

ESSAY AUGUST 6, 2025

## No Rule of Law Without Solvency

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When states reach the limits of fiscal capacity, the legal order is jeopardized.

**E**VERY RIGHT IS A LIABILITY. A PENSION, A HEALTHCARE benefit, a tax deduction—even the right to private property—derives its validity from being legally enshrined in one form or another. Yet beneath this legal articulation lies a fiscal reality. Protecting and enforcing each of these rights requires a financial commitment that the state must honor through lawful public means: transparent and lawful taxation, properly allocated budgets, and reliably managed currency.

Trouble begins when the state reaches the limits of its financial capacity. At that point, it can no longer fulfill its fiscal commitments within the boundaries of law. Instead, it begins to meet them at the margins of

legality—through improvisation, manipulation, and disguised extraction. The result is not just economic degradation. It is the erosion of the rule of law.

This raises the question of what, exactly, the rule of law demands. Legal theorists have offered a range of answers, often speaking of it in idealized terms. Some define it procedurally: the rule of law requires general, prospective, stable, and publicly known laws. Others adopt more substantive definitions, encompassing rights to property, equality before the law, or access to justice. Some go further still, suggesting that the rule of law must include expansive claims to social and economic justice—redistribution, affirmative rights to housing and employment, environmental equity, and so on.

But these accounts share a common limitation: they treat the rule of law as a purely ideal concept. There's nothing inherently wrong with that, but it creates a risk—we focus so much on what the law should be that we overlook what it needs to function. The result is a vision of legality disconnected from the practical realities that sustain it.

This means that the rule of law is not simply an independent variable in the architecture of the modern state; it is also a dependent one. Lawyers—inveterate normativists that we are—tend to fixate on what the law ought to be, losing sight of the material and institutional conditions it requires to function. But the rule of law does not arise from legal principles or political will alone. It relies on underlying material and institutional conditions—especially the state's ability to remain fiscally solvent.

When that solvency erodes, the machinery of legality begins to stall. Rights go unenforced, procedures become empty rituals, and the state operates increasingly by discretion rather than by law. When the state nears the outer limits of its fiscal capacity, the consequences are stark. The state then turns to functional substitutes for taxation: methods of financing public obligations without formal tax increases or budgetary debates. Chief among them is inflation.



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Inflation is a tax by other means. It transfers wealth from savers to the state, from the private sector to the public ledger, without a single vote being cast. It erodes the real value of nominal public liabilities—such as pensions, social benefits, and government debt—diluting what the state owes its citizens. It also distorts private obligations, quietly rewriting contracts and undermining expectations. But that is a separate concern. What matters here is that inflation operates as a form of unlegislated taxation, bypassing the formal procedures and public accountability that define democratic legality.

Inflation is only one such tactic. Depending on the seriousness of the fiscal shortfall—and on the government's ability or willingness to reduce spending—insolvent states may also freeze bank accounts, convert savings into low-yield bonds, impose retroactive taxes, or use regulatory takings to confiscate private assets. They may declare emergencies to bypass legislative procedures, defer payments, or devalue the currency overnight.

These are not routine exercises of administrative discretion within a stable legal framework; they are extraordinary responses to fiscal breakdown. I witnessed some of these measures firsthand growing up in Brazil during a period of fiscal distress and hyperinflation (which at one point reached 6,000% annually), when emergency decrees, account freezes, payment moratoria, and index manipulation became part of everyday life. While such actions were typically carried out under color of law, they blurred the line between legality and expediency. What unites them is the substitution of legal rule with administrative discretion—a shift that tends to gradually undermine the rule of law.

History is full of episodes where state insolvency did not merely erode legal order—it obliterated it. Ancient Rome offers a distant, but instructive, illustration. While the Roman Empire lacked a modern legal

order, it depended on legal and monetary institutions to maintain stability. In the third century, mounting military expenditures, administrative burdens, and declining revenues led emperors to reduce the precious metal content of coins. But debasement meant to stretch limited fiscal resources unleashed high inflation. Faced with growing instability, Emperor Diocletian issued the 301 AD Edict on Maximum Prices. The law fixed prices under penalty of death; yet it proved unenforceable, drove commerce underground, and contributed to a broader erosion of confidence in imperial institutions, paving the way for the mounting civil strife that followed.

Many centuries later, Weimar Germany offered a modern counterpart: a constitutional state undone in no small part by fiscal collapse. Hyperinflation in the early 1920s wiped out savings, shattered public trust, and made a mockery of legal and contractual commitments. In response, German jurists developed the theory of *Wegfall der Geschäftsgrundlage*—the disappearance of the basis of the transaction—as a way for courts to adjust debts and obligations no longer tenable in nominal terms. In the chaos that followed, the door was opened to the demise of democratic institutions and the rise of political forces we now recall with unease and revulsion.

Argentina offers a more recent example. In the early 2000s, confronted with a collapse in public finances and an inability to meet its obligations, the government faced a deep fiscal and financial crisis. It responded by freezing bank accounts and soon after forcibly converting dollar-denominated deposits into devalued pesos—an emergency measure that wiped out household savings and shattered financial expectations. In the years that followed, the state manipulated inflation statistics, seized pension funds, rewrote private contracts by decree, and expropriated private assets, all under the banner of expediency. These were not merely improvised policy responses; they marked a deeper unraveling of legal certainty. As the state's solvency eroded, so too did the rule of law.

Brazil tells a parallel story. There, fiscal fragility has repeatedly corroded the reliability of legal protections. In the 1980s, facing acute budgetary strain and hyperinflation, the government relied on monetary restatement mechanisms, wage and price controls, and complex

indexation formulas to reallocate resources outside the formal budget process. These tools not only altered private contracts but also allowed the state to quietly redefine its own obligations—delaying, diluting, or reshaping payments it was otherwise bound to make. The pattern continued into the early 1990s, when President Collor—the first democratically elected leader in decades—abruptly froze personal checking accounts of individuals and companies in a desperate attempt to reduce liquidity and contain inflation. The move upended financial expectations and triggered a wave of litigation that dragged on for more than twenty years. Although the severity of these interventions has diminished, the underlying dynamic of fiscal weakness compromising legal certainty remains visible in Brazil to this day.



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Even the United States is not immune. In 1933, amid collapsing revenues and rising debt burdens, President Roosevelt took the country off the gold standard, nullified gold clauses in public and private contracts, and required citizens to exchange their gold holdings with the Treasury under threat of severe criminal penalties, including prison. These extraordinary measures sharply reduced the real value of federal obligations and triggered a constitutional showdown. In the 1935 Gold Clause Cases, the Supreme Court narrowly upheld Roosevelt's actions, even as it acknowledged the threat they posed to the sanctity of contractual commitments. A generation later, in 1971, President Nixon, facing mounting balance-of-payments pressures and eroding confidence among foreign central banks, suspended the dollar's convertibility into gold, severing the last external check on US monetary expansion. From that moment on, fiscal and monetary restraint would rely almost entirely on domestic institutions: rules, norms, and political self-restraint.

But as expenditures grew and deficits deepened, those internal constraints began to erode. Over the past two decades, the Federal Reserve has purchased trillions in Treasury securities—especially in response to the 2008 financial crisis and the COVID-19 pandemic—effectively

financing deficits without direct legislative approval. These measures, while technically legal, bypass the deliberative rigors of the budget process. Informal workarounds like these have increasingly displaced formal fiscal governance. The result is a slow but significant institutional drift, and one that blurs the line between emergency response and permanent exception—a quiet slide toward rule without accountability.

This pattern is not merely a matter of economic policy. It reveals something deeper: the contingent nature of legality itself. The monetary constitution—the framework of rules and norms that governs how money is created, valued, and managed—serves as a backbone of the broader legal order. When fiscal pressures grow too great and those rules give way, legality begins to unravel. Law continues to be cited, but no longer constrains. Its forms persist, but its substance erodes. What remains is a hollowed-out shell: the rule of law in appearance, but not in effect.

To preserve the rule of law, we must stop treating it as an autonomous force, detached from material realities. Legal constraints depend on solvency. No constitutional text or institutional reform can substitute for the fiscal capacity that makes law enforceable. The rule of law may restrain the state—but only if the state can afford to be restrained.

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