

# Budget and Constitution: A Proposal for Revision in the Light of the Maastricht Treaty\*

RAINER S. MASERA

## 1. Introduction

This brief note is intended as a contribution regarding the problems deriving from the hypothesis of Italy's adhesion to the European Economic and Monetary Union, as concerns the procedures for the determination of the public budget and possible changes in them, including changes of a constitutional nature.

This work starts from the need for transparency in the budget process in Italy, looking more closely at the implications of some proposed changes in the rules governing amendments to the Finance Bill and then examines the consequences of the Maastricht Treaty.

Regarding this last aspect, I would emphasise the need for the harmonisation criteria stipulated in the Treaty to take on explicit constitutional status in each member state, so as to encourage transparency in the voter/parliament relationship concerning the modifications of the budget procedure and the different definition of the powers of parliament and government, especially considering the irreversibility of the Union.

---

□ When this article was written, the author was Minister for Budget and Economic Planning, Rome (Italy).

\* This work deals with institutional subjects, although naturally from the economist's point of view. The work, for which the author alone is responsible, benefited from long discussions with G. Motzo, G. Vegas, C. Fresa and F. Bilancia: see the works by these authors on the subjects cited in the text.

The public budget is the site of the most significant economic and financial transactions in any modern country. The conditions under which such transactions take place (which influence all other exchanges) are obviously of the greatest importance. Thus, transparency and full information on the choices and the implications of the budget are fundamental, both in the short and the long term.

As the analysis of finance based on the theory of asymmetric information has made clear, it is impossible to remain bound to Walrasian-Paretian models in which both individual transactions and the set of all transactions themselves contain all the necessary and sufficient information so that the agents involved, acting rationally, adjust their choices and their behaviour in such a way as to lead instantly to optimal allocation of resources. In that context, there would be no "information costs". Actually, since the information stemming directly from the transactions is in itself imperfect, only its indirect acquisition, the cost of which must be covered in successive transactions, can lead to an optimum which, even though it does not come at zero cost, as in classical economics, is the only one possible.

The objective must be to minimise the cost of acquiring information, without forgetting that it will presumably never be cancelled.

## 2. The reform of the budget process in Italy

In the light of the foregoing, among other things, the procedure for the formation of Italy's public budgets needs to be rethought.

The social pact that is embodied in the public finances and renewed annually with the approval of the budget requires, as a necessary if not sufficient condition for its optimality, correct and complete "information" on the rules and the operating procedures connected with the preparation and the approval of the state budget.<sup>1</sup>

Besides the significant progress which Law 468/1978 embodied in terms of scrupulous drafting of the annual Finance Bill, as well as the budget adjustment and report, one of the distinguishing elements

<sup>1</sup> On this subject, see D. Da Empoli, P. De Ioanna and G. Vegas, *Il bilancio dello Stato. La finanza pubblica tra Governo e Parlamento*, Il Sole 24 Ore, Milan, 1995. The first version of the present note was drafted on the occasion of the presentation of this volume to the Senate.

of the last 15 years of management of the budget and of the financial manoeuvres has been an increasing procedural rigidity. There has been a progressive complication, induced by the wish, sometimes illusory, that more cumbersome, formal procedures would make behaviour and decisions harmful to the public finances more difficult. This resulted in a complicated, almost incomprehensible and extremely segmented set of procedures that drag along throughout the entire year.<sup>2</sup>

From this state of affairs arises the need for a thorough reassessment of the budget procedure in order to simplify instruments and procedures and, in a word, to enhance transparency, both internally, for the decision-makers themselves, and externally, for taxpayers and voters.

Such a process presumes more thorough-going institutional reforms, to which I will refer later.

In any case, we cannot do without a revision of the budget structure, not only and perhaps not even primarily in order to reduce the number of items, but principally to regroup the different expenditure entries, presently scattered over some six thousand items, by a different logic. To this end, options are still open as to whether the regrouping should be done according to function or to cost centre.

The former method would achieve better visibility of the overall magnitude of state intervention in the various sectors of the economy. The latter, to my mind preferable, would allow the operational cost of the public administration to be monitored constantly and would be linked to the current reform of management, with consequent full responsibility of managers, and to a reform of controls. In this context, sustaining a duplicate budget – one in abbreviated form for parliamentary examination and for making major public choices and the other, more ample substantially structured by cost centre and then by item (albeit fewer in number) for management – could be feasible.

Among other things, a new budget would ease the introduction of the "zero-base budgeting" technique for the appropriations of each item, obliging parliament and administration to rethink the motives for their interventions and the reasons for each expenditure.

I am also convinced of the need for a full and simultaneous link between the flow budget and the capital account, as in "private" balance sheets.

<sup>2</sup> Appendix 1 shows, as an example of the subjects discussed here, the essential timetable of the Italian budget procedure.

Finally, the reform of the budget structure leaves unanswered the question of the revision of Article 81 of the Constitution, which I will now deal with, but in a prevalently European context.

It is first worth emphasising the importance of recent changes in case law before the Constitutional Court. A long season of acritical extension of the principle of substantial equality provided for by Article 3(2) of the Constitution (on the basis of which the procedure has always been to extend, by means of "additive" sentences, subjective entitlements to persons not included in Italy's vast spending legislation, in a process of upwards parity, in fact harming the public finances) has given way to a recent phase (Sentences 78, 99, 103, 320, 358, 409 and 421 of 1995) of recognition of the values contained in Article 81(4), on the basis of which entitlements can be attributed only if and to the extent that the necessary financial resources are budgeted; if they are lacking, the full subjective property right is diminished. Far from being the principle longest disregarded by the Constitutional Court, although often deemed as such, the principle of financial coverage of expenditure legislation is a law in force which requires complete implementation. This shows how constitutional principles are anything but unimportant in marking the limits within which the public finances operate.

The evolution of constitutional case law with reference to the need to temper guarantees of equality (which could result in either extension of benefits or a reduction in revenues) with budget equilibrium in compliance with Article 81 and with final defence of savings (Article 47), guaranteed only by monetary stability, must therefore be decisively confirmed.

It is necessary to consolidate and unequivocally define the new tendencies, in opposition to the established practice of simple extension, given that the extension, through case law, of benefit entitlements in a measure and in a subjective domain not taken into account by parliament can potentially overturn any and all programmes to curb expenditure.<sup>3</sup>

In itself, the principle of equality, precisely because of its lack of predeterminability, allows almost inexhaustible applications and – depending on the standpoint from which it is viewed – opens up even

<sup>3</sup> On the basis of incomplete estimates, the impact of the extensive sentences of the Constitutional Court over the last decade can be valued at more than 50 trillion lire in past expenditure and in over 8 trillion lire annually in additional current expenditure, also including that – still to be applied – of sentences 495/93, 240/94 and 264/94.

more expansionary perspectives as successive groups seek parity of treatment.

The combined consideration of Article 3 and Article 81, however, suggests that entitlements can be conferred only if and to the extent that the necessary financial resources are provided. This limit, which applies to the parliament, must also apply to the Constitutional Court. If the latter's judgement is supreme and incontestable – about which there is no doubt – this does not detract from the fact that the Court itself should undertake to observe Article 81, facing in its sentences the question of the increased cost determined by the extension of entitlements.<sup>4</sup>

One way to deal with this problem, familiar to German case law, provides that, in the act in which the entitlements are extended beyond the persons defined by law, the amount of the benefits conferred on each one by the law itself must be simultaneously reduced. In short, one cannot simply add the extra benefits deriving from the extensive interpretation of the court without taking account of the fact that each increase in entitlements implies choices and costs. This is an obligation deriving from the requirements of compliance with the budget constraint. Non-compliance ultimately has an adverse effect on price stability, and hence on savings protection.

This is naturally not the only possible response to the problem. To cite Germany again, a technique of ample diversification of Constitutional Tribunal sentences interpreting the principle of equality has evolved. The decisions run the gamut between the two extremes: rulings of nullity of laws judged to be "unequal" and rulings of unconstitutionality without annulment, allowing a reasonable period within which the parliament must correct the error, in any case in conformity with the budget constraint.

The time allowed to the legislature to implement sentences extending entitlements and to find the necessary financial resources ranges from nine months, in the easier cases, to nine years, in the most complex and onerous cases; that is, by the end of the second legislature following the publication of the sentence.<sup>5</sup>

<sup>4</sup> These subjects were widely discussed in a seminar held at Palazzo della Consulta. See Atti di un seminario tenuto a Roma l'8 e 9 novembre 1991, *Sentenze della Corte Costituzionale e Art. 81, U.C., della Costituzione*, Giuffrè, Milan, 1993.

<sup>5</sup> On this, see the papers by D. Schefold and E. Denninger, *Sentenze della Corte Costituzionale, op. cit.*

Solutions of this type naturally presuppose a co-operative relationship between parliament, government and Constitutional Court, characterised by observance of the budget constraint.

In the Italian system, there does exist provision (Article 7 of Law 362 of 23/8/1988) that, in the case of Constitutional Court sentences which produce interpretations of legislation in force liable to bring about greater expenditure, the Minister of the Treasury shall report to parliament and adopt consequent legislative initiatives. This means, in substance, that a new law can regulate the expenditure deriving from Constitutional Court sentences, indicating the source of finance.

As we have seen, this legislative directive could be supplemented with a provision that when other means of coverage cannot be found the law shall reductively redistribute among all recipients, old and new, the benefits provided for by the laws censured by the Constitutional Court and extended by it, in amount of benefits or number of recipients, in application of the principle of equality (this would be tantamount to the principle of equality at zero cost). The Constitutional Court itself would provide an indication in this regard in its extensive sentences, except where the "minimum" content of the constitutionally guaranteed benefits is involved.

The Italian Constitution pays less explicit attention than those of other industrial nations to the problem of public finance and the "budget constraint" in other respects as well.

In particular, the constitutions of the main European countries have introduced limitations to the parliament's powers to increase expenditure.<sup>6</sup> Italy may be the only European democracy in which government lacks formal decision-making powers in the formation and management of the budget and public expenditure. This power is heavily influenced by parliament's ability to modify, even markedly, the bills of the Executive, reducing its autonomy in terms of economic legislation.

In reality, in the last three years great steps forward have been taken, in practice, towards the unitary and systemic management of the public financial documents, consequent among other things to the opportune and practical utilisation of the Economic and Financial Planning Document; so much so that parliament has always ratified

<sup>6</sup> See "Struttura e funzione della deliberazione parlamentare sul progetto di bilancio", *Dossier di documentazione*, Senato della Repubblica, Rome, November 1994.

the overall balance presented by the government, although occasionally introducing modifications significantly affecting the homogeneity of the bill as a whole.

It may now be time to consolidate the results thus achieved, also in the light of the Italy's evolution towards a tendentially two-party political system, and to formalise the procedures which are emerging. This would reduce, amongst other things, the great waste of time and resources implicit in the current, formally "open" system.

As part of a general project to clearly re-establish the respective roles of government and parliament, it would be advisable to assign to the former the primary responsibility for making public finance choices, and in principle allow the latter only to approve or reject such choices, with the rejection naturally entailing the fall of the government. We must prevent rigorous budgetary decisions from being denatured under a variety of pressures that threaten to let spending flows get out of control.

In this context, aside from the proposal for modifying the accounting law currently before parliament,<sup>7</sup> we need to evaluate the advisability of modifying the principle that the accompanying legislation to the budget may be amended. It seems, however, that such a change can only be introduced by constitutional amendment or a modification of parliamentary rules. Restriction of amendability, in particular, would seem to require the modification of the provisions of Articles 71 and 81 of the Constitution.

More broadly, there have been, for example, proposals to institute the following principles:

- parliament cannot present amendments that increase expenditure;
- each new expenditure law must find coverage in the budget approved at the beginning of the financial year;
- total government expenditure cannot increase (in percentage terms) more than GDP;
- the budget balance on current account must always be non-negative.

On this basis, the annual budgets themselves could fix a ceiling both for the ratio of tax revenue to GDP and for indebtedness. Limits

<sup>7</sup> See Atto Camera no. 2479.



could also be set on the size of the public debt. However, in order not to relinquish the necessary flexibility to meet certain expenditure components, a sub-set of budget items could be singled out within which the government is empowered to reduce appropriations, up to a certain percentage, and to make offsetting shifts of funds, without resorting to legislative procedures. These offsets would be effected, in the first instance, within the appropriations for each government department. For extraordinary or exceptional events, there could be a provision, in the second instance, for the establishment of a fund that would be activated only in these circumstances.<sup>8</sup>

A reform of this type would contribute to a process of providing information, thus establishing an important precondition of credibility for the government's actions in the area of economic policy. The market would provide a clear evaluation of the choices adopted and mitigate the distortions that, in the uncertainty over the compromise to be reached between parliament and executive, can cause tensions.

At the same time, as will become clearer later, the line of action proposed is in keeping with the provisions, on the Community level, of the Maastricht Treaty, in which budget powers are substantially lodged with the Council, while the peculiarities highlighted here show how in Italy parliament can modify expenditure provisions, both in content and date of passage.<sup>9</sup>

More generally, since 15 European countries now act within a Community, which will continue to be strengthened, the problem of the harmonisation of the national budget formation procedures would appear to be unavoidable.

The problem can be posed in broader terms, raising the issue of constitutional reform, not only in Italy but in other European countries as well.

<sup>8</sup> The recent experience of other countries has shown the scant practicality of automatic reduction clauses for public expenditure, as indicated by the difficulties met in the attempt to reduce the budget deficit in the 1980s in the US under Gramm-Rudman-Hollings.

<sup>9</sup> As will become clearer, it does not seem that the extensive interpretation of Article 11 of the Constitution can serve to overcome these obstacles, which derive not only from this specific case, but also from the set of Community norms that have impinged upon relations between parliament and the executive at other times (see L. Ferrari Bravo and E. Moavero Milanesi, *Lezioni di diritto comunitario*, Editoriale Scientifica, Milan, 1965).

### 3. Budget formation in the European Union in the light of Maastricht

The single market was constructed starting with the "Copernican revolution" consisting in the adoption of the principle of mutual recognition of national norms after prior establishment of conditions of minimum harmonisation (Community directives).

The Maastricht Treaty deals with the question of the single currency mainly by means of the creation of the European Central Bank.<sup>10</sup> It seems, however, less than precise concerning the conditions for harmonisation, particularly those affecting fiscal policies, in the phase of monetary union.

The Maastricht constraints were substantially conceived as necessary conditions for participating in Stage III of EMU. In this respect, convergence standards were defined to which the national budget and public finances must conform.

That is, the need for prior minimum harmonisation is recognised, notably of fiscal policies, which are closely linked to monetary policy by means of budgetary constraints and the volume (and growth) of the public debt.

The problem discussed here regards the participating countries, but in the period *following* the creation of the single currency.

There can be no doubt that, if certain minimum conditions regarding the budget deficit and the trend of the debt/GDP ratio are to be observed *before* entry into Stage III, predetermined and mandatory conditions must, in principle, also be respected *afterwards*.<sup>11</sup> The

<sup>10</sup> For a more in-depth view of the role of the European Central Bank and other aspects of minimum harmonisation procedures, see M. Sarcinelli, "The European Central Bank: a full-fledged scheme or just a fledgling?", *Banca Nazionale del Lavoro Quarterly Review*, no. 181, 1992; M. Marè and M. Sarcinelli, "The European Union: how to assign the functions of government", *Banca Nazionale del Lavoro Quarterly Review*, no. 191, 1994.

<sup>11</sup> In reality, this extremely important problem does not, in my view, appear fully transparent in the Maastricht Treaty, even though the legal interpretations provided by the studies cited (see C. Fresa, "Trattato sull'Unione e condotta delle politiche economiche nazionali: i vincoli al governo della finanza pubblica", mimeo, Rome, September 1995) suggested that the imprecision about the period before and after should be removed by recognising the permanent validity of these constraints. I would, in reality, have preferred this interpretation to have been rendered explicit at Maastricht – also because it would have underlined some inadequacies of the parameters then being adopted (see R. Masera, "Single market, exchange rates and monetary unification", *World Economy*, 1994) which in any case *cannot and must not be* called into question again today

most recent *Green Paper* of the European Commission is relevant in this regard. In the foreword, it declares: "The Treaty has provided four criteria for measuring this convergence and one of them, covering public finances, focuses both on budget deficits and outstanding public debt. *These four criteria are both key indicators of sound economic management and the objective basis for a political decision. They must be strictly and fully respected, both before and after the changeover to the single currency. The Treaty lays down procedures for ensuring respect for the criteria and sanctions when they are not respected*".<sup>12</sup>

Actually, it is open to question whether some of the minimum conditions set for proceeding to Stage III are also the most opportune afterwards and actually thus represent the harmonisation conditions required during monetary union itself. In particular, convergence criteria on interest and inflation rates take on substantially different connotations in the context of the monetary union. It is therefore public finance constraints that constitute the true, enduring parameters: in this connection, it should be noted that with the creation of the single currency not only the issue of new public debt but also the rollover of existing debt will be effected in the new common currency.

However, the period of validity of the rules for convergence in Stage III (non-divergence) must be made explicit and transparent. In the budgetary sphere the rules aim at the harmonisation and the lasting definition of relations between parliament and government in each sovereign state and between the individual states and the European Council. However, as we will endeavour to show, the norms and the procedures set up to safeguard these constraints do not seem well suited to guaranteeing the stability of the Union.

Art. 104C of the Treaty affirms the principle that member states must avoid excessive deficits; at the same time, the Protocol on the excessive deficit procedure annexed to the Treaty fixes the maximum ratio of the budget deficit to GDP at 3 per cent and of the public

as concerns the *before* – formalising and rendering transparent the question in a Protocol of understanding. Regarding the *after*, the 1996 Inter-Government Conference could examine the question of the parameters of "non-divergence", ensuring that they remain compulsory but possibly re-examining their significance at the level of economic analysis. On this subject, the criteria of rate of increase of total government expenditure and of the balance of the current accounts are worthy of mention.

<sup>12</sup> European Commission, *One Currency for Europe. Green Paper on the Practical Arrangements for the Introduction of the Single Currency*, Brussels, 1995, p. 1.

debt to GDP at 60 per cent. However, it also provides that the latter can be higher if it "is sufficiently diminishing and approaching the reference rate at a satisfactory pace".

These are the fiscal conditions that member states must respect unless they are prepared to be left out of Stage III of Economic and Monetary Union. It should be underscored that this represents a precise constraint for every member, backed by a major sanction: exclusion from Stage III. This is the real deterrent aimed at ensuring compliance with the measures contained in the Treaty.

In this connection, Art. 104C continues as follows: "If a Member State does not fulfil the requirements under one or both of these criteria, the Commission shall prepare a report". In Paragraph 7 it further states: "Where the existence of an excessive deficit is decided ... the Council shall make recommendations to the Member State concerned with a view to bringing that situation to an end within a given period".

The procedure further provides that if the Council's recommendations are not accepted, they shall be made public. Subsequently the Council can instruct the member state to take the measures aimed at the deficit reduction within the given period. This action may be accompanied by such sanctions as the requirement for public information prior to the issue of bonds or other securities, a request to the European Investment Bank to reconsider its loan policy, the obligation to make a non-interest-bearing deposit with the Community.<sup>13</sup> Paragraph 10 of Article 104C expressly precludes the right to initiate non-compliance proceeding before the European Court of Justice (undertaken either by the Commission or by another member state) pursuant to Article 169 or 170 for violation of the obligation to avoid excessive public deficits. This effectively prevents recourse to the much more severe enforcement instrument typical of the Treaty, namely the infringement procedure sanctioned by the Court.

At Paragraph 3 of the protocol on the excessive deficit procedure it is also specified that the member states must ensure that the national budget procedures allow them to undertake the commitments imposed by the Treaty.

Even though the problem does not appear to have been examined in detail yet, it is obvious that there is a substantial asymmetry in

<sup>13</sup> See C. Fresa and F. Bilancia, "Unione economica e monetaria e limiti alla sovranità nazionale", mimeo, Rome, September 1995.

the sanction mechanism, depending on whether the failure to comply with the constraints occurs before or after the transition to Stage III. In the former case, the real sanction consists in exclusion from EMU at the outset. In the latter, the length and the complexity of the sanction process raise the possibility of constraints not being observed, creating – apart from obvious economic distortions – a problem of free riding that could undermine the stability of the Union. In fact, expulsion of a member state found to be in non-compliance with the standards is not provided for, nor could it be, without bringing into question the very concept of irreversibility of the Economic and Monetary Union. This self-evidently carries consequences for the effective functioning of the Union, the efficacy of common economic policy and the adjustment mechanisms for the currency area.

The problem can be framed analytically as an infinitely repeating game that encourages cooperative solutions and, at the same time, allows for reaction/sanction strategies. The simplest optimal sanction strategy mandates cooperative behaviour as long as the adversary behaves in the same way and switching to a non-cooperative attitude as soon as he does. Given the irreversibility characteristic of the Union and the informational asymmetry that prevents instant knowledge of the effects of non-cooperative behaviour, strategies different from those now envisaged would appear opportune, so as to induce the potentially deviant country to agree to cooperative behaviour.

Bearing this in mind, one may wish to share the view expressed by the German central bank that some strengthening of the disciplinary measures under article 104C – possibly by making use of automatic procedures – is necessary.<sup>14</sup>

<sup>14</sup> An *ex post* approach to strengthening such procedures was initially favoured by the Bundesbank's President, Mr H. Tietmeyer. Arguing that the measures worked out at Maastricht were inadequate, Mr Tietmeyer has recommended that a system of automatic mechanisms be added to deter financial misconduct by future members of the Monetary Union. The addition should be formalised in an attachment to the Treaty to be agreed by the members eligible for participation in the Monetary Union – not by all EU member states. Such a document might envisage majority voting as an apt instrument for triggering automatic measures which – albeit allowing for flexibility in some cases – could go as far as freezing of disbursements of European funds. Acceptance of Mr Tietmeyer's suggestion would bypass the procedure of modifying the Treaty itself. See H. Tietmeyer, interview in the *Frankfurter Allgemeine*, 18 October 1995.

#### 4. The German proposal for a stability pact for Europe

This particular issue was recently taken up by the German finance minister Mr T. Waigel, in anticipation of the Ecofin Council held on November 27, 1995.<sup>15</sup> Contrary to the impression conveyed by some analysts, the minister did not advocate that the Maastricht criteria be made more stringent. Instead, he followed an approach akin to what has been recommended in this paper – namely:

1) fiscal discipline is a necessary condition for a member state to achieve monetary stability;

2) it should be made clear that the Maastricht criteria related to public finance are permanent, and that their enforcement is a premise for the correct functioning of the Monetary Union;

3) all participants in the Monetary Union should pledge their firm commitment to financial and monetary stability.

Differences – albeit not substantial ones – exist as to the range and emphasis on the most suitable safeguard mechanisms/instruments. Waigel focuses on an adequate set of disciplinary procedures towards acceptable common standards of fiscal restraint. In this light, he suggests the establishment of a “European Stability Council” – whose members would be the finance ministers of member countries – charged with monitoring targets, warning diverging member countries, and setting the guidelines for national financial policies.

Convergence criteria to be supplied by the Commission would be used to assess the compatibility of national performances with the Maastricht criteria. Should the 3 per cent limit be exceeded, an automatic procedure would oblige the defaulting country to make a non-interest-bearing deposit with the European Central Bank of an amount of funds corresponding to 0.25 per cent of its GDP for each percentage point or part by which the deficit limit is exceeded. As soon as the member state concerned no longer exceeds the upper limit for the public sector deficit, the “stability deposit” will be refunded, while if the deficit limit continues to be exceeded after two years, the deposit will turn into a fine.

<sup>15</sup> See T. Waigel, “Stability pact for Europe – Fiscal policy in the third stage of the EMU”, mimeo, Bonn, November 1995.

In the medium term, the public deficit should not exceed the stricter limit of 1 per cent of GDP, although larger deficits – in any case no higher than 3 per cent – may be tolerated “in economically unfavourable periods”. Narrowing the ordinary limit to 1 per cent would go a long way towards averting the risk of ever trespassing on the exceptional 3 per cent limit.

The exact figure of the medium-term limit for the public deficit might be open to debate, but the need for stricter quantitative targets should not be questioned, certainly not by countries presently displaying unacceptably high debt/GDP ratios – at least for the time needed by them to bring their ratio under the 60 per cent threshold.

The stance taken in this paper with respect to budgetary procedures is that – regardless of which disciplinary measures are to be retained (which, as demanded by the Maastricht Treaty, will have to be built in fully common mechanisms) – the monitoring of the financial performance of member states must rely primarily on pre-emptive remedial action to ensure the attainment of the objectives compatible with fiscal discipline. Hence the emphasis on the advisability of adequate institutional – and constitutional – reforms to avoid the need to resort *ex post* sanctions.

With reference to the need to adapt internal legislation to the needs of the Treaty, the European Commissioner Mr Monti<sup>16</sup> has argued convincingly that the government should be endowed with instruments of last resort for deficit containment, which would be automatically activated whenever budget balances were assumed to be incompatible with the convergence targets. His approach is consistent with – and may be thought of as ancillary to – the approach based on institutional reforms geared to secure *ex ante* compliance. Both, by sheltering bottom line decision-making from the vagaries of political expediency, enhance the credibility of commitments towards sustainable financial restructuring and budgetary balance convergence, as demanded by the suggested legislation.

On the other hand, neither of the two approaches rules out a thoughtfully designed sanction-based mechanism, as advocated by Waigel. This, however, would be kept in background, as a safeguard making potential offenders toe the line, to be activated under exceptional circumstances.

<sup>16</sup> See M. Monti, “Politica fiscale d’anticipo”, *Corriere della Sera*, 17 December 1994, and “La regola che manca”, *Corriere della Sera*, 18 July 1995.

Far from being conflicting, the two approaches which have been highlighted may be seen as complementary. Indeed, should prospective sanctions fail to deter misconduct, the actual punitive action would most likely compound the disarray of the economy that is being disrupted by lack of financial orthodoxy and could well aggravate the difficulties across the rest of the Union. By contrast, a clearly spelled-out mandate – enshrined in the constitution and in the budgetary law – to hold deficits and national debt within the guidelines set in the Treaty on European Union would serve as guidance to governments and parliaments, which would also be largely relieved from the pressure of unrealistic demands on the part of the public. A scenario would thus be generated which would enhance the credibility and the financial stability of the Union. Democratic consultation and decision making would also benefit from the Treaty being made fully visible to the people through internal legislation.

In other words, the sequence of procedures for determining budgetary balances would be both guided and sustained by the obligation not to breach internal legislation, enacted as opportune at different levels of juridical cogency. As it were, a shadow constitution implicitly adopted by becoming a member of an institution moulded by the Maastricht Treaty – setting rules presiding over budgetary policy – would be rendered manifest through an explicit incorporation of the Treaty itself into national law.

Lastly, Waigel’s view on the “qualitative” objectives of the Union is also close to that reflected in this paper. In particular, there is agreement on seeing budgetary discipline and financial stability as compatible with high growth and employment rates, provided investment promotion is a priority to be consistently pursued by governments to improve potential growth. The already mentioned current budget surpluses (or at least balance) should be earnestly sought for the additional reason that they would favour investment policies. However, it is necessary that yearly increases in public expenditures be kept below the rate of GDP growth, so as to reduce – or at least stabilise – the tax burden.



## 5. Conclusions

The foregoing remarks are aimed at furthering the credibility and stability of EMU. The single currency (the euro) will be viable throughout such a large and heterogeneous area only if it is really stable: only in this case can it be accepted as a means of storage of wealth and substituted for the most stable national currencies.<sup>17</sup>

The institutional arrangements of the Economic and Monetary Union bear principally on the conduct of monetary policy, the coordination of national economic policies, avoiding excessive deficits, policies of regional cohesion, and lasting convergence between economies. The convergence criteria of the Treaty for the stage preceding full monetary union must not be called into question, but minimum harmonisation procedures must be stipulated to make the Union stable. Financial policy, like social and wage policies, remains within the sphere of competence of individual member states: it would appear necessary to establish the regulations needed to make the Union operational, at the same time preparing the prerequisites for a common starting point that is economically sustainable.<sup>18</sup>

Summing up, a correct relationship between citizens across Europe, on the one hand, and their national parliaments, on the other, rests primarily on making the public fully aware that national sovereignty is to be exercised in ways which will be increasingly conditioned by Union participation. While the principle of subsidiarity continues to apply to fiscal policies in Stage III, it should be openly recognised that fiscal leeway will be somewhat reduced by the constraints resulting from the Monetary Union. The breach of common rules would impinge on the Union's fundamental interest in safeguarding monetary stability and would endanger the very subsidiarity principle.<sup>19</sup>

<sup>17</sup> See H. Tietmeyer, report on "Sistema monetario e rapporti tra banche centrali", in *Gli incontri di studio a palazzo Giustiniani*, Senato della Repubblica, Rome, 1995.

<sup>18</sup> *Ibid.*

<sup>19</sup> It should be noted that, in some respects, Maastricht fiscal policy constraints are more rigorous than those regarding monetary policy. In fact, monetary responsibility is assigned to the European Central Bank (in whose boardroom sit representatives of the national central banks) with no quantitative targets set by the Treaty for its operations. By contrast, fiscal policy is submitted to clearly identified plafonds.

Attention has therefore been drawn to the need to render transparent, at European level, the significance of the fiscal constraints lodged in the Treaty, for the restrictions on national sovereignty and the definition of the relations between parliament and government that these constraints determine in each sovereign state.

With reference to Italy, it would be advisable to start dealing with the question of possible budget modifications in the Constitution. This has to be projected in a European key: the budget constraints imposed on individual states by the Treaty must be rendered mandatory for the start of Stage III of the Union.

It is perplexing that the Commission's *Green Paper* on the practical measures for the introduction of a single currency not only does not consider the complex problems set forth here but judges the budget constraints and the laws enacted to safeguard them as fully adequate to ensure the Union's operability.

In discussing the institutions of the Union, the *Green Paper* actually declares: "EMU is built on two foundations: a strong focal point for the coordination of economic policies (the Council of Economics and Finance Ministers) and an independent monetary institution (ESCB). The Council ... is responsible for defining the broad guidelines of economic policy; it has means at its disposal to apply pressure on participating countries to meet their budgetary commitments. In addition, there is no possibility of bail out".<sup>20</sup>

Apart from the problem of substance, namely the cogency of the constraints and the asymmetry of the sanction mechanism, there is also, in any case, an institutional problem: a clear limitation of sovereignty of the member states' parliaments, which only a constitutional law can implement.

Specifically concerning Italy, one could argue that Article 11 of the Constitution allows ordinary legislation to enact the limitations on sovereignty that derive from international treaties. It is clear, however, that the article was intended for different purposes.<sup>21</sup> However, the need for transparency requires clarification of these subjects and the rendering explicit of the Treaty's implications for the budget procedures and for Article 81 of the Constitution itself.<sup>22</sup>

<sup>20</sup> European Commission, 1995, *op. cit.*, p. 6.

<sup>21</sup> On this subject, see L. Ferrari Bravo and E. Moavero Milanesi, 1995, *op. cit.*

<sup>22</sup> This is clear from the procedures followed by the Federal Republic of Germany. On this see F. Bilancia, "Mutuo riconoscimento ed armonizzazione minima, il mercato unico e la moneta unitaria", mimeo, Rome, September 1995.

Finally, it must be emphasised that the solution must be found quickly, in any case not later than 1999, given the timetable set by the Treaty for the establishment of Economic and Monetary Union.

Actually there is even less time: firstly, because some of the themes broached here could be included in the process of completion of the Maastricht Treaty; secondly, because – given the sequence of events planned (the reference “scenario”) for the introduction of the euro – decisions regarding admissibility must be taken between the end of 1997 and the first half of 1998.<sup>23</sup> In this connection, the heads of government will, however, have to reconcile the need for credibility implicit in the requirement of full observance of the Maastricht obligations with the equally important need for a sufficient number of countries at the “starting line” (Table 1). Nor must the overall assessment neglect the risk that too-rapid convergence on some parameters – specifically the debt/GDP ratio – could generate recessionary tendencies.

At any rate, the precepts of transparency and completeness of information for citizens (economic agents) require that the legal and economic “rules of the game” be made known well before the date of the transition to the European currency, and hence to the single currency, in order to give the necessary credibility to the irreversibility of the process, among other things.

In conclusion, the more concrete and realistic is the path towards EMU, for Europe and for Italy, the more stringent and closer in time the problems discussed here become.

<sup>23</sup> See on this “The scenario for the change over the single currency”, in European Council, Presidency Conclusions, Madrid, 16 December 1995. On the technical level, this means defining the duration of phase 2B – that is, the period between the decision to move on to Stage III (single currency) and the introduction of the single currency itself. On this subject, without underestimating the technical difficulties to be overcome in the transition phase, an excessive duration of this phase must be avoided, for this, as past experience has shown, would increase the risks for the stability of the system.

TABLE 1

## ECONOMIC INDICATORS AND CONVERGENCE CRITERIA OF THE MAASTRICHT TREATY

Country	Consumer prices			Long-term interest rates		
	1995 estimates	1996 forecasts	1997 scenario	1995 estimates	1996 forecasts	1997 scenario
Austria	2.3	2.2	2.3	6.5	6.3	6.8
Belgium	1.5	2.4	2.2	7.6	7.0	7.3
Denmark*	2.1	2.4	2.7	8.4	7.8	8.1
Finland	1.2	2.0	2.2	8.0	7.2	7.5
France	1.8	2.1	1.8	7.5	7.1	7.4
Germany	1.9	2.1	2.2	6.6	6.3	6.7
Greece	9.3	7.9	7.0	14.3	12.8	10.0
Ireland*	2.4	2.3	2.6	8.3	7.9	8.0
Italy	5.4	3.5	3.0	12.0	10.5	9.2
Luxembourg	1.9	2.2	2.5	6.1	6.0	5.9
Netherlands*	1.9	2.1	2.4	7.2	6.7	7.0
Portugal	4.2	3.5	3.2	11.4	10.4	10.3
Spain	4.7	3.7	3.5	11.1	10.4	10.3
Sweden	2.8	2.8	3.0	10.1	8.8	8.9
United Kingdom	3.5	3.0	2.6	8.3	7.9	8.0
Maastricht constraint <sup>a</sup>	3.0	3.6	3.6	9.7	8.9	9.2
United States	2.2	2.1	2.4	6.6	6.2	6.2
Japan	-0.6	-0.3	0.7	3.4	3.2	3.5
Country	General government financial balance as a % of GDP			General government gross debt as a % of GDP		
	1995 estimates	1996 forecasts	1997 scenario	1995 estimates	1996 forecasts	1997 scenario
Austria	-5.5	-5.0	-4.6	68.0	68.9	71.5
Belgium	-4.5	-3.1	-3.5	134.4	132.3	130.0
Denmark*	-2.0	-1.3	-0.5	73.6	72.7	70.5
Finland	-5.4	-1.5	0.0	63.2	64.6	64.5
France	-5.0	-3.9	-2.9	51.5	53.4	54.2
Germany	-2.9	-2.8	-2.4	58.8	59.5	59.3
Greece	-9.3	-8.3	-7.3	114.4	114.0	113.1
Ireland*	-2.7	-2.0	-1.3	85.9	81.3	76.9
Italy	-7.5	-5.9	-4.4	125.1	124.6	122.7
Luxembourg	0.4	0.6	0.7	6.3	6.7	6.8
Netherlands*	-3.1	-2.7	-2.2	78.4	78.2	77.8
Portugal	-5.4	-4.7	-4.1	70.5	71.0	70.9
Spain	-5.9	-4.7	-3.6	64.8	65.8	65.4
Sweden	-7.0	-4.5	-3.2	81.4	80.8	79.8
United Kingdom	-5.1	-3.7	-2.8	52.5	53.3	53.2
Maastricht constraint <sup>a</sup>	-3.0	-3.0	-3.0	60.0	60.0	60.0
United States	-1.6	-1.5	-1.5	63.1	63.0	62.1
Japan	-3.9	-4.8	-4.1	83.1	90.1	97.3

<sup>a</sup> Average of the three countries with the best inflation results, plus 1.5 percentage points for consumer prices, and plus 2 percentage points for long-term interest rates.

– Countries in italics according to present forecasts for 1997, fulfill all Maastricht criteria.

– Countries with asterisk, according to actual forecasts for 1997, fulfill the requisites according to an extensive interpretation of Treaty art. 104C regarding the public debt/GDP ratio.

Sources: For Italy: Economic and Financial Planning Document for 1996-98 and Financial Bill for 1996.

For the other European Countries, EU forecasts and scenario based on two technical assumptions.

– The first one is the unchanged policies assumption, which involves the exclusion – mainly for public finance data – of the effects deriving from measures not specified in detail. Consequently, forecasts for 1997 are essentially an extrapolation of 1996 trends.

– The second assumption supposes exchange rate stability (in nominal terms for the currencies of the EMS and in real terms for all the others) at the average values of September 1995.

For United States and Japan: OECD provisional forecasts. Private consumption deflators have been used for consumer prices for these two countries.

## APPENDIX 1

## Essential budget procedure timetable in Italy

- By the end of February the Minister of the Treasury presents a report to parliament estimating cash requirements of the state sector for the current year, together with the out-turn for the previous year (Law 468/1978, Article 30(1)).
- By the same date the Minister of the Budget sends parliament a report giving the data on the performance of the economy in the previous year and updating the forecast for the current year (Law 468/1978, Article 30(1)).
- By the end of March, the Accountant General's Office sends the central accounting offices the galley proofs (the final proof for the three-year budget plan and the item schedules for the annual budget) giving current appropriations and a blank space for the estimates regarding the subsequent fiscal years.
- By the same date, the Ministers of Budget and Treasury present to parliament the Annual Report on the economic situation of the country in the previous year.
- By May 15, the government presents to parliament the Economic and Financial Planning Document which is also transmitted to the regions (Law 468/1978, Article 1a).
- By the end of May, the Minister of Treasury presents an initial report on budgetary cash flow and treasury management in the first quarter (Law 468/1978, Article 23(2)).
- By the same date the Ministry of the Treasury, by means of the Accountant General, transmits to the State Audit Office the statement of accounts of the previous year for ratification (Law 468/1978, Article 23(2)).
- By the same date, the Inter-Regional Commission gives its opinion on the Economic and Financial Planning Document (Law 468/1978, Article 1a(2)).
- By June 30, the Minister of Treasury, in concert with the Minister of Budget, presents to parliament the budget adjustment bill (Law 468/1978, Article 17(1)).
- By the same date, the Minister of the Treasury and the Minister of the Budget present to parliament the bill for the approval of the statement of accounts for the preceding year (Law 468/1978, Article 21).

- By July 31, the government presents to parliament the bill for the annual and three-year budgets on a current programmes basis, which is also transmitted to the regions (Law 468/1978, Article 1a).
- By the end of August, the Minister of the Treasury presents a second report, on budgetary cash flow and treasury management in the first two quarters (Law 468/1978, Article 30(2)).
- By September 15, the Inter-Regional Commission gives its opinion on the bill for the annual and three-year budgets on a current programmes basis (harmonisation of central and regional government documents) (Law 468/1978, Article 1a(2)).
- By the same date, the Interministerial Committee for Economic Planning (CIPE) approves the Forecasting and Planning Report, the sector reports (scientific research and public administration) and the guidelines for the annual and three-year budget bills (Law 468/1978, Article 24).
- By September 30, the Ministers of Budget and Treasury present to parliament, subject to approval by CIPE, the Forecasting and Planning Report (Law 468/1978, Article 1a).
- By the same date, the government presents to parliament the three-year financial planning budget and at the same time the draft finance bill for the following year, with the relative accompanying legislation (Law 468/1978, Article 1a).
- By the end of November, the Minister of Treasury presents to parliament a third report, on budgetary cash flow and Treasury management for the first three quarters (Law 468/1978, Article 30).
- By the end of the year, the Houses approve the budget and final statement of accounts presented by the government (Law 468/1978, Article 81c). If there is not time enough for approval, parliament may authorise the government to conduct provisional management of the still unapproved budget for a period of no more than four months. During provisional management, allowed expenditure consists of as many twelfths of the budget expenditure for each item as there are months of provisional management, plus any additional expenditure due on account of items not susceptible to being split into twelfths (Law 468/1978, Article 16).

## APPENDIX 2

## Articles of the Constitution cited in the text

- Art. 3. All citizens have equal social dignity and are equal before the law, without distinction of sex, language, religion, political opinion, personal and social circumstances.

It is the task of the Republic to remove the economic and social obstacles which, by limiting the freedom and equality of citizen in fact, impede the full development of the human being and the effective participation of all workers in the political, economic and social organisation of the country.

- Art. 11. Italy repudiates war as an instrument of aggressive attack on the freedom of other peoples and as a means of resolution of international disputes; it consents, in conditions of parity with the other states, to the limitation of sovereignty necessary for a system which ensures peace and justice between nations; it promotes and supports international organisations having this aim.

- Art. 47. The Republic encourages and protects saving in all its forms; it disciplines, coordinates and oversees the exercise of credit.

It supports the use of private savings for home ownership, direct farm ownership and direct and indirect share investment in the large productive organisations of the country.

- Art. 71. The right to initiate laws belongs to the government, to each member of parliament and to the organs and the institutions specified by constitutional law.

The people may exercise the right of initiative by means of a proposal for a bill, divided into articles, by at least fifty thousand voters.

- Art. 81. The Houses annually approve the budgets and the final statement of accounts presented by the government.

Provisional budget management can only be guaranteed by law and for periods of no longer than a total of four months.

The law approving the budget cannot include new taxes or new expenditure.

Every other law which introduces new and greater expenditure must specify the means by which it will be covered.