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Osaka University
The Spanish Constitutional Reform as a Consequence of the Economic Crisis and the Budgetary Stability

Ramón Vilarroig MOYA*

ABSTRACT
In this paper, we are going to discuss what led Spain to carry out a constitutional reform. The reform that occurred was voted in with a large majority, however it also received a lot of criticism from the formal aspect and opportunity.

The reform was brought on because of the economic crisis and the European conception of facing it. The aim was to combat the crisis from economic principles such as budgetary stability. The European Union requires Member States to meet deficit and debt requirements. The ratio of the annual government deficit to gross domestic product (GDP) should not exceed 3% at the end of the preceding financial year and the ratio of gross government debt to GDP should not exceed 60% at the end of the preceding financial year. Being outside such ratios can even entail sanctions.

At the end of the article an analysis of the Japanese financial situation can be found, where the difference in debt ratios that far exceed the limits envisaged by the European Union can be seen.

KEY WORDS
Budgetary Stability, Financial sustainability, Constitutional Reform

I. INTRODUCTION
The sustained economic downturn occurring both in Europe and around the world has also been perceived in Spain. There have been legislative changes to tackle the crisis and appease the financial markets.

However, all European countries have limits to undertaking the crisis because of the constraints imposed by European legislation.

In this paper, we will analyze the rules and principles that have been established by the European Union and what actions can be taken by the Member

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States, especially deals that are outside its scope to confront the economic crisis.

The main principle that must be studied is the budgetary stability recognized by the European Union treaties and imposed to all Member States.

II. THE EUROPEAN UNION’S LEGAL FRAMEWORK FOR CURBING THE ECONOMIC CRISIS

II.1. EUROPEAN TREATIES

The main treaties referred to by the European Union are:

1. The Treaty on European Union (TEU) – Maastricht Treaty –
2. The Treaty on the Functioning of the European Union (TFEU)

The Treaty on European Union (TEU) was created to meet the following principles (Article 2 original TEU):

- Promote harmonious and balanced development of economic activities,
- Sustainable and non-inflationary growth respecting the environment,
- A high degree of convergence of economic performance,
- A high level of employment and of social protection,
- The raising of standard of living and quality of life, and
- Economic and social cohesion and solidarity among Member States.

To achieve those principles, it was considered necessary to establish a common market and an economic and monetary union. In this sense, the Union represented a new stage in European integration since it opens the way to economic and political integration. Nevertheless, the economic, political and monetary union vary from one another1).

There have been several important amendments to the original Treaty that we resume in the following table2):

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1) The Economic Union, the Monetary Union and the Political Union are three desires that have transited through different paths and times. As Ruiz Almendral points out: “There is no doubt that the Maastricht Treaty meant a change of direction in European integration. The idea of a political integration (an ever-closer union) led to an expansion of the issues which was to be the subject of regulation by the Union. It opens the way directly for a higher communitari-

Treaties

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<td>Treaty on European Union (Treaty on Maastricht)</td>
<td>7.2.1992</td>
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<td>Treaty of Amsterdam</td>
<td>2.10.1997</td>
<td>1.5.1999</td>
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<td>Treaty of Nice</td>
<td>26.2.2001</td>
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There are also several treaties of accession that have permitted several States access to the European Union:

Treaty of Accession

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<td>Treaty of Accession of Austria, Finland and Sweden³)</td>
<td>24.6.1994</td>
<td>1.1.1995</td>
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<td>Treaty of Accession of the ten new Member States⁴)</td>
<td>16.4.2003</td>
<td>1.5.2004</td>
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<tr>
<td>Treaty of Accession of Bulgaria and Romania⁵)</td>
<td>25.4.2005</td>
<td>1.1.2007</td>
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Notwithstanding, the amendments introduced by the different Treaties, the goal of an economic Union and a common market based on balanced economic growth and price stability remains today.

The Economic and Monetary Union (EMU) puts the finishing touches to the single market. Economic policy consists of three components.

1. The Member States must ensure coordination of their economic policies,
2. Provide for multilateral surveillance of this coordination, and
3. The members are subject to financial and budgetary discipline.

The objective of monetary policy is to create a single currency and to ensure this currency’s stability thanks to price stability and respect for the market economy⁶).

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³) Treaty of Accession of Austria, Finland and Sweden (1994), which increased the number of Member States of the European Community to fifteen.

⁴) Treaty of Accession of Cyprus, Estonia, Hungary, Latvia, Lithuania, Malta, Poland, the Czech Republic, Slovakia and Slovenia (2003). This Treaty increased the number of Member States of the European Community from 15 to 25.

⁵) Treaty of Accession of Bulgaria and Romania (2005). This Treaty increased the number of Member States of the European Community from 25 to 27.

⁶) The Treaty provides for the establishment of a single currency in three successive stages:
Monetary policy is based on the European System of Central Banks (ESCB), consisting of the Central European Bank (CEB) and the national central banks. These institutions are independent of the national and community political authorities.

The EMU requires that the different State Members sacrifice part of their sovereignty in order to be subject to the European Union directives.

Therefore, the treaties have created guidelines to achieve the convergence criterion of public finances in order to limit the fiscal capacity of governments in terms of public spending and healthy public accounts.

The convergence criteria are (Article 140 TFEU):

1. A high degree of price stability. In practice, the inflation rate of a given Member State must not exceed by more than 1.5 percentage points that of the three best-performing Member States in terms of price stability during the year preceding the examination of the situation in that Member State\(^7\).

2. The sustainability of the government financial position\(^8\). In practice, the Commission, when drawing up its annual recommendation to the Council of Finance Ministers, examines compliance with budgetary discipline on the basis of the following two criteria\(^9\):

- **The annual government deficit**: the ratio of the annual government deficit to gross domestic product (GDP) **must not exceed 3%** at the end of the preceding financial year. If this is not the case, the ratio must have declined substantially and continuously and reached a level close to 3% or, alternatively, must remain close to 3% while representing only an

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\(^7\) Article 1 of Protocol number 13 TEU.

\(^8\) The sustainability of the government financial position; this will be apparent from having achieved a government budgetary position without a deficit that is excessive as determined in accordance with Article 126 TFEU.

\(^9\) Art. 1 of Protocol number 12 TEU is the one which includes the references mentioned of excessive deficit.

“The reference values referred to in Article 126 (2) of this Treaty on the Functioning of the European Union are:

- 3% for the ratio of the planned or actual government deficit to gross domestic product at market prices;
- 60% for the ratio of government debt to gross domestic product at market prices”.

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exceptional and temporary excess;

- **government debt**: the ratio of gross government debt to GDP **must not exceed 60%** at the end of the preceding financial year. If this is not the case, the ratio must have sufficiently diminished and must be approaching 60% at a satisfactory pace.

3. Exchange rates. The observance of the normal fluctuation margins provided for by the Exchange Rate Mechanism of the European Monetary System\(^{(10)}\). The Member State must have participated in the exchange-rate mechanism of the European monetary system without any break during the two years preceding the examination of the situation and without severe tensions. In addition, **it must not have devalued its currency** (i.e. the bilateral central rate for its currency against any other Member State’s currency) on its own initiative during the same period. After transition to stage three of EMU, the European Monetary System was replaced by the new exchange-rate mechanism (ERM II).

4. The durability of convergence\(^{(11)}\). In practice, the nominal long-term interest rate must not exceed by more than 2 percentage points that of, at most, the three best-performing Member States in terms of price stability (that is to say, the same Member States as those in the case of the price stability criterion). The period taken into consideration is the year preceding the examination of the situation in the Member State concerned.

The observance of the mentioned criteria is regulated in Article 126 TFEU where it is required that the Commission monitors the budgetary situation of Member States. Especially regarding two factors; public deficit and public indebtedness\(^{(12)}\).

10) The observance of the normal fluctuation margins provided for by the Exchange Rate Mechanism of the European Monetary System, for at least two years, without devaluing against the currency of any other Member State (Article 140 TFEU).

11) The durability of convergence achieved by the Member States and of its participation in the Exchange Rate Mechanism of the European Monetary System being reflected in the long-term interest rate levels (Article 140 TFEU).

12) Art. 126.c (2) TFEU:

“2. The Commission shall monitor the development of the budgetary situation and of the stock of government debt in the Member States with a view to identifying gross errors. In particular, it shall examine compliance with budgetary discipline on the basis of the following two criteria:

(a) whether the ratio of the planned or actual government deficit to gross domestic product exceeds a reference value, unless..."
II.2. EUROPEAN PRINCIPLES.

As provided in Article 3 TEU the European Union must provide sustainable development based on balanced economic growth and price stability:

“The Union shall establish an internal market. It 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 promote scientific and technological advancement.

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.

It shall respect its rich cultural and linguistic diversity, and shall ensure that Europe’s cultural heritage is safeguarded and enhanced.”

In a similar way, Article 119.3 TFEU recognizes the budgetary stability:

“1. For the purposes set out in Article 3 of the Treaty on European Union, the activities of the Member States and the Union shall include, as provided in the Treaties, the adoption of an economic policy which is based on the close coordination of Member States’ economic policies, on the internal market and on the definition of common objectives, and conducted in accordance with the principle of an open market economy with free competition.

2. Concurrently with the foregoing, and as provided in the Treaties

- either the ratio has declined substantially and continuously and reached a level that comes close to the reference value;
- or, alternatively, the excess over the reference value is only exceptional and temporary and the ratio remains close to the reference value;

(b) whether the ratio of government debt to gross domestic product exceeds a reference value, unless the ratio is sufficiently diminishing and approaching the reference value at a satisfactory pace. The reference values are specified in the Protocol on the excessive deficit procedure annexed to this Treaty”.
and in accordance with the procedures set out therein, these activities shall include a single currency, the euro, and the definition and conduct of a single monetary policy and exchange-rate policy the primary objective of both of which shall be to maintain price stability and, without prejudice to this objective, to support the general economic policies in the Union, in accordance with the principle of an open market economy with free competition.

3. These activities of the Member States and the Union shall entail compliance with the following guiding principles: stable prices, sound public finances and monetary conditions and a sustainable balance of payments.”

To achieve these goals, especially those aimed at balanced economic growth, the EU has some exclusive competences and other competences that are shared with the Member States.

The Union shall have exclusive competences in the following areas (Article 3 TFEU):

(a) customs union;
(b) the establishing of the competition rules necessary for the functioning of the internal market;
(c) monetary policy for the Member States whose currency is the euro;
(d) the conservation of marine biological resources under the common fisheries policy;
(e) common commercial policy.
(f) the Union shall also have exclusive competence for the conclusion of an international agreement

The Union shall share competences with the Member States in the following areas:

(a) internal market;
(b) social policy, for the aspects defined in this Treaty;
(c) economic, social and territorial cohesion;
(d) agriculture and fisheries, excluding the conservation of marine biological resources;
(e) environment;
(f) consumer protection;
(g) transport;
(h) trans-European networks;
(i) energy;
(j) area of freedom, security and justice;
(k) common safety concerns in public health matters, for the aspects defined in this Treaty.

In conclusion, the Member States whose currency is the euro cannot use monetary policies to face the economic crisis because that policy depends exclusively on the European Union. In this way, Member States cannot issue currency or devalue the currency to deal with the crisis.

Furthermore, Member States must respect some principles in order to achieve the objectives of the European Union, such as budgetary stability, which means additional restrictions to the competences of Member States.

If Member States cannot incur a structural deficit that exceeds the limits established by the European Union, when their income decreases the level of expenses should be reduced to the same extent.

The control of the limits of public deficit and public indebtedness is held by the Commission\(^\text{(13)}\).

All Member States must respect the convergence criteria previously mentioned and there is no possibility of Union’s financial assistance except in the case of natural disasters\(^\text{(14)}\).

Recently, on June 23, 2016, a referendum was held in the United Kingdom where they decided whether to leave the European Union, known as “Brexit”. From this, the UK decided to leave the European Union\(^\text{(15)}\) and therefore do not

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13) Art. 126.2 TFUE: “The Commission shall monitor the development of the budgetary situation and of the stock of government debt in the Member States with a view to identifying gross errors. In particular it shall examine compliance with budgetary discipline (…)”.

14) Art. 122.2. TFUE: “Where 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. The President of the Council shall inform the European Parliament of the decision taken”.

15) To leave the European Union, the United Kingdom has to invoke an agreement regulated in Article 50 of the Lisbon Treaty which gives the two sides two years to agree the terms of the split. Theresa May (current Prime Minister of the United Kingdom) has said that she intends to trigger this process by the end of March 2017, meaning the UK will be expected to have left by the summer of 2019, depending on the precise timetable agreed during the negotiations.
apply all the principles vinculated with the Union.

II.3. STABILITY AND GROWTH PACT (SPG)-1997-

In order to strengthen the coordination and control of the economic and budgetary policies of the EU Member States and to ensure compliance with the margins of deficit and public debt established by the Maastricht Treaty, the SPG was drawn up\(^\text{16}\).

The Stability and Growth Pact (SGP) is a set of rules designed to ensure that countries in the European Union pursue sound public finances and coordinate their fiscal policies.

With this Pact, Member States are able to respect the medium-term budgetary objectives set out in their stability or convergence programs to achieve budgetary positions close to balance or in surplus. They are also able to take any corrective budgetary measures they deem necessary to achieve the objectives set in their stability and convergence programs, as soon as they have information showing significant divergences, both actual and foreseen, with respect to those objectives.

Some of the SGP’s rules aim to prevent\(^\text{17}\) fiscal policies from heading in potentially problematic directions, while others are there to correct\(^\text{18}\) excessive


\(^{17}\) Cerón Cruz and Fuente del Moral assert, as a preventive measure, each year the States submit a document called the Stability Program (if the State is part of the euro) or Convergence Program (if not) to the Commission in which they present the information and forecasts of their economic and fiscal policies. As it was established that the medium-term budgetary objective should be close to “balance or in surplus”, they should spell out the plan of action to achieve this objective. The somewhat diffuse formulation of the medium-term objective allows States to vary their budgets in line with the business cycle. The programs submitted by the countries are examined by the Council of the European Union which, after consultation with Ecofin, issues a document with its opinion and recommendations (Cerón Cruz, J.A.; Fuenes del Moral, F.: “The fiscal policy of the European Union in the face of the economic crisis”. Communication presented at the XII Meeting of World Economy (International Congress of Economy of Santiago de Compostela. Available at: http://e-archivo.uc3m.es/bitstream/handle/10016/15826/politica_ceron_2010.pdf?sequence=5 [Accessed November 13, 2016])

\(^{18}\) In the ‘corrective arm’ of the SGP, the Excessive Deficit Procedure (EDP) ensures the
budget deficits or excessive public debt burdens\(^{19}\). There are also rules to enforce or sanctions States members.

However, we share the opinion of Ruiz Almendral who indicates that the sanctions were not excessively credible since the hardest sanction is that which can be imposed by the markets themselves\(^{20}\).

The Council is committed to rigorous and timely implementation of all elements of the stability and growth pact in its competence and in addition is:

- urged to regard the deadlines for the application of the excessive deficit procedure as upper limits;
- invited always to impose sanctions if a participating Member State fails to take the necessary steps to bring the excessive deficit situation to an end and to apply rigorously the whole range of sanctions provided for;
- invited always to state in writing the reasons which justify a decision not to act.

In September 2004, the Commission reacted to this and to the debate surrounding the stability and growth pact by issuing a communication on strengthening economic governance and clarifying the implementation of the Stability and Growth Pact. It proposes a series of improvements to the pact. The Commission focuses particularly on the trend in economic factors in the Member States and the long-term sustainability of public finances.

At the European Council of 22 and 23 March 2005 the Finance Ministers reached a political agreement on better management of the stability and growth pact\(^{21}\).

\(^{19}\) correction of excessive budget deficits or excessive public debt levels. It is a step-by-step approach for reining in excessive deficits and reducing excessive debts
\(^{20}\) Ruiz Almendral, V.: *Estabilidad presupuestaria y gasto público en España*, *op. cit.*, p. 91.
II.4. ECONOMIC GOVERNANCE (SIX PACT\textsuperscript{22}) -2011-

The Six Pact was published the day after Spain published the reform of Article 135 of the Constitution in the BOE.

The Six Pact has three purposes:
1. Guarantee fiscal discipline
2. Stabilize economies
3. Avoid future crises.

As a response to weaknesses in its economic governance system revealed by the economic and financial crisis, the EU has taken a wide range of measures to strengthen economic governance and to achieve sustained convergence, economic growth and jobs. Central to these efforts have been the legislative packages known as the six-pack and two-pack.

The four objectives to be achieved with the Six Pact commitments are:
1. Boosting competitiveness
2. Promote employment
3. Contribute to the sustainability of public finances
4. Strengthening financial stability

With a focus on financial stability, this Pact seeks to ensure that the different constitutions of Member States incorporate the Community legislation contained in the Stability Pact.

- A reinforced economic agenda with closer EU surveillance. This includes agreed policy priorities and targets as part of the Europe 2020 strategy; additional commitments taken by Member States participating in the Euro Plus Pact; tighter EU surveillance of economic and fiscal policies as part of the Stability and Growth Pact and through new tools to tackle macro-economic imbalances; and a new working method – the European semester – to discuss economic and budgetary priorities at the same time every year.
- Action to safeguard the stability of the euro area. In 2010, the EU responded to the sovereign debt crisis by setting up temporary support mechanisms for its Member States, which will be replaced by the permanent European Stability Mechanism (ESM) in 2013. These support

\textsuperscript{22}The Six Pact consists of a comprehensive package of measures adopted by the European Parliament and endorsed by the Council and consists of five Regulations and a Directive which entered into force on December 13, 2013. The Regulations are: EU 1175/2011 and 177/2011) that modify the preventive and corrective aspects of the SGP; Whereas the EU regulations 1173/2011 and 1174/2011 have a clear sanctioning orientation. Finally, there is Council Directive 2011/85/EU on budgetary frameworks of the member States.
measures are conditional on rigorous fiscal consolidation and reform programs, and are developed in close cooperation with the IMF.

• Action to repair the financial sector.

II.5. EUROPEAN STABILITY MECHANISM

Another aspect of the European economic governance reform is the constitutionalisation of a bailout fund for States with financial difficulties\(^{23}\).

In Article 136 of the TFEU a new third paragraph was added with the aim of establishing a stability mechanism for the Member States whose currency was the euro. Access to this mechanism and aid was subject to stringent conditions.

On 2 February, 2012, the Treaty establishing the ESM was signed and the reform of the TFEU was implemented. It is set up as an international financial institution located in Luxembourg City as a permanent firewall for the Eurozone, to safeguard and provide instant access to financial assistance programs for member states of the Eurozone in financial difficulty.

In order to be eligible for aid, the Treaty on Stability, Coordination and Governance must be ratified, and the rule of budgetary balance must be constitutionalised.

The lending capacity of the MEDE is conditional on the ratification of the Stability Treaty Coordination and Governance, as well as the constitutionalisation of the norm of budgetary balance\(^{24}\). The ESM has 80,000 million euros of disbursed capital and has a subscribed capital of 700,000 million euros. This capital gives it an effective lending capacity of 500,000 million euros\(^{25}\).

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23) García Roca and Martínez Lago indicate that MEDE is: “an instrument that has undergone constant changes of conception and quantity by the very dynamics of the crisis. First, a system of bilateral loans was adopted for States affected by the public debt crisis that would later lead to the creation of the European Financial Stability Facility (EFSF) to deal with the first crisis in Greece. This fund remained active until June 30, 2013.

The “European Financial Stability Mechanism” was then developed by developing the new Article 136.3 TFEU provision.

Finally, the European Stability Mechanism (ESM) arrived, developing the forecast of the new Article 136.3 TFEU (García Roca, J.; Martínez Lago, M. A.: Estabilidad presupuestaria y consagración del freno constitucional al endeudamiento, Civitas, Pamplona, 2013, p. 48).


25) The ESM can provide financial assistance through the following financial instruments:

• Conventional loans as part of a macroeconomic adjustment program.
• Purchase of sovereign debt in the primary and secondary markets.
II.6. FISCAL COMPACT (TREATY ON STABILITY COORDINATION AND GOVERNANCE IN THE ECONOMIC AND MONETARY UNION) –TSCG–

The Fiscal Compact is an intergovernmental agreement signed on March 2, 2012, by 25 heads of state or government of Union countries (except the United Kingdom and the Czech Republic)\(^\text{26}\).

Article 1 of the Treaty states that:

“By this Treaty, the Contracting Parties agree, as Member States of the European Union, to strengthen the economic pillar of the economic and monetary union by adopting a set of rules intended to foster budgetary discipline through a fiscal compact, to strengthen the coordination of their economic policies and to improve the governance of the euro area, thereby supporting the achievement of the European Union’s objectives for sustainable growth, employment, competitiveness and social cohesion”.

It is therefore intended to strengthen economic and monetary union on the basis of budgetary discipline.

Article 3 indicates that contracting parties must have a balanced budget or a surplus and a lower structural deficit limit set to reach 0.5% of GDP, although this deficit may reach 1% if public debt is significantly below 60%.

However, temporary deviations are allowed when there are exceptional circumstances which, because of their unusual nature are beyond the control of States, seriously affect their financial situation and periods of severe economic recession\(^\text{27}\). We could say that a year ago, on November 11, 2015, the terrible

\(^{\text{26}}\) Spain authorized the ratification of the Treaty by means of the processing of Organic Law 3/2012, of July 25.

\(^{\text{27}}\) Art. 2 Fiscal Compact: “2. The rules set out in paragraph 1 shall take effect in the national law of the Contracting Parties at the latest one year after the entry into force of this Treaty through provisions of binding force and permanent character, preferably constitutional, or otherwise guaranteed to be fully respected and adhered to throughout the national...
attack in France that took place in Bataclan, was considered an exceptional circumstance.

García Roca y Martínez Lago state: “It should be emphasized that this whole European legal framework for discipline, coordination and indebtedness imposed on internal officers, and of which the TECG represents a twist, or its level of detail and concreteness, leaves little room for maneuver to the Constitutions and internal laws. The States simply moved the same rules and procedures of correction, mimicking the normative framework that has been realized. (...) While the maneuverability of governments is maintained and the importance of democratically elected parliaments is minimized.”

These authors criticize that: “the whole system of budgetary stability is determining a clear limitation on the autonomy of national parliaments in budgetary matters.” (…)

This discouraging panorama deserves to be rethought, since the measures that have been orchestrated to overcome the seriousness of the present crisis do not demonstrate its capacity to address the demands presented by the different economic areas. In view of the little ingenuity required by accounting verification and the statistical evaluation of figures and ceilings imposed on public finances, the value of political decisions that need sound parliamentary frameworks should be regained, both within Europe and within States of the Union. Where is representative democracy in this scenario?28)

III. THE SPANISH CONSTITUTIONAL REFORM

III.1. SPANISH LEGAL FRAMEWORK

The evolution of the Spanish regulation in terms of budgetary stability is as follows:

First of all, Law 18/2001, of December 12, General of Budgetary Stability was approved. This rule was established with the aim of creating the guiding

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principles to which the budgetary policy of the Spanish public sector should be adapted in order to achieve economic stability and growth within the framework of the Economic and Monetary Union, as well as the determination of the procedures necessary for the effective implementation of the principle of budgetary stability, in accordance with the principles derived from the Stability and Growth Pact, and by virtue of the State’s competence with respect to the bases and coordination of the overall planning of economic activity.

With Law 18/01, an Organic Law was approved; LO 5/2001, December 13. The Organic Law established the coordination mechanisms between the State Treasury and the Autonomous Communities in budgetary matters. This topic is reserved to Organic Law and cannot be regulated by an ordinary Law.

As evident, the regulation of budgetary stability rules began in Spain as a result of the approval of the Stability Pact. It was a rule that went beyond the budget deficit, but not in excessive, because it intended there to be no deficit.

This first rule was approved by the governing Popular Party. So, when the Socialist Party came to power, they amended the Stability Law with the aim of seeking budgetary stability in the budget cycle. The rule that introduced the change was Law 15/2006, of May 26

On September 27, 2011, the constitutional reform took place, shortly before the adoption of the Six Pack Regulations.

Finally, Organic Law 2/2012, of April 27, Law on Stability and Financial Sustainability was approved, which complies with the constitutional mandate to approve a new Organic Law. This standard has recently been reformed by the Organic Law 1/2016, of October 31, reforming the Organic Law 2/2012, of April 27, on Budgetary Stability and Financial Sustainability.

III.2. CONSTITUTIONAL REFORM. NEW ART. 135 CE

1. Constitutional Procedure

On September 27, 2011, the reform of Article 135 of the Spanish Constitution was carried out in Spain with a broad consensus of the political

29) Subsequently, a Royal Legislative Decree was approved, 2/2007, of December 28, approving the Consolidated Text of the General Law on Budgetary Stability.

30) The (new) Article 135 of the Constitution was approved well before the signing and ratification of the Fiscal Compact, whose Article 3(2) establishes that the contracting States shall approve: “provisions of binding force and permanent character, preferably constitutional, or otherwise guaranteed to be fully respected and adhered to throughout the national budgetary processes”.
forces with 316 deputies voting in favor and only 5 against.

The reform of the Constitution is regulated in Articles 166 to 169 of the Constitution. The process of constitutional reform, as usual, is complex and requires special majorities, due to the importance of the norm that it is intended to modify.

However, the process of constitutional reform in Spain has been very quick and, perhaps for that reason, very controversial.

The first controversy arose from the constitutional procedure chosen since the reform was made under Article 167 of the Constitution\(^\text{31}\) that requires a 3/5 majority, and not by the procedure of Article 168\(^\text{32}\) which is to be used when amending the Preliminary Title, the Second Chapter, the First Section of Title I (referring to fundamental rights and public freedoms), or Title II (referring to the Crown), which requires the Ratification by referendum once the reform is approved by the Cortes Generales.

The choice of Article 167 EC brought about the lodging of an amparo appeal, 5241-2011, promoted by Deputies of the Parliamentary Group Esquerra Republicana Izquierda Unida-Iniciativa Per Catalunya Verds.

The question of unconstitutionality was not admitted by the Constitutional

\begin{itemize}
  \item \textbf{Article 167 Spanish Constitution:}
    \begin{enumerate}
      \item Bills on Constitutional amendment must be approved by a majority of three-fifths of the members of each Chamber. If there is no agreement between the Chambers, an effort to reach it shall be made by setting up a Joint Commission of Deputies and Senators which shall submit a text to be voted on by the House of Representatives and the Senate.
      \item If adoption is not obtained by means of the procedure outlined in the foregoing paragraph, and provided that the text has obtained a favourable vote by an absolute majority of the Senate, the House of Representatives may approve the amendment by a two-thirds vote.
      \item Once the amendment has been passed by the Parliament, it shall be submitted to a referendum for its ratification, if so requested by one tenth of the members of either Chamber within fifteen days after its passage.
    \end{enumerate}
  \item \textbf{Article 168 Spanish Constitution:}
    \begin{enumerate}
      \item When a total revision of the Constitution is proposed, or a partial revision thereof, affecting the Preliminary Title, Chapter II, Section 1 of Title I, or Title II, the principle shall be approved by a two-thirds majority of the members of each Chamber, and the Parliament shall immediately be dissolved.
      \item The Chambers elected must ratify the decision and proceed to examine the new Constitutional text, which must be approved by a two-thirds majority of the members of both Chambers.
      \item Once the amendment has been passed by the Parliament, it shall be submitted to ratification by referendum.
    \end{enumerate}
\end{itemize}
Court’s Order 9/2012, of January 13.

2. The opportunity of the reform

Apart from the procedural question, which has received harsh criticism from the doctrine\textsuperscript{33}, questions have also been raised about the need for such reform\textsuperscript{34}.

But there is no doubt that the reason for the constitutional reform must be sought in the high-risk premium of the Spanish bond and in what seemed to be an imminent situation of financial rescue for Spain, which did not occur.

Regarding the constitutional reform, Ruiz Almandral has written that: the reform was a speedy reaction to the unsustainably high cost of Spanish bond yields, which had climbed to 7\% interest rate during August 2011. This constitutional reform was primarily intended to ‘appease’ financial markets and instill credibility in the Spanish economic system. The new Article 135 refers to a future ‘organic law’ to fully implement the new measures. On 27 April 2012, Organic Law 2/2012, (Law on Budgetary Stability and Financial Sustainability) was approved to this end\textsuperscript{35}.

3. Content of the reform

Article 135 of the Spanish Constitution after the reform is as follows:


34) In Jimena’s words: "I consider that reform was by no means legally necessary, but rather the consequence of a state of economic and political necessity caused by an addiction to irresponsibility in decision-making and academic pusillanimity in activity researcher; On the one hand, the reform of Article 135 EC responds to an economic requirement imposed in fact on Spain as a member of the Club of the Twenty-Seven (and the seventeenth of the euro zone), and not as Regulation of EU law. And, on the other hand, this reform entails an inflection in our historical constitutionalism that is not justified either by the current economic and financial crisis or by the recent supranational European integration, since the fundamental problem of budgetary balance and responsibility in the Public debt is classic. (Jimena, Luis: “The reform of article 135 of the Spanish Magna Carta (The overcoming of the clichés of the taboo and constitutional rigidity”, Constitutional Theory and Reality, no. 30, 2012, p. 339).

1. All public administrations will conform to the principle of budgetary stability.

2. The State and the Self-governing Communities may not incur a structural deficit that exceeds the limits established by the European Union for their member states. An Organic Act shall determine the maximum structural deficit the state and the Self-governing Communities may have, in relation to its gross domestic product. Local authorities must submit a balanced budget.

3. The State and the Self-governing Communities must be authorized by Act in order to issue public debt bonds or to contract loans. Loans to meet payment on the interest and capital of the State’s Public Debt shall always be deemed to be included in budget expenditure and their payment shall have absolute priority. These appropriations may not be subject to amendment or modification as long as they conform to the terms of issue. The volume of public debt of all the public administrations in relation to the State’s gross domestic product may not exceed the benchmark laid down by the Treaty on the Functioning of the European Union.

4. The limits of the structural deficit and public debt volume may be exceeded only in case of natural disasters, economic recession or extraordinary emergency situations that are beyond the control of the State and significantly impair either the financial situation or the economic or social sustainability of the State, as determined by an absolute majority of the members of the Congress of Deputies.

5. An Organic Act shall develop the principles referred to in this article, as well as participation in the respective procedures of the organs of institutional coordination between government fiscal policy and financial support. In any case, the Organic Act shall address: a) The distribution of the limits of deficit and debt among the different public administrations, the exceptional circumstances to overcome them and the manner and time in which to correct the deviations of each other. b) The methodology and procedure for calculating the structural deficit. c) The responsibility of each public administration in case of breach of budgetary stability objectives.

6. The Self-governing Communities, in accordance with their respective laws and within the limits referred to in this article, shall take the appropriate procedures for effective implementation of the principle of
stability in their rules and budgetary decisions.

Until the constitutional reform, Article 135 indicated that the Government had to be authorized by Law to issue Public Debt or to issue credit and that the credits to meet the payment of interest and capital of the State Public Debt were always understood to be included in the State of budgeted expenses and could not be subject to amendment or modification.

However, the reform begins by indicating that all Public Administrations will adapt their actions to the principle of budgetary stability. Let us remember that this principle was already in force in our legal system.

Nevertheless, the first time that budgetary stability in Spain was regulated, the macroeconomic situation was good and there were no crisis tensions, such as problems with the deficit or debt, and neither the State Administration nor the Autonomous Administrations generated a serious debate about stability 36).

The first aspect that highlights the Constitution is that all Public Administrations will adapt their actions to the principle of budgetary stability. Not only the State Administration, but also the Autonomous and local Administrations. Therefore, there is an important limit to the financial autonomy of the Autonomous Communities established in Article 156 EC.

36) In 2001, the ‘internal stability pact’ set strict deficit limitations for budgetary policy. In practice, the 2001 laws radically changed how the central government’s budget was designed and applied, and as a result, the question of indebtedment slowly began to creep into the financial agreements with the autonomous communities. But the question of curbing the deficit was not the main purpose of these financial agreements, which determine how communities are financed. It can in fact be argued that the 2001 internal stability pact did not provide sufficient incentives to strictly enforce the rules, which to some extent had no teeth, so that no real sanctions were imposed upon autonomous communities that failed to meet the deficit targets. Also, the rules only addressed the deficit, not the debt, so that communities were also able to increase their debt burden with relative freedom. Despite the obvious shortcomings of the existing legal regime, in the period 1997-2007 deficit and indebtedment were low and there was not much debate, in political or academic circles, on the subject. This was probably also due to the relatively good shape of Spain’s finances in that period. In fact, the only ongoing debate concerned the question of whether the central government had the authority to impose debt and deficit limits on autonomous communities and local entities (see infra). It is not an overstatement to say that until 2010, there were barely even academic seminars on the subject of the internal stability pact and discussions on the financing system of autonomous communities typically ignored the debt and deficit figures. In this context, the hasty approval of Article 135 of the Spanish Constitution was not subject to much previous debate either (Ruiz Almendral, V.: “The Spanish Legal Framework for Curbing the Public Debt and the Deficit”, European Constitutional Law Review, 9, 2013, pp. 192-193).
This limit, also reflected in the prohibition that the State or the Autonomous Communities incur structural deficits, will be fixed by an Organic Law that must relate to the gross domestic product.

The Constitution is stricter with local authorities to which the Constitution imposes budgetary balance. The State and the Autonomous Communities can have deficits, provided that these are not structural and the limits established in the Treaty of Functioning of the European Union are respected, nevertheless the local authorities must always present balanced budgets.

The third section reproduces what was established in the previous Article 135, that is, it is remembered that the issuance of public debt is subject to the principle of reservation of law and that the payment of public debt is mandatory and a priority credited to the time to make the payment. The constitutional norm wants to send a message of tranquility to potential foreign and national investors in the sense that the interests of the public debt will always be paid.

Nevertheless, even with the rigidity with which sections 1 and 2 of Article 135 EC are pronounced, the regulation itself introduces flexibility mechanisms in the case of natural disasters, economic recession or extraordinary emergency situations which are beyond the control of the State and significantly impair the financial situation or the economic or social sustainability.

These situations that allow a State to overcome the limits of structural deficits must be appreciated by the absolute majority of the members of the Congress of Deputies.

A second element of flexibility is that the specific deficit limitations are to be established in an organic law, which is easier to change than the Constitution. Article 135.5 CE indicates that an organic law must also develop the other principles contained in the Article as well as establish how the autonomous communities and the municipalities participate in the process of distributing the deficit and debt threshold among the different entities.

This part 5 of Article 135 has been transposed into Law 2/2012, April 27, on Budgetary Stability. As stated in Article 1 of the aforementioned Law, it aims to establish the guiding principles which bind all public authorities and which should be adjusted to the budget policy. This policy must be oriented to obtain the budgetary stability and financial sustainability, as a guarantee of sustained economic growth and job creation. The principles to which it refers are: budgetary stability 37),


1. The preparation, approval and execution of Budgets and other actions that affect the


financial sustainability\(^{38}\), multiannual\(^{39}\), transparency\(^{40}\), efficiency in the use of

1. The actions of the Public Administrations and other subjects included in the scope of this Law will be subject to the principle of financial sustainability.

2. Financial sustainability shall be understood as the ability to finance current and future expenditure commitments within the limits of deficit, public debt and non-performing commercial debt in accordance with the provisions of this Law, the delinquency regulations and European regulations.

   It is understood that there is sustainability of commercial debt, when the average period of payment to suppliers does not exceed the maximum term provided for in the delinquency regulations.

3. In order to comply with the principle of financial sustainability, financial operations shall be subject to the principle of financial prudence.


The preparation of the Budgets of Public Administrations and other subjects included in the scope of this Law will be framed in a medium-term budgetary framework, compatible with the principle of annuity that governs the approval and execution of Budgets, in accordance with European regulations.

\(^{40}\) Article 6 LO 2/2012. Principle of transparency.

1. The accounts of Public Administrations and other subjects included in the scope of this Law, as well as their Budgets and settlements, must contain sufficient and adequate information to verify their financial situation, the fulfillment of the objectives of budgetary stability and of financial sustainability and compliance with the requirements agreed in the European regulations in this area. In this regard, the Budgets and general accounts of the different Administrations will integrate information on all the subjects and entities included in the scope of this Law.

2. It is the responsibility of the Ministry of Finance and Public Administration to provide the public availability of economic and financial information related to the subjects included in the scope of this Law, with the scope and periodicity derived from the application of the rules and agreements of Community provisions.

   The Public Administrations shall provide all the necessary information for compliance with the provisions of this Law or the rules and agreements adopted in its development and shall ensure the consistency of the accounting rules and procedures as well as the integrity of the collection systems and data processing.

3. The forecasts used for budgetary planning, as well as the methodology, assumptions and parameters on which they are based, will also be made publicly available.
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public resources\textsuperscript{41)}, responsibility\textsuperscript{42)} and institutional loyalty\textsuperscript{43)}.

\textsuperscript{41)} Article 7 LO 2/2012. Principle of efficiency in the allocation and use of public resources.

1. Public expenditure policies should be framed within a framework of multi-year planning and programming and budgeting, taking into account the economic situation, the economic policy objectives and compliance with the principles of budgetary stability and financial sustainability.

2. The management of public resources will be guided by effectiveness, efficiency, economy and quality, for which purpose policies of rationalization of expenditure and improvement of the management of the public sector will be applied.

3. The legal and regulatory provisions, in their elaboration and approval phase, administrative acts, contracts and collaboration agreements, as well as any other action of the subjects included in the scope of this Law that affect the present expenses or future public revenues, must assess their impact and effects and strictly comply with the requirements of the principles of budgetary stability and financial sustainability.

\textsuperscript{42)} Article 8 LO 2/2012. Principle of responsibility.

1. The Public Administrations that fail to comply with the obligations contained in this Law, as well as those that provoke or contribute to produce the breach of the commitments assumed by Spain in accordance with the European regulations or the provisions contained in international treaties or agreements of which Spain is a party, will assume in the part that is attributable to them the responsibilities that would have resulted from such non-compliance.

In the process of assuming responsibility referred to in the previous paragraph, the hearing of the affected administration or entity will be guaranteed, in any case.

2. The State shall not assume or respond to the commitments of the Autonomous Communities, Local Corporations and entities provided for in Article 2.2 of this Act linked or dependent on them, without prejudice to mutual financial guarantees for the joint execution of specific projects.

The Autonomous Communities will not assume or respond to the commitments of the Local Corporations or entities linked or dependent on them, without prejudice to mutual financial guarantees for the joint implementation of specific projects.

\textsuperscript{43)} Article 9 LO 2/2012. Principle of institutional loyalty.

The Public Administrations will adapt their actions to the principle of institutional loyalty. Each Administration shall:

A) Assess the impact that their actions, on the matters referred to in this Law could cause to the rest of Public Administrations.

B) To respect the legitimate exercise of the powers that each Public Administration has attributed.

C) To consider, in the exercise of their own powers, the totality of the public interests involved and, in particular, those whose management is entrusted to other Public Administrations.

D) To provide the rest of Public Administrations with the information they need on the activity they carry out in the exercise of their own powers, and in particular, that arising from the fulfillment of the obligations to provide information and transparency within
It also establishes the necessary procedures for the effective implementation of the principles of budgetary stability and financial sustainability, in which the participation of institutional coordination bodies among Public Administrations in matters of fiscal and financial policy is guaranteed.

The Organic Law also establishes the limits of deficit and debt\(^{44}\), the exceptional cases in which they can be overcome and the mechanisms for correcting deviations; and the instruments to make the responsibility of each Public Administration effective in case of non-compliance, in the development of Article 135 of the Spanish Constitution and within the framework of European regulations.

Finally, the new Article 135 of the Spanish Constitution imposes the adoption of any appropriate procedures for effective implementation of the principle of stability in their rules and budgetary decisions to the Self-Governing Communities.

IV. THE JAPANESE SITUATION

The General Government Gross Debt of Japan is, in 2016, 232.4%. The Japanese Ministry of Finance offers the following data\(^{45}\):

The Japanese financial system has a Bond Dependency Ratio of 35.6% for FY 2016. Meanwhile the Tax Revenues are 57.6 trillion Yen; the total expenditure reaches 96.7% trillion Yen.

In these graphics, it is evident how the economic philosophies of the European Union seem different from the Japanese.

In Japan, it seems that Keynesian theories are more influential where a model is advocated in which the principle of budgetary balance between ordinary income and expenditure should be replaced by that of budgetary imbalance. In times of economic depression, the state must spend more than it incurs for tax and financing the deficit with public debt thus giving idle workers jobs and borrowing the money

\[^{44}\text{Art. 11 LO 2/2012 mimics that of the Fiscal Compact (Article 3(3)(b)), but it is in fact stricter (except for the fact that it will not enter into force until 2020): 2. “No Public Administration may incur structural deficit, defined as an adjusted cycle deficit, net of exceptional and temporary measures. However, in the case of structural reforms with long-term budgetary effects, in accordance with European regulations, a general structural deficit of 0.4 per cent of the national Gross National Product expressed in nominal terms may be achieved in all Public Administrations, or the one established in European legislation when this was lower”.}\]

\[^{45}\text{http://www.mof.go.jp/english/budget/budget/fy2016/02.pdf}\]
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(Reference 2) General Government Gross Debt (International Comparison)

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(Notes) 1) Figures represent the general government bond data.
2) FY2016 draft budget data is not reflected in the above data.

(2) Trends in General Account Tax Revenues, Total Expenditures and Government Bond Issues

[Graph showing trends in tax revenues, total expenditures, and government bond issues over time.]
required. That is, public spending must move exactly in the opposite direction to changes in the demand of private individuals\textsuperscript{46}. We could sum up this theory with the famous phrase of: “\textit{spend now and pay later}”.

However, the ideological thought that seems to be predominate in Europe is that of Buchanan, which we could summarize as follows\textsuperscript{47}:

1. The constitutional commitment to the limit of the deficit is very functional. Without sufficient income, the State relies on credit to provide public services. But credit is not always accessible and is always expensive, making the borrowing scheme unsustainable in the long term.
2. The deficits generate monetary instability that ends up producing hyper infraction and impoverishment.
3. Recourse to public debt, instead of taxes or money creation, transfers the real burden to future generations who should not be forced to pay for resources that have been used in times past.
4. In addition, debt restricts popular sovereignty and replaces electoral programs and political responsibility. The State responds to creditors and not to citizens, resulting in a weakening of the democratic principle.

We could summarize this thesis in the phrase: “\textit{tax finance rather than debt finance is the only political choice in public finance that is moral}”.

Amidst both theories, there are authors such as Stiglitz who have argued for a deliberate use of the deficit in times of recession to increase effective demand. The Nobel Prize has criticized those who defend austerity as a way to leave the crisis\textsuperscript{48}.

It is not our role to solve these economic dilemmas that have been pronounced by great wise men, but it seems reasonable to think that excessive indebtedness leads to a situation of dependence that can weaken the democratic principle. Examples such as Greece give a sample of what is indicated.

On the other hand, stability understood as an equilibrium or surplus with insurmountable restrictions to go to debt in any situation may not be advisable in all economic conjunctures.

Once again, the balance between debt and income should be sought with its

\textsuperscript{46} For a detailed study of the various political theories see: Pérez de Ayala, J. L.: The public financial economy (an institutional approach on the political economy of the Public Treasury), Editorial de Derecho Financiero, EDERSA, Madrid, 1988.


\textsuperscript{48} News consulted on November 15, 2016: http://www.elmundo.es/economia/2016/09/15/57d9a252468aeb06368b461b.html
flexibility clauses in the event of unforeseen circumstances.

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