

# WHO WILL EVER KICK US OUT? Italy, the Balanced Budget Rule and the Implementation of the Fiscal Compact

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## 1 INTRODUCTION<sup>1</sup>

Trapped in a severe macroeconomic crisis, financial and fiscal imbalances, and the subsequent sovereign debt crisis involving the European Economic and Monetary Union (EMU), the leaders of the different Member States convened at an EU Council meeting in December 2011 in order to engage in a debate on how they might foster budgetary discipline, strengthen the mechanism of economic policy coordination and improve economic policy governance in the euro area. Twenty five Member States agreed on a Treaty on Stability, Coordination and Governance in the Economic and Monetary Union (TSCG) or Fiscal Compact Treaty (FCT) with the formal status of a Treaty between the EU participating States later finalized in an informal summit in January 2012 and signed in March of the same year. This article analyzes the implementation of the new Treaty within the Italian legal order. Section 2 introduces the concepts of the balanced budget rule as an external constraint in the context of the Italian fiscal and economic policy. Section 3 briefly surveys the fundamental provisions introduced by the Fiscal Compact. Section 4 analyzes the implementation of the Treaty in Italy with particular reference to the new amendments to the Italian Constitution. Section 5 concludes. We argue that because of the many loopholes in the Italian process of implementation, the new Treaty won't per se change or straighten out the Italian approach responsible for the current public debt situation.

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<sup>1</sup> This paper is the result of joint reflections; nevertheless, sections 2 and 4 can be attributed to Giovanni Boggero and section 3 to Pasquale Annicchino. The final remarks were written jointly by the two authors, who would also like to express their gratitude to Giuseppe Martinico and Camilla Buzzacchi for their comments.

## 2 THE BALANCED BUDGET RULE AS AN EXTERNAL CONSTRAINT ON ITALY'S FISCAL POLICY

In early 2008, Italy's public debt as a percentage of GDP was at its lowest rate since 1994. Due to fiscal deficit improvements in 2006 and 2007, the European Commission recommended the ECOFIN Council to abrogate the Excessive Deficit Procedure (EDP) against Italy, in accordance with Article 104 § 3 TEU.<sup>2</sup> In June 2008 the Council finally abrogated Decision 2005/694/EC.<sup>3</sup> This however did not imply that Italy was out of danger. As the Council of the European Union spelled out in its Opinion on Italy's Updated Stability Programme in February 2008, *a public debt-to-GDP ratio above 100% and the still relatively high [...] budgetary deficit, increase economic uncertainty and generate a high cost of debt service, making Italy vulnerable to increases in interest rates.*<sup>4</sup> A year later, on November 30 2009, after the updated Stability Programme of the 4th Berlusconi Government had not shown any considerable progress when compared with its original version, the ECOFIN Council again assessed Italy's excessive deficit, stressing that the budget deficit *cannot be considered temporary, since the deficit is projected to increase further in 2010 and, on a no-policy change basis, to decrease*<sup>5</sup>.

Despite profiting from low interest rates for almost a decade, Italy's political class increased public spending rather than pursuing a sustainable consolidation of the national budget. Though running primary surpluses until 2008, at the outbreak of the European sovereign-debt crisis, the huge public debt was not significantly reduced, nor did Italy reach a balanced budget in structural terms.<sup>6</sup> Only recently, Italy was forced to cope with EU fiscal rules, with the alternative being the risk of a financial collapse. EU economic and fiscal oversight became progressively more intrusive vis-à-vis the Member States, in particular after the Lisbon Treaty entered into force. The first legal tool implementing new Article 121 TFEU was the 'European Semester',<sup>7</sup> a timetable meant to address the problems of both poor fiscal oversight and ineffective economic policy coordination between Member States. Through a so-called 'integrated approach', the 'European Semester' provided

<sup>2</sup> Recommendation for a Council Decision abrogating Decision 2005/694/EC on the existence of an excessive deficit in Italy, 7 May 2005, SEC(2008) 574 final.

<sup>3</sup> Council Decision of 3 June 2008 abrogating Decision 2005/694/EC on the existence of an excessive deficit in Italy, 2008/560/EC.

<sup>4</sup> Council Opinion of 12 February 2008 on the Updated Stability Programme of Italy, 2007-2011, 2008/C 49-08.

<sup>5</sup> Council Decision of 19 January 2010 on the existence of an excessive deficit in Italy, 2010/286/EU.

<sup>6</sup> The primary surplus was eroded 'on account of a significant increase in current primary expenditure'. See European Commission Staff Working Paper, *Assessment of the 2011 national reform programme and stability programme of Italy*, 7 Jun. 2011.

<sup>7</sup> The 'European Semester' entered into force on 1 Jan. 2011 and was then translated into EU secondary legislation in November 2011 through Regulation No. 1175/2011. See G. Trupiano, *The New*

EU Institutions with new powers enabling the Commission and the Council to exert direct influence on the democratic legislative procedure of each Member State.

The balanced budget rule has been at issue, at least since the first 'European Semester'. The legal act in which we may find the first formal encouragement to enshrine the rule into the internal legal orders of the Member States is the intergovernmental Euro Plus Pact, – :- signed on March 24 2011 by twenty-three European Union Heads of State and Government.<sup>8</sup> Implicitly alluding to the model of the German 'Debt-Brake', the Pact, which builds on the Franco-German 'Competitiveness Pact' initiative,<sup>9</sup> prescribed the transposition into binding national law ('e.g., *Constitution or Framework Law*') of the fiscal rules stemming from the Stability and Growth Pact (SGP), in particular those demanding balanced budgets in structural terms. The Pact hinted that the existing EU rules were not sufficient to limit sovereign debt, therefore requiring the Member States to change their own rules at national level.

The nature of the Euro Plus Pact however is not merely political, as many scholars seem to believe.<sup>10</sup> Its provisions in fact integrate those of the 'European Semester',<sup>11</sup> insofar as they provide further objectives for the coordination of fiscal and economic policy (see Article 2-a 2. letter d) Regulation n. 1175/2011). Thus, a Member State, by submitting its National Reform Program (NRP) and its Stability Programme (SP), should *inter alia* take into account the general guidance issued by the European Council. This was done proactively by Italy in its 2011 DEF, the Economic and Financial Document containing both its NRP and its SP. Point 2.2 letter a) of the Pact explicitly mentions the intention of embedding a balanced budget rule into the Constitution.

In its recommendation issued on July 12 2011, the ECOFIN Council welcomed the commitment to enshrine a balanced budget into the Constitution, qualifying it *as in line with the principles of the Euro Plus Pact* (§ 16).<sup>12</sup> The first law bills for amending the Constitution were put forward by some members of the Italian Parliament starting on July 19, 2011, whereas the bill which afterwards

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*European Governance: The European Semester and the Coordination of Economic and Budgetary Policy*, in F. Praussello, ed., *The Eurozone Experience: Monetary Integration in the Absence of a European Government*, Roma, Franco Angeli, 2012.

<sup>8</sup> European Council, Brussels 24/25 March 2011 – Conclusions, EUCO 10/1/11 REV 1 – CO EUR 6 CONCL. 3.

<sup>9</sup> The draft is available here: [http://www.euractiv.com/sites/all/euractiv/files/BRNEDA224\\_004512.pdf](http://www.euractiv.com/sites/all/euractiv/files/BRNEDA224_004512.pdf).

<sup>10</sup> See *inter alia* M. Ruffert, *The European Debt Crisis and European Union Law*, Com. Market Law Review 48, 1777–1806, 2011.

<sup>11</sup> See Euro-Plus Pact I, Economic Policy n. 2.

<sup>12</sup> *Council Recommendation of 12 July 2011 on the National Reform Programme 2011 of Italy and delivering a Council opinion on the updated Stability Programme of Italy, 2011-2014*, (2011/ C 215/02).

represented the basis for the reform had been submitted shortly after the Euro Plus Pact was signed. In August 2011, amid severe turbulence on the sovereign bond markets, the European Central Bank (ECB) intervened, in accordance with the Securities Market Program (SMP) launched in May 2010. Its President, Jean-Claude Trichet and the Italian member of the Governing Council, Mario Draghi, secretly sent a letter to the Italian Prime Minister, regarding *as crucial that all actions listed* [in the letter should have been] *followed by parliamentary ratification by end September 2011*. Quite surprisingly, the letter only alluded to the enshrinement of a balanced budget rule at the very end (*A constitutional reform tightening fiscal rules would also be appropriate*), as if all measures contained in the letter could be realized only in the light of this precise fiscal policy principle.

That this principle was of paramount importance to the EU as a whole is evidenced by a further private letter from the Commissioner for Economic and Monetary Affairs and Vice-president of the EC dated November 8 2011, requesting clarification on the letter submitted by PM Silvio Berlusconi to the President of the European Council and the President of the European Commission on the occasion of the first Euro Summit on October 26 2011. In particular, the EU Commissioner requested that Italy report back on “*secondary legislation required to make the [balanced budget] rule operational and consistent with the EU budgetary framework*”, as well as on “*the monitoring mechanisms/institutions*” due to be established (§ 6 - 2). Additionally, at the time there were still questions to be answered concerning the consistency of the rule’s ‘asymmetrical approach’, as designed in the bill of the Government<sup>13</sup>, i.e., if an absence of the obligation to consolidate during an economic upturn was still in conformity with the medium term objective and the SGP deficit criteria.<sup>14</sup> Finally, EU Commissioner Rehn hinted that an expenditure rule, *rectius* a constitutional cap on public spending, would also be welcome at EU level. As the European Commission had pointed out in its recommendation, Italy was suffering from a “*lack of effective enforcement mechanisms to control primary expenditure*”. This stand furthermore conforms with the principles underlying the Council directive on requirements for budgetary frameworks of the Member States which were approved on the same day.<sup>15</sup>

On November 11 2011, Berlusconi’s Government offered a brief reply to the letter: **1)** the law bill, which was due to be passed by Parliament, had been revised in order to apply the rule symmetrically in cyclical upturns and downturns. On this point the Commission seemed to be rather uninformed, since the joint

<sup>13</sup> See Art. 2 of the bill A.C. No. 4620, presented according to Arts 71 and 138 IC.

<sup>14</sup> Similarly Camera dei Deputati, *Introduzione del principio del pareggio di bilancio nella Carta costituzionale*, A.C. n. 4620 e abb. N. 511, 4 Oct. 2011.

<sup>15</sup> See Proposal for a Council Directive on Requirements for Budgetary Frameworks of the Member States, Brussels, 29 Sep. 2010 COM(2010) 523 final, 4.

examination of different law bills submitted to the Parliament had already started on October 5 2011; **2**) as for the monitoring mechanisms, the Italian Government generally refers to a future power of the Court of Auditors (Corte dei Conti), which was going to be “*entitled to undertake legal actions before the Constitutional Court if a breach can be presumed*”. No trace of such a provision is to be found in either the final version of the Constitutional Law n. 1/2012 approved by Parliament on April 17 2012 or in the reinforced Law n. 243/2013 pursuant to new Article 81(6) IC; **3**) the Italian Government argued that an expenditure rule had already been envisaged by Article 40 lett. h) of the Law n. 196/2009, as amended by Law n. 39/2011. However the aforementioned limit, extended to all kinds of expenditure and not only to discretionary ones, is not *apriori* set nor it is enshrined in the Constitution. As the Government itself clarified, the expenditure rule should be “*set in principle by the Economic and Financial Document (DEF) and adopted with the subsequent budget law and must be consistent with the three-year resource plan*”. In the DEF submitted by the Monti Government to the European Commission on April 20, 2012 as well as in 2013 DEF no reference to any kind of expenditure rule is to be found. After the Constitutional amendment had entered into force, the ECOFIN Council made clear in its recommendation<sup>16</sup> that “*implementing legislation*” was still “*needed to specify key features of the rule*”. It remains therefore to be seen (see *infra* Part 3) whether the reinforced Law n. 243/2012 actually provides Italy with the “*appropriate correction mechanisms and escape clauses*”.

In the light of the above, it is worth bearing in mind that the whole constitutional revision procedure was intertwined with several EU legal acts issued by EU institutions which were not only in charge of monitoring the procedure itself, but were also willing to provide the Italian Government with explicit guidance. Before agreeing on the Treaty on Stability, Coordination and Governance in the Economic and Monetary Union (TSCG), the so-called Fiscal Compact Treaty (FCT), the choice of embedding a balanced budget rule into the Italian Constitution was hardly to be referred either to the Italian legislator or to the Italian Government.<sup>17</sup> The present article offers no discussion of whether Italy’s commitment to amend its Constitution should have rather been judged as an order by EU institutions to do so and, if this was the case, whether this order was or not *ultra vires* in respect to Article 5§1 TEU in combination with Article 4§2 TEU (violation of the conferral of powers principle infringing the national

<sup>16</sup> Council Recommendation on the National Reform Programme 2012 of Italy and delivering a Council opinion on the Stability Programme of Italy, 2012-2015, Brussels 6 Jul. 2012.

<sup>17</sup> T. Groppi, *The Impact of the Financial Crisis on the Italian Written Constitution*, Italian Journal of Public Law, Vol. 2 (2012), 6.

identity of a Member State)<sup>18</sup>. Nevertheless, it must be observed that, for the first time in Italian constitutional history, the commitment to amend the Constitution was initially submitted by the Italian Government directly to EU institutions. This was a rather peculiar procedure, one which is not taken into account by Article 71 IC in combination with Article 138 IC.

### 3 THE FISCAL COMPACT TREATY

As previously stated, the necessity of fostering budgetary discipline and achieving better coordination among the different members of the Euro zone led to the new Fiscal Compact, which substantially amends and consolidates the previously existing rules of the Stability and Growth Pact and the measures enacted later with the so-called “Six-Pack”. The Treaty was agreed upon at the European Council on 9 December 2011, during one of the worst periods of the Euro area crisis, and went into effect on January 1 2013 due to the effect of the ratification of the 12th Contracting Party, Finland on December 21st 2012, with endorsement from all the States, except the Czech Republic and the United Kingdom. It is worth mentioning that under the new framework for European Economic Governance, financial assistance is conditional on the ratification of the Treaty and the transposition of the required rule on balanced budget.<sup>19</sup>

The Fiscal Compact consists of two main elements: a structurally balanced budget rule, comprehending an automatic correction mechanism, and a reinforcement of the rules on the excessive deficit procedure. In general, as provided by the Treaty, Governments’ budgets should be either balanced or in surplus.

For the purposes of our analysis, it is worth highlighting Articles 3 and 8 of the Treaty. Article 3 (1) FCT specifies that the general budget of the signatory States must be “balanced or in surplus”, and adds the detail providing in the same article for the possibility to deviate from the objective temporarily “only in exceptional circumstances as described by Article 3(3)(b) FCT. As an overall

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<sup>18</sup> On the ties between national and constitutional identities under Art. 4§2 TEU see *inter alia* D. Preshova, *Battleground or Meeting point?: The Respect for National Identities in the European Union – Article 4(2) The Treaty on European Union*, Croatian Yearbook of European Law and Policy 8 [2012] 267–298.

<sup>19</sup> For a general analysis of the Treaty see P. Craig, *The Stability and Governance Treaty: Principle, Politics and Pragmatism*, 37 European Law Review 2012. The conditionality principle is also expressed in the preamble of the ESM Treaty: ‘financial assistance (...) will be conditional as of 1 March 2013, on the ratification of the (Stability Treaty) by the ESM member concerned and, upon expiration of the transposition period referred to in Article 3(2) (of the Stability Treaty) on compliance with the requirements of that article’. See also L.B., J.H.R., Editorial, *The Fiscal Compact and European Constitutions: ‘Europe Speaking German’*, in European Constitutional Law Review, 8, 1, 2012, 1–7.

assessment, the requirements are not that different from existing EU legislation.<sup>20</sup> Article 3(2) FCT defines the rule of implementation of the Treaty. Member States must enact rules on the balanced budget rule within national law within a year from the entry into force of the Treaty. Article 3 FCT also specifies the nature of the national provision through which the rule should be implemented: “provisions of binding force and permanent character, preferably constitutional, or otherwise guaranteed to be fully respected and adhered to throughout the national budget process”. This part of the provision is complemented by the request of a mechanism that should automatically correct “significant observed deviations” from the goal of reaching a balanced budget in the medium-term<sup>21</sup>. This should be done upon the proposal of the Commission. The provision of Article 3(2) FCT it is further reinforced by Article 8(1), which “invites” the European Commission to report on the measures enacted by the different States to comply with Article 3(2) FCT, and when it finds that a Member States failed to implement the provision “the matter will be brought to the Court of Justice of the European Union by one or more of the Contracting Parties”. The judgment of the Court will oblige the infringing party to implement “the necessary measures to comply with the judgment within a period to be decided by the Court”. Should the State fail to implement the measures dictated by the judgment, another contracting party can bring a new case to the Court of Justice in order to request the imposition of financial sanctions. For some countries, among them Italy, Article 4 of the Treaty bears particular importance, because it mandates that if a Member State has a debt of over 60% of its economy (defined according to EU Law) it must reduce its debt by 1/20<sup>th</sup> per year.

These provisions mandated by the Fiscal Compact can raise important theoretical and practical questions. From a theoretical point of view, it is worth asking questions regarding the national measure needed to comply with the request, and the role of the national legislature in the process of implementation of the Treaty<sup>22</sup>. Will the Fiscal Compact respect all the expectations that have raised so far? Technically the text of the international treaty does not fully guarantee either the introduction of the debt brake into the various domestic legal orders or

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<sup>20</sup> According to Peers: ‘Article 3(1) is not as dramatic at it might first appear, as compared to existing EU legal obligations’, See. S. Peers, *The Stability Treaty: Permanent Austerity or Gesture Politics?*, European Constitutional Law Review, 8, 2012, 414.

<sup>21</sup> As for Art. 3(1), Peers argues that this provision does not differ too much from EU law already in force: ‘On an overall assessment, Article 3(2) does not differ much in principle from existing and proposed EU legal obligations, but it is more precise and more binding (in terms of legal hierarchy) than those obligations’, S. Peers, *supra*, 416.

<sup>22</sup> See the questions raised by M. Maduro in A. Kocharov (ed.), *Another Legal Monster? An EUI Debate on the Fiscal Compact Treaty*, EUI working paper 20112/09, available at: [http://cadmus.eui.eu/bitstream/handle/1814/21496/LAW\\_2012\\_09\\_Kocharov\\_ed.pdf?sequence=1](http://cadmus.eui.eu/bitstream/handle/1814/21496/LAW_2012_09_Kocharov_ed.pdf?sequence=1).

its implementation in the correct legal form. To this extent, the implementation into Italian law offers a useful case study and an opportunity for reflection.

#### 4 NEW ARTICLE 81 IC: LIMITING PUBLIC BORROWING WITHOUT DOING AWAY WITH LOOPHOLES

Before attempting to demonstrate that Constitutional Law n. 1/2012 and the reinforced Law n. 243/2012<sup>23</sup> indeed limited public borrowing according to Treaty's provisions, but at the same time left open many loopholes for the purposes of circumventing this limit, a brief analysis should be devoted to the original version of Article 81 IC, the article which sets out the procedural rules on national budgeting.<sup>24</sup>

According to some legal scholars,<sup>25</sup> a “balanced budget rule” was already part of the Italian Constitution prior to the reform, but, because of the recklessness of the Italian political class, supported by the accommodating interpretation of the Italian Constitutional Court, the rule's rationale was distorted to the extent of rendering it meaningless. According to another doctrinal position, and vice versa, from the very beginning, former Article 81(4) IC did not incorporate any reference to a “balanced budget”, but only to the necessity of a so called “financial coverage” on the part of any law (other than the annual national or regional budget law) implying new or additional expenditure. This coverage was thought of merely as a tool to avoid single parliamentary initiatives that were not coordinated with the framework of financial planning, a task which was expected to be carried out by the government.<sup>26</sup>

<sup>23</sup> The legal basis of which is Art. 81(6). On the very nature of this Law see R. Dickmann, *Brevi considerazioni sulla natura rinforzata della legge n. 243/2012 di attuazione del principio costituzionale del pareggio di bilanci pubblici*, Federalismi.it n. 6/2013. The full text of the reinforced Law is available at the following address: [http://www.pbo-dpb.gc.ca/files/files/Italy%20-%20Legge%20n%20243%202012\\_eng.pdf](http://www.pbo-dpb.gc.ca/files/files/Italy%20-%20Legge%20n%20243%202012_eng.pdf).

<sup>24</sup> Articles 97, 117 and 119 IC were also amended in order to explicitly bind all government entities as well as regional and local authorities to the new rule. A. Gagliano, *The Introduction of the 'Balanced Budget' Principle into the Italian Constitution: What Perspectives for the Financial Autonomy of Regional and Local Governments?*, in *Perspectives on Federalism*, vol. 5, n. 1 (2013). G. Boggero, *Gli obblighi di Regioni ed enti locali dopo la legge n. 243/2012*, in *Amministrare* n. 1/2014 - aprile, 93-148.

<sup>25</sup> T. Groppi, *supra*, 7-8; G. Alfano, *L'art. 81 della Costituzione e la "legge finanziaria". Sistemática disapplicazione della norma da parte dei suoi naturali destinatari*, in [www.forumcostituzionale.it](http://www.forumcostituzionale.it), November 20, 2008; G. Bognetti, *Il pareggio del bilancio nella Carta costituzionale*, AIC n. 4/2011, 1 and 7; G. Di Gaspare, *Innescare un sistema in equilibrio della finanza pubblica ritornando all'art. 81 della Costituzione*, in [www.amministrazioneincammino.luiss.it](http://www.amministrazioneincammino.luiss.it); A. Martino, *Budget Deficits and Constitutional Constraints*, *Cato Journal*, Vol. 8, No. 3, 1989, 708.

<sup>26</sup> A. Brancasi, *Il principio del pareggio di bilancio in Costituzione*, Osservatorio sulle Fonti, n. 1/2012; G. Rivosecchi, *Il cd. pareggio di bilancio tra Corte e legislatore, anche nei suoi riflessi sulle Regioni: Quando la paura prevale sulla ragione*, AIC n. 3/2012; V. Onida, *Le leggi di spesa nella Costituzione*, Giuffrè, Milano, 1964; G. Della Cananea, *Indirizzo e controllo della finanza pubblica*, Il Mulino, Bologna, 1996, 128.



In the end, however, both interpretations, though diverging, came more or less to the same conclusion, namely that Article 81(4) IC itself did not expressly forbid financial coverage by means of public borrowing. The case-law of the Italian Constitutional Court, which since 1966 has denied that old Article 81 (4) IC represented the enshrinement by the Italian Constitution of a “balanced budget rule” in an accounting sense, failed to consider that the recourse to medium and long term public borrowing in effect bypassed the Constitutional norm.<sup>27</sup> It might in fact be true, as Bognetti recalls,<sup>28</sup> that the former Article 81 was meant not to constitute a formal deficit limit to what the budget law provided on an annual basis, but rather a fiscal-discipline device; however, as a matter of fact, neither a literal nor an original intent<sup>29</sup> reading of this provision provided any guidance as to how exactly new expenditures should be covered.<sup>30</sup> According to the Constitutional Court, the legislative power should merely have ensured a long-term tendency towards a balance between revenues and expenditures (*ex multis*, see Decision n. 1/1966).<sup>31</sup>

Moreover, it must be borne in mind that even if the wording “any other law” (former Article 81(4) IC) was finally interpreted in a chronological way comprehending not only the current financial year’s laws, but all subsequent laws adopted after the annual budget law,<sup>32</sup> there was still no clear constitutional limit to public borrowing as a tool for financial coverage. Uncontrolled public borrowing was indeed the main flaw of Italy’s fiscal Constitution. The 2012 Constitutional amendment was specifically aimed at limiting the recourse to public borrowing, by fixing clearer constraints directly in a primary source of law. Though the provisions of the Fiscal Compact Treaty (FCT), after the Law authorizing the ratification n. 114/2012 had entered into force,<sup>33</sup> were thus susceptible to be applied, for example Article 117(1) IC, which asserts that international obligations are to be interpreted as an interposed standard of review, on the basis of which the constitutionality of domestic law is to be assessed, a mere ratification would probably not have been evaluated as complying with Article 3(2) FCT. While the FCT constitutes binding international law, its provisions as such wouldn’t have

<sup>27</sup> So stipulated Art. 7 of ordinary law n. 362/1988, whose limits were however constantly exceeded and derogated. See G. Alfano, 2–3 e G. Bognetti, *Costituzione e Bilancio dello Stato. Il problema delle spese in deficit (Note ispirate dalla lettura di un libro di G. Rivosecchi)*, AIC, 2009, 27.

<sup>28</sup> G. Bognetti, *supra*, 18–19.

<sup>29</sup> A. Pirozzoli, *Il vincolo costituzionale del pareggio di bilancio*, AIC n. 4/2011, p. 5.

<sup>30</sup> Cfr. A. Martino, *supra*, 709. Only a systematic approach as laid down by Della Cananea could have stopped irresponsible public borrowing. See G. Della Cananea, 99–106.

<sup>31</sup> Recently, probably owing to the critical financial situation in Italy, the Constitutional Court has seemed to acknowledge that Art. 81(4) IC enshrines the balanced budget rule in an accounting sense. See C. Buzzacchi, *Copertura finanziaria e pareggio di bilancio: un binomio a rime obbligate?*, AIC n. 4/2012.

<sup>32</sup> See Constitutional Court, Judgement No. 384/1991.

<sup>33</sup> Law No. 114/2012 23 Jul. 2012, G.U. n. 175 del 28 luglio 2012.

been self-executing, considering that they would have lacked any procedural character, in particular regarding the content of the budget law, the criteria for ensuring the balance, those for allowing deviations, as well as the rules defining the monitoring assessment.

From a formal point of view, the ultimate goal of the FCT seems to have been achieved,<sup>34</sup> since from 2014 onwards, «*no recourse shall be made to borrowing [...]*» [Article 81 (2) IC]. Part of the legal doctrine is, however, uncertain concerning the meaning of the first part of the phrase. Quite surprisingly, few legal scholars argue that the recourse to public borrowing has now been de facto prohibited.<sup>35</sup> On the contrary, the present provision, like Article 81(1) IC, should not be interpreted alone, but rather together with the exceptions to the general rule laid down in the same Article 81(2) IC. Article 81(1) and (2) IC in fact provide a «*rule related to the primary balance*» (Euro Plus Pact), i.e., a brake for public borrowing, whereby the budget should be balanced without any new net borrowing, while allowing for the renewal of maturing public debt by the State and possibly even elusive financial investments such as securitization of debt or direct capital intervention in public or private companies.<sup>36</sup> “Net borrowing” is in fact a common term used instead of “deficit”, enshrined in Article 2(b) of the Protocol n. 12 on the Excessive Deficit Procedure and quoted from Article 3(3)(a) FCT. This interpretation is confirmed in Article 2(1)(d) of the reinforced Law no. 243/2012.

In other words, Article 81(1) and (2) IC allow the automatic stabilizers to work. Therefore, the new Article 81 IC does not really require Italy to commit itself to a static numerical balance or a zero-deficit rule for every fiscal year, but rather to achieve a cyclically-adjusted balance (net of one-off and temporary measures), which allows for a higher deficit during a slowdown.<sup>37</sup> As the 2005 Franco-German agreement showed, the use of a structurally balanced budget rule will offer some political room for manoeuvre, in particular in determining the cyclical components, i.e., the so called “output gap”, which is the difference between nominal GDP and potential GDP.

The fact that, unlike Article 3(1)(b) of the Fiscal Compact Treaty, the Italian Constitution simply places a stop upon net borrowing without indicating any lower limit to it in terms of a percentage of GDP,<sup>38</sup> does not make the Italian provision any more rigid. On the contrary, Article 3(2) of the reinforced Law

<sup>34</sup> So R. Miccù, *Costituzionalizzare l'economia all'epoca della crisi* in A.A., *Il diritto costituzionale alla prova della crisi economica*, Atti del Convegno del 26-27 aprile 2012, 553-569.

<sup>35</sup> F. Bilancia, *Note critiche sul cd. pareggio di bilancio*, AIC n. 4/2012, 2-3.

<sup>36</sup> Dossier – Chamber of Deputies <http://documenti.camera.it/leg16/dossier/Testi/ac0691.htm>.

<sup>37</sup> D. Morgante, *La costituzionalizzazione del pareggio di bilancio*, Federalismi.it, 11 luglio 2012, 6.

<sup>38</sup> F. Bilancia, *supra*, 4.

n. 243/2012 stipulates that «*the balancing of budgets corresponds to the medium-term objective*». No explicit enshrinement of the stricter limit laid down in Article 3(1)(b) FCT is in fact to be found in the Law. Article 3(5), in combination with Article 8(1) of the Reinforced Law, generically refers to EU Law and any international agreements, without a specific commitment to a precise figure. This hints at the fact that Italy may want to rely solely on its medium term objective, a benchmark which is easily and frequently modified, rather than on the narrowest figure set by the FCT, which may overly limit the government's instinct for public spending.<sup>39</sup>

Additionally, an escape clause is defined in the second part of Article 81(2) IC. 'In exceptional circumstances' and upon authorization approved by the two Houses of Parliament with an absolute majority vote, the Italian government may in fact resort, though only temporarily, to public borrowing. Those circumstances allowing for counter cyclical economic policies are listed in Article 5(d) of Constitutional Law n. 1/2012, and include, as it is the case in Article (3)(1)(c) in combination with Article (3)(3)(b) FCT, events outside the control of the State, such as "severe economic recessions", "financial crises" and "natural catastrophes". These expressions are reworded in Article 6 of the reinforced Law No. 243/2012, which also sets forth the conditions under which deviating from the medium term objective is considered not to be significant, that is, without triggering automatic corrections. The boundaries between recourse to public borrowing for exceptional circumstances and for reasons connected to automatic stabilizers are, however, not clearly defined.

As for significant deviations,<sup>40</sup> Article 8 of the reinforced Law does not specify at what pace the deviation needs to be corrected. The original bill did, however, define a precise reduction at a lowest rate of 0.5% per year.<sup>41</sup> The provision was repealed in the parliamentary commission reviewing the bill, based on the assumption that it is more prudent to wait for the EU to decide, without establishing too-rigid steps that may otherwise be softened after political negotiation during the "European Semester". Moreover, the correction mechanism laid down in the reinforced Law does not provide for any explicit obligation to run surpluses after deviating. More generally, no trace is to be found of a constitutional obligation to run a surplus in times of economic upturns. The aforementioned fears of Olli Rehn seemed thus to be justified, since Italy eventually implemented an asymmetric balanced budget rule.<sup>42</sup>

<sup>39</sup> Cfr. M. Nardini, *La legge n. 243/2012 e l'adeguamento dell'ordinamento nazionale alle regole europee di bilancio*, Osservatorio sulle Fonti, n. 1/2013, 8. *Contra* G. Scaccia, *La giustiziabilità della regola del pareggio di bilancio*, AIC n. 3/2012, 11.

<sup>40</sup> Article 6(3) Reg. 1175/2011.

<sup>41</sup> Dossier – Chamber of Deputies, 17 Jan. 2013 <http://documenti.camera.it/leg16/dossier/Testi/BI0599b.htm>.

<sup>42</sup> *Contra* D. Morgante, *supra*, 18.

A final remark should be made regarding monitoring and enforcement of the new rules. Also in this respect, the room for political discretion remains high. As for the monitoring mechanism, Article 16 of the reinforced Law establishes the Parliamentary Budget Office (PBO), the creation of which was provided for by Article 5(f) of Constitutional Law No. 1/2012.<sup>43</sup> Though formally autonomous and independent, the Office is based at the Parliament, and its three members are appointed for a six-year term by the Presidents of the two Houses of Parliament, after being chosen from a list of ten names and being elected with a two-thirds majority by the parliamentary commissions responsible for financial matters. No incompatibility with a Member of Parliament's mandate is foreseen. Moreover, the PBO has no real power, besides its monitoring assessment duties – which are, however, shared with the Government (Article 7) – and apart from a rather weak “comply-or-explain” rule [Article 18 (3)], to bring a lawsuit before the Constitutional Court. In the end, the monitoring is awkwardly split between the PBO and the Court of Auditors.

Both bodies are not empowered with any new effective right to apply to the Constitutional Court as part of the *ex post* budget auditing on whether the State budget and assets have been properly managed (with reference to the Court of Auditors see Judgment no. 335/1995). According to Article 27 of Law No. 340/2000, the latter may in fact bring a complaint before the Constitutional Court only in two events: the first is when the Court of Auditors is about to discharge its duties to preventively review the lawfulness of the executive's acts. In this case, the judges may discover the lack of financial coverage according to Article 81(4), whereas it is indeed more difficult to ascertain whether the budget as such is expected not to be balanced on the basis of a bare lacking of coverage.<sup>44</sup> The second case is when the Court of Auditors is faced with the task of delivering its Report on the State General Account (*Rendiconto generale*) at the end of every fiscal year. The State General Account may be held not to be in conformity with the Budget Law, and therefore an unbalanced budget eventually be ascertained. Should this kind of lawsuit be successful, the violation will nonetheless be acknowledged post factum, and the budget could have already produced many of its effects.<sup>45</sup> A last tool for maintaining the financial equilibrium might be to raise a “conflict of powers allocation” to the Constitutional Court ex Article 134 IC. However, the conflict may generally be raised solely within the *ex-ante* review (see

<sup>43</sup> See Chamber of Deputies, *The Establishment of the Parliamentary Budget Office in Italy*, 20–22 Feb. 2013 and D. Cabras, *Un Fiscal Council in Parlamento*, in *Federalismi.it* n. 20/2012.

<sup>44</sup> The right of the Court of Auditors to raise a plea of constitutional legitimacy while reviewing the legality of State's acts has been allowed since 1976 (Constitutional Court, Judgment No. 22/1976).

<sup>45</sup> So G. Scaccia, *La giustiziabilità della regola del pareggio di bilancio*, AIC n. 3/2012, 8; M. Bergo, *Pareggio di bilancio “all'italiana”*. *Qualche riflessione a margine della legge n. 243/2012 attuativa della riforma costituzionale più silenziosa degli ultimi tempi*, *Federalismi.it* n. 6/2013, 28.

*ex multis* Order No. 573/2000) and in any case not, for instance, with reference to Legislative and law decrees issued by government ex Articles 76 and 77 IC (see Judgment no. 406/1989).

## 5 CONCLUSIONS

In spite of the fact that an explicit limit upon the extent of public borrowing has now been enshrined in the Italian Constitution, and is no longer a bare provision of a single ordinary law, there are several reasons to doubt that this reform, both formally and substantially, has brought about a fundamental breakthrough. This is also due to the very same text of the Fiscal Compact Treaty (FCT) that can be assumed to have mainly a political relevance. As far as the Italian legal order is concerned,<sup>46</sup> first of all, since the beginning of the 1990s, the rather sporadic case law of the Italian Constitutional Court has already placed limits upon public borrowing as a normal tool for covering public expenditures and has interpreted the need for a coverage of expenditures so as to also be valid for subsequent financial years and not only for the prevailing one (Judgment no. 384/1991). However, nothing radical has changed since then. On the contrary, after a while, public debt has begun to increase again.<sup>47</sup> That is mainly because the rule has not been interpreted strictly enough, i.e., as an obligation to be respected every year and not in a vague long-term goal; but also because it was mainly regional budgets, and not the national one, which were challenged before the Constitutional Court. Now, as we have tried to point out, the new rule requiring a “structurally balanced budget” in reality offers further room for many loopholes to be put into place. In other words, the Fiscal Compact Treaty (FCT) does not provide for stricter obligations.

Moreover, an audit that is weak, fractured and complicated will not ensure a strict control upon the compliance with the rule. The reasoning underlying the eventual choice of the constitutional legislator not to empower any organ with the right to incidentally claim before the Constitutional Court, seems to match the outdated political and philosophical thinking that the political class should be collectively held responsible for the budget, rather than a bureaucratic or a jurisdictional body. Only the Head of State can exert some influence here, preventing a law from entering into force if deemed unconstitutional, for example

<sup>46</sup> This is the opinion expressed by Peers, according to whom the Fiscal Compact’s relevance *«is instead political (and therefore economic) as a flamboyant gesture which signing and ratifying this treaty represents makes it easier for states contributing to the ESM and EFSF to justify these actions to their parliaments and publics – and possibly also their constitutional courts»*. See S. Peers, *The Stability Treaty: Permanent Austerity or Gesture Politics?*, *European Constitutional Law Review*, *supra*, 441.

<sup>47</sup> [http://www.bancaditalia.it/pubblicazioni/econo/quest\\_ecofin\\_2/qef\\_31;internal&action=\\_setlingua&ge.action?LANGUAGE=en](http://www.bancaditalia.it/pubblicazioni/econo/quest_ecofin_2/qef_31;internal&action=_setlingua&ge.action?LANGUAGE=en).

under Article 74(1) IC. However the Head of State's power is not unlimited according to Article 74(2) IC, pursuant to which 'if such law is passed again, it shall be promulgated'.

Those scholars who have favoured the solution adopted are in fact afraid of "judicial activism" in fiscal matters, since, according to them, it would undermine the autonomy of the Parliament and Government's.<sup>48</sup> However, in order to be coherent with their opinion, they should also be very critical of two rather recent judgments of the Italian Constitutional Court (see for example no. 223/2012 and no. 116/2013) which basically misapplied the austerity measures pushed for by the last Berlusconi government, thus causing a new budgetary hole, which now needs to be filled.

We agree that, ultimately, Constitutions are about constraints, and that stricter rules could have prevented, or could in the future still prevent, huge public debt from being accrued. However, realism should teach us that as long as Constitutions can be amended by the same politicians who decide to resort to public spending, a single rule in a Constitution could not work in isolation.<sup>49</sup> It is therefore better to acknowledge, similarly to the Netherlands by simply referring in an ad-hoc Act of Parliament to EU and international fiscal rules,<sup>50</sup> that whether or not a EU Member State will be sanctioned, is a blatant political matter, which will ultimately be decided in Brussels as a result of harsh negotiations. If a Member State already possesses a rather strong "stability culture" (*Stabilitätskultur*), as it is the case of the Netherlands, there is no need to rack one's brain in order to find out the best rule to tighten up public finance management. If a Member State does not possess such a culture, a structurally balanced budget rule will serve as a placebo for calming down financial markets, but, because of the many loopholes with which the rule will inevitably be filled, it won't per se change or straighten out the attitude of a political class, which will make every effort to procrastinate regarding budgetary consolidation. Paradoxically, former Italian Prime Minister, Silvio Berlusconi, was right in urging the new government to break EU budgetary rules, because *they will*

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<sup>48</sup> M. Luciani, *Audizione alla Camera dei Deputati Commissioni Riunite (I e V)*, supra, p. 10; R. Perez, *Il bilancio dopo le riforme europee*, in L. Cavallini Cadeddu (a cura di), *Il coordinamento dinamico della finanza pubblica*, Napoli, Jovene, 2012, 18.

<sup>49</sup> As libertarian philosopher De Jasay wittily pointed out '[...] With its key always within reach, a chastity belt will at best occasion delay before nature takes its course [...]'. A. De Jasay, *The State*, Indianapolis, Liberty Fund, 1998 (ed. or 1985).

<sup>50</sup> See M. Diamant – M.L. van Emmerik, *Mandatory Balanced Budget Rule in Dutch legislation following examples abroad?*, (September 1, 2013). Available at SSRN: <http://ssrn.com/abstract=2328757> or <http://dx.doi.org/10.2139/ssrn.2328757>.

*never kick us out of the single currency.*<sup>51</sup> Both ex Prime Minister Enrico Letta and current Prime Minister Matteo Renzi seems to have taken into account this suggestion, pushing hard for a relaxation of EU budget rules. The former, on July 3rd 2013, he hailed the decision of the European Commission to temporarily ease deficit rules to help Member States boosting growth through investment programs.<sup>52</sup> The latter reinforced the same political objective to tilt the balance in favor of more flexible fiscal rules, by declaring EU deficit limits for outdated and officially putting off the target of balancing the State budget in structural terms until 2016.

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<sup>51</sup> *Silvio Berlusconi urges Italian Government to Break EU Austerity Measures*, International Business Times, 17 Jun. 2013.

<sup>52</sup> *EU: Letta hails greater budget flexibility from executive*, Adnkronos, 3 Jul. 2013 [http://www.adnkronos.com/IGN/Aki/English/business/EU-Letta-hails-greater-budget-flexibility-from-executive\\_32358913894.html](http://www.adnkronos.com/IGN/Aki/English/business/EU-Letta-hails-greater-budget-flexibility-from-executive_32358913894.html).