Articles 2(3) and 5(1) TFEU) and the substantive provisions governing public finance in Articles 121–126 TFEU. Under those articles, the Union competence for economic policy is one of ‘mere coordination’, limited to providing ‘a framework to coordinate these policies to a certain degree’. The EU has no power to determine the content and composition of government revenues and expenditures, dictate structural reforms, or determine social allocations at national level. This is not a mere reflection of good administration under the principle of subsidiarity. Under Articles 4(1), and 5(1)–(2) TFEU, the Union can have no powers

20 See Chapter 1, Section 1.2.2.
21 Hereafter, unless otherwise specified, this book follows EU policy documents in using both ‘economic policy’ and ‘fiscal policy’ interchangeably to describe those competences over the use of government revenue, debt or expenditure to influence the economy. Cf: Kaarlo Tuori and Klaus Tuori, The Eurozone Crisis: A Constitutional Analysis (Cambridge University Press, 2014), 31 on the distinction between economic and fiscal policy.
24 Pringle v. Ireland [64]: ‘arts 2(2) and 5(1) TFEU restrict the role of the Union in the area of economic policy to the adoption of coordinating measures.’ Brummer v. EU Treaty (Germany) (2 BvR 2134/92 & 2159/92) BVerfGE 89, 155, [1994] 1 CMLR 57 (Bundesverfassungsgericht) [64], [91]; Gauweiler Order for Reference (Germany) (2 BvR 2728/13); ECLI:DE:BVerfG:2014:rs201401142bvr272813, [39]: ‘In this field of economic policy, the European Union is [...] essentially limited to a coordination of Member States economic policies.’ Weiss v. Bundesrat and Federal Government (Order for Reference) (Germany) (2 BvR 859/15, 2 BvR 1651/15, 2 BvR 2006/15, 2 BvR 980/16); ECLI:DE:BVerfG:2017: rs201707182bvr085915, [65]; Weiss Decision (Germany) [163]: ‘the competence of the European Union in economic policy matters is essentially limited to coordinating the polices of the Member States [...] it is not, however, authorised to pursue its own economic policy agenda.’
other than what the Member States have given it, and *nemo plus iuris transfere (ad alium) potest quam ipse habet*, what the Member States have given it is limited by their own constitutional identities.\(^{25}\) This marks

an immutable boundary of the EU legal order. Not only has fiscal policy not been conferred on the Union but, according to the ‘constitutional identity’ jurisprudence of the German Constitutional Court (BVerfG), it cannot ever be so conferred without infringing the ‘eternity clause’ (Article 79(3)) of the German Basic Law (BL). Numerous other constitutional courts have drawn similar boundaries around their own constitutional formulas for democratic legitimation of fiscal policy. Chapter 1 extracts three constitutional tests that constrain the application of fiscal federalism theory in the European legal order:

1.3.1.2 no unlawful restrictions on fiscal sovereignty;
1.3.1.3 no unlawful conferral or delegation of fiscal sovereignty; and 1.3.1.4 no structural impairments of fiscal sovereignty through finite financial dispositions of structural significance to budgetary autonomy.

The second thesis of this book is that, as a matter of fiscal federalism theory, hard budget constraints and market discipline are indispensable for the fundamental guiding principles of price stability, sound public finances and a sustainable balance of payments (Article 119(3) TFEU) in EMU. Chapter 8 concludes with five institutional determinates necessary for fiscal federalism to ‘work’ in a large, decentralized economic and monetary union bound by the fiscal sovereignty of its Member States:

8.1.1 market discipline; 8.1.2 hard budget constraints; 8.1.3 fiscal...
symmetry; [8.1.4] decentralized fiscal autonomy; and [8.1.5] appropriately designed fiscal rules.

In sum, any model of European fiscal federalism must, first, preserve the fiscal sovereignty of its constitutional democracies; and, second, it must have market discipline under hard budget constraints. As for the selection of appropriate models for EU fiscal federalism, this book proposes that the three constitutional tests identified in Chapter 1,\(^{31}\) as well as the five principles identified in Chapter 8,\(^{32}\) provide an intersecting set of criteria to guide the determination of which models are implementable within the constitutional boundaries of the European legal order.

The procedure of this book is divided into two parts, each according to its two research aims.

### Overview of Part I

Part I pursues the first principal aim of this study: to investigate the existence of permanent constitutional boundaries of European fiscal federalism that are integral to the stability of the EU as a whole.\(^{33}\) Rules which limit the integration of EU law in national legal orders are a necessity that derives from the nature of European constitutionalism.\(^{34}\) The EU is different from other advanced federations that presuppose the existence of a single ‘constitutional demos’.\(^{35}\) EU constitutionalism is characterized by opposing forces of perennial disquiet, possessed of a top-down hierarchy of greater legal supremacy than any individual expression of Member State sovereignty on one hand, yet on the other hand derived from the confederate authority of national orders which sanction its reach.\(^{36}\) Where EU

\(^{31}\) Listed in Chapter 1, Section 1.3.1.1, at nn 482–484 and Section 1.4, at nn 574–576. For discussion, see Sections 1.3.1.1–1.3.1.5.

\(^{32}\) See Chapter 8, Sections 8.1.1–8.1.5, listed at Section 8.1.6.

\(^{33}\) Part I (Chapters 1–4) employs a grounded-theory approach, by which the analysis pursues hypotheses implicit in the data. This is appropriate because, while this book begins with the notion that there are indeed constitutional boundaries of the EU legal order, it does not begin with a supposition of what those boundaries might be. A grounded-theory approach is necessary to extract them before they can be subjected to classical positivist methodologies in Part II. See the general framework in Kathy Charmaz, *Constructing Grounded Theory* (Sage Publications, 2006).

\(^{34}\) DR Phelan, *Revolt or Revolution: The Constitutional Boundaries of the European Community* (Sweet and Maxwell, 1997).
