By building on recent research comparing the EU and USA and drawing on Riker's (1964) influential theory of federalism, this book explores the origins of fiscal unions. It investigates early American history and traces its constitutional debates to argue that an internal threat—such as a sovereign debt crisis leading to social unrest threatening the Union—triggers the emergence of federal taxing powers—i.e. a federal fiscal union. It then contrasts the American experience of fiscal integration with the European one and subsequently concludes with the insights for the EU. It is a first monograph to compare the American and European models of fiscal integration, making two original contributions to the theoretical and empirical literature. In reference to the former, it introduces the concept of fiscalization, which defines the emergence of a 'fiscal union' with federal tax powers. Concerning the latter, by analysing the Confederation period of the USA and applying Riker's theory using mainly unexplored primary sources, such as the protocols from state ratification conventions of 1787/88, this book adds to the US–EU comparative federalism literature. It shows that paradoxically, by not agreeing to give the EU fiscal capacity, so that they could protect their fiscal sovereignty, member states gave up more of this very fiscal sovereignty to the central institutions than states in classical federations. This research allows the reader to learn about the similarities—and the differences—between the pre-Constitution USA and the modern EU with regards to their fiscal arrangements; a comparison of the arguments that were used while debating those arrangements; and finally the conditions under which the central level of government in systems of multi-level government is likely to acquire a power to tax.

'. . . Tomasz P. Wozniakowski innovatively compares the 1780s sovereign debt crisis in the US with the 2010s equivalent crisis in the EU, to show the conditions which led to fiscalization in the US (creation of an independent federal fiscal power) . . . This is a wonderful work of scholarship but also a required reading for those policymakers engaged in reforming the fiscal structure of the EU economic governance.'
SERGIO FABBRINI, Dean of the LUISS Political Science Department, Rome

'The fiscal integration of a federation is necessarily a highly fraught process. By comparing the 18th-century US with the modern EU, Wozniakowski manages to shed new light on both of these complex histories . . . He marshals considerable research to explain why the US made this transition and the EU has not, despite the advantages it might confer on the member states'
ROBIN L. EINHORN, Professor of History, emerita, University of California, Berkeley

'The Covid pandemic and Russia's invasion of Ukraine have demonstrated quite clearly the weakness of the EU. Europe's fiscal incapacities are central to why the EU cannot meet the challenges it faces today. Wozniakowski's excellent book examines the origins of fiscal federalism in the US with a careful eye towards the implications of these processes for the EU. This insightful and illuminating analysis sheds profound light on both the challenges and opportunities for the EU. . . .'
SVEN H. STEINMO, Professor of Political Science, University of Colorado, Boulder

'. . . Here is finally a book that studies fiscal integration in the EU as a case of a coming-together federation, in comparison with the US. It is solidly researched and bold in its conclusions; what more can we ask from scholarly work? Highly recommended.'
WALTRAUD SCHELKLE, Professor in Political Economy, London School of Economics and Political Science

'What drives the development of fiscal unions? In this ground-breaking, diachronic comparison of the early US with the current EU, Tomasz Wozniakowski delves into the little-known debates of key actors on fiscal integration in order to demonstrate convincingly that the key driver of fiscalization is internal threat during sovereign debt crises. A must read for all those interested in why America had a Hamiltonian moment and Europe did not during the Eurozone crisis.'
VIVIEN A. SCHMIDT, Jean Monnet Professor of European Integration, Boston University

Jacket image: Adolphe Yvon, *Genius of America*, c. 1868 (detail). Saint Louis Art Museum, Gift of Mrs. E. P. Hilts in memory of Mr. and Mrs. M. Rumsey.

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Economic Integration in Europe & the United States

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1

Introduction

1.1 The problematic

Since the euro was introduced two decades ago, many scholars have argued that a monetary union cannot function properly without pooling some of the fiscal resources at the supranational level—a fiscal union (see, e.g., Eichengreen 1990, Marzinotto et al. 2011).[1] These ideas became politically salient again when the euro crisis demonstrated that fiscal policies cannot be separated from monetary policy, and especially after the French President, Emmanuel Macron, became the main advocate of the European Union's (EU) 'fiscal capacity' derived from EU taxes on Big Tech (De La Baume and Vinocur 2018).[2] This debate has further accelerated as the result of the crisis caused by the Covid-19 pandemic as well as Brexit, as the EU was searching for the means to kick-start its economy and fill its budgetary gap following the departure of its third largest net payer. The discussions often draw inspiration from the experience of another system of multi-level government in which a monetary union went hand in hand with a fiscal union—the United States (USA) (Henning and Kessler 2012). However, this process was not an easy one—American citizens were not fans of taxation as they waged a long and costly war against Great Britain, which started precisely because of taxes (hence 'no taxation without representation'). And yet, soon after they gained independence, the states agreed on a fully-fledged fiscal union, equipping the federal government with a vast power to tax. Why? And what can the Europeans learn from this American experience?

I tackle this problematic through an original approach. By building on recent research comparing the EU and the USA (McKay 1999, 2001; Nicolaïdis

[1] This chapter is derived from an article published in the *Journal of European Public Policy* on 9 February 2017, available online: http://wwww.tandfonline.com/10.1080/13501763.2017.1285340.

[2] This tax can only be levied effectively at the EU level, which makes it similar to the tariff in the US history—when the US federal government was given the power to tax, within a decade it raised six times more revenue from the tariff than the states (Chapter 2.2.2; cf. Woźniakowski 2018: 637).

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and Howse 2001; Fabbrini 2007; Schütze 2009; Egan 2015; Schelkle 2017) and drawing on Riker's (1964) influential theory of threats, I develop my own theory for the emergence of fiscal unions. My goal is to discover the conditions under which fiscal unions come about. To do so, I investigate early American history and trace its constitutional debates to argue that an internal threat—such as a sovereign debt crisis leading to social unrest threatening the existence of the Union—constitutes such a condition. I then contrast the American experience of fiscal integration with the European one and subsequently conclude with insights for the EU.

Every government has two main tools that can be used to influence macroeconomic conditions—monetary policy and fiscal policy. In order to function properly these two policies need to be synchronized to some extent. In 1992 in Maastricht the majority of the member states of the EU decided to pool monetary policy at the supranational level. However, fiscal policy remained at the level of the member states. Five years later, the governments of these states realized that some kind of coordination of fiscal policies, at least regarding public debt and deficit, needed to be introduced. Consequently, the Stability and Growth Pact (SGP) was implemented. Nonetheless, when Germany and France were not punished for breaking the rules of the SGP in 2003, it became clear that these rules are subject to political bargaining.

Still, no action was taken to make the rules automatically enforceable. However, when the global financial crisis erupted in 2008, and turned into the sovereign debt crisis of the euro area, it became apparent that some changes at the EU institutional level needed to be introduced in order to prevent a crisis happening in the future. Nevertheless, member states, in order to guard the core of their competences—fiscal policy—would not agree to pool any sources of revenue at the EU level. Instead, they have introduced another set of rules regulating the fiscal policies of member states; these rules are supposed to be more easily enforceable. Surprisingly, by avoiding comparisons with federations and the 'F-word' in general (Borriello and Crespy 2015), the innovative institutions, such as the Fiscal Compact and the European Semester, in fact give to the EU institutions the kind of power to regulate the fiscal policies of the member states that even the powerful USA federal government does not possess (cf. Hallerberg 2006; Fabbrini 2013).

A federal government that cannot raise revenue from its own sources will not be able to sustain a federation (see, e.g., Kincaid 2014: 292–3; Riker 1975: 111). In order to become viable, central governments must therefore at some point become financially independent from the member states. This lack of sustainability can also be applied to the EU, and indeed can be viewed as its main flaw. While the idea of giving EU institutions the power to tax in order to overcome this weakness has been around for many years (see, e.g., Eichengreen 1990), taxing would be difficult to implement because 'it implies a fundamental transfer of sovereignty from the nation-states to European institutions' (De Grauwe 2013: 169).

It was precisely this same reason that, in the eighteenth-century USA, made it very difficult to create a federal fiscal union. As Ferguson (1961: 290) notes about the struggle for the federal power to tax in the late 1780s: '(n)othing testifies more to the audacity of the founding fathers than their demand that the people relinquish what they had fought Britain to preserve'. The US emerged as a result of thirteen colonies' fighting for independence from the most powerful state in the world at that time: the British Empire. The most important reason that led Americans to take up arms was neither culture nor language, but taxation. In the case of the British colonists in North America, they felt that the taxes, which were being imposed upon them by London without their consent, were unjust and that Britain imposed these taxes only because none of the American people were represented in the House of Commons. Therefore, these taxes were seen as unlawful and not fulfilling the criterion of 'no taxation without representation'. It is puzzling why Americans decided to 'relinquish' a power to tax and give it to their federal government as early as 1787, only four years after the end of the War of Independence and only six years after the ratification of its first constitution—the Articles of Confederation, which did not give Congress any power to tax, as the Union's budget was based on states' contributions. I argue that the American states needed a trigger to agree on such a 'fundamental transfer of sovereignty'. This book shows that the sovereign debt crisis constituted just such a trigger and activated the causal chain that ultimately led to the federal power to tax. The USA can thus be seen as an example of successful fiscalization, a process that I define in the section on conceptualization in Section 1.3, whereby the federal tax power was firmly based in the Constitution.

It can be argued that the federal power to tax was one of the most important features of the US Constitution. For instance, Alexander Hamilton noticed: 'I have applied these observations thus particularly to the power of taxation, ... because it is the most important of the authorities proposed to be conferred upon the Union'.[3] Meanwhile, the lack of such a tax power has been identified as one of the main flaws of the EU. For example, Moravcsik claims that '(o)ne institutional weakness is the EU's insignificant fiscal capacity' (2001: 169).

[3] *Federalist* 33, PAH IV: 466.

The importance of the federal power to tax for the viability of a union has been recognized in classical studies of federalism (see, e.g., Riker 1964). Yet, only very recently, as a result of the sovereign debt crisis in the euro area and the Coronavirus crisis, the fiscalization of the EU has become politically salient. Nonetheless, the research on how a fiscalization process comes about in federations is rather scarce. Recent studies focus on a 'fiscal union' with the implicit assumption that such a fiscal union implies a large central budget, regardless of the way in which the funds are obtained (contributions vs. own resources). For instance, even though Bordo et al. (2011: 26) conclude their comparative study of five federations with the idea that the economic crisis in all of the countries that they analysed increased the fiscal capacity of the central government and 'instituted a system of transfers and equalization payments', these authors did not study *how* the federal government acquired such fiscal capacity in the first place. This, I argue, is precisely the problem of the EU—such an independent fiscal capacity does not exist, and so the EU cannot fiscally expand in times of crisis. One of the five lessons that Bordo et al. provide for the euro area is that the recent European crisis may also lead to an increase of such fiscal capacity and financial transfers. However, they do not specify what they mean by 'fiscal capacity'—is it simply a large budget or does it also relate to the *mode* of obtaining revenues?

This book shows that the mode of raising revenues, and not only the size of the budget, may be crucial for the viability of the union. The US case demonstrates that building a federal budget that relies solely on the contributions from the member states and not on the federal power to tax, may lead to destabilizing effects for the union. Moreover, recent research has shown that 'the political contestation in the reform of the Eurozone is one-dimensional between advocates of fiscal transfer and discipline' (Lehner and Wasserfallen 2019: 45). The former, fiscal transfer, would be difficult to sustain without some kind of fiscalization, which is also needed to repay a common debt, recently issued by the European Commission to finance the Recovery and Resilience Facility (RRF) as a response to the Coronavirus crisis. For this reason, studying the mechanism of the emergence of a fiscal union with an independent federal (supranational) power to tax is more salient now than ever. The objective of this book is to shed further light on the nature of the European integration process and demonstrate the mechanism of the emergence of fiscalization in the form of a federal power to tax. The focus on the *emergence* of this power is inspired by the conclusion in Rodden's (2006: 281) seminal book on fiscal federalism: 'students of comparative federalism must try harder to understand the conditions under which the wide variety of fiscal and political structures around the world emerge and become stable. … As authority continues to shift … up to higher level entities like the European Union, the questions addressed by Alexander Hamilton, James Madison, and John Jay are more interesting and crucial than ever'.

Hence, this book aims to answer the following research question: *What are the conditions under which fiscalization of a federal type of polity is likely to emerge?* This question aims at an explanation of how the process of fiscalization gets started. What does initially push federal or federal-type polities along towards fiscalization? Why does this process occur in some cases (USA) while not in others (EU)? Why does the process of fiscalization take place—under which conditions does this fiscal structure emerge, and if it does not—what factors prevent it from occurring? Answering this question through a comparative federalism lens, a topic I elaborate on in the next section, will allow us to shed a further light on the nature of fiscal integration.

1.2 Comparative federalism lens

This book puts special emphasis on the possible lessons the EU can learn from adopting a comparative federalism lens. There is a large body of literature on federalism and fiscal federalism (see, for instance, the classical studies of Riker 1964; Friedrich 1968; Oates 1972; Elazar 1987), but there is little research on how fiscal federalism, in the form of the federal power to tax, comes about. In the last two decades, scholars have started to use analytical tools developed in the federalism literature to investigate various aspects of the EU (Bednar at al. 1996; Burgess 2000, 2012; McKay 2001; Nicolaïdis and Howse 2001; Filippov et al. 2003; Ansell and di Palma 2004; Kelemen 2004; Borkowski 2006; Menon and Schain 2006; Trechsel 2006; Glencross and Trechsel 2010; Parzymies 2012; Bokajło 2014; Rojewska 2016; Grosse 2018). Furthermore, some researchers have also adopted fiscal federalism theory to analyse the financial relations among different levels of government in the EU (von Hagen and Eichengreen 1996; Börzel and Hosli 2003; Hallerberg 2006; Zahariadis 2013; Csehi 2019; Zgaga 2020). While some scholars argued against European fiscal union (Jones 2016), many of them would draw on the classical theorists of the fiscal federalism literature (Musgrave 1959; Oates 1972) to postulate the need for fiscalization ('a fiscal capacity') at the EU level, either to finance redistributive policies (Inman and Rubinfeld 1992; Persson and Tabellini 1996; Scharpf 1999) or to address asymmetric shocks (Sachs and Sala-i-Martin 1991).

Within this literature, comparative federalism deserves considerable attention and in order to better understand the developments of the EU, many scholars (e.g. Nicolaïdis and Howse 2001; F. Fabbrini 2013, 2016; Trechsel 2005; Benz 2017; Bolleyer 2017; Csehi 2017; Fossum and Jachtenfuchs 2017; Lacey 2017; Thorlakson 2017) have started to examine similar processes occurring in the established federations. Some scholars have tended to focus on the comparison of certain areas of public policies in the USA, on the one hand, and the EU, on the other. The areas of focus include monetary policy (McNamara 2002; Schelkle 2017), market integration (Egan 2015), trade policy (Freudlsperger 2017, 2020), fiscal integration (Eichengreen 1990; Georgiou 2022; Hallerberg 2006; Henning and Kessler 2012), among the other policies (McKay 2005; Mendez and Mendez 2010). Another strand of this literature has tended to focus on the more general, institutional design of the polities of focus (Nicolaïdis and Howse 2001; S. Fabbrini 2005a, 2019; Trechsel 2005; Bokajło 2007; Lacey 2013; Keating 2017), including their accountability structures (S. Fabbrini 2021). Hence, the re-emergence of the comparative federalism studies in 1990s has had an impact on the analysis of the EU, which has been included as a case study in the comparative federalism literature (e.g. Inman and Rubinfeld 2020).

A comparison with the USA can shed a different light on a polity such as the EU (McKay 1999, 2001; Egan 2015; S. Fabbrini 2004, 2017; Schütze 2009; Schelkle 2017). The rationale for such a comparison lies in the fact that both cases are examples of the so-called 'coming together' type of federation, where previously independent states decide to pool part of their sovereignty to the higher level in order to better protect themselves against common threats (Riker 1964; Stepan 1999; S. Fabbrini 2015). A number of scholars have already compared the EU with the USA from the point of view of federalism (Cappeletti et al. 1986; Weiler 1986; Sbragia 1992; Elazar 2001; Nicolaïdis and Howse 2001; S. Fabbrini 2005b, 2007; Trechsel 2005; Schütze 2009; McKay 2001; Woźniakowski 2016). Moreover, in the wake of the euro area crisis a number of studies have been conducted in which scholars have looked at US fiscal history in search of potential solutions for the EU (Bordo et al. 2011; Henning and Kessler 2012; Sargent 2012; Hallerberg 2013; Riedel 2013; Steinbach 2015; Woźniakowski 2018). In comparing these two polities, this book therefore falls within a well-established tradition.[4] Comparing the EU with the USA does not imply that one regards the EU as a federation—it only signals, as Burgess (2009: 30) demonstrates, that 'integration' is quite similar

[4] See Tortola 2014, for an overview of this literature.

to the coming together of state units that were previously independent, just as in the case of the USA. This is what, for instance, Kelemen does, when he compares the EU and the USA at the same stages of the 'federal' development by showing that in many areas of the 'core state powers' (see also: Genschel and Jachtenfuchs 2013) the early US republic resembled the modern EU (Kelemen 2013).

I analyse how both the legal mechanisms of the new economic governance of the EU and the actions of its institutions, such as the European Commission, created a system in which the fiscal and economic autonomy of member states has been limited. In doing so, I do not aim at a comprehensive analysis of the aforementioned institutions or policies—this has been done to a large extent. The scope of this book is limited to demonstrating, and giving concrete evidence to justify its claims, that a *fiscal regulation* process is taking place in the EU. In doing so, the framework of the concept of 'regulation' (Genschel and Jachtenfuchs 2013) as opposed to *fiscalization* is used, which allows me to identify institutions and policies that fall within the definition of these concepts. Significantly, while the former implies that federal-like institutions have an ability to regulate state fiscal policies, the latter entails that a central government has the power to conduct its own fiscal policy. I will show that by avoiding the classical fiscal federalism solutions, that is, a fiscal union with a large and autonomous federal budget, the result for EU member states was a system of fiscal regulation of the national budgets. As mentioned earlier, such fiscal regulation of the member states is not the case in classic federations, such as the USA.

Consequently, this book argues that the new economic governance of the EU has introduced a number of mechanisms which have a profound impact on the vertical shift of power between the EU institutions and the EU member states. The implications of these new mechanisms are not usually perceived, or understood, by public opinion, as they represent a 'covert integration' of core state powers (Héritier 2013). As a result, EU institutions were given authority in certain domains of fiscal policy, the very policy that member states of the euro area so jealously protected, after they relinquished control over their currencies when they adopted the euro. Hence, my motivation for writing this book is twofold. First, I wish to show that an internal threat triggers fiscalization—central taxing power. Second, I seek to demonstrate the paradox of fiscal integration—namely, that less central taxing power comes at the cost of less fiscal and political sovereignty of member states.

At the time of, arguably, the largest crisis the EU was facing since its creation (until the Coronavirus crisis), more and more analyses, papers, and policy recommendations were produced, which, in the search for possible remedies to and explanations of the crisis, drew from the examples of the federal states (Henning and Kessler 2012; Maduro 2012; S. Fabbrini 2017; Woźniakowski and Maduro 2020). Moreover, scholars, particularly economists, have successfully demonstrated the need for a supranational tax in the euro area (see, e.g., Eichengreen 1990). What has been neglected, though, is how such power to tax emerges and—consequently—the insights for the EU, and especially for the euro area, from the time in US history of the Articles of Confederation, including the ratification process of the Constitution. This book sets out to rectify these gaps in the scholarship and it does so by incorporating the theory of federalism developed by William H. Riker, the topic I turn to in the following section.

1.3 Theory

This book builds on a theory of federalism developed by William H. Riker, because, by introducing a 'threat hypothesis', Riker's theory focuses on the origins of federations, which I have incorporated into my analysis of the emergence of fiscal unions.[5] It can be argued that federalism and federation are similar concepts, as they both share the same etymological Latin root and come from the word *foedus*, which means 'relationship', 'arrangement'. However, it is important to underline their differences. Whereas federalism is a doctrine or a set of principles that characterize such an arrangement; a federation, on the other hand, is a form of the organization of the state which follows these principles. It can be said that a federation requires federalism, but federalism does not necessarily require the existence of a federation. One can think of polities, such as the EU, which follow only some elements of federalism, but are far from fully-fledged federations, such as the USA. Within many definitions of federalism (see, e.g., Duchacek 1970; Elazar 1987; Friedrich 1968) William H. Riker (1975) has stated a very general, but probably the most accurate one:

> Federalism is a political organization in which the activities of government are divided between regional governments and a central government in such a way that each kind of government has some activities in which it makes final decisions. (Riker 1975: 101)

[5] Indeed, as McKay (1999: 9) notes: 'Riker provides a coherent framework for the analysis … of the origins of unions'.

Riker, one of the most prominent scholars of federalism, provided theoretical and empirical contributions to this field of study that are still relevant today. The most acclaimed work on the topic was his book from 1964 entitled *Federalism: Origin, Operation, Significance*, in which he outlined his theory of the emergence of federations. Perhaps the most important contribution of his book was his hypothesis concerning the origins of federations. Riker was interested in how—under which conditions—federations emerge. He analysed, so he claimed, all the cases of successful and failed federations and argued that he was able to demonstrate that in all successful cases the conditions he outlined were present, whereas in the negative cases, they were either not present at all or were present only momentarily. The conditions were the following:

1. The politicians who offer the bargain desire to expand their territorial control, usually either to meet an external military or diplomatic threat or to prepare for military or diplomatic aggression and aggrandizement. But, though they desire to expand, they are not able to do so by conquest, because of either military incapacity or ideological distaste. Hence, if they are to satisfy the desire to expand, they must offer concessions to the rulers of constituent units, which is the essence of the federal bargain. The predisposition for those who offer the bargain is, then, that federalism is the only feasible means to accomplish a desired expansion without the use of force.
2. The politicians who accept the bargain, giving up some independence for the sake of the union, are willing to do so because of some external military-diplomatic threat or opportunity. Either they desire protection from an external threat or they desire to participate in the potential aggression of the federation. And furthermore, the desire for either protection or participation outweighs any desire they may have for independence. The predisposition is the cognizance of the pressing need for the military strength or diplomatic manoeuvrability that comes with a larger and presumably stronger government. (It is not, of course, necessary that their assessment of the military-diplomatic circumstances be objectively correct.)

(Riker 1964: 12)

These two conditions, Riker continued, were always present in the federal bargains. Moreover, both groups of politicians must freely agree to this bargain, therefore any use of force is excluded (Riker 1964: 12). The conditions are not sufficient (even though Riker was tempted to make such a claim, but he 'cannot possibly collect enough information to prove sufficiency' [1964: 13]), but necessary 'predispositions for making any federal constitutions'. Importantly, in order to prove his threat hypothesis, Riker did not have to demonstrate that the perceptions of the threat were correct—it was enough to show that the political elites had a subjective perception of a threat, which led them to strike a bargain.

By analysing the perceptions of political elites that led to what I call a *fiscal bargain* (the creation of a federal fiscal union, where federal government is given the power to tax), I follow Riker's theory of threats. I do this in Chapter 3 and Section 2.3. In Section 2.2, in turn, I outline the economic situation that led to such perceptions, with a focus on the economic depression and fiscal crisis in the states in the mid 1780s in the USA, and the euro crisis in the 2010s in the EU (Section 4.2). This book will follow the main Rikerian claim, but in so doing it will take into account an *internal threat* and consequently will argue that the internal existential threat is a necessary condition for the emergence of fiscalization, a concept I define below.

In conceptualizing the fiscalization process, I build on the definition of federalism developed by Riker, who stressed the importance of the ability to make final decisions for each tier of government in at least one policy area. By building on this observation I emphasize the significance of the ability of the federal government to make final decisions in the area of fiscal policy, so it can raise its *own* revenues. Thus, I define the concept of fiscalization as follows:

> Fiscalization is a process through which a certain level of government (supranational/federal/central) expands its power to raise its own sources of revenue, and in so doing it decreases the level of vertical fiscal imbalance.

The concept of vertical fiscal imbalance (contributions/transfers as a percentage of total revenue) has usually been used to analyse the financial dependence of the member states of the union (i.e. regional governments) *on the central government* (Rodden 2002: 672). Conversely, I use it to show the financial dependence of a central government *on the member states* and the potential consequence of such dependence for the viability of the union. For the purposes of this book, the fiscalization process is limited to the central government—by central I refer to either the federal (US) or the supranational (EU) levels of government—and, if successful, fiscalization leads to the emergence of a *federal fiscal union*, that is, a union with the federal power to tax. I have added an adjective 'federal' in order to differentiate such a fiscal union from many other uses of this concept (Fuest and Peichl 2012). Therefore, a central budget that consists of contributions from its constituent units cannot be recognized as part of the fiscalization process, even though its size may be significant. This is a crucial difference between fiscalization and other concepts that are used in the literature, such as 'fiscal capacity', which tends to emphasize only the size of the budget, and not the means of obtaining the revenue. In the concept I propose, it is crucial that a government has a power over the source of the revenues, for instance a power to tax. The fiscalization process is also limited to the 'getting money' side of the budget (Riker 1964: 54) and does not concern the spending side.

Importantly, *fiscalization* is fundamentally different from *regulation of fiscal policies of the member states of the union* (in this book also called 'fiscal regulation' for the sake of simplicity): while the former entails that a central government has the ability to raise its own revenues and thus a power to conduct its own fiscal policy, the latter implies that federal-like institutions have the power to regulate the fiscal policies of the member states of the union. Consequently, although both are the instruments of fiscal integration, their scope and potential consequences are fundamentally different, as I show in Chapters 2 and 4. Accordingly, these two instruments of fiscal integration should not be confused. I hypothesize on the conditions under which the first of these instruments is likely to emerge in the following section.

1.4 Hypothesis

In this book the following hypothesis, which is a starting point for a more specific model, will be tested: *If a federation encounters an internal threat, then the process of fiscalization will be launched.* In order to be more precise, the following model, upon which I elaborate in more detail below, will serve as an analytical basis for this study: *The more severe the internal threat, the higher the likelihood of the fiscalization process occurring.*

> The more severe the internal threat > the more perception that solutions cannot be found at the member state level > the more incentives for the member states to seek solutions at the federal level > the higher likelihood of the adoption of the solution at the federal level > the higher likelihood of the fiscalization process occurring

In formulating my model, I built on Riker's 'threat hypothesis'—I argue that the mechanism of striking a fiscal bargain resembles the mechanism leading to a federal bargain. Similarly, the two bargains must result in a constitutional-level arrangement, which secures their outcomes. However, while the federal bargain necessarily results as part of the constitution making process; the fiscal bargain may also emerge later on, for instance as a constitutional amendment (or a treaty change). The main difference is that while in the federal bargain the main motive driving politicians to forge the bargain is an external threat, in the case of the fiscal bargain it is an internal threat.

The fiscal bargain, just like the Rikerian federal bargain explained in Section 1.3, can only be struck if the two groups of political leaders—those offering the bargain and those accepting it—are willing to make such an arrangement. Thus, it has to be based on consent. The outcome of the fiscal bargain would usually be written in the federal constitution (or another constitutional level legal act).[6] Both groups of politicians need to accept some losses resulting from such a bargain. However, those key political leaders of the constituent units must expect that the fiscal bargain will lead to more gains than losses. Presumably, both groups expect that the bargain will extend their *fiscal* territory (similar to the territorial extension motive of the federal bargain), that is, they anticipate that together they will collect more revenue than they would have done separately. In Chapter 2 I will show that it was indeed the case in the USA, where the federal government, within a decade of the ratification of the Constitution, collected *circa* 600 per cent more revenue from the same source (custom duties) than the states had done separately.

The essential element of my hypothesis is, therefore, an internal threat, which is the main motive to strike a fiscal bargain. Significantly, it is not necessary that those fears of a threat are justified—it is sufficient that the elites *perceive* some phenomenon as a threat. Hence, both *the actual* and *the perceived* threats may lead to the fiscal bargain. While it would be difficult to provide an exhaustive list of what exactly constitutes an internal threat, we can enumerate some instances that clearly fall within its definition. Namely, it would be any situation that would inflict socio-political damage, for instance an economic depression (which may lead to social unrest). I expect to find the evidence for those empirical implications of my internal threat hypothesis. The next step in my hypothesized chain of events leading to the fiscal bargain would be the acknowledgement in the statements of the political elites of such a threat. Then, I expect to find statements on the counter measures that the

[6] The constitutional arrangement, however, may lack stability as the member states of a federation may want to change the institutional design in order to benefit from the redistributive nature of those institutions (see Filippov et al. 2003).

elites plan to undertake in order to tackle this (whether real or imagined) internal threat. Finally, I expect to find arguments by the key political leaders, linking the threat, however it may be exemplified, with a need for the fiscal bargain. Such a bargain would lead to fiscalization—granting federal-like government the power to tax, which would be used to either tackle the current threat or prevent such a threat from causing economic (and political) damage in the future. The empirical evidence of the threat will therefore be, for instance, both the actual economic crisis (and its perception among the elites) and the fears of a future crisis emerging in the union. The methods to be used in the attempt to find this evidence are the subject of the following section.

1.5 Research design

In this section, I will discuss my case selection in order to demonstrate why it is legitimate to compare the fiscal structures of the modern EU with the eighteenth-century USA. I will then present my methods, putting a special emphasis on the case study, comparative analysis, and process tracing. I will conclude with the data collection, where I will show how I gathered the primary sources which will be analysed in the following empirical chapters.

It has been argued that 'the primary criterion for case selection should be relevance to the research objective of the study' (George and Bennett 2005: 83). The main research objective of this book is theory testing. Given this objective, it is important to note that the case selection was made within the 'coming-together' forms of federation, as identified by Stepan (1999). It is important because the research question of this book concerns the emergence of federal fiscal powers, in a situation in which, previously, the full fiscal power was vested in the hands of the member states.

In the coming-together federations, the member states decide to pool some of their fiscal power to the federal level. A reverse situation happens in the case of the 'holding-together' forms of federation, in which previously centralized states (like Spain or Belgium for instance) at some point decide that federalization is needed to accommodate the diverse needs of different regions, so the country can 'hold' together. In focusing only on the coming-together type of federal or quasi-federal polities, I follow the advice of George and Bennett (2005: 83), who argue that in some types of comparative study 'all the cases must be the instance of the same subclass'. The comparison between the EU and the USA is a well-established tradition in the comparative federalism field, and is sometimes labelled 'the lessons for Europe' type of research.[7] As Burgess (2009: 30) puts it: 'federalism in the context of the EU is the application of federal principles to the process of European integration where the term integration refers to the sense of a coming together of previously separate or independent parts to form a new whole'.

One of the most common critiques to this kind of comparison is that federations, such as the USA, are much more centralized than the EU, to such a degree that this difference 'amounts to a difference in kind'.[8] Those are justifiable critiques and should not be dismissed too quickly. They refer, however, to the comparisons made between the modern USA and the modern EU and in such a case they are valid to a large extent. In order to counter these critiques, one could compare the two polities at the same point in their development since their creation. Many scholars have already followed this path of inquiry and compared the antebellum USA (the pre-Civil War period) to the EU (Glencross 2009; Henning and Kessler 2012). As Kelemen (2013) puts it when he argues the benefits of comparing the USA with the EU at the same stage in their 'federal' development:

> One challenge in comparing the EU to federal polities is that one must determine not only which federal systems potentially offer the most relevant comparisons, but from which point in time one should draw the comparisons. In other words, should we compare the allocation of core state powers in the EU with that in the US ... today? Or should we compare the EU with the early years of those federations? ... Therefore, any comparison of the integration of core state powers in the EU with that in coming-together federalisms should be based on a long-term, historical perspective, and we should recognize that the EU is only in its sixth decade of integration, whereas the US federal system was founded in 1789. (Kelemen 2013: 213)

My aim is to follow this advice and to compare the two polities when their fiscal structures were similar, as acknowledged by Sargent (2012). Notwithstanding this rationale, there are many differences between the USA in the 1780s and the EU in the 2010s, which have to be mentioned. On the one

[7] Sometimes scholars also draw lessons *from* the EU for the USA—see for instance Kelemen (2014).

[8] For instance, Moravcsik (2001: 186): 'I have argued that the EU is an exceptionally weak federation. So weak, indeed, that the difference in degree between it and national federations amounts to a difference in kind. The EU's narrow substantive range, modest budgetary resources, lack of coercive force, minuscule bureaucracy, constraining decision-rules within a multi-level system, and far more powerful competitors mean that it might well be thought of something qualitatively different from existing federal systems'.

hand, fiscal discipline, high tax capacities and levels of prior debt, a banking crisis, monetary union, and a tradition of different welfare and nation states, were all present in the EU, but not in the USA. On the other hand, in the USA there was a common cause of the debt of the states: the War of Independence, while—prior to the Coronavirus crisis—this was not the case in the EU, where debt resulted mainly because of the policies of individual countries (Steinbach 2015).

In Chapter 2 devoted to the US case, I first analyse the fiscal situation of both the states and the union. Then, in Chapter 3, I examine the arguments concerning the federal power to tax that were used during the ratification process of the US Constitution. I do so, because for my argument it is important to consider how the threat was perceived by the political elites. The EU case is different than of the USA, as the emergence of a fiscal capacity has not happened so far, and maybe never will. Nevertheless, the dynamics of the crisis, which constitutes an internal threat, may change this. Based on my theoretical argument, the process of fiscalization will be launched if the crisis continues to affect the economy and to threaten the EU. Although fiscalization did not happen, the EU decided to implement stringent regulation of the national fiscal policies instead, to issue common debt, and to launch a debate on the future of the EU, where the idea of fiscalization (or, in the EU jargon, 'fiscal capacity') plays an important role. Consequently, in Chapters 4 and 5, I analyse regulation of the fiscal policies of the EU member states, as well as the debates concerning fiscalization in order to test my 'threat' hypothesis. Below I outline the methods used to achieve that goal.

In order to answer such a complex research question as outlined in Section 1.1 ('What are the conditions under which fiscalization is likely to emerge?'), it is more appropriate to conduct case studies rather than large N studies. This is because such a question requires an in-depth investigation of the conditions that precede the emergence of fiscalization, and so only a historical study can be employed to discover the most important conditions. Comparison, on the other hand, can shed further light on a polity such as the EU. It enables the researcher to see all the differences, as mentioned earlier in this section, but also the similarities of the instruments of fiscal integration. The method employed in this book will therefore be a focused, structured comparison (George 1979; George and Bennett 2005). I will conduct a theory-guided historical analysis, with historical institutionalism being my main methodological approach (Steinmo et al. 1992; Thelen and Steinmo 1992). Importantly, historical institutionalism, as Steinmo (2008) notices,

> is distinguished from other social science approaches by its attention to real-world empirical questions, its historical orientation and its attention to the ways in which institutions structure and shape behavior and outcomes. (Steinmo 2008: 118)

For these reasons—taking history and institutions seriously in order to answer salient, 'real-world empirical questions'—historical institutionalism is the most appropriate approach for the kind of research question I aim to answer.

I use process tracing (PT) (George 1979; George and McKeown 1985; Collier 2011; Bennett and Checkel 2015), a method which focuses on time, allowing the researcher to 'specify the causal mechanisms that connect causally relevant events within ... process' (Falleti 2013: 141). PT allows for the analysis of the phenomenon under scrutiny on a temporal dimension, rather than at one particular point in time. This type of inquiry is what Pierson (2004) calls a moving picture, as opposed to a snapshot. In this way, PT allows for not only timing of important (usually causal) events to be analysed, but also their sequence—what happened when, which events were first, and which came only later. PT also enables the researcher to trace pertinent actors involved in the case (usually in decision-making)—their knowledge and behaviour—'who knows and does what when' (Bennett and George 1997: 19). This feature of PT has profound implications for the type of data the researcher uses for her/his work. A useful distinction has been made between data set observations and causal process observations (Brady and Collier 2010: 184–96). PT employs mainly the latter category and can be seen as collecting 'empirical material in order to detect the potential observable manifestations of underlying causal mechanisms' (Beach and Pedersen 2011: 20).

I collected such empirical material and subsequently analysed original evidence from primary sources in the empirical Chapters 2–5. In Chapters 2 and 3 devoted to the US case, I did original work on the primary sources that were collected and published in *The Documentary History of the Ratification of the Constitution* (Kaminski et al. 1976–; abbreviated here as DHRC). Moreover, I used the following collection of primary sources: *The Papers of Alexander Hamilton*, Vol. IV–V (Syrett 2011, (abbreviated here as PAH); *The Papers of George Washington: Confederation*, Series, Vol. II–IV (Abbot 1995) (abbreviated here as PGWCS), and *The Records of the Federal Convention of 1787*, Vol. I–IV (Farrand 1911) (abbreviated here as RFC).

In Chapters 4 and 5, devoted to the EU case, I also relied on primary sources, for instance the official documents of the European Commission, or the documents in which the EU member states provided their preferences on a number of issues regarding the future of the EU, including its fiscalization. Admittedly, these 'contributions' of the member states, as they are called, are not a perfect source, but they do have a number of advantages. First, all the members states answered the same set of questions, including one about the prospect of fiscalization in the EU. Second, an analysis of such an official 'survey' among the governments of the member states allows for a more holistic view than other types of sources, for instance, interviews. Third, by categorizing the arguments used by the member states, in the official documents in which they stated their preferences, I can test my hypothesis, and consequently check if any threat factor played a prominent role in this debate.

The empirical Chapters 2–5 employ document analysis as a main method for gathering information needed to test the hypothesis outlined in Section 1.4. The document analysis stage starts with the collection of primary sources, mainly official documents, such as legislative texts, declarations, speeches, press releases, minutes from the ratification conventions of the US Constitution, etc., but also pamphlets, letters, and newspaper articles such as those in *The Federalist.* I then review and analyse this evidence. This part of the empirical analysis will be concluded with the examination of findings in light of the formulated hypothesis.

Although some scholars have argued that 'interviewing is often necessary for establishing motivations and preferences' (Rathbun 2008: 690), I decided not to conduct interviews in order for the treatment of my two cases to be equal. As the aim of this book is to discover motivations in *both* the eighteenth-century USA and the modern EU, and as—unfortunately—I cannot interview Alexander Hamilton or the other Framers, I decided to rely on written documents in both cases.[9]

In this book two citation styles have been used. First, in-text parenthetical citations (author-date or Harvard-style), the most common format in political science, have been used for secondary sources. Second, citations in footnotes, most commonly found in the discipline of history, have been used for primary sources, which are less well suited to the author-date style. The reason for the differentiation of citation styles lies in the nature of this comparative study, which has extensively used primary sources. This differentiation allows the reader to easily identify a given source. Moreover, the number of each essay in *The Federalist* is always provided. Due to the extensive use of primary sources, the bibliography has been divided into two sections: primary and

[9] I am grateful to Alexander Trechsel and Stefano Bartolini for pointing this out to me.

secondary sources. The narrative has been enriched by the use of the iconographic material—tables and figures and the original quotes within the text. The four empirical Chapters 2, 3, 4, and 5 conclude with a summary, which allows for the systematization of the narrative and highlighting of the most important findings. Italics and capitals, if not stated otherwise, used in quotations are part of the original text. I used abbreviations throughout the text and, for the sake of the flow of the narrative,[10] I do introduce abbreviations several times, for example if they appear in more than one section.

In parts of the book devoted to the EU, the thematic scope of the analysis is limited to the euro-crisis and its aftermath. Thus, when I refer to the crisis I mean the euro-crisis, if not otherwise stated. I am aware of the most recent temporary changes in the economic and fiscal governance of the EU which came about as a result of the Covid-19 pandemic and I occasionally do refer to them. However, a fully-fledged analysis of the Coronavirus crisis and its aftermath lies beyond the scope of this monograph, for various reasons. On the one hand, the ratification of the Own Resources Decision allowing the European Commission to issue debt necessary to finance the Next Generation EU, of which the Recovery and Resilient Facility (RRF) is a central part, was completed only on 31 May 2021, when the book's manuscript was basically finished.[11] On the other, despite being called a 'Hamiltonian moment' by German Finance Minister Olaf Scholz,[12] this recovery instrument is quite limited both in its timeframe and scope, for several reasons. First, this instrument will not be permanent, as it will be 'only used to support the recovery from the economic fallout caused by the COVID-19 pandemic'.[13] Second, it is not clear how exactly this debt will be paid back because the EU still lacks its own taxing power as the European Council only agreed on the EU's levy on plastic waste. This leaves other potential new sources of revenue, such as a digital levy or a Financial Transaction Tax, for further debate as the EU will 'over the coming years

[10] And in order to make it easier for the reader to follow an admittedly wide range of—not always common—abbreviations (such as CSRs, MTOs, MIP, etc.).

[11] European Council, *Green light from all member states for EU recovery spending*, available at https://www.consilium.europa.eu/en/press/press-releases/2021/05/31/green-light-from-all-member-states-for-eu-recovery-spending/, accessed 10 June 2021.

[12] Vorwärts, *Olaf Scholz: „Wir arbeiten an einer besseren Europäischen Union,* available at https://www.vorwaerts.de/artikel/olaf-scholz-arbeiten-besseren-europaeischen-union, accessed 10 June 2021.

[13] European Council, *Green light from all member states for EU recovery spending*, available at https://www.consilium.europa.eu/en/press/press-releases/2021/05/31/green-light-from-all-member-states-for-eu-recovery-spending/, accessed 10 June 2021.

work towards reforming the own resources system'.[14] Third, the distribution of funds to the member states will be conditional on the implementation of Country Specific Recommendations (CSRs), a core part of EU's fiscal regulation regime. Finally, less than half (up to €312.5 billion in 2018 prices) of the RRF's funding will be in the form of grants, while the rest (€360 billion) will take the form of loans, similar to previous lending mechanisms as described in Section 4.2.3.

1.6 Contribution

This book sheds light on the mechanism of the emergence of a federal power to tax, making two original contributions to the theoretical and empirical literature. In reference to the former, in Section 1.3 it introduced the concept of fiscalization, which defines the emergence of a power to tax on the part of central government, and of a federal 'fiscal union', a concept which is often used, but is rarely defined. For instance, Fuest and Peichl (2012) provide five different elements of a fiscal union—it is sometimes difficult to know which elements or definitions scholars use when they write about a 'fiscal union' or 'fiscal integration' (see, e.g., Daniele and Geys 2015). Such a conceptual clarification helps to distinguish two fundamentally different instruments of fiscal integration: fiscalization, employed in the USA, as explored in Section 2.2, and fiscal regulation, mainly used by the EU, which I investigate in Section 4.2.

Concerning the latter, this book develops three main bodies of empirical literature, adding, first, to the historiography of the period. While federal fiscal policy under both the Articles of Confederation (Ferguson 1961; Dewey 1968; Becker 1980; Brown 1993) and the US Constitution (Studenski and Krooss 2003; Edling and Kaplanoff 2004; Einhorn 2006) has been well researched, the controversy over the federal power to tax during the ratification process of the US Constitution attracted less scholarly attention (but see: Beard 1913; Edling 2003; Maier 2010: 179–82 (on Massachusetts), 362–9 (on New York); Einhorn 2006: 162–73 (on the federal convention in Philadelphia), and 173–83 (on ratification in the states); Rakove 1996: 193–6).

Second, by analysing the Confederation period of the USA and the link between the sovereign debt crisis and the emergence of federal tax power, this book adds to the US–EU comparative federalism literature. As Thomas

[14] European Council, Special meeting of the European Council—Conclusions, EUCO 10/20, Brussels 21 July 2020, available at https://www.consilium.europa.eu/en/press/press-releases/2020/07/21/european-council-conclusions-17-21-july-2020/ accessed 10 June 2021.

J. Sargent remarked in his Nobel Prize lecture: 'The fiscal institutions of the EU today remind me of those in the U.S. under the Articles of Confederation' (2012: 3). However, the US–EU comparative federalism literature has largely overlooked the critical juncture period in the USA, from 1776 to 1789, when the system of financing the US federal government resembled that of the modern EU (but see: Georgiou 2022). Instead, in order to provide lessons on how federal solutions could be used in the euro area, this strand of literature has focused on the US federal fiscal policy *after* the Constitution was ratified (Bordo et al. 2011; Henning and Kessler 2012; Gaspar 2015).[15] This book sets out to fill these gaps in the literature and in doing so, in the empirical chapters, it relies mainly on primary sources.

Finally, by analysing the official documents issued by the EU member states, as well as those from the debate during the ratification process of the US Constitution, this book adds to the literature on states' preferences regarding fiscalization (but see Tarlea et al. 2019 for the analysis of the governmental preferences on the EU's Economic and Monetary Union reform and Kincaid 2014 for an analysis of the idea of concurrent taxation in *The Federalist*). Consequently, in Chapters 2, 3, and 5 I list the main arguments regarding fiscalization, which allows the main hypothesis of this study to be tested, as described in Section 1.4. This research enables the reader to learn about the similarities (and the differences) between the pre-Constitution USA and the modern EU with regards to their financial arrangements; a comparison of the arguments that were used while debating those arrangements; and, finally, the conditions under which the central level of government in federal-like polities is likely to obtain a power to tax. This is important, because of the crucial role taxes play in politics and the fact that a federal form of government is popular around the world, including its in traditional form of a nation state and—more recently—as a supranational polity, such as the EU.

In sum, the main contribution this book makes is to the literature on US–EU comparative federalism. At the same time, the scope of such an interdisciplinary work means that it touches upon many strands of research, including political economy (e.g. the Open Economy Politics tradition), the history of ideas, and economic history. While I am cognizant of these different sets of literature, it is not my ambition—nor, in my view, would it be feasible—to contribute meaningfully to all of them.

[15] See, however, Steinbach (2015) for an analysis of the pre-Constitution events related to the mutualization of sovereign debt.

Contributing to all strands of research is not feasible because it would require much more time, resources, and space than one could reasonably expect from one monograph. Contributing to the field of historical political economy, for example, would require devoting much more space to distributive conflicts, societal interests, the North–South divide, and so on. In turn, situating the narrative within the debates in modern political theory would be necessary to add to research on the history of ideas. Lastly, making a contribution to economic history would require more analysis of data—for example, which states were net payers, and which were net beneficiaries of different schemes, and so on. While I am certain that pursuing these paths would be interesting, I have elected to choose the field to which I can make the strongest scholarly contribution with this monograph—namely, the comparative federalism literature covering the USA and the EU. Nevertheless, I believe that the book is sufficiently engaging to attract scholars from those other strands of research as well.

This book proceeds as follows: in Chapter 2 I investigate the fiscal history of the early USA and provide empirical evidence for the main argument of this book, which links the emergence of a federal power to tax with an internal threat in the form of a sovereign debt crisis. In Chapter 3, I analyse the debates on a federal power to tax during the ratification process in order to show that many arguments are focused on the internal threat. Chapters 4 and 5 are devoted to analysis of the fiscal governance of the EU and the member states' arguments concerning the EU's fiscal capacity. In Chapter 6, I conclude with a comparative analysis of the two polities under investigation. I contrast their fiscal structures and the main arguments regarding fiscalization and provide some insights for the EU in forging a federal fiscal union taken from the US confederation.