

# Quaderni

del Dipartimento di Scienze Politiche  
Università Cattolica del Sacro Cuore

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# Austerity measures, shift of sovereignty and democratisation of European institutions\*

di LUCA LIONELLO

***Abstract** – The paper analyses the recent reforms of the Economic and Monetary Union (EMU) in the light of the sovereign debt crisis. In the last few years, the Euro area has created rescue mechanisms to avoid default of its Member States, has strengthened economic governance and has introduced a stronger European prudential supervision on the banking system. Several Member States have therefore adopted austerity measures to respect the new rules on fiscal integration under European coordination. The current process of transformation of the EMU presents, however, several contradictions, which could undermine the legitimacy and efficacy of the reforms. First, the development of stronger European economic governance is eroding core sovereignty of Member States, raising concerns from national Constitutional Courts. Second, the new economic governance is managed by intergovernmental bodies, which do not directly respond to the citizens in contradiction with the democratic principle. Lastly, the adoption of austerity measures under the new rules on fiscal integration has caused the violation of social and labour rights in many Member States.*

## **Introduction**

The process of European integration has always developed overcoming contradictions. Each new Treaty has aimed to fill in the gaps and deficits of the system, producing at the same time new contradictions in need of adjustments to preserve the entire project of unification. This is actually the essence of the functionalist method that has led the process of European integration until now, constantly increasing the competences and the strength of the Union. For this reason, Jacques Delors said that «[t]he process of European integration is like riding a bike: you stop pedalling and you fall off». Functionalist integration in Europe has been characterised by the constant and

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\*This is an updated version of the paper presented at the International Graduate Legal Research Conference (IGLRC) 2013 at King's College London (8-9 April 2013).

slow extension of European competences on the basis of the spill over effect, the progressive involvement of supranational institutions along with intergovernmental bodies, the consensus among all members and the development of the *acquis communautaire*.

The sovereign debt crisis however marks a turning point in the process of integration. It does not represent another crisis that may be overcome simply by amending and developing the existing legal framework of the Union. The contradictions of the Economic and Monetary Union (EMU), that have determined the present crisis, are in fact rooted in the existing model of European integration and the present compromise between dominant intergovernmentalism and necessary supranationalism. Furthermore, what is now at stake is not just a political impasse between governments, but also most achievements reached in over sixty years of integration that could disappear should the monetary union collapse. The inability of functionalism to overcome this systemic crisis now demands new political solutions to solve present legal contradictions of the economic and fiscal process of integration.

This paper aims to reflect on the sovereign debt crisis, the reforms adopted to face it, as well as their contradictions. On the basis of these considerations the paper argues that the functionalist method is unable to lead European integration beyond the current crisis.

My analysis will touch on three main points.

The first considers deficits and defects of the EMU as it has been shaped by the Maastricht Treaty and its further developments, considering in particular the Stability and Growth Pact (SGP).

The second regards measures adopted since May 2010 to prevent national defaults and strengthen the European economic governance on the basis of both primary legislation, such as the European Stability Mechanism (ESM) and the Fiscal Compact, and secondary legislation, such as the Six Pack, the Two Pack and the project of banking union.

The third point focuses on contradictions inherent to the current process of fiscal integration with particular attention paid to austerity policies. These contradictions regard fundamental issues at the centre of the political and legal development of the integration process, such as the loss of core national sovereignty, the application of the democratic principle and the respect of citizens' rights.

## Asymmetries in the Economic and Monetary Union

The causes of the sovereign debt crisis can be found in the limits and deficits of the Economic and Monetary Union (EMU), as it has been created by the Maastricht Treaty and developed by the Stability and Growth Pact and further Treaty changes.

The framework of the EMU has been characterised from the beginning by a clear asymmetry between the monetary and the economic policy. Most Member States agreed to give up their monetary sovereignty to the European System of Central Banks (ESCB), composed of the European Central Bank (ECB) and National Central Banks. The ECB is an institution provided with wide independence whose main objective is the pursuit of price stability<sup>1</sup>, on the model of the German *Bundesbank*. At the same time, Member States were not willing to relinquish their economic sovereignty in terms of fiscal and budgetary competences that remained in the hands of national governments under a weak European coordination<sup>2</sup>.

In this way, Member States allowed *de facto* a detachment of monetary policy from economic policy. This phenomenon is quite unusual as normally monetary and economic competences are both fundamental attributes of sovereign States and even if the national central bank is independent, it still takes decisions coherently with the policies of its national government and the economic situation of the country. In the case of Europe, the challenge has been to avoid such detachment becoming a divergence between a central monetary policy dedicated to price stability and different economic policies that Member States may develop independently at national level. Divergent fiscal policies and budgetary laxism of Member States could in fact have determined imbalances within the Eurozone undermining the objectives of the EMU.

In order to prevent such a scenario the Treaty had already foreseen certain rules to provide the Union with fiscal and economic discipline, such as the prohibition of monetary financing and privileged

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<sup>1</sup> The independence of the ESCB is outlined in art. 130 of the Treaty on the Functioning of the European Union (TFEU), while the primary objective of price stability is outlined in art. 127.1 TFEU.

<sup>2</sup> In particular art. 121 TFEU foresees the adoption of the broad guidelines of economic policies to assure a close coordination and the definition of common objectives, while art. 126 TFEU sets a procedure to monitor public deficit of Member States.



access to financial institutions, the no-bail-out clause, the adoption of broad economic policy guidelines and a procedure to avoid excessive government deficit<sup>3</sup>. Germany, concerned that several Member States could stop respecting the stability criteria after the launch of EMU, insisted on introducing a Stability and Growth Pact (SGP)<sup>4</sup> that specifies the norms of the Treaty on the economic coordination, multilateral supervision and excessive deficit procedure. On the basis of this pact, adopted by the European Council of Luxembourg in spring 1997, Member States accepted to permanently contain their level of public debt<sup>5</sup> in order to ensure the stability of the EMU.

At the same time, many governments shared the conviction that financial markets would also oblige Member States *to keep their public finances in order*. In particular, the no-bail-out clause<sup>6</sup>, that makes it illegal for the Union and the States to assume debts of other members, would push them to contain deficit in order to get credit from the market at an affordable interest rate.

If we look at the first ten years of the Euro, before the beginning of the crisis, results have been fairly positive<sup>7</sup>.

The Eurozone has enjoyed macroeconomic stability, even if growth performances have been quite heterogeneous among Member States. Prices have been stable and inflation low, while trade and investments in the Eurozone have increased. The single currency became stronger compared to all other international currencies, challenging the leading role of the US dollar at a global level.

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<sup>3</sup>These provisions are now included in Title VIII of the TFEU.

<sup>4</sup>The Pact includes three legal acts: Resolution of the European Council on the Stability and Growth Pact (Amsterdam, 17 June 1997), Regulation (EC) 1466/97 on the strengthening of the surveillance of budgetary positions and the surveillance and coordination of economic policies, Regulation (EC) 1467/97 on speeding up and clarifying the implementation of the excessive deficit procedure.

<sup>5</sup>Annual deficit must not exceed 3% of GDP and public debt must not exceed 60% of GDP (or at least diminish towards the 60%).

<sup>6</sup>The no-bail-out clause is outlined in art. 125 TFEU: the Union and Member States «shall not be liable for or assume the commitments of central governments, regional, local or other public authorities, other bodies governed by public law, or public undertakings of any Member State, without prejudice to mutual financial guarantees for the joint execution of a specific project».

<sup>7</sup>On 7 May 2008 the Commission published a major report: *EMU@10: Successes and Challenges after 10 Years of Economic and Monetary Union*, Luxembourg, 2008 ([http://ec.europa.eu/economy\\_finance/publications/publication\\_12682\\_en.pdf](http://ec.europa.eu/economy_finance/publications/publication_12682_en.pdf)).

Nevertheless, the economic coordination proved quite ineffective. Member States did not meet most economic guidelines adopted by the Council and experienced great difficulties in containing their public debt and deficit. The incapacity of European supervision to ensure the fulfilment of the stability criteria became clear a few years after the adoption of the SGP, when the Council decided in 2003 not to sanction France and Germany<sup>8</sup>, despite them incurring an excessive deficit. That pushed the Commission to report the Council to the European Court of Justice, which however recognised the political discretion of the Council not adopting sanctions according to the Treaties<sup>9</sup>. A reform of the SGP in 2005 has introduced a more flexible application of the stability criteria<sup>10</sup>.

Markets also have been unable to prevent Member States from exceeding their deficit. On the contrary, all countries, even those whose public finances were less solid, enjoyed low interest rate on their debts. This happened because the Eurozone has been considered by the markets as a homogeneous area, where all Member States, despite the no-bail-out clause, would finally intervene to sustain each other in order to guarantee the stability within the EMU. This situation encouraged several governments, instead of consolidating their finances, to increase public debt.

Considering these controversial results, it could be argued that the creation of a single currency necessarily demanded an effective fiscal and economic integration that Member States did not want to establish as it would have required a substantial loss of sovereignty in favour of the European institutions. The economic governance based on the open method of coordination and the soft law has been quite

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<sup>8</sup> ECOFIN Council Conclusions Regarding the Correction of Excessive Deficits in France and Germany, Frankfurt am Main, 25.11.2003.

<sup>9</sup> ECJ, Judgment of 13 July 2004, Case C-27/04, *Commission v. Council*, para. 80: «As the Commission acknowledges, the Council has a discretion. Commission recommendations, and not proposals within the meaning of Article 250 EC, are placed before it, and it may, in particular on the basis of a different assessment of the relevant economic data, of the measures to be taken and of the timetable to be met by the Member State concerned, modify the measure recommended by the Commission, by the majority required for adoption of that measure».

<sup>10</sup> Regulations (EU) 1055/2005 and 1056/2005 have provided a wider interpretation of the “exceptional circumstances” clause, the taking into account of «other relevant factors» to monitor the respect of stability criteria and more flexible deadlines for correcting excessive deficits.

ineffective, if we consider how far the EU still is from the targets of the “Lisbon Strategy” and “Europe 2020”<sup>11</sup>. Also, the supervision on public deficit hasn't worked efficiently because it depended on the political discretion of the Council.

At the same time, the promoters of the monetary union knew to have put Europe on a track directed at a stronger economic and political unification that would be necessary in the middle term in order to guarantee the sustainability and the legitimation of the new system. The outcomes of the sovereign debt crisis will show whether they were right.

### **The breakdown of the EMU and the efforts done to save it**

The dramatic collapse of Greece and the contagion to several Member States revealed the weaknesses of the EMU. The soft European supervision allowed *de facto* the development of wide economic and fiscal divergences within the Eurozone, which the financial crisis has made even deeper since 2008. Even if the Euro has remained substantially stable, international markets have started to demand higher interest rates to buy sovereign bonds of weaker EU countries, not only because of mistrust in their financial stability, but also to challenge the resistance of the EMU as a whole. It is in fact the present system of economic and monetary union that is under question. Markets are testing if a monetary union not provided with the means of keeping the economies of its members compact can remain stable in the middle and long term.

Financial speculation has definitely undermined the stability of public finances of several Member States, starting with Greece, making realistic national defaults and subsequent exit from the EMU. In order to avoid such a scenario that would jeopardise the stability of the EMU and produce catastrophic effects on the European economy, two kinds of measures have been adopted.

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<sup>11</sup> The “Lisbon Strategy” launched in 2000 by the European Council aimed at making the European economy more dynamic, competitive, prosperous, fair and environmentally sustainable. It was based on the open method of coordination. In June 2010 the European Council has adopted a similar ten years strategy called “Europe 2020”.

On the one hand, European Member States tried to heal the wounds of the crisis providing financial help to countries attacked by speculation and preventing their default. That has been implemented, after long hesitation, through the creation of temporary rescue funds, such as the ESFM and the EFSF<sup>12</sup> under art. 122.2 of the Treaty on the Functioning of the European Union (TFEU)<sup>13</sup>. The rescue packages in favour of Greece, Ireland, and Portugal have avoided a deeper escalation of the crisis and a wider contagion. Subsequently members of the EMU have created a permanent mechanism to intervene in case of financial difficulties. The European Stability Mechanism<sup>14</sup> (ESM) has been established on the basis of the new paragraph 3 of art. 136 TFEU<sup>15</sup>, which has been introduced *ad hoc* by the European Council in December 2010. In order to support Member States, the ESM can provide stability support loans in the framework of a macro-economic adjustment programme, finance recapitalisations of banks and financial institutions through loans to the governments, purchase debt in the primary and secondary debt markets and provide precautionary financial assistance in the form of credit lines. The European financial aid is conditional to the signature of a “memorandum of understanding” between the national government and the European Commission<sup>16</sup> in connection with the European Central Bank (ECB)

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<sup>12</sup>The European Financial Stability Facility (EFSF) was a special purpose vehicle (SPV) that could guarantee on a pro-rata basis lending up to € 440 billion to Euro area Member States. The European Financial Stabilisation Mechanism (EFSM) was instead an emergency funding programme financed by borrowing secured against the EU budget (up to € 60 billion). Countries could get financial support at an interest premium. Both funds have been created in May 2010 with a three years mandate.

<sup>13</sup> Art. 122.2 TFEU foresees that if «a Member State is in difficulties or is seriously threatened with severe difficulties caused by natural disasters or exceptional occurrences beyond its control, the Council, on a proposal from the Commission, may grant, under certain conditions, Union financial assistance to the Member State concerned».

<sup>14</sup>The European Stability Mechanism (ESM) is an intergovernmental organisation under public international law established on 27 September 2012 and based in Luxembourg. It has a total subscribed capital of € 700 billion.

<sup>15</sup>The European Council in December 2010 has introduced an amendment to art. 136 TFEU. The new third paragraph reads: «The Member States whose currency is the Euro may establish a stability mechanism to be activated if indispensable to safeguard the stability of the Euro area as a whole. The granting of any required financial assistance under the mechanism will be made subject to strict conditionality».

<sup>16</sup>After the request for financial assistance the Board of Governors of the ESM entrusts the European Commission to negotiate in connection with the ECB and

and the International Monetary Fund (IMF). The memorandum foresees all measures the government has to endorse in order to consolidate public finances<sup>17</sup> and appoints the so-called *troika* (composed by the EC, the ECB and the IMF) to monitor the application of reforms.

At the same time, Member States under pressure from Germany decided to focus on the causes of the crisis, improving the weak economic coordination and supervision of national budgets, that was not able to prevent the increase of public deficit and debt in several Member States.

This objective was pursued in the first instance with a reform of the SGP through the approval of the Six Pack<sup>18</sup> and the Two Pack<sup>19</sup>. These consist of a set of regulations and one directive that modify the economic and budgetary supervision provided by the Treaty. One important innovation is the introduction of a European supervision on macroeconomic imbalances in the framework of art. 121 TFEU with the possibility of sanctions<sup>20</sup>. The Commission was given the authority to organise missions to collect information on the economic situation of Member States and monitor the compliance with the SGP<sup>21</sup>. The debt reduction has been better defined and has become a stricter criterion in the assessment of public finances<sup>22</sup>. The most important innovation, however, was the introduction of semi-automatic decisions within the multilateral surveillance and the excessive deficit procedure<sup>23</sup>: the Council automatically approves recommendations from the Commission, unless a reverse qualified majority of its members decides against it. These reforms have reinforced the effectiveness of the rules, which the Maastricht Treaty had set in order to coordina-

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the IMF a Memorandum of Understanding. The Managing Director of the ESM prepares at the same time a proposal for a financial assistance facility agreement to be adopted by the Board of Governors. Afterwards the European Commission signs the Memorandum on behalf of the ESM. Finally the Board of Directors approves the financial assistance facility agreement. A similar procedure applied in the case of the EFSE.

<sup>17</sup> The decision to provide financial help is taken by the EFSF and the ESM by qualified majority of its members.

<sup>18</sup> The Six Pack includes Regulations (EU) 1173/2011, 1174/2011, 1175/2011, 1176/2011, 1177/2011 and Directive 2011/85/EU.

<sup>19</sup> The Two Pack includes Regulations (EU) 472/2013 and 473/2013.

<sup>20</sup> Introduced by Regulation (EU) 1176/2011.

<sup>21</sup> As modified by Regulation (EU) 1177/2011.

<sup>22</sup> *Ibid.*

<sup>23</sup> As modified by Regulations (EU) 1173/2011 and 1174/2011.

te national economies. Their introduction raises nevertheless several doubts on the compatibility with the EU Treaties. If art. 136 TFEU on the reinforced economic governance of the Eurozone can probably legitimize the strengthening of sanctions from European institutions<sup>24</sup>, the adoption of semi-automatic decisions does not find any clear reference in the Treaties<sup>25</sup>.

Some efforts have been taken to develop growth policies on the basis of a common strategy. The European Semester<sup>26</sup> introduced with the Six Pack aims to fix economic objectives among Member States: it is a period, from January to July, during which the budgetary and structural policies of Member States are reviewed by the European Commission in order to avoid inconsistencies with the stability criteria and the emergence of macroeconomic imbalances. The Two Pack has extended this supervision introducing for the Euro area a common budgetary timeline until December, during which the Commission examines the draft budget of Member States before the final approval<sup>27</sup>.

An important turning point in the process of economic and fiscal integration is represented by the Treaty on Stability, Coordination and Governance<sup>28</sup> (TSCG or Fiscal Compact) signed on 2 March 2012 by 25 members of the European Union. The opposition of two Member States, notably the United Kingdom and the Czech Republic, prevented the reform of the European Treaties in accordance with art. 48 of the Treaty on the European Union (TEU), so the other governments under Franco-German pressure decided to stipulate a separate international agreement.

The new Treaty aims to strengthen the coordination of fiscal policies and budgetary consolidation within the EMU in order to improve economic governance. Several provisions were already present in the Six Pack, like the obligation to gradually reduce public debt towards the GDP ratio of 60%<sup>29</sup> or the stricter application of the exces-

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<sup>24</sup> As modified by Regulations (EU) 1173/2011, 1174/2011, 1176/2011.

<sup>25</sup> It consists in an alternative procedure to the rules set in art. 126 TFEU and the SGP.

<sup>26</sup> The European Semester has been introduced by Regulation (EU) 1175/2011.

<sup>27</sup> See Regulation (EU) 473/2013.

<sup>28</sup> The Fiscal Compact entered into force on 1 January 2013 for the 16 States that completed the ratification process before this date.

<sup>29</sup> Introduced by Regulation (EU) 1175/2011.

sive deficit procedure. Even the creation of a Euro-summit in charge of the new intergovernmental governance of the Eurozone does not produce any considerable improvement from the existing Euro group meetings. The most important innovation is instead the balanced-budget amendment that Member States are obliged to introduce in their national Constitution within one year of the ratification of the Fiscal Compact, as provided by art. 3 TSCG. According with this new rule the budgetary position of the general government of Member States must be balanced or in surplus. Structural deficit cannot be higher of 0.5% of the GDP at market prices. The European Court of Justice is in charge of verifying whether Member States have complied with these provisions<sup>30</sup>.

The introduction of the balanced-budget amendment in national Constitutions determines *de facto* a substantial loss of the national sovereignty of Euro countries, as they have lost the possibility to develop economic policies based on indebtedness. Even if the European Treaties and the SGP had already provided binding rules to contain public debt, the introduction of the golden rule in national Constitutions has drastically reduced the discretion of Member States in developing their economic and budgetary policies. These new provisions should now push Euro countries towards a process of budgetary consolidation providing the EMU with enough stability.

The ratification of the TSCG is a legal condition for Member States to receive financial support from the European Stability Mechanism. In this way drafters of the Treaties made it clear that financial solidarity can only be given in return for budgetary responsibility.

This important loss of economic sovereignty determined by the Fiscal Compact has made it difficult for all EU countries to sign and ratify the agreement. This is why the TSGC was adopted only by a part of Member States out of the framework of the European Treaties and it required only 12 ratifications to enter into force. This split of the EU highlights once again the importance of multi-speed integration in the EU, the difficulty to proceed by unanimity and the necessity to share a common goal for the unification process.

Aside from the consolidation of public finances, Member States have also approved a reform of the European banking system in order

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<sup>30</sup> Under art. 8 TSCG.

to stop the vicious circle of the debt and banking crisis<sup>31</sup>. In 2010, the reform of the European prudential supervision has foreseen the creation of the European Systemic Risk Board (ESRB)<sup>32</sup> in order to strengthen coordination between national supervisory authorities. In 2012, the Commission proposed a project of banking union for the Eurozone, including a Single Supervisory Mechanism, a Single Resolution Mechanism and common Deposit Guarantee Schemes. In autumn 2013, Member States have found the agreement to introduce the Single Supervisory Mechanism<sup>33</sup>, which the ECB will manage, and the single fund for the resolution of banks<sup>34</sup>.

### Contradictions in act

The new process of fiscal integration and budgetary consolidation through the adoption of austerity measures raises three main legal issues that make the present approach to the crisis contradictory and partly insufficient.

The first issue regards the compatibility of the process of fiscal integration, based on the traditional functionalist method, with national Constitutions. It is not clear if the current process of fiscal integration, which *de facto* impinges upon national economic sovereignty, is admissible according to the fundamental laws of Member States.

In order to answer this question it should be considered that fiscal policy is a core component of national sovereignty. Historically national States have been born and raised on a central power able to impose and collect taxes. This power is now experiencing a progressive erosion by the EU. The development of a strong European supervision on

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<sup>31</sup> There was a strong relationship between banks and sovereign debts because European banks held huge quantities of sovereign debt of Member States and governments intervened massively to prevent banks' default.

<sup>32</sup> This is composed by an authority in charge of macro-prudential supervision, the European System of Financial Supervisors (ESFS), and three authorities in charge of micro-prudential supervision: the European Securities and Markets Authority (ESMA), the European Banking Authority (EBA) and the European Insurance and Occupational Pensions Authority (EIOPA).

<sup>33</sup> *Proposal for a Council Regulation conferring specific tasks on the European Central Bank concerning policies relating to the prudential supervision of credit institutions*, COM/2012/511.

<sup>34</sup> See European Council, *Press Release 564/13*, Brussels, 18.12.2013.



national budgets has substantially reduced the capacity of Member States to fully exercise their fiscal competence. This compression of national sovereignty has already obliged several Member States to reform their own Constitution, introducing lastly the balanced-budget amendment.

The new process of fiscal integration, pursued by secondary legislation and Treaty changes has not left indifferent the “guardians” of the constitutional orders of national States, that are Constitutional Courts. In particular, the *Bundesverfassungsgericht* (BvG) is playing a fundamental role in challenging the legitimacy of the process of integration, highlighting the limits of functionalism to achieve more integration.

In the famous ruling on the Lisbon Treaty<sup>35</sup> the Court of Karlsruhe affirmed that certain competences, such as defence, fiscal policy and education, have to remain under national control and cannot be transferred in the future to the EU<sup>36</sup>. Despite the principle of *Europafreundlichkeit* outlined in art. 23 GG<sup>37</sup>, the commitment to European integration cannot deprive Germany of its core sovereignty, for example in the economic and fiscal field. The *Grundgesetz* is indeed the fundamental law of a sovereign State, whose fundamental features cannot be changed through constitutional amendments under art. 79 GG<sup>38</sup>. The Constitution is the expression of a settled legal

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<sup>35</sup> Federal Constitutional Court, Judgement of 30 June 2009.

<sup>36</sup> Federal Constitutional Court, Judgement of 30 June 2009, para. 249: «Essential areas of democratic formative action comprise, *inter alia*, citizenship, the civil and the military monopoly on the use of force, revenue and expenditure including external financing and all elements of encroachment that are decisive for the realisation of fundamental rights, above all as regards intensive encroachments on fundamental rights such as the deprivation of liberty in the administration of criminal law or the placement in an institution. These important areas also include cultural issues such as the disposition of language, the shaping of circumstances concerning the family and education, the ordering of the freedom of opinion, of the press and of association and the dealing with the profession of faith or ideology».

<sup>37</sup> The principle of “openness to Europe” at art. 23.1 of the Constitution commits Germany to participate in the development of the European Union «that is committed to democratic, social, and federal principles, to the rule of law, and to the principle of subsidiarity, and that guarantees a level of protection of basic rights essentially comparable to that afforded by this Basic Law».

<sup>38</sup> Art. 79 of the German Constitution affirms that the Basic Law may be amended only by a law carried by two thirds of the Members of the *Bundestag* and two thirds of the votes of the *Bundesrat*. Amendments to this Basic Law affecting the division of

order that can be modified, but not overturned, as it would happen if the German Parliament lost its full control of the budget. The loss of core sovereignty would then only be possible through a legal break, recurring on the *pouvoir constituant* under art. 146 GG<sup>39</sup>, probably adopting a new Constitution by referendum<sup>40</sup>.

In the opinion of the BvG the integration process based on functionalism is limited, at least for Germany, by the respect of key competences that cannot be transferred at European level without starting a true constitutional process involving the people. These considerations have of course a deep impact on the development of the European economic and fiscal governance that might be stopped by national Constitutional Courts (in particular the BvG), if they consider the erosion of national sovereignty excessive. This has not happened yet, but since the beginning of the sovereign debt crisis the German Constitutional Court has already intervened to monitor the legitimacy of reforms, in particular the participation of Germany in the EFSF and the ESM<sup>41</sup>. Despite the Court declaring these measures legitimate, it has also highlighted that they cannot produce the effect to deprive the German Parliament of its full control on the budget<sup>42</sup>.

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the Federation into *Länder*, their participation on principle in the legislative process or the principles laid down in articles from 1 to 20 shall be inadmissible.

<sup>39</sup> Art. 146 of the German Constitution reads: «This Basic Law, which since the achievement of the unity and freedom of Germany applies to the entire German people, shall cease to apply on the day on which a constitution freely adopted by the German people takes effect».

<sup>40</sup> Federal Constitutional Court, Judgement of 30 June 2009, para. 179: «According to the Basic Law, those entitled to vote have the right by a decision “freely adopted” to decide on the change of identity of the Federal Republic of Germany that would be effected by its becoming a constituent State of a European federal State, and the concomitant replacement of the Basic Law. Like Article 38.1 first sentence of the Basic Law, Article 146 of the Basic Law creates a right of participation of the citizen entitled to vote. Article 146 of the Basic Law confirms the pre-constitutional right to give oneself a constitution from which constitutional authority emanates and by which it is bound».

<sup>41</sup> Federal Constitutional Court, Judgement of 7 September 2011 on “Constitutional legitimacy of aid measures for Greece and the Euro rescue package”; Judgement of 12 September 2012 on “Constitutional legitimacy of the ratification of the ESM Treaty and the Fiscal Compact”.

<sup>42</sup> German Constitutional Court, Judgement of 12 September 2012, para. 195: «As representatives of the people, the elected Members of the German *Bundestag* must retain control of fundamental budgetary decisions even in a system of inter-governmental governing. In its openness to international cooperation, systems of

Therefore, the Court has affirmed that the liability of Germany to the European rescue mechanisms cannot be increased without the authorisation of the German Parliament<sup>43</sup>.

In conclusion, the *Bundesverfassungsgericht* in its last judgements has marked a boundary for the functionalist method of integration that cannot transfer certain competences to the European institutions. As the President of the German Constitutional Court, Andreas Voßkuhle<sup>44</sup>, made clear, the process of de-sovereignisation of Member States and strengthening of the EU cannot automatically continue until Europe is politically united: the loss of national core sovereignty to the EU as well as the creation of a political union cannot be realised through a “salami tactic”, but will demand a constitutional process with a clear decision made by the people.

The second contradiction that undermines the legitimacy of the process of fiscal integration is the democratic deficit of the decision making process. The European economic governance is essentially based on the intergovernmental method that *de facto* excludes European citizens. The European Parliament only has the right to be informed of the results of the multilateral surveillance<sup>45</sup> and the excessive deficit procedure<sup>46</sup> by the Council and the Commission. The Parliament

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collective security and European integration, the Federal Republic of Germany binds itself not only legally, but also with regard to fiscal policy».

<sup>43</sup> German Constitutional Court, Judgement of 12 September 2012, para. 248: «With a view to the binding limitation of the burdens on the budget to EUR 190.024.800,000, which is to be ensured by a reservation to this effect, the safeguarding of the *Bundestag*'s overall budgetary responsibility does not require providing a special right of resignation or termination in the Treaty. The limitation of liability sufficiently ensures that the entry into force of the Treaty alone does not establish an automatic and irreversible procedure regarding payment obligations or commitments to accept liability. Instead, every new payment obligation or commitment to accept liability requires a new mandatory decision by the German *Bundestag*. In other respects, the general provisions apply in this context».

<sup>44</sup> See: [www.euractiv.com/future-eu/key-german-judge-backs-eu-budget-news](http://www.euractiv.com/future-eu/key-german-judge-backs-eu-budget-news).

<sup>45</sup> The TFEU reads at art. 121.2: «On the basis of this conclusion, the Council shall adopt a recommendation setting out these broad guidelines. The Council shall inform the European Parliament of its recommendation» and at art. 121.5: «The President of the Council and the Commission shall report to the European Parliament on the results of multilateral surveillance. The President of the Council may be invited to appear before the competent committee of the European Parliament if the Council has made its recommendations public».

<sup>46</sup> The TFEU reads at art. 126.11: «The President of the Council shall inform the European Parliament of the decisions taken».

plays a more important role in the adoption of detailed rules on the multilateral surveillance on the basis of the ordinary legislative procedure<sup>47</sup>. Nevertheless, the democratic principle, solemnly affirmed by both national Constitutions and European Treaties<sup>48</sup>, does not efficiently apply to the EMU.

If the deficit of democracy is a long-standing issue in the history of European integration, the present crisis has made it much more dramatic. We are not only facing the traditional opposition between Community system and intergovernmental method. The necessary process of budgetary consolidation has in fact deprived many European citizens of the right to vote on the fiscal policies they have to implement, in open violation with the basic principle of modern democracies that is “no taxation without representation”. National parliaments no longer have the competence to freely develop economic and fiscal policies, while the European Parliament does not have the power yet to influence the Council in making its decision: as a result, citizens are basically cut off.

This situation is much more serious for countries that requested European financial aid in order to avoid national default. The memoranda signed by Greece, Portugal and Ireland to access the European and international financial support have *de facto* introduced in these countries a kind of “compulsory administration” in charge of applying reforms and consolidating public finances. The ESM, that is an intergovernmental organisation acting under the mandate of the Council of Governors, behaves as an extraneous body to the citizens. Furthermore, countries in financial difficulties either take the extreme and disastrous choice to leave the monetary union or, whatever government is elected, it has to respect the commitments taken in the *memorandum*.

The challenge to European democracy has then become a priority to legitimate reforms and complete the process of integration.

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<sup>47</sup> See art. 121.6 TFEU. In case of reform of the Protocol on the excessive deficit, the European Parliament has the right to be consulted in accordance with art. 126.14 TFEU.

<sup>48</sup> The Treaty on the European Union (TEU) mentions the democratic principle at art. 2: «The Union is founded on the values of respect for human dignity, freedom, democracy, equality, the rule of law and respect for human rights, including the rights of persons belonging to minorities» and art. 10.1 TEU: «The functioning of the Union shall be founded on representative democracy».

The democratic deficit was in a way tolerable when integration was limited to the common market. The expansion of European competences to the monetary and fiscal policies, touching more and more directly the rights of the citizens, has progressively made indispensable a stronger democratisation of the Union. If such a process does not take place, citizens will reduce their support for Europe and national Constitutional Courts may intervene to declare illegitimate further loss of competence to EU institutions, as they are not fully democratic<sup>49</sup>.

For the moment, faced with the difficulties of reforming the Union, it may be suggested a stronger involvement of national parliaments to provide European decisions with more democratic legitimation. The Lisbon Treaty has already foreseen a wider responsibility for national parliaments, for example in the special procedure of Treaty changes under art. 48 TEU or in the application of the principle of subsidiarity. The German Constitutional Court has taken the same approach when it said that democratic legitimation of European decisions comes from national parliaments and therefore the German *Bundestag* cannot be deprived of its sovereignty in core issues<sup>50</sup>. Despite the importance of involving national parliaments, this approach is inadequate in fixing the democratic deficit of the European Union. If it provides for a wider democratic legitimation of national positions within the Council, it does not confront the main issue of the EMU that is its intergovernmental structure. Until the Council conserves its dominance, European decisions will not reflect the will of the citizens, but the interest of single countries to be protected through veto right or political pressure. So, instead of fragmenting democratic legitimation among 28 national parliaments, it would be necessary to strengthen the role of the European Parliament before the Council and the Commission. After the entry into force of the Lisbon Treaty, the European Parliament is already on a par with the Council in accordance with the ordinary legislative procedure<sup>51</sup> that regards several competences, but not the fiscal and budgetary policies.

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<sup>49</sup>The *Bundesverfassungsgericht* has already highlighted limits of European democracy: Federal Constitutional Court, Judgement of 30 June 2009, para. 287, 288, 295.

<sup>50</sup> Federal Constitutional Court, Judgement of 30 June 2009, para. 262, 271, 274.

<sup>51</sup> See art. 294 TFEU.

The new process of integration requires then further steps in the direction of strengthening the role of the European Parliament and European parties. This challenge represents not only a legal issue, but also a political problem. It is clear that the distance between citizens and institutions increases disaffection and incomprehension of the citizens for the European project, leaving space to populist and Euro sceptic movements, dangerous for the stability of the EMU.

Lastly, the loss of national economic sovereignty has been necessary in restoring market confidence and assuring the correct functioning of the EMU in the future, since sharing the same currency necessarily demands mutual responsibility and the application of common rules. At the same time, the reduction of national sovereignty has meant in most cases the application of austerity measures to respect the new fiscal and budgetary rules fixed in the Six Pack, the Two Pack and the Fiscal Compact. This has been much more evident for those countries that required the financial support of the EFSF and the ESM to avoid national default. Austerity policies endorsed by Member States have mainly consisted of cuts to the public services and privatisations. Citizens have had to face big sacrifices in terms of higher taxation and less welfare.

This has determined the violation of social and labour rights protected by national Constitutions and European law<sup>52</sup>. Even if these norms are in large extent programmatic and cannot be automatically enforced in front of national Courts, the dramatic reduction of public services raises several doubts on the legitimacy of austerity measures. If the process of fiscal integration on one hand has been necessary to stabilise the Monetary Union and to secure the entire project of unification, it has also increased *de facto* wide social disparities among European citizens in violation of the principle of non-discrimination, which is one of the basic values of the European legal order.

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<sup>52</sup> Art. 3.3 TEU reads: «The Union ... shall work for the sustainable development of Europe based on balanced economic growth and price stability, a highly competitive social market economy, aiming at full employment and social progress, and a high level of protection and improvement of the quality of the environment ... It shall combat social exclusion and discrimination, and shall promote social justice and protection, equality between women and men, solidarity between generations and protection of the rights of the child. It shall promote economic, social and territorial cohesion, and solidarity among Member States».

The contradiction between the protection of social rights and the respect of fiscal obligations reflects the political difficulties in consolidating national budgets and promoting at the same time economic growth. As Member States after the ratification of the Fiscal Compact have reduced borrowing capabilities, the only subject able to invest in welfare and growth policies is therefore the EU<sup>53</sup>. The Eurozone, which after long hesitation has decided to grant financial assistance to its members in difficulties, under art. 122.2 and 136.3 TFEU, should now launch a common plan for economic growth and social care.

Such a project raises many problems in terms of feasibility and legitimacy. Lacking a proper tax capacity of EU institutions, European resources mainly depend on contributions of Member States that during the crisis have become even more reluctant to support the common budget<sup>54</sup>.

An initial proposal to launch growth policies at European level has been the creation of Euro bonds, jointly issued by all members of the EMU. It consists of an ambitious project that can be differently formulated balancing European and national guarantees<sup>55</sup>. The main obstacle of the Euro bonds is the German government, which is reluctant to mutualise public debt through joint obligations, whose solvency would be ensured in the end by the strongest and most stable countries. The German Constitutional Court has also excluded the recourse to Euro bonds, if they determine a loss of control of the *Bundestag* on the German public expenditure.

Another solution to finance growth policies at European level may be to provide the EU or at least the Eurozone with more autonomous resources consisting for example of a tax on financial transactions<sup>56</sup>

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<sup>53</sup> As Tommaso Padoa-Schioppa used to say: «Austerity for the States, growth for Europe».

<sup>54</sup> On 8 February 2013 the European Council decided to cut the European budget by 3.3% for 2014-2020. Despite the opposition of the European Parliament, several Member States and in particular the UK insist to reduce national contributions to the EU budget.

<sup>55</sup> In the Green Paper on the feasibility of introducing Stability Bonds issued on 23 November 2011 the European Commission has categorised Euro bonds in three broad approaches, based on the degree of substitution of national issuance ([www.ec.europa.eu/europe2020/pdf/green\\_paper\\_en](http://www.ec.europa.eu/europe2020/pdf/green_paper_en)).

<sup>56</sup> In February 2013, eleven Member States have submitted to the Commission a project of enhanced cooperation on a harmonised Financial Transaction Tax.

or a pollution tax. The income might be used to finance European projects in accordance with the Strategy “Europe 2020”.

The European Investment Bank (EIB) may also play a more important role. Member States may agree to increase the subscribed capital of the bank in order to provide more resources to finance key strategic infrastructures.

A recent German proposal is the introduction of “competitiveness contracts” to be signed by the Commission and Member States in order to provide them with more resources to undertake structural reforms without violating the new fiscal rules.

Needless to say that the management of more resources at European level will make the process of democratisation even more urgent.

## Conclusion

The sovereign debt crisis is about the identity of the EU. European citizens and Member States are at a crossroad. The contradictions highlighted in this paper have shown the difficulties of proceeding on the track of fiscal integration on the basis of the traditional functionalist method. A process based on the erosion of national sovereignty through subsequent Treaty changes adopted by unanimity in favour of non fully democratic EU institutions cannot work efficiently in regards to fundamental competences such as the fiscal and the budgetary policies, that touch national core sovereignty and basic interest of citizens. The European unification at this point of the process is no longer self-sustaining, but demands on the contrary clear political choices for a comprehensive reform of the EU. Such a process will probably demand different speeds of integration with the Eurozone as main actor.

Due to the intensity of the crisis many European politicians and intellectuals have recently called for a true European political unification<sup>57</sup>. Most of the calls for a European political union maintain

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<sup>57</sup> Particularly relevant is for example the statement made by Angela Merkel on 7 June 2012 ([www.euractiv.com/priorities/merkel-calls-political-union-sav-news-513201](http://www.euractiv.com/priorities/merkel-calls-political-union-sav-news-513201)) and the declaration of François Hollande on 16 May 2013 ([www.independent.co.uk/news/world/europe/francois-hollande-calls-for-european-political-union-within-two-years-8619824.html](http://www.independent.co.uk/news/world/europe/francois-hollande-calls-for-european-political-union-within-two-years-8619824.html)).



at the moment a *quantum* of uncertainty about what steps to take. Some proposals aim to build a genuine European federation through all necessary legal reforms to be adopted at European and national level (even approving a new German Constitution<sup>58</sup>, for example). Others suggest strengthening the Community method, finding a more balanced compromise between the general interests of Europe and national resistances.

In conclusion, beyond any imaginable scenario, the present shift of sovereignty from Member States to European institutions requires an acceleration of the integration process. Measures adopted until now have already challenged the ability of the Union to face the crisis. If some pragmatic adjustment is still possible to improve the European budgetary supervision and economic coordination, fundamental issues on the effectiveness and the legitimacy of the new process of fiscal integration demand more courageous answers. The limits of functionalism to answer efficiently the problems of the EMU will probably demand a relaunch of the constitutional process through a wider involvement of the citizens.

In the framework of a credible constitutional project, the strengthening of the economic government and a process of institutional democratisation should be able to balance solidarity and responsibility, dragging Europe and Europeans out of the crisis.

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<sup>58</sup>The German Minister of Finances Wolfgang Schäuble has proposed the adoption of a new Constitution in June 2012.

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