

A CONSTITUTIONAL FRAMEWORK FOR THE MARKET ORDER VERSUS RESOURCE USAGE WITHIN IT: THE CASE OF A EU FISCAL CONSTITUTION

Auke R. Leen
Leiden University, The Netherlands

ABSTRACT

At this moment in the European Union, one of the main regulatory changes and challenges intruding on the function of private industries to manage resources on the basis of competitive advantages is a revised EU Constitution. Since the rejection of the draft European Constitution, a revision of the fiscal powers of the EU does not seem to be a priority. The 2005 French and Dutch “no” vote, however, was a revolution, and it is said that half of all historic revolutions were fiscal revolutions. The present approach to what steps to take as a result of the rejection is almost guaranteed to be a very toilsome process inside the realm of partisan advocacy. Moreover the approach is almost irrelevant in terms of both explanatory content and normative potential.

There is another way: fiscal constraints. Instead of streamlining existing EU Treaties and giving more room for majority voting, it would be better to shift the emphasis to the making of authentic fiscal rules. This paper is based on the idea that the EU is not a benevolent despot but a Leviathan: it shifts the grounds of the discussion to the question of within which constitutional alternatives should the EU’s fiscal powers be exercised. We have to leave room for the best while still guarding against the worst. The paper explores the analytical arguments in support of appropriately designed constitutional limits on the basis of a voluntary consent of those who are to be subject to it. The paper also gives the contours of such a model fiscal constitution: a separation of fiscal powers and a sharp border between tasks of the EU and its Member States seems to be required.

In sum, the paper offers an alternative to the present non-constitutional approach: it examines the motivation for and possible elements of a model EU fiscal constitution. The paper emphasizes that political reforms in the EU may be appropriate if aimed at constitutional structure but are not if aimed at modifying patterns of resource use within the market order.

INTRODUCTION

After the French and Dutch voted “No” in 2005 to the proposed European Constitution, a revised fiscal constitution as part of the general constitution does not seem to be a priority. It seems more opportune first to look at the general lines for cooperation between Member States. If, however, the “No” of the French and Dutch citizens is a revolution, the truth counts that at least half of all revolutions in world history were fiscal revolutions (Nef, 2002, Leen, 2006). It is telling that it is the fiscal policy with regard to the decrease in the amount of the Dutch contribution to the budget of the European Union and the income support of the EU for French farmers on which the governments have to hold the line to please their citizens. The EU’s budget is the cause of many of the bitterest arguments. The objective of spending seems to be to achieve acceptable net balances rather than agreed policy. The budget hovers between one that redistributes money between Member States and one that achieves certain EU-wide policies. The 2007-2013 budget has little relevance to the EU’s priorities; compromises come at a high price. It is said that the EU budget has never been used as a means to meet the objectives of the Union but rather as a negotiating tool for its members (Figueira, 2006).

The problems of the Pact on Stability and Growth are just as illustrative. The German government broke the rules on budgetary deficits of up to five years. They did not, however, expect any serious financial punishment. With the recently revised rules Member States can almost always get away with a larger deficit. Deficits are allowed if they are temporary, are exceptional, have been caused by an economic recession or have not been created by government policies.

Fiscal decision-making is often based on the rule that policies have to pose as little resistance as possible for the majority that must approve of them. The feeling dominates that someone else pays (Spicer, 1995). The results are ever-growing government tasks, budgets and taxation; less and less resources are directed by private owners into the most productive activities, as determined by the demands of the final consumers. In the last four years no member of the United States Congress has on total voted for a reduction in government outlays, notwithstanding the rhetoric in speaking of the need for fiscal responsibility (Dirksen, 2005). In the last years in hearings of the Congress with a balance of 145 to 1, witnesses arguing in favor of programs compared to those who spoke against them (Payne, 2006). Moreover, decisions on spending are made independently of those on taxing. From a revenue-maximizing government, the Leviathan approach to taxation, seems to be a reasonable starting point for fiscal analysis. A constitution, agreed on by citizens, binding the Leviathan seems to be the answer to ensure that the best remains a possibility by guarding against the worst (Brennan and Buchanan, 2000). Unlimited government power to tax and spend undermines the ability of the private sector, producers and consumers, to plan and peacefully interact in managing resources for mutual improvement. Though it is said that the proposed EU Constitution was no real constitution at all, from a fiscal point of view it should have been one.

The present strategy to save the rejected Constitution is almost guaranteed to be a toilsome process. Instead of emphasizing policies within rules for making the EU more efficient and giving more room for decision-making by means of simple or qualified majorities, the emphasis can be shifted to the establishment of the rules themselves. A constitutionally mindset is necessary. A fiscal constitution, voted for by the citizens, takes center stage in establishing trust between the Member States and forms the basis for a general constitution. The question then becomes what constitutional rules should guide fiscal constraint in the EU.

CONSTITUTIONAL POLITICAL ECONOMY

Constitutional politics defines the basic rules for ordinary politics. We have to differentiate between day-to-day interaction and its constitutional framework. Constitutionalism shifts the grounds of the discussion and answers the question within which constitutional alternatives should the fiscal powers of the EU be exercised.

There are no unique constitutional solutions; several combinations of electoral and non-electoral rules are possible to restrain and specify the powers of government. The 1974 and 1986 Nobel Prize winners in economics Friedrich Hayek and James Buchanan also aim at authentic fiscal constitutions. On the most general level what seems to be needed to guard against the EU Leviathan, is a clear separation of fiscal powers and a sharp border between tasks of the Member States vis-à-vis Brussels (Buchanan, 1994). For Hayek it is necessary to create a Legislative Assembly (upper house) that states the rules and a Governmental Assembly (ordinary legislature or parliament) that administrates within those rules (1982, Vol. 3). A new and differently elected and organized Legislative Assembly should draw up fiscal rules that should have the effect of permanent rules, and should not be subject to influences of particular groups. In the EU, however, there is an intentional combination of the European Commission, the European Council and European Parliament all of whom state what the budget is and make the policy within it (Treaty, 2005). Consequently the proposed change in policy of the EU from unanimity to majority rule is no effective constraint on the exercise and growth of government power (Baldwin and Widgrén, 2004).

Constitutional economics is both thinking outside the box and back to basics. For the EU this is scientifically uncharted territory. Hayek's model of bicameralism for fiscal powers for example, to my knowledge, has never been part of any political agenda. It is thinking outside the box of mainstream public finance (Rosen a.o., 1992). In due course the separate "taxation chamber" can even grow into an institution where all legislation in the EU is made independently from the direct policy use of it. For Buchanan the European constitution is an opportunity to be grasped by EU citizens for going back to constitutional basics (1991, 1996). However, the constitutionalist mindset that persons owe loyalty to the constitution rather than to the government is (has become) foreign to European thinking (Buchanan, 2003). This lack of a constitutional mindset is a part of the present problem in the EU.

THE SCOPE OF A FISCAL CONSTITUTION: POLITICAL AND CULTURAL DIFFERENCES, AND THE ADVANTAGES OF DECENTRALIZED DECISION-MAKING

Constitutionalism can be the core of fiscal constraints in which the consent of free individuals (trust) and subsidiarity (the primary liability for the solution of problems lies with the smallest functional unit) are two of the main problems.

Often the identity of Europe (Patten, 2006) is discussed as a problem of the real or illusory sovereignty of nations (cp. Wriston, 1992). Notwithstanding that, cultural and political differences make it difficult to have a fiscal constitution in the sense of an all-out democratic process in which majorities do decide (Leen, 2006). It is, however, the popular thing to do (Leonard, 2006; Verhofstadt, 2005). Democracy, however, can only be transposed to a supra-national organization under very restricted conditions (Hayek, 1939, 1949; Gillingham 2003). The solidarity and trust that is necessary for policies within the EU is very tenuous. Even within one country if things do differ like language (Belgium), religion (Northern Ireland) or economic development (Northern and Southern Italy) solidarity is hard to find. Solidarity has to be bought with financial pet projects for local constituents. A shared framework, a fiscal constitution, however, can facilitate a robust democratic debate about EU objectives.

Subsidiarity an organizing and enforceable principle that is congruent with the market (Backhaus, 2001) has become a part of the European constitution. It states that powers should only be shifted to Brussels when states themselves cannot achieve the same results. (Treaty, 2005, Title III, Article I-11). From this principle, which can also be described as economic federalism (Inman and Rubinfeld, 1997), flows the responsibility of the state to provide the legal conditions under which the citizens can accumulate wealth in order to satisfy their needs themselves. Freedom, however, is also a good in itself. Man is first and all a spiritual being. Real (moral) choices can only be made on the basis of individual freedom. A market economy makes room for human freedom and uses existing knowledge the best (Hayek, 1982, Vol. 1; Buchanan, 1986). The problem in a market economy is not giving central authorities, be it Brussels or a local government—even if benevolent — all the knowledge it needs to pursue their goals. The problem is to give each individual all the knowledge needed, mostly in the form of price signals, so he can decide for himself how to pursue his goals. In this way society uses unique individual knowledge and preferences that do differ in time and place.

The above is also the core of Austrian economics (Houmanidis and Leen, 2001) a way of economic thinking, in which, knowledge dissemination and the discovery thereof is central. One of the failures of mainstream (equilibrium) economic analysis is that it assumes that equilibrium (the equilibrium price in demand and supply) is actually brought about. The difficulty, however, is to describe the possible realization of equilibrium as the result of the systematic way in which individual plan revisions are made as a consequence of the disappointment of earlier plans. Entrepreneurial discoveries are the steps through which any possible tendency toward market equilibrium must proceed (Kirzner, 1985). Wealth is greater for all by minimal politicization, i.e. central decision making, of life. The change in (constitutional) rules that de-politicization involves is of potential advantage for all parties.

THE APPROACH TO THE PROBLEM

The construction of a model fiscal constitution requires carefully combined eclectic methods synchronized with the questions asked, the intended scope, and the policy advice generated so as to be fit for legislation and implementation (Voigt, 1996).

What is needed is the approach of fiscal sociology; it is a fusion of economics and sociology. It is a change of socio-political rules we are looking at. How can social order be established and preserved? The fiscal constitution must accommodate not only Member States with different constitutions, and economic and political systems, but also with different histories, cultures and socio-political visions (Backhaus, 2001, 2006). The burden of taxation can be properly identified as the focus of research in fiscal sociology. Fiscal sociology is a science that became necessary after the twentieth century separation of economics, sociology, politics and law with the resulting lacunae. Large comprehensive studies, which once characterized the activities of leading social scientists, became de-emphasized.

The roots of constitutional-contractarian economics are to be found in the tradition of liberalism (Buchanan, 1994; Feulner and Wilson, 2006; Hayek, 1960; Murray, 2006; Pilon, 1995). Personal liberty and property both need protection, since both are the means (either in services in kind or in money) by which the state seeks revenue through taxation. They are the core subjects of constitutional economics (Buchanan, 1991; Manne, 1985; Voigt, 1997). The critical distinction between constitutional and within-constitutional rules and the real influence of the voters on the first, but not on the second, are central to our research program (Elster, 1992; Fossum and H-J Trenz, 2006, Norman, 2003).

Austrianism (Rothbard, 1962; Kirzner, 1973), with its emphasis on the freedom of individual decision-making, fits into constitutionalism (Baird, 1989; Boettke, 1998; Buchanan, 1986). The Austrian method, praxeology, is a verbal axiomatic-deductive method. In the words of Böhm-Bawerk, one of the founders of Austrian economics, "I shall have to start with self-evident trivialities which are close at hand. I shall merely present them in a certain connection and lead them into certain conclusions, equally so manifest that they merely need to be formulated with full clarity and purpose" (1962; cp. Leen, 2005). It is a method suited to analyzing assumptions appropriate for a choice among rules instead of those relevant to making empirical predictions about outcomes generated under well defined rules.

THE CONTOURS OF CONSTITUTIONAL RULES

The central question of the paper--of which only a preliminary sketch of an answer can be given--is: "What are the possible electoral and non-electoral constitutional rules of a European fiscal constitution?" Part of the difficulty is that though we do have a hint of an answer, the problem it solves is not precisely known. The problem involves constitutional illiteracy. A constitutional mindset is needed: the choice by individuals who are related one to another in an anticipated set of interactions of a reciprocally binding constraint (Rawls, 1971). We have to shore up constitutional understanding. Rules and institutions rather than outcomes should be the focus. In general, orthodox public finance does not give an understanding of observed fiscal processes in the EU nor is it a basis for improvement on grounds that are acceptable to the taxpayers. As is to be tested in this research project, the logic of a constitutional approach can give such an interpretation, just as it gave an analytic interpretation of the popular tax revolts sweeping across the US in the late 1970s.

The goal of every constitution is to legitimize political authorities, create limits on their power and institutionalize a distinction between regular politics and the rules of the game, as well as authorize other constraints, e.g., human rights. In constitutional economics two sorts of decisions have to be made. First, we must choose from possible constitutional rules and second we have to state rules for daily policies within that framework.

(1). Behind a veil of ignorance, countries and people choose electoral and non-electoral constitutional rules. No one knows his future position. (Of all the Member States it was Germany, beforehand a most unlikely candidate that broke the rules of the stabilization pact). It is at this initial constitutional decision stage, where the basic fiscal arrangements are chosen, that citizens can really control the state and widespread public agreement is possible (Brennan and Buchanan, 2000). It is always easier to secure agreement on a set of rules than to secure agreement for example on who is our favorite player. Compare Odysseus choice of binding himself in advance so as to be later seduced by the Sirens (Elster, 1984, 2000, 2003). The tone of the discussions is theoretical and argumentative. Gains for all members are real.

If free initiative of citizen is to be the rule, a constitution must contain a principled-based limitation of the role of government. An example is the constitution of the U.S. where, in principle, the central authorities have few and limited competences while the states have many and large ones (Carson, 1983; Markman, 2005). The former have powers related to foreign policy and national defense, latter have powers relating to the criminal justice system and the protection of the family. In the proposed EU constitution, however, there seems to be little that does not fall under the jurisdiction of Brussels. The EU has tasks to do under all circumstances (e.g., customs, competition and monetary policy, fishing, and internal market policy), tasks that can be appropriated if necessary (e.g., environmental policy and consumer protection) and tasks it supports (e.g., tourism) (Treaty, 2005). The influence of the EU is also enhanced by the possibility of subsidizing activities. See how acute the gold rush response is with "matching" grants. Suppose the EU gives a subsidy of 50% to a certain activity. To accept this and the EU-influence that goes with it, the gain of the activity for the local government only has to be half of the total costs (Edwards, 2005).

Also we have to look at which specific fiscal rules are prudent in the setting of the EU. Examples are the TABOR (Tax payer Bill of Rights) rules (New and Slivinski, 2005) in several states of the US (Hawks, 2003;

Mauro, 2000). These rules are the result of taxpayers revolts in the U.S. whose origins were, like the situation in the EU, populist and constitutional rather than elitist and legislative (Brennan and Buchanan, 2000).

(2). We have to state rules for day-to-day policies within the framework. Making decisions by majority ensures the workability of the political process. The tone of the discussions is one of weighting up interests and bargaining (Elster 1995). Ordinary politics tend to be conflictual. In the proposed EU constitution, however, unanimous consent was given a smaller role, without making the above division in decision-making. The Lamfalussy process (2001), a four-level approach to securities markets legislation in order to create a single EU securities market, can be seen as a non-constitutional arrangement to cover part of the problems constitutional political economy also tries to cover. It, however, focuses on the day-to-day issues of EU policies.

SUMMARY AND CONCLUSION

A fiscal constitution fights the sense of malaise that gripped the EU after French and Dutch voters rejected the EU constitutional treaty. It shifts the grounds for debate towards authentic tax reform — moved beyond the realm of partisan advocacy and the persistent mismatch between policy priorities and the allocation of funds. Scientifically, the paper suggests guidelines for exclusion and inclusion of provisions within a fiscal constitution of the EU that are not prizes to be captured in partisan struggle. The emphasis is not, as is usually the case on the basis of a benevolent EU government (a proviso that is rarely made explicit), on the enhanced economic efficiency of existing tax legislation or making government “work better” (e.g., more room for majority-voting and insuring that all interests are somehow “more fully” represented). A different approach is put to the test: an analysis of constitutional design that is defined by the limits it places on the powers of Brussels to tax and spend and hence on the possibility it creates for the private sector to allocate and coordinate the use of resources.

The methods used in this paper are suited to problem at hand. There is a difference between assumptions for the analysis of choice among rules versus predictions about outcomes generated under well-defined rules. The paper tackles the problems other sciences believe are too speculative and, because of their all too exclusively empirical approach are unable to define or cope with them. We focus on the choices among constitutional constraints, and not, as is usually the case, on choices within given constraints. Empirical tests are not possible since they are limited to behavior under constraints that have been historically experienced. Choice among rules is inherently speculative. Speculation, however, can be reasoned (Brennan and Buchanan, 2000; Hayek, 1952). Hypotheses are conceptually refutable as Austrian economics and constitutionalism both subscribe to in their methodology.

As a result the research program creates a framework against the tendency to centralize decision-making that is often the result of the analysis applied to this problem of the mainstream approach of economics, politics and law (Klaus, 1998; Sowell, 1996). Also, constitutional rules just as they do for individuals, substitute for (improving the) morals between countries (Buchanan, 2001). In the market it is not, as Adam Smith ([1776], 1974) said, because of the benevolence of the baker that we expect our daily bread, but because of his self-interest within a constitutional order of private property. We apply the (market) exchange perspective to politics.

The model fiscal constitution emanates from belief in the people as the ultimate source of legitimate public power, instead of, as is now the case, from EU Treaties which have elements of a constitution but not this one. A constitution is an internal self-limitation of power, instead of treaties that are external limitations of power. The model EU Constitution also lays out first principles for institutional change that may constrain the natural proclivities of politicians to subvert the genuine interests of the participants in the network of market exchange (Buchanan, 2001).

In sum, the paper states the categorical distinction that must be made between reforms in the constitutional framework of the market order, the legal foundations of the free enterprise system, and political action directed at changes in resource usage. The proposed and for this reason fortunately rejected EU Constitution blurred the distinction. An understanding of constitutional economics suggests that a revised, fiscal EU Constitution may be appropriate if public policymakers aim at constitutional structure (and leave businesses the task of achieving competitive advantage through managing global resources), but not if they do aim at modifying patterns of resource use within the operation of markets themselves (Buchanan, 2001).

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