World Congress of Constitutional Law 2022
Workshop 24 "New Frontiers of Federalism"

Economic policy in a federal state: interstate competition between autonomy and solidarity

Summary of the oral presentation

1. In a federal system, each level of government – the central one and the several states – is in principle vested with a large degree of autonomy, and is allowed to develop the policies it prefers by passing legislation in its field of competence[1].

Since the 2000 decade, there is, within the field of federalist studies, a clear revival of research pertaining to the decentralisation of industrialised states, the influence of the European integration and the development of other international organisations which co-ordinate the policies of nation-states and, eventually, the use of federal mechanisms to manage domestic or ethnic tensions[2]. In this context, we are now witnessing a new massive wave of papers and books on so-called 'plurinational' federalism or on 'regionalism', and this also in the field of fiscal and economic federalism.

If we look more specifically at the process of decentralisation in economic and budgetary matters, one can identify two opposite forces that influence the institutional framework of federal states. On the one hand, there is the global scale, with the increasing role of supranational organizations and international economic regulation; on the other, there is a growing perception that some decisions in the economic field could best be taken by sub-national territories, considering that they are particularly well-placed to respond to local consequences of economic globalization and the decisions made here and there by multinational groups[3]. The idea is that these sub-national territories can best adapt to the situation and design adequate legal framework to ensure local economic development and prosperity[4].

The concept of federalism is one of the privileged expressions of this. There are indeed federal countries, which have a distribution of powers that allow the several states to take a certain range of *decisions of economic policy*. This logic follows the idea that a decentralised and federal model would have an *added value* in the fields of economy and competition. The 'Musgravian' taxonomy (named after Richard Musgrave, 1910-2007), which structures the economic role of the state around three functions (the allocative, the distributive and the macroeconomic and monetary ones), provides a suitable framework theory to discuss the merits of federalism. For some authors, the federal structure stimulates normative competition and ensures the principle of subsidiarity and, according to a liberal philosophy, the

[1] K.C. WHEARE, *Federal Government*, 3rd ed., Oxford, OUP, 1963; G. BERGER et al, *Le Fédéralisme*, Paris, PUF, 1956; C. BEHRENDT and F. BOUHON, *Introduction à la Théorie générale de l'État*, 4th ed., Brussels, Larcier, 2021.

[2] F. LÉPINE, "A Journey through the History of Federalism. Is Multilevel Governance a Form of Federalism?", *L'Europe en Formation*, 2012, pp. 21-62. See for the Spanish and Canadian examples A. LECOURS and F. ROCHER, "Le fédéralisme comme mode de gestion de la diversité : le cas du Canada et de l'Espagne", *Éthique publique*, vol. 9, 2007.

[3] See C. CHAVAGNEUX and M. LOUIS, *Le pouvoir des multinationales*, Paris, Presses universitaires de France, 2018.

[4] See K. OHMAE, "How to invite Prosperity from the Global Economy into a Region", in A. J. SCOTT (ed.), *Global City-Regions, Trends, Theory, Policy*, Oxford, Oxford University Press, 2001, pp. 33-43.

fragmentation of political power. For instance, according to Wallace Oates, federalism can, in economic terms, be seen as the best form of government[5]. In line with this, we can notice that the first theories of regulatory competition originated in the United States – a federal system – and they were thereafter improved by economists who were trying to determine which level of power (the federal one or the several states) is best placed to regulate certain aspects of the economy, such as taxation powers. In doing so, they were coherent with the classical model of fiscal federalism such as developed in the 1950's by Charles Tiebout and its inherent support for decentralized systems[6].

However, competitive federalism gives also rise to various concerns: the constitutional system has to ensure a difficult balance between two poles, the autonomy of each level of power in the country and the necessary economic unity of the country as a whole.

2. As a federal country, Belgium, despite its small size, shows characteristic features related to this discussion.

During the second half of the 20th century, claims for autonomy in the North and South of the country became more pronounced. They led, in 1970s, to the beginning of an unfinished and fragile process traditionally referred to as 'state reform', and which aims at transforming the unitary state into a federal state. This mutation is based on a dual approach for autonomy: cultural and linguistic autonomy based on a community approach on the one hand (powers pertaining to *persons*; 'persoonsgebonden aangelegenheden'), and economic and industrial autonomy linked to a *territory* ('plaatsgebonden aangelegenheden') on the other.

According to this devolution process, the powers related to the public intervention in the field of economy have been progressively distributed between the federal government and the several states. According to the special Act of 8 August 1980 on institutional reforms (articles 6, 6*bis* and 7), the powers recognised to the states are related to the territorial and economic development. They include under more: town planning, environment and water policy, rural renewal and nature conservation, housing, the regional aspects of economy, energy policy, employment policy, public works and transportation, and the administrative supervision of cities and municipalities. There also have the power to lay taxes and to participate in the country's international relations. Indeed, according to article 167 of the Constitution, all federated states are allowed to conclude international treaties, provided that the subject-matter of the treaty in question falls within the area of powers attributed to the states (principle of *in foro interno, in foro externo*).

3. However, the central constitution puts several *limits* to the economic autonomy of the state authorities. The several states may differ in economic profile and wealth, and *both* excessive competition and undue solidarity must be avoided.

In this respect, the Constitution tries under more to preserve national cohesion by impeding excessive inter-state competition. State legislation can indeed have effects which go well beyond the respective state lines, and which can have a negative effect upon legislation of neighbouring states (e.g., in the field of closing hours of shops, state aids, prohibition to sell certain goods, workers' social protection legislation, etc.). While stimulating a certain degree of competition among the several states can represent an added value for the federation as a whole, excessive freedom left to state legislators can turn out to be detrimental. The example of workers' social protection statutes is well known, under more in the US Supreme court case law, but there are many other examples, such as in budget law, etc.[7]

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[5] W. E. OATES, *Fiscal Federalism*, New York, Harcourt Brace Jovanovich, 1972. See also, by the same author, "An Essay on Fiscal Federalism", *Journal of Economic Literature*, 1999, pp. 1120-1149.

[6] C.L. TIEBOUT, "A pure theory of local expenditures", *Journal of Law and Economics*, 1956, pp. 416-424.

[7] C. BEHRENDT and X. MINY, « Les motifs budgétaires dans le contentieux constitutionnel », in L. MEZZETTI and E. FERIOLI, *Giustizia e Costituzione agli albori del XXI secolo*, Bologna, 2018, pp. 393-399.

It is for that reason that in Belgium, several economic instruments have remained in the hands of the central level: the rationale is to avoid counterproductive normative competition. The Act of 8 August 1980 provides twelve areas which remain within the competence of the federal authority (article 6, § 1, VI, paragraph 4). The federal authority is also competent to adopt general rules about public procurement, consumer protection, the general organisation of the economy, and limitations on public subsidies for companies.

Furthermore, the several states have the power to grant direct investment aid to companies (to the extent that such aid is in accordance with EU rules) but *corporate taxation* belongs to the powers of the central government[8]. The mobility of capital, the dangers in terms of tax avoidance and the difficulties relating to the case of big industrial groups explain why the power of corporate taxation has not been attributed to the states but is remained within the scope of the central government.

However, federal constitutional law does not necessarily resort to prohibitions (which forbid states to enact certain statues) but also uses other mechanisms (such as an obligation of prior information of the federal government or the other states, or an obligation of inter-state consultation, etc.) and sets guidelines for what one could call a fair interstate competition. In this respect it is worth noticing that the efficient management of certain topics, particularly in the economic sphere, does not necessarily suit well with a rigid distribution of powers, even if the division of powers in Belgium is based on the principle of exclusivity (meaning that a particular subject-matter does either belong to the federal government or the states, but not to both at the same time).

4. Also, the concept of *federal loyalty* was enshrined in 1993 in article 143, §1, of the Constitution in 1993. In 2004, the Constitutional court held that this principle "implies, for the federal authority and for the several states, the duty not to disturb the balance of the country's construction as a whole, when they exercise their respective powers; it means more than the mere material exercise of powers: it indicates in what spirit this must be done"[9]. The Court also stated that "the principle of federal loyalty, considered together with the principle of reasonableness and proportionality, means that each legislator is required, in the exercise of its own powers, to ensure that its action does not make the exercise of the powers of the other legislators impossible or excessively difficult".

The several components of the Belgian state – the federal government and the different states – also have the possibility to conclude among them *intra*-Belgian treaties, called "cooperation agreements" (*accords de cooperation*, *samenwerkingsakkoorden*) which can be compared to the *interstate compacts* known in US constitutional law. There are also situations in which the conclusion of these cooperation agreements is mandatory.

5. It is also worth mentioning the existence of so-called "mixed international treaties", i.e. treaties that fall within the scope of powers of both the federal and the state legislatures [10]. In the case of a treaty covering federal and federated topics, a procedure providing for consultation and unanimity was developed in the 1990s[11].

6. Moreover, the constitution aims to prevent the several states from breaking with the basic principles of economic organization of the federation as a whole (such as the principle of a free market). This has been called 'the economic constitution', and academic writing has widely

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[8] See E. TRAVERSA, "Le droit fiscal belge entre européanisation et régionalisation", in A. BAILLEUX and M.-C. VAN GRIEKEN, *Liber amicorum Maurice Eloy*, Limal, Anthemis, 2014, pp. 687-704.

[9] Const. court, case no. 119/2004, 30 June 2004.

[10] See C. BEHRENDT and M. MRANCKEN, *Principes de Droit constitutionnel belge*, 2nd ed., Brussels, La Charte, 2021, p. 556, and F. BOUHON and X. MINY, *Introduction au droit public – Considérations générales et particularités belges*, Brussels, Larcier, 2021, pp. 447-452.

[11] The Cooperation Agreement of 8 March 1994 on the conclusion of mixed treaties establishes a permanent "concertation body" which regulates the involvement of all parties concerned in the negotiations. During the negotiations, this "dialogue body" determines which provisions concern which level of government.

addressed this topic[12]. Naturally, there have been various debates about the relationship between concepts of economy, the rule of law, democracy, and parliamentary sovereignty.

7. The concept of "economic constitution" appeared in German literature at the end of the nineteenth and beginning of the twentieth century. It flourished during the period of the Weimar Republic and also after WWII, when it gained significance in the context of European integration and the supremacy of EU law[13]. In this context, it is necessary to examine whether supra-legislative norms – understood as the body of rules and norms that concern the organisation of power – can be considered to protect and promote a certain way of organizing the economy and the market, with a view to making its functioning (more) 'efficient' (with all the subjectivity of judgment which this implies). The concept of "economic constitution" constitutes thus a departure from the basic principles of classic constitutionalism, according to which supra-legislative rules, out of reach of simple parliamentary majorities, govern relations between powers and between citizens and powers[14]. However, for some theorists, especially Friedrich von Hayek, the federal structure of a state is in itself a method capable of safeguarding a free market, precisely by limiting the state's interventionist capacities. Indeed, the competition that economic federalism permits presupposes a free-market logic and not a collectivist one.

In Belgium, it is precisely during the process of federalisation of the state that explicit rules inspired by liberal (or neo-liberal) economic doctrines have appeared. While the Constitution remains relatively neutral on this point, as the Constitutional court recently pointed out[15], the freedom of trade and industry has been recognised since 1988, through article 6, § 1, VI, paragraph 3, of the Act of 8 August 1980, as a main principle for the exercise of powers by all Belgian authorities. Also, the Constitutional Court has stressed the centralising role played by this provision, in pointing out that it "reflects Parliament's intention to maintain a uniform basic regulation of the organisation of the economy in an integrated market"[16]. The Court also verifies that state enactments comply with this this principle.

Moreover, the freedom of trade and industry, which protects entrepreneurial freedom and free competition, is enshrined in the federal Code of Economic Law (Article II.3). While it does not have *as such* the status of a constitutional provision, the Constitutional court accepted to *combine it* with the constitutional principle of equality and non-discrimination, so that it was indirectly elevated to this status[17]. The principle of freedom of trade and industry is moreover protected by supranational and European rules. Indeed, European integration is the other major driving force behind the implementation of economic and budgetary rules in domestic law, particularly regarding deficit and debt limitation. Belgium ratified the Treaty on Stability, Coordination and Governance in Economic and Monetary Union (TSCG) on 28 March 2014. To respect it, the intra-Belgian cooperation agreement of 13 December 2013 concluded by the federal government and the different federated entities was approved by the parliaments.

8. In the foregoing paragraphs, we have tried to show that the relationship between federalism and the economy is interesting in several ways.

On the one hand, it is important to maintain *mechanisms of solidarity* in order to avoid the dissolution of the federal union. On the other, the federal framework can also be mobilised to consolidate a given set of economic principles, which can be called the 'economic constitution' of a country.

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[12] See recently L. FONTAINE, *Capitalisme, libéralisme et constitutionnalisme*, Paris, Mare & Martin, 2021.

[13] See more in detail, with critical analysis, G. GRÉGOIRE and X. MINY, *The Idea of Economic Constitution in Europe*, Leyden, Brill, 2022.

[14] See D. GRIMM, *Constitutionalism – Past, Present and Future*, Oxford, OUP, 2016.

[15] Const. court, case no. 66/2015, 21 May 2015. See also P. NIHOUL, *Éléments de droit public de l'économie*, Brussels, Larcier, 2017, pp. 26–27.

[16] Const. court, case no. 83/2010, 8 July 2010

[17] Const. court, case no. 50/2015, 30 April 2015.

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