

# Europe's Fiscal Constitution

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## 1. Introduction

In a public consultation paper, the European Union (EU) asks its citizens and Member States to come up with ideas how to reform the EU Budget. The key research challenge of our paper – to answer the consultation paper – is to give a novel angle from the point of fiscal sociology and Austrian economics towards the selection among the alternative budgetary powers made available to the EU.

We do suggest guidelines for exclusion and inclusion of provisions in the EU-Budget that are not prizes captured in negotiations, often partisan struggles, between the Member States. The focus is on the normative evaluation of quasi-permanent budgetary institutions and their tasks. We do also suggest that such a constitutional framework creates trust and facilitates a robust democratic debate. The emphasis is not, as is usually the case based on a benevolent EU, to enhance economic efficiency (making the EU “work better”) and / or to increase the equity of budget rules. We will put to test a different approach: an analysis that we define by the limits it places on the powers of Brussels, an egoistic despot, to “tax and spend”. Though the model of a budget-maximizing Leviathan-like EU bureaucracy, a discretionary agency, may seem extreme, the norms laid down may possible prove acceptable as embodying a minimax strategy: to ensure that the best remains a possibility by guarding against the worst.

## 2. Background And Approach To The Problem

Since the rejection of the draft Constitutional Treaty in 2005 by French and Dutch voters, a revision of the budgetary powers of the EU is a priority. If, the “no” of the French and Dutch citizens was a revolution, the truth counts that at least halve of all historic revolutions were fiscal revolutions<sup>1</sup>. Hence the 2007 consultation call by the Commission is, in the words of Dalia Grybauskaitė (European Commissioner for Financial Programming and Budget), a “unique, may be once-in-a-lifetime opportunity”, to discuss a fundamental review of the EU Budget<sup>2</sup>.

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1 Nef, R., *Lob des Non-Zentralismus*, Sankt Augustin: Aca-demia Verlag, (2002).

2 European Commission: Communication from the Commission. Reforming the Budget, Changing Europe. A public Consultation Paper in view of the 2008/2009 budget re-view,

In 2011 the Commission will come up with a final reform proposal for the next Financial Framework (2014 and onwards). In the mean time the Commission asks Europeans and the Member States for their completely “open and no taboo” opinion on the reform of the EU budget: a wide-ranging review of all aspects of EU spending and resources.

The road suggested in the Commission’s consultation paper, just as the approach after the rejection of the draft Constitutional Treaty, can be a very toil-some process inside the realm of partisan (Member States’) advocacy. Solidarity, for instance, has to be bought with financial pet projects for individual Member States. Or, alternatively, budget reform is discussed by the direct application of abstract ethical norms in a vacuous (without a model of governmental-political behavior) institutional setting.

Moreover, fiscal decision-making is often based on the rule that policies have to pose as little resistance as possible for the majority that must approve of them. The feeling, often, dominates that someone else pays<sup>3</sup>. In the four years before 2005, no member of the US congress has on total voted for a reduction in government outlays, though the rhetoric to speak of fiscal discipline was on the rise<sup>4</sup>. A situation, probably, that is not much different for Europe. Besides, in general, it is most likely that possible rates of government spending will always be higher than the revenue from the taxes legislatures are willing to impose on their constituents<sup>5</sup>. This since decisions on the spending side of the budget are made independently of the decisions on the taxing side. Ever growing government tasks and a growing government budget and corresponding taxation are the result.

The paper shifts the grounds for the debate on the reform of the EU budget towards an authentic fundamental review: it focuses on the choices among quasi-permanent constraints (within which alternatives should the EU’s budgetary powers be exercised) and not, as is usually the case<sup>6</sup>, on choices within given constraints. The paper adopts a rule-based perspective on the EU Budget: we do choose budgetary rules of which we know that such institutions, once selected, will remain in being over an indeterminately long sequence of budgetary periods. We should take literally Grybauskaite remark about an “once-in-a-lifetime possi-

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Brussels, 12.9.2007, SEC (2007) 1188 final.

3 Spicer, M. W. On Friedrich Hayek and Taxation: Rationality, Rules, and Majority Rule. *National Tax Journal*, Vol. 48, No. 1, (1995).

4 Dirksen, J. Vote Tally Report 108-2. *NTUF Policy Paper* 156, (2005), [www.ntu.org](http://www.ntu.org).

5 See Buchanan (1980, 2000).

6 ECB, The EU budget: How much scope for Institutional Reform? *European Central Bank, Occasional Paper Series*, no. 27, April (2005).

ECFIN workshop, The role of fiscal rules and institutions in shaping budgetary outcomes: proceedings from the ECFIN workshop. *Economic Papers*, nr. 275, (2007).

bility". The rules are quasi-permanent and long-lived. Members States are unable to predict with precision what their position will be at any particular moment in the future. In particular, they are presumed to be unable to identify their position (a veil of ignorance) either as payer or as spending beneficiary in a sequence of separate budgetary periods. History shows that these kinds of debate about a framework for political action, not an instrument thereof, have been possible and fruitful<sup>7</sup>.

Our research is a normative activity. It is not discussed in traditional constitutional law, which mostly looks at existing positive law<sup>8</sup>. In public finance, however, the whole problem seems to have no place either. It is typical something that is often considered to be too vague; it is to be described as fiscal sociology<sup>9</sup>. Primarily, the method used to discuss constitutional limitations cannot be empirical. There is a clear difference between our empirical knowledge of decision-making within a given framework and discussions about the framework itself. To discuss the latter is like speculation. In that realm, hypotheses are only conceptually refutable.

### **3. Fiscal Sociology And Austrian Economics**

The EU fiscal system has three segments. The first segment is the EU budget. The second one is the harmonization of the national tax systems. The third is the coordination of the budget policies of the Member States through EU's fiscal rules, e. g., the Pact on Stability and Growth and the Maastricht convergence criteria. This paper concentrates on the first segment. Cultural, political (3.1), and economic (3.2) reasons make it difficult to have fiscal decision-making re the EU budget in the sense of an all-out democratic process on a broad spectrum of EU tasks.

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- 7 Buchanan, J. M., *Choice, Contract, and Constitutions*. Indiana-polis: Liberty Fund, (2001). Elster, J. *Arguing and Bargaining in the Federal Convention and the Assemblée Constituante*. Center for the Study of Constitutionalism in Eastern Europe, Working Paper no. 4, August, (1991).
  - 8 Kinneging, A. *De Europese Grondwet, het staatsrecht en de constitutionele theorie*. In: Cliteur, P., Franken, H., Voermans, W., eds. *Naar een Europese Grondwet*, Den Haag: Boom, (2004), p. 130.
  - 9 Backhaus, J. *Fiscal Sociology: What for?* *American Journal of Economics and Sociology*, Jan. (2002).  
Backhaus, J. *Fiscal Sociology: Guest editor's introduction*. *Journal of Economic Behavior & Organization*, Vol. 59 (2006).

### 3.1 *Political And Cultural Differences*

Fiscal policy and democracy are hard to reconcile. It is an almost impossible combination to ask for. To understand and solve this problem we do need the approach of fiscal sociology: a fusion of economics and sociology. It is (a change of) socio-political rules we are looking at. How can social order be established and preserved? A fiscal constitution must accommodate not only Member States with different constitutions and different economic and political systems, but also with different histories, cultures and socio-political visions<sup>10</sup>. We can identify the burden of taxation as the focus of research in fiscal sociology. Fiscal sociology is a science that became necessary after the twentieth century separation of economics, sociology, politics and law, with the resulting lacunae. Large comprehensive studies, which once characterized the activities of leading social scientists, became de-emphasized.

In the middle of the previous century, Friedrich Hayek<sup>11</sup> wrote that democracy can only under very restricted conditions be transposed to a supra-national organization. A little later, his American counter-ego Milton Friedman said the same. If you apply both ideas to the situation in Europe, we have to conclude that the EU is not only missing the necessary homogeneity to form clear policy goals in a democratic way, but it misses as well the stimuli not to waste money.

Why is it so hard to expect concrete policy goals and fiscal constraint from the European parliament – the most democratic institution of the EU? Of course, very general objectives (e. g., prosperity for everyone) will be easy to agree on. After that, however, it becomes difficult. Concrete objectives will be difficult to formulate. The countries of the EU differ too much in culture, history and economic development. Every choice supposes a balancing of the pros and cons (cp. Hayek<sup>12</sup>. The recently weakened Services Directive of 2006, e. g., is supposed to show the social face of the EU. No worker from Eastern Europe, however, will be glad with the “social protection” of the revised directive or the “social clause” in the new Treaty of Lisbon (2007). Within a relatively homogeneous country like the Netherlands, however, the original directive would be no problem. Every plumber from the north of the Netherlands is welcome in the south. Likewise, the Netherlands, e. g., is supporting with a low price of gas a national pride: the

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10 Backhaus, J. Fiscal Sociology: Guest editor’s introduction. *Journal of Economic Behavior & Organization*, Vol. 59 (2006).

11 Hayek, F. A. *Freedom and the Economic System*, Public Policy Pamphlet, No. 29, Chicago: The University of Chicago Press, (1939).

Hayek, F. A. *The Economic Conditions of Interstate Federalism*. In: *Individualism and Economic Order*, London: Routledge and Kegan Paul, (1949), pp. 255-272.

12 See Hayek (1944), (1986), p. 168.

agriculture of vegetables in greenhouses in the west of the country. However, the very same solidarity for a, e. g., Spanish national pride is something completely different. The same goes for the other way around.

Hence, if a parliament cannot give and agree on policy objectives, the European Commission remains *de facto* the administration. Often below the guise that it concerns only a technical affair. That is hard to maintain. Over a change in policy, no matter how technically it does look like, the parliament belongs to decide. Moreover, also the Commission has to do with the various wishes of the Member States that do make up the members of the Commission.

Besides that, large countries will never transfer their economic power to Brussels. The course of events re the reformation of the Pact on Stability and Growth is characteristic thereof. It is naïve to expect the same reforms if a few small countries had broken the rules. Therefore, we can expect that, e. g., the new rule on decision-making by the way of a qualified majority, to be introduced in 2014, based on the double majority of Member States and people, 55 % of the Member States representing at least 65 % of the Union's population, is violated if it should be of a disadvantage to large countries.

The EU, also, has hardly any incentives not to waste money. The best guarantee not to waste money is that the same person both owns and does spend the money<sup>13</sup>. For then we can expect that you loan on the penny and sees to it that you do get value for your money. Members of parliaments or commission members, however, do spend others men's money, on behave of, often again, other men. That is almost a guarantee for ineffective and inefficient spending. Of members of a local parliament we can expect some restraint in spending the taxpayers' money of their own citizens. What to think, however, of an Eastern-European member of the EU-parliament who does spend the money of West-European taxpayers at projects in Eastern Europe? To satisfy the members of parliament of Western-European countries pork-barrel legislation will rise. Not much different as is presently the case in the US where the support of congressional representatives has to be bought with financial presents (pet projects) for their local constituents. In short, we will see more signs along the roads that state, "This project has been realized with the help of the EU". A project, if the Member State had to decide and pay for itself, it would not have spent the money on.

In sum, cultural and political differences make it difficult to have a fiscal constitution in the sense of an all-out democratic process in which majorities do decide. We can transpose democracy to a supra-national organization only under

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13 Friedman, M. and R. Free to Choose. Harmondsworth: Penguin Books, [1979], (1981), p. 146.

very restricted conditions<sup>14</sup>. It is, however, the popular thing to do<sup>15</sup>. The solidarity and trust that is necessary for concrete policies within the EU is very tenuous. Even within one country if things do differ like language (Belgium), religion (North-Ireland) or economic development (North and South-Italy) solidarity is hard to find. All of these situations do characterize the situation within the European parliament. Policies, no matter how good the intentions behind them, which are possible for each of the countries separately, are no option for the EU as a whole. Europe lacks the necessary homogeneity; priorities cannot be set. To transfer authority and hence policy to Brussels has its limits. Hence, of an (in the future) democratically chosen Chinese parliament with its approximately 3000 members we can expect more priority setting than by the 751 members of the European parliament. China with its fifty minorities but overwhelming majority of almost 95 per cent Han Chinese is more a unity than the 27 members of EU are.

### *3.2 Economic Differences*

Why does the new Treaty of Lisbon (2007) set out individual freedom as one of the core values of the EU? It is a good in itself. We can only make real choices based on individual freedom. Freedom is also essential to develop as a moral being. Man is first and for all a spiritual being. The choices, e. g., we make to help other people, have to be taken in freedom.

Individual freedom is also a necessity for our economic order: the market economy. Not only, quite visible, the climate and the physical characteristics of the Member States do differ, but, less visible, though of more importance, also men in their preferences and knowledge do differ. A market economy, as has been emphasized by the Austrian-born economist Hayek, is to make optimal use of those differences in knowledge<sup>16</sup>. Hence, the problem in a market economy is not to give the central authorities, be it Brussels or a local government, all the extra knowledge it needs to pursue policy. The problem is to give each individual all the extra knowledge he needs, mostly in the form of price (profit) signals, so he can decide for himself how to pursue his own goals. In this way, society does make

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14 Gillingham, J. *European Integration 1959-2003. Superstate or New Market Economy*. Cambridge: Cambridge University Press, (2003).

Gillingham, J. *Design for a New Europe*. Cambridge: Cambridge University Press, (2006).

15 Leonard, M. *Democracy in Europe. How the EU can survive in an age of referendum*. Essays Centre for European Reform, (March 2006).

Verhofstadt, G. *De Verenigde Staten van Europa, Manifest voor een nieuw Europa*. Antwerpen: Houtekiet, (2005).

16 Hayek, F. A. *Law, Legislation and Liberty*. London: Routledge & Kegan Paul, (1982), Volume 1.

use of often-unique knowledge of local circumstances and preferences that do differ in time. Knowledge that is difficult to centralize. An idea as valid for individuals as for countries and has found its expression in the idea of subsidiarity<sup>17</sup>.

Hayek describes the market process as one of learning by discovery. We are looking at the core of Austrian economics. In Austrian economics knowledge dissemination and the discovery thereof are of central importance. Endogenous change in the ends-means relationship – says Israel Kirzner, building his theory as Hayek did – is possible with the entrepreneurial element in each individual market participant: alertness. Alertness is “the propensity [...] toward fresh goals and the discovery of hitherto unknown resources”<sup>18</sup>. A disequilibrium situation points to market ignorance. From it emerge profitable opportunities, alertness exploits. Alertness gives a more realistic image of human action (and hence real choice) and makes possible the description of the market as a unified discovery process. “[The] ‘alertness’ view of the entrepreneurial role rejects the thesis that if we attribute genuine novelty to the entrepreneur, we must necessarily treat entrepreneurially generated market events as not related to earlier market events in any systematic way. The genuine novelty [...] attribute[d] to the entrepreneur consists in his spontaneous discovery of the opportunities marked out by earlier market conditions (or by future market conditions as they would be in the absence of his own actions)” [...] “[These] entrepreneurial discoveries are the steps through which any possible tendency toward market equilibrium must proceed”<sup>19</sup>.

A market economy makes room for human freedom and uses existing knowledge the best<sup>20</sup>. Hence we should make decisions re rules on an as decentralized level as possible. The economic way to solve problems when sovereignty sharing by the way of a complete harmonizing of all rules is impossible is to apply the concept of mutually recognition of differences<sup>21</sup>. In a market exchange, strong differences of opinion are taken care of in a peaceful way. Subsidiarity, an orga-

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17 Backhaus, J. Das Subsidiaritätsprinzip als Baustein einer entstehender Europäischen Verfassung. (2001).

18 Kirzner, I. M. Competition and Entrepreneurship, Chicago: University of Chicago, Press, (1973), p. 34.

19 Kirzner, I. M. Discovery and the Capitalist Process. Chicago: University of Chicago Press, (1985), pp. 11-12.

20 Hayek, F. A. Law, Legislation and Liberty. London: Routledge & Kegan Paul, (1982), Volume 1.

Buchanan, J. M. Liberty, Market and State. Brighton: Wheatsheaf Books, (1986).

21 Backhaus, J. Das Subsidiaritätsprinzip als Baustein einer entstehender Europäischen Verfassung, (2001), p. 9.

nizing and enforceable principle is congruent with the market<sup>22</sup>. In a sense, competition between local authorities or Member States, where there is freedom of movement, provides experimentation with alternative models that is conducive to growth. It resembles the market economy best<sup>23</sup>. Subsidiarity has remained a part of the new (reformed) European Treaty of Lisbon. It states that we should only shift powers to Brussels when Member States themselves cannot achieve the same results<sup>24</sup>. From this principle, which we can also describe as economic federalism<sup>25</sup>, flows the responsibility of the Member States to provide the legal conditions under which the citizens can accumulate wealth in order to satisfy their needs themselves.

In sum, in the last centuries the goal of a market economy in which everyone aims at his own interests and uses his own knowledge has been a basic economic value in Europe. For James Buchanan this is all a part of the superiority of the Western value system<sup>26</sup>. In the 19e century John Stuart Mill already wrote, “it is now recognized, though not till after a long struggle, that both the cheapness and the good quality of commodities are most effectively provided for by leaving the producers and sellers perfectly free, under the sole check of equal freedom to the buyers for supplying themselves elsewhere”<sup>27</sup>. John Maynard Keynes spoke in similar words a century later, “The advantage to efficiency of the decentralization of decisions and individual responsibility is even greater, perhaps, than the nineteenth century supposed; and the reaction against the appeal to self-interest may have gone too far”<sup>28</sup>.

#### 4. Constitutional Political Economy

In constitutional economics, we define the rules of the socio-economic-political game. We have to make two sorts of constitutional decisions. First, we must choose from possible constitutional (so-called higher law) rules. Behind a veil of ignorance, countries and people choose electoral and non-electoral constitutional

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22 Ibid.

Apolte, T. Die eigentümliche Diskussion um Zentralisierung und Dezentralisierung in der Europapolitik. *Perspektiven der Wirtschaftspolitik*, 5(3), (2004), pp. 271-291.

23 Hayek, F. A. *The Constitution of Liberty*. London: Routledge, (1960), p. 230.

24 See: Treaty 2004, Title III, Article I-11, cp. Treaty, 2007.

25 Inman, R. P., Rubinfeld, R. P. Rethinking Federalism. *The Journal of Economic Perspectives*, Vol. 11, No. 4. (Autumn, 1997).

26 Buchanan, J. M. Restoring the Spirit of Classical Liberalism. Notes from FEE, (July 2005), p. 1.

27 Mill, J. S. *On Liberty*. Harmondsworth: Penguin Books, [1859], (1974), p. 164.

28 Keynes, J. M. *The General Theory of Employment, Interest, and Money*. New York: Harcourt, [1937], (1964).



rules. No one knows his future position. (Of all the Member States, Germany broke the rules of Pact on Stability and Growth. Though beforehand, Germany was a most unlikely candidate.) It is at this initial constitutional decision stage, where we choose the basic fiscal arrangements, that citizens not only can really control the state, but widespread public agreement is possible<sup>29</sup>. This since the prospect for general agreement changes dramatically if we allow for some introduction of ignorance and / or uncertainty into the Member States' calculus. The prospects of agreement relate directly to the predicted length of life of the tax reform. Then we will tend to opt for rules that are "fair". Hence the measures to be discussed below are meant not just for the upcoming, 2013, sixth financial framework but "forever". Besides, it is always easier to secure agreement on a set of rules than to secure agreement for example on who is our favorite player. The tone of the discussions is theoretical and argumentative. Gains for all members are real.

Second, we have to state rules for day-to-day policies within the framework. Making decisions by majority ensures the workability of the political process. The tone of the discussions is one of weighting up interests and bargaining<sup>30</sup>. Ordinary politics, post constitutional choice, tends to be conflictual. The reformed EU treaty, however, gives unanimous consent a smaller role, without making the distinction between the just-mentioned two sorts of decisions.

Part of the difficulty of our answer is constitutional illiteracy. We have to shore up constitutional understanding: the choice by individuals, who are related one to another in an anticipated set of interactions, of a reciprocally binding constraint<sup>31</sup>. Rules and institutions rather than outcomes should be the focus. In general, orthodox public finance, with its emphasis on the direct application of normative criteria to tax arrangements, does not give us an understanding of observed fiscal processes in the EU nor is it a basis for improvement on grounds that are acceptable to the taxpayers. As we do test in this paper, the logic of a constitutional approach can give such an interpretation, just as it gave an analytic interpretation of the popular tax revolts sweeping across the U.S. in the late 1970s. A constitution contains a principle-based limitation of the role of government in society and defines the basic rules for ordinary politics. A constitution is a framework for political action, not an instrument for action<sup>32</sup>.

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29 Brennan, G., Buchanan, J. M. *The Power to Tax, Analytical Foundations of a Fiscal Constitution*. Indianapolis: Liberty Fund, (1980), (2000).

30 Elster, J. *Arguing and Bargaining in the Federal Convention and the Assemblée Constituante*. Center for the Study of Constitutionalism in Eastern Europe. Working Paper no. 4, (August, 1991).

31 Rawls, J. A. *A Theory of Justice*. Oxford: Oxford University Press, (1971).

32 Elster, J. *Ulysses Unbound*. Cambridge: Cambridge University Press, (2000), p. 100.

There are no unique constitutional solutions; several combinations of electoral and non-electoral rules are possible. In this paper, we first look at the tasks the EU has to do, and second we look at the way fiscal policy is decided. If political and cultural differences do exist (3.1), and freedom of choice and free initiative of citizens is important (3.2), limiting constitutional rules do make sense. Which reform of the EU budget is necessary? We can look back and learn from history. We look at what did shape the American fiscal constitution<sup>33</sup>. If the problem is to carry over tasks to supranational authorities, as is the case in new Treaty of Lisbon, we do feel protected if these supranational authorities can act on two provisions. Firstly, and, for James Buchanan, most importantly, on provisions that lay out the (limited) range and scope of activities that are appropriately to be undertaken (4.1)<sup>34</sup>. Secondly, on provisions that state a bicameral fiscal (constitutional) framework (4.2)<sup>35</sup>.

#### *4.1 Limiting The Tasks Of The Eu*

If the problem is how to establish a limited government, we can look at the constitution of the U.S. In the U.S., two authorities are of interest: the authorities in each of the states and the federal government in Washington. Is that not too much government? Not if both authorities compete with each other in the sense that they each have their own branch of power. We can guard a branch if a constitution does support us. As has been said by James Madison, one of the founders of the American constitution, in the U.S. constitution the central authorities do have little and limited and the states do have many and large competences<sup>36</sup>. The former has powers related to foreign policy and national defense. The latter has powers related to the criminal justice system and the protection of the family. In the EU Treaty of Lisbon, however, the opposite seems to be the case: there seems to be little that does not fall under the jurisdiction of Brussels. The Treaty describes tasks that the EU has to do under all circumstances (e. g., customs, competition and monetary policy, fishing, trade and the internal market policy), tasks

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33 Dam, K. W. The American Fiscal Constitution. The University of Chicago Law Review, Vol. 44, Nb. 2, (1977).

34 Buchanan, J. M. Choice, Contract, and Constitutions. Indiana-polis: Liberty Fund, (2001), p. 442.

35 Nef, R. Lob des Non-Zentralismus. Sankt Augustin: Aca-demia Verlag, (2002).

36 Markman, S. Constitutional Myths and Realities. Imprimis, Vol. 34, Number 8, (August, 2005).

that can be appropriated if necessary (e. g., environmental policy and consumer protection) and tasks the EU supports (e. g., tourism)<sup>37</sup>.

Power, however, wants more power, all to the good or to the bad. Hence, every possibility, how artificially, the EU will use to enlarge it. The manner of subsidizing activities, for instance., enormously enhances the influence of the EU. Suppose the EU gives a subsidy of 50 % to a certain activity. That is almost blackmail; no local government, in their good mind, is opposed to it. For the local authorities the gains of the activity has to be only halve of the total costs<sup>38</sup>. The pressure to accept the subsidy is enormous. Even, however, if the given task for the (federal) central authorities is small, as, e. g., described in the U.S constitution, for interstate trade. Just as the EU-authorities do have a stake in border crossing interests. That, however, is a license for government involvement, at least in the US, in approximately everything. Look at what did happen in the US. The federal authorities may not meddle with agriculture in the separate states. Yet – with the rule and power of the authority over interstate trade in hand – it states how many acres in the separate states have to remain wasted. How can the federal authorities motivate this? A farmer did grow grain on his “wasted” land and fed the grain to his cattle. At first site, no interstate trade seems to take place. The Supreme Court, however, did argue that if the farmer had not grown grain on his wasted land, he would have bought it. He, also, influenced the price of grain on the market and so interstate trade<sup>39</sup>.

In general, federalism in the US is (1) the division of powers of government between the national government and the states. (2) the separation of powers in which each branch of the national government---the legislative, the executive, and the judicial branch---has distinct responsibilities, yet is subject to the checks and balances of the other branches. In addition, (3) there is the principle of limited government in which the national government is constrained to exercise only those powers set forth by the constitution<sup>40</sup>.

In sum, even if there is a clear separation of powers and limitation of tasks, as in the US, central government often grabs the possibility to enlarge its powers. What then can we expect of the description of tasks in the (revised) EU treaty? There seems to be little that does not fall directly or indirectly under the jurisdiction of Brussels. The EU has tasks to do under all circumstances (e. g., customs, competition and monetary policy, fishing, and internal market policy), tasks that

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37 See: Treaty (2005, 2007).

38 Edwards, C. Downsizing the Federal Government. Washing-ton: Cato Institute, (2005).

39 Snyder, J. R. Unrestrained Appetites, Unlimited Government. The Freeman: Ideas on Liberty, (May 1998).

40 Markman, S. Constitutional Myths and Realities. Imprimis, Vol. 34, Number 8, (August, 2005), p. 2.

can be appropriated if necessary (e. g., environmental policy and consumer protection) and tasks it supports (e. g., tourism)<sup>41</sup>. The just-stated possibility of subsidizing activities enormously enlarges the influence of the EU. See how acute the gold rush response is with “matching” grants. In general, also EU-tasks, in principle, are many and hard to control by a democratic decision-making process. A process in which everyone thinks that other people do pay for a certain policy and changing majorities have to be bought, time and again. An ever-increasing government budget might be expected.

#### *4.2 The Institutional Structure Of Fiscal Decision-Making*

For Hayek it is necessary to create a Legislative Assembly (upper house) that states the rules and a Governmental Assembly (ordinary legislature or parliament) that administrates within those rules<sup>42</sup>. A new and differently elected and organized Legislative Assembly should draw up semi-permanent fiscal rules, and should not be subject to influences of particular groups. In the EU, however, there is an intentional combination, the decision-making (institutional) triangle, of the European Commission, the European Council and European Parliament. All of whom state what the budget is and make the policy within it<sup>43</sup>. Consequently, the proposed change in policy of the EU from unanimity to majority rule is no effective constraint on the exercise and growth of EU power<sup>44</sup>.

Constitutional economics is both thinking outside the box and back to basics. For the EU it is scientifically largely uncharted territory. Hayek’s model of bicameralism for fiscal powers for example, to my knowledge, has never been part of any political agenda. It is thinking outside the box of mainstream public finance<sup>45</sup>.

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41 See Treaty (2004, ep. 2007).

42 Hayek, F. A. *Law, Legislation and Liberty*. London: Routledge & Kegan Paul, (1982), Volume 3.

43 See Treaty (2004, 2007).

Scharpf, F. W. *The Joint-Decision Trap Revisited*. *Journal of Common Market Studies*, Vol. 44, No. 4, (2006) pp. 845-64.

Thomson, R., Hosli, M. *Who Has Power in the EU? The Commission Council and Parliament in Legislative Decision-making*. *Journal of Common Market Studies*, Vol. 44, No. 2, (2006).

44 Brennan, G., Buchanan, J. M. *The Power to Tax, Analytical Foundations of a Fiscal Constitution*. Indianapolis: Liberty Fund, (1980), (2000).

Baldwin, R., Widgrén, M. *Council voting in the Constitutional Treaty: Devil in the details*. CEPS Policy Brief, No. 53, (July 2004).

45 Blankart, C. B. *Öffentliche Finanzen in der Demokratie*, München: Franz Vahlen, (1991).

Rosen, H. S., Windisch, R., Oberdieck, E. *Finanzwissenschaft I*, München: Oldenbourg Verlag, (1992).

Enderlein, H., eo. *The EU Budget. How Much Scope for Institutional Reform?* European Central Bank, Occasional Paper Series, no. 27, (April 2005).

In due course, the separate “taxation chamber” can even grow into an institution where all legislation in the EU is made independently from the direct policy use of it. For Buchanan the European constitution is an opportunity, EU citizens need to grasp, for going back to constitutional basics<sup>46</sup>. The constitutionalist mindset, however, that says that persons owe loyalty to the constitution rather than to the government, is (has become) foreign to European thinking<sup>47</sup>. The idea that there are, or should be, any limits on the powers of the government has largely passed from the contemporary scene. This lack of a constitutional mindset is also part of the problem this research program has to tackle.

Of central importance is that constitutionalism can be the core of fiscal constraints in which subsidiarity (the primary liability for the solution of problems lies with the smallest functional unit) and the consent of free individuals (trust), two of the main problems of the EU, are of central importance.

## 5. Conclusion

In general, the EU-budget hovers between one that redistributes money between members and one that achieves certain EU-wide policies. The budget is the cause of many of the bitterest arguments between the Member States. Often, the objective of spending seems to be to achieve acceptable net balances rather than agreed policy. It has been said that the EU budget has never been used as a means to meet the objectives of the Union but rather as a negotiating tool for its members<sup>48</sup>.

If fiscal dissatisfaction in the EU is the result of a growing tendency in which majorities do decide, and hence does give changing majority coalitions political authority, within that framework we can never solve the problem. There is another possibility. From the point of view of constitutional economics and fiscal sociology two things are necessary. One, we need a fiscal constitution on the bases of a clearly enumerated list of tasks for the EU. Second, we have to split fiscal powers: the establishment of a separate legislative branch of the EU that does state the principles of taxation and another branch that makes policy inside those rules. Presently, however, often majority by means of the European Commission and

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46 Buchanan, J. M. An American Perspective on Europe’s Constitutional Opportunity. *Cato Journal*, Vol. 10, No. 3, (Winter 1991), pp. 619-629.

Buchanan, J. M. Europe as Social Reality. *Constitutional Political Economy*, 7, (1996a), pp. 253, 256.

47 See Buchanan, 1996b, 2003, cf. Weiler, 1996; Shaw, 2000; Bermann, 2004; Bellamy, 2006.

48 Figueira, F. How to Reform the EU Budget? Going Beyond Fiscal Federalism. Utrecht, (2006). Eppink, D-J Europese Mandarijnen, Achter de schermen van de Europese Commissie. Tiel: Lannoo, (2007), p. 190.

the European Parliament does set the fiscal rules as well as does make policy inside those rules on a seemingly endless list of possible tasks.

In the wake of the demise of the proposed Constitution, instead of the present non-constitutional approach, a model fiscal constitution for the EU budget can become an agenda-setting focal point for a new scientific research program (constitutional economics and fiscal sociology) and future EU policy. A fiscal constitution is a means proportionate to the problem at hand. A fiscal constitution (1) can be a real possibility. In history, constitutional debate has always been possible and fruitful. (2) it creates trust between the states. A shared framework facilitates a robust democratic debate. (3) it makes subsidiarity a real possibility. The market economy functions within a limited government. And (4) it substitutes for improving the morals between Member States. Just as the market economy does the same by steering self-interested human behavior within a constitutional order of private property.

In sum, this paper shows how we can use the reformed new EU-budget by imposing constraining rules to promote solidarity and trust in the setting of an EU-Leviathan. Instead of emphasizing efficiency, to up-date goals and means, and / or to aim at greater fairness the paper shifts the emphasis to the making of authentic rules: the design of possible constraints on a revenue-maximizing EU. Because of their voluntary consent (an internal criterion based on the desires of the Member States themselves) it is acceptable to the Member States that are to be subject to it. No external criteria, and hence no agreement over the goodness or badness of these criteria used, e. g., allocative efficiency or equal treatment for equals, are necessary. The shared framework of a model EU-budget (politically independent fiscal rules) creates trust and social cohesion between the Member States, the European Parliament, Commission, and Council of Ministers. It facilitates a robust democratic debate within a consistent, transparent and reliable policy and legislation framework. Member States can anticipate making appropriate behavior adjustments, including those made over a long-term planning period. The paper gives the analytical arguments in support of two appropriately designed budgetary measures (moderately permanent features) re the up-coming EU Budget Review: a clear limitation of tasks and a split in budgetary powers.

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