FROM THE FINANCIAL TO THE SOVEREIGN DEBT CRISIS: NEW TRENDS IN PUBLIC LAW (*)

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CONTENTS: 1. The historical foundations of public law and their erosion in a globalized world. — 2. New trends in public law from the financial to sovereign debt crisis. — 3. Multilateralism and cooperation among governments. — 4. EU and Member States. — 5. Executives and parliaments. — 6. «Politicians» and «experts». — 7. Central and local governments. — 8. Public and private sector. — 9. «More» and «less» state at the same time: beyond the zero-sum game narrative.

1. Even if historically controversial in some legal cultures, like the English one, the idea of public law, born in Europe, is now widely recognized throughout the world. Formed as a result of the changes that give birth to the modern state, public law establishes the authority and the legitimacy of modern governmental ordering. From this perspective, public law holds its distinctive character because of the singularity of its object, which is the activity of governing. The core elements of the concept of public law have been variously identified by the legal culture. Conventionally, it is possible to refer to three of them: the sovereignty of the state, the autonomy of politics, the primacy of the constraints posed by the constitution (1).

Firstly, public law is based on the idea of the sovereignty of the state. The state has the monopoly of the legitimate use of physical

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(1) To follow the approach suggested by M. LOUGHLIN, *The idea of public law*, Oxford, Oxford University Press, 2003; ID., *Foundations of public law*, Oxford, Oxford University Press, 2008.

force within a given territory. That's why the state retains full control of whatever happens within the confines of the country's borders (2).

Secondly, public law recognizes the autonomy and the primacy of the political realm. Politics emerges as a product of contests for authority in government. That's why the arrangements of government are the result of human choice. The legal power of the state exists only through the public capacity of collective action. The political process shapes the economic role of the state. All the attempts made in the economic literature to elaborate a theory of the «optimal» role of the state don't take into proper consideration the fact that the government's role is not apolitical. In the real world, the economic role of the state is determined largely by politics. In a democratic setting, with a market economy, politics has a direct impact on all governmental functions (3).

Thirdly, public law is based on the idea that the political process takes place according to the constitution and the rule of law. The proper work of a representative democracy implies a sound balance between the prerogatives of the executive and those of parliament, the recognition of the countervailing powers of the judiciary and of independent authorities, the devolution of functions to local communities.

In the last twenty years, due to the globalization, the powers of most states declined, and the historical foundations of public law became unstable.

The authority of the states over people and businesses inside their territorial boundaries was greatly weakened. As a consequence, where states were once the masters of markets, the markets, on many crucial issues, became the masters over the states (4).The privatization process greatly reduced the role of the state both in economic activities and in welfare provisions. Many public goods and services of general interest

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(2) From an economic analysis of law perspective, Y.Barzel, *A Theory of the State. Economic Rights, Legal Rights, and the Scope of the State*, Cambridge, Cambridge University Press, 2002.

(3) The point is stressed by V. Tanzi, *Government versus Markets. The Changing Economic Role of The State*, Cambridge, Cambridge University Press, 2011, 306 ss.

(4) For such a conclusion, see S. Strange, *The Retreat of the State. The Diffusion of Power in the World Economy*, Cambridge, Cambridge University Press, 1996; D. Swann, *The Retreat of the State: Deregulation and Privatisation in the UK and US*, New York, Harvester Wheatsheaf, 1988. Empirical evidence at the European level is provided by V. Schneider & F. M. Hage, *Europeanization and the Retreat of the State*, 15 *Journal of European Public Policy* 1 (2008).

began to be produced by private firms and nongovernmental organizations. The deregulation movement pressed states to give up control powers and to put their confidence in the self-regulatory virtues of the markets. Following this path, governments dismissed many regulatory tools, from entry controls to prices and standards setting.

Governments tried to react to these changes increasing their global and regional cooperation. Firstly, they established new international institutions, like the Wto, in order to set up tools, devices and procedures for global regulation ([5]). Nonetheless, economic globalization largely exceeded legal and institutional one. Many markets were fully integrated throughout the world, even in the absence of a common regulatory framework. As a consequence, the institutional landscape of economic global governance remained highly fragmented and too weak.

Secondly, governments greatly accelerated the integration process at European level, in order to establish an «ever closer Union». They created a single market, without internal barriers. To that purpose, many EU directives were issued aiming to the approximation of laws, sector by sector. European agencies and national regulatory authorities were set up with the task of ensuring the proper working of markets, the introduction of an effective competition and the protection of consumers. In 1992, the Maastricht Treaty established the economic and monetary union and fixed procedures and criteria for the adoption of a single currency. The monetary policy was delegated to a new independent body, the European Central Bank.

All these changes deeply modified the institutional settings of public law. The autonomy and the primacy of the national political process seemed to decline in favor of supranational institutions and technical authorities, legitimized only by expertise. The executive took the center of the stage in the national and in the international arena, relegating the parliament to a complementary role. As the sovereignty of the state was declining, also the authority of national constitutions was eroded. Especially in Europe, the dominance of the Treaties in the economic field was clearly stated, notwithstanding the attempts of

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([5]) From the point of view of global administrative law, B. Kingsbury *et al.*, *The Emergence of Global Administrative Law*, 68 *Law & Contemporary Problems* 15 (2005), and S. Cassese, *Administrative Law Without the State? The Challenge of Global Regulation*, 37 *J. Int'l L. & Pol.* 663 (2005), and, more recently, B. Kingsbury, *The Concept of 'Law' in Global Administrative Law*, 20 *European Journal of International Law* 20 (2009).

some constitutional courts to safeguard the fundamental values of the national charters.

2. The 2008 financial crisis put into question the fundamental assumptions and theories of the last two decades about the retreat of the state and the rise of markets' dominance over governments.

The crisis forced governments to act as saviors and to nationalize banks, financial institutions, and other strategic companies. The deregulation recipe was seriously attacked and regulatory reforms, needed to strengthen standards and controls over finance and business, were put at the top of the policy agenda. Furthermore, the idea of a spontaneous adjustment by the markets toward an efficient equilibrium was brought into question, and governments adopted comprehensive recovery plans.

The 2010 sovereign debt crisis suddenly reversed these trends. Governments became worried to avoid their default. Extraordinary measures of taxation and public expenditures' cuts were adopted. Safety nets were established at international level. Euro-zone countries were asked to provide financial assistance one to the other, on the basis of the solidarity principle.

The double shocking experience of the financial market failure and of the sovereign debt crisis led governments "in the storm". To get out of if, they are facing unknown challenges and transformations. But the direction towards which they are moving is difficult to assess. Outputs are not one way, as they were in the 1980s and in the 1990s, because at present distrust in government comes immediately after a market failure.

Mutations both in external and in internal frontiers of government affect different institutional issues, concerning in particular the relationships between: i) multilateralism and cooperation among governments; ii) European Union and national countries; iii) executive and parliament; iv) «politicians» and «experts»; v) central and local governments; vi) public and private sector.

3. The first changing pattern of public law is that of supranational cooperation. In a greatly interdependent world economy, the number of global public goods — from financial stability to sustainable growth — quickly increases, and calls for greater collective action (6). The

(6) T. Sandler, *Overcoming Global and Regional Collective Actions Impedi-*

move towards a new economic global governance, however, is not the result of a single strategy, but rather an original mix or blend of different solutions enhanced by flexibility and experimentalism (7).

At first sight the 2008 financial crisis launched a new multilateralism. Numerous and regular G-20 leaders' summits took place immediately after its burning. The United Nations became an important forum for discussion among world leaders about the development of markets and proper institutions to regulate them. New international or supranational institutions — such as the Financial Stability Board — were created. Both the International Monetary Fund and the World Bank, and other multilateral development banks, were promised new resources to mitigate the 'development emergency' caused by the crisis (8).

Relevant regulatory reforms were designed at international level. All financial institutions and operations were put under review. The most important achievement was the agreement reached by the Basel Committee on Banking Supervision (BCBS) on the new bank capital and liquidity framework, which increases the resilience of the global banking system by raising the quality, quantity, and international consistency of bank capital and liquidity.

The experience of such a great level of global economic integration, even after a shocking experience like the financial crisis, didn't produce a radical change on the institutional side. As a matter of fact, states didn't transfer authority to existent or new supranational bodies. They just decided to let evolve the Financial Stability Forum in a Board and to strengthen the role and the financial resources of IMF. Also the enlargement of the G-8 in the G-20 as the «premier forum of international economic governance» didn't entail any delegation of authority.

Nonetheless, governments recognized the importance of cooperation in order to ensure financial stability and sustainable growth throughout the world. The crisis showed how far an individual gov-

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ments, 1 *Global Policy* 40 (2010); with specific reference to the problem of systemic risk, I. GOLDIN & T. VOGEL, *Global Governance and systemic Risk in the 21st Century: Lessons from the Financial Crisis*, 1 *Global Policy* 4 (2010).

(7) G. NAPOLITANO, *The two ways of global governance after the financial crisis: Multilateralism versus cooperation among governments*, 9 *International Journal of Constitutional Law* (2011).

(8) N. WOODS, *Global Governance after the Financial Crisis: A New Multilateralism or the Last Gasp of the Great Powers?*, 1 *Global Policy* 51 (2010).

ernment's decision (to bailout or not a big financial institution, just to take an example) may affect the economic and financial outcome of other countries. Since September 2008, then, governments realized the existence of relevant spill-over effects of every response to the crisis they were going to adopt, from banks' bailouts to regulatory reform, from recovery policies to fiscal sustainability measures.

At the same time, wary of the near relation of the required decisions to the core of sovereignty, national countries did not want to tie their hands and to commit to some form of legally binding supranational authority. That's why governments developed new forms of cooperation through a «concerted practice» way of action. They assumed purely national decisions that, in some way, appeared similar in conduct and in result. Many Western countries adopted bailouts of banks and other financial institutions, regulatory reforms of financial markets, and recovery programs ([9]). To some extent, these decisions may be considered independent parallel behaviors, each of them rationally satisfying a purely domestic interest. At some points, however, they appeared to be the results of an informal concerted practice, able to combine the resurrected authority of the state with the necessity of supranational cooperation.

From this perspective, the enlarged G-20 summits became the most important forum wherein to share points of view, define common strategies, and assess consistent, even if not compulsory, execution of those strategies by governments. The parallel approval of similar pieces of legislation at national level signaled the willingness of governments to effectively cooperate, though leaving space for opportunistic behaviors.

4. A second changing trend of public law concerns the relationship between national countries and the European Union.

At the beginning, bailout measures in favor of the bank system were purely national. There was no serious effort at coordination at the European level. The «communitarian method» was set apart and the European Commission was located at the margins. The Commis-

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([9]) D.T. Zaring-S.M. Davidoff, *Big Deal: The Government's Response to the Financial Crisis*, *Admin. L. Rev.* 463 (2009), 61 ff.; R.A. Posner, *A Failure of Capitalism: The Crisis of '08 and the Descent into Depression*, Harvard University Press, Cambridge (Mass.), 2009; G. Napolitano, *The role of the State in and after the financial crisis, in Comparative Administratve Law*, ed. by P. Lindseth and S. Rose Ackerman, Edward Elgar, Cheltenham, 2010, 569 ff.

sion succeeded only to establish some minimal rules and requirements on state aids legitimacy. That's why, during the financial crisis, the role of national governments seemed to have increased, at the same time weakening the constraints of European rules and institutions (especially those of the single market).

Nevertheless, two years later, the sovereign debt crisis suddenly required a stronger European Union and a more integrated economic governance. Emergency management institutions, like the European Stabilization Mechanism and the European Financial Stability Facility, were set up. The role of the European Central Bank greatly expanded, through the implementation of a temporary «financial stabilization program», consisting in the purchase of national public debt titles on the secondary market. The stability and growth pact was reformed; a specific «Euro-plus» agreement was reached; and a supplementary treaty in order to reinforce the economic governance was announced.

This new setting implied an increased role of the European Union on topics such as the public debt oversight and the coordination of economic policies. Even if the European Union seemed too slow in properly reacting to the ever changing threats arising from the crisis, the output is a relevant development of its rules and institutions. The permanent nature of the European Stabilization Mechanism gives the E.U. a constitutional 'soul'. It becomes a community not only of benefits, but also of risks, which must be socialized.

The strengthening of the European integration does not necessarily determine a weakening of the authority of national countries. Many tools of the new European economic governance are based on intergovernmental agreements and mutual surveillance among Member States. Decisions to lend money to Member States are submitted to consent at national level. Conversely, countries borrowing money in the framework of the European financial assistance have to adopt a massive legislative and administrative program of structural adjustments in order to comply with the conditions established at the European stage.

In the new Growth and Stability Pact, greater attention is paid to the proper implementation of European targets and obligations at national level. Member States have to approve a draft of the «national program of reform» and have to submit it to the European Union institutions and to the other Member States during the «European semester». The Euro-plus Pact requires that subscribing countries adopt specific provisions in their national constitutions in order to

ensure the full respect of deficit and debt thresholds. Notwithstanding the primacy of European Treaties, national constitutions still matter, also from the perspective of the EU law. But the European Court of Justice can be asked, even by another Member State, to exercise the judicial review over the proper adoption of constitutional amendments.

5. A third fundamental institutional issue concerns the relationship between executives and parliaments.

In the short time management of the financial crisis, the executive played a pivotal role in all countries. Many bailout decisions in favor of financial institutions were taken by the executive on a «de facto» basis to face a sudden emergency. After that, the approval of specific pieces of legislation was needed. Parliaments, then, entered the scene. But they were just asked to delegate a widely discretionary power to the executive, through «black» or at maximum «grey hole» clauses. The power of parliament greatly increased only in those countries, like U.S., where special parliamentary committees were established to conduct investigations on the causes of the financial crisis and to oversight the governmental behavior in managing the emergency.

The sovereign debt crisis is at the origins of other transformations in the relationships between executives and parliaments. The executive has the fundamental responsibility before the international community and the E.U. to announce the adoption of all the measures necessary to restore the stability of the public finance and to ensure its proper implementation. However, the executive needs the consent of the parliament to adopt the announced measures and it can pay a high price for that if the parliament, more sensible to citizens' preferences, votes against. The parliament can lead the executive to resignation and electoral defeat or agree on a new executive based on an enlarged parliamentary majority.

Even in the sovereign debt crisis management, institutional devices agreed at European level among governments must be ratified by national parliaments. Moreover, the intervention of the European Financial Stability Facility and of the European Stabilization Mechanism in individual cases is decided by the Board of governors, composed of the finance ministers of the Member States. But, as required by the German Constitutional Court, the decision of the finance minister must receive the prior approval from the parliament and its budget committee on a case by case basis. The supplementary treaty

on the economic governance and the fiscal pact institutionalize the dialogue between the European Parliament and the budgetary committees of the national parliaments, developing in this specific field the solutions introduced with the Lisbon Treaty.

6. The fourth changing trend of public law regards the relationship between «politicians» and «experts».

Fiscal policy is at the heart of the democratic process. As a consequence, the related decisions are taken by parliament. On the contrary, financial markets' oversight and monetary policy are usually delegated to highly qualified experts, operating within independent financial authorities and central banks ([10]). After the crisis, such a division of competences became less clear, and overlapping increased.

The remedies to financial market's failures were adopted by political actors, not experts. Bailout measures required the expenditure of public money to avoid the clash of systemic financial institutions. That's why only political bodies could have the authority to ask the taxpayers to bear the burden. In this context, independent authorities were simply asked to deliver a technical advice about the existence of the conditions and the requirements needed to grant the public aid. Assuming the political responsibility for the bailout measures and the public opinion discontent for that, the executive assumed the control of the regulatory process, reforming markets and oversight agencies and heading financial stability councils.

At the European level, anyhow, new independent financial authorities were established, strengthening the role of national ones *vis a vis* the executive and making them cooperate in a more effective way. Also the macro-prudential oversight function was delegated to a highly technical body, the European Systemic Risk Board, headed by the president of the European Central Bank.

In facing the sovereign debt crisis and in monitoring the condition of public finance at national level, the role of experts and independent bodies is increasing. Policy decisions, of course, were taken by heads of governments at European and national level. But, due also to the delays in putting into work the financial assistance mechanisms, the

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([10]) The division of tasks rationale is explained by A. Alesina-G. Tabellini, *Bureaucrats or politicians? Part I: A Single Policy Task*, 97 *American Economic Review* 169 (2007); A. Alesina-G. Tabellini, *Bureaucrats or politicians? Part II: Multiple Tasks*, 92 *Journal of Public Economics* 426 (2007).

European Central Bank largely extended its functions. The financial stabilization program adopted by the Bank became a powerful tool to sustain the value of national debt titles and, at the same time, to push reluctant countries to adopt structural reforms.

Moreover, the reformed Growth and Stability Pact and the new Euro-plus Pact require the establishment of independent authorities for statistics and public accounting and reinforce the sanction powers of the European Commission in case of member States' infringements to fiscal sustainability requirements. Criteria and procedures are even stricter in the legal framework of the supplementary Treaty for an enhanced economic governance. The room for political evaluations, anyhow, is opened through the establishment of regular Euro-summit meetings, chaired by the President of the Euro-summit, appointed by the Heads of states and governments.

7. The fifth changing trend concerns the division of powers and competences between central and local governments.

The crisis strengthened the fiscal power of central governments because they were charged with the task of ensuring before international and European institutions the full respect of the public debt and deficit thresholds. As a consequence, the weakening of local institutions was great, because their financial autonomy was highly limited. Moreover, especially in the countries mostly affected by the sovereign debt crisis, it was decided a reduction in the number of local authorities.

At the same time, some countries developed a system of fiscal federalism in order to enhance greater efficiency in the production of public goods and services and in public spending. This way, every citizen could have also the hope — or the illusion — that cuts in public spending would not affect services provided by local authorities, thanking to gains in efficiency. Moreover, if the privatization's process gets unavoidable, especially local communities must be empowered to supply services to the citizens.

8. The last issue is related to the choice between the public and the private sector in the production of goods and services.

At the beginning of the crisis, in 2008 and 2009, through bailouts and recovery programs, the economic role of the state expanded. It purchased stocks in relevant companies, from financial institutions to auto-makers. In some countries, like U.K., the new public ownership

was defined as «temporary», but without any precise time-schedule. That's why, in several countries, governments are still present in many strategic market areas. In the meanwhile, the conflict between the administrative law regulating the state as a stockholder and the common law of commercial companies is increasing.

Suddenly, in 2010, the sovereign debt crisis showed the necessity of downsizing the government, because the market discipline was not making discounts neither to it. The reduction of governmental intervention in some countries was needed because of the conditionality required in the legal framework of the European financial assistance. The agreements reached with the European institutions and the International Monetary Fund obliged the borrowing States to adopt a massive program of privatizations. Similar strategies must be adopted by many Member States in order to comply with the new requirements of fiscal sustainability issued at European level.

As a consequence, the responsibility of delivering general services is shifting to private hands. From this perspective, many questions arise. How far can governments delegate public functions and services to private parties (11)? Will the «big society» prove to be fair and effective (that means capable of satisfying the demands of citizens in a not discriminatory way) (12)? Will the empowerment of communities still remain a public task (played by the «enabling state») and how institutions at central and local level will perform it (13)? Will the civil society be able to supplant the limits and weaknesses of financial regulations? (14)

All these general legal questions become harder to reply in a historical moment in which the financial crisis and the sovereign debt one represent two sides of the same coin. The scarcity of resources limits the capacity both of the public and the private sector. As a

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(11) J. Freeman, *Private Parties, Public Functions and the New Administrative Law*, 52 *Admin. L. Rev.* 813 (2000).

(12) Some critical remarks in M. Loughlin, *Big Government, the Big Society and the British Constitution*, Paper presented at the conference on «The Impact of Economic Crisis on Institutions, University Luiss Guido Carli, Rome, May 23, 2011.

(13) On the origins of the formula, N. Gilbert-B. Gilbert, *The Enabling State: Modern Welfare Capitalism in America*, New York-Oxford, Oxford University Press, 1989.

(14) It's the point raised by R. McCormick, *Towards a more sustainable financial system: the regulators, the banks and civil society*, *Law and Financial Markets Review*, (2011), 129 ff.

consequence, remedies conceived to address one side of the problem immediately affect the other one.

9. If the image of a swinging pendulum fits well the transformations occurring in the public sphere, the output in institutional and economic terms is much more difficult to assess.

The traditional foundations of public law are even more eroded. But also the recent changes of it must be carefully reassessed. New concepts are needed in order to better understand the «concerted practices» way of supranational cooperation; the building up of a «joint sovereignty» at European level and the transformation of the E.U. in a community of risks; the new intertwining between executive and parliament, politicians and experts, central and local governments; the rise of the «enabling» role of the state as a consequence of the greater involvement of the private sector in the exercise of tasks of general interest.

The shifts of sovereignty and power caused by the financial and the sovereign debt crisis, anyhow, cannot be described through the narrative of a «zero-sum» game. There is «more» and «less» state at the same time. Losses and gains of institutional actors don't cope one each other. On the contrary, there is an enrichment of the moves at disposal of the different players and a huge complication of the rules of the game. This means that there is still a lot of work to do for public law scholars.