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Comparative Fiscal Federalism and the Post-Covid EU: Between Debt Rules and Borrowing Power

Edited by Sergio Fabbrini, Tiziano Zgaga, and Tomasz P. Woźniakowski

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Editorial

Comparative Fiscal Federalism and the Post-Covid EU: Between Debt Rules and Borrowing Power

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Abstract
This thematic issue examines two main research questions: What are the features, the determinants, and the implications of fiscal integration in a system of multilevel governance like the EU? And, what can the post-pandemic EU learn from established federations when it comes to fiscal integration? We attempt to conceptualize the patterns of EU fiscal integration. In so doing, we identify eight instruments of fiscal integration in a federal or multilevel polity, equally divided between fiscal capacity and fiscal regulation, depending on the side of the budget and the mode of integration (autonomous or dependent). For instance, as part of the fiscal capacity instrument of integration, we propose to distinguish between revenue and expenditure capacity. Revenue capacity is then further divided into tax capacity, based on EU/federal taxes, and budgetary capacity, based on non-independent sources, for instance, contributions from the member states. Expenditure capacity is divided into autonomous spending capacity, meaning direct spending by the EU, and a dependent transfer capacity, where the EU merely distributes resources (both grants and loans) to the member states.

Keywords
economic governance; EU budget; EU taxes; fiscal capacity; fiscal integration; fiscal solidarity; fiscal union; fiscalization process; Next Generation EU; own resources

Issue
This editorial is part of the issue “Comparative Fiscal Federalism and the Post-Covid EU: Between Debt Rules and Borrowing Power” edited by Sergio Fabbrini (LUISS University), Tiziano Zgaga (University of Konstanz), and Tomasz P. Woźniakowski (University of Wrocław/ LUISS University).

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1. Instruments of Fiscal Integration in the Post-Covid EU

This thematic issue argues that today’s EU finds itself in a sort of fiscal limbo. Following the Covid-19 pandemic, the core of the EU’s fiscal regulation—the Stability and Growth Pact (SGP)—is currently suspended until 2024. Thanks to an unprecedented recovery programme—Next Generation EU (NGEU)—the EU’s fiscal capacity has changed but these changes are limited in time (NGEU expires in 2026) and scope (borrowing power and not fully-fledged taxing power). At the same time, the Russian war against Ukraine forced the EU to put in place ad hoc fiscal solidarity solutions to support common military initiatives and cushion the economic implications of the war on Europe. As a result, we argue that this original combination of rules and resources—the EU’s new fiscal policy mix—needs a clear-cut conceptualization. In this editorial, we move beyond Genschel and Jachtenfuchs’ (2014) distinction between two instruments of fiscal integration—fiscal capacity and fiscal regulation—and develop it further. Fiscal capacity involves two sides: revenues and expenditures. Fiscal regulation comprises rules regulating the EU’s revenues and expenditures. At the same time, it also includes rules regulating the revenues and expenditures of member states (MSs), thus

constraining national sovereignty over a crucial area of core state powers like fiscal policy (Zgaga et al., in press).

2. EU's Fiscal Patterns

An attempt to conceptualize the patterns of EU fiscal integration is represented by Table 1.

Fiscal capacity and fiscal regulation can be conceived of as autonomous if supranational institutions (the European Commission and the European Parliament) are involved in the decision-making process. On the contrary, the two instruments of fiscal integration are dependent on the MSs if the intergovernmental institutions (the Council and the European Council) are the key decision-makers. Starting from the upper left cell, the autonomous revenue capacity results from the process Woźniakowski (2018) coined "fiscalization" which leads to central tax capacity. Hence, for us, revenue capacity is autonomous if the centre finances itself only or mainly through independent resources in the form of taxes. Second, a dependent revenue capacity leads to what we call budgetary capacity, where the focus is on the size of the budget rather than on the mode of obtaining the revenue. Here, the revenues are based mostly on MSs' contributions rather than on independent resources. Moving down the capacity axis, the lower left cell, autonomous spending capacity, means direct spending by the EU—for instance, to provide common public goods. In this sense, spending capacity resembles a federal budget which is used directly by a government—for instance, for military or welfare expenditures. Spending capacity can involve both independent and non-independent resources and differs from transfer capacity, where the EU distributes independent and non-independent resources in the form of both grants and loans to the MSs, which spend them subject to conditionality. In this sense, transfers resemble grants-in-aid known from the established federations. Such a dependent budgetary capacity and transfer capacity represent the biggest part of the revenues and expenditures of the regular EU budget (the Multiannual Financial Framework) and NGEU.

Moving right the axis of the instruments of fiscal integration, to fiscal regulation, the upper left cell, which indicates the regulation affecting EU revenues, is called the revenue regulation of the centre. This includes rules on the EU budget. The second cell, which points to the regulation affecting MSs' decisions on taxes and debts, is called the revenue regulation of the units. Such rules involve tax harmonization and rules on borrowing, such as those of the SGP, the Six Pack, and the Two Pack. The third cell is the expenditure regulation of the centre. This concerns restraints on policy areas of EU spending, for example, the Common Agricultural Policy and cohesion policy, but also the lack of EU welfare benefits. The fourth cell indicates the expenditure regulation of the units and refers to the impact of the EU on the spending policies of the MSs, as exemplified by various *Country Specific Recommendations of the European Semester*, the annual framework for EU economic regulation.

It is not yet clear how the post-pandemic EU is going to combine fiscal regulation and fiscal capacity. As Zgaga (2023a, p. 2) notes, this implies that "the future division of fiscal sovereignty between the EU and the MSs has not yet been clarified." Can the EU learn something from established federations and, if so, what exactly?

3. Comparative Fiscal Federalism

This thematic issue discusses the fiscal trajectory of the EU from the perspective of comparative federalism, according to which the EU is not a sui generis political system, but can be better understood if compared to established federations (Fossum & Jachtenfuchs, 2017; S. Fabbrini, 2019). Specifically, this thematic issue adopts comparative fiscal federalism to interpret EU fiscal developments in light of the experience of consolidated federations with different borrowing, taxing, spending,

Table 1. Instruments and modes of EU fiscal integration.

		Instruments of fiscal integration			
		Fiscal capacity		Fiscal regulation	
Mode of fiscal integration (autonomous or dependent)		Autonomous: Supranational institutions involved	Dependent: Intergovernmental institutions only	Regulation of the centre (autonomous or dependent)	Regulation of the units (autonomous or dependent)
Side of the budget	Revenue capacity	Tax capacity based on independent resources (fiscalization)	Budgetary capacity based on non-independent resources	Revenue regulation of the centre	Revenue regulation of the units
	Expenditure capacity	Spending capacity of independent or non-independent resources	Transfer capacity of independent and non-independent resources	Expenditure regulation of the centre	Expenditure regulation of the units

and regulatory powers, and identify insights from them. We consider both decentralized federations (federal unions, like the US and Switzerland) and centralized federations (federal states, like Germany and Canada; S. Fabbrini, 2017; Kelemen & McNamara, 2022).

Comparative federalism shows that developing fiscal autonomy requires "fiscalization" which is defined as "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" (Woźniakowski, 2022, p. 10), namely the dependency on national transfers. Fiscalization comes about as a result of an existenstial internal threat and stresses that what matters for fiscal autonomy is not only the resources' size (revenue endowment) but also the resources' source (revenue diversification). A crucial lesson from comparative fiscal federalism is that multilevel governance systems managed to develop an autonomous fiscal capacity at the central level only once they developed a significant tax capacity, i.e., access to taxes that produce large revenues, such as an income tax and a value-added tax. On the one hand, such fiscalization process leading to the emergence of a federal fiscal union with taxing powers (Woźniakowski, 2022) would imply that significant fiscal powers are transferred to the centre which, thus, would no longer depend on national transfers. On the other hand, in federations, the empowerment of the centre does not significantly impair the spending power of the constituent units, but rather the fiscal sovereignty of the centre coexists with the fiscal sovereignty of the units (Zgaga, 2023a).

4. Overview of Contributions

By combining the contributions from the disciplines of political science, political economy, and law, this thematic issue aims to locate the post-Covid EU in the context of the literature on comparative fiscal federalism. The first set of contributions focuses on the nature of the EU's revenue capacity. Groenendijk (2023) analyses the EU's revenue capacity to show that the EU's own resources, to a large extent, constitute de facto taxing power, that the EU significantly uses off-budget borrowing capacity, and that it has a variety of schemes that offer revenue capacity to the centre, through the pooling of resources (transfers, guarantees) by its MSs and third countries. García Antón (2023), on the other hand, argues that the EU has the power to tax, embedded in the narrative of the internal market, provided that the chosen resources in the basket match its objectives and policies, but the MSs are still the "masters" to unanimously decide the level of resources.

The second set of contributions deals with the evolution of the EU's fiscal capacity and the use of off-budget financial instruments. Breuer (2023) compares the introduction of NGEU with the public goods budget of the European Coal and Steel Community (ECSC). Revisiting the ECSC budget system allows her to understand the fiscal federal appearance of the NGEU funds, which is limited through the institutional structure of the EU's transfer budget. Capati (2023), in turn, explains the change in the EU's financial assistance regime between the euro crisis and the Covid-19 pandemic. The author finds that financial assistance in the EU moved from "intergovernmental coordination" with the European Stability Mechanism to a form of "limited supranational delegation" with the NGEU' s Recovery and Resilience Facility and argues that such a change is due to a collective policy-learning process. F. Fabbrini (2023) examines the two key tools deployed by the EU to fund Ukraine in its war against Russia, namely the European Peace Facility and the Macro-Financial Assistance Instrument. The author argues that while the war in Ukraine quickly prompted the EU to replicate some of the novelties it used to respond to the Covid-19 pandemic, structural fiscal and governance weaknesses still limit the ability of the EU to mobilize resources and leverage power on the international stage. In turn, Serowaniec (2023) focuses on the phenomenon of "debudgetization" of public finances in Poland after Covid-19 and the Russian invasion of Ukraine to show that using off-budget instruments in cases of emergency limits the transparency, legitimacy, and parliamentary oversight of state public finances.

The third set of contributions compares the EU with established federations. Woźniakowski (2023) compares the mode of financing the NGEU with the American central budget, under the Articles of Confederation when Robert Morris was in charge of the United States' finances. The author shows that both are based on borrowing, without significant tax capacity, which could be used to pay off this central/federal debt. He points to the risk of disconnecting borrowing from taxing, which may result in fiscal chaos and even social unrest, when the central debt is paid by the MSs, rather than from the central tax revenues. In turn, Georgiou (2023) focuses on the historical development of fiscal regulation and federal fiscal capacity in the US and fiscal relations between the EU and the states. He outlines that the NGEU, with its borrowing at the central level and the bulk of spending at the state level, resembles the American system of grants-in-aid and "intergovernmental relations." Successively, Donnelly (2023) examines four mechanisms for establishing federal spending programs in the EU, Canada, and the US despite veto players' resistance. He shows that three of these mechanisms were used to overcome the opposition against the NGEU: clocks (temporary), caps (limited amount of borrowing), and compartments (limited range of public policy expenditure). In turn, Zgaga (2023b) operationalizes the fiscal sovereignties—the fiscal sovereignty of the centre (here, the EU) and the fiscal sovereignty of the units (here, the MSs)—and specifies the conditions under which the two can coexist. He shows how a federal union like Switzerland organizes the coexistence of fiscal

sovereignties and identifies insights for the EU. Finally, Buti and S. Fabbrini (2023) outline the political and institutional conditions for the convergence towards a new fiscal equilibrium, combining central (although limited) fiscal capacity with binding (although simplified) rules on MSs' fiscal policies. They propose a "Triple-T model" composed of existential threats to the EU, trust among the units, and a time horizon—all three elements must come together for central fiscal capacity to emerge.

5. Conclusions

In conclusion, this thematic issue aims to contribute to an original strategy of fiscal governance for the EU, based on the combination of rules and resources in the form of a new fiscal policy mix. Overalll, our contributions show that the EU mainly uses transfer capacity, and very little spending capacity, while its revenue capacity is still mainly budgetary capacity, with a very limited tax capacity. This budgetary capacity—unable to address the various crises-related challenges via the regular EU budget—involves financial instruments which are often ad-hoc, temporary, off-budget, conditional, borrowing-based, transfer-oriented, intergovernmental, and with limited parliamentary accountability. The historical experience of the established federations shows that the central budget is mainly used to finance common goods at the federal level (via spending capacity) and less so as grants-in-aid or transfers to the MSs (via transfer capacity). If the EU wants to become resilient to future threats, it may have to follow this path of fiscalization, through creating a central fiscal capacity consisting of a tax capacity, which could be used to finance European public goods.

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Conflict of Interests

The authors declare no conflict of interests.

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Article

Revenue Capacity of the EU: Taxes, Tax Sharing, and Resource Pooling

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Abstract
This article analyses the revenue capacity at the "centre" of the EU. It first outlines major elements ("segments") of EU "federal" fiscal capacity, both on the revenue and expenditure side, as well as on- and off-budget. It provides a new typology of taxes in a multi-level setting, based on tax ownership and decision-making on tax bases and/or rates. It then enters the so-called EU budgetary galaxy and (a) analyses how the centre utilises different types of revenue capacity and (b) discusses if the so-called "own resources" have tax features. The article finds that these own resources, to a large extent, de facto constitute taxing power, that the EU significantly uses off-budget borrowing capacity (through the European Investment Bank and the European Commission) and that the EU has a variety of schemes that offer revenue capacity to the centre, through the pooling of resources (transfers, guarantees) by its member states and by third countries. The way in which a large portion of the Next Generation EU resources have been channelled into the EU budget (by means of externally assigned revenue) completes the image of a centre with fiscal capacity, rather than an entity that spends but has no true fiscal powers.

Keywords
EU budget; EU finances; fiscal autonomy; fiscal capacity; fiscal integration; Next Generation EU; own resources; revenue capacity; tax sharing

Issue
This article is part of the issue "Comparative Fiscal Federalism and the Post-Covid EU: Between Debt Rules and Borrowing Power" edited by Sergio Fabbrini (LUISS University), Tiziano Zgaga (University of Konstanz), and Tomasz P. Woźniakowski (University of Wrocław/ LUISS University).

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1. Introduction

Possibilities to provide the EU with the "power to tax" have been discussed for decades, most recently by the European Parliament (Fernandes & Hayer, 2023), but such a power has never formally materialised. Instead, in the EU there is an upward-funding scheme with transfers which euphemistically are labelled "own resources" (OR), that pay for the expenditure in the Multiannual Financial Framework (MFF) and the annual EU budgets. The EU is therefore said to suffer from an extreme negative fiscal gap: The centre spends but does not raise any autonomous revenue. This is contrary to most consolidated federations (and to most unitary states), where there is a so-called positive fiscal gap (Boadway & Keen, 1996): The centre raises more revenue than needed for its own expenditure, resulting in downward funding from the centre to the units.

In contrast to the state of affairs regarding the regular long-term EU budget, EU public finances at large have evolved rapidly under the pressure of major crises. In response to the eurozone crisis, member states (MSs) started to pool resources to fund stability mechanisms and eventually created the European Stability Mechanism (ESM). In response to the Covid-19 pandemic, Next Generation EU (NGEU), an unprecedented recovery program financed through bonds issuing on behalf of the EU by the European Commission (EC), was created to supplement the regular long-term budget. Some have referred to this as a Hamiltonian moment in the development of the EU fiscal regime (for a discussion on the adequacy of that comparison, see Georgiou, 2022). In response to Russia's invasion of Ukraine, the European Council decided in May of 2022 to provide Ukraine with exceptional Macroeconomic Financial Assistance (MFA+; this is specifically addressing

Ukraine). In addition, resources for military assistance were made available to Ukraine through the European Peace Facility (EPF). More generally, resource pooling by MSs has a longer history which includes the European Development Fund (now mainstreamed into the general EU budget), InvestEU (the former Juncker Plan), and several earlier trust funds. Rather than developing into a single, autonomous, EU budgetary order, EU finances have developed into a "budgetary galaxy," with a variety of funds and instruments positioned off-budget and around the regular EU budget (Crowe, 2017; High Level Group on Own Resources, 2016, Annex IV).

This article deals with the revenue capacity of the "centre" or "federal" level of the EU. It analyses what revenue capacity this centre currently uses, both on- and off-budget. Regarding the regular long-term budget, this article calls a spade a spade and challenges the prevalent view that the EU has no federal taxes. Both the traditional own resources (TOR) and the VAT transfers are de facto EU taxes and constitute autonomous revenue capacity (ARC) for the centre. It argues that resource pooling by means of transfers by EU MSs, and in some cases third countries, has always been quite common in the wider galaxy and that the same is true for resource pooling based on borrowing. What is new (or Hamiltonian) with NGEU borrowing is that resources are channelled into the regular long-term budget, as externally assigned revenue (EAR).

The article is structured as follows: It first deals with the concepts of fiscal capacity, fiscal regulation, and fiscal autonomy; subsequently, actual revenue capacity is analysed; the final section contains the discussion and conclusion. Unless stated explicitly otherwise, the term EU will be used hereafter to denote its centre or "federal" level.

2. Conceptual Issues

2.1. Fiscal Capacity in Seven Segments

In this article, *fiscal capacity* is understood as the power to tax, borrow, and spend. If we leave aside borrowing capacity for now and first focus on the power to tax and spend, governments can be placed in a so-called expenditure-revenue space, as shown in Figure 1 for a federal government.

Along the horizontal axis, the share of federal government in total government revenues is plotted. This refers to autonomous resources for the federal level, using its own extractive capacity, i.e., its ARC. This builds on the definition given in the introduction to this thematic issue (Woźniakowski et al., 2023), where such ARC is defined as fiscal capacity resulting from independent sources, i.e., from central taxing powers. This conceptualisation of revenue (or tax) capacity is thus different from other uses of the same term or of similar and related terms, such as tax(able) capacity and tax effort in the context of effectiveness of tax systems, for example of developing countries (e.g., Chigome & Robinson, 2021). The article does not address capacity aspects of taxes that relate to the sensitivity of revenues to rate changes (tax elasticity) or the development of the tax base (tax buoyancy; e.g., Cornevin et al., 2023).

Along the vertical axis of Figure 1, the share of federal government in total government expenditure is plotted. Here we also refer to the autonomous dimension: expenditure made for the federation's own production, i.e., for its own policies and services, relating to its *autonomous spending capacity* (ASC) as defined in the introduction to this thematic issue (Woźniakowski et al., 2023). The two shares can be thought of as two dimensions of (de)centralisation. The further away from the origin (O) a combination of revenue-share and expenditure-share lies, the more centralised the federation is.

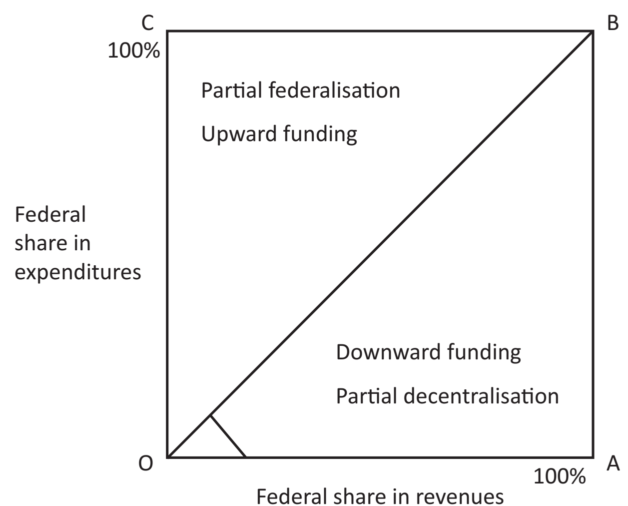

Figure 1. Federal government shares in total government expenditures and revenues. Source: Author's work based on Steunenberg and Mol (1997).

On the line OB lie all the points with an equal revenue-share and expenditure-share for federal government. Here, for both the federal level and the units within the federation there is full congruency between expenditure (or production) and revenue. This means there is no need for transfers between the federal level and the units. Points O, A, B, and C stand for four different highly hypothetical ideal types of fiscal structure: In O there is full decentralisation, without any federal government; in B there is full centralisation, without units; in A there is federal taxation but with production at the unit level; and in C there is federal production with taxation at the unit level. The upper-left triangle of Figure 1 represents situations where federal revenue capacity falls short of spending capacity. The lower-right triangle represents cases where federal revenue capacity exceeds spending capacity. Such incongruencies between revenue and spending capacity imply vertical fiscal gaps (Boadway & Keen, 1996). As seen from the federal level, a negative fiscal gap results in the need for upward

funding. In the conceptualisation used in this thematic issue ((Woźniakowski et al., 2023), and from the perspective of the federal level, such funding would create *dependent revenue capacity*. A positive vertical gap creates the opportunity for downward transfers (or *transfer capacity*).

In the literature, there is some confusion over terms. Vertical fiscal *gaps* may imply incongruencies that as such are not necessarily problematic but need to be offset by means of intergovernmental transfers. Such gaps may actually be desirable because, for example, downward funding provides the federal level with the possibility to use fiscal transfers for reasons of equity (such as equalisation transfers) and/or stability. Highly relevant to the EU situation, upward and downward funding may be combined in that upward funding provides the means for the federal level to engage in downward funding. Vertical fiscal *imbalances* may imply an undesirable mismatch or misallocation, which should be corrected by changing the allocation of capacities as such. Sharma (2012) suggests using the term vertical fiscal *asymmetries* for both cases. Brueckner (2009) suggests using the term *partial decentralisation* when production is decentralised but not matched with revenue capacity (the lower-right triangle in Figure 1). *Partial federalisation* refers then to a situation where federal production is not matched by revenue capacity (the upper-left triangle).

Partial federalisation thus implies a need for additional fiscal capacity, derived from upward funding. Deviating slightly from the introduction to this special issue (Woźniakowski et al., 2023), we distinguish between two elements of revenue capacity: (a) ARC and (b) transfer-based revenue capacity (TBRC). For the latter, we do not use the term "budgetary capacity" because this term implies a more generic type of capacity, almost equal to fiscal capacity. If we then bring in borrowing, ARC can be further split into (a) autonomous tax capacity (ATC) and (b) autonomous borrowing capacity (ABC). On the expenditure side, we make a similar distinction for spending capacity: (a) ASC and (b) transfer spending capacity (TSC).

A complication arises if we take into account the possibility of off-budget expenditures and revenues. This issue is highly relevant to the EU's finances. In addition to on-budget revenue capacity (ATC + ABC + TBRC) and on-budget spending capacity (ASC + TSC), we must distinguish between off-budget revenue capacity and off-budget spending capacity. Figure 2 shows these five different segments of (on-budget) fiscal capacity and the two off-budget segments of fiscal capacity. For now, we do not make further distinctions within the off-budget segments. The dotted lines indicate that the share of the various on-budget (revenue and expenditure) components can vary. Still, ATC + ABC + TBRC = ASC + TSC. Also, off-budget revenue capacity = off-budget spending capacity.

2.2. Fiscal Regulation: Tax Ownership and Decision-Making

If we focus on taxing capacity (segment ATC), federal taxing powers can be non-existent, exclusive, or shared, depending on who "owns" the relevant tax base. In addition, a distinction can be made depending on who decides on the content of the tax base (i.e., what exactly is taxable and what is not?) and/or the level of the rates. In the literature, two possibilities have been especially discussed. First, there is tax sharing: Different levels of government tax the same base. Secondly, there is joint taxation: a tax-sharing situation where the governments involved also co-decide on the various parts of the base and rates (Groenendijk, 2011). Table 1 shows that there are more possibilities.

Sometimes it is argued that there is little difference between tax sharing and upward or downward funding by means of intergovernmental grants, for example,

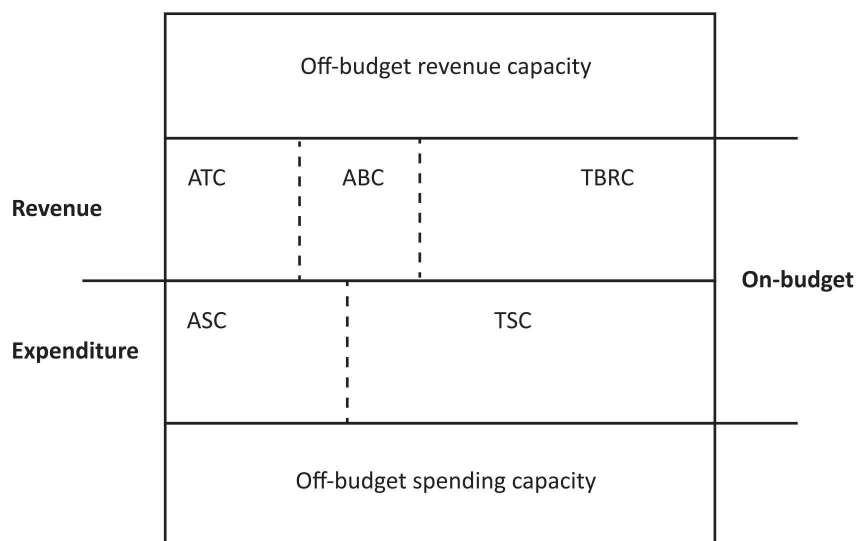

Figure 2. Fiscal capacity in seven segments.

Table 1. Division of taxing powers according to base and decision-making.

		Ownership of tax base		
		At the federal level (exclusive)	Co-ownership (tax sharing)	At the unit level (exclusive)
Decision on tax base content and/or rates	Federal level decides	Autonomous federal tax	Centrally split taxation	Centrally regulated tax at the unit level
	Federal level and units decide together	Coordinated federal tax	Joint taxation	Coordinated tax at the unit level
	Units decide	Decentrally regulated federal tax	Decentrally split taxation	Autonomous tax at the unit level

when, with downward funding, the level of such grants is linked to the level of (certain) federal tax revenues and the units are entitled to a certain share of the federal revenue cake. Tax sharing however involves some elements that are often missing in the case of intergovernmental grants (see in more detail Blöchliger & Petzold, 2009). First, tax sharing implies risk sharing as both the federal level and the units bear the risk of tax revenue slack and fluctuations. With intergovernmental grants, grant levels are often set for the longer term and are independent of short-term revenue fluctuations (with the risk of such fluctuations being borne by the granting government). Secondly, revenues from tax sharing are non-conditional, which is not necessarily the case with intergovernmental grants.

Both revenues from tax sharing and from intergovernmental grants can be earmarked. This is true for non-shared taxes as well, as it is for borrowing. Earmarking can be present throughout all fiscal capacity segments. With earmarking a certain part of a fiscal revenue capacity segment is linked to a certain part of a fiscal spending capacity segment.

2.3. Fiscal Autonomy

How does fiscal capacity relate to fiscal autonomy? The problem here is that fiscal autonomy is not defined uniformly in the literature (e.g., Gomes, 2012) and that it has different dimensions (see, for example, Zgaga, 2023b). It can mean the independent power to tax, based on co-ownership of tax bases. In that case, the higher the ATC, the more autonomy. It can also mean the ability to independently cover expenditure, i.e., revenue adequacy (do ATC and ABC provide sufficient means for ASC?). It can refer to the share of autonomous revenues and spending as compared to revenue and spending associated with up- and downward funding (ATC, ABC, and ASC in relation to TBRC and TSC). It can also refer to discretion regarding specific revenue and expenditure issues (i.e., institutional autonomy, such as the right to set own tax rates, the right to decide whether certain revenues are earmarked or not, the absence of conditionality for intergovernmental grants, etc.). Also, with borrowing (ABC) there can be differences in autonomy: For example, can federal borrowing be backed up by federal guarantees (i.e., future revenue on the federal budget) or does it have to be backed up by the units?

3. Revenue Capacity and the EU Budgetary Galaxy

Based on the previous section, this section analyses the actual revenue capacity the EU has on- and off-budget. First, the focus is on the EU's OR and the question of whether they constitute EU taxes or not (Section 3.1). Subsequently, the use of on-budget funds and assigned revenue is discussed (Section 3.2). Then, the focus will shift to the off-budget domain. Section 3.3 deals with off-budget funds based on transfers. Section 3.4 discusses similar funds and instruments based on borrowing. Finally, Section 3.5 addresses the NGEU: off-budget borrowing, that is however partly used on-budget.

The review in this section is based on literature and document analysis. The main literature and policy documents used are referred to in the text. Use has also been made of Begg et al. (2022) and Crowe (2017), and additionally of a very large number of legislative documents and various websites (especially for Sections 3.3–3.5). No reference is made to these sources for reasons of conciseness and readability.

3.1. Own Resources: Autonomous Tax Capacity or Transfer-Based Revenue Capacity?

The *Future Financing of the EU: Final Report and Recommendations of the High Level Group on Own Resources*, henceforth Monti report, defines OR as "revenue allocated irrevocably to the Union to finance its budget and accruing to it automatically without the need for any subsequent decision by the national authorities" (High Level Group on Own Resources, 2016, p. 20). The decision to allocate resources to the EU (the own resources decision [ORD] usually revised with each new MFF) requires unanimity in the Council and ratification by all MSs. After ratification, the revenue is "owned" by the EU. According to the report, this type of decision is very similar to a central government attributing some fiscal revenue by means of intergovernmental grants to sub-national levels of government. The report further

argues that OR do not constitute EU taxes because, based on its reading of the TFEU, within the EU tax competencies remain with national authorities and the EU does not have the power to levy taxes. In this view, all OR are thus in the TBRC segment. The report also argues that what would deserve to be called a real EU tax would be decided and levied by the EU, and the rates would be set by the EU legislative authority. The revenue would a priori (and not after ratification) accrue to the EU budget. The report argues that the TFEU does not allow this possibility and the EU would first have to be granted the power to levy taxes. It considers such a treaty change not realistic or viable, and it, therefore, refrains from proposing such a step (High Level Group on Own Resources, 2016, p. 24).

At the same time, the Monti report argues that MSs should register in their own budgets all revenue that will be transferred to the EU as attributed revenue ("reserved" as being "owned" by the EU), rather than as expenditure (as would be the case with intergovernmental grants). The report also discusses the extent to which some OR are more "owned" by the EU than others. Are the TOR, for example, more owned by the EU than other OR? The TOR, which for 99.9% are made up of custom duties, cover 12.8% of the 2023 EU budget (Definitive adoption of the European Union's annual budget, 2023, p. 44). The Monti report defines these TOR as follows:

> In short, TOR are fiscal resources levied on companies and/or individuals, whose proceeds are attributed directly to the EU even if the collection is done at national level. This "right of access to the source of taxation," which involves independence from decisions of MSs—also called financial autonomy—is considered essential to qualify as an OR in the literature. (High Level Group on Own Resources, 2016, pp. 22–23)

In our view, this means that the TOR are taxes and represent ATC. That the actual levying is done by MSs is indeed not relevant. History is full of examples where actual tax levying has been outsourced to tax collectors. In the case of the European Coal and Steel Community, taxes on coal and steel production were levied by regional banks (Breuer, 2023). In addition, it is the EU that decides the base and the rates of the customs duties (based on its exclusive competencies in these fields), and the right of access to the source of taxation is exclusive to the EU. In the terminology of Table 1, the TOR are thus clear examples of autonomous federal taxes, with ownership of the tax base at the federal level, as well as decision-making at the federal level. Although the Monti report also takes the position that the TOR are exclusively owned by the EU, it refrains from calling the TOR EU taxes and prefers the continued use of the term OR. While this position is defendable given a certain reading of the TFEU and especially in light of the crucial role the Monti report gives to the ORD, the report also explicitly refers to "the sensitivity of the word 'tax,' and…the quality attached to it as one of the last expressions of sovereignty" (High Level Group on Own Resources, 2016, p. 20). Moreover, according to the report:

> Thus, talking about an "EU tax" or mislabelling the EU's own resources as EU taxes without further specification may not only be incorrect from a legal point of view, it fuels suspicion and incites criticism towards any attempt to reform the system of own resources by making policy makers and citizens believe that there is a hidden agenda behind such reform. (High Level Group on Own Resources, 2016, p. 20)

While acknowledging—but not necessarily agreeing with—some of the legal nuances as discussed in the Monti report, we find this position to be overly restrictive and counterproductive to a real debate on the nature of EU revenue capacity.

How about the VAT transfers, which finance 12.3% of the 2023 EU budget (Definitive adoption of the European Union's annual budget, 2023, p. 44)? Here we have a so-called call-up rate (0.3% for the 2021–2027 period, but higher in earlier periods) which is applied over the harmonised VAT resource base. Even though the VAT base as such is heavily harmonised, some differences still exist between MSs. These differences contribute to the need to design corrections for a more harmonised VAT resource base. For 2021–2027, these corrections are to be kept at a minimum, correcting MSs' VAT base only in the few cases foreseen in the TFEU and for infringements to the VAT directive. The Monti report also argued in favour of simplification, in line with many earlier proposals for a consolidated or moderated VAT resource, but also here insists on calling the VAT transfer an OR rather than a tax and uses the term revenue sharing. In our view, the VAT transfers are an example of tax sharing, more precisely of joint taxation, and constitute ATC (similar to the TOR). The call-up rate is decided upon jointly by the federal level and the units (through the ORD and its ratification), with MSs being free (within the limits of the VAT Directive) to set their own rate(s). The fact that the VAT call-up rate is not decided upon unilaterally at the federal level is not prohibitive for the tax nature of the shared and joint VAT. Intergovernmental decision-making can go hand-in-hand with supranational taxation, as the example of the European Coal and Steel Community shows (Breuer, 2023). Moreover, some sort of representation of units in federal decision-making is prominent in many federations, but that does not turn the (federal or shared) taxes involved into intergovernmental transfers.

The VAT resource has been reduced in magnitude in favour of the more general gross national income (GNI) contributions (i.e., the contributions based on the GNI of MSs). To some extent, this was due to administrative complexities which were exacerbated as a result of UK rebate corrections. The most important argument

against relying too much on the VAT resource is that a VAT is often perceived as being regressive (for a critical analysis of this view, see Thomas, 2022). Moreover, GNI contributions are thought to reflect better a country's economic capacity to contribute to the EU. Within the OR system, the GNI contributions (which finance 64.0% of the 2023 EU budget; Definitive adoption of the European Union's annual budget, 2023, p. 44) serve as a balancing resource, financing spending not covered by other revenues. Commonly, they are considered to be transfers and not taxes. Following our scheme, they constitute TBRC, not ATC. In this context, the Monti report emphasises the fact that both the VAT resources and the GNI contributions do not flow from any common policy. While this is debatable for the VAT anyway, because of its clear links to the functioning of the common market, the argument in general does not hold. What is the direct link in a nation-state between a personal income tax and national policies? As stated in the previous section, a tax does not have to be earmarked or linked to a policy field, in order to be—or to be called—a tax.

The ORD and MFF 2021–2017 have introduced a new OR that finances 3.8% of the 2023 EU budget (Definitive adoption of the European Union's annual budget, 2023, p. 44): the non-recycled plastic-based resource, or plastics own resource (i.e., national contributions based on the amount of non-recycled plastic packaging waste). A uniform call rate of €0.80 per kilogram is applied to the weight of plastic packaging waste that is not recycled, with a mechanism to avoid excessive contributions from less wealthy MSs. This OR is closely linked to the EU policy priorities, encouraging MSs to reduce packaging waste and stimulate Europe's transition towards a circular economy, part of the European Plastics Strategy. This OR has all the elements of a regulatory environmental tax and includes a base that is exclusive to the EU as well as, through the ORD, joint decision-making. It therefore is a coordinated federal tax and represents ATC.

One of the typical features of the EU budget is that it is both a budget for states and for citizens (Crowe, 2020). This is also reflected on the revenue side and that means we have to stretch our ideas a bit about who the taxpayers are in the EU context. The TOR have individual taxpayers (such as companies and citizens). A further revised VAT resource that would go even more in the direction of a true EU rate in addition to national rates would also have individuals as taxpayers. The plastics OR, however, has MSs as taxpayers. Stretching it a bit further, we could even conceive of the GNI contributions as an EU income tax, with MSs as taxpayers. It is exclusive to the EU, and the federal level and the units co-decide on its level, i.e., it is a coordinated federal tax.

To sum up, when we look at the core features of the current OR through the framework developed in the previous section, these OR are part of the EU's ATC. The TOR are exclusive EU taxes; the VAT resource is a shared tax. If we allow for the possibility of two types of taxpayers (individuals and MSs), the GNI resource and the plastics resource can be looked upon as being exclusive EU taxes.

3.2. Assigned Revenue and On-Budget Funds

The EU budget is not only financed by OR but has revenue from a variety of other sources as well which cover 7.1% of the 2023 EU budget (Definitive adoption of the European Union's annual budget, 2023, p. 44). These sources are brought together in the budget under the main heading of "miscellaneous" revenue, scattered over titles three to six of the budget. They consist of administrative revenue, interest, revenue from fines, and revenue related specifically to Union policies. Some of this revenue is so-called internal assigned revenue and is linked to the supply of goods, services, or products by the EU (e.g., revenue from the selling of EU publications is assigned to expenditure for the production of these publications). This earmarking is an exception to the general budgetary principle of universality (Regulation (EU, Euratom) 2018/1046 of the European Parliament and of the Council of 18 July 2018, 2018, Article 22.3). Next to internal assigned revenue, there is external assigned revenue (EAR; Regulation (EU, Euratom) 2018/1046 of the European Parliament and of the Council of 18 July 2018, 2018, Article 22.2).

One type of EAR is contributions from third countries. They come in various types. First, there is a contribution linked to the Withdrawal Agreement for the UK. Secondly, there are contributions linked to the European Economic Area (EEA), from European Free Trade Area members Norway, Iceland, and Liechtenstein. EEA contributions to the operational costs of EU programmes are calculated using a "proportionality factor" (Agreement on the European Economic Area, 1994, Article 82.1). This factor is based on the relative size of the GDP of the countries concerned compared to the total GDP of the EEA and is calculated annually. It is applied to all EU budget lines that have EEA relevance. This contribution to the EU operational costs represents the largest part of the EEA contributions. EEA states also contribute to the administrative costs of the EC, but this contribution is negotiated individually for each programme on an annual basis; it is both financial and in kind. EEA contributions are centrally collected by the EC's Directorate-General for Budget and redistributed among the relevant directorates-general. Thus, the contributions are clearly earmarked. An important principle of EEA contributions to the EU budget is that they are additional to it and do not lead to a lowering of contributions of EU MSs based on GNI. The result of European Free Trade Area participation is thus an increase in programme funds compared to the initial amounts as decided upon in the context of the MFF. Thirdly, there are earmarked contributions from a large variety of other non-EU countries to specific programmes (e.g., Horizon Europe, Erasmus+, International Security Fund, EU Global Navigation Satellite Systems, Programme for

Competitiveness of Small and Medium-Sized Enterprises [COSME], European Solidarity Corps, Visa Information System, and Schengen Information System). Here, Switzerland, Israel, and Turkey are the main contributors (for details, see European Court of Auditors, 2021). Fourthly, some of the EU decentralised agencies receive direct contributions from non-EU countries, as does the European Institute for Innovation and Technology (an independent EU body).

Another example of EAR concerns the Innovation Fund. This fund supports investments by poorer MSs in the decarbonisation of their energy sectors and the increase of their energy efficiency. The programme is administered by the European Climate, Infrastructure and Environment Executive Agency and project management of the fund has been delegated to the European Investment Bank (EIB). The expenditures (approximately €3 billion in 2023) will be financed by the auctioning of 2% of the total allowances for 2020–2030 under the EU Emissions Trading System (ETS) and from additional allowances transferred by some beneficiary MSs. A similar construction and funding mechanism is used for the Modernisation Fund (MF), which is the off-budget pendant of the on-budget Innovation Fund and has the same objectives (see Section 3.3). Whereas the Innovation Fund is run by the European Climate, Infrastructure and Environment Executive Agency, the MF is run by the beneficiary MSs in close cooperation with the EC and the EIB.

More generally, the general EU budget makes use of on-budget funds in a variety of areas. One example is the European Development Fund. Until its incorporation into the EU's general budget in 2021, the European Development Fund was funded outside the EU budget by the EU MSs based on specific contribution shares or keys which were subject to negotiation. The European Development Fund keys were, thus, different from the EU budget key, reflecting the comparative interests of individual MSs in this policy area. Now, European Development Fund expenditure is covered by general revenue as well as EAR (in the ex-ante budgetary phase often estimated as *pro memoria*). For example, the same applies to the European Defence Fund. Such on-budget funds are often used to supplement or co-finance MSs' expenditures.

How can we fit in these examples of assigned revenue? They represent a mix of sources. Some of the assigned revenue is related to the exchange of goods and services (quid pro quo) which does not really represent revenue capacity unless it comes with considerable profits. Some assigned revenue can be looked upon as examples of TBRC. The EEA contributions to some extent resemble the regular GNI contributions of EU MSs. Revenues from the sale of ETS allowances, which now largely feed into ETS MSs' budgets, are under consideration as potential new OR, but they are already used as earmarked revenue for the EU budget—at least partly and outside of the OR-funded MFF—and for the off-budget MF.

3.3. Off-Budget Funds and Facilities, Based on Transfers

Within the EU budgetary galaxy, we find some off-budget funds, funded by (a selection) of EU MSs, sometimes supplemented by third countries. In some cases, these off-budget are linked to the EU budget, in the sense that the EU budget contributes to these funds, as shown in Table 2.

The EU Trust Funds are part of the EU's external actions: the Madad Fund, the Bêkou Fund, the EU Trust Fund for Colombia, and the EU Emergency Trust Fund for stability and addressing root causes of irregular migration and displaced persons in Africa. These funds are financed by contributions from the EU budget, from MSs and from third countries. The set-up of the Facility for Refugees in Turkey is similar to these trust funds but does not include contributions from third countries. Plans to

Table 2. Off-budget funds based on transfers.

Off-budget fund	Involved parties	Role of involved countries	Role of EU budget
EU Trust Funds	EU MSs and third countries	Direct contributions	Contributions
Facility for Refugees in Turkey	EU MSs	Direct contributions	Contributions
MF	MF members (Bulgaria, Croatia, Czechia, Estonia, Hungary, Latvia, Lithuania, Poland, Romania, and Slovakia)	Funded by the sale of ETS Transfer to the MF of additional allowances by some MF countries	None
Single Resolution Fund	Banking Union countries	Funded by private sector contributions Guarantee by ESM; backstop by Banking Union countries	None
EPF	EU MSs	Direct contributions	None

create a trust fund for the post-war reconstruction of Ukraine were presented in 2022 but have not yet been followed up.

The Single Resolution Fund is an odd one out, as it is financed by private banks across the 21 Banking Union countries. The Single Resolution Fund as such is not private but is owned by the Single Resolution Board, an independent EU agency. The so-called backstop is an emergency fund that can be used to double the size of the Single Resolution Fund if needed, by means of transfers from Banking Union countries (but to be repaid later by the private sector).

The EPF, established in March 2021, is meant to finance all external Common Foreign and Security Policy actions in military and defence areas. It finances the common costs of military Common Security and Defence Policy missions and operations (including support of such activities by other organisations) and provides capacity-building support to third countries (such as assistance measures). It replaced the Athena Mechanism and the African Peace Facility. Contributions to the EPF are determined based on a GNI distribution key. The EPF originally had a financial ceiling of close to €6 billion for the 2021–2027 period, with an annual ceiling going up from €420 million in 2021 to €1.1 billion in 2027. As the EPF is currently the prime vehicle for support to the Ukrainian armed forces, it has been topped up in 2023 by €2 billion, with the possibility of an additional top-up of €3.5 billion until 2027.

3.4. Off-Budget Funds, Facilities, Instruments, and Mechanisms, Based on Borrowing

Whereas the EU cannot borrow to balance its budget, it has the competency to borrow to support its policies. In other words: Borrowing is allowed, but not to cover a (ex ante) on-budget deficit. This means that in the case of the EU, ABC (in Figure 2) is non-existent; borrowing by definition is part of off-budget revenue capacity. A large part of the borrowing and lending activities of the EU has traditionally been in the hands of the EIB, often referred to as the second financial arm of the EU. The EIB is the world's largest multilateral borrower and lender. Shareholders are the 27 EU MSs, which have a share in the EIB's capital based on the size of their GDP at the time of accession to the EU. In addition to paid-in capital, the EU MSs have committed to uncalled capital. The EIB is authorised to have maximum loans outstanding equivalent to 2.5 times its subscribed (i.e., paid-in and uncalled) capital. The EIB provides the EU with a lot of financial capacity, but this capacity is placed within a banking domain and is therefore essentially non-fiscal in nature.

The InvestEU Fund combines the European Fund for Strategic Investments and 13 other—formerly independently managed—EU financial instruments. It aims at projects in four main policy areas: sustainable infrastructure; research, innovation and digitisation; small- and medium-sized enterprises; and social investment and skills. It supports the use of a wide range of financial products (equity, debt, and guarantees) by the EIB and other implementing partners, by means of guarantees from the EU budget and from EU MSs.

Table 3 also lists two well-known stability mechanisms developed in the aftermath of the financial crises. First, there is the European Financial Stabilisation Mechanism, which can be used to provide financial assistance to any EU country experiencing or threatened by severe financial difficulties. Secondly, there is the ESM, which has the same function and is the default option for support to eurozone countries. Thirdly, the (medium-term) Balance of Payments (BOP) facility concerns non-EMU MSs only and aims at supporting countries that face difficulties in their balance of current payments or capital movements by means of granting loans. Fourthly, Macro-Financial Assistance (MFA) is the EU-external counterpart of the BOP facility. MFA is used as a complement to International Monetary Fund financing. To a large extent, BOP and MFA support are about back-to-back loans where the EC uses its standing in the capital markets to provide third countries with highly concessional loans.

In November of 2022, the EU established MFA+ for Ukraine, following earlier MFA programmes (MFA I–IV,

Table 3. Off-budget capacity based on borrowing.

Off-budget fund/instrument	Bond issuance	Guaranteed by
EIB	By EIB	Paid-in and uncalled capital of EU MSs
InvestEU	—	EU budget and EU MSs
European Financial Stabilisation Mechanism (for all EU MSs)	By EC	EU budget
BOP facility (for non-EMU countries)	By EC	EU budget
ESM (for EMU countries)	By ESM	EMU MSs
MFA and MFA+ (Ukraine)	By EC	EU budget (External Action Guarantee) MFA+, with additional guarantees by EU MSs
SURE	By EC	EU budget and EU MSs

MFA in the context of the Covid-19 pandemic in 2020–2021, and Emergency and Exceptional MFA in 2022). MFA+ is more comprehensive than regular MFA. It includes a subsidy on the payment by Ukraine of interest on the loans, which is paid from by the EU budget, through EU MSs contributions in the form of EAR. MSs as well as third countries have the possibility to provide additional contributions as EAR to the EU budget, which will then feed into the use of the MFA+. Because the 2021–2027 MFF ceilings do not allow for the additional guarantees needed for the MFA+ borrowing, guarantees by MSs back up the borrowing by the EC.

The Support to Mitigate Unemployment Risks in an Emergency (SURE) is a loan instrument established in 2020 to support EU MSs in their (short-term) efforts to secure jobs and incomes during the Covid-19 pandemic. It is an off-budget emergency loan supplement to grants based on longer-term support by means of the on-budget European Social Fund. SURE represents the first large-scale borrowing scheme by the EU, far beyond back-to-back loans.

3.5. Next Generation EU and the Recovery and Resilience Facility: Off-Budget Borrowing, Partly Used On-Budget

Last but not least, there is NGEU, funded by borrowing by the EC, with a guarantee from the EU budget (using the 0.6% GNI unused headroom under the increased OR ceiling). NGEU is implemented through the Recovery and Resilience Facility (RRF) that supports concrete reforms and investments in EU MSs as part of their national recovery and resilience plans. RRF uses two types of instruments: loans (€385.8 billion) and grants (€338 billion). In addition, a small part of the NGEU funds are used to reinforce several existing EU programmes. Loans, which will remain off-budget, will be repaid by the EU MSs. Grants will be paid from the EU budget. To that end, the grant and reinforcement parts of NGEU are brought on budget as EAR. These parts will have to be repaid out of the EU budget as soon as repayment of the NGEU borrowing starts (2028 up until 2058), but these repayments should not crowd out other expenditures which could result in the need to find new additional revenue to fund the EU budget.

4. Discussion and Conclusions

The Irish philosopher and politician Edmund Burke stated, in his observations on the French Revolution, that "the revenue of the state is the state" (Burke, 1790, p. 188). The previous section has provided an inventory of various types of revenue capacity the EU currently has, both on-budget and off-budget. The picture that emerges from that inventory is at odds with the widespread perception of the EU as a wanting fiscal entity that lacks real fiscal sovereignty, that has no or limited powers to tax and that cannot borrow to finance its own budget (e.g., Cipriani, 2014, pp. 7–8; Farri, 2023, p. 86; Lindholm, 2023, p. 4; Zgaga, 2023a, pp. 704–706). Following Burke's reasoning, in this view, the EU is perceived as an entity that lacks its most state-like feature, i.e., autonomous revenue. The actual situation is, however, one where the EU does have ARC consisting of both ATC and ABC. Five major conclusions can be drawn regarding this revenue capacity.

First, off-budget intergovernmental resource pooling is rather prominent in the EU budgetary galaxy. This is done in many ways: by means of MSs' and third countries' contributions to off-budget funds, through pooling of resources as special EAR to the EU budget, and by means of guarantees to back-up borrowing. This has been part and parcel of EU finances for decades and is obviously linked to the preferences of MSs for intergovernmental arrangements in certain policy fields. This is, therefore, not new and not at all Hamiltonian, but these preferences can change over time, as the 2021 incorporation of the European Development Fund into the general EU budget shows. An interesting avenue for further research would be to study the advantages and disadvantages of off-budget operations from the perspective of the different EU institutions involved and compared to on-budget finances.

Secondly, ABC is off-budget capacity. This is related to treaty constraints regarding borrowing: Borrowing is not allowed to cover on-budget expenditure as this should always be covered by OR, with the GNI contributions as a balancing resource. This has led to a major role for the EIB, in financial transactions that otherwise would—or at least could—have been incorporated into the EU budget and would then have had a fiscal nature. Although the focus of this article was on the EU budget and its "galaxy" and not on the second financial arm of the EU, the EIB and its capacity to co-shape EU policy should be taken into account when discussing fiscal capacity. In addition, off-budget funds and mechanisms based on borrowing such as the ESM, the European Financial Stabilisation Mechanism, the BOP facility, regular MFA, and MFA+ also constitute significant borrowing capacity, as does SURE. The development of this capacity can be called quasi-federalisation (Woźniakowski, 2022, p. 100). This is the EU's way of federalisation of its borrowing capacity, given treaty constraints.

Thirdly, NGEU and the RRF provide a bridge between the off-budget world of EU borrowing and the no-borrowing-allowed world of the EU budget by using EAR for the grants part of the schemes. Even though this construction is artificial as a result of treaty constraints, it de facto means that the EU borrows to finance its regular expenditure. This perception, of course, rests on the assumption that NGEU/RRF spending is regular—rather than exceptional—and that this spending finally brings the overall EU finances to a level that lives up to its responsibilities. If there is something Hamiltonian about the NGEU, then it is exactly that (see also Woźniakowski, 2022, p. 43, referring to *The Federalist Papers*, paper no. 31). If one looks at NGEU and RRF spending as

exceptional, temporary, and mainly done at the MS level, just facilitated by the EU, then NGEU is not Hamiltonian. In that view, as Cannizzaro (2020) has put it, NGEU has just made the EU into a debt agency for its MSs, without any real change in fiscal power.

Fourthly, the EU has a de facto power to tax, in the form of customs duties, a shared VAT, and a plastics tax. Also here, treaty constraints play a role: An artificial route has to be followed every seven years to confirm this de facto power through the ORDs. For example, we have the weird situation that there have been autonomous tax revenues from customs duties (common tariffs) since 1968 as part of the Common Commercial Policy. But this tax has had to be acknowledged in the ORDs of 1970, 1985, 1988, 1994, 2000, 2007, 2014, and 2020, each time resorting to the safe label of OR rather than admitting the existence of EU taxation. This reluctance to use the term "tax" in relation to the EU is also detrimental to a proper discussion of future funding of the EU budget. As part of the decision-making on the MFF 2021–2027, new possible revenue sources have been put forward. In addition to resources based on the Carbon Border Adjustment Mechanism and resources based on a revision of the ETS, a digital levy, a resource based on the reallocated profits of very large multinational companies, a resource based on the Financial Transaction Tax and a resource linked to corporate income taxation have all been mentioned. Even though the status of some of the proposals is not clear, as they coincide with decision-making on Pillars 1 and 2 of the Base Erosion and Profit Shifting framework of the Organisation for Economic Co-Operation and Development, it is obvious that such revenues concern EU taxes. They should not be presented as intergovernmental transfers that provide "own resources" to the EU or as resources that are "based on" such taxes.

Finally, the nature of the EU as a federal union (i.e., a federation by aggregation of previously independent units; Fabbrini, 2019) obviously has an impact on the availability of suited candidates for EU taxes. Some of these potential resources concern rather small tax bases and are "fringe taxes," just as the plastics own resource is. This is because those taxes that produce larger amounts of revenue, that are stable, that have a low excess burden, that can relatively easily be administered et cetera (i.e., that satisfy all the requirements listed in all the reports that have tried to find revenue sources for the EU), are already in use by nation states, and often have been so for centuries. Tax sharing is then a smart option and could, in addition to the VAT, for example, be applied to corporate income taxation and energy/carbon taxation (EC, 2010). The Financial Transaction Tax would also be suited for tax sharing.

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Conflict of Interests

The author declares no conflict of interests.

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Article

Building up the EU Revenue Side: But What Is a Tax in EU Law?

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Abstract
While the US Constitution expressly grants the federation the power to tax, Article 311 TFEU is silent on whether such power exists at the EU level. This contribution argues that the Union has the power to tax, provided that the chosen resources in the basket match the objectives and policies of the Union. Since the achievement of the internal market is a shared competence (Article 4 TFEU), the Union can decide the level of resources tailored to this goal. Although the Union has a broad power to tax under Article 311 TFEU to pursue its objectives and policies, the member states are still the "masters," able to decide the level of resources under the unanimity rule. To resolve this paradox, this contribution embraces a democratic legitimacy of EU taxes that grant the European Parliament the power to decide the revenue side of the EU budget. EU democratic taxes approved by the European Parliament could reaffirm the redistributive function of taxes, thereby allowing the redistribution of wealth from rich to poor.

Keywords
democratic legitimacy; EU budget; EU fiscal capacity; EU internal market; EU taxation; Next Generation EU

Issue
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1. Introduction: Is There an Implicit Power to Tax Within the EU Treaty Architecture?

Since 1970, the EU budget has been predominantly financed by transfers from the national budgets, which are themselves drawn essentially from taxes levied by the member states. This way of funding is not at odds with international organizations such as NATO or the OECD. The Covid-19 pandemic has started to change the EU fiscal landscape. The Next Generation Economic Recovery Program (NGERP) is composed of the European Union Recovery Instrument (Council Regulation of 14 December 2020, 2020) and the Recovery and Resilient Facility (Regulation of the European Parliament and of the Council of 12 February 2021, 2021). The NGERP authorizes the Commission to borrow on the capital markets (€800 billion) on behalf of the Union to support the post-pandemic economic recovery within EU member states and to grant them sufficient resilience. The NGERP would provide resources to the member states, two-thirds of which would be disbursed as grants and one-third as loans to fund their economic recovery.

The NGERP has important fiscal underpinnings in so far as it has implicitly triggered the need for the EU to create its own tax resources through the structure of the EU budget to repay the resources borrowed from the financial markets. The EU's Own Resources Decision (ORD; Council Decision of 14 December 2020, 2020) for the period 2021–2027 becomes a milestone in the path towards strengthening the fiscal autonomy of the EU (De Witte, 2021; Fabbrini, 2022; Garbarino, 2022). Some authors have stressed that the NGERP abandons a "surveillance model" where the member states maintain all power of taxation, and the EU has a corrective role as an enforcer of discipline and replaces it with a progressive adoption of a classic fiscal federalism model where the EU acquires taxation powers and its own independent sphere of fiscal authority, and thus its own fiscal tools for macroeconomic stabilization (Fabbrini, 2022).

In this temporary framework (2021–2027), the following taxes are forecast to finance the NGERP: (a) national contributions calculated on the weight of non-recycled plastic packaging waste (Plastics Own Resource), (b) Carbon Border Adjustment Mechanism and EU Emissions Trading System, (c) digital levy, (d) financial transaction tax, (e) a financial contribution linked to the corporate sector or a new common corporate tax base (Interinstitutional Agreement, 2020, Annex 2).

Despite the initial optimism towards EU fiscal federalism, represented in the words of the German Finance Minister Olaf Scholz, making the ORD akin to the "Hamilton moment" in the US, a more cautious approach has been taken in the literature. Firstly, as De Witte (2021) pointed out, the NGERP is a case of "creative legal engineering" since it has bypassed the traditional EU budget mechanism following the Treaty on the Functioning of the European Union (TFEU, 2016, Article 311) to be approved under the joint legal basis of Article 122 TFEU and Article 175(3) TFEU. Secondly, not only is the NGERP temporary, but the Union still lacks its own power of taxation (Fabbrini, 2022; Traversa, 2022; Woźniakowski, 2022). Thirdly, although the European Council has only agreed to a non-recycled packaging waste as of 1 January 2021, it seems to be configured more as a contribution by the member states than as a proper tax levied on the heads of EU citizens (Martín Jiménez, 2022; Neumeier, 2023; Sciancalepore, 2023).

Several authors, who have advocated for a permanent EU fiscal capacity based on EU taxes and not based on state financial transfers of the EU member states, have supported a constitutional EU reform to recognize the EU power to tax (Fabbrini, 2022; Poiares Maduro, 2012). The rejection of the EU power to tax in the current EU treaties is grounded in the argument that the EU lacks any authority to tax since it is not a sovereign state or a sovereign organization (De Grauwe, 2013, p. 169; Moravcsik, 2001). There has not been an explicit transfer of sovereign power to tax from the member states to the European institutions, as conversely occurred in the US when the federal power to tax emerged in 1787: "The Congress shall have power to lay and collect taxes, duties, imposts and excises, to pay the debts and provide for the common defence and general welfare of the United States" (Constitution of the United States of America, 1787, Article 1, Section VIII, clause 1). Unlike in the US, where the debt crisis triggered the recognition of the EU power to tax, in the EU, the debt crisis accelerated the process of regulation of the fiscal policies of the member states (Woźniakowski, 2022, p. 82).

Following the fiscal patterns provided in the editorial to this thematic issue of *Politics and Governance* (Woźniakowski et al., 2023), autonomous fiscal capacity requires independent resources (EU taxes). This contribution aims to shed light on the meaning of taxes under EU law. Does the Union have an implicit power to levy taxes under Article 311 TFEU? This author will argue that EU law has embraced a functional definition of taxes as a transfer of mandatory resources for financing the EU's policies and objectives. This author will argue that such a broad definition of taxes is included within the wording of resources in Article 311 TFEU. The structure of this article is as follows. Section 2 outlines the concept of taxes in EU law, which are mandatory resources to finance general interest. Section 3 is devoted to presenting the argument that taxes fall within the broad meaning of resources in Article 311 TFEU since they are a means to pursue EU policies and goals, namely the internal market (TFEU, 2016, Article 4). However, the unanimity rule could become a procedural obstacle to the approval of EU taxes. Section 4 critically analyses the basket of resources in the period (2021–2027) and elaborates on the premises for a more autonomous EU power to tax. Section 5 defends the major role of the European Parliament in deciding the level of resources. Section 5 briefly summarizes the findings of this contribution.

2. A Functional Concept of Tax in EU Law Linked to the Internal Market

Taxes are conceptualized as compulsory contributions paid to the government to finance public expenditure (Barassi, 2005; Barker, 2005; Menéndez, 2013). In comparative law (Italy, France, Belgium, UK, Germany, etc.), the common features of a tax are (a) mandatory contribution imposed by an organ of the government, (b) collecting money to finance public expenditure and promote general interest, and (c) gathering revenue which goes into the state's budget, with the taxpayer receives nothing in return (Barassi, 2005, p. 62). There are minor differences between countries. For example, in Germany, taxes can be imposed by a public entity (i.e., a church); a few countries link taxes with the ability to pay principle (Spain, France, Italy); some countries carve out payment in kind as taxes (Luxembourg, Switzerland). In domestic law, taxes must be distinguished from the payment of public fees/contributions (so-called "non-fiscal levies"), where the payer obtains a particular benefit/service from the public authorities in exchange for the payment.

Taxation is not mentioned in the TFEU, not as an exclusive competence of the European Union (Article 3), as shared competence (Article 4), as a coordinating competence (Article 5), nor as a complementary competence (Article 6) between the member states and the EU. However, Articles 2–6 of the TFEU do not set a clear-cut classification of the distribution of competence between the Union and the states. In the current legal debate on the exercise of competence, which has superseded the previous legal debate on the existence of the Union's competence, there is a complex interaction between the EU and national powers which triggers discrepancies between the formal allocation of power in the treaties and the actual legal practice (Azoulai, 2014). This precisely occurs to taxation, which remains within the sovereignty of the member states. However, the Union

has a legislative power to harmonize the member states' legislation in the field of indirect taxation (TFEU, 2016, Article 113) and direct taxation (TFEU, 2016, Article 115) to prevent interference or obstacles to the establishment or functioning of the internal market, provided unanimity is obtained.

Unlike in domestic law, the concept of tax under EU law has a broad scope. The Court of Justice of the EU (CJEU) concludes that a tax must comply with three requirements. Firstly, taxes impose an obligation upon the taxpayer alongside enforcement by the tax administration: "There must be an obligation to pay those amounts and, where that obligation is not satisfied, the debtor must be pursued by the competent authorities" (IRCCS, 2017, paragraph 32). Secondly, taxes are intended to finance general interest (IICCS, 2017, paragraph 34). Taxes must simply pursue a general interest, regardless of whether the tax collection is ring-fenced into a special fund distinct from the state's budget (CIBA, 2010, paragraphs 23–24, C) or there are prevailing regulatory reasons (i.e., environmental policy) rather than purely budgetary purposes (Endesa, 2023). Thirdly, the amount payable in a tax must be unrelated to the costs of the transaction (SONAE Tecnologia de Informação, 2021, paragraph 32).

Such a broad concept of tax contrasted with the opinion of Advocate General (AG) Campos Sánchez-Bordona, who supported a narrow meaning of tax. In IRCCS, the AG interpreted that these Italian electric charges were contributions of a non-fiscal nature since the collection went outside the state budget and did not involve the national tax authorities (IRCCS, 2017). Advocate General Campos Sánchez-Bordona insisted again on this distinction between taxes and financial contributions of a non-fiscal nature in his opinion in Messer France (Messer France, 2018, paragraph 33).

In a nutshell, the CJEU simply requires that a tax be mandatory, unrelated to any public costs, and pursue a general interest. In this definition, it is neither relevant that the collection is ring-fenced for a particular use (CIBA, 2010), that it responds to several listed general interests (IRCCS, 2017), or that the prevailing reasons are regulatory rather than revenue-raising. Such a broad functional concept of tax in EU law serves a harmonization goal insofar as domestic taxes could become obstacles to the internal market (Martín Jiménez, 2018, p. 177).

Since the internal market justifies a broad definition of taxes, what is the meaning of the internal market? Article 3(3) of the Treaty on the European Union (TEU, 2016) mandates the Union to establish an internal market. TFEU (2016, Article 26(2)) defines the internal market as "an area without internal frontiers in which the free movement of goods, persons, services and capital is ensured in accordance with the provisions of the treaties." The invocation of EU freedoms of circulation, particularly in the work performed by the CJEU, has eroded member states' power to design their domestic tax systems. The retained power formula in the case law of CJEU—"Although direct taxation does not as such fall within the purview of the Community, the powers retained by the member states must nevertheless be exercised consistently with Community law" (Schumacker, 1995, paragraph 21)—shows that there is no nucleus of sovereignty that member states can invoke against the Union action (Azoulai, 2014). Hence, the achievement of the internal market is the entire raison d'être for harmonizing domestic tax legislation and limiting sovereign rights.

The legal meaning of the internal market is still devoid of clear contours and ambiguities, thereby triggering enormous legitimacy issues within the European polity (García Antón, 2018; Weatherill, 2017). Rather than simply eliminating obstacles, the achievement of the internal market reflects a broad metaphor to foster the political and social integration of the EU. As Weiler (1991, p. 2477) observed in his hallmark "The Transformation of Europe," the internal market:

> Is not simply a technocratic program to remove the remaining obstacles to the free movement of all factors of production. It is, at the same time, a highly politicized choice of ethos, ideology, and political culture: the culture of "the market."

The achievement of the internal market has led the integration process to achieve non-market aims and pursue a social and political integration agenda (De Witte, 2012). Therein are the constant tensions emerging between the economic and the social/political dimensions of the goal of the internal market (Elisabeta Dano and Florin Dano v Jobcenter Leipzig, 2014; Laval un Partneri, 2007; The International Transport Workers' Federation and The Finnish Seamen's Union, 2014). Baquero Cruz (2018, p. 2) recalls an anecdote told by the legendary Judge Pierre Pescatore that illustrates the metaphor of the internal market:

> The first one is a story about how the physical copy of the Treaty of Rome, which was to be signed on 25 March 1957 in a formal ceremony at the Campidoglio, was not ready because of a delay at the Zecca dello Stato, the Italian state printing works. What the representatives of the six member states ended up signing was a stack of white pages, with the first printed pages on top.

These white pages, signed in 1957, illustrate the "leap into the unknown" that the internal market means for European integration. The CJEU's constant struggle between the two competing principles of neutrality and territoriality in its case law in taxation is a clear example that the contours of the internal market are far from being immanent or predetermined (Schön, 2015).

3. EU Taxes Are Covered by "Own Resources" in Article 311 TFEU

3.1. EU Taxes to Achieve the Internal Market

Article 311 TFEU stated: "The Union shall provide itself with the means necessary to attain its objectives and carry through its policies. Without prejudice to other revenue, the budget shall be financed wholly from own resources." As Neumeier (2023, p. 335) stated, there is little or no discussion in the literature on the meaning of own resources and the legal requirements to qualify as a resource. The High-Level Group on Own Resources report emphasized that the Union does not have the power to levy taxes:

> Thus, talking about an "EU tax" or mislabelling the EU's own resources as EU taxes without further specification may not only be incorrect from a legal point of view, it fuels suspicion and incites criticism towards any attempt to reform the system of own resources by making policymakers and citizens believe that there is a hidden agenda behind such reform. (Monti et al., 2016, p. 20)

In the author's view, the denial of EU taxes under Article 311 TFEU is mere "rhetoric," preventing citizens and member states from thinking that there is a hidden integration agenda. Taxes, as previously defined by the CJEU, are means to pursue a general interest. Resources in Article 311 TFEU are meant to fund EU policies and objectives. Hence, resources are sufficiently broad to include taxes as a means to fund objectives and policies (Bizioli, 2022). Regardless of the label used, what is important for EU law purposes is that taxes/resources support EU policies and objectives. This link between EU taxes and EU objectives is obvious in the recent Plastics Own Resource (Neumeier, 2023). Despite being designed as a national contribution rather than a proper tax levied on the heads of EU citizens, it goes beyond raising funds for the Union to embrace an environmental protection goal (Neumeier, 2023; Sciancalepore, 2023). Since the Union has shared competence in the environment (Articles 4(2) and 192 TFEU), the Plastics Own Resource contributes to achieving such a goal.

Under EU law, it is not relevant whether the revenue collected is allocated to the member states to provide them with sufficient resources to face the adverse consequences of the pandemic (NGERP) or to the EU itself to cover the administrative expenditure of all European institutions. What is crucial is that taxes/resources match the Union's goals and objectives. This strong functional link between resources and EU policies is stressed in Chapter 2 of the 2016 High-Level Group on Own Resources, which articulates a system of own resources to support EU policies and objectives (Monti et al., 2016, pp. 36–56). Neumeier (2023) also referred to this link by labeling the resources in the ORD as "political own resources."

If there is an EU competence to achieve a particular objective, there should be EU own resources to achieve it. While the link between resources and environmental goals of the Union is straightforward in Article 192 TFEU, how can an EU tax contribute to pursuing the internal market goal if it is still a journey to the unknown? The achievement of the internal market is a shared competence between the Union and the member states (TFEU, Article 4(2)). The EU's competence to harmonize legislation to guarantee the establishment or functioning of the internal market (TFEU, Articles 114–117) has evolved. Although in the beginning, such Union power was connected to the harmonization of existing domestic laws, the CJEU has progressively transformed this "harmonization" power into a "regulatory" power that was—almost—completely independent of the existence of national legislation (Schütze, 2014). In areas such as the value added tax (VAT), which have been heavily harmonized, some authors conclude that the Union has a de facto power to tax (Groenendijk, 2023). That means that not only does the EU have the competence to design the VAT rules through the VAT Directive, but it also keeps a percentage of VAT collected as its own resource (a rate of 0.3% on each member state's VAT base). In direct taxation, in the last six years, we have witnessed an unprecedented development of tax harmonization in areas of anti-avoidance and transparency. Every legislative measure of the Union in relation to direct taxes fits within the legal basis of TFEU (Article 115): (a) Council Directive of 14 December 2022 (2022) on ensuring a global minimum level of taxation for multinational groups in the Union (Directive (EU) 2022/2523 of 14 December 2022, 2022), (b) Council Directive of 12 July 2016 (2016) laying down rules against tax avoidance practices that directly affect the functioning of the internal market, and (c) Council Directive of 29 May 2017 (2017) amending Directive (EU) 2016/1164 as regards hybrid mismatches with third countries (Council Directive (EU) 2016/1164 of 12 July 2016, 2016; Council Directive (EU) 2017/952 of 29 May 2017, 2017). While the former directive introduces a series of anti-avoidance measures to be implemented by the member states, the latter directive, the so-called Pillar 2 Directive, ensures a minimum level of effective corporate taxation at the level of the member states. One may argue whether such recent EU legislation, which basically aims to protect domestic tax collection by the member states, contributes to the functioning of the internal market.

There are no limits to the legislative action of the Union to pursue the internal market. It seems that the principles of subsidiarity and proportionality (TFEU, 2016, Article 5; EU Protocol No 2 on the application of the principles of subsidiarity and proportionality to the TFEU) play an insignificant role. The impact assessment on subsidiarity and proportionality prepared by the Commission in relation to EU tax proposals (e.g., Pillar 2 Directive) is quite short and vaguely justifies the EU proposal in the general need to obtain tax

coordination. The Commission is bestowed with broad discretion (European Commission, 2022). The CJEU has also endorsed the broad discretion of the EU legislative power within the subsidiarity and proportionality analysis (Czech Republic v European Parliament and Council of the European Union, 2019; Vodafone and Others, 2010, paragraph 52 and 77). No legislative EU tax measure has been successfully challenged by a member state for breaches of the subsidiarity and proportionality principle.

In a nutshell, the meaning of the internal market justifies almost any legislative measure of the Union. Consequently, any resource levied on the Union under Article 311 TFEU could serve to achieve such a broad and undefined regulatory goal. However, some authors have rejected the EU power to levy taxes under the principles of conferral in Article 5 TUE (Traversa, 2022). The member states reacted to prevent the competence creeping under Articles 114–117 TFEU by introducing the principle of conferral in the 1992 Treaty of Maastricht. The Lisbon Treaty also put more limits on the Union's competence (see Charter of Fundamental Rights of the European Union on the TFEU, 2016, Article 51). The principle of conferral entails that competences not conferred upon the Union in the treaties remain with the member states. The EU may do no more than its member states have authorized it to under its governing treaties (Weatherill, 2017). This author does not share Traversa's (2022) view that the principle of conferral limits the power of the Union to levy taxes under Article 311 TFEU (Traversa, 2022). The principle of conferral relates to the substantive competences of the Union and not means/resources to allow the Union to exercise such competences. If the Union has shared competence to create and consolidate the internal market (TFEU, 2016, Article 4(2)), all EU resources are possible to attain such an objective. The only limit is that the ORD cannot create resources that are detached from the EU policies and objectives. The previous open-ended meaning of the internal market towards an unknown social/political integration in pursuit of a close union of Europeans could justify the EU levying EU taxes under Article 311 TFEU without any substantive restriction.

3.2. A Procedural Obstacle to Approving EU Taxes Under Article 311 TFEU: The Unanimity Rule

The need for unanimity in decision-making can jeopardize the approval of EU taxes. Article 311 TFEU provides for a legislative procedure under which the European Parliament is merely consulted. The fact that the Council must act unanimously means that each member state has a veto right that could hinder the approval of EU taxes. The ratification of the national parliaments of the Council's decision on its own resources (TFEU, 2016, Article 311.3) renders the Council decision an act equivalent to primary legislation (Killmann, 2019). The unanimity rule in Article 311 TFEU is reinforced within the prohibition to apply the general *passerelle clause* (TEU, 2016, Article 48 (7)) introduced in the Lisbon Treaty to shift from unanimity to a qualified majority. Article 353 TFEU (2016) rules out the general passerelle clause for the own resources (TFEU, 2016, Articles 311(3), 311(4)).

The approval of EU resources is subject to a "double unanimity filter," both for legislating in tax matters (for the internal market, TFEU Articles 113 and 115; for environmental reasons, Article 192(2)) and to include new taxes as resources in Article 311 TFEU (Grisostolo & Scarcella, 2023). On the one hand, the Union must agree in the ORD that a new resource will finance part of the Union's budget under 311 TFEU. On the other hand, a tax directive containing the tax regulation needs to be approved under Articles 113 and 115 TFEU.

Is there any possibility of circumventing the second unanimity rule to approve the directive containing the tax? In the author's view, the qualified majority present in Article 114(2) TFEU cannot be applied as the legal basis. Article 114(2) TFEU expressly excludes harmonization of "fiscal provisions." On the meaning of fiscal provisions within the scope of Article 114(2) TFEU, the CJEU has confirmed that this term covers not only all areas of taxation but also all aspects of taxation, whether material or procedural rules (Airbnb Ireland UC v Région de Bruxelles-Capitale, 2022, paragraphs 27–30; Airbnb Ireland and Airbnb Payments UK, 2022, paragraphs 29–31). In the Airbnb cases, such a broad interpretation of "fiscal provisions" in Article 114(2) TFEU meant that several domestic measures (i.e., the obligation to withhold, appoint a representative, etc.) were outside the scope of the EU Directives 2000/31, 2006/123, 2015/1535, approved under Article 114(2) TFEU, and thus fell within the exclusive competence of the member states. Similar argumentation would preclude the recourse to a qualified majority within the legal basis of the elimination of market distortions in Articles 116 and 117 TFEU. Firstly, the meaning of "fiscal provisions" in Article 114(2) TFEU should have a force of attraction within all the articles of Chapter 3 ("Approximation of Laws"). Secondly, it is unlikely that EU taxes could be tailored to the wording of Article 116 TFEU, which requires that "a law, regulation or administrative action in member states is distorting the conditions of competition in the internal market" (Englisch, 2020, p. 58–61).

The debate in the EU law boils down to circumventing unanimity. This is, for example, the case of the recent lawsuit presented by Exxon against the EU temporary solidarity contribution targeting companies in the energy sector that benefited from the high energy prices approved by the European Council on 30 September 2022 (Council Regulation (EU) 2022/1854 of 6 October 2022, 2022). The solidarity contribution was approved under the qualified majority in Article 122(1) TFEU, which allows the Council to introduce measures in case of severe difficulties arising in the supply of certain products, such as energy. The General Court must assess whether the solidarity contribution has a fiscal nature and should be carried out in accordance with the

unanimity rule in Article 311 TFEU and not by qualified majority voting (Article 122).

The member states are the key stakeholders in deciding where the Union should go within the integration path and, thus, whether it should be granted sufficient resources to achieve this goal. Accordingly, the double unanimity filter preserves the veto power of the member states in deciding the revenue side of the EU budget.

4. Financing the EU Budget More Autonomously?

The 2020 Interinstitutional Agreement sketches a list of own resources in the period 2012–2027. In the author's view, a look at the list shows disappointing outcomes: First, it is unlikely that the new resources match the massive borrowing derived from the temporary NGERP expenditure and, second, it is not clear yet whether the new resources will become permanent candidates to finance the EU budget in long-term multiannual financial frameworks.

First, the environmental taxes, namely the Plastics Own Resource, the Carbon Border Adjustment Mechanism, and the EU Emissions Trading System are regulatory taxes. While "pure taxes" are implemented to raise revenue for the government to pay for public services and public infrastructure, the main purpose of "regulatory taxes" is not to raise revenue but rather to correct market failures, promote/disincentivize, and reduce negative externalities (Avi-Yonah, 2011; Avi-Yonah & Edrey, 2021). These EU environmental taxes aim to reduce the use of non-recycled plastic and the emission of greenhouse gases and prevent carbon leakage. Not much revenue collection is expected in the long term insofar as the member states are progressively reducing their environmental damage and adopting a more environmental-friendly policy, for example, by reducing the use of non-recycled plastic (Martín Jiménez, 2022).

Second, an EU digital levy cannot be enforced in the context of the current solutions to the tax challenges of the digitalization of the economy. In the recent 11 July 2023 Statement of the Two-Pillar Solution to Address the Tax Challenges Arising from the Digitalization of the Economy, the OECD/G20 BEPS Inclusive Framework compels the countries to remove the existing digital levies (OECD & G20, 2023). The repeal of digital levies permits states to collect taxes on the residual profit of multinationals under Amount A of Pillar 1. Since 138 states, including European Union member states, signed the statement, it does not make sense that the EU insists on enforcing a digital levy against the international consensus under Pillar 1. Third, the financial transaction tax, also mentioned in the High-Level Group on Own Resources report (Monti et al., 2016), was eventually not approved when the Commission proposed it in 2011 in the aftermath of the 2008 financial crisis. The fact that only 11 member states supported the 2011 initiative does not foresee a broad consensus in the Council to reach unanimity.

Fourth, the last resource is "the financial contribution linked to the corporate sector or a new common corporate tax base" (Interinstitutional Agreement, 2020). Last 21 June 20023, the Commission proposed a new temporary statistical own resource based on company profits to be replaced by Business in Europe: Framework for Income Taxation (BEFIT). "Such statistical resource is a national contribution calculated as 0.5% of the notional EU company profit base, an indicator calculated by Eurostat based on the national accounts statistics" (European Commission, 2023a). Such statistical resource implies that rich member states, with more registered companies subject to corporate income tax, would eventually contribute more to the EU budget than poorer member states. Although this statistical own resource is likely to collect more revenue to pay back the NGERP expenditure, rich member states could raise concerns about why they must contribute more to the EU budget.

The ORD (2021–2017) still relies on national contributions to finance the EU budget. Examples are the Plastics Own Resource and the statistical own resource based on company profit. The Union is extensively funded with contributions from member states, such as the one based on the gross national income and the VAT's own resource (a rate of 0.15%–0.3% to the national VAT base that could not exceed 50% of the gross national income). The literature stresses that the EU should have more autonomy to create its own resources and reduce the dependency of the member states (Hudetz et al., 2017; Monti et al., 2016). The 10 May 2023 Resolution of the European Parliament concluded that the financing of the Union is in breach of the intention of the founding fathers and the spirit of the treaties, which called for autonomous resources (European Parliament, 2023).

Prior to the NGERP, some authors have countered that the EU budget dependency on member states' contributions could be justified under the principle of subsidiarity in Article 5 TEU, which allocates tasks or responsibilities to the lowest level of government that can be expected to cope adequately with the task (Lipatov & Weichenrieder, 2016, p. 15). The principle of subsidiarity matches the so-called "decentralization theorem," which stipulates that policies should be decentralized unless the EU is more effective than actions taken at the lowest levels of government. Unlike federations such as the US, Canada, and Switzerland, where the central government provides public services and redistributes funds from those with high incomes, the public sector in the EU is decentralized (Bordignon & Scabrosetti, 2016; Büttner, 2016). Since the Union does not provide public goods or redistribute income, the member states are free to articulate their tax system to provide them.

Assessing whether the Union should provide public goods and redistribute revenue is a political debate that would require a reform of the treaties. The subsidiarity principle could be a suitable yardstick to determine to what extent the EU budget would require more autonomous resources and less dependency on

the member states. In the author's view, a common market tax (CMT) could be the right candidate to finance the EU budget and guarantee major EU autonomy if this scenario occurs. Some commentators have already mentioned the possibility of taxing companies that profit from the internal market and EU policies (Kotsogiannis, 2016; Woźniakowski & Poiares Maduro, 2020). The CMT should be designed considering the following two premises. Firstly, the CMT should be levied in areas where the Union has exercised its legislative competence to harmonize the legislation of the member states. In fiscal federalism studies (Peeters & Smet, 2022), this is referred to as tax autonomy, which means the capability of a specific level of government to legislate on the elements of the tax (tax base, tax rate, allowances, etc.). Secondly, the CMT should not increase the effective tax burden on European citizens. Either a new tax or surcharges on top of their national taxes would likely trigger massive discontent and feed Eurosceptic discourses. If so, as reflected in some federal states (e.g., Spain and Germany), the best initial solution would likely consist of shared taxes between the Union and the member states. In a later stage, a surcharge on an EU harmonized taxable base (VAT/corporate taxation) could replace the initial revenue-sharing mechanism and pave the way towards a more autonomous EU fiscal capacity.

Applying the above premises to design the CMT, there are several alternatives within a revenue-sharing mechanism. In the field of indirect taxation, the CMT could be based on the VAT system. The 2016 High-Level Group on Own Resources report already mentioned a VAT own resource to replace the current one, a complex statistical resource dependent on the gross national income (Monti et al., 2016, p. 52). The taxable base and the scope rules of VAT have been extensively harmonized (Council Directive of 28 November 2006, 2006). The fact that the Union has exercised its legislative competence to harmonize the taxable base (tax autonomy) justifies the Union sharing tax collection with the member states. The design of a CMT based on VAT would require, first, harmonizing the VAT tax rates. Although the VAT taxable base is harmonized in the directive, the tax rates vary tremendously among the member states. Second, it would be necessary to determine the percentage of revenue to be transferred by the member states to the Union. Such a percentage to share with the Union could be objectively determined by measuring the volume of VAT intra-community transactions of goods and services. Such a chargeable event reaffirms the internal market dimension of a CMT based on VAT.

In the field of direct taxation, the BEFIT proposal could be the basis for a CMT. As stated, the Commission intends to replace the statistical resource on the notional EU company profit base with the BEFIT. The BEFIT directive proposal was launched on 12 September 2023 by the Commission (European Commission, 2023b). The initiative aims to introduce a common set of rules to calculate the taxable base of groups with a taxable presence in the EU provided that they have an annual revenue of more than €750 million. In contrast with VAT, the corporate tax base has not yet been harmonized. In direct taxation, the EU has only harmonized anti-avoidance provisions (Council Directive (EU) 2016/1164 of 12 July 2016, 2016; Council Directive (EU) 2017/952 of 29 May 2017, 2017) and certain cross-border intra-group transactions (e.g., Council Directive of 3 June 2003, 2003; Council Directive of 30 November 2011, 2011). The BEFIT proposal will overturn the pending 2016 proposal for a Common Consolidated Corporate Tax Base, which never had sufficient support within the Council. BEFIT provides that all companies that are members of the same group calculate their tax base following a common set of tax adjustments to their financial statements. Once the tax bases of all members of the group are aggregated into one single tax base, each member of the BEFIT group will have a percentage of the aggregated tax base, calculated based on the average of the taxable results in the previous three fiscal years. Although the pillar 2 directive guarantees that the effective tax rate of a multinational enterprise in each jurisdiction cannot be below 15% (Council Directive (EU) 2022/2523 of 14 December 2022, 2022), the member states are competent to determine the corporate tax rate and collect the corporate taxation. Provided that unanimity is eventually reached to approve BEFIT, a decision needs to be made regarding how the revenue is to be shared between the Union and the member states.

5. A More Democratic Role of the European Parliament in the Approval of EU Resources

From the previous sections, a paradox emerges. The Union can no longer be characterized as an international organization but as a separate supranational political power with separate interests/goals from the member states (Pescatore, 1972). Since the achievement of the internal market is a shared competence, Article 311 TFEU permits the Union to create the necessary resources to achieve this goal. However, the member states secured their positions as the masters of the treaties under the double unanimity filter to decide which resources are included in the basket (TFEU, 2016, Article 311). In terms of resources, the Union is still a prisoner of an international organization's mindset. That mindset reproduces the imbalances in the EU's economic governance (Economic and Monetary Union). While the monetary policy is centralized by the European Central Bank, the economic policy remains at the member-state level.

The US Constitution expressly refers to the power of Congress to levy taxes. Such power of the US Congress to tax is unrestrained and clearly derived from the American Revolution under the slogan "no taxation without representation" (Avi-Yonah & Edrey, 2023; Georgiou, 2023). Collecting taxes conveys a democratic expression of how we divide the bill for the goods and services that we collectively deliver to ourselves (Kleinbard,

2016; Menéndez, 2013; Pantazatou, 2023). This democratic relationship between the level of expenditure and the revenue is materialized in the two primary functions of taxation: (a) It determines how much of society's resources will be transferred to the government to provide public goods, and (b) it plays a central role in re-distributing wealth among different individuals from rich to poor (Murphy & Nagel, 2002, p. 76).

Such democratic justification is absent in Article 311 TFEU, which provides for a legislative procedure under which the European Parliament is merely consulted. As if the Union were still an international organization, the member states have the role of approving the basket of resources under unanimity constraints. As stated, this way of financing the EU budget is highly dependent on the member states' contributions, which is in line with the decentralization level and the lack of EU public goods. If the Union eventually provides public goods and redistributes income in the future, the role of the Parliament should be increased. The marginal role attributed to the European Parliament within Article 311 TFEU is unacceptable. Taxes must embrace a democratic rationale, as the American Revolution showed, and the US Constitution later codified (Constitution of the United States of America, 1787, Article 1, Section VIII, Clause 1). In the author's view, Article 311 TFEU should be amended to recognize an explicit autonomous EU power to tax, thereby granting the EU Parliament a decisive role in approving the autonomous resources and redistributing the proceeds collected to achieve EU solidarity (TEU, 2016, Article 2).

Increasing the democratic legitimacy of EU taxes by granting a decisive role to the EU Parliament enhances solidarity. Since its inception, the Union has promoted solidarity through different mechanisms. For example, the Common Agriculture Policy has provided income support for farmers, and the European Structural Funds have supported social and economic development in the member states. The NGERP is no exception. The funds are allocated to the member states to recover from the Covid-19 pandemic. However, as De Witte (2021, p. 678) argues, "This distribution of funds through the EU does not operate a direct transfer from the richer to the poorer member states, as the EUR 750 billion will neither be 'German' nor 'Greek' debt but truly common debt." If the European Parliament had a major role in approving the basket of EU taxes, they would eventually lead to a proper fiscal transfer from rich to poor, strengthening true EU solidarity.

6. Conclusions

In EU law, taxes are included within the broad definition of resources under Article 311 TFEU. In assessing domestic taxes, the CJEU has endorsed a functional definition of taxes as a means to serve general interests. Such a functional definition of tax could be extrapolated to Article 311 TFEU, which requires that resources match EU policies and objectives. The Union has a broad margin to decide the level of resources needed to achieve its EU policies and goals. Since the achievement of the internal market is a shared competence, the Union is entitled to decide the level of resources needed to achieve this goal. The debate on how to finance the EU budget oscillates between the contributions of the member states and the need for major autonomy. For the purposes of granting the EU major autonomy in creating its own resources, this author has already sketched a potential CMT, which could be either a direct or an indirect tax.

Although the Union has a broad power to tax under Article 311 TFEU, the member states are still the "masters," able to decide the level of resources under the double unanimity filter. Such a paradox needs to be solved by increasing the role of the European Parliament in deciding the basket of resources. Adding democratic legitimacy to the approval of EU taxes could enhance solidarity. Although the Union has traditionally exercised solidarity (Common Agriculture Policy, European Structural Funds, NGERP), EU democratic taxes approved by the European Parliament could reaffirm the redistributive function of taxes, thereby allowing the transfer of wealth from the rich to the poor.

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Article

Revisiting Early Fiscal Centralisation in the European Coal and Steel Community in Light of the EU's Transfer Budget

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Abstract
The last few years have resulted in substantial changes for the EU's fiscal powers, primarily through the introduction of the Next Generation EU funds. This article argues that the assessment of these developments as federalisation processes is based upon a central misunderstanding of the EU budget as a public goods budget in a federal state. The EU is a compound polity comprising of mature states, and its budget may be termed a "transfer budget," which allows member states to predict budgetary costs and benefits. To understand the transfer-oriented nature of the budget, this article adopts a historical institutionalist lens. Revisiting the fiscal centralisation in the European Coal and Steel Community allows us to understand how the six delegations agreed to combine economic and social aims in this budget, which was intended to serve the European Coal and Steel Community with similar elements to a public goods budget. Revenue consisted of debts and a levy on coal and steel produce, whereas expenditure ranged from investments to payments to individual workers. The Treaty of Rome, with its anti-supranational basis, triggered a critical juncture in Europe's budgetary history: Since 1957, a transfer budget evolved. Revisiting the European Coal and Steel Community budget system allows us to understand the fiscal federal appearance of the Next Generation EU funds: While the EU makes new attempts to use its budget for the provision of common goods, its functions are limited by the institutional structure of the transfer budget.

Keywords
budgetary history; EU budget; European Coal and Steel Community; fiscal integration; Next Generation EU

Issue
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1. Introduction

The last few years have led to significant changes in the fiscal powers of the EU. Considering the Covid-19 crisis, the European Commission (EC) proposed a substantial recovery package in May 2020. The package was debated upon and challenged in July 2020 and agreed upon in December 2020 by the European Council (Regulation of the European Parliament and of the Council of 12 February 2021, 2021). The Next Generation EU (NGEU) Funds have been implemented alongside the EU's Multiannual Financial Framework for the spending period 2021–2027 (Council Regulation of 17 December 2020, 2020). These funds have enlarged the fiscal capacities of the EU temporarily, with the debt being distributed through loans and grants under the Recovery and Resilience Facility. In 2021, the Multiannual Financial Framework was amended once again by redirecting cohesion funds towards member states' efforts to support Ukrainian refugees under the Flexible Assistance to Territories Package (EC, 2022b). This indicated remarkable flexibility regarding previously earmarked funding, which is usually not the case within the EU budget. Overall, these steps towards an enlarged fiscal capacity through debt issuance appear a significant development in the federalisation of the EU's fiscal powers. Our assessments of the budget's development are, however, based upon a central misunderstanding. The EU budget is understood in the same way as a public goods budget in a fiscal federal state, and we therefore speak

about the EU budget with a fiscal federal vision in mind. However, the institutional structure of the EU budget can be described as a transfer budget, which is also highlighted in Woźniakowski et al.'s (2023) conceptualisation of the EU's weakness in independent revenues and high level of non-independent transfer capacities. As a result, the EU budget mainly provides for transfers between member states.

The main purpose of a transfer budget is to transfer financial means from one region or sector to another. The size of its revenue is decided upon ex-ante through a contribution key. The potentially heterogeneous interests of its members are safeguarded through a segmented budget structure wherein (most) expenditure is earmarked. It should be noted that while the revenue of the EU budget is legally the EU's own revenue, resources such as the gross-national-income-based resource are perceived as member states' contributions. Both the ex-ante agreement about the purpose of the budget as well as the rigidity and inflexibility of the system allow member states to calculate their gains and losses in the budget. The consequence is the *juste retour* dynamic, a simple cost–benefit calculation. This dynamic slowly became politicised over the course of the 1980s, given the UK's budgetary rebate crisis. The predictability of the member states' contribution has therefore become a necessity for agreeing to the shared budget. Once we step back from the developments between 2020 and 2022, we may observe change and evolution in the EU budget, not just regarding its size or its funding areas, but also treaties and amendments that have altered the budget (Laffan & Lindner, 2005, pp. 199–201). However, what is considered appropriate for the budget is steered by an underlying budgetary logic, that has remained the same since the 1970s. This underlying budgetary logic is essentially a historical institutionalist path dependency; to maintain this logic, institutional change and evolution of the budgetary system is necessary.

The main explanation as to why the EU budget has not developed into a public goods budget is not only limited to its position as a core state power (Genschel & Jachtenfuchs, 2013, p. 1). European integration has focused on the enlargement of the functional space at the European level, but questions related to identity or communities have remained at the national or regional levels due to the absence of a growing European identity or a European demos (Genschel & Jachtenfuchs, 2021; Hooghe & Marks, 2019; Kuhn, 2015). The kind of processes that allow agreement to be reached on what constitutes the right level of welfare or what kind of public goods are redistributed to whom require parliamentary legitimacy, public debate, and public discourse, as well as an elected government, which is not the case at the EU level. Hence, agreements related to public common goods continue to be routinely reached at the (sub-)national level of the member states. The existence of the EU's transfer budget is not necessarily a problem as such: When there is a functional need for instruments resembling those of a public goods budget, such as borrowing to stabilise its market or to support particular social groups, the EU can always temporarily deviate from the underlying budgetary logic and escape the transfer budget's institutional rules. The temporal nature of these instruments ensures that the budget returns to its old form post a pre-defined time span. Alterations also include the use of fiscal galaxies (Crowe, 2017). These circumventions do not require permanent changes to the EU budget, nor do they affect the underlying budgetary logic.

The EU budget has, however, not always been a transfer budget. It has evolved through an early critical juncture: The budget of the European Coal and Steel Community (ECSC) included features of a public goods budget. European budgetary history thus began with profound fiscal centralisation, agreed upon during the ECSC negotiations between 1950 and 1951. Revenues were gathered through a levy on coal and steel production and through borrowing on the international capital markets and were redistributed and allocated for research and investment, as well as for financial support to individual coal and steel workers during periods of retraining and unemployment (for an in-depth study, see also De Feo, 2015). The six delegations under Jean Monnet agreed upon major fiscal centralisation because they combined economic efficiency with social aims. It was decided that the ECSC's budget would be used as a public goods budget for the coal and steel sector. This does not mean that their aims always worked out as intended: The ECSC budget system displayed several shortcomings, and the High Authority's fiscal autonomy was continuously challenged by the member states.

Understanding the aforementioned context is important because the ECSC budget system depicts the differences between a public goods budget and a transfer budget. In particular, the recent alterations to the fiscal powers involve attempts to use the EU budget more as a public goods budget and no longer as a transfer budget alone. EC publications and statements by heads of state and government justify this move to support European citizens in times of growing inequality, citing the Covid-19 pandemic, the need for a digital and green transition, and the war in Ukraine. However, the institutional structure of the budget, including its underlying budgetary logic, clashes with these new policy ideas. The budget is not designed to meet these challenges because its institutionalised purpose is to allocate transfers between states, regions, and some sectors.

The above argument has been elaborated in this article as follows. A short literature review contextualises my argument in the empirical and theoretical literature on the EU budget. I then trace the negotiations of the ECSC budget system, elaborating how and why the delegations agreed upon the centralised system between 1950 and 1951. Consequently, I elaborate on the identified critical juncture: the European Economic Community (EEC) regarding its transfer budget, including

the establishment and reinforcement of its underlying budgetary logic. The last section concludes the article.

The analysis of the negotiation procedures between 1950 and 1951 is based upon freshly collected archival material from the Historical Archives of the EU (Florence, Italy). This archive holds a variety of dossiers of meeting minutes and delegations' reports for the time period from June 1950 until the agreement on the Treaty of Paris in April 1951. The Archiv der Sozialen Demokratie (Bonn, Germany) was also consulted because it holds confidential communications between trade union representatives from the coal and steel industries in France, West Germany, Italy, Belgium, Luxembourg, and the Netherlands, as well as communications with member state delegations. Trade union representatives had crucial insights about the negotiation proceedings, as some of them were present during the first half of the negotiation proceedings (roughly from June until November/December 1950). Most decisions regarding the budget's revenue acquisition were made in 1950, but decisions regarding the expenditure allocation were made during the second half of the negotiations in 1951. Importantly, the German or French titles, wherein I have cited the archival material, do not reflect the delegation that drafted these reports. The archival dossiers contain transcripts of meetings' minutes, drafted during the negotiations by administrative assistants, to be translated into the national languages. Hence, the German title of a reference does not indicate that the source has been compiled by a German delegate. It only indicates that the consulted dossier is the German language version. To ensure replicability and transparency, all consulted and cited archival data has been digitalised during the research process and can be consulted by readers.

2. The Transfer Budget of a Compound Polity

The EU is a compound polity, a "decentralised…fragmented political system" (Ferrera et al., 2023, p. 2) and the Weberian state structure is not a natural endpoint for the EU anymore (Eilstrup-Sangiovanni, 2022). Budgetary competencies or—in the words of the editors of this thematic issue—a polity's "fiscal capacities" remain limited at the supranational level (Woźniakowski et al., 2023). A budget allows a polity to exert central control (Tilly, 1994), which is not the case within the EU. Previous research analyses the weak pattern and limited extent of EU involvement in core state powers (Genschel & Jachtenfuchs, 2013). These researchers and the editors of this thematic issue highlight the small fiscal capacity of the EU, an element stressed throughout research on the EU budget (Laffan, 1997, p. 29; Lindner, 2006, p. 3). However, and here I depart from Woźniakowski et al.'s (2023) argument, interpreting EU fiscal developments in terms of fiscal federalism, may no longer be as revealing as we once thought. This is because the EU's fiscal competencies are not only determined by a struggle between the national and supranational levels but also by a struggle over the kind of issues to be funded or financed by the EU budget. The enlargement of markets and the "functional scale of governance" (Genschel & Jachtenfuchs, 2021, p. 350) have been uploaded to the EU level. However, the "scope of communities" (Genschel & Jachtenfuchs, 2021, p. 350) and matters related to these communities have remained at the nation-state level. The EU lacks a growing European demos and most European citizens have not adopted European identities (Kuhn, 2015, p. 145). While events such as the Covid-19 pandemic have turned the post-functional trade-off upside down (Genschel & Jachtenfuchs, 2021, p. 350), such turns are issue-specific: Matters related to health or natural disasters are much more likely to invoke feelings of solidarity among Europeans (Bremer & Genschel, 2020). Overall, issue-specificity linked to the question of who receives the financial means as well as the (a)symmetry of a crisis determine the agreement among member states on fiscal solidarity.

As an alternative analytical lens, historical institutionalism captures the specific institutional evolution of budgetary institutions: "How (do) temporal processes and events influence the origin and transformation of institutions" (Fioretos et al., 2016, p. 4)? Historical institutionalism allows an assessment of the "kind" of path dependency that structures the development of the EU budget. Identifying critical junctures as moments of substantial change allows us to understand why institutions develop differently, for instance, during times of uncertainty (Capoccia, 2015). Previous literature considers the EU budget as a matrix of independent institutions: The budget changes because new, additional institutional layers address previous inadequacies to preserve the balanced budget rule (Ackrill & Kay, 2006, p. 114). But it appears as if something else is going on. We know that institutional alterations can be necessary to fulfil specific institutional demands (Genschel, 1997). Institutional change is thus steered by a logic of appropriateness, wherein rules steer and structure what is considered "natural, rightful, expected and legitimate" (March & Olsen, 2004, p. 2). This logic therefore forms a sub-system, a metatheoretical lens of "the interrelationships among institutions, individuals and organisations in social systems" (Thornton et al., 2012, p. 2). Therefore, the EU budget is steered by a logic of how the budget's purpose and objective are perceived and accepted. This logic determines how individuals, ministers, heads of state and government, or staff of the institutions debate and discuss the budget and agree on institutional change. Institutional change is therefore necessary to safeguard the underlying budgetary logic and this institutional change can take very different forms.

Before explaining how this logic evolved, I first look at the negotiations between 1950 and 1951 in order to explain the ECSC's contrasting budget system including elements of a public goods budget.

3. Fiscal Centralisation in the European Coal and Steel Community

This section explores my claim of the ECSC budget system including elements of a public goods budget. To do so, I trace how the six member states agreed on the ECSC's budget system: Why and how did the six member states agree on such a high level of fiscal centralisation? And what purpose did they assign to the budget within the ECSC's wider aims? The choices during 1950–1951 were based upon Jean Monnet's and Robert Schuman's aim of tying Germany's coal and steel industry in a wider unification under the supranational High Authority, including economic and socio-political aims (Schuman, 1950). Moreover, they aimed for "equalization and improvement of the living conditions of workers in the [coal and steel] industries" (Schuman, 1950). These aims were repeatedly referred to during the negotiations.

3.1. The European Coal and Steel Community's Own Revenue Acquisition Through Debt and Taxation

Jean Monnet introduced his idea of a high level of fiscal independence during the first days of the negotiations in June 1950. He recommended that sufficient financial resources were to be gathered with a tax from "contributions that are levied on production units" ("Plenarsitzung der Konferenz über den Schuman-Plan in Paris on June 1950" in Schwarz, 1997). The gathered resources would allow for subsidising production sites and financial compensations for employees in case of companies' closures ("Plenarsitzung der Konferenz über den Schuman-Plan in Paris on June 1950" in Schwarz, 1997), thereby addressing socio-political aims. The High Authority would have the legal power to access loans to increase its financial capacities through the issuance of debt ("Allgemeines-Band 1," 1950). Within the gathered archival data, I could not find evidence of a delegation taking issue with the taxation system or the borrowing powers. Such straightforward agreement might also not be that unusual for the macroeconomic context of the 1950s, given the comfort of debt and active fiscal intervention in the post-war Keynesian framework. Directing revenue from national budgets to a European project, whose success was entirely unclear, would have arguably been difficult to justify before parliaments and citizens in a post-war period. The revenue system of the ECSC became entrenched in Art. 49 of the Treaty of Paris. Coal and steel companies were to transfer the levy to the High Authority via assigned regional banks from 1953 onwards (Commissaire aux Comptes, 1953, p. 26). It should be noted, however, that while fiscal capacity was entirely autonomous, the revenue complexity was extremely low with only two revenue sources. Moreover, all six member states had been recipients of the US Marshall Fund since 1948. The US exerted considerable influence to ensure that the Schuman Plan was successfully implemented, which might have weakened the delegation's reluctance to have their coal and steel industries emit levies to the High Authority.

In 1953, the High Authority received the first levies from coal and steel plants, with the maximum of the levy being calculated according to the products' net proceeds (Commissaire aux Comptes, 1954, pp. 80–81). The High Authority could save money and place it into a reserve fund for times of economic downturn (Vertrag über die Gründung der Europäischen Gemeinschaft für Kohle und Stahl, 1952, Art. 15.3), omitting the principle of a balanced budget. The self-sustainability of this revenue system became a problem in the long run: The future problems of the coal and steel industry had been unforeseeable, triggered by increasing Brazilian and US coal and steel competition starting in the late 1950s. The 1970s were a period of slow economic growth after the first oil crisis (1973), including recession, unemployment, and inflation (Wallace, 1980, p. 55). Reports from the late 1970s and 1980s show how the funds were used for workers' housing, re-employment, and general supportive measures (Commission of the European Communities, 1977, Annex C, 1980, pp. 18–19). However, the decreasing levy seriously affected the feasibility of the socially-minded policies of the ECSC. The Commission stated in an aide-mémoire from November 1977, that the structural difficulties in the coal and steel industry were causing serious budgetary problems (Commission of the European Communities, 1977, p. 22). The evolution of the levy is visualised in Figure 1, which covers the entire period of existence of the ECSC. The levy rate remained as high as 0.9% from 1952 to 1957, then fell from 1957 onwards and never recovered. The lowest rate of 0.2% was applied in 1962, then stabilised at around 0.3% until 1991, before being set at 0% from 1988 until 2002.

In 1955, the High Authority issued the first loan in the US amounting to 62,333.02 European currency units (ECU)/USD (Commissaire aux Comptes, 1956, p. 123). The budget report cites all figures in Belgian Francs, which have been translated into the ECU by the author. The USD and the ECU have been linked via the European Monetary Agreement since 1955. Adjusted to the prices of January 2020, this amounts to 601,957.88 USD. To put this into perspective, the Marshall Fund, the US reconstruction programme for Europe, amounted to 13 billion USD, which would amount to approximately 140 billion USD as per 2020 prices. The ECSC loans were distributed for unspecified purposes and for building houses for coal and steel workers in Germany and Belgium (Commissaire aux Comptes, 1956, p. 123). Two loans of one million ECU/USD (9,657,126,865.67 dollars in 2020 prices), taken up for the budgetary year 1955–1956 and distributed across the entire Community, had a much greater impact (Commissaire aux Comptes, 1956, p. 215). It is of course difficult to assess the overall impact of the investments made through the above-mentioned loans; rather, these figures are evidence of the High Authority's political scope for revenue generation.

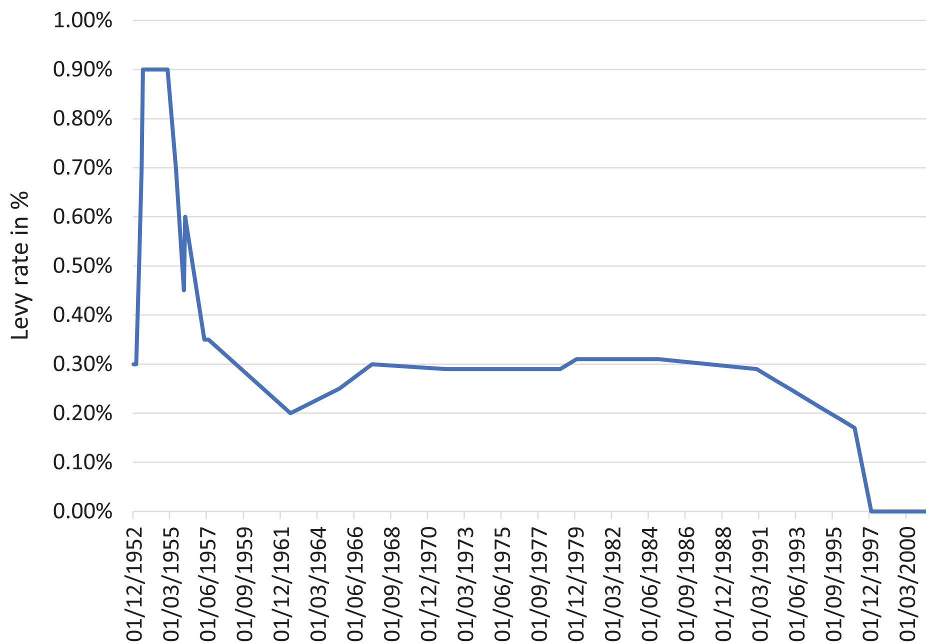

Figure 1. The evolution of the levy on coal and steel produce between 1952 and 2022. Source: Author's own graph, based upon data from the Centre virtuel de la connaissance sur l'Europe (2016).

Why could the ECSC not use debt to finance support measures for coal and steel workers during the crisis of the 1970s? The type of revenue was earmarked for expenditure: Debt could finance investment and research projects but could not be used to finance non-refundable payments to workers and other such expenses (Vertrag über die Gründung der Europäischen Gemeinschaft für Kohle und Stahl, 1952, Arts. 51 §2, 56.b; Weides, 1960, p. 213). The earmarking of the budget segments was not always respected in the ECSC, but it would become an important part of the future transfer system of the EEC. To circumvent the decreasing revenue from the levy, the EEC decided during the 1970s to use the Regional Fund and the European Investment Fund to top up financial assistance for the resettlement of former coal and steel workers, which was justified with reference to "community solidarity" (Commission of the European Communities, 1977, p. 18). This is an example of the kind of temporary flexibility to circumvent the rigid and inflexible nature of the EEC budget, which may be traced throughout Europe's budgetary history.

3.2. The European Coal and Steel Community's Expenditure for Socio-Economic Aims

One feature of a public goods budget is to create welfare and provide necessary public goods. A central focus of the ECSC budget was the social support for coal and steel workers ("Besprechung beim Vorsitzenden der Konferenz über den Schuman-Plan, Monnet, in Houjjarray on July1950" in Schwarz, 1997). According to Jean Monnet, the inclusion of social aspects should create a feeling of hope among the workers: "The workers must believe in the plan as a hope" ("Besprechung beim Vorsitzenden der Konferenz über den Schuman-Plan, Monnet, in Houjjarray on July" in Schwarz, 1997). He was addressing a shared demand from the European trade unions: to unify Europe, improve living standards, and ensure full employment and social justice (International Confederation of Free Trade Unions, 1950, pp. 1–2). These socio-political aims were reflected in the budget system through an agreement on non-refundable payments to individual coal and steel workers. Since the creation of the single coal and steel market could force companies to shut down, the High Authority was required to provide financial assistance to those affected or fund their training for re-employment ("Verschiedene Dokumente, Band 1," 1950). These non-refundable payments were co-financed, with 50% coming directly from member states' public budgets. An example of non-refundable payments is seen in the 1955–1956 budget report. The High Authority financed social housing projects, investment in research and the dissemination of information about research projects (Commissaire aux Comptes, 1956, p. 99). Payments were directed to French, Italian, and Belgian workers (Commissaire aux Comptes, 1956, p. 115).

Further, member states agreed on a temporary compensation fund for some countries, which would facilitate the creation of a single market to avoid a steep fall in prices for companies that worked unprofitable ("Allgemeines-Band 1," 1950). The agreement on the compensation fund caused much more intense discussions, both its redistributive character and potential losses were much more pronounced. The Italian delegation stressed the need for this fund for its steel companies and the Belgian delegation for its coal production ("Allgemeines-Band 1," 1950). The German delegate

Walter Hallstein reported to his foreign ministry that the compensation funds were "in principle desired. Tendency: No one wants to pay. Everyone wants to receive. The raised task [of creating the single market for coal and steel] cannot bypass compensation funds" ("Schumanplan-Verhandlungen," 1950, translation by the author). In spite of some delegations' reluctance, the compensation fund was eventually agreed to ("Verschiedene Dokumente, Band 1," 1950). This temporary instrument is mentioned in the budget reports from 1953 onwards for the transitional period until the full establishment of the coal and steel market.

Moreover, the six delegations struggled to arrive at a consensus over the decision-making power of expenditure allocation: Jean Monnet argued that only the High Authority should decide on expenditure, thus limiting the powers of national governments to channel investments to their own coal and steel companies ("Verschiedene Dokumente, Band 1," 1950). During these discussions, there was a recurring element involving weighing the intention to create a relatively autonomous High Authority, "to leave old forms of governmental cooperation behind" versus keeping national control over the sectors ("Allgemeines-Band 1," 1950). The final decision to have the High Authority decide over investments (Vertrag über die Gründung der Europäischen Gemeinschaft für Kohle und Stahl, 1952, Art. 54), formally made the institution an autonomous actor in allocating expenditure, but it was informally challenged by the member states (Kaiser, 2018, pp. 252–254).

Overall, the simultaneous agreement on economic as well as social aims resulted in a centralised budget with features similar to a public goods budget. During the negotiations, the member states weighed the benefits versus the costs of the budget (now referred to as the juste retour logic). They agreed on fiscal solidarity to support those member states whose coal and steel economies and workers were in particularly dire situations. And, we do have evidence that the ECSC's financial support improved coal and steel workers' living and working conditions (Groenendijk & Hospers, 2002, p. 603), though other funds, such as the Marshall Plan or the short-lived European Payments Union, provided substantially greater financial resources (Gillingham, 2014, p. 63).

4. The Evolution of the Transfer Budget Since 1957 and Its Underlying Budgetary Logic

The change from the ECSC budget system to the EEC budget system constitutes a critical juncture in Europe's budgetary history, primarily based on the contrary governance features of the EEC. The intergovernmental EEC was primarily a rejection by the member states of the supranational ECSC and dirigiste High Authority. To sustain the EEC's work, the six member states agreed on a highly-segmented budget structure with earmarked funding, financed through member states' contributions. Therefore, the practice of segmentation and earmarking as well as the use of temporary funding instruments constitute a continuity between both budget systems. However, the transfer budget system since the EEC has even weaker features than the budget of an international organisation (see Patz & Goetz, 2019). The member states and not the Commission of the Communities decide over its fiscal capacities. Some features of the segmented nature and the practice of earmarking were also implemented in the EEC but with a balanced budget: Debt issuance was moved outside the budget system into the European Investment Bank to sustain planned economic investments. The carefully earmarked segments, several of which were already capped during the Treaty of Rome negotiations, allowed agreement among a multitude of heterogenous interests securing national preferences and trade-offs. Table 1 illustrates the differences between a transfer budget and a public goods budget.

Member states awareness around the potential limitations of the EEC's budget has existed since its creation: The central article on the creation of own resources (now Art. 311 of the Consolidated Version of the Treaty on the Functioning of the European Union, 2012) was debated by the delegates for the future option to create own resources. Policymakers imagined that soon questions about the fair distribution of member states' contributions would be made redundant through the introduction and replacement of financial contributions with own resources ("Entwurf eines Protokolls der Konferenz der Aussenminister," 1957). Throughout the 1960s, such ideas were continuously discussed, after being delayed by the Empty Chair Crisis. However, the budget treaties promised a replacement of all member states' contributions with their own resources. The initial period of institutional openness for the budget system was once again avoided by the refusal to increase the value-added tax after the 1970s. Changes to the budgetary institutions continued. Other resources were introduced under the Delors I and II agreements, the introduction of the resource calculated with the gross national income (Laffan, 1997, p. 38). These changes did not only address the lack of revenue but also challenged the prominence of the Common Agricultural Policy to increase the importance of cohesion funds. Throughout these decades, various plans for budgetary reform were always available: plans to increase own resources, to increase the overall size of the budget, to strengthen the social dynamics of the budget, and to introduce other areas of expenditure (Sapir et al., 2004).

Yet, the logic of the budget, of what was considered appropriate and acceptable, became reinforced over time. This underlying budgetary logic consists not only of institutional practices but also political perception. The segmented nature of the budget preserves member states' pre-negotiated funding preferences and limits the EC's ability to redirect revenue without the Council's approval. The segmentation specifies the purpose for

Table 1. Differences between a public goods budget and a transfer budget.

	Public goods budget	Transfer budget
Principles	A public goods budget facilitates a polity's welfare regime (e.g., unemployment benefits) and provides common goods (e.g., maintaining an education system and infrastructure). It can be adapted to different economic cycles to stabilise the economy in times of boom and bust.	The central purpose of this budget is to transfer funds from one region, state, or sector to another. Fiscal galaxies allow sub-groups of members/states to pursue budgetary goals that not all members agree to.
Revenue acquisition	A public goods budget allows autonomous decision-making to demand more revenue; "including rules concerning the extraction of revenue" (Levi, 1988, p. 1). Taxation requires representation and democratic accountability. To stabilise the economy, it can issue debt or have deficits and pursue anti-cyclical policies.	Revenue is decided upon ex-ante, before the beginning of a budgetary year(s). The contributors to the budget will try to calculate their gains and losses (the juste retour calculation); this might trigger discussion about the fairness of a member's contribution. Debt is avoided because it endangers the predictability of future financial burdens.
Expenditure allocation	Expenditure will be allocated to a variety of aims and can be moved among expenditure goals with flexibility. Such flexibility might be necessary to address changing socio-economic circumstances. The expenditure allocation will also be targeted towards individuals.	Expenditure is decided upon ex-ante and distributed among budgetary segments and earmarked. Alterations to the previously agreed expenditure allocation require time and consensus: The contributing members will have to agree to the alterations and recalculate how this alters their revenue contribution and expenditure expectations.

which the means are used, and the practice of earmarking specifies how much of the means are agreed upon. Consequently, member states do not agree to reform proposals wherein revenue is neither segmented nor earmarked (see Sapir et al., 2004, p. 186, who argue in favour of a reform proposal in which at least a part of the budget revenue is neither segmented nor earmarked).

Moreover, budgetary revenue predominantly consists of actual or perceived member state contributions even though it is legally the EU's own (as specified in Art. 311 TFEU; Council Decision of 14 December 2020, 2020). The gross national income contribution is perceived as member states' contribution. It is frequently communicated to the electoral audience as a substantial financial loss and, therefore, perceived as a bill that the EU writes to its member states. Another more recent example is the resource from the new tax on non-recycled plastic, which has been rebated like any other member state contribution. The Council weakened the Commission's proposal with a yearly lump sum reduction (Council Decision of 14 December 2020, 2020, Arts. 1c, and 2) and the tax contributed was a meagre €5.8 billion to the annual revenue of €239.6 billion in 2021 (EC, 2022a). More European taxation thereby results in more own resource revenue, but it does not alter the perception of who contributes with more financial means to the EU. Therefore, it does not challenge the underlying logic of the transfer budget. It would be necessary to create own resources that cannot be used for member states' perceptive purposes of the payer versus receiver logic (for an in-depth discussion, see García Antón, 2023).

Functional necessity can, however, trigger deviations from the underlying budgetary logic. Examples of this include the miniature debts issued by the EC in the 1970s and 1980s (Horn et al., 2020), or the temporary introduction of debt to finance the NGEU funds. In the case of the NGEU, the EC has been empowered to issue loans on behalf of the EU, while the member states steer the allocation of the resources under the Recovery and Resilience Facility (Regulation of the European Parliament and of the Council of 12 February 2021, 2021, Art. 12). Another example is the more recent redirection of €17 billion from cohesion and social funds, to support member states' efforts to help Ukrainian refugees (Regulation of the European Parliament and of the Council of 19 October 2022, 2022). However, these temporary deviations do not change the underlying logic.

5. The Establishment of Next Generation EU Funds and the European Coal and Steel Community Agreement

Both the insights into the ECSC budget system, as well as the evolution of the EU's budget since 1957, allow us to understand the recent development of the NGEU funds in a new light. This is because there are important similarities between the objectives of the ECSC budget and the budgetary changes introduced under the NGEU funds. These similarities are summarised in Table 2, followed by an explanation of this observation.

Table 2. Similarities between revenue and expenditure of the ECSC budget system and the NGEU funds.

	Budget system of the ECSC	Changes introduced under the NGEU funds
Revenue similarities	Revenue is gathered through a levy subjected on coal and steel produce. The High Authority is also allowed to issue debt. The maximum levy is decided by the Council.	The EC is allowed to issue debt, but the amount is limited ex-ante (€750 billion, in 2019 prices). It remains unclear how the debt will be repaid, but repayment will start in 2028 until 2058 (EC, 2023a).
Expenditure similarities	The High Authority uses its revenue for common goods, such as social support for individual coal and steel workers. It also uses its revenue for task-related objectives, such as investment in research and social support for individuals.	The NGEU funds include new policy objectives related to investment and the digital and green transition. These funds also include instruments to support individuals, the Support to Mitigate Unemployment Risks in an Emergency instrument and are public goods oriented (the Recovery and Resilience Facility and the Just Transition Fund).

The first part of this article has outlined several elements within the ECSC budget that resonate with a public goods budget. The delegates agreed in 1950 and 1951 that the budget should deliver not only financial transfers but also social aims. All member states kept an eye on a just distribution and returns for their own national sector, but they also accepted a substantial level of fiscal solidarity and redistribution among the industry's workers.

The redistributive elements of the NGEU funds increasingly touch on the objectives of a public goods budget. These instruments seek to address already existing vulnerabilities of the EU's member states, many of them being long-term consequences of the financial and eurozone crisis (Armingeon et al., 2022). The Support to Mitigate Unemployment Risks in an Emergency instrument includes non-refundable support to individuals, to prevent sharp rises in unemployment (Andor, 2020). Policy priorities under NGEU range from social and health priorities to technical innovations (Regulation of the European Parliament and of the Council of 12 February 2021, 2021). These social aims are included in several new EU initiatives. The EU declares to strive for a just transition—"leaving no one behind" (EC, 2023b)—and suggests a new form of solidarity and willingness for fiscal redistribution. The Common Provisions Regulation includes more specific criteria regarding the funds' distribution to "prevent any discrimination based on gender, racial or ethnic origin, religion or belief, disability, age or sexual orientation during the preparation, implementation, monitoring, reporting, and evaluation of programmes" (Regulation of the European Parliament and of the Council of 24 June 2021, 2021, Art. 9). There is thus an increasing focus on individual recipients. These instruments aim to not only address economic aims but also social aims, sustaining important observations about "policy learning" (Capati, 2023; Schelkle, 2021, p. 52). At the heart of these debates is an ever-existing question of the overall purpose of the EU budget, either as an instrument to provide side payments as part of the single market, or to facilitate the promotion of equality and solidarity on a more genuine level (Lindner, 2006, p. 6). However, the EU's ability to renegotiate the latter choice is limited by the EU budget's institutional structure of the budget. Since the member states rely on the ex-ante predictability of financial costs, they cannot abandon the existence of its *juste retour* dynamic.

6. Conclusion

The article argues that we should assess changes in the EU's fiscal capacities in terms of its structure as a transfer budget as well as an underlying budgetary logic. The agreement on the NGEU Funds as temporary change does not challenge this logic. Therefore, it is not clear whether the consensus about the NGEU funds will result in a more fundamental alteration of the budget's role in the EU, or whether the institutional structure will revert to its old form. The necessity to repay the issued debt may also have a sobering effect on future plans and result in a much smaller Multiannual-Financial Framework for the spending period 2028–2034. A fundamental reformation of the transfer budget is unlikely because its structure is closely intertwined with the features of the EU as a polity. There is therefore no institutional context in which the budget could be transformed into a public goods budget. Maintaining the underlying budgetary logic of the transfer budget is, therefore, a necessity for the EU to agree on its budget, as permanent deviations from this logic jeopardise the predictability of member states' budgetary costs and benefits. The wishful thinking of breaking away from the underlying budgetary logic has been a recurrent element since the mid-1970s, but member states have no functional need, nor is it in their economic interest, to deviate from it.

However, it is likely that the temporary introduction of instruments, which mirror features of a public goods budget, will become more frequent. In times of polycrisis

(Zeitlin et al., 2019), the EU may have to agree on ad hoc budgetary solutions, to avoid disrupting the single market and to ensure that the cohesion of the EU does not decline further. The worsening climate crisis is unlikely to be perceived as the fault of any one member state and is likely to evoke feelings of European solidarity similar to those seen during the Covid-19 crisis (Cicchi et al., 2020). However, the repeated reliance on such temporary instruments raises questions about fiscal injustice. This is because fiscal solidarity at the EU level seems to be issue-specific: Natural disasters or exceptional health crises are perceived as European problems. Structural inequalities, such as poverty, do not trigger feelings of European solidarity. Therefore, they are not addressed by the EU budget, although they may well be linked to the austerity measures implemented through the EU's broader fiscal framework and fiscal regulations.

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Conflict of Interests

The author declares no conflict of interests.

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Article

Collective Policy Learning in EU Financial Assistance: Insights from the Euro Crisis and Covid-19

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Abstract

This article examines policy change in the EU's financial assistance regime through a collective learning perspective. By defining a financial assistance regime as the set of rules governing the disbursement and withdrawal of funding to the member states in the context of crisis management, the article seeks to address the following research question: How can we explain the exact form of change in the EU's financial assistance regime between the euro crisis and the Covid-19 pandemic? The article finds that financial assistance in the EU moved from "intergovernmental coordination" with the European Stability Mechanism to a form of "limited supranational delegation" with the Recovery and Resilience Facility and argues that such a change is due to a collective policy-learning process. This finding suggests that the EU tends to learn from past crisis experiences, freeing itself from established institutional constraints, only when the next crisis becomes a concrete cause for concern. However, when the next crisis strikes, the EU is indeed able to radically alter its practices based on previous policy failures.

Keywords

collective learning; Covid-19; European Union; European Stability Mechanism; financial assistance; policy change; Recovery and Resilience Facility

Issue

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1. Introduction

Since the 2010s, the EU has had to confront two large-scale economic crises of a different nature, i.e., the policy-induced European sovereign debt crisis (hereinafter euro crisis) and the exogenous Covid-19 pandemic. Both crises required a decisive response by the EU in terms of financial assistance. The euro crisis was the first major economic shock the EU experienced since the establishment of the Economic and Monetary Union. When it erupted in 2009, as it was yet to face a severe economic downturn, the EU was devoid of any crisis-management instrument that could provide ailing member states with financial assistance. While the EU's response to the euro crisis was thus largely "improvised" (Van Middelaar, 2019), it also constituted a litmus test for institutional resilience and formed the basis for the EU's response to the Covid-19 pandemic. This article then raises the following question: How can we explain the exact form of change in the EU's financial assistance regime between the euro crisis and the Covid-19 pandemic?

The article conceptualises "financial assistance" as the mechanism through which the EU provides member states experiencing economic difficulties with funding to preserve or restore financial stability. It identifies a financial assistance regime as a set of "formal and informal rules, practices and bodies" governing the disbursement and withdrawal of funding to the member states in the context of crisis management (Rehm, 2022). The EU's financial assistance regime is thus operationalised as the decision-making procedure (or governance system) of the major financial instrument the EU adopts in response to a specific economic crisis. As the article aims to explain

policy change in the EU's financial assistance regime between the euro crisis and the Covid-19 pandemic, it selects the European Stability Mechanism (ESM) and the Recovery and Resilience Facility (RRF) respectively as comparative case studies.

The article's analysis contributes to our understanding of what the introduction to this thematic issue conceptualises as "transfer capacity" (Woźniakowski et al., 2023). Both the ESM and the RRF are indeed instances of transfer powers, whereby the two financial instruments provide assistance to member state governments in the form of either "grants" or "loans," and the governments themselves are then responsible for spending those resources based on different forms of conditionality. As such, transfer capacity is opposed to "spending capacity," which implies the EU's ability to spend directly across the Union's territory, for instance, to ensure the provision of common public goods (Woźniakowski et al., 2023). The EU's transfer capacity can be financed either by means of independent resources, raised through taxation (own resources) or borrowing (common debt), or by means of non-independent resources, that is capital contributions from the member states.

To this effect, the article provides an explanation for change in the EU from an intergovernmental transfer capacity of non-independent resources (with the ESM) to a form of supranational transfer capacity of independent resources (with the RRF). Specifically, it argues that, following the pandemic outbreak, EU institutions and member state governments were collectively able to learn policy lessons about the governance of financial assistance from the management of the euro crisis, leading to a change in the EU's financial assistance regime.

The above argument has the following structure. Section 2 places the article within the relevant literature. Section 3 discusses the article's analytical framework and the research strategy adopted for the empirical analysis. Section 4 examines patterns of financial assistance in the EU's response to the euro crisis and the Covid-19 pandemic. Section 5 empirically tests the policy learning argument and discusses its relative explanatory power. The final section summarises and concludes.

2. Institutional Change and Policy Learning in the European Union Following Covid-19

This article builds on and seeks to contribute to two strands of the literature on EU studies. First, by examining the EU's financial response to the Covid-19 pandemic, it contributes to ongoing research on EU economic governance and institutional change in times of crisis. Second, by tracing the identification of policy failures from the euro crisis and their translation into policy lessons during the pandemic, the article contributes to policy learning studies and investigates whether and how learning has the potential to bring about policy change in the EU.

To make sense of the EU's economic governance approach to the Covid-19 crisis, research on the RRF has focused on such aspects as the unprecedented provision of "grants" financed through common debt (de la Porte & Jensen, 2021), increased economic solidarity (Genschel & Jachtenfuchs, 2021), and the establishment of fiscal capacity (F. Fabbrini, 2022). When it comes to the issue of governance change the RRF involves for EU financial assistance, however, the literature is still contested. While some agree that it largely reproduces consolidated decision-making procedures (Vanhercke & Verdun, 2022), others find in the RRF an instance of "paradigm change" (Buti & Fabbrini, 2022; S. Fabbrini & Capati, in press; Schelkle, 2021). By drawing on a comparative analysis of the governance mechanisms behind the ESM and the RRF (the major financial instruments adopted in the EU's response to the euro crisis and the Covid-19 pandemic respectively), this article sheds light on the form of change the EU's financial assistance regime has undergone following the pandemic outbreak.

The literature has found the causes behind the establishment of the RRF in the exogenous and symmetric nature of the pandemic crisis as opposed to the endogenous and asymmetric euro crisis (Buti & Papaconstantinou, 2021), political entrepreneurship by powerful EU institutions (Kassim, 2023) and member states (Becker, 2022), or national material interests (Schramm, 2023). However, while these factors can explain the innovative character of the RRF as a supranational EU instrument based on common debt, they fail to account for its governance mode. At a closer look, the RRF overcomes the ESM's governance mechanism that proved controversial in the response to the euro crisis, thus suggesting the EU has learnt from the previous financial management experience.

Although the literature on policy learning is extensive, few attempts have been made at exploring whether and how policy learning occurs in the EU and its potential to induce policy change. In examining the causes behind institutional change in the EU following the Covid-19 pandemic, existing research has either focused on learning by single institutions, like the European Central Bank (ECB; Quaglia & Verdun, 2022) and the European Commission (Mirò, 2020), or within single countries, like Germany (Schoeller & Heidebrecht, 2023). Thus, whether the EU as a whole has actually undergone a process of "collective learning" is still much underexplored. This research gap is all the more relevant in that, while learning might concern single actors, conceived of as either individual (e.g., the German chancellor) or institutional actors (e.g., the European Commission), the response to any major crisis in the EU arguably involves and depends upon a "network of responders" (Moynihan, 2009) rather than a single decision-maker. Individual learning does in fact not automatically bring about collective learning and policy change (Heikkila & Gerlak, 2013).

An exception to this is Ladi and Tsarouhas' (2020) and Radaelli's (2022) study on collective learning in the EU. Though perceptive, these works put forward broad theoretical claims on how policy learning drives

European integration in times of crisis that deserve to be methodologically organised and empirically substantiated. The present article takes on this endeavour.

3. Analytical Framework and Research Design

For analytical purposes, this article defines policy learning as the "updating of beliefs or policies based on lived or witnessed experiences, analysis or social interaction" (Dunlop & Radaelli, 2013, p. 599). As this definition might also apply to learning by single actors or institutions, collective learning includes "the collective identification and embedding of practices and behaviours" leading to policy change (Moynihan, 2009, p. 189). While policy learning and policy change are analytically distinct (e.g., actors might learn without inducing change just as change might occur without learning), learning is understood as likely to produce change (Radaelli, 2022) and "is indicated when policy changes as the result of such a process" (Hall, 1993, p. 278). The article thus adopts a macro-level approach to policy learning (Moyson et al., 2017) and deals with "governance learning" (Challies et al., 2017), or how policy actors learn about the appropriateness of different modes of governance. Specifically, the article tests whether the EU, as a collective institutional framework based on the systemic interaction among policy actors (i.e., EU institutions and member state governments), learnt from financial assistance failures during the euro crisis in its response to the Covid-19 pandemic, leading to a change in the EU's financial assistance regime.

The EU is a breeding ground for policy learning, both across policy fields and in financial assistance specifically. First, as an ever-evolving incomplete integration process, the EU has advanced in a "failing forward dynamic" through the lowest common denominator bargains among member states between one crisis and the next (Jones et al., 2016). Such integration pattern, based on the persistence of incomplete measures to address rising policy challenges, provides repeated opportunities for learning through trial and error, dysfunctional learning, and "learning to fail" (Dunlop & Radaelli, 2016; Radaelli, 2022). Second, albeit not immune to hierarchical involutions and dominance-based dynamics—as the response to the euro crisis shows (S. Fabbrini, 2016)—EU policymaking has increasingly developed into a multi-level, anti-hierarchical institutional framework that fosters ideational innovation and entrepreneurial politics, moving towards "networked governance" (Schout, 2009). In the absence of a fixed, top-down mode of governance for dealing with rising policy issues, decision-makers can work simultaneously at different levels and in different formats, exchange views, and negotiate policy outcomes among a range of potential alternatives (Piattoni, 2009). This, in turn, inevitably increases the scope for collective learning. Third, crises are believed to be key triggers for policy learning and learning-based institutional change (Deverell, 2009). While crises do not necessarily lead to policy learning, they nonetheless stand as major "windows of opportunity" for learning and learning-induced change (Ladi & Tsarouhas, 2020). Although the nature of the causal relation between crisis, learning, and change remains debated, the literature agrees that the temporal sequence goes from crisis to change through policy learning. In this light, not only is learning the "possible result of the way of managing and responding to crises," but European integration as such may depend on the EU's ability to learn lessons from crises (Radaelli, 2022, p. 2). In this respect, policymakers first exchange information and build knowledge based on a crisis-management experience. They thus learn lessons from policy failures associated with crisis management. Finally, policymakers can draw on those policy lessons to devise a policy response to a crisis (May, 1992).

During the Covid-19 pandemic, policy learning in EU financial assistance is expected to be facilitated by the temporal proximity with the previous euro crisis. As a large-scale economic shock, the euro crisis constitutes the most recent precedent where financial assistance was activated within the EU. In Ladi and Tsarouhas' (2020, p. 1045) own words, "it can be claimed that this time proximity has enabled quicker and deeper learning." This is all the more so as the EU governance of financial assistance during the euro crisis resulted in a manifest policy failure, both in terms of efficiency and democratic legitimacy (Donnelly, 2021; S. Fabbrini, 2013). Crisis-management experiences associated with policy failures constitute valuable testing grounds for policy learning as policy failures can act as relevant incentives for policymakers to consider institutional change. As May (1992, p. 342) has argued, "it is reasonable to presume that acknowledgement of policy failure by the policy elites within the relevant policy domain constitutes the relevant trigger for policy reconsideration and redesign."

The article builds around collective learning a "putatively explanatory narrative" (Mirò, 2020, p. 2) behind policy change in the EU's financial assistance regime and puts that narrative to a plausibility test through the identification of several "observable implications" (Beach & Pedersen, 2013). As Heikkila and Gerlak (2013) suggest, collective learning unfolds through a set of subprocesses or phases, including (a) acquisition, (b) translation, and (c) dissemination. Acquisition involves the collection of information by single individuals or groups of actors about experienced "errors" or "problems." This subprocess can be triggered by changes in opportunities from the external environment, such as those stemming from a crisis outbreak, and can help policymakers discern the need for collective action. Translation consists of the interpretation of the information acquired, aimed at "drawing lessons" for the way forward. It can substantiate policy proposals that build on past failures, thus informing collective action. As both acquisition and translation are likely to occur through group dialogue and deliberation, the two phases may happen simultaneously while remaining analytically separate. Because the acquisition and translation of knowledge by individual

agents or groups do not automatically lead to collective learning, dissemination finally involves the distribution of the lessons learnt across all members (of a community or an organisation) through informal bargaining or formal negotiations. To this effect, the learning actors may have to persuade or convince others that their ideas are worth being pursued through collective action (Figure 1).

In tracing the occurrence of collective learning about the EU's financial assistance regime following the pandemic crisis, the article identifies the following observable implications. First, if acquisition took place, there will be evidence of individual or institutional decision-makers questioning the use of the existing ESM to provide financial assistance in the renewed context of the Covid-19 pandemic, pointing to its past policy failures. Second, if translation occurred, there will be evidence of policymakers putting forward alternative solutions to secure financial assistance against the pandemic crisis, moving away from the ESM governance based on the lessons learnt. Third, if dissemination was achieved, there will be evidence of informal bargaining and/or formal negotiations among EU policymakers whereby a group of them tries to persuade others that collective action to reform the governance of financial assistance in light of the pandemic is needed, thus leading to a change in the EU's financial assistance regime. Finding empirical evidence of these indicators turns the argument into a plausible causal mechanism that deserves further assessment against alternative or complementary hypotheses.

To test whether and how learning occurred in the EU's response to the Covid-19 pandemic, this article relies on (a) primary sources of EU institutions and member state governments, (b) 10 semi-structured elite interviews with EU and government officials selected among those directly involved in the negotiations for the RRF, and (c) relevant international reports and newspaper articles for the sake of data triangulation. Interviews were conducted between March and July 2022 and lasted 40 minutes on average, ranging from 20 minutes to 80 minutes. Questions included what role the interviewee's institution played in the response to the two crises and whether and how the previous euro crisis influenced the interviewee's institution's response to the Covid-19 pandemic.

The sample was diversified based on the participants' roles and institutional affiliation to ensure the validity of the interviews. Respondents included senior and lower-level officials from the European Commission (n = 3), Council of the European Union (n = 4), and European Parliament (n = 1), as well as member state government officials from the French Permanent Representation (n = 1) and the German Finance Ministry (n = 1). In addition, respondents served in a number of different capacities, such as policy officer (n = 6), legal officer (n = 1), policy advisor (n = 2), and policy assistant (n = 1). To maximise the number and quality of the interviews, the respondents were granted confidentiality. Therefore, in the Supplementary File, quotes are not attributed to proper names but to letters. The interviewing process stopped when "theoretical saturation" was reached, that is "the point in data collection and analysis when new information produces little or no change to emerging findings and themes" (Tracy, 2020, p. 174). The insights collected through interviews were checked against a systematic analysis of official measures taken by EU institutions and member state governments, policy statements, and press coverage.

4. The EU's Financial Assistance Regime: From "Intergovernmental Coordination" to "Limited Supranational Delegation"

The EU's response to the euro crisis culminated in the adoption of the ESM in September 2012. Thought as the

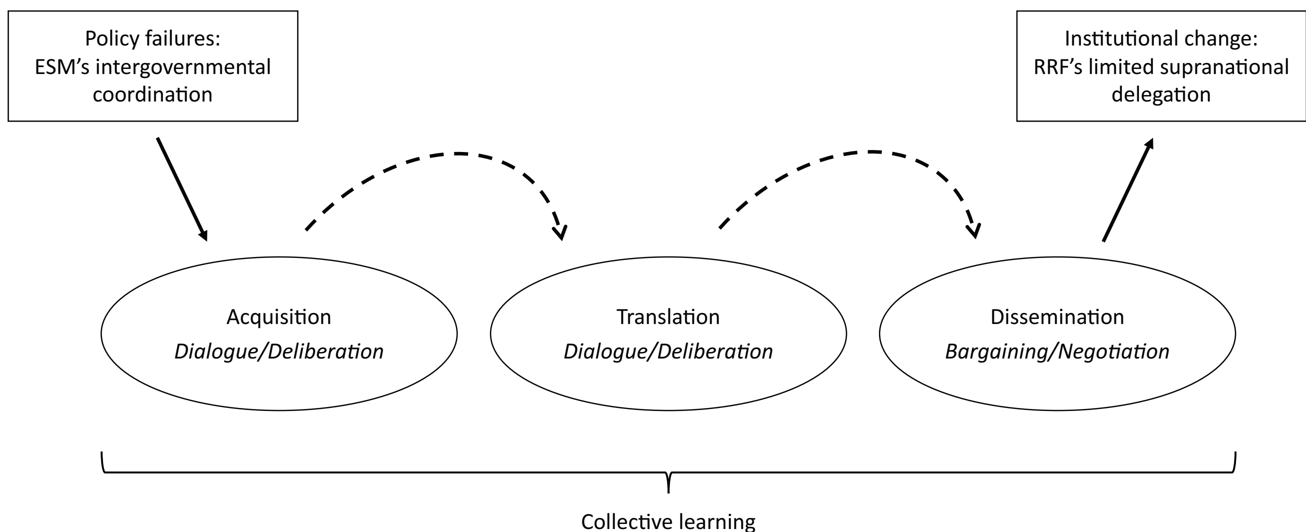

Figure 1. Visual representation of the "collective learning" process behind policy change in the EU's financial assistance regime.

major financial response to the crisis, the ESM is an international institution outside of the EU legal framework and comes with its own set of decision-making bodies and voting rules. Its institutional structure consists of a board of governors, a board of directors, and a managing director, and its financial capacity derives from the members' capital contributions in accordance with their GDP (Treaty Establishing the ESM, 2012).

In full swing during the euro crisis, the ESM provides stability support to ESM members based on strict conditionality in the form of macroeconomic adjustment programmes. To this end, an ESM member may send a request to the chairperson of the board of governors, who may in turn entrust the European Commission and the ECB with assessing both the existence of a risk to the financial stability of the eurozone or its member states and the sustainability of public debt in the ESM member concerned. Based on such assessment, the board of governors may decide to activate a financial assistance facility in support of the ESM member. In that case, the board of governors mandates the Commission, along with the ECB and the IMF, with negotiating the conditionality scheme of the financial assistance facility in a memorandum of understanding whose terms reflect the severity of the weakness to be addressed. The memorandum of understanding needs to be approved by the board of governors and signed by the Commission on behalf of the ESM. At the same time, on a proposal from the managing director and after consent of the board of governors, the board of directors approves a financial assistance facility agreement, including the financial terms and conditions of the programme and the disbursement of financial assistance. Finally, the European Commission, along with the ECB and IMF, monitors the compliance of the ESM member with the conditionality agreed in the memorandum of understanding (Treaty Establishing the ESM, 2012, Arts. 12–13).

Overall, the decision-making process for granting stability support and the disbursement of financial assistance is spearheaded by the board of governors and concluded by the board of directors, while the prevailing logic is based on mutual agreement, consensus, and unanimity. Indeed, although the board of directors approves financial assistance facility agreements by qualified majority voting (QMV), it is the board of governors that initiates and steers the decision-making process for providing stability support, and it does so by mutual agreement. This arguably makes the ESM an instrument based on the intergovernmental coordination between member state governments (Smeets et al., 2019). Based on this thematic issue's conceptual framework (Woźniakowski et al., 2023), the ESM thus establishes an intergovernmental transfer capacity of non-independent resources.

While the ESM remains operational, the EU's major financial reaction to the Covid-19 pandemic consisted of the adoption of the RRF within the Next Generation EU package. The RRF is an EU treaty-based instrument and stands as the core programme of Next Generation EU, which is legally integrated into the 2021–2027 Multiannual Financial Framework. Its financial capacity derives from the unprecedented large-scale emission of common debt through the European Commission's borrowing operations on the financial markets and from an increase in the Union's own resources (Regulation of the European Parliament and of the Council of 12 February 2021, 2021). Two decision-making procedures arise from the RRF—one for the disbursement of financial assistance and the other for the suspension (and lifting thereof) of financial payments. Both procedures revolve around the European Commission and the Council, but the balance of power tilts towards the Council in the former procedure (disbursement) and towards the Commission in the latter (suspension and lifting of suspension; S. Fabbrini & Capati, in press).

In practice, the Commission assesses member states' national recovery and resilience plans (NRRPs) based on a specific list of criteria. On a proposal from the Commission, the Council approves such an assessment by QMV, paving the way for the Commission's decision on the disbursement of the financial contribution. An emergency brake allows member states to exceptionally ask the president of the European Council to bring any NRRPs to the next European Council meeting for discussion, in which case the Commission cannot authorise the disbursement of the financial contribution until the European Council has discussed the matter. The powers of the European Council on NRRPs are, however, limited in both time and scope. On the one hand, the whole process should not take longer than three months since the Commission first asked for the opinion of the Economic and Financial Committee. On the other, member state governments have no veto power over the disbursement of financial contributions, and the final decision on authorising such disbursement lies with the European Commission. The European Commission can propose to the Council to suspend all or part of the financial assistance under the RRF or to lift such suspension, with the Council acting by reversed QMV. This slightly diminishes the decision-making role of the Council, as it needs a qualified majority to reverse the Commission proposal.

The institutions involved in the decision-making process and their voting rules suggest the governance of the RRF is not fully supranational and by far not intergovernmental. A fully supranational procedure would entail the Council and European Parliament sharing decision-making powers on a Commission proposal, with the Council acting by QMV and the Parliament by a simple or absolute majority (as per Art. 294 TFEU). Under the RRF, the Commission has the monopoly of policy initiative, while the Council decides on a Commission proposal alone. At the same time, intergovernmental governance would imply a preeminent role of the European Council and the Council, both acting by unanimity (as per Art. 24 TEU). In this case, the European Council is only allowed to discuss an NRRP before the Commission can

authorise the payment. Moreover, member state governments within the Council and, even more so, within the European Council can exercise no veto power at all. Hence, the governance of the RRF constitutes a form of "limited supranational delegation." Contrary to the ESM, the RRF thus establishes a form of supranational-like transfer capacity based on independent resources. Table 1 below summarises the governance of the RRF in comparison with that of the ESM.

What emerges is that the EU's financial assistance regime shifted from intergovernmental coordination as epitomised by the ESM in response to the euro crisis to a form of limited supranational delegation as epitomised by the RRF in response to the Covid-19 pandemic. The EU thus moved from an intergovernmental transfer capacity of non-independent resources to a form of supranational-like transfer capacity of independent resources.

5. Different Outcomes for Different Crises: Collective Learning in EU Financial Assistance

What explains such a change in the EU's financial assistance regime between the two crises? This section empirically tests the plausibility of the policy learning argument in three steps. First, it discusses the policy failures associated with the EU's financial management of the euro crisis through the ESM as identified by policymakers and the epistemic community. Second, it traces the occurrence of collective learning by examining the mechanisms of acquisition, translation, and dissemination of the relevant policy lessons and how such mechanisms led to the adoption of the RRF as an instrument of "limited supranational delegation." Third and finally, the section reflects on the results of the empirical analysis and discusses the relative explanatory power of policy learning compared to alternative hypotheses.

5.1. Policy Failures

When the Covid-19 pandemic broke out in March 2020, the ESM was the single major crisis-resolution tool in the EU. It thus stood as a "default option" for eurozone countries in need of financial assistance (Howarth & Quaglia, 2021, p. 7). In fact, prospects of relying on the ESM as the major response to the pandemic crisis were still prevalent in EU circles at least until early April 2020 (Bufacchi, 2020). However, no eurozone member opted for activating the instrument in their response to Covid-19, not even when its new health-related conditionality-light credit line (i.e., the Pandemic Crisis Support) became operational in May. After all, the ESM had come out of the experience of the sovereign debt crisis scratched and ailing. Owing much to its intergovernmental logic, the ESM had failed adequately to meet the criteria of efficiency and legitimacy in dealing with the crisis (Donnelly, 2021; S. Fabbrini, 2013).

In terms of efficiency, unanimity rules in the ESM decision-making system created multiple veto players, each virtually able to stop the adoption of any solution to the crisis. This allegedly contributed to slowing down the EU's reaction to the financial turmoil and made it difficult to stop the spread of the crisis from Greece to other Southern European member states (Interviews E and I). In terms of legitimacy, and again due to their intergovernmental character, decisions in the ESM were taken with little (if any) consideration for the European Parliament and national parliaments, despite having

Table 1. The ESM and RRF: Governance and capacity-building.

	Governance		Capacity-building		
	Decision-making institutions	Voting rules	Resources	Financing	Outcome
ESM	ESM board of governors, ESM board of directors, and ESM managing director	Unanimity (board of governors) and QMV (board of directors)	Non-independent	ESM members' capital contributions based on their GDP	Intergovernmental transfer capacity of non-independent resources
RRF	European Commission and Council	Disbursement: QMV in the Council on a proposal from the European Commission Suspension: Reversed QMV in the Council on a proposal from the European Commission	Independent	Mostly borrowing (EU debt), partly increase in own resources	Supranational-like transfer capacity of independent resources

implications for eurozone citizens at large. Those decisions thereby produced a vacuum of democratic accountability (Interview J; Howarth & Spendzharova, 2019). On top of that, the asymmetric vulnerabilities of eurozone members to the euro crisis and the ensuing divide between "creditor" and "debtor" countries allowed the most powerful actors at the time—notably Germany—to "weaponize" the ESM as a way of imposing "practical authority over other institutions, core EU policy principles, programmes, institutions and regulations and [placing] conditions on other countries" (Donnelly, 2021, p. 1576). Over time, this greatly contributed to increasing levels of public distrust towards the EU in general and its financial assistance practices in particular (Interviews G and J; Schmidt, 2020).

5.2. Acquisition

The shortcomings in the EU's financial response to the euro crisis provided EU policymakers with relevant hints on how (not) to go about financial crisis management during the Covid-19 pandemic. When the pandemic broke out, the experience of the euro crisis was still very vivid to EU policymakers, as were the policy failures in the EU's response to it. As one EU officer admitted:

> Even if [most] leaders between the two crises changed, governments and EU institutions have a living memory and especially with respect to the use of the ESM they realised what the huge repercussions of how they dealt with the previous crisis were. (Interview C)

At an early Eurogroup meeting on 16 March, Italian Prime Minister Giuseppe Conte was among the first to claim the inadequacy of existing financial tools, stressing that "the ESM was crafted with a different type of crisis in mind" and that "probably the only way forward would be the creation of a common European debt instrument" (Johnson et al., 2020). Conte's concerns were echoed on 25 March by a French-led initiative (Interview F) including nine member state governments who, acting on the basis of "past experiences" and "thorough exchange of information," called on a "common debt instrument issued by a European institution" to counter the damage caused by the pandemic, thereby dismissing the ESM (Wilmès et al., 2020). The acquisition of knowledge based on the management of the euro crisis soon assumed a collective character when, in their joint statement of 26 March, the members of the European Council stressed the importance of "drawing all lessons from the crisis," concluding that in "that respect, the time has come to put into place a more ambitious and wide-ranging crisis management system within the EU" (European Council, 2020a, p. 6).

While the exact governance features of the new financial instrument were yet to be discussed at this stage, it was already clear that, due to the manifest policy failures in the EU's response to the previous crisis, "the new system would [have to] be much more supranational in comparison with the ESM" (Interview A) and that "something was learnt with respect to financial governance and how the ESM fared in its management of the euro crisis" (Interview D). At this time, the idea of relying on the ESM as the major tool to address the Covid-19 crisis had completely vanished as it was perceived as "poisonous" by the policymakers' large majority (Interview B).

The acquisition of knowledge from the financial response to the euro crisis by some key actors—including the Italian prime minister, the French president, and other government representatives, mostly from Southern Europe—thus paved the way for the subsequent translation of it into policy proposals for a new financial instrument to address the Covid-19 pandemic.

5.3. Translation

In the conclusions to their meeting of 26 March, government heads had invited the European Commission to come up with proposals for Europe's recovery. On 16 April, in a speech at the European Parliament, European Commission President von der Leyen thus put forward the idea of an ambitious "Marshall Plan for Europe's recovery." She acted on the premise that "Europe has had economic crises before" and that "the moment has arrived in which we must know how to discard old burdens," adding that "this is the lesson we need to learn from this crisis" (von der Leyen, 2020). On the same day, the European Policy Centre published a discussion paper identifying several "key lessons [that] can be learned and applied from [the euro crisis], including the need to 'jointly set up and finance a common Covid-19 recovery and growth fund'" (Emmanoulidis & Zuleeg, 2020, p. 3). One month later, French President Macron and German Chancellor Merkel came up with their joint initiative for a common debt instrument to replace the ESM in addressing the pandemic, one based on "an in-depth reflection on the lessons we need to draw" (Présidence de la République Française, 2020). Reporting on it, the *Financial Times* acknowledged that:

> The lesson of past crises is that inadequate measures sharpen disagreements among governments, stimulate public frustration with the EU and sow doubts in financial markets about the eurozone's stability. The French-German initiative stands out from crisis-fighting measures deployed in the sovereign debt and bank turmoil of a decade ago. ("Franco-German rescue plan is a big step forward," 2020)

Along these lines, in its legislative initiative for the establishment of the RRF of 28 May, the European Commission advanced a largely supranational, comitology-like governance limiting the Council's role to the suspension of payments on a recommendation from the Commission

and based on the use of reversed QMV rather than unanimity. The legislative proposal thus distanced the governance of the RRF from that of the ESM. The Commission then emphasised among the "grounds for the proposal/initiative" exactly the "lessons learned from similar experiences in the past" (European Commission, 2020, p. 34). In that respect, an EU officer revealed that "the very negative experiences from the ESM bailouts in Portugal, Spain, Ireland and Greece were contemplated and contributed to the greater role by the European Commission in the definition and governance of the RRF" (Interview G). Following the Commission's proposal, on 9 June, the German, Portuguese, and Slovenian governments presented the 18-month programme of their Council presidency, suggesting they would steer upcoming negotiations by "drawing all lessons from the crisis and tackling its socio-economic consequences" (Council of the European Union, 2020).

In this phase, some EU and national policymakers—notably the Commission president, the French president, and the German chancellor—translated the lessons learnt from the mismanagement of the euro crisis into policy proposals for establishing the RRF around a supranational governance system that differed from the intergovernmental ESM. This opened a process of dissemination of new ideas through hard bargaining and negotiations, leading up to collective learning.

5.4. Dissemination

The Commission's initiative was followed by several rounds of negotiations before an agreement could be reached. While learning through bargaining might sound odd, negotiations can produce information and shed light on alternative courses of action which would otherwise remain uncharted (Dunlop & Radaelli, 2016). In particular, the governance of the RRF became "the single most important and difficult question" that the political leaders would deal with (Interview F; Ludlow, 2020). While a large majority of policymakers—the so-called "solidarity coalition" (S. Fabbrini, 2023)—endorsed the RRF's governance mechanism as per the Commission's scheme, a small coalition of veto players—the self-defined "Frugal Four," including Austria, Denmark, the Netherlands, and Sweden—opposed it, favouring unanimity in the Council instead.

Upon assuming the Council presidency on 1 July, the German government thus circulated a draft proposal providing that the Council would not only suspend payments on a recommendation from the Commission but that it would have a say on any phase of the process and approve the Commission's assessment of NRRPs by QMV (Ludlow, 2020). The German draft was debated at the EU ambassadors meeting on 8 July. On that occasion, Dutch EU Permanent Representative De Groot appreciated Germany's effort but said the Netherlands still favoured unanimity voting in the Council on a Commission recommendation. As an insider argued, by then "the Frugals themselves had become increasingly aware that a solution like the ESM would be impracticable for the Covid-19 pandemic and only pushed for unanimity to obtain a greater role of governments in the Council" (Interview H). Overall, therefore, the German proposal was hailed as a big progress in the negotiations by the Frugal Four as it somewhat moved the balance of decision-making powers under the RRF from the European Commission to the Council ("POLITICO Brussels Playbook: Michel's not taking 'no,'" 2020).

On 10 July, in his "negotiating box" ahead of the European Council meeting of 17–21 July, Charles Michel reiterated that "it is essential to learn the lessons" with a clear reference to the unanimity issue (European Council, 2020b), and supported the German blueprint for the governance of the RRF. The European Commission's Representative Gert-Jan Koopman welcomed it and said that "the Commission was not opposed in principle to enlarging the Council's role" in the governance of the RRF (Ludlow, 2020, p. 28). Government representatives of the solidarity coalition appreciated the preservation of an overarching supranational system of financial assistance, while the Frugal Four started softening their positions. It was on this basis that a compromise on the governance of the RRF was achieved at the European Council meeting of 17–21 July. The Dutch government insisted that the member states should have continued control over the national recovery plans, claiming for them the power to stop the activation of financial assistance in case an NRRP appeared not to be in line with the established criteria. Such a request was opposed by both the Italian government and the Commission, who feared this could jeopardise the supranational structure of the recovery instrument (Ludlow, 2020).

Working closely with Merkel, Michel thus put forward a clause providing that, in case of doubts or concerns, the member states could ask to discuss any NRRP at the next European Council meeting before the Commission could recommend the activation of financial assistance. At the same time, the European Council would have no veto powers over the disbursement of payments and the last say would continue to lie with the Commission (European Council, 2020c). In this way, they were able to strike a deal with the Frugal Four without shaking the supranational nature of the RRF's governance. The added clause, known as the "emergency brake," represented the fundamental compromise behind the recovery instrument (Interviews F, H, and J) and allowed the establishment of the RRF around a form of "limited supranational delegation."

Pointing to collective learning, the final RRF regulation, published on 12 February 2021, reported:

> The Facility should be a dedicated instrument designed to tackle to adverse effects and consequences of the Covid-19 crisis in the Union. It should be comprehensive and should benefit from the experience gained by the Commission and the member

> states from the use of other instruments and programmes. (Regulation of the European Parliament and of the Council of 12 February 2021, 2021, p. 5, emphasis added)

5.5. Discussion of Results

Overall, in the interviews with policymakers involved in the EU's response to the pandemic, learning from past crisis experiences was identified as one of the main factors behind the establishment of the RRF by all but one (*n* = 10). In particular, policy learning emerged from the interviews as one of three competing—but not mutually exclusive—narratives on the causes behind governance change in the EU's financial assistance regime following Covid-19, with the other narratives revolving around the nature of the pandemic crisis as "exogenous" rather than "endogenous" (as was instead the euro crisis) and the effects of the pandemic crisis as "partly symmetric" rather than "fully asymmetric" (as were those of the euro crisis). A minor narrative, which a few interviewees also mentioned as a potential cause of change in the governance of financial assistance, concerned Brexit and the constraining effects of the "British veto" in the past (Interviews A, D, and F).

As for the relative explanatory weight of policy learning in relation to the other narratives, no unanimous view emerged from the interviews. While some posited that policy learning was conditional upon the different nature and effects of the Covid-19 pandemic compared to the euro crisis (Interviews A, B, and E), others argued that the experience of the euro crisis would have urged EU policymakers to learn key policy lessons anyway (Interviews C, D, and G). For our purposes, however, policy learning has an analytical role of its own. While the different nature and effects of the pandemic vis-à-vis the euro crisis may indeed shed light on policymakers' willingness to set up a dedicated financial assistance mechanism larger in size and more comprehensive in scope than the ESM, it is specifically through learning from the policy failures of intergovernmental coordination that change in the governance of financial assistance towards a form of supranational delegation can best be explained.

6. Conclusion

This article has examined policy change in the EU's financial assistance regime between the euro crisis and the Covid-19 pandemic. It has shown that the governance of financial assistance in the EU moved from intergovernmental coordination with the ESM as a response to the euro crisis to a form of limited supranational delegation with the RRF in response to the Covid-19 pandemic. By relying on official documents, semi-structured elite interviews, and international reports, the article has argued that such a change was due to a process of collective learning. To do so, it has traced how the outbreak of the pandemic crisis prompted the acquisition, translation, and dissemination by EU and national policymakers of policy lessons from the management of the euro crisis and the use of the ESM. It has then shown how the unfolding of such a process ultimately led to a governance change in EU financial assistance with the establishment of the RRF.

The article makes both a theoretical and an empirical contribution. Theoretically, it applies the concept of policy learning to crisis-induced institutional change in the EU. In particular, it turns collective learning into a testable causal mechanism behind policy change in EU financial assistance following the outbreak of Covid-19, examining its plausibility and discussing its explanatory power compared to alternative hypotheses. In doing so, the article corroborates the potential of a policy learning framework to account for European supranational integration in times of emergency politics. Empirically, the article sheds light on the policymaking dynamics leading to the establishment of the RRF, focusing on the role of actors and their motivations. It shows that EU collective action to address the pandemic crisis was informed by the policy failures of the ESM during the previous euro crisis and that policy learning led to a change in the EU's financial assistance regime through hard bargaining and negotiations.

The article's findings raise two points of discussion. First, despite the failures of intergovernmentalism in the EU's response to the euro crisis, the ESM was in full swing up until the coronavirus outbreak, marking a long period of institutional path dependence. Intergovernmental coordination was only challenged after Covid-19 had turned into a global pandemic, forcing EU and government officials to come to terms with the mismanagement of the previous economic crisis. This may suggest that the EU tends to learn from past failures, freeing itself from established institutional constraints, only when the next crisis provides a window of opportunity for institutional change. Second, as the process of collective learning indicates, when the next crisis strikes, the EU is able to radically alter its governance methods based on previous policy failures. This may imply that European integration proceeds mostly through "critical junctures" leading to radical and abrupt changes, rather than gradually or incrementally between one crisis and the next.

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Conflict of Interests

The author declares no conflict of interests.

Supplementary Material

Supplementary material for this article is available online in the format provided by the author (unedited).

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Article

Funding the War in Ukraine: The European Peace Facility, the Macro-Financial Assistance Instrument, and the Slow Rise of an EU Fiscal Capacity

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Abstract
The war in Ukraine represented a major geopolitical shock for the EU. In the face of an illegal Russian aggression, EU institutions and member states rallied to support Ukraine. Nevertheless, the war in Ukraine also exposed the limited fiscal capacity of the EU. As a result, EU institutions and member states had to come up with creative ways to financially back Ukraine's military and civilian efforts. This article examines the two key tools deployed by the EU so far to fund Ukraine in its war against Russia, namely the European Peace Facility and the Macro-Financial Assistance Instrument. The article details the legal features of these tools, evaluates their intergovernmental vs. supranational nature, and reflects on their significance for the consolidation of an EU fiscal capacity. As the article argues, the war in Ukraine quickly prompted the EU to replicate some of the novelties it used to respond to the Covid-19 pandemic, namely the use of common borrowing and spending. Nevertheless, structural fiscal and governance weaknesses still limit the ability of the EU to mobilize resources and leverage power on the international stage.

Keywords
debt; EU budget; European Peace Facility; Macro-Financial Assistance Instrument; war in Ukraine

Issue
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1. Introduction

The war in Ukraine has posed an unprecedented challenge for the EU. The return of war on the European continent shattered illusions of perpetual peace and forced the EU to confront the demands of hard power at its eastern borders. In this context, a pressing need for the EU has been to support Ukraine financially in its efforts to defend itself against the Russian aggression. The Russian military invasion of Ukraine, in fact, caused a dramatic death toll, with probable cases of war crimes, massive displacement of refugees, and widespread damage to critical infrastructures. Reacting to these horrific facts and such a blatant breach of international law, the EU mobilized resources to assist the Ukrainian military in purchasing defense weapons and the Ukrainian civilian authorities in funding operational government expenses and rebuilding critical infrastructures.

The purpose of this article is to examine from an EU law and policy perspective the two key instruments that the EU deployed in 2022 to finance Ukraine in the war against Russia's aggression, namely the European Peace Facility (EPF; Council Decision (CFSP) 2021/509; see Council of the EU, 2021) and the Macro-Financial Assistance Instrument (MFA+) for Ukraine (Regulation 2022/2463; see European Parliament & Council of the EU, 2022). The article endeavors to detail the legal features of these tools, evaluate their intergovernmental vs. supranational nature, and reflect on their impact on EU fiscal integration. As the article points out, at the beginning of the war in Ukraine, the EU resorted to the EPF, a novel funding instrument dedicated to foreign policy

objectives, worth €5.6 billion, which is fully funded by member states' transfers and subjected to their unanimous intergovernmental decision-making in the Council. Subsequently however, as the war in Ukraine continued, the EU crafted the MFA+, a larger €18 billion financing tool approved jointly by the European Parliament and Council, which enables the Commission to issue common debt, backed up by states' guarantees, and to transfer these own resources to Ukraine.

As the article argues, the war in Ukraine quickly prompted the EU to replicate some of the novelties it used to respond to the Covid-19 pandemic. As it is well known, to address the devastating socio-economic consequences of the pandemic, the EU agreed in 2020 to establish ground-breaking instruments such as a €100 billion unemployment re-insurance system called SURE (Council Regulation 2020/672; see Council of the EU, 2020a) and a €750 billion recovery fund, known as Next Generation EU (NGEU; Council Regulation 2020/2094; see Council of the EU, 2020d). The latter, in particular, empowered the Commission to raise funds by issuing common debt on the financial markets, to transfer these amounts to the member states as grants and loans, and prospectively to levy new taxes to repay capital and interests on the debt. Formally speaking, the financial tools rolled out to address Covid-19 were designed to be temporary. Yet, NGEU and SURE provided a model that the EU promptly re-used when facing the war in Ukraine. In particular, the MFA+ entails once again common borrowing and spending. This suggests a trend towards consolidating at the EU level of government what I called a "fiscal capacity" (F. Fabbrini, 2022) or what the editors of this thematic issue call a "budgetary capacity" (Woźniakowski et al., 2023).

Nevertheless, if this development is in line both with accounts of historical institutionalism (Dopfer, 1991; Pierson, 1996) and the logic of failing forward that drives European integration (Jones et al., 2021), a number of caveats are in order. The consolidation of fiscal capacity in the EU continues to be hampered by structural weaknesses. In particular, as the article highlights, the MFA+ is exclusively designed to fund Ukraine *in 2023*—for a 12-month period. Moreover, tactical opposition by a single member state—Hungary, which vetoed the measures for several months—almost derailed the effort to pass the MFA+. In fact, the need to modify the general EU budget act—the Multi-Annual Financial Framework (MFF; Council Regulation 2020/2093; see Council of the European Union, 2020c)—in order to enable to Commission to issue common debt proved so daunting that the MFA+ was adopted by resorting to member states' financial guarantees, which will only in time be replaced by a single guarantee from the EU budget when the MFF is amended. This confirms that several constitutional and governance shortcomings still limit the EU's ability to mobilize resources and leverage power on the international stage. While, certainly, the war in Ukraine supports the insight from historians, political scientists, and sociologists that war is a powerful driver of state-building and institutional change (Centeno & Enriquez, 2016; MacMillan, 2020; Tilly, 1975), at the moment, the effort to establish a permanent fiscal capacity in the EU remains a process still in the making.

As such, this article is structured as follows. Sections 2 and 3 analyze respectively the EPF and the MFA+, highlighting their main legal features, legal bases, funding mechanisms, and governance arrangements. Section 4 contextualizes the EPF and MFA+ in light of the legal and institutional innovations created by the EU and its member states to respond to Covid-19, it points out that the war in Ukraine increased the need for the EU to reproduce funding mechanisms based on common debt akin to those rolled out during the pandemic, and it reflects on how the war in Ukraine contributed to the slow consolidation of a fiscal capacity in the EU. Section 5, however, underlines how this trend is slowed by governance shortcomings and constitutional constraints, which make it difficult for the EU to decide, and to upscale its financial firepower. Finally, Section 6 concludes and highlights some very recent developments relevant to this topic.

2. The European Peace Facility

The EPF is a novel funding mechanism that the EU created in 2021 as part of the financial package for 2021–2027, which is centered on the MFF and also includes (in response to Covid-19) the NGEU Recovery Fund. Its name notwithstanding, the EPF was specifically established as a €5.6 billion special fund to finance the common costs of military operations by EU member states under the EU Common Security and Defence Policy (CSDP), as well as actions to improve the military and defence capabilities of third states and partners. The EPF—which is adopted in the form of a Council decision—is based on Articles 28(1), 41(2), 42(4), and 30(1) of the Treaty on European Union (TEU; 2012), which respectively allow the EU to act when the international situation so requires, to pool resources to this end, and to adopt initiatives unanimously in the Council. The EPF is built as an off-budget fund, outside the MFF, because Article 41(2) of the TEU explicitly prohibits charging to the EU budget "expenditure arising from operations having military or defense implications.''

The EPF, as a tool of the EU Common Foreign and Security Policy and CSDP, is exhibit A of intergovernmentalism in the EU. The Council Decision 2021/509 (see Council of the European Union, 2021) establishing the EPF is extremely long—76 articles and five annexes—and over-complicated. The EPF, as clarified in Article 9, should be used to achieve "the strategic priorities set by the European Council and the Council," and must be consistent with the Common Foreign and Security Policy goals of the EU (Article 8). Importantly, according to Article 36, "assistance measures can be implemented through grants." Yet, from a governance viewpoint, the

EPF is managed by a Facility Committee (FC), composed of representatives from all 27 member states, which must take decisions by unanimity (Article 11(14)). A large administrative bureaucracy operates under the direction of the FC (Articles 12, 13, and 15). Moreover, as a further guarantee to member states, the decision establishes a direct link between participation in decisions on and contribution to the financing of operation and assistance measures: In particular, pursuant to Article 5, "a member state which has abstained in a vote on a Council decision…is not obliged to contribute to the funding of that operation.''

From a financing viewpoint, the EPF is entirely resourced through member states' transfers. According to Article 18(7)(a), the EPF revenues consist primarily of "contributions payable by the contributing member states." As clarified in Article 26, member states' contributions are determined on the basis of the gross national income and are requisitioned by the FC annually (Article 29). Nevertheless, as a further guarantee of member states' intergovernmental discretion, Article 27 states that a "member state which has indicated its intention to abstain from the adoption of an assistance measure…may identify other assistance measures to which it will make an additional contribution." This means that while the EPF is a common financial pot, each member state still maintains full control of where its share of the funding is directed. Furthermore, numerous reporting and accounting obligations are connected to the EPF, including a duty by administrators to report to the FC on expenditures every three months (Article 38) and a right for the Council to review the decision whenever a member state so requires, and at least every three years (Article 75).

At the explosion of the war in Ukraine, the EU quickly decided to mobilize the EPF to provide financial support to the Ukrainian military, including funding for the purchase of lethal weapons—a step which was hailed as historic (not least given that some EU member states still abide by a policy of military neutrality). In particular, in February 2022, the Council approved Decision 2022/338 (see Council of the EU, 2022a) on assistance measures for the supply to the Ukrainian armed forces of military equipment. The decision empowered the EU High Representative to implement the measure (Article 4), making arrangements with the beneficiary, including ensuring compliance with international human rights law and humanitarian law (Article 3) and foresaw a disbursement of €450 million (Article 2). This amount was subsequently doubled in March 2022 (Council Decision 2022/471; see Council of the EU, 2022b) and tripled in April 2022 to a total of €1.5 billion (Council Decision 2022/636; see Council of the EU, 2022c). Subsequently, EPF funding to support the Ukrainian military was further tapped in May 2022 (Council Decision 2022/809; see Council of the EU, 2022d) and July 2022 (Council Decision 2022/1285; see Council of the EU, 2022e), bringing the total size of support to €3.1 billion. This, combined with other EPF expenditures towards other third countries carried out in 2022, largely depleted in a single year a budget that had been designed for a seven-year time frame. As a result, the Council decided in December 2022 for a €2 billion increase in the EPF for 2023 (Council Decision 2023/577; see Council of the EU, 2023a).

3. The Macro-Financial Assistance Instrument

Given the limited resources available under the EPF, and as the war in Ukraine worsened, in the fall of 2022, the European Commission proposed to establish the MFA+ in the form of a regulation of the European Parliament and Council. The MFA+ is based on Article 212 of the Treaty on the Functioning of the European Union (TFEU; 2012), which allows the EU to provide financial assistance to third countries. This provision is similar to but different from Article 148 TFEU, which allows the EU to support a country threatened with difficulties as regards its balance of payments because the latter only applies to EU member states, which are outside the Eurozone. In fact, Articles 212 and 213 TFEU had long been used by the EU to assist countries under the European Neighbourhood Policy (Erlbacher, 2019). Going beyond the piecemeal support that the EU had given to the Ukrainian government in the initial months of the war, the MFA+, worth €18 billion, was designed to provide predictable, continuous, orderly, and timely financial relief to Ukraine in 2023, thus supporting its rehabilitation and reconstruction and prospectively its preparation for EU membership (European Council, 2022). The Commission's proposal was endorsed by the European Parliament and the member states in the Council, but Hungary vetoed it, mostly as a bargaining chip to obtain a concession from the Commission on an unrelated measure: To tackle the problem of rule of law backsliding at play in Hungary, in fact, the Commission had suspended the transfer of NGEU funds to Hungary, which was thus eager to use every available card to overcome the application of the rule of law conditionality regulation (Regulation 2020/2092; see European Parliament & Council of the EU, 2020) and obtain EU funds.

In the end, in order to circumvent Hungary's veto, in December 2022, the Council decided to amend slightly the Commission proposal and passed it with the European Parliament's approval. Specifically, the Council changed the original funding scheme proposed by the Commission, which envisaged guaranteeing the issuance of €18 billion of common debt through the EU budget. Since that required an amendment to the MFF—a change on which Hungary had a right to veto on the basis of Article 312 TFEU—the Council rather opted to back up the €18 billion of new common debt of the MFA+ through member states' guarantees, provided by 26 member states pro-quota (European Parliament, 2022c). In what is certainly not a coincidence, though, two days before the Council also approved the Hungarian National Recovery and Resilience Plan (NRRP; Council of

the EU, 2022f), thus ensuring that Hungary could access, in the future, NGEU money, if the Commission were to de-block them pursuant to the rule of law conditionality regulation. Admittedly the MFA+ still foresees that were an amendment to the MFF to be approved then the EU budget would replace member states' guarantees; but, as the MFA+ only operates in 2023, it is unclear if that will actually occur.

The MFA+ presents more supranational features than the EPF. The Regulation 2022/2463 (see European Parliament & Council of the EU, 2022) is only 21 articles long and fairly linear. As clarified in Article 2, the objective of the instrument is to provide "short-term financial relief to Ukraine...and initial support towards post-war reconstruction," and the MFA+ areas of support include financing Ukraine's funding need, restoring critical infrastructure, as well as alignment with the EU regulatory framework (Article 3). Based on Article 4 of its regulation, the MFA+ provides support in the form of loans, although additional amounts can be contributed by member states as grants. From a governance viewpoint, the MFA+ regulation vests the key decision-making power in the European Commission. Pursuant to Article 11, "the support under the instrument shall be made available by the Commission in installments." The regulation however introduces a number of pre-condition for the support under the MFA+, including "that Ukraine continue[s] to uphold and respect effective democratic mechanisms...and the rule of law" (Article 8). The Commission signs the memorandum of understanding with Ukraine setting out priority actions (Article 9); reviews compliance with the ex-ante conditionality (Article 12); and can reduce, suspend, or cancel support under the MFA+ (Article 13).

From a financing viewpoint, the MFA+ instrument is based on the issuance of common EU debt, rather than member states' transfers. Specifically, Article 16 states that "in order to finance the support under the instrument in the form of loans, the Commission shall be empowered, on behalf of the Union, to borrow the necessary funds on the capital markets or from financial institutions." Loans to Ukraine, which are set at a very favorable term, "shall have a maximum duration of 35 years" (Article 16(2)) and the EU can offer an interest rate subsidy to Ukraine (Article 17). The supranational dimension of EU common debt, though, is counterbalanced by the intergovernmental left-over of member states' guarantees. As mentioned, given the impossibility to amend the MFF and raise the EU budget ceiling, Article 5(2) states that member states contribute to guaranteeing the debt "in the form of irrevocable, unconditional and on-demand guarantees through a guarantee agreement to be concluded with the Commission." Such national guarantees are determined pro quota on the basis of each member state's gross national income (Article 5(3)), but "shall cease to be callable as of the date of application of an amendment to" the MFF regulation (Article 6(f)). The usual annual reporting obligation is imposed by the regulation on the Commission (Article 20), which must also constantly keep the European Parliament and Council informed on disbursement operations (Article 15).

4. Exogenous Threats and Path Dependency: The Consolidation of an EU Fiscal Capacity

The EU's financial response to the war in Ukraine in 2022 reveals a trend towards the consolidation of fiscal capacity in the EU (F. Fabbrini, 2022). The unprecedented geopolitical threat posed by the Russian military aggression at Europe's eastern borders forced the EU institutions and member states to resort to funding mechanisms analogous to those rolled out in response to the Covid-19 pandemic. At the start of the war in Ukraine, the EU member states deployed for the first time the EPF, a new tool designed to back up the EU voice in foreign affairs. Nevertheless, the limited size of the EPF—and arguably its complicated governance arrangements—quickly led the Commission to propose an alternative funding instrument: the MFA+. Grounded on a different treaty legal basis—and justified also in light of the EU grant of candidate status to Ukraine—the MFA+ enabled the Commission to raise €18 billion on the financial markets on behalf of the EU and to transfer these to the Ukrainian government in 2023 as concessionary loans subject to standard conditionality.

While the EPF presents features which resemble the traditional EU budget, the MFA+ rather tracks the solution that the EU adopted to tackle the Covid-19 pandemic. As is well known, the EU budget—the MFF—is mostly funded by member states' transfers (Zamparini & Villani-Lubelli, 2019), and, as pointed out above, the same is true for the EPF. On the contrary, in response to the Covid-19 pandemic, the EU experimented with novel financial instruments, legally engineering a constitutional transformation in the EU architecture of economic governance (De Witte, 2021). To address the socio-economic damages caused by the pandemic, in particular, the EU set up SURE, worth €100 billion, and subsequently the NGEU Recovery Fund, worth €750 billion. Under SURE, the Commission was empowered to raise €100 billion on the financial markets by issuing common debt on behalf of the EU, subject to €25 billion of member states' guarantees. In the case of NGEU, instead, the Commission was empowered to raise €750 billion by issuing common debt on behalf of the EU, with the general EU budget serving as a backup through an increase of the EU's own resources decision (ORD) ceiling (Council Decision 2020/2053, Article 5(1); see Council of the EU, 2020b).

From this point of view, the MFA+ follows in the footsteps of SURE and NGEU. In particular, the MFA+ scheme tracks SURE, to the extent that both mechanisms rely on member states' guarantees to empower the Commission to issue EU common debt. Moreover, like SURE, the MFA+ provides loans rather than grants. At the same time, the MFA+ also draws from the example of NGEU—

and specifically the Recovery and Resilience Facility (RRF), the main program funded under the Recovery Fund (Regulation 2021/241; see European Parliament & Council of the EU, 2021). The RRF requires member states to design NRRPs, with specific targets, milestones, and objectives to be achieved in order to receive NGEU funds and empowers the Commission to assess them. At the same time, the rule of law conditionality regulation subjects disbursement of funding to the respect of basic rule of law principles, which again the Commission is empowered to evaluate. Along the same lines, as mentioned, the MFA+ regulation foresees that Ukraine and the Commission will enter into a memorandum of understanding outlining the specific objectives to be achieved with EU funding, and empowers the Commission to evaluate compliance as a condition for the payment of installments. At the same time, while the EPF conditions funding to continuing respect of international human rights law and humanitarian law, the MFA+ requires Ukraine to abide by democratic and rule of law principles to receive cash, effectively replicating—albeit arguably in a lighter form—the EU rule of law conditionality rules.

Therefore, the EU funding response to the war in Ukraine, culminating with the adoption of the MFA+, seems to confirm existing political science theories of European integration, as well as legal scholarship work on emergency governance. In political science, the theory of historical institutionalism has long argued that EU integration is path-dependent. According to this view, history matters and shapes the direction of integration, because past events or decisions constrain later events or decisions. For Pierson (1996, p. 126), in particular, the path of European integration can be discerned as a process whereby key political actors "carry out institutional and policy reforms that fundamentally transform their own positions (or those of their successors) in ways that are unanticipated." Along the same lines, more recently, Jones et al (2021, pp. 1519–1520) have explained that:

> European integration proceeded through a pattern of failing forward: In an initial phase, lowest common denominator intergovernmental bargains led to the creation of incomplete institutions, which in turn sowed the seeds of future crises, which then propelled deeper integration through reformed but still incomplete institutions—thus setting the stage for the process to move integration forward.

Otherwise, in law, scholars (Gross & Ní Aoláin, 2006) have long pointed out that once norms are adopted in times of emergency, they set a precedent and often become entrenched over time.

The abovementioned theoretical concepts of path dependency, failing forward, and emergency governance help to make sense of the developments at play here. Interestingly, all measures enacted by the EU to address the Covid-19 pandemic had a sunset. In particular, given the difficult political negotiation (de la Porte & Jensen, 2021), NGEU was presented as an exceptional tool, with the decision to empower the Commission to issue common debt on behalf of the EU as a purely one-off initiative. Moreover, by design, NGEU also revealed a number of ambiguities, which potentially limited its extension in the future. On the one hand, EU institutions and member states agreed on the common borrowing and spending, but effectively postponed the issue of debt repayment, and common taxes: While an Interinstitutional Agreement (2020) binds the Council, Parliament, and Commission on a roadmap to introduce new EU own resources in the years ahead, the possibility always remains that member states may have to increase their share of national contributions to the MFF to repay the NGEU debt if no alternative source is found. On the other hand, the largest envelop of NGEU, the RRF is designed as a program to provide support to member states: This however raises the question of time-bound implementation, with the risk that not all funds may be spent successfully, within the tight deadlines. Clearly, if member states were to be forced to pay back the NGEU debt with national funds or if NGEU funds were not to be used properly, then the appetite for further common EU debt would decline.

Yet, the explosion of the war in Ukraine in February 2023—exactly two years since the outburst of Covid-19, and as the EU and the world were slowly re-emerging from the pandemic—quickly changed the circumstances. Facing a sudden geo-strategic threat at its border the EU mobilized to raise necessary resources and fund the war efforts. In this new scenario, SURE and NGEU offered the policy template and legal technique that the EU could use in order to address a new crisis. Hence, after deploying the innovative EPF, the EU institutions quickly agreed to empower the Commission to issue yet again more common debt on behalf of the EU, this time to fund the Ukrainian government. As such, a policy strategy that had emerged in the context of the pandemic was redeployed to deal with a different occurrence, suggesting that the use of common debt by the EU may become less of an emergency measure and more of a standard practice. In the end, a number of question marks still remain, not least whether the Ukrainian government will be in a financial position to repay the loans it is receiving from the EU, and whether EU member states will continue to be unwavering in their support to Ukraine. However, the EU's financial response to the war in Ukraine seems to confirm that external threats are one of the strongest drivers of fiscal integration (Woźniakowski, 2022) and that, despite some of the rhetoric, the EU has become accustomed to resorting to common debt to address unexpected crises.

5. Governance Problems and Constitutional Constraints: Challenges Towards Fiscal Integration

Nevertheless, the road towards the consolidation of a fiscal capacity in the EU remains fraught with difficulties

and uncertainties. Indeed, as also the approval of the MFA+ highlights, the EU is hampered by governance problems and constitutional constraints which severely undermine its capacity to raise a fiscal capacity and rise to the geopolitical challenges it is facing. A rough comparison between the EU and the US funding to Ukraine in the first year of the war drives home the point. The €3.1 billion of EPF funding combined with additional smaller EU grants and the €18 billion of MFA+ support (which however applies to 2023) pale in comparison to the $54 billion of spending the US provided to Ukraine in just three months, between March and May 2022 (Pallaro & Parlapiano, 2022), which were further increased by an additional $44 billion in December 2022 as part of a stunning $858 billion military bill for 2023 (Edmondson, 2022). Needless to say, US defense spending is the backbone of NATO. Yet, even accounting for the additional spending that EU member states provided on their own, how can we make sense of this embarrassing imbalance?

To begin with, there are a number of constitutional constraints on the ability of the EU to raise fiscal resources. At the time of the approval of NGEU, a debate occurred on whether EU efforts to establish a fiscal capacity were limited by national or EU constitutional rules (Gordon, 2022). In the end, legal concerns were largely overcome, including in the most reluctant member state: Germany. In particular, in an important ruling delivered in early December 2022, the German Federal Constitutional Court rejected the legal challenges that had been raised against the NGEU and ORD (Bundesverfassungsgericht, 2022). As the Court clarified in a 7–1 judgment, the establishment of NGEU and the empowerment of the European Commission to issue €750 billion of common debt violated neither the EU treaties nor the German Basic Law. According to the Court, the Recovery Fund was compatible with Articles 122, 125, and 311 TFEU, and did not constitute an ultra vires action by the EU, thus complying with the integration agenda foreseen in the Basic Law, particularly as the size of NGEU funded by raising common debt was inferior to the size of the MFF, resourced via states' transfers. As a result, albeit with caveats that may come to haunt it later, the German Federal Constitutional Court endorsed the path towards common debt.

Yet, other EU constitutional rules weaken the EU's ability to mobilize resources at need. On the one hand, Article 41(2) TEU explicitly prohibits charging to the EU budget "expenditure arising from operations having military or defense implications," which means that CSDP expenses have to be covered by separate funds, like the EPF, set up outside the MFF. On the other hand, Title II of Part VI of the TFEU, which sets the "financial provisions" of the EU, lays out daunting rules. In particular, according to Article 310(1) TFEU, the revenues and expenditures of the EU budget "shall be in balance." Moreover, Article 312 TFEU states that the MFF, which is to be approved by the Council unanimously with the consent of the European Parliament, must set "the amounts of the annual ceilings on commitments appropriations by category of expenditures and of the annual ceilings on payment appropriations." Finally, Article 311 TFEU requires the EU budget to "be finance[d] wholly from own resources," to be approved by the Council unanimously, and ratified by each member state in accordance with its constitutional requirements. The combined effect of these provisions is to require a cumbersome amendment to the MFF and ORD every time the EU wants to increase spending and borrow money. This is why, in the MFA+ case, national guarantees had to be used to empower the issuance of €18 billion of EU debt.

A second main structural obstacle towards the development of a permanent fiscal capacity in the EU also flowing from the EU Treaties is the governance problem. As scholars have emphasized, Common Foreign and Security Policy and CSDP are by design fully intergovernmental policies: Supranational institutions like the European Parliament and the Commission have hardly a role and decision-making power is fully vested in the member states in Council and European Council. These arrangements however constantly subject EU actions to member states' vetoes, and, as a result, the EU has so far punched well below its weight in foreign relations (S. Fabbrini, 2013). In fact, the institutional features of the EPF, detailed above, reflect this state of affairs. The EPF has a highly cumbersome governance structure, with a 27-member FC at the helm, and member states still have multiple prerogatives, including the right to opt out of funding operations they dislike. While in the end member states unanimously agreed to deploy the EPF to support Ukraine in 2022, it is clear that this is not congenial to fast and vigorous decision-making.

Otherwise, intergovernmental governance also afflicts the core decision-making procedures about EU public finances. As noted, member states' governments must unanimously approve the MFF or amendments thereof and the ORD—which must also be ratified by each member state in accordance with its constitutional requirements (usually parliamentary procedure). This again means that a single member state can veto efforts by the others to enable further EU borrowing and spending—even for unrelated, idiosyncratic reasons. This is exactly what happened in the case of the MFA+: As explained, Hungary vetoed an amendment to the MFF, which was needed to raise the EU budget ceiling required to issue €18 billion of new common debt, seeking to leverage its vote in order to obtain the Council endorsement of its NRRP, overcoming the Commission's rule of law concerns (Scheppele, 2023). The shrewd blackmail by the Hungarian government forced the other member states to resort to member states' guarantees. Clearly, however, the dependence on the consent of 27 member states for any financial operation is bound to continuously create challenges for the EU in the long term.

In this context, it appears therefore a number of institutional reforms are clearly needed to increase the EU's capacity to act—as pointed out by the European

Parliament (2022a). In particular, if the EU wants to make its fiscal capacity permanent it must remove the balance budget obligation enshrined in Article 310 TFEU and overcome unanimity requirements on decisions about borrowing and spending, as well as taxing, as proposed by the European Commission (2019). In fact, the EU must also be endowed with the power to levy direct taxes—a practical necessity, particularly as the EU step by step increases the amount of common debt it will have to repay. At the same time, enhanced EU powers in the fiscal domain require constitutional adjustments to make sure that the European Parliament—the sole EU institution directly elected by European citizens—gains an equal voice to the Council on revenues, in line with the old adage "no taxation without representation" (European Parliament, 2022b). Some of these constitutional changes can be achieved through the use of *passerelle* clauses (Article 48 TEU), while others require an outright treaty amendment. Be that as it may, support for such steps has increased not only among EU institutions and leading national policy-makers (Macron, 2022; Scholz, 2022) but also in the European citizenry at large: The Conference on the Future of Europe (2022) listed these reforms in a package of recommendations for future action. It remains to be seen though if the war in Ukraine will provide the spur to achieve these constitutional reforms (F. Fabbrini, 2020).

6. Conclusion

The war in Ukraine has posed yet another unprecedented challenge for the EU. The Russian military aggression of a sovereign country at the EU's eastern borders shattered European illusions of perpetual peace and forced the EU to face the reality of hard power. In response to the illegal Russian invasion, the EU mobilized to support Ukraine. In particular, the EU deployed for the first time the EPF, funding the purchase of weapons for the Ukrainian military, and it then established the MFA+, devising a scheme to predictably fund the Ukrainian government in 2023. As this article argued from an EU law and policy perspective, the EU efforts to support Ukraine increased over time through the use of funding mechanisms which track the model employed to address the Covid-19 pandemic. In particular, while the EPF is a new mechanism of common EU spending, the MFA+ also relies on the issuance of common EU debt. As such, the war in Ukraine reveals a trend towards the consolidation of a fiscal capacity, or budgetary capacity, in the EU.

Needless to say, the above-mentioned trajectory should not be seen as inevitable. On the one hand, the economic policy measures adopted in response to Covid-19, which served as a template to address the war in Ukraine, present a number of ambiguities. In particular, NGEU effectively postponed the issue of debt repayment, leaving open the possibility that member states may have to increase their national contributions to the EU budget, thus reducing their willingness to issue new common EU debt. And NGEU still depends on the member states' capacity to implement the reforms and investment programs enshrined in their NRRP, leaving open the possibility that member states may not successfully use the available funds, thus reducing their willingness to issue new common EU debt. On the other hand, the financial instruments deployed to support Ukraine also leave some questions open, including whether the Ukrainian government, whose creditworthiness is challenged by the war, will be able to repay the loans it is receiving and whether political support for the war efforts will remain unwavering in the EU as the conflict drags on.

Nevertheless, the demands of the war create financial pulls which are difficult to resist. In fact, as this article was going to press in June 2023, the Council agreed to a further €3.5 billion top-up of the EPF, increasing its size to €12 billion (Council of the EU, 2023b). Moreover, and most remarkably, the Commission proposed, as part of a mid-term revision of the MFF (European Commission, 2023c), to establish a new Ukraine Facility worth €50 billion for the period 2024 to 2027, to secure long-term financial support to the Ukrainian government in its war efforts beyond the MFA+, which is limited to 2023 (European Commission, 2023d). The facility would provide both grants and loans to Ukraine, along with the model of the RRF, and be funded both by empowering the Commission to issue additional common EU debt, guaranteed by the EU budget headroom and by an increase in the EU budget itself. The Commission also proposed to amend the ORD with an adjusted package of the EU's own resources (European Commission, 2023a) and identified additional sources of EU revenues, including profits from the sales of the new Carbon Border Adjustment Mechanism certificates, and novel statistical-based own resources on company profits (European Commission, 2023b). The Commission's MFF reform package, which is worth over €75 billion and includes also extra resources in the field of migration and technological development, will now have to be approved by the European Parliament and the Council, and there may be resistance in the latter on spending increases unrelated to the war. However, a budget increase to support Ukraine seems to be almost guaranteed, which would confirm that wars and external security threats remain the most powerful engine of fiscal integration in federal unions of states.

Yet, as this article pointed out, the process of fiscal union in the EU remains in the making because constitutional constraints and governance problems hamper the EU's ability to raise resources and rise to the geopolitical challenges it faces. While the EPF is a purely intergovernmental arrangement, an idiosyncratic veto by Hungary forced the EU to set up the MFA+ through member states' guarantees—rather than the single guarantee provided by the EU budget. Otherwise, the EU treaties currently prevent the use of EU resources for CSDP purposes and

severely constrain the ability of the EU to borrow money and spend. As a result of this, the EU has faced challenges in financially supporting a neighbor—and now candidate member state—like Ukraine and had to find a creative solution to fund the war efforts. Longer term, as the article claimed, a number of constitutional reforms are needed if the EU wants to endow itself with the means to act autonomously on the international stage. From this point of view, while the EU funding of the war in Ukraine has strengthened the path towards fiscal integration that the EU had taken in addressing the Covid-19 pandemic, further steps will be needed to make this legally permanent and economically sustainable.

Conflict of Interests

The author declares no conflict of interests.

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Article

The Debudgetisation of Public Finances in Poland After Covid-19 and the War in Ukraine

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Abstract
The experience of dealing with the socio-economic consequences of the Covid-19 pandemic and the war in Ukraine confirms the thesis that decisions on financial assistance must be taken without delay and that the government must have a certain degree of freedom and flexibility to act. However, do emergencies entitle governments to bypass the principles of responsible and transparent fiscal policy-making? Do the challenges countries face in dealing with the effects of the Covid-19 pandemic and the war in Ukraine also legitimise governments' furthering of the debudgetisation of public finances? This article aims to answer these questions. The background of the considerations will be an analysis of Polish legal solutions and systemic practice. First, it is worth noting that anti-crisis measures in Poland have been taken primarily through extra-budgetary financial instruments, which are not included in the monitored scope of public finance. Surprising budgetary solutions appear, such as transferring Treasury securities instead of subsidies or pushing certain expenditures outside the state budget, to circumvent regulations and legally binding restrictions. In the context of parliamentary scrutiny, this means that a significant proportion of public debt is outside parliamentary control, and the scale of circumvention of the constitutional limit on public debt has been increasing for several years, reaching a considerable percentage of the GDP in 2021. This phenomenon is also accompanied by a record increase in public debt, fuelled by borrowing to finance tasks related to countering the Covid-19 pandemic and the socio-economic consequences of the war in Ukraine. It is, therefore, worth taking a closer look at the Polish government's budgetary solutions, which undoubtedly do not contribute to fostering transparency in budgetary policy.

Keywords
budget process; Covid-19; debudgetisation; Poland; public debt; public deficit; state budget; war in Ukraine

Issue
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1. Introduction

The European Union and its member states have faced unprecedented challenges recently. On the one hand, they have been struggling with the effects of the Covid-19 pandemic, which has become a major socio-economic crisis (Fabbrini, 2022). Healthcare measures and restrictions on movement, affecting production, demand, and trade, have reduced economic activity and led to rising unemployment, falling business incomes, increasing public deficits, and widening inequalities within and between member states. For this reason, it has become a priority for the European Union to take various initiatives aimed at minimising the negative economic and social effects of the crisis, any fragmentation of the single market, and significant divergences and imbalances in the EU economy (Woźniakowski et al., 2023). Poland was one of the European Union countries in which the economic crisis had a relatively mild course, as evidenced by a relatively small decrease in the value of the gross domestic product, as well as the maintenance of a low unemployment rate and a real increase

in average wages in the national economy, including in the enterprise sector. The mild course of the crisis in Poland was significantly influenced by the provision of extensive financial support by the state (launch of the so-called "Anti-Crisis Shield") aimed at compensating commercial entities and their employees for the financial consequences of the pandemic, the most significant of which were the losses caused by administrative restrictions imposed on economic activity and the decline in demand caused by changes in the population's lifestyle (Serowaniec & Witkowski, 2020, pp. 162–163). Thanks to the Anti-Crisis Shield, entrepreneurs could apply for exemptions from paying social security contributions for three months. During this period, they were still entitled to health and insurance benefits. The Shield also provided for the payment of a standstill benefit to the self-employed. This benefit was non-contributory and tax-free. The Shield was designed to protect employees as well as employers. Employers could apply for a subsidy for employees' salaries in connection with reduced working hours. Significant funding was also allocated to direct increases in healthcare facilities and measures to adapt economic operators and public institutions to operate under pandemic conditions. The state's extensive support of the public and private sectors in counteracting the negative effects of the pandemic has also exacerbated the imbalance in public finances. Overall, the state has provided more than €51 billion in aid (Moszyński, 2021, pp. 171–182).

Just one year after the global economy returned to growth after a brief but deep recession triggered by the Covid-19 pandemic, there was another unexpected economic shock caused by Russia's aggression against Ukraine. As a result of this event, global prices of energy commodities and food jumped, triggering price increases for other goods and services. In connection with the geopolitical situation, the intensification of the process of expanding the defence potential of the member states, including the process of modernising their armed forces, has also become important. Central and Eastern European countries, including Poland, were in a particularly difficult situation. Not only did they have to rapidly switch their source of massive amounts of raw material imports from Russia to other regions of the world (which contributed to an increase in the prices of these raw materials and, consequently, very high inflation), but they also faced challenges arising from the need to assist refugees from Ukraine and the rapid deterioration of the geopolitical situation in the region (Fabbrini, 2023).

Compared to other Central and Eastern European countries, Poland coped with the challenge of the new economic situation. Admittedly, inflation in Poland was as high (14.4%) as in other countries in the region. However, the economic growth rate placed Poland among the top countries in Central and Eastern Europe, and the unemployment rate was one of the lowest in the European Union. Not all economic indicators look so favourable, however. In addition to very high inflation, Poland is struggling with a declining investment rate (16.7%), among the lowest in the European Union. Only Greece and Bulgaria had a lower investment rate among the EU and candidate countries than Poland in 2022. In comparison, the Czech Republic had an investment rate of 27%, Slovakia 20.4%, Romania 24.9%, and Hungary 28.4%. Fiscal policy, in turn, has again become pro-cyclical and pro-inflationary (Supreme Audit Office, 2022, pp. 12–13). The effect of such macroeconomic policies does not improve the economy's competitiveness and shifts the burden of the costs of these policies onto future generations. The pro-inflationary effect of the pursued policy may also make it difficult to determine the social and economic consequences in the coming years and entail significant costs for public finances. Poland's main macroeconomic indicators for 2020–2022 are presented in Figure 1 (Supreme Audit Office, 2020, 2021, 2022).

As is well known, in emergencies, the executive becomes the "main player" in managing a given threat (Bar-Siman-Tov, 2020, pp. 11–12). The experience of dealing with the socio-economic impact of the Covid-19 pandemic or the war in Ukraine only confirms this thesis. Decisions on financial assistance have to be taken without delay, and the government must have a certain degree of freedom and flexibility to act in this respect (Serowaniec, 2023, pp. 83–91). In Poland, these activities were mainly carried out through various types of funds. At first sight, there is nothing unusual about such an arrangement. Indeed, several EU member states (including Germany, France, Spain, Italy, and the Czech Republic) have established Covid-19 counteracting or defence funds. These solutions have given governments flexibility in managing crisis-related expenditures. In these countries, however, the funds are either an integral part of the state budget or are subject to parliamentary control (Chiru, 2023, pp. 37–52). In contrast, the "originality" of the Polish solutions lies in the creation of additional funds for crisis prevention that are not included in the state budget. This means that, in addition to the state budget, there are separate sources of public funds that are not subject to the regime that is appropriate for such funds that are collected within the budget. New budgetary solutions have also been introduced into the Polish legal system. These include the transfer of state securities instead of subsidies and reporting state budget expenditure in periods other than those in which it was actually incurred. In this situation, the state budget does not properly reflect the state's finances. A significant part of the resources allocated for public purposes is redistributed outside the state budget. As a result, a significant part of the public funds spent and collected are removed from the control of the parliament and the public. After all, it should not be forgotten that social and parliamentary control over the use of public funds is one of the pillars of a democratic state that abides by the rule of law (Kuca, 2022b, pp. 320–332). Therefore, the process

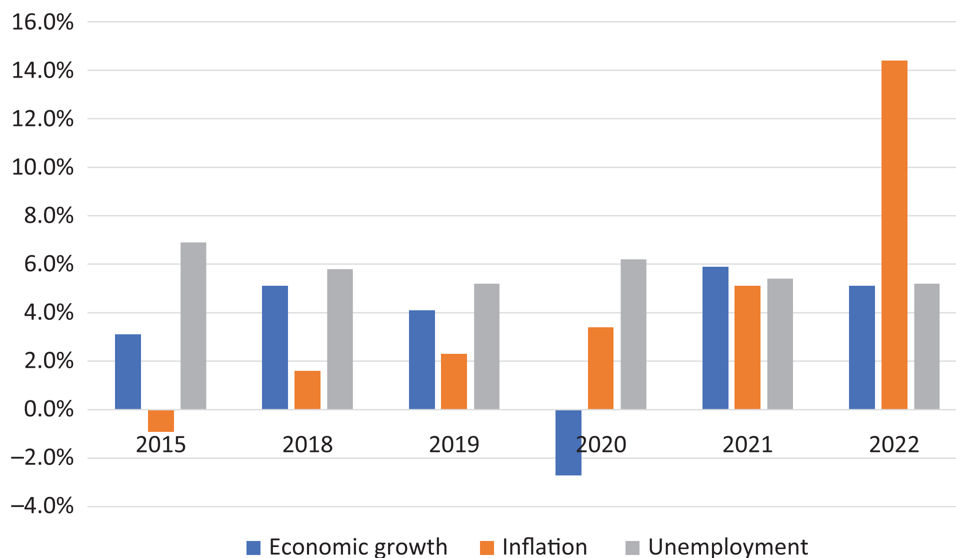

Figure 1. Poland's macroeconomic situation 2015–2022. Source: Author's work based on Supreme Audit Office (2020, 2021, 2022).

of debudgetisation of public finances, which allows public funds to be spent outside the state budget, is advancing in Poland. It is worthwhile to have a closer look at this process in detail.

The article seeks to answer two key questions. Does the occurrence of emergencies legitimise those in power to bypass the principles of responsible and transparent fiscal policy-making? Do the challenges Poland faces in counteracting the effects of the Covid-19 pandemic and the war in Ukraine legitimise the government to debudgetise the public finances? The research objective outlined in this way determines the temporal scope of the analysed systemic practice, which will primarily cover the years 2020–2023, i.e., the period in which Poland experienced these extraordinary circumstances affecting the economy and public finances. The background of the considerations will be the analysis, not only of the Polish systemic practice but also of the recommendations of the EU bodies, formulated towards the Polish government, among other things, within the framework of the European Semester.

2. Transparency and Efficiency of Public Spending in Poland From an EU Perspective

One of the key challenges highlighted by EU bodies in the context of the condition of Poland's public finances is the problem of the increasing scale of the Polish government's circumvention of the principles of efficient and transparent fiscal policy. For the first time, this significant problem was highlighted in the Council of the EU recommendations of 9 July 2019 on the 2019 National Reform Programme of Poland and delivering a Council opinion on the 2019 Convergence Programme of Poland (Council of the EU, 2019). At that time, an increase in public expenditure as a proportion of GDP was noted. In doing so, it rightly pointed out that Poland's public finances would be exposed to upward spending pressures in the future, particularly to an ageing population. These factors reinforce the need to introduce new instruments to manage better expenditure, including regular assessment of its effectiveness and efficiency. Therefore, the Council recommended that the Polish government take further steps to increase the efficiency of public spending, including by improving the budget system (Serowaniec, 2021, pp. 340–350). The document also noted the need to establish a fiscal council in Poland. In fact, Poland still does not have a body to monitor the medium-term sustainability of the public finances, which in most cases takes the form of a fiscal (policy) council. The council is treated as a non-partisan public body, not a central bank, government, or parliament. Its role is to prepare macroeconomic forecasts used in the preparation of the state budget, to monitor progress in the implementation of fiscal policy, or to provide advice to the authorities. Poland is the last EU country not to have such a body (Fasone, 2022, p. 261). As a side note, it is worth noting that during the parliamentary debates on the European Semester, the Sejm devoted relatively little space to issues of budgetary transparency. The focus was more on health, social, and energy policy issues (Schweiger, 2021, pp. 131–132; Woźniakowski, 2021, pp. 159–160).

The Council of the EU recommendations of 12 July 2022 on the 2022 National Reform Programme of Poland and delivering a Council opinion on the 2022 Convergence Programme of Poland (Council of the EU, 2022) reiterated that one of the major challenges facing the Polish government is the need to increase spending efficiency by addressing long-standing deficiencies in the budget process. These include complex and outdated budget classifications, sub-optimal recording of information, lack of viable medium-term planning, and

the fact that expenditure reviews do not directly affect the budget process. These factors increase the need for new tools to improve expenditure management, including regular evaluation of effectiveness and efficiency. The Council rightly points out that during the pandemic, most of the spending on Covid-19 measures was done through a special fund managed by the Bank Gospodarstwa Krajowego (BGK) and through off-budget financial instruments. While this gave the government greater flexibility in managing crisis-related spending and avoided the risk of exceeding the constitutional level of public debt, it reduced parliamentary scrutiny of spending and public access to up-to-date information. For this reason, considering the level of central sector deficit outside parliamentary control, according to data collected by Eurostat, Poland ranked first among the large EU countries and second among all EU countries (behind Cyprus). By comparison, 16 EU member states have no deficit that is outside parliamentary control (Dudek et al., 2022, pp. 25–26).

In its 2022 report, the European Commission (2022a) highlighted that Poland was unprepared from a structural deficit perspective before the pandemic crisis. Poland had not taken advantage of the good economic situation before the Covid-19 pandemic to prepare its public finances for a downturn. The Polish economy was developing dynamically, the labour market situation was the most favourable ever, and Poland's main trading partners were experiencing strong economic growth. Instead of preparing public finances for the downturn, Poland implemented costly policies that not only burdened its public finances in the short term but also generated high long-term liabilities (e.g., income-independent social benefits for families with children and pensioners and reversal of earlier reforms, such as extending working lives). As a result, while most EU countries were generating surpluses before the pandemic, Poland was running budget deficits. Consequently, Poland was among the three countries (alongside Hungary and Romania) with the most worrying structural state of public finances. In its forecasts, the European Commission also highlighted a sharp increase in the average cost of servicing Polish debt. In 2023, according to European Commission forecasts, Poland's average debt servicing costs will be the second highest in the European Union, with only Hungary incurring higher costs. High debt servicing costs will also increase the public finance deficit by 1% of GDP (European Commission, 2023). Obviously, the phenomena mentioned above affecting the transparency and efficiency of public spending is not exclusive to Poland, as they are faced by old (e.g., Spain, Portugal, Italy) and new member states (Cyprus, Romania, or Hungary; Ehnts & Paetz, 2021, pp. 235–236; Ramkumar & Rebegea, 2021). However, given that the Institute for Responsible Finance estimated the off-budget deficit to account for more than 80% of the real central sector deficit in 2022, analysing the Polish case seems particularly interesting (Dudek et al., 2023, p. 5).

It is also worth noting that the recommendations issued for Poland under the European Semester on improving the efficiency of public spending and the budgetary process were also taken into account within the National Recovery Plan. As a result, the National Recovery Plan, as a so-called milestone, formulates the demand for a significant reform of the fiscal framework (Reform A1.1). In the current version of the National Recovery Plan, accepted by the European Commission, it is stated that "the overarching objective of the reform is to increase transparency and efficiency of public spending" (Recovery and Resilience Facility: Operational arrangements between the European Commission and Poland, 2022, p. 8). To this end, future reform should aim to: (a) enable more efficient management of public funds, (b) increase transparency and accountability in the management of public funds, and (c) enhance the sustainability of public finances and prevent unsustainable expenditure growth. According to the milestones, the reform is to implement two legislative measures. First, the Public Finance Act is to be amended by the introduction of a new classification system, a new budget management model, and a redefined medium-term budgetary framework. As a result of this amendment, a new budgetary system will be established. Secondly, the Public Finance Act will be amended by extending the scope of the Stabilisation Expenditure Rule to more general government entities, particularly special purpose funds. According to the arrangements, the reform implementation should be completed by 31 March 2025.

3. The Phenomenon of Debudgetisation of Public Finances in Poland

Although the Constitution of the Republic of Poland of 2 April 1997 gives the institution of the state budget particular importance in the processes of spending and collecting public funds, the growth of the extra-budgetary economy, subject to specific formal and material rigours, has intensified in recent years (Kornberger-Sokołowska, 2022, pp. 311–312). The principle of transparency of public finances in Poland is essentially being weakened by the emergence of public resources that are separate from the state budget and not subject to such strict rigour in their operation and parliamentary control (Serowaniec et al., 2021, pp. 47–52). A comparison of the content of the state budget with the Budget Act and other laws related to state expenditure leads to the conclusion that more and more state revenues and expenditures are included outside the state budget and even the Budget Act (Kuca, 2018, pp. 144–153). In recent years, more and more funds, foundations, agencies, institutes, and other units located outside the system of the public finance sector (in the meaning given by the Public Finance Act) and not subject to the regulations of the Public Finance Act have been established—placing them outside the state budget and beyond any parliamentary control (Kuca, 2021, pp. 28–29). In this situation,

the state budget does not properly reflect the state's finances, as a significant part of the funds allocated for public purposes is redistributed outside this budget. In the context of parliamentary control, this means that a significant part of the public debt is outside parliamentary control, and the scale of circumvention of the constitutional limit on public debt has been increasing for several years (Kuca, 2022b, p. 320). This phenomenon is also accompanied by a record increase in public debt, driven by borrowing to finance tasks related to countering the Covid-19 pandemic and the socio-economic impact of the war in Ukraine.

3.1. Emergence of Resources of Public Funds Separate From the State Budget

One of the basic forms used by those in power to circumvent the principles of transparent budgetary policy is the creation of further funds, foundations, agencies, institutes, and other entities outside the state budget. They are not included in the monitored scope of public finances, and budget rules do not cover their operation. For example, due to Russia's armed aggression against Ukraine, the Armed Forces Support Fund (FWSZ) was established based on the Law on Homeland Defence (U3O) of 11 March 2022. According to the act, the FWSZ is a special-purpose fund established within the structures of BGK to increase expenditure on the modernisation of the Polish armed forces. The fund is to be one of the three sources of funding for the Programme for the Development of the Armed Forces, in addition to the state budget and revenues from the sale of shares in companies with industrial defence potential. In 2022–2023, nearly €15 billion was intended to be allocated from the FWSZ for this purpose, of which €12 billion was to come from the proceeds from the issuing of bonds. The first version of the plan was a public document, but after problems with the bond issuing came to light, the document was made secret. Such a step towards a plan containing only the amounts of revenue and expenditure of the FWSZ (financial information) has to be assessed critically. It can be compared to the secrecy of the Budget Act in the defence section (Sejm, 2022a).

In accordance with the requirements of Article 41(1) of the U3O, the financial and accounting service of the FWSZ is provided by BGK. It is worth noting that BGK is a Polish state-owned bank, the only entity of its kind in Poland wholly owned by the State Treasury. It was established by law to support government social and economic programmes as well as local government and regional development programmes. It specialises in servicing government financial programmes, distributing related special purpose funds, and servicing state institutions' bank accounts. The contract for the financial and accounting service of the FWSZ between the Ministry of Defence and BGK was signed on 10 May 2022. The planned receipts and expenditures of the FWSZ in 2022–2023 were included in the Financial Plan of the FWSZ for 2022 and 2023, unclassified documents prepared by BGK. Both plans were presented to MPs during the 79th Public Meeting of the Parliamentary National Defence Committee, on 22 June 2022. The documents contained only financial data on planned revenues and expenditures from the FWSZ. However, they did not specify what the planned funds were to be spent on (material plans), information that is not normally covered by the secrecy clause (Sejm, 2022b).

Following the failure of the BGK bond issue for the FWSZ scheduled for 24 October 2022, a correction was made to the Financial Plan of the FWSZ for 2022, and a new version was presented to the MPs of the Parliamentary Committee on National Defence for their opinion on 4 November. This time, however, the meeting was kept secret, and the Financial Plan of the FWSZ for 2022 became a classified document. As a result, the Polish taxpayer does not have any information about the sources from which the technical modernisation process of the Polish army will be financed in part concerning the FWSZ (Sejm, 2022a). This is up to one-third of the planned expenditure for this purpose, expected to reach nearly €34 billion in 2023. In addition, the decision will mean that the Ministry of Defence will no longer have to publicly explain the non-execution of the FWSZ revenue and expenditure plan, which could prove politically advantageous given the parliamentary elections scheduled for 2023 (Sejm, 2023a).

Countering the effects of the pandemic, on the other hand, was financed primarily with funds from the Covid-19 Counteracting Fund, established at the BGK under the Act on Counteracting and Combating Covid-19, fed by both public funds and bonds issued by BGK. The Prime Minister became the dispenser of the funds, and pandemic control entities were able to use them. By excluding the fund from parliamentary control, the government explained that decisions on financial assistance given to entrepreneurs to save jobs had to be taken immediately (Sejm, 2020). Indeed, the government must have the freedom and flexibility to act. The Covid-19 pandemic has faded, so what is the purpose of this fund now? The government has turned the Covid-19 Prevention Fund into a vehicle for social and development projects. Indeed, these funds are now being used for investment programmes and compensation related to freezing electricity and heat prices. This year's amount of expenditure planned by the fund is close to €5.5 billion. However, this amount is not final, as the fund's financial plan can change at any time, as the Prime Minister sees fit; indeed, last year, there were 11 versions of the fund's plan (Sejm, 2023b). Practice also shows that the fund's expenditure increases annually, with changes amounting to billions of euros. Figures released by BGK show that in 2022, the fund's expenditure amounted to €9.6 billion, almost one billion higher than expectations at the beginning of the year (Ministry of Finance, 2022). This shows the alarming scale of the opacity of public finances, which is not justified by countering the effects of Covid-19.

At the end of 2022, BGK operated 20 funds (11 launched after 2019). The inflows and outflows of these funds amounted to more than €22 billion, equivalent to approximately 3.5% of gross domestic product. The expenditure incurred by the funds operated by BGK corresponded to 21% of the state budget expenditure. Both their number and the total value of the funds at their disposal, as well as the variety of tasks financed by these funds, have grown dynamically in recent years, making them, with the appropriate proportions, a kind of alternative budget operating outside the strict control and procedures envisaged for the state budget (Supreme Audit Office, 2022, pp. 339–340).

The problem of the opacity of public finances was also highlighted by the Supreme Audit Office. On the occasion of the audit of the budget execution for 2020, the Supreme Audit Office pointed out "the need to increase the transparency of public finances by stopping the growth of extra-budgetary units in the government sector. As a rule, the tasks of this sector should be financed directly from the state budget" (Supreme Audit Office, 2020, p. 9). In the opinion of the Supreme Audit Office, the exclusion from the state budget account of operations, the nature of which indicated the legitimacy of their inclusion in this budget, significantly reduces the transparency of public finances and lowers the rank of the state budget. In 2022, as in 2021 and 2020, significant funds for implementing public tasks were planned in the Covid-19 Counteracting Fund and in the Polish Development Fund S. A. to support, among other things, enterprises affected by the consequences of counteracting the pandemic (Supreme Audit Office, 2022, p. 5). The Supreme Audit Office did not question the legitimacy of the assistance provided to entities affected by the consequences of the pandemic but pointed out that the planning of these funds took place in disregard of the Budget Act, even though it had a significant impact on the general government deficit and the increase in the sector's debt. Indeed, in each of the cases analysed above, the Sejm was completely disregarded in the decision-making processes, which raises legitimate questions in the context of the principle of the exclusivity of the legislature in shaping state expenditure and revenue (Supreme Audit Office, 2021, pp. 21–22).

3.2. Other Forms of "Flexible" Implementation of the State Budget

In order to counteract the socio-economic effects of the Covid-19 pandemic and the war in Ukraine, the United Right government also proposed other forms of "flexible" execution of budget expenditure. These included budget solutions not used before, involving the free transfer of Treasury securities instead of subsidies or the "pushing" of certain expenditures outside the state budget. Undoubtedly, gratuitous transfer of Treasury bonds to entities outside the public finance sector instead of grants may contribute to deforming the state budget result. As a result, these transactions are not recognised as a grant in the state budget, i.e., an expenditure. However, this practice distorts the picture of public finances, even the one in the narrower view of the national methodology. There is a disintegration of the budget deficit ratio and the public debt (Supreme Audit Office, 2022, pp. 5–6).

Moreover, such a procedure generates additional costs for entities receiving bonds and generates additional debt management costs on the part of the Ministry of Finance, as it has to spread these issues over different types of instruments so as not to disrupt the market, as these entities almost immediately dispose of these bonds. This situation is unprecedented anywhere in the world. In 2020, the scale of these operations was just over €4 billion; in 2021, it was already close to €5 billion. In 2022, Treasury securities with a nominal value of almost €5.8 billion were transferred free of charge to various entities, bypassing the state budget expenditure account and, thus, the state budget result. The total value of such financing between 2019 and 2022 amounted to more than €16 billion. An example of this practice is the transfer of bonds to the public media as a supposed compensation for low radio and television licence fee revenues. Because individual public media institutions, such as radio stations, receive a pool of government bonds from the Treasury, these institutions must establish brokerage accounts to service these bonds. They incur additional costs; these bonds are then monetised (sold), and the proceeds are spent on the bodies' statutory purposes. In the past, these operations were carried out with a normal subsidy from the state budget. The number of entities receiving an implicit subsidy in this form is growing exponentially. Among others, universities, the National Media Institute, the Central Transport Port, and, more recently, even mines are receiving bonds instead of subsidies. These operations were originally intended to be incidental, but in reality, due to their scale and regularity, they have become systemic solutions. The scale of this phenomenon is illustrated in Figure 2.

Another means by which budget expenditures may be "flexibly" executed is through the introduction of legal solutions that allow state budget expenditures to be reported in different periods than they were incurred. On the one hand, expenditures that do not expire at the end of the financial year make it possible to finance tasks initiated in a given year, the completion of which is to take place in the first quarter of the following year, thus ensuring greater flexibility in the state budget (Serowaniec, 2021). On the other hand, this solution is a derogation from the principle of annuality of the state budget and should therefore be incidental. The legislator has introduced two exceptions allowing expenditures to be made after the end of the fiscal year. Firstly, it allows the Council of Ministers (not later than 15 December of a given financial year) to determine, after obtaining the opinion of the Parliamentary Committee for the Budget

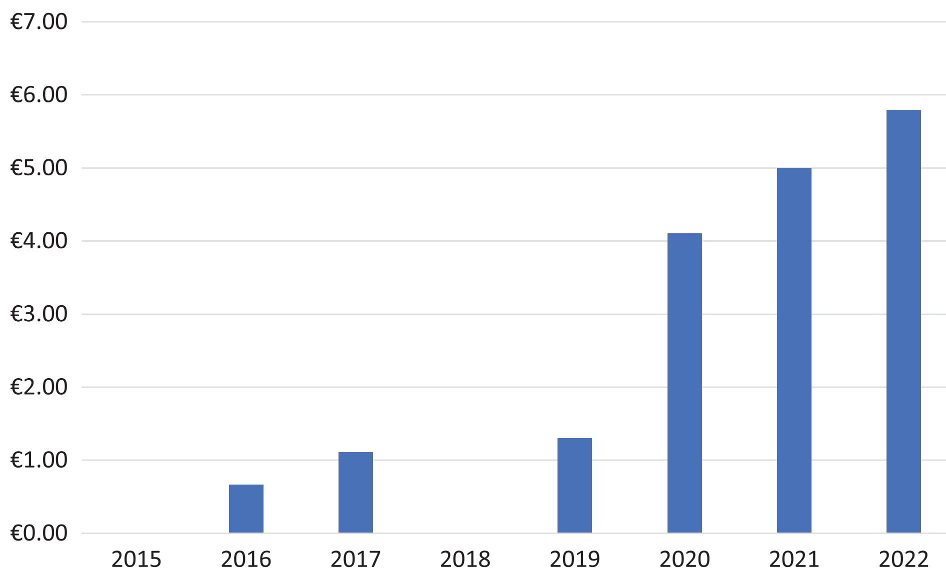

Figure 2. Amount of government bonds transferred from the state budget instead of subsidies between 2015 and 2022 (in billion). Source: Author's work based on Supreme Audit Office (2020, 2021, 2022).

in this respect, a list and a financial plan of non-expiring expenditures and the final date for their implementation, but no later than 31 March of the following financial year. Secondly, it entrusts the Minister of Finance, at the request of the authorising officer of the budgetary part, with the possibility of agreeing to settle the liabilities due as of 31 December of the previous year against the expenditure plan of that year within nine working days of the following year. Given the need to counteract the effects of the Covid-19 pandemic in 2020, the Council of Ministers were able to establish, through a regulation, no later than 30 December 2020, a list and a financial plan of non-expiring expenditures, taking into account the degree of realisation of state budget revenues and expenditures and the possibility of continuing and implementing tasks financed from the state budget in 2020. Significantly, the expenditures included in this list could have been made until 30 November 2021, which undermines the sense of parliamentary control of state revenues and expenditures, as the resolution on granting or refusing to grant discharge is adopted within 90 days of the submission to the Sejm of a report on the implementation of the Budget Act submitted by the Council of Ministers within five months of the end of the fiscal year (Kuca, 2022a, pp. 158–160). By virtue of the Regulation of the Council of Ministers of 28 December 2020 on state budget expenditures not expiring at the end of the fiscal year in 2020, a detailed list of planned state budget expenditures that do not expire at the end of the fiscal year and a financial plan of state budget expenditures that do not expire at the end of the fiscal year in 2020 was established. These expenditures included as many as 1,186 tasks for a total expenditure of €2.6 billion, which accounted for 2.3% of state budget expenditure. In 2019, the ratio was 0.03%; in 2018 and 2017, 1.3% and 0.3%, respectively (Supreme Audit Office, 2021, p. 91). In addition, the list of non-expiring expenditures included many tasks which should have been implemented in 2021. This was a consequence of the inclusion in the amendment to the Budget Act for 2020 of tasks scheduled for implementation in 2021. The applied forms of state budget execution were incompatible with the purpose for which the institution of non-expiring expenditures was introduced into the legal system, as they generated the problem of a lack of clear reporting rules and violated the principle of annuality of the state budget (Kuca, 2022a, pp. 167–168).

According to the Ministry of Finance, the state budget deficit in 2022 was €2.8 billion (0.4% of GDP) against the planned €6.6 billion in the 2022 Budget Act (Supreme Audit Office, 2022, pp. 10–11). In 2021, the state budget deficit was more than twice as high at €5.9 billion (1% of GDP; Supreme Audit Office, 2021, p. 10). The juxtaposition of these figures might suggest that public finances are in an excellent state. Unfortunately, this is not the case, as the real state budget deficit is many times higher, as shown by the data sent to Eurostat. In the report on the Budget Act that the government sent to the Sejm, only approximately 12.5% of the true government deficit was shown: The true deficit is approximately €22.4 billion (Dudek et al., 2023, pp. 5–6). This result is influenced precisely by the use of so-called "flexible" forms of state budget execution. Indeed, the main operations not included in the state budget for 2022 included: the financing of public tasks carried out by BGK-operated funds (€9.5 billion), Treasury bonds transferred in 2022 (€5.8 billion), and non-expiring expenditure from 2021 (€1.7 billion; Supreme Audit Office, 2022, p. 5). In 2020–2022, almost 8% of the annual GDP is a deficit not included in the state budget but in the central sector deficit, which is only under the government's control. Over the last few years, the government has therefore been generating deficits outside the control of the budgetary process, outside the

control of parliament and social surveillance, as detailed in Figure 3.

A consequence of the "flexible" forms of state budget execution undertaken by the United Right government is also the deepening of the imbalance in public finances, resulting in a significant increase in public debt. This debt, calculated according to the European Union's methodology, has increased by as much as €50 billion in 2020. The increase in public debt calculated according to this methodology—just for the year 2020 alone—would once have taken almost a decade to reach the same level (Supreme Audit Office, 2020, p. 9). At the end of 2021, the difference between the size of government debt (EDP) and sovereign public debt (PDP) had increased to €58 billion, representing 10% of GDP (Supreme Audit Office, 2021, p. 303). Ultimately, at the end of 2022, there was a record difference of €67.2 billion between public debt calculated according to the EU methodology and that determined according to national rules (Supreme Audit Office, 2022, p. 5). The resulting differences are due, among other things, to the recognition of the liabilities of the Polish Development Fund S. A. (financing of financial and anti-crisis shields) and BGK (Covid-19 Counteracting Fund) within the debt calculated according to the EU methodology and the non-inclusion of these liabilities in the debt calculated according to the national methodology (Kuca, 2022b, pp. 328–329). Detailed differences in the amount of public debt in Poland calculated according to the EU and national methodologies are presented in Figure 4.

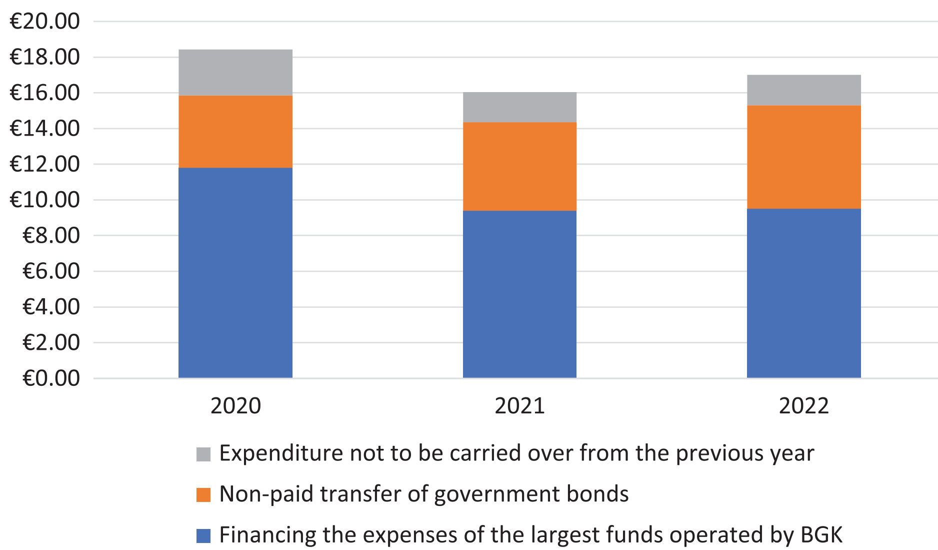

Figure 3. "Flexible" forms of state budget execution in 2020–2023 (in € billion). Source: Author's work based on Supreme Audit Office (2020, 2021, 2022).

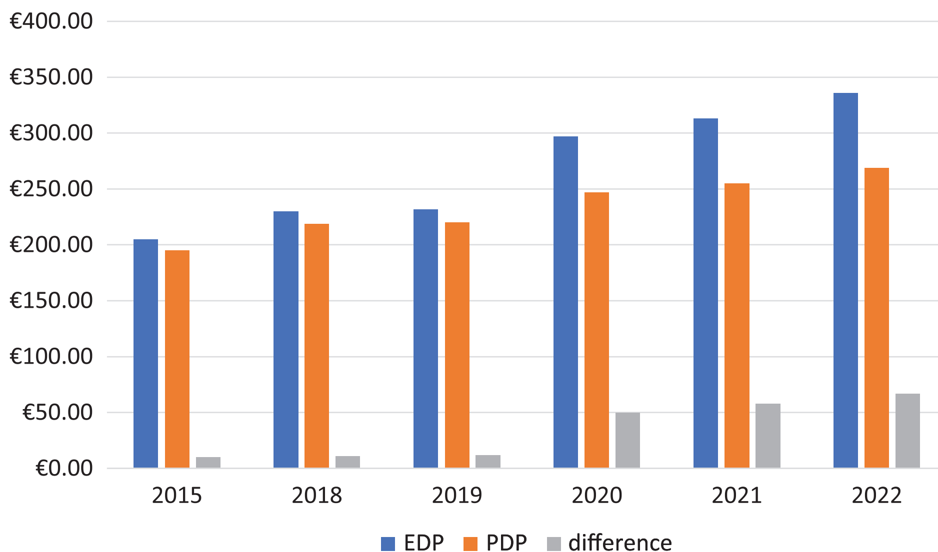

Figure 4. Public debt in Poland according to EU (EDP) and national (PDP) methodologies from 2015 to 2022 (in € billion). Source: Author's work based on Supreme Audit Office (2020, 2021, 2022).

Therefore, we have a situation that is classically referred to as "breaking the thermometer," or rather, more accurately, replacing a real thermometer with one where virtually any number can be entered as the temperature. In practice, however, the methods used to avoid exceeding the prudential threshold result in a significant increase in the cost to the public sector of servicing this debt. Indeed, servicing liabilities incurred by BGK and Polski Fundusz Rozwoju S. A., even though the State Treasury guarantees their repayment, costs more than servicing debt incurred directly by the State Treasury (Wantoch-Rekowski, 2023, pp. 350–351). This is surprising, as these expenditures affect the amount of the State Treasury's debt, but as a result of their exclusion from the Budget Act, they are outside the control of the Sejm (Kuca, 2022b, pp. 328–329). For these reasons, they should be included in the state budget (Kielin, 2022). As a consolation, one can only point out that, considering the level of public debt, Poland, with an EDP of 48.1% of GDP, does not compare badly with other EU countries, where the average is as high as 84%, with Greece (170%) and Italy (145%) holding the record. However, for example, the Czech Republic and Romania have debts of 44% and 47% of GDP, respectively (European Commission, 2022b).

4. Conclusions

A comprehensive assessment of the functioning of the Polish public finance sector under the conditions of the Covid-19 pandemic and the war in Ukraine is hampered by the deteriorating transparency of public finances over the last few years and the lack of publicly available data on financial operations related to counteracting the effects of these extraordinary circumstances. This is particularly evident concerning those institutions (BGK) that fully depend on public authorities and carry out significant financial operations related to the pandemic or the war in Ukraine. At the same time, they are not formally classified as part of the public finance sector; thus, they are not subject to the regulations on financial records and reporting appropriate for entities in this sector. Under the guise of "flexibility" in dealing with crises, we are therefore faced with bypassing the budget process rules.

An example of this is the Covid-19 Prevention Fund, which still exists, but its expenditure is now completely unrelated to the pandemic. The Supreme Audit Office, when assessing the implementation of the Budget Act for 2022, drew attention to the direction of change in the public finance system, which meant that the financial management of the state is largely carried out outside of the state budget, bypassing the rigour that accompanies it. The state budget no longer fulfils the function of the basic act of state financial management. For this reason, for the first time in Poland's recent history, the Supreme Audit Office gave a negative assessment of the government's execution of the state budget.

Resolving this situation will require several measures. First, efforts should be made to restore the state budget to its proper rank related to its special character and central position in the public finance system. This must be accompanied by limiting the organisational and legal forms of public financial management to budget entities and the exceptional participation of executive agencies and a few special-purpose funds. Thus, the importance of budgetary principles, particularly fiscal consolidation, can be restored, and the principle of the unity of the state budget can be preserved. Given the substantive changes, it will become necessary to carry out institutional changes, including the creation of a new institutional architecture—a Fiscal Council, which can significantly contribute to the restoration of the due position of the state budget, to the preservation of the principle of transparency and openness of budget management, without which it is difficult to speak of properly conducted budget management. The actual state of public finances would also be more effectively communicated if the government abandoned the practice of reporting revenues, expenditures, deficits, and public debt in two different ways, i.e., according to the national and EU methodology, as many circles advocate.

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Conflict of Interests

The author declares no conflict of interests.

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Article

No Borrowing Without Taxing? Fiscal Solidarity of Next Generation EU in Light of the American Experience

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Abstract
This article argues that the EU response to the pandemic, the Next Generation EU (NGEU), dubbed a "Hamiltonian moment" for Europe, can be better understood if compared to the US under the Articles of Confederation. The key aspect of the original Hamiltonian moment was the assumption of states' debts after the Union was given tax power. None of this happened with the NGEU. The EU was not given any significant new sources of revenue, apart from some environmental levies, and was only allowed to borrow more on the financial markets to finance new fiscal solidarity mechanisms. In the US, this kind of borrowing power gave rise to monetary financing of the debt and enormous inflation. Instead of backing the enlarged borrowing powers with a fiscalization process leading to tax powers, the EU created a hybrid system of temporary, limited quasi-fiscalization in the form of the NGEU, which has legitimacy gaps. Simultaneously, the EU introduced enhanced fiscal regulation with conditionalities in the form of the new European Semester (an annual EU cycle of economic and fiscal coordination) tied to the allocation of the NGEU funds. Additionally, the EU has only promised to work in the future on various forms of revenue needed to pay the new debt. Hence, I will show that the NGEU could be better described as a "Morrisian moment" for Europe, as Robert Morris, the superintendent of finance of the US (1781–1784), was the very first finance minister of a similar kind of a union, with the power to borrow but no power to tax, governed by the unanimity rule in fiscal matters, which led to the failure of his proposals for national revenue.

Keywords
central fiscal capacity; comparative federalism; democratic legitimacy; economic governance; fiscal federalism; fiscal solidarity; fiscal union; fiscalization process; tax power

Issue
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1. Introduction

The core of a state is money, and the state's ability to raise it independently—mainly via taxation—is perhaps the most important feature of state capacity because it is "a necessary condition for everything else states do" (Kiser & Karceski, 2017, p. 76). At the same time, the importance of this power makes it difficult for the states to relinquish some of it to the higher level in political systems of multilevel government, such as the EU or the US. Many scholars used federalism to examine the developments of the EU (e.g., S. Fabbrini, 2017; Schütze, 2009), and some have compared the EU to the early US history, focusing mainly on the policies conducted by Alexander Hamilton (Gaspar, 2015; Henning & Kessler, 2012; Steinbach, 2015), although a few focused on the period when the fiscal structure of the US resembled the EU—the pre-Constitution US (see Georgiou, 2022, pp. 142–143; Sargent, 2012; Woźniakowski, 2018, 2023). Equally, the EU fiscal response to the Covid-19 pandemic, the Next Generation EU (NGEU) has attracted scholarly attention since its inception and has been analyzed from many perspectives, including its legal nature (De Witte, 2021; F. Fabbrini, 2022), its social component (Bekker,

2021), and its origins (S. Fabbrini, 2022; Genschel & Jachtenfuchs, 2021). However, a clear definition of the concepts commonly applied to describe the NGEU, such as borrowing, taxing and spending powers, fiscal capacity, and fiscal union, was often lacking.

By situating the NGEU within a clearly defined theoretical framework of the patterns of fiscal integration and in comparison with a polity representing similar patterns of such integration (a significant central borrowing powers without significant taxing powers), i.e., the US under its first Constitution—the Articles of Confederation (1781–1789)—this article aims to contribute to our understanding of the fiscal and economic integration of the post-Covid-19 EU. The contribution of this article is also related to the debate initiated by the seminal article by Kelemen and McNamara (2022) on the role of threats in multilevel polity development. Indeed, it was a military threat that pushed the American colonies towards the creation of an independent confederation. However, as I showed in my recent monograph, an internal (socioeconomic) threat, and not an external (military) threat, was necessary in order to push the nascent US confederation on the path towards a federation, including the federal power to tax, arguably the most important feature of the new Constitution of 1787 (see Woźniakowski, 2022, for details).

This article will argue that the EU response to the pandemic, mainly in the form of a special recovery fund (NGEU), dubbed a "Hamiltonian moment" for Europe, can be better understood if compared to the pre-Constitution US. The key aspect of the original Hamiltonian moment was the assumption of states' debts after the Union was given tax power. None of this happened with the NGEU. The EU was not given any new significant sources of revenue, apart from some environmental levies, and was only allowed to borrow more on the financial markets to finance new fiscal solidarity mechanisms. In the US, this kind of borrowing power gave rise to monetary financing of the debt and enormous inflation. Instead of backing the enlarged borrowing powers with a fiscalization process leading to tax powers, the EU created a hybrid system of temporary, limited quasi-fiscalization in the form of the NGEU. This system has accountability gaps as the European Parliament had largely been excluded from both its negotiation and implementation. Simultaneously, the EU introduced enhanced fiscal regulation in the form of the new European Semester (an annual EU cycle of economic and fiscal coordination) tied to the allocation of the NGEU funds. Additionally, the EU has only promised to work in the future on various forms of revenue needed to pay the new debt. Hence, I will show that the NGEU could be better dubbed a "Morrisian moment" for Europe, as Robert Morris, the superintendent of finance of the US (1781–1784), was the very first finance minister of a similar kind of a union: with a power to borrow but not to tax, governed by the unanimity rule in fiscal matters, which led to the failure of his proposals for national revenue. Hence, I aim to answer the following research questions: Which patterns of fiscal integration, as shown in the introduction to this thematic issue (Woźniakowski et al., 2023), does the NGEU represent, and how does it compare with the patterns of US fiscal integration under the Articles of Confederation? Are there any lessons for the EU from this American fiscal history?

This article proceeds as follows: In the next section, I present the theoretical framework, focusing mainly on fiscal capacity building in its two modes: first, an autonomous mode, that is, tax capacity in the revenue side of the budget and spending capacity in the expenditures side of the budget; second, a dependent mode, that is, budgetary capacity in the revenue side of the budget and transfer capacity of expenditures side of the budget. Section 3 focuses on the fiscal structure of the US under the Articles of Confederation (1781–1789), which resembles the most the debt-based financial architecture of the NGEU, followed by Section 4, which contrasts this American experience with the European one and demonstrates the main similarities and differences between the fiscal structure of the US under the Articles of Confederation and the NGEU. Section 5 concludes with potential lessons for the EU.

2. Theoretical Framework

In recent years, we have witnessed significant, even paradigmatic, changes in how the EU manages its own fiscal sphere (potentially leading to the creation of EU taxes) on the one hand, and how it influences the fiscal sovereignty of its member states, on the other (Zgaga, 2023). These two distinct processes have been dubbed "fiscalization," in my earlier work (Woźniakowski, 2022) and fiscal regulation, respectively. These two instruments of integration—capacity (proceeded by fiscalization) and regulation—should not be confused with each other, even if both represent forms of fiscal integration (cf. Genschel & Jachtenfuchs, 2013). These processes started with the introduction of the common currency in Europe and were strengthened during crises, albeit in different ways. While the euro crisis triggered the enhancement of the fiscal regulation regime of the EU, leaving the fiscalization process intact, apart from the creation of the lending mechanisms based on the borrowing power which the EU has been enjoying for over 40 years (e.g., the EU-budget-based European Financial Stabilisation Mechanism; cf. Cabral, 2021); the Covid-19 crisis led to the strengthening of two instruments of fiscal integration specifically in relation to the capacity instrument. Quasi-fiscalization has been initiated in the form of the NGEU with an enlarged EU borrowing, and this NGEU was linked with the second instrument of integration—fiscal regulation, in the form of the enhanced conditionality-driven European Semester. As a result, the European Semester now also has the "carrots" in the form of financial transfers from the Recovery and Resilience Facility, which is the largest part of the NGEU,

and not just "sticks," in the form of the financial sanctions for not respecting the debt and deficit criteria of the Stability and Growth Pact.

This article builds on this crucial differentiation between fiscalization and fiscal regulation. However, it follows a more nuanced conceptual framework of the patterns of fiscal integration, including instruments, sides of the budget, and modes (autonomous or dependent), as defined in the introduction to this thematic issue, which is summarized in Table 1.

The introduction to this thematic issue (Woźniakowski et al., 2023) sheds new light on the nature of the ways in which the public finances are raised, spent, and governed in a multilevel government. It argues that there is a need to distinguish both fiscal capacity and fiscal regulation based on the entity it affects the most—whether it is the central/supranational level or constituent units/member state level of government. As Table 1 shows, fiscal integration is divided not only into capacity and regulation, but those two instruments of integration are further divided based on the mode, i.e., the level of autonomy that a particular level of government (mostly the EU or federal government in this case) has. If the central/federal budget is based on independent sources over which the centre has power, for instance, federal taxes, we can talk of tax capacity (proceeded by fiscalization process). On the other hand, if the budget is composed of contributions from the states (so the centre does not have power over them, as those resources depend on the member states/units), we can talk about budgetary capacity but not tax capacity. Both the US under the Articles of Confederation—or Confederation USA (CUSA)—and the EU today have budgetary capacity but not tax capacity, as they lack significant power to tax. This similarity in budgetary capacity is coupled with a crucial difference when it comes to the expenditure side of the budget in the capacity axis. While the CUSA enjoyed spending capacity as the central budget was spent by the Union itself (i.e., the Confederation Congress), the EU lacks such a spending capacity, as the EU institutions do not usually spend the budget themselves. Rather, the EU has a transfer capacity, as the large majority of the funds are distributed further to its member states, which then spend them on their respective territories. Similar differentiation is applied to the regulation axis of Table 1—revenues and expenditures of both levels of government can be regulated, as explained in more detail in the introduction to this issue (Woźniakowski et al., 2023).

I focus on the capacity instrument of fiscal integration, especially on the revenue side of the budget, to show that both the NGEU and the US under the Articles of Confederation have a "budgetary capacity" based on non-independent resources, mainly borrowing and states' contributions, but do not have "tax capacity" based on independent resources, meaning taxing power. When it comes to the expenditure side of the budget in fiscal capacity building, the CUSA at that time had spending capacity, as the Congress could spend the money itself. In contrast, the NGEU is an example of transfer capacity as the EU does not spend the money itself. Rather, it transfers the borrowed funds to the member states based on conditionality anchored in the implementation of the fiscal regulation framework (Country Specific Recommendations of the European Semester). Even though the European Commission does not spend money on behalf of the EU, it has oversight authority on the spending side of the budget via National Recovery and Resilience Plans.

In principle, the NGEU follows the old paradigm of lending mechanisms, which were successfully used in the past by the EU and were within EU law (see Woźniakowski, 2022, pp. 100–104). The loans taken by the Commission on the financial markets were then distributed to the states. The Commission lent via three main schemes: the European Financial Stabilisation Mechanism for members of the euro, the Balance of Payment was used for non-euro EU members, and finally,

Table 1. Instruments and modes of EU fiscal integration.

		Instruments of fiscal integration			
		Fiscal capacity		Fiscal regulation	
Mode of fiscal integration (autonomous or dependent)		Autonomous: Supranational institutions involved	Dependent: Intergovernmental institutions only	Regulation of the centre (autonomous or dependent)	Regulation of the units (autonomous or dependent)
Side of the budget	Revenue capacity	Tax capacity based on independent resources (fiscalization)	Budgetary capacity based on non-independent resources	Revenue regulation of the centre	Revenue regulation of the units
	Expenditure capacity	Spending capacity of independent or non-independent resources	Transfer capacity of independent and non-independent resources	Expenditure regulation of the centre	Expenditure regulation of the units

Source: Woźniakowski et al. (2023, p. 2).

non-EU members could borrow via Macro-Financial Assistance. Loans had to be repaid, and the EU was, in a way, lending its good credit rating to the countries that did not have such a good rating and would have had to pay more for the loans on the financial markets. Thus, the loans were cheaper, and this was their main benefit. However, this is not the case for all the EU members, as some of them enjoy better credit ratings than the European Commission, and for this reason, they may not be interested in the loan part of the NGEU. Indeed, this is true not only for Germany or Finland, with traditionally good credit ratings but also for France—the difference in spreads between France and the EU was 0.37% as of March 2023, a rise from 0.06% only two years earlier (Kraemer, 2023). Indeed, as of February 2023, the Commission has distributed €144 billion under the Resilience of Recovery Facility, in which the amount for grants (€96 billion) was two times higher than the amount for loans (€48 billion; European Commission, 2023, p. 4). Hence, there is a risk that a large part of the NGEU loan component will never be used and, for this reason, the two parts of the NGEU should be kept separate. Nevertheless, both parts are based on borrowing, a method similar to the financing of the first American Union, before the federal Constitution of 1787 was ratified, which is the focus of the following section.

3. The US Under the Articles of Confederation (1781–1789)

The US emerged as a result of a fight for the independence of the 13 North American colonies from the British Empire. One of the most pressing concerns after the start of the Revolutionary War (1775–1783) was the issue of money. All the states agreed on their common objective—independence—but the fact that the war started precisely because of the taxes imposed without their consent did not make financing this common endeavour less difficult. As this was the very power that the states wanted to secure in their own hands, to avoid the same situation as before 1776 (that they had not given consent to the taxes imposed on them), the 13 states were not willing to transfer the "power of the purse" to the newly created Union. The government of the Confederation consisted of a single institution, Congress, which ensured equal representation for all the states. There was no executive or judiciary. Hence, the states gave this Congress the power to issue debt on their credit, to print currency, and to ask for states' contributions, but not the power to tax. As a result, the Union between 1775 and 1789 relied on three main sources of revenue: (a) printing paper money, (b) borrowing, and (c) requisitions from the states, which was the equivalent of the contributions from the member states to the EU budget (Ferguson, 1961).

The US declared independence on 4 July 1776, and one year later, the first Constitution was drafted and sent to the state legislatures for ratification. However, the process took another four years, and only in 1781 were the Articles of Confederation ratified. Hence, for the first five years, the US had no legal basis as a union. This did not prevent the Continental Congress from exercising its powers, mainly regarding the conduct of the war and its financing. For instance, all the 40 emissions of the Continental paper currency—the Continental dollar—took place before 1780 (1775–1779), and this method of financing federal expenditure before 1778 provided 86% of all the revenues, the rest being borrowing, mainly domestic. In the second phase of the war effort (1778–1781), due to a dramatic depreciation of the Continental dollar (by 1781, to obtain $1 in specie, i.e., hard money in silver or golden coins, it took $100 Continental dollars), borrowing became the major method of public finance. Total borrowing covered 61% of the war cost, of which 7% were foreign loans, and the rest domestic borrowing in the form of certificates of debt; 34% were currency emissions, while the requisitions provided only 4% of all the war cost (Baack, 2001, p. 654).

This model of financing the common needs prevailed because the individual states failed to contribute as much as Congress requested. In social sciences, such a phenomenon is called a free-rider problem, which one can observe if a state benefits from the common goods, such as security—or externalities of policies of another state—without paying for them. Indeed, as one commentator observed, the Articles of Confederation:

> Gave to the confederation the power of contracting debts, and at the same time withheld the power of paying them….It provided the mode in which its treasury should be supplied for the reimbursement of the public credit. But over the sources of that supply, it gave the government contracting the debt no power whatever. Thirteen independent legislatures granted or withheld the means according to their own convenience. (Dewey, 1968, p. 49)

The states failed not only in a sphere where direct money transfer to the common coffer was involved but also in protecting the common currency from losing its value. As an institution without any taxing powers, it was asking the states to redeem the Common currency via local taxes and fees payable in Continental dollars, which would then be sent to the confederal treasury to be burned. This would save the value of the dollar and prevent inflation. However, the states did so to a limited extent and continued to issue their own paper money—resulting in huge inflation (Studenski & Krooss, 2003). When it comes to the second main source of Congress revenue—the requisitions—the picture is not optimistic either. In general, states failed to send the contributions of the value that Congress asked for. For instance, between 1777 and 1779, the states sent slightly over half of what they should have (58% or $55 million out of $95 million).

The third main mode of raising the confederation revenue was borrowing, which took three forms: domestic bonds, debt certificates, and foreign loans. The total sum the Congress borrowed amounted to £32 million (the states borrowed less, £23 million). When it comes to the total cost of war, loans covered one-third of the expenditure, while the remaining two-thirds came from issuing fiat (paper) currency (28% in Continental dollars and 39% in states' emissions; Perkins, 1994, p. 103). What is similar between NGEU and the US back then is the lack of tax capacity in both polities and backing of the central borrowing power with the states' taxing powers, the problem which the Union's very first finance minister, Robert Morris, tried—and failed—to overcome in an institutional environment of unanimity.

Robert Morris was born in Liverpool and emigrated to America to become a wealthy businessman and an important public figure. He served in many public bodies, both at the state level in Pennsylvania and at the Union level, in Congress and its many committees. His main role, however, started when he became a superintendent of finance (in 1781, a few months before the decisive battle with the British in Yorktown). His role was appreciated to the extent that he was even called "a financier of the Revolution" (Rappleye, 2010), and indeed he played an important role in securing the finances of the Confederation. Morris even used his personal funds for the war expenses and was decisive in securing foreign loans in Amsterdam in 1782 of $2 million with a very good interest rate of 5%. This loan was important for the needs of the Union but came at an unfortunate time politically. It was a time when the states were debating the need for a national tariff (called impost), and one of the main arguments was that it would be difficult to convince foreign investors to lend to the Union if it did not have a steady source of revenue. By securing this loan before the states agreed on such a central tax capacity, Morris lost an important argument for the introduction of a national tariff.

Having said that, once the Dutch investors realized the fiscal problems the Union was facing, they included it in their risk assessment. Consequently, the interest that the Union had to pay rose to 9%. While the Dutch loans were non-political and came from private investors in Amsterdam (the main financial centre of Europe at the time, next to London), they came only once it was evident the US would win the war following the Yorktown battle of 1781. On the contrary, the French loans were basically an extension of Louis XVI's foreign policy and were provided in order to help Americans win the war. Thus, this source of foreign loans stopped after 1781.

Morris tried many methods in his battle to empower Congress with a taxing power. In one bold move, he decided to stop paying the interest to domestic bondholders, hoping that this would create social pressure in state legislatures whose green light was necessary for granting Congress a tax power. However, the decision of state legislatures to volunteer to pay their citizens' confederal interest meant those hopes came to nothing. However, his main quest for independent revenue sources led to the drafting of two proposals on empowering the Confederation Congress with the power over impost; the fiscalization process failed as both proposals were vetoed, first by Rhode Island in 1781 and then when a modified proposal, with changes requested by this state, was made in 1783 and vetoed again, this time by New York (Studenski & Krooss, 2003). Unable to secure central tax capacity, Morris resigned in 1784. As a result, an entirely new Constitution had to be drafted in which a unanimity requirement was abandoned for the fiscalization process to successfully back the Union's borrowing powers (for details see Woźniakowski, 2022). Such borrowing power without taxing power existing in a political system governed by unanimity in fiscal matters are just a few examples of similarities between the 1780s US and the EU of 2020s, a topic I delve deeper into in the following section.

4. Contrasting the American Experience With the European

As the EU is heading towards a post-Covid-19 future, its architecture emerges at the intersection of divergent responses to past crises. EU response to the Euro crisis led to the strengthening of national budget constraints. However, the Covid-19 crisis was met with large-scale fiscal solidarity stimulus and a temporary withdrawal of these constraints. Since the introduction of the euro, many scholars have argued that the Economic and Monetary Union cannot respond adequately to (a)symmetric economic shocks as long as it is not embedded in a political and fiscal union (Cicchi et al., 2020; De Grauwe, 2006; Demertzis & Wolff, 2019). These arguments gained salience during the Covid-19 crisis (Woźniakowski & Maduro, 2020). It became obvious that national fiscal responses may be inadequate—especially in member states with high levels of prior debt—and inadvertently increase existing asymmetries. At the same time, the judgement of the German Constitutional Court of 5 May 2020 demonstrated that fiscal solidarity via the ECB's monetary backdoor may reach its (legal) limits. The €800 billion Recovery Fund (NGEU) based on the EU debt reacts to both weaknesses noted above: It avoids the legal constraints of the monetary backdoor and compensates for fiscal asymmetries. However, it is not clear how exactly this debt will be repaid as the EU still lacks its own significant tax capacity as it was only agreed on the EU's levy on plastic waste and the Carbon Border Adjustment Mechanism, leaving other potential sources such as a digital levy for further debate as it will "over the coming years work towards reforming the own resources system" (European Council, 2020, p. 8), which so far has resulted only in an institutional agreement in which different EU institutions agreed on a roadmap towards achieving that goal (cf. F. Fabbrini, 2022). However, it is far from certain if all of the modest taxes included

in this agreement, including digital levy or a Financial Transaction Tax, will ever be implemented. Such a debate on the future of the Economic and Monetary Union often draws its inspiration from the historical experience of other systems of multilevel government that succeeded in establishing a viable economic union, such as the US (Genschel & Jachtenfuchs, 2016). Contrasting these two polities does not imply that one regards the EU as a federation; it only signals that integration is quite similar to the coming together of previously independent states into a multilevel polity, just as in the US case (Burgess, 2009, p. 30).

I argue that the fiscal architecture of the NGEU resembles more the CUSA between 1776–1789, ruled by its first Constitution (the Articles of Confederation), rather than the US under its current Constitution, drafted in 1787 and ratified in 1789. There are five important similarities in the patterns of fiscal integration of the two polities. First, both polities, the CUSA and NGEU, could borrow from the financial markets, and these loans constituted an important part of their revenues. In the US case, it was one-third of the total cost of the war, while the NGEU funding consisted solely of funds borrowed on the markets. Second, both polities lacked tax capacity in the form of central tax powers, but at the same time, in both polities, the fiscalization process was initiated as there were discussions (and special committees created for this purpose) on specific proposals for enriching the central government with such a power of the sources of revenue independent from the states. In the US, two proposals for a national tariff failed due to a veto of a single state. In the EU case, so far, an interinstitutional agreement between EU institutions (Interinstitutional agreement of 16 December 2020, 2020) was reached in late 2020, in which a roadmap towards European taxes was put forward which is binding, but "the possibility always remains that member states may have to increase their share of national contributions to the MFF to repay the NGEU debt if no alternative source is found" (F. Fabbrini, 2023, p. 56). As part of this roadmap, only an insignificant levy on plastic, which is another form of member states' contribution, and the Carbon Border Adjustment Mechanism have been introduced so far (see García Antón, 2023). Third, as the result of introducing budgetary capacity, based mainly on borrowing, without tax capacity, the individual states were de facto responsible for the payment of the central debt, mainly via contributions to the central budget for the debt payment, based on a special formula reflecting the wealth of individual states. Importantly, such borrowing with no taxing powers may create similar dynamics as in the US, where the financing of the Congress' loans fell on the states, which used the means of direct taxation to repay this debt. This, in turn, led to tax rebellions constituting an existential internal threat, triggering the Philadelphia Convention and the creation of an entirely new Constitution, this time with federal tax powers as its most important federal competence (for a detailed explanation of this fiscalization process, see Woźniakowski, 2022). Fourth, the unanimity requirement existed in both cases. The similar structure of key institutions in both polities, composed of the representatives of the states (the European Council and Continental/Confederation Congress) ruled by unanimity in fiscal matters, may lead to a deadlock in fiscalization. The fifth similarity is the insufficient democratic legitimacy, as in both cases, a popularly elected federal legislature was excluded from drafting or executing budgetary capacity. In the US, such a body did not exist at the time, as the Confederation Congress consisted of representatives from the states, each having one vote per state. That was one reason this Congress lacked tax power as such, the power was too great to be vested in a single body with limited checks and balances. It was a purely intergovernmental, and not supranational, institution to use the analytical framework of the introduction of this thematic issue. In the EU case, the European Parliament was largely excluded from both the drafting of the NGEU and its implementation (Crum, 2020).

Notwithstanding those similarities, three main differences have to be mentioned. First, the Confederation Congress enjoyed spending capacity as it did spend the money itself as opposed to the EU institutions, which have transfer capacity as the NGEU funds are transferred further to the member states (see Table 1). Due to the conditionality, the Commission has the authority to influence how the money is spent. However, it is a very different kind of power from the power to spend (cf Fasone & Simoncini, 2023). Second, while the US borrowing power was firmly based in Art. 8 of the Articles of Confederation and was permanent, the NGEU borrowing is limited in time: The funds need to be raised until 2026, and the EU loans need to be repaid by 2058. Third, there was no limit on the amount of borrowing in the US, while it is a very specific amount of €800 billion in the NGEU case. This leads me to the fourth difference: The NGEU funds cannot be used to tackle any current (or future) threats to the EU, such as Russia, while the borrowed funds in the US were used to finance the ongoing war. Finally, while the loans taken by the CUSA were used to provide the most fundamental common good—security—the NGEU largely fails in this regard as it does not finance any significant European-wide public good, such as common defence, but focuses on the national level instead. These similarities and differences are summarized in Table 2.

The way the NGEU is designed has a number of consequences for the development of the EU as a polity. First, the EU will not be able to mobilize large resources in times of crisis, as any future recovery mechanism would need to be negotiated among the member states, which can be both risky and lengthy. Second, the decision to rely on special mechanisms beyond the regular EU budget and to exclude the European Parliament raises questions about the accountability of such power and may undermine the EU's democratic legitimacy. Third, the effectiveness of the EU may be damaged if a large part of the NGEU is never used. One of the main reasons behind

Table 2. Similarities and differences between the fiscal structure of the US under the Articles of Confederation and the NGEU.

Similarities	Differences
1. Borrowing on the markets (budgetary capacity)	1. US: spending capacity (by the centre); NGEU: transfer capacity (to the member states)
2. No taxing powers (no tax capacity)	2. Borrowing power: US (permanent); NGEU (one-off)
3. Central debt repayment based on member states contributions	3. US: no limit on borrowing; NGEU: limit of both time and amount
4. Unanimity requirement in tax matters	4. US: loans used to tackle an ongoing threat; NGEU: to tackle past threats
5. Insufficient democratic legitimacy	5. US: loans to finance common public good (common defence); NGEU: to finance national public goods

the introduction of the NGEU based on the EU loans was the fact that the EU can borrow cheaply on the markets. In fact, the entire financing of the NGEU is based on credit: The grants and loans for distribution to member states originate from loans the European Commission takes on the financial markets. The idea behind introducing the loan component, apart from its political goal to appease the demands of the Frugals (i.e., the group of NGEU sceptics led by the Netherlands), was that the EU could borrow much more cheaply than many member states. In a way, by using its excellent credit rating and then lending to its member states, the EU was lending its good credit rating and thus allowing (fiscally troubled) countries to pay less for their public debt. But this only makes sense if the EU rating is better than those of the individual countries. If this rating deteriorates, there is a risk that a large part of the loan component will never be used, as many countries could borrow on better terms than the Commission. This is true not only for traditionally "fiscally responsible" countries such as Finland, Germany, or the Netherlands, but it is true also for France, as shown in Section 2. It seems that the investors started to notice that an entity that does not control a source of revenue needed to pay off the borrowed funds and cannot extract this revenue directly from its population (firms or individuals) but has to instead rely on contributions from its member states, has a higher risk of default.

Overall, the NGEU does not represent a paradigm change in the development of the EU as a polity. Indeed, the NGEU, similarly to the traditional EU budget, the Multiannual Financial Framework (MFF), has a transfer capacity, meaning that its funds are further distributed to the member states, but not a spending capacity, i.e., the ability to spend the funds itself (see Table 1). In the capacity building axis of Table 1, the NGEU is a continuation of the dependent mode of capacity building. First, when it comes to the revenue side of the budget, it represents budgetary capacity based on non-independent resources. In the MFF case, it is largely contributions from the member states, while the NGEU budgetary capacity is based on loans. These loans may then paid off via contributions of the member states, as the agreed new "own resources" may not have the potential to generate enough revenues to pay off NGEU loans. Secondly, concerning the expenditures side of the budget, the NGEU is an example of the transfer capacity of non-independent resources to the member states.

5. Conclusions: Lessons for the Next Generation EU?

This article has shown the limitations of comparing the NGEU with the Hamiltonian fiscal policies. Instead, I argued that the NGEU can be better understood if compared with policies of Hamilton's predecessor, Robert Morris, who was in charge of the finances of the Union in the 1780s when the US was governed by its first Constitution, the Articles of Confederation. The main lesson Morris could teach the EU is perhaps the following: In a federal union, it is easier to secure an agreement on the borrowing power of the centre than the federal tax power to pay this debt. In a unanimous environment, giving concession to one opposing state may not be enough to pass relevant legislation, as the experience of Morris showed and the journey with Rhode Island and then New York vetoing two proposals for a national tariff. In fact, Morris resigned in 1784 after his failure to convince the states to give the Union an independent revenue stream. This led to fiscal chaos and an existential internal threat, which was fundamental in securing the drafting and ratification of the new Constitution with a federal fiscal union (Woźniakowski, 2022). It remains to be seen if similar dynamics will be at play in Europe if the EU fails to match its borrowing power with sufficient tax power.

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Conflict of Interests

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Article

Fiscal Rules and Federal Capacity in American Fiscal History: Lessons for Europe?

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Abstract
Recent comparative fiscal federalism work has noted how the US displays a mix of substantial federal capacity and no federal fiscal rules for sub-federal units as opposed to the EU's mix of regulation and lack of capacity. The difference is explained by the lack of federal capacity in the EU case, which presumably creates a need for regulation. However, these studies are cross-sectional. This carries the obvious drawback of abstracting the actual political and historical processes that have given rise to the respective mixes of regulation and capacity in the two polities. In this article, I trace the historical process by which the specific mix of no rules and capacity became entrenched in the US in the second half of the 20th century and ask whether that political-economic history has any lessons for the EU today.

Keywords
comparative federalism; fiscal capacity; fiscal federalism; fiscal rules; political development

Issue
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1. Introduction

Since the outbreak of the eurozone crisis in 2010, comparative federalism scholarship seeking to draw lessons for the EU from the history of fiscal institutions in federal unions has flourished (Bordo et al., 2011; Frieden, 2016; Henning & Kessler, 2012; Kirkegaard & Posen, 2018; Sargent, 2012; Woźniakowski, 2022). Comparisons to the US have had pride of place in this literature. The focus on "lessons" betrays a key fact about this literature, namely that much of it has come at the request of European policymakers grappling with how to develop a more stable set of monetary and fiscal institutions in the EU. One key observation, whose potential implications for the EU have been insufficiently discussed (Georgiou, 2023), is that the US and the EU feature diametrically opposed mixes of federal fiscal rules for the constituent units of the union and federal fiscal capacity (Cottarelli & Guerguil, 2015; Hallerberg, 2014). While the EU has a mix of intrusive (at least on paper) fiscal rules for member states (the Stability and Growth Pact) and almost non-existent central fiscal capacity, the US has the exact opposite: no federal rules whatsoever on state fiscal behaviour along a large federal budget. This "fiscal policy mix" is one of the key themes of this special issue, as laid out in the introduction (Woźniakowski et al., 2023).

The literature tends to explain the difference by the lack of federal capacity in the EU case, which presumably creates a need for regulation. It should be noted that this was not the explanation put forward by most economists in the 1990s when the Stability and Growth Pact was negotiated. The dominant rationales for the EU rules were the fear of fiscal dominance and the attempt to prevent negative spillovers from member-state fiscal policies. It is only since the eurozone crisis forced onto the policy agenda the issue of a federal EU fiscal capacity that the above explanation has become prominent.

There are two problems with the way the literature arrives at this explanation, however. First, many other federal unions with federal fiscal capacity do have at least some rules constraining sub-federal fiscal behaviour. The relationship between no regulation and

capacity is not a necessary one but a historical and political construction. Second, the comparative studies that note the distinct mixes of regulation and capacity are cross-sectional. They compare the US fiscal system of the early 21st century with the EU's system of public finance. Yet, what has driven most of the comparative federalism literature is the quest for insights into how the EU can *develop* into a more stable monetary and fiscal arrangement. Policymakers are interested in processes of political development leading to stable institutions and the lessons such historical experiences may carry for the policy challenge they need to address today. Static cross-sectional studies are not particularly helpful in that respect because they abstract the actual political and historical processes that shaped the institutional equilibria they describe and compare. In other words, the comparison of the fiscal policy mix in the EU and the US may tell us where the EU should aim to go, but it does not tell us much about how it might get there.

The methodological implication here is that drawing policy lessons for the EU from the US fiscal system requires first and foremost examining how the system was created, not how it functions today. Instead of comparing the US to the EU, one needs to compare American political development to European integration. This article thus offers a historical analysis of the emergence of the US system and then asks whether that history has any lessons for the EU today.

To do this, however, it is necessary to offer a more precise description of the contemporary American fiscal system. As the guest editors observe in the introduction to this thematic issue (Woźniakowski et al., 2023), the distinction between regulation and capacity needs to be refined by differentiating between autonomous and dependent modes of fiscal instruments and between the revenue and spending side of the budget. I would add the balance sheet dimension too—As I will show, the way fiscal liabilities are structured across levels of government is of crucial importance. Indeed, when referring to a "fiscal capacity," the underlying reality is multifaceted: Such a capacity revolves around a precise mix of fiscal powers at the constitutional level, revenue streams (including borrowing proceeds) and spending commitments at the level of flows and assets and liabilities at the level of stocks. The comparative fiscal federalism literature tends to focus on the size of budgets and thus on just the level of centralised spending; however, that is inadequate to accurately capture the reality and dynamics of fiscal systems, especially in systems of multi-level government.

Section 2 thus offers a succinct description of the American fiscal system. Crucially, the absence of regulation acquires its full meaning when one observes that it is synonymous with a system of market discipline for municipal debt and a substantial degree of vertical fiscal imbalance. In the US, "municipal" debt refers to the debt of any government other than the federal government. State, city, county, and special jurisdiction (school districts for example) governments are included. The US is thus a rather rare example of a federal union in which "hard budget constraints" constrain sub-federal government fiscal policy.

The historical circumstances in which market discipline was established form the first of the two historical episodes that have shaped the structure of the contemporary American fiscal system. The second is the rise of federal fiscal capacity starting in the 1930s. These are the subject of Section 3. Section 4 looks at the lessons the American experience has for the EU.

A crucial dimension of the historical process that has given shape to the contemporary American fiscal system is the sequencing of these two developments. Another is the historical timing of each episode in relation to the broader processes of the development of government intervention in the modern economy (e.g., North, 1985; Walker & Vatter, 1997) and the rise and growing concentration of bondholder power (Roos, 2019). I suggest that because the EU differs from the US on these two crucial historical dimensions, the path to, and substantive outcome of, a "capacity without regulation" institutional equilibrium in the EU will differ substantially from the US experience.

2. The Substance of the American System

The US federal government has no power to directly constrain or steer the conduct of fiscal policy by other levels of government, whether the states or local governments. The states are fiscally sovereign (Rodden, 2012), largely because the 11th Amendment essentially renders them immune from prosecution for defaulting on their obligations (Orth, 1987). However, scholars who study the political economy of fiscal federalism consider the US as a (successful) example of a federal union with "hard budget constraints" on sub-federal governments (Inman, 2003; Rodden, 2012; Rodden et al., 2003; Wibbels, 2003). They identify the established reputation of the federal government of refusing to bail out sub-federal governments that get into fiscal trouble as the source of a system of market discipline that efficiently constrains fiscal behaviour by state and local governments. Rodden (2006, Chapter 4) has shown that credit rating agencies and investors price the default risk of US states as opposed to that of German Länder for example, where the market perception is that the federal government ultimately backstops the Länder. In support of this assessment, scholars cite the rarity of state and local government defaults since the late 19th century (Inman, 2003; Rodden, 2012) as well as the fact that, during the Great Recession, the budget shortfalls in the states were only correlated with the depth of the local recession, suggesting that the institutional framework is not the source of poor fiscal performance (Inman, 2010).

A second, and related, feature of the system is that the states invariably (with the sole exception of Vermont) have a set of more or less stringent rules governing their fiscal behaviour (for the most widely cited state-by-state

stringency evaluation of the rules, see ACIR, 1987). The rules that have received the most attention in the literature are the various balanced budget rules (for a succinct summary of the history of the introduction of the various types of rules, see Rodriguez-Tejedo & Wallis, 2012). The key point in relation to the theme of this article is that these rules have been adopted entirely independently by the states and in response to demand by their own citizenry—in no way do they represent external political constraints. By contrast, in the EU, only Germany had independently adopted national fiscal rules before the Maastricht Treaty was ratified in 1992 and its convergence criteria (the precursor to the Stability and Growth Pact) were introduced by the same token (IMF, 2022). The states adopted rules for the first time after the 1840s defaults, i.e., once the system of market discipline was established. As a result, whether they have an independent impact on fiscal performance or not (a point of dispute in the relevant literature) is less significant than the fact that they are themselves a consequence of the primary feature of the system which is market discipline.

One result of the balanced budget rules is that the states do not have the means to conduct countercyclical deficit-financed stabilisation policy in times of recession. Krugman (2008) famously railed against the "Fifty Herbert Hoovers" during the Great Recession. Such stabilisation is entirely the responsibility of the federal government.

Consequently, the structure of public debt in the US is heavily skewed towards the federal government. In yearend 2022, outstanding federal government debt stood at around 120% of GDP, as opposed to about 14% for municipal debt (Federal Reserve Bank of St. Louis, n.d.). But whereas the federal government debt has a single issuer, municipal debt has around 93,000 potential issuers (that is approximately the number of state and local governments in the 2017 US Census of Governments). As a result, the holders of municipal debt are predominantly retail investors (households and non-profit organisations held 40.4% of that debt in 2022; Municipal Securities Rulemaking Board, 2022, p. 4) as opposed to the federal debt that is held by institutional investors. As Rodden (2012, p. 136) has observed, this means that municipal debt involves no "too-big-to-fail" problem and any cross-state spillovers resulting from potential defaults are limited. Consequently, the political power of the bondholders over the federal government is quite limited, as opposed to state governments where retail investors enjoy concentrated influence as voters (state debt tends to be held by residents).

Of course, a key feature of the system is the substantial fiscal capacity of the federal government. The federal budget hovered between 20% and 25% of GDP in the decade preceding the 2020 crisis and soared to 30% in 2020–2021. During that time, the combined budget of states and local governments hovered between 13% and 15% of GDP, excluding the federal help received through grants-in-aid. Indeed, what is much less well known outside the US is that the federal budget funds to a large extent a series of transfers (grants-in-aid) to state and local governments, the bulk of which comes in the shape of matching grants. In 2019, the total amounted to about 750 billion US dollars (3.5% of US GDP), accounting for about a third of total state spending. About 85% of these grants-in-aid are for welfare programs as these are for the most part administered by the states (CRS, 2019). In the public finance jargon, this large-scale transfer of revenue from the federal to sub-federal governments is called "vertical fiscal imbalance." In times of systemic stress like the Great Recession or 2020–2021, Congress channels federal reflationary spending through increased grants-in-aid (Inman, 2010; Rodden, 2012, pp. 134–135). In 2021, these amounted to 1.245 trillion US dollars and 5.6% of GDP (OMB, 2023, p. 205). This is both the result of the procyclical fiscal retrenchment generated by the states' fiscal rules and of the structure of intergovernmental relations in the US. Because most welfare programs are administered by the states and because the easiest way of reflating the economy is to boost spending on these programs, Congress is forced to act through the states when it wants to pursue a fiscal stimulus. This differs from a bailout because Congress adopts measures applying to all the states instead of targeting transfers to those in fiscal dire straits or assuming their liabilities. However, the increased grants-in-aid do reduce default risks and fiscal pressures on the states. Grants-in-aid thus accounted for 23.9% of state and local spending in 2015, 27% in 2020, and fully 38.5% in 2021 (OMB, 2023, p. 206).

In summary, the two dimensions of the American fiscal system each encompass a more complex reality. "No regulation" refers to a system of market discipline for a small portion of the overall system, whose share of total public borrowing is much smaller than its share of total spending and whose liabilities are held by diffuse and powerless bondholders. "Capacity" refers to a large federal budget tasked with providing macroeconomic stabilisation and welfare spending for the system as a whole, but which largely relies on and funds the states through intergovernmental transfers. Put differently, the system is not structured around two entirely separate spheres of government and fiscal policy, as the American constitutional doctrine of dual sovereignty might imply and as the shorthand of "no regulation and capacity" suggests. That is true of the liabilities of each sphere, but not of revenue, spending, or the distribution of fiscal policy functions.

3. The Historical Emergence of the American System

Two crucial historical episodes have given rise to the present American fiscal system. The first was the wave of state defaults in 1841–1843 (English, 1996; Grinath et al., 1997; Rodden, 2006, Chapter 3; Wibbels, 2003). The failure of the federal government to provide a bailout

established the system of market discipline that still prevails today. The second was the emergence of what economic historian John J. Wallis has called the "third system of government finance" (Wallis, 2000) during the New Deal in the 1930s (Wallis, 1984). Its rise has driven the growth of grants-in-aid funding and the federal budget and led to the centralisation of the system.

In 1841–1843, eight states and one territory defaulted on debts accumulated during the two previous decades for infrastructural investment and the chartering of state banks. A legislative effort to provide a federal bailout was led in Congress by representatives of these states. The Johnson Plan essentially proposed a repeat of the Hamiltonian assumption of state debts in 1790 (Edling, 2007; McCraw, 2012, Chapters 8–9). The federal government would provide bailouts to all the states, not just those in distress. This was designed to win over representatives from the fiscally sound states. The proposal failed—It never actually reached the floor for a vote and neither of the two national parties (Whigs and Democrats) endorsed it.

I see three distinct explanations for this in the literature: the Congressional balance of virtuous versus profligate state coalitions, the power(lessness) of bondholders, and the nature of the federal bargain and the associated fiscal policy functions of the overall system.

Wibbels (2003) argues that the bailout proposal failed because the profligate states were in a minority in Congress (eight out of 26, 16 out of 42 senators, and 60 out of 242 representatives). This variable on its own, however, fails to explain the 1790 Hamiltonian assumption. Hamilton did not have a majority in Congress for his debt assumption plan before the famous bargain with James Madison in which he agreed to support the transfer of the federal capital from New York to the banks of the Potomac in exchange for Madison procuring congressional votes for the plan. Two other variables complete the picture and, crucially, provide a link to the New Deal episode.

First, bondholders were rather powerless, for two reasons. First, these were retail investors, not concentrated institutional investors in "too-big-to-fail" institutions. Second, in the majority, they were out-of-state and even extra-US, mostly British, residents. Indeed, the politics of the defaults pitted state citizens as taxpayers against foreigners as bondholders. In his book on the political economy of sovereign debt, Roos (2019) argues that throughout the 20th century debt restructurings and defaults have become ever rarer due to the growing concentration and centralisation of creditors. Bondholders have gone from a multitude of retail investors to a handful of too-big-to-fail international financial institutions, which explains the rise of bondholder power and the decline of losses inflicted on them. This framework neatly explains the failure of British bondholders of US state debts in the 1840s to get their government to exert serious diplomatic pressure on their behalf (Rodden, 2006, p. 60), as well as their failure to sway the defaulting states to repay by withholding credit for all states and the federal government (English, 1996).

A second reason for this failure provides the link with the third explanation. In his various writings, Edling (2007, 2014) has shown that what he calls the "first American fiscal regime" was essentially driven by the need to provide the federal government with the fiscal means to provide for the common defence. States and local governments were responsible for any infrastructural investment that did take place (Wallis, 2000) during this period. Cross-state spillovers were limited and fiscal policy did not perform any of the modern public finance functions that it would come to perform in the 20th century (Musgrave, 1939)—certainly not macroeconomic stabilisation and income redistribution (the two functions most closely related to the Keynesian revolution in fiscal policy). The Constitution even forbade the federal government from redistributing wealth and income across the union (through the constitutional requirement of apportioning geographically direct taxes). Even whether the federal bargain could be said to include the power for the federal government to raise direct taxes is debatable. Congress only levied an income tax for the first time during the Civil War in 1861, and the Supreme Court struck down the next attempt in the Wilson–Gorman Tariff Act of 1894 in its famous *Pollock v. Farmers' Loan & Trust Company* ruling the following year. It would take the 16th Amendment in 1913 to clarify that the federal government could freely exercise its taxation powers.

This distribution of fiscal responsibilities corresponds to what scholars of American federalism call the "dual federalism" of the first 140 or so years in American history (Walker, 1999, Chapter 3). Unlike the Hamiltonian assumption, the states' fiscal troubles in the 1840s were unrelated to the common defence. They derived from the attempt to raise the productive potential of local economies, which under the prevailing understanding of the nature of the constitutional bargain was considered a matter for the "sovereign" states, not the federal government. This understanding was grounded in the material reality of the American economy being a collection of locally organised economies rather than an integrated unit. Infrastructural investment thus generated little spillovers. It was therefore particularly hard for proponents of assumption to convincingly argue that the federal government was, politically if not legally, liable for state debts. And because the states were not dependent on borrowed funds for anything other than capital expenditures, they could overcome the obstacle of temporarily being deprived of funding by foreign creditors.

The second historical episode is the rise of the third system of government finance during the 1930s. That episode involved three distinct but related developments: a steep rise in the fiscal size of government, a centralisation of fiscal activity in the federal government, and the rise of "intergovernmental relations" and grants-in-aid. Total government spending approximately

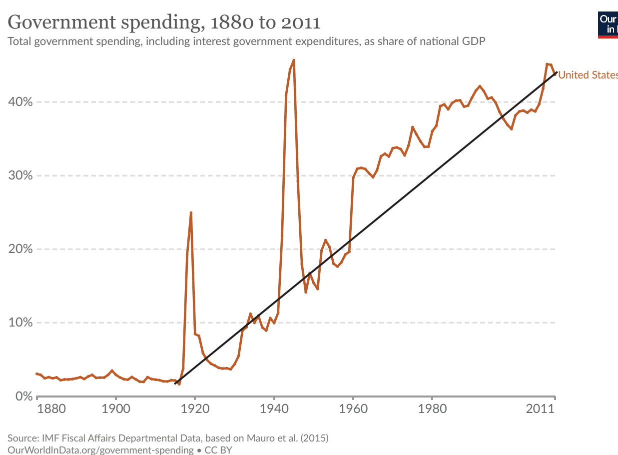
doubled from slightly below 10% in 1929 to slightly below 20% in the second half of the 1930s, and after the Second World War, the steady upward trend continued. But whereas in 1929 the federal government accounted for about a third of total spending, by the middle of the 1930s its share overtook that of state and local governments. In the post-war period, that share fluctuated around two-thirds (U.S. Bureau of Economic Analysis, n.d.). However, at the same time as the growing fiscal weight of the federal government, grants-in-aid became a permanent feature of the system, and have trended upwards ever since. Scholars of American federalism see these grants-in-aid as the hallmark of the new era of "cooperative federalism" (Walker, 1999, Chapters 4–6) introduced by the New Deal.

The growth in the overall size of government is easily explained by the rise of the modern welfare state and Keynesian macroeconomic management in the US—the "fiscal revolution in America" (Stein, 1969). Modern public finance policy functions came into their own. In Musgrave's classic typology, these functions are macroeconomic stabilisation, capital allocation, and income redistribution. Admittedly, capital allocation has a longer history than the other two, in particular through public spending for infrastructural investment, which modern territorial states performed very early on and much before the steep rise in the fiscal size of government that occurred in the 20th century. With the advent of the modern public economy, however, that function was also stepped up, largely due to the vast expansion in education and health outlays.

A key characteristic of modern public finance, and one which marks a sharp break in the fiscal history of advanced capitalist countries including the US, is that the growth in the fiscal size of government it entails is driven by civilian, not military, spending. Piketty (2022, p. 126) has recently referred to this as the "fiscal state's second leap forward." It is worth dwelling on this in relation to American fiscal history and in particular to the advent and maturation of the "third system of government finance" (Wallis, 2000) from the 1930s onwards because, in this case, this development coincides with the rise of the American imperial and national security state. The US emerged as the global hegemon from the Second World War and the National Security Act of 1947 created the apparatus of the contemporary American national security state. This might lead one to think that both the growth in the overall size of government and the fiscal centralisation that came with it were due to the crucial role played by the federal government in projecting American military power abroad. If such were the case, the fiscal transformation of the 1930s and 1940s would stand in continuity with the central role the federal government has always played in providing for the common defence of the union, which drove American political development and fiscal history in the first century of the American Republic as forcefully argued by Edling (2007, 2014). That is not the case, however. Figure 1 clarifies this very neatly. The trends in total government and military spending as a share of GDP have moved in opposite directions from the end of the Second World War onwards. If military spending had been the driver of fiscal development in the post-1930s era, then at least since the late 1940s the fiscal size of government in the US should have declined in line with the decline in the relative size of military spending.

Given that the rise in total government spending was not driven by the growth in the fiscal function that was already the prerogative of the federal government, two key questions arise. Why did fiscal activity and modern public finance policy functions become concentrated at the federal level of government? And why did the growth in the fiscal size of government and fiscal centralisation occur nearly simultaneously?

The obvious functionalist argument in this connection is that, in the 20th century, the US became a mature modern economy integrated at a national scale, in which cross-state spillovers became a major feature as did the need to pursue macroeconomic stabilisation. Indeed, this is the core of Beer's (1973) classic account



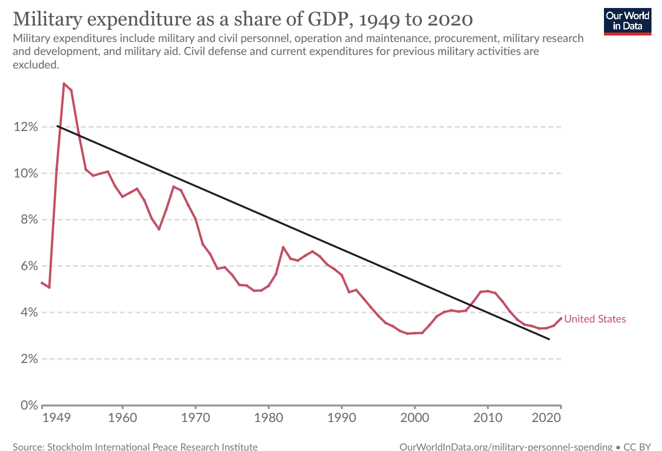


Figure 1. Trends in total government and military spending as a share of GDP, in the US. Source: Ortiz-Ospina and Roser (2016) and Herre et al. (2013).

of the "modernisation of American federalism" and the rise of federal power. That both of these challenges (managing spillovers and stabilising the macroeconomy) are best pursued by the federal level of government is the core prescription of the theory of fiscal federalism (Oates, 1972).

The functionalist argument, however, does not explain the politics surrounding the fiscal transformation of the American government. In fact, the progressive impulse to institute welfare state policies (including income taxes, social insurance schemes, and increased public spending on health and education) originated in the states at the turn of the 20th century (Robertson, 2017, Chapter 6). Until 1932, the growth of state and local fiscal activity far outpaced that of federal activity (Robertson, 2017, p. 123). But for two distinct reasons, the modern public economy did not flourish there.

First, as one of the key texts of the American Political Development school argues, the states were administratively very weak (Skowronek, 1982). They were organisations dominated by their respective legislatures (giving party machines extensive political influence) and judiciaries—a "state of courts and parties" as Skowronek (1982) summed it up. In the fiscal realm, their weakness, coupled with the balanced budget rules that many states had already adopted, meant that when the Great Depression hit, most of them were unable to maintain revenue levels (Robertson, 2017, pp. 143–144). This meant that there was no institutional inertia favouring the states over the federal government when functional pressures in favour of expanded administrative capacity and fiscal activity started arising. The institutional obstacles on the way to federal empowerment were weak.

There was a second positive political reason for carrying out the fiscal revolution directly at the federal level. States in the more industrialised North-East and the Mid-West did initiate progressive reforms. But very quickly, the limits of state-by-state reform made themselves felt, as interstate competition limited the extent to which such reforms could be implemented (Robertson, 2017, Chapter 6). The first reaction to this obstacle was the movement for uniform state legislation (Graebner, 1977). But just as, say, direct tax harmonisation in the EU has been impossible to achieve under conditions of unanimity, so did uniform state legislation prove a failure. As Robertson (2017, p. 133) explains: "Very few uniform laws, even for commercial transactions, were ever adopted by all the states. It was federal spending power that provided an alternative way to motivate states across the nation to take action." Indeed, grants-in-aid, in the form of matching grants, first arose during the first three decades of the 20th century as a way of overcoming the obstacle of interstate competition. They were the carrot by which the federal government wished to get the states to adopt its policies—but they mostly provided funds for infrastructural investment and manpower policies. The novelty of the New Deal was to generalise and hugely expand this model (Wallis, 1984), extend it to social insurance and, after 1937, task it with stabilisation functions:

> The growth of national grants-in-aid during the New Deal [w]as "astounding." Federal grant spending exploded from $250 million in 1932 to $2.9 billion in 1934. Grants constituted thirty percent of all federal spending in 1935. Federal grants amounted to $4 billion in 1940, sixteen times higher than spending in 1932. (Robertson, 2017, p. 149)

The spike in federal fiscal activity was probably greater than it would otherwise have been for a third reason related to constitutional politics. The 10th Amendment and the doctrine of enumerated powers place limits on federal regulatory powers. The Supreme Court relied on these to invalidate several federal laws regulating economic activity in the early decades of the 20th century and then struck down the flagship legislation of the early New Deal, the National Industrial Recovery Act, in 1935. Implementing federal policy thus came to depend even more on using the fiscal carrot to prod the states in the desired direction because the regulatory stick was constitutionally unavailable.

Finally, the grants-in-aid solution involved a crucial political advantage that explains its success. In the New Deal party system, the pivotal role was held by the Southern Democrats (Katznelson et al., 1993). The representatives of the segregated South opposed any notion of New Deal liberalism transforming their local labour markets structured around white supremacy and low-wage black labour. They opposed liberal labour legislation and would only accept federal welfare spending if the states maintained the power to administer the programs. Roosevelt for example insisted that the draft Social Security Act should rely on the states "as much as possible'':

> New Deal policy designers favored substantial state authority over welfare programs…because [it] was politically expedient. State control could allow conservative Southern Democrats to support such a bill, because it would allow Southern states to maintain white supremacy in their region. (Robertson, 2017, p. 153)

4. Lessons for the European Union Today?

The historical timing of the two episodes is crucial in explaining the overall shape of the system. The occurrence of the 1840s fiscal crisis at a time when the modern public economy was not yet in place was key to its outcome. It made it much easier for the federal government to refuse to step in because its fiscal role was limited to military affairs, because the consequences of allowing the troubled states to default were limited and because concentrated bondholder power did not yet exist.

In response, the states adopted rules constraining their fiscal behaviour. This, in turn, contributed to their being unable to become the conduits of the fiscal revolution in the 20th century once the modern public economy came into its own. This, together with interstate competition, cleared the way for the federal government. But the constitutional structure inherited from the time of "dual federalism," and the fact that Southern segregationists exploited that structure to preserve the institutions of the local labour market, shaped the fiscal revolution into the peculiar structure of "cooperative federalism'' that relies on a substantial volume of intergovernmental transfers while allowing the states to administer the welfare programs they receive the grants for.

Are there any lessons for the EU from this history? The US experience displays a fundamental difference from the EU's: historical timing. The attempt to fashion an EU fiscal system since Maastricht comes long after modern public finance policy functions became entrenched in the fiscal systems of the member states themselves and at a time of highly concentrated bondholder power. In the US, the two historical episodes described in the previous section took place either before or simultaneously with the rise of the modern public economy and bondholder power. This has important consequences.

Compare, first, the 1840s fiscal crisis in the US with the eurozone crisis of 2010–2012. As I have argued elsewhere (Georgiou, 2022a), the eurozone crisis was at its core a conflict pitting institutional investors against the German government and its Northern allies over whether a system of market discipline would be institutionalised for the governance of the sovereign debt market in the EU. The German government had insisted on the no-bailout clause in the Maastricht Treaty. It waived the no-bailout commitment aside in Spring 2010, out of a fear that a disorderly Greek default would amount to another "Lehman" moment. But very quickly, it came back to the negotiating table with the proposal of inserting orderly restructuring procedures in member state bonds, which was agreed upon in October–November 2010. The bondholders pushed back, went on a credit strike and forced the Berlin government to backtrack and tacitly agree to the backstopping of member state bonds by the European Central Bank from 2012 onwards. Not only is market discipline dead as an organising principle, but the backstopping of sovereign bonds by the European Central Bank has become increasingly open-ended and unconditional, exceptionally so since 2020 and in particular since the introduction of the Transmission Protection Instrument.

In other words, all of the ingredients that forced the most fiscally powerful EU member states to discard market discipline were absent in the 1840s US: concentrated bondholder power, spillovers, and government dependence on a steady flow of bond finance for the funding of fundamental policy functions. This was despite the fact that the EU's decision-making system afforded those member states the final say over bailouts due to the unanimity requirement that governs such decisions in the European Council—just as the system of congressional representation did in the 1840s and which Wibbels (2003) picked up as the explanation for the defaults.

There is one other reason for the failure of Germany and its allies to impose a system of market discipline for public debt in the EU, which provides the link to the comparison of the transformation of the American fiscal system from the 1930s onwards with the EU's attempt since 2010 to create a federal fiscal capacity. Contrary to what obtains in the US since the 1930s, the vast majority of public debt in the EU is the liability of member states, not the federal centre. This may now slowly and gradually change, but throughout the 2010s allowing a member state to default would have signalled that a huge proportion of what were hitherto the key safe assets of the system were no longer risk-free. This would have profoundly destabilising financial and macroeconomic effects—Safe assets are, as per the International Monetary Fund (2012, pp. 81–122) itself, the "financial system's cornerstone" and advanced capitalist states' public debt is the safe asset par excellence. In other words, the extreme decentralisation of fiscal liabilities in the EU makes the introduction of hard-budget constraints in the shape of market discipline illusory—quite unlike the situation in the US.

The current distribution of fiscal liabilities in the EU points to a key contrast between its experience since 2010 and the transformation of the American fiscal system in the 1930s. In the US, the constituent states of the union were administratively and fiscally weak and were already part of an integrated single market in which interstate competition placed limits on what they could do fiscally. Their weakness cleared the way for the federal government. As put by Young (2018, p. 176):

> Movements towards centralization in America occurred at roughly the same time as (and partly as a result of) pressures to expand the role of government generally…the arcs of centralization and of the growth of government largely coincided. In Europe, the movement towards unification began well after much of the expansion of government generally had already taken place.

Consequently:

> Institutional inertia thus plays a profoundly different role in Europe and the United States. Efforts to decentralize American government…confront an entrenched federal regulatory and welfare bureaucracy….In Europe, by contrast, the entrenched bureaucracies exist at the member state level.

The entrenched bureaucracies are not the only obstacle deriving from the historical timing of the "movement towards centralisation" in relation to the "fiscal state's second leap forward" in the EU. Another is the

difficulty in terms of financial and market dynamics of transitioning from the extreme decentralisation of fiscal liabilities to a more centralised structure akin to that of the American system. One crucial difficulty is what happens to member state public debt during the transition period—the period during which the EU steps up its emission of bonds before it has reached a plateau in terms of the stock of outstanding bonds at levels that would ensure an adequate supply of supranational safe assets for investors to hold. Clearly, during this period market discipline cannot be applied to member state bond markets. Member state treasuries are thus under little pressure to relinquish their hold on public bond issuance since they enjoy the benefits of the European Central Bank's backstopping of their bonds. Second, the transition raises issues of market liquidity for investors. As I was told in an interview and subsequent email exchange by Alessandro Tentori (chief investment officer for Southern Europe for Axa-Investment Managers), investors want to see the EU move closer to the American structure of public debt with a European equivalent of the US Treasury bond market. However, they are weary of "another EU-backed bond which might compete for liquidity with issuers such as France and Germany" and instead favour "a broader euro-version" (A. Tentori, personal communication, April 12, 2023). That "broader euro-version" has echoes of the "eurobonds" that Germany and its allies rejected in 2010–2015 (Matthijs & McNamara, 2015), namely the introduction of joint and several liability for member state debt. The political difficulty of joint and several liability is precisely that it pools liability for "legacy" debt, namely bonds issued independently by member states prior to the establishment of institutions governing the system of joint and several liability. Indeed, fiscal centralisation in the US is not based on joint and several liability: Each level of government is liable for its own emissions.

It thus appears quite unlikely that the EU will be able to quickly, if ever, transfer a substantial amount of fiscal activity to the federal level—such as to replicate the structure of the distribution of fiscal liabilities that obtains in the US, and which allows market discipline to operate on municipal debt. In fact, the strength and established fiscal size and policy functions of the member states suggest that a viable future for an EU fiscal capacity could be an extreme version of the US grants-in-aid system: The bulk of borrowing could be carried out at the federal level while the bulk of spending would remain at the member state level. However weak they may have been, the US states were still sufficiently strong to force the federal government to opt for "cooperative federalism" instead of outright federal responsibility. EU member states are even stronger than US states were in the 1930s but would still benefit from a federal fiscal capacity.

Next Generation EU (NGEU) is indeed a first step in that direction. The EU only spends an infinitesimal fraction of the proceeds raised through borrowing backed by the EU budget. The rest is channelled to the member states in a system of grants-in-aid and "intergovernmental relations" that strongly resembles the American case. The loans component of NGEU still places ultimate liability for paying back investors in EU debt with the Commission. If a member state defaults, the Commission will be left to pick up the tab. The EU member states are less dependent overall on these transfers than the American states are on federal transfers, but the American federal government directly spends a much greater proportion of its revenues than the Commission does. NGEU has raised the question of whether it is the precursor to a permanent fiscal capacity. Its advantages are very clear: It provides safe assets that investors crave, has macroeconomically and macrofinancially stabilising effects, and is politically very popular in a majority of member states. It is also worth remembering that the politician who first dubbed NGEU "Europe's Hamiltonian moment" is currently the German chancellor (Georgiou, 2022b), i.e., the leader of the key member state whose reluctance on the matter had until 2020 postponed the introduction of such a fiscal capacity. If NGEU is successfully implemented, it will provide both additional momentum in favour of a permanent EU fiscal capacity and a blueprint for such a capacity that would rely on grants-in-aid much more heavily than the US federal budget has ever done.

The prospect of a permanent European version of the grants-in-aid system also suggests that the EU could finally solve the enforcement problem that it faces with the European Semester—or indeed issues of the rule of law. Despite the fact that the EU is not constrained by any equivalent of the American "anti-commandeering" constitutional doctrine (Young, 2018, p. 163), its capacity to actually enforce its economic policy recommendations (including the excessive deficit rules) and even rule of law treaty obligations and Court of Justice of the EU rulings is admittedly negligible. In the US, by contrast, where the notion that the federal government can constrain the policy choices of the states is unthinkable, the federal government has succeeded in exercising substantial influence thanks to the fiscal carrot of grants-in-aid, by designing those grants as matching grants. Indeed, the lure of NGEU funds has led the Hungarian government to backtrack on its ongoing rule of law disputes with the European Parliament and Commission. Similarly, the new, far-right, Meloni government in Italy has also been surprisingly compliant and has shunned any confrontations with the Commission on its economic policy commitments since entering office in 2022 ("Italy's Meloni needs the cash," 2023).

The prospect of an EU version of the grants-in-aid system raises another crucial issue, however, namely that of the power to raise revenue autonomously. The US could only carry out the fiscal transformation of the 1930s because the federal government enjoyed an unrestrained power to tax following the adoption of the 16th Amendment in 1913. It could therefore embark upon large-scale borrowing on the basis that the full

productive potential of its vast economy was available to it for raising revenue. That is a constitutional amendment the EU will have to adopt too if it is to permanently scale up its own fiscal activity. As argued by García Antón (2023) elsewhere in this issue, this would imply revising Article 311 TFEU governing the revenue side of the EU budget to subject it to the ordinary legislative procedure while also developing a new normative justification for EU taxes as policy tools invested with democratic and redistributive functions. As Woźniakowski et al. (2023) point out, such a process of "fiscalisation" would introduce an unmistakable political dimension to Europe's economic and monetary union. That would potentially have similar profoundly transformational consequences as the introduction of the third American fiscal regime.

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Article

Clocks, Caps, Compartments, and Carve-Outs: Creating Federal Fiscal Capacity Despite Strong Veto Powers

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Abstract
This article examines four mechanisms for establishing federal spending programmes despite tough opposition based on identity or ideological politics, as well as disputes between haves and have-nots. It contrasts the use of clocks (time limits), caps, compartments (special justification for spending that would otherwise have been rejected), and carve-outs (exemptions to federal spending programmes to buy off objecting veto players) to secure political support for national-level programmes, and asks under what conditions those limits might be breached. We look at the EU, Canada, and the US. These tactics are most successful at "getting to yes" for federal authorities when they can isolate individual objections. As long as those objections persist, the limits will persist as well.

Keywords
budget politics; Canada; European Union; fiscal federalism; political economy; redistribution; state-building; United States

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1. Introduction

The EU is a political entity that is constantly evolving and is in between an international organisation and a fully federal state. This in turn reflects tensions between the desire of some member states to promote federal institutions and fiscal capacity and those that prefer limited fiscal resources at the EU level. A key feature of the EU's development to date is the lack of a sizeable federal budget, funded either by taxes, by borrowing, or by both. This article explores lessons for the development of budgetary capacity-building on the expenditure side (Woźniakowski, 2022; Woźniakowski et al., 2023) under politically challenging circumstances (Buti & Fabbrini, 2023).

The absence of common fiscal capacity and the reliance on member state resources generates uneven abilities across the EU to meet grand societal challenges like pandemic-capable health provision, military expenditure (to meet Russia's war on Ukraine), infrastructure and industrial policy (the reindustrialisation, greening and energy transition of Europe), and of dealing with the aftermath of financial crises to stabilise European Monetary Union. Well-off member states or those with good credit can channel finance into these needs and subsidise private investment easily, while others cannot, leading to the undersupply of public goods and the undermining of EU public policy efforts (Howarth & Quaglia, 2021). Nevertheless, there are instances in which piecemeal and temporary financial instruments have been established without it leading to a federal budget that some desire.

This article examines how partial and/or temporary budgetary programmes can be agreed upon in the face of opponents with identity and ideology issues that stand in the way of agreement and magnify divides between haves and have-nots. It starts with an outline of four tools that countries can use to ensure national/federal fiscal capacity despite these obstacles. It then examines what happens when countries use them to address the concerns of political actors blocking agreements or intent on imposing conditions. *Clocks*, *caps*, *compartments*, and *carve-outs* (the 4Cs) allow federal budget proponents to

secure agreement for spending programmes and foot-draggers to contain the universality of budget commitments and their impact on the powers of subnational governments. Finally, it discusses what might be expected to happen afterwards, when limits run out.

The article compares how Canada and the US, two countries with very different challenges to budget development, have overcome their own obstacles in budgeting, and draws parallels with recent EU experience. It then extrapolates these findings to suggest the range of outcomes available to European negotiators moving forward when confronted with expensive demands that many member states cannot meet individually.

2. Clocks, Caps, Compartments, and Carve-Outs

A demand-led approach to budgeting argues that states develop budgets to survive and adapt to internal and external pressures. Existential threats to the state from outside (war) incite governments to spend, tax and borrow, concentrate power, and build effective institutions to survive (Levi, 1988; Tilly, 1992, 2017). The EU as well, although not a fully formed state, has developed spending programmes that were previously unthinkable in response to Brexit, threats from Russia, the financial crisis, and the Covid-19 pandemic (Kelemen & McNamara, 2022; McNamara & Kelemen, 2022). Internal demands also drive budget commitments. Social security and health care programmes followed the expansion of voting rights to workers and women in the early 20th century (Goodin et al., 1999; Skocpol, 1994). States also sometimes extend their involvement in critical industries, as they concentrate power over finance and industry for national economic development, strategic advancement in the international system, and preparedness for future challenges (Hall, 1986; Wade, 2004). All of these financial commitments take place in a variety of national forms reflecting local political circumstances.

Budget commitments also come with discussions of whether and how to pay for these initiatives, which entail political discussions of who benefits and who pays, with a focus on (re)distribution. A liberal, interest-based approach to political economy consequently focuses on the supply side, assuming that political actors are motivated by economic self-interest rather than sharing resources, with those with an abundance of critical resources preferring to limit costs, while have-nots prefer to increase spending. In the absence of existential threats that compel haves to commit resources to preserve their own interests, and where haves have sufficient political power to block decisions, budgets will remain modest, determined by those with resources (Scartascini & Stein, 2009). Veto points in the decision-making process allow actors who favour frugality over expenditure to block or strongly constrain budget development (Tsebelis & Chang, 2004). The same is true in federal systems that rely on the coordination of member states in the union (Scharpf, 1988).

This article examines a specific sub-set of situations where resistance to federal fiscal capacity is coupled with ideological and identity politics. Identity means here an attachment to group-specific ways of doing things that the state seeks to protect from outside harmonisation. These can be rooted in ethnic attachments (local) or cultural (way of life) associations. By ideology, we mean attachment to principles on what government should and should not do. Ideological commitments can be combined with and transform other cleavages to make them less open to negotiation. They can be combined with identity issues, or more decisively with material divides between haves and have-nots, making it difficult for groups to compromise over budgets and programmes. Identity and ideology are therefore specific, lasting motivations that are difficult to overcome with logrolling and side-payments. We examine how these issues and the use of 4C strategies play out in two different scenarios: asymmetric federations, where challenges to federal budgets emanate from provinces or states in the union based on identities that set them apart from the rest; and symmetrical ones, where challenges come from political parties based on ideology. To undertake this contrast, we study Canada as an example of asymmetric federalism with strong identity-based obstacles to budget creation and the US as an example of symmetric federalism, albeit with moments of asymmetry, in which ideology forms the larger obstacle, combined with identity politics to create a highly polarised negotiating environment. Finally, the EU is a formally symmetric quasi-federal system in which a special combination of identity and ideology politics forms the biggest challenge to budget development, with an emphasis on ideology.

Clocks refer to time limits placed on a new budgetary line to satisfy those who would otherwise oppose it. This can be most frequently expected as (a) an emergency response requiring fiscal capacity that would otherwise pose an existential threat, (b) the insufficiency of redistribution to solve the problem in the short term as an alternative, and (c) the dominance of budget conservatives over budget enlargers over the long term. Where these conditions are obtained, clocks can be used by budget conservatives to make concessions in the short term and dial back budget enlargement after the emergency passes. Clocks might be overcome by political and economic setbacks incurred by ending the expenditure.

Caps, meanwhile, refer to ex-ante numerical or formulaic limits on spending into the future. They may be combined with clocks or applied only to specific compartments (see the following paragraph). Versel (1978) shows that an effect of rule-based budgeting, which requires the legislature to approve expenditures every year, thereby imposing a clock, also requires the executive to prioritise expenditures across different programmes, effectively imposing caps on some of them. Caps might be overcome by the insufficiency of funds to secure politically important goals.

Compartments refer to the splitting up of policy areas into artificially separate components that permit negotiation over the overall size and purpose of federal programmes, where the primary obstacle is partisan political disagreement, and there is otherwise no veto power being exercised by a member state of the union. This can be most frequently expected as a response to political polarisation over federal capacity, and inability to agree, while rewarding societal groups that political parties want to claim credit for supporting. It is therefore a form of (re)distribution that requires denying consistency or universality of expenditure. Key to compartments is the discursive identification of particular projects and constituents as particularly deserving, while others are not. A form of pressure seeking to overcome compartments is potential synergies between different budget items (Khan, 2002).

Carve-outs refer to the provision of exceptions for an individual subnational government or segment of society while the rest of the country proceeds with a common strategy and associated budget. This is essentially the opposite tactic as compartments: It allows holdouts to control their own affairs while allowing the rest to proceed. It serves asymmetric federations well, where identity issues are salient enough to block agreement on non-economic grounds. Carve-outs that apply when building budgets also tend to apply when reducing them: Exceptions are made for budget cuts for the community in question.

Caps and clocks are tools that function best when the obstacles to agreement are based on a combination of distributional and ideological divides. The formula allows haves and ideologically frugal countries to agree to either ad-hoc or structural spending that they view as indispensable for the functioning of the union while imposing institutional limits on how much (caps) and/or how long (clocks) the commitment lasts. Fiscal rules have been studied primarily as mechanisms to restrain politicians from spending at the member-state level in the EU (Hallerberg et al., 2007). However, they can also be key to agreements to augment a collective budget. These strategies facilitate linking and/or delinking conflict over expenditures from concerns and demands about money. Expenditures become a necessary evil to surmount a challenge despite ideological opposition to spending.

Carve-outs, in contrast, soften disagreements based on identity, where the objecting party or parties permit the rest of the federation to move forward without them, or based on special terms and self-governance. This can be seen in the Canadian case of Québec, but also in efforts to release Republican-led states in the US from obligations of federal law and programmes.

Compartments, finally, soften the link based on ideology, and particularly of identity. Federal spending programmes can be designed to apply to "deserving" constituents while leaving others outside the programme's perimeter. They can also be designed to allow the member states of the union to pick and choose whether to participate in what otherwise would be national standards and programmes (Skocpol, 1995).

This article focuses on Canada and the US and draws parallels to recent EU experience. Each of these cases demonstrates strong ambitions for national programmes and budgetary resources supporting them that were jeopardised by political opposition but passed in part through one of the three mechanisms above. Each are (quasi) federal systems with distinct institutional frameworks, politics of identity, and ideology, but also broadly similar challenges to face and different budgetary outcomes.

3. Identity and Budget Politics in Canada

Canada is a country with relatively strong social security programmes in health and pensions, plus institutionalised transfers between have and have-not provinces and weak military spending. Federal transfers play a large role in ensuring that minimum levels of provision are attained at the provincial level, while carve-outs based on identity politics for the province of Québec are a perennial feature of social and health programmes. Ideology plays a role in determining the extent of coverage for health in particular, though to a lesser degree than in the US. Carve-outs for Québec are therefore frequently used to pass budget programmes, while compartments are used to set limits on health care spending in particular, giving ideological adherents of fiscal restraint influence over coverage.

Budget politics in Canada involve federal-provincial disputes in four notable areas that are relevant to the capacity of the federal government to set up national programmes of minimum standards. Constitutional law and practice cuts two ways with regard to taxes and budgets. On the tax side of the budgetary equation, the federal government enjoys constitutional authority to raise and redistribute tax revenue for national and provincial programmes (Heaman, 2017). Although Canadian provinces are otherwise more politically and legally independent of the federal government than sub-national units in many other federations, the special status and identity politics of the province of Québec challenge the development of national policies and budgets most strongly. Carve-outs are useful tools for securing agreement with Québec where identity politics play a large role, while compartments are useful for shaping budget commitments with the rest of Canada, where ideological differences across different regions of Canada regarding the appropriate size of government are more prevalent. Ideologically, the western province of Alberta stands out for its critique of taxes, interprovincial income redistribution and federal government authority generally, while accepting social security programmes.

Canada is a country in North America with a special constitutional status and associated political and fiscal arrangements for the predominantly francophone province of Québec. After the British conquest in 1763,

provincial authorities and the Catholic Church were granted autonomy over domestic policy, law, and service provision, while the British Empire expanded more uniformly over the rest of Canada, establishing an asymmetric form of federalism based on identity politics in Québec. Québec politicians of all stripes claim that the province is a distinct society whose survival in a largely anglophone country requires the state to control and maintain ownership of social, economic, cultural, and language policy to the greatest extent possible, to be "masters in our own house" (*maîtres chez nous*; Taylor, 1993). This imperative to protect the distinct society collides with language rights for anglophones entrenched in the Charter of Rights and Freedoms in the 1982 Constitution. The constitution was repatriated from the UK parliament without the consent of Québec, and the province has never signed it. Asymmetry is preserved by the Notwithstanding Clause in the Constitution, which allows any provincial legislature to override the Charter, and which successive Québec governments have used liberally and symbolically to assert their rejection of universally applicable rights under the Charter.

This history had two effects: reinforcing the insistence on Québec's provincial autonomy from federal programmes and fiscal capacity once the welfare state was established in the 1950s and 1960s (Cameron & Simeon, 2002) and increasing the desire to negotiate transfers from the federal budget to compensate for economic decline after 1980. The ideational commitment to regulating society and economy to preserve and promote francophone society served as the foundation of demands for special arrangements in the fiscal arrangements of the country, both in taxes and in social security. Income taxes are assessed and collected in the rest of Canada by the federal government's income and excise tax agency, which acts on behalf of the provinces and territories and subsequently transfers income destined for them. In Québec, residents and corporations submit federal and provincial tax returns separately, which ensures that the provincial government can set rates and tax credits, manage refunds, and receive tax income directly without involving the federal government. This effectively amounts to a carve-out for Québec in tax policy.

As a general grant, the province receives "equalisation payments" out of the Canadian federal budget (officially known as Equalization and Territorial Formula Financing). Equalisation payments were instituted in the 1950s alongside the introduction of universal health care to help minimise extremes in the ability of provinces to pay for public policy programmes (Government of Canada, 2011). There are in principle no strings attached, so the money can be spent on any item the province chooses, and the programme was designed to run in perpetuity. The province of Québec receives payments since it counts as a have-not province since the flight of financial and industrial capital after the first independence referendum in 1980. It also claims the special need for transfers to compensate for its ownership and provision of major social services in the country's largest province (Government of Canada, 2006). Informally, the equalisation payments are also thought to be a means of holding the country together politically, with Québec extracting rents out of the federal budget to compensate for the post-1977 decline in population, economic activity, and associated tax income. This in turn has caused ire among have provinces, particularly Alberta, with its rich hydrocarbon resources. In the early 2000s, to appease protests from the provinces of Alberta, as well as the Atlantic province of Newfoundland and Labrador, these provinces were granted carve-outs of hydrocarbon revenue from the equalisation formula, reducing their transfers. The Atlantic provinces benefitted as well from this adjustment. In sum, carve-outs became essential to keeping the equalisation payments programme in line with political demands and economic developments over time.

Since the 1950s, the primary pattern in Canadian fiscal federalism is the combination of federal programmes to provide common standards for social services across the country to decrease disparities in level of care, and a combination of federal grants and conditionality to make this happen. However, since the provinces are the primary competent authorities in these areas, negotiations are required, and not always successful (Stevenson, 2009). Where budgets shrink or are deliberately limited, ideological considerations loom larger. Health care and pensions are outlined below.

Universal health care across Canada is a provincial matter, paid for and implemented from provincial coffers, but required by federal law according to minimum standards and subsidised by federal transfer payments. Hospital and medical insurance originated in the province of Saskatchewan and was later mandated by federal legislation, coupled with financial transfers. A primary goal was to ensure minimum standards for health care access across the country, including access for internal migrants moving from one province to another (Béland et al., 2021). Hospital insurance and doctor treatment were introduced in 1957, and federal payments to the provinces were last renamed as the Canada Health Transfer in 2004. Federal minimum standards in health care access and portability are regulated in the Canada Health Act, which withholds grants from provinces that mandate private sector health services that breach universal access. Universal health care access enjoys strong societal and political support across the country, and the federal government uses conditionality in the Canada Health Act transfers to warn provincial governments from permitting privatised health care as a substitute for access to doctors and hospitals.

However, a limitation of coverage (compartmentalisation) was required to secure passage of health care in the first place in cooperation with the provinces, where beliefs in fiscal conservatism led to institutionalised limits on the purposes of expenditures, rather than overall amounts. Unlike the European case, health

coverage does not extend to medication, dentistry, or prescription glasses, which effectively remain uncovered or covered through private or employment-related supplemental insurance. The primary reason is that while the Canada Health Act provides medications in hospitals, medications and other treatments outside hospitals fall under the constitutional jurisdiction of the provinces, which have shown little interest in funding these items. Previous attempts at extending this coverage were rare and limited and had to confront ideological opposition from the Progressive Conservative Party in particular (Loeppky, 2014). The exception is Québec, which introduced pharmacare in 1997, emulating European ideas of social services the rest of the country was not ready for. Québec assesses and collects premiums based on the provincial income tax bracket and tax return, and provides deductions for other health expenditures (RAMQ, 2023).

Overcoming compartmentalisation by mandating prescription medication coverage therefore initiates a political process similar to that with equalisation payments, focusing on a combination of (minimum) obligations and distribution. Medications are costly and all provinces would have to adjust, but some provinces would face higher costs than others and differing abilities to pay. Since 2021, the Canadian federal minority government (Liberal Party) has been finding difficulty in extending health coverage to make this happen, which it needs to do to secure continued support from the democratic socialist New Democratic Party. However, negotiations proved difficult, pitting parties, provinces (haves and have-nots), and politicians across the political party spectrum (fiscal conservatives vs. progressives) against one another (Lexchin, 2022).

Health care financing during the Covid-19 pandemic showed strong federal involvement, with emergency funds allocated to the provinces, and federal transfers to individuals losing jobs, which further softened the impact on provincial health budgets (Béland et al., 2021).

Pensions are an area where fiscal federalism and differences between Québec and the rest of Canada are most evident. Canada has a Canada Pension Plan in which the federal government sets standards, premiums, and financial strategies, while Québec has its own Québec Pension Plan, where it decides and manages finances independently. A key difference is that the Canada Pension Plan is designed as a pay-go system, in which current retirees are funded by the contributions of the working. In contrast, the Québec Pension Plan is a fully-funded pension system with investments that fund pension payments. These have been managed since 1965 through the Caisse de Dépôt et Placement du Québec. This means that the province's pension system is a sizeable institutional investor. Although it invests in financial markets, a core part of its mission is to make strategic investments in infrastructure and business in the province. Most importantly, Québec can change its pension plan unilaterally, while the rest of Canada must do it collectively at the federal level. Carve-outs provide a way for Québec to remain "master of its own destiny" while offering a pension plan along with the rest of the country (Béland & Weaver, 2019).

The Canadian case shows that resistance to federal budgeting programmes based on a desire of a province to remain in control of programmes as a matter of supporting local identity, way of life, and political culture can be overcome with carve-outs. The most important element for Québec politicians is ensuring the survival of the distinct society. This is most visible in language, but also in social welfare programmes and the way that funds are managed. At the same time, compartments have proven useful in diffusing moderate ideological disagreement over the size of government. We see fewer resorts to clocks, however, particularly in comparison to the US. This is likely due to the smaller level of ideological polarisation over social services in Canada since the 1980s.

4. Identity, Ideology, and Budget Politics in the US

The US is a country with a strong pension system and good access to health care for retirees and soldiers but with otherwise highly uneven access (across states and social classes) to health care. It also has strong attachments to military spending. Ideology plays a strong role in limiting budget commitments to health and other social security programmes outside of pensions, as well as attitudes toward taxation. Identity also continues to play a strong role, with the country's racialised politics driving attitudes toward access to health and other programmes, as well as the federal government in general, and a continued attachment to anti-majoritarian decision-making institutions that previously allowed the states of the South, and now Republican-led states, to gatekeep budget commitments. One result is that compartments are used frequently to secure passage of budget items in Congress, appropriating money for some beneficiaries and purposes of a larger programme, while isolating others. Another, which the Supreme Court has increasingly permitted, is the replacement of federal minimum standards with state choice in whether to participate. This is seen in health care in particular, where ideology and identity politics combine to generate radically different approaches to health care provision. And finally, budget impasses over capping federal spending typically follow the passage of large budget programmes, led by programme opponents. Despite this dysfunctionality of US budget politics, compartments have proven effective means of bridging political differences.

Budget politics in the US involves state-federal disputes and partisan disputes based on identity and ideology simultaneously, without the pronounced asymmetric features of Canada. The US Constitution of 1789, though more centralised than the preceding Articles of Confederation, favoured a small federal government, limited fiscal capacity, and a system of lawmaking that

over-represented the less populous slave-owning states in the Union. Parallel to this, Southern identity played a significant role in challenging federal authority to do much of anything without Southern consent (states' rights doctrine). The Civil War expanded presidential power and federal authority, increased tariff and excise tax income, and ensured that secession (and therefore asymmetry) was no longer acceptable and a bargaining chip in legal and financial matters. However, the peace between the Whites that followed the hung election of 1876 undercut those changes (Blight, 1993). In exchange for the presidency, Republicans acquiesced to the end of reconstruction and the institutionalisation of white supremacy laws across the board. Southern Democrats, and Dixiecrats after 1948, devoted themselves to fighting federal power and federal social spending programmes, particularly ones that could benefit previously enslaved populations and their descendants. This included plans for health insurance from Presidents Roosevelt and Truman (Lavin, 1972). They married identity issues with ideological ones that became central to opposing not only federal authority and fiscal capacity but also road-blocking the establishment of universal health insurance from the 1930s onward, even as other forms of social security were agreed upon. Thus a broad programme for social security was broken up into compartments to ensure that some components were passed.

The Roosevelt administration introduced social security in 1935 as a combination of pension insurance and universal health insurance but dropped health insurance to ensure passage in the face of ideological resistance against "socialism." This opposition intensified with the election of a Republican Congress in 1938, determined to rein in the powers of an increasingly powerful federal government and increased with ideological polarisation and Cold War anti-communist rhetoric during successive attempts in 1939, 1943, and 1945. Political support for the budget was possible, however, when groups were considered deserving (Skocpol, 1995). The most notable of these deserving are veterans and serving military personnel directly after the Second World War, who benefited from health (Veterans Administration) and education (G.I. Bill, ROTC Scholarship) services not available to ordinary Americans. 1948 proved a breaking point for the Democrats, however, when President Truman desegregated the military and then sought universal health insurance (the latter of which failed). Compartmentalisation worked in incremental ways that the racialised and ideology-infused political landscape of the day would allow for. A renewed push to add new compartments to health insurance finally succeeded in 1965 as part of the Great Society legislation after 20 years of renewed pushing in Congress. Medicare was instituted for residents 65 and older, and Medicaid for those below the poverty line, with states running the programmes (Palmer, 2023). This partial provision of health care steamrolled opposition from both the Republican Party and States' Rights Democratic Parties which had previously held it at bay, with the latter framing social welfare in terms of the damage it would do to white supremacy and segregation (Lavin, 1972; Skocpol et al., 1988). It also enjoyed lasting political support as long as the recipients were children and pregnant women (Blank & Ellwood, 2001).

However, the push to extend health coverage in the Great Society programmes would have a backlash. Southern Democrats would finally abandon the party en masse and join Republicans along with Dixiecrats into the Republican Party most of us know today: one in favour of minimising taxes, reducing social security programmes of all kinds, and cutting budgets except for military expenditures. This strengthened ideological and identity-based divides over time, to the present day. The transformation of American politics in the 1960s, 1980s, and 2010s saw conservative frustration over social welfare expansion exacerbated by further intrusion of federal powers into individual rights and state competences that sparked ideological grievances. Desegregation in the 1950s, social and civil rights in the 1960s, the expansion of federal regulatory powers in the 1970s in areas from the environment to reproductive rights for women, to a renewed focus on the separation of church and state (particularly in schools), and the expansion of progressive income taxes generated resistance in all of these areas.

Ideological resistance from Republicans and moderate Democrats did not stop budget enlargement for social security when Democrats controlled the House, Senate, and White House, though politicians had to compartmentalise and sometimes cap to succeed. The Clinton administration sought to introduce tax credits for the working poor and succeeded. It also tried to introduce universal health care in 1993 and failed, after a massive public relations campaign by Republicans. However, in 1997 it succeeded at expanding health care coverage to children living in families with income equaling 133% of the poverty line or less as part of the Children's Health Insurance Program. Tellingly, in exchange for health care coverage, the Clinton administration agreed to new national caps and carve-outs for the states on access to welfare and unemployment insurance. The Personal Responsibility and Work Opportunity Reconciliation Act (1997) gave states leeway to tie welfare to work requirements and overall caps. Although this act bore more of a Republican desire for state autonomy in determining requirements, the Clinton administration had indeed campaigned on reducing welfare use and promoting work instead. But caps, compartments, and carve-outs are seen here as well, with reduced eligibility for food stamps, a five-year limit on federal grants supporting Temporary Assistance for Needy Families, and state rights to not cover residents meeting eligibility requirements (Blank & Ellwood, 2001).

The most contentious and fraught budget commitment afterwards came with the Patient Protection and Affordable Care Act (Obamacare) of 2010, which attracted ideological opposition even in the face of economic need (Barrilleaux & Rainey, 2014). In addition to

setting out minimum standards for health insurance coverage by private firms and providing means-based subsidies, it required states to expand Medicaid coverage to individuals earning 138% of the federal poverty level or less. Rather than pursue a single-payer system, the Patient Protection and Affordable Care Act broke health care into different compartments that helped garner support from a Democrat-controlled Congress. Republican activists fought the legislation in court, failing to kill the act entirely, but ensuring that state governments could carve themselves out of requirements. Carve-outs were made possible by the Supreme Court's 2012 ruling that allowed states to decide whether to expand Medicaid. Republican-governed states were the most frequent users of the carve-out (Rose, 2015).

Throughout these confrontations, and including today, compartments remain key to securing and maintaining spending programmes. This can be seen in the segregation of spending on physical infrastructure in the Infrastructure Investment and Jobs Act of 2022, which could only be passed by cutting out spending on social infrastructure, and the Inflation Reduction Act of 2023, which suffered the same fate. The Inflation Reduction Act was passed in a highly polarised political environment with the narrowest of Democratic margins in the House and Senate, insufficient to pass Senate filibuster rules and budget resolution rules without support from Republicans and/or Democrats facing strong Republican challengers at home. The Inflation Reduction Act borrowed and spent to develop technology and infrastructure for the country's energy transition and climate change efforts while underfunding social programmes the Biden administration also supported. Previous efforts to pass spending legislation had failed to secure Congressional support that included both physical infrastructure and social spending. Splitting the two kinds of spending allowed the first of these to pass, while the second failed to proceed. Meanwhile, where spending proposals could build on a sense of political unity, bipartisan spending agreement proved possible. This was first the case for the physical infrastructure bill, the Infrastructure Investment and Jobs Act of 2021, but also the Chips and Science Act of 2022, both of which were major industrial policy initiatives (Donnelly, 2023).

Also notable is that the high degree of political polarisation in American politics based on ideology and identity leads to efforts to use caps retroactively to roll back spending (and taxes) that had already been agreed in the past by a previous Congress. In the 1980s, political willingness to accept progressive taxes and spending programmes came to an end with the Reagan administration, which initiated pushback against Great Society programmes that continue within the Republican Party to this day. Tax rollbacks were features of the Reagan and Trump administrations in particular. In the 1990s, Republican lawmakers sought caps on the overall borrowing capacity of the US government (debt ceiling), which they used repeatedly as leverage to demand further caps on a range of government spending programmes to which they are ideologically opposed. While Republicans spared pensions (social security) and health care for seniors (Medicare) and veterans, they targeted other forms of social security by imposing time limits on eligibility for unemployment insurance. A more radicalised party later demanded the complete dismantling of most social security programmes like the Affordable Care Act and provisions of the Inflation Reduction Act, using the potential of forcing a default on US government debt to push through reductions.

The most dramatic type of cap demand started with the Tea Party Republican Congress, which forced a government shutdown from November 1995 to January 1996 over the Contract With America. The contract, which was the Republican Party's campaign manifesto, also contained a global budgeting clock, known as zero-line budgeting, in which Congress would have to approve expenditures every year, allowing nothing to be extended without approval. This scenario was repeated and extended to the instalment of a debt ceiling during the Obama administration in 2011, allowing Republican congresses to demand retroactive, non-targeted cutbacks to government spending. By 2023, fights over the debt ceiling were motivated by a variety of social and environmental goals contained in federal infrastructure, climate and health care provisions constituting part of the Biden administration's Build Back Better programme.

Overall, we see that identity and ideology challenges make budget commitments challenging in the US. Compartments proved essential to early social spending packages from the 1930s onward, and remain a strong feature to this day, based on a sense of who deserves support. Ideological opposition to social spending was insufficient to block programmes entirely, but sufficient to ensure programmes like Medicare and Medicaid were targeted, with the effect of excluding many Americans. Compartments also helped pass large industrial policy programmes and subsidies under the Biden administration, while excluding certain citizens that would have benefited from earlier versions of legislation. Caps, meanwhile, get used retroactively. And increasingly, carve-outs for states that want to opt out of federal programmes are an increasing phenomenon.

5. Identity, Ideology, and Budget Politics in Europe

Identity and ideology have been used by Germany, the Netherlands, and a number of other allies in the so-called New Hanseatic League to ensure a minimalist EU budget, in contrast with the preferences of many other EU countries. German mark nationalism prior to the euro segwayed into refusal of EU fiscal competencies in the Maastricht Treaty in 1992 (Dyson & Featherstone, 1999), coupled with demands for balanced budgets in European Monetary Union in the Stability and Growth Pact in 1995, the introduction of the European Semester in 2011, the establishment of the European Stability Mechanism

in 2012 in response to the eurozone crisis (Hodson, 2022), German rejection of France's call for an EU budget to improve competitiveness in pre-pandemic 2020 (Donnelly, 2021), and demands of the German finance minister in 2023 for the EU to return to these norms (Fleming, 2023). The EU's requirement of unanimity for budgetary decisions, whether regular or extraordinary, also allowed other frugal states to drag their feet at the onset of the Covid-19 crisis in response to calls for budget programmes (Beramendi, 2007). However, when a compromise was finally struck, a combination of clocks, caps and compartments was key to reaching an agreement. Investments in post-Covid-19 health provision, military security and energy transition in light of Russia's attacks on Ukraine and the West, and economic infrastructure and manufacturing to address supply chain shocks and shortages were permitted as productivity-enhancing investments, within a time limit of four years, and with limits on the volume of grants versus loans.

Europe has used a combination of the 4C techniques over the last half-decade to advance common borrowing and fiscal capacity with German (plus Dutch and Scandinavian) consent, albeit with limits. These moments of agreement entailed special circumstances forcing Europe into an existential crisis, given the necessity of unanimity in the Council (Christiansen & Reh, 2009; S. Fabbrini, 2013). The techniques allowed German negotiators to acquiesce to collective financial endeavours in mid-2020 while assuring domestic budget hawks that the measures would neither be lasting nor set a precedent for spending in other instances. The importance of a crisis is illustrated by Germany's rejection of French proposals for an enlarged EU budget to fund investments in improved economic competitiveness as recently as early 2020, and its transformation of the existing budget to focus on promoting structural adjustments (the Budget Instrument for Convergence and Competitiveness). Not only did leaders have opposed stances, but their voters also did as well, with pronounced ideological divides over frugality versus macroeconomic countersteering and identity-based divides between North and South making compromise difficult (Matthijs & Merler, 2020). Not only was a crisis necessary, but a method was also required. The 4Cs made compromise possible, although caution should be exercised in assuming these programme changes are lasting.

The 2020 Recovery and Resilience Facility (RRF), cobbled together with other funds to form the Next Generation EU fund, attracted attention due to the willingness of member states to support collective borrowing for a limited time, and up to a limited amount, for a limited range of public policy investments. The EU borrows collectively and makes funds available to member states as a combination of grants and loans for a period of four years to support investments in public health, greener economies, and digitalised public administrations. While limited in size and time horizon, Next Generation EU represents a breakthrough in EU member states willingness to contemplate fiscal transfers across national borders and to fund these transfers with collective debt. It does not, however, and is not intended to displace the EU's system of macroeconomic coordination involving budget restraint (Hodson & Howarth, 2023; Vanhercke & Verdun, 2022).

The common borrowing agreed on for Covid-19 relief and recovery remained at the overall target proposed by France and Germany but with more loans and a smaller grant amount than originally envisaged. Instead of €500 billion in grants, only €390 were in grants at the end of the process, with another €360 in loans. Clocks were used and played a strong role in the Dutch debate over ratification: The RRF was envisaged as a four-year programme that would not be extended or repeated. Compartments were also central to the deal: Loans and grants were limited to expenditure on health, environment, and digitalisation, while other spending purposes (social) were cordoned off. These compartments also implied conditionality of access, which the Commission would monitor and enforce.

This pattern of targeted spending for a limited crisis was also repeated to organise funding for aid to Ukraine and invest in EU military/industrial capacity, as is seen in the European Peace Facility (Bounds, 2023; F. Fabbrini, 2023). This all raises the question of what happens when the RRF expires, and the European Peace Facility as well. Ideological objections from the Netherlands to continued RRF spending remain significant and signal a significant chance of non-renewal unless heavily compartmentalised as an alternative to clocks, or in combination with new clocks that allow leverage. Conversely, the strongly Atlanticist outlook of the Dutch government means that it is more receptive to the common defence being a collective good, which is worth the collective borrowing and spending effort, as seen in its support for the European Peace Facility. That is further supported by slower changes in German thinking to permit spending for military purposes. If this effect leads to increased collective spending, it will be due to the compartmentalisation effect that grants defence spending special status.

6. Conclusions

This article has conceptualised how identity and ideology can frustrate efforts to pass federal spending programmes, and how four tools can be deployed to overcome obstacles to agreement. We see that carve-outs are particularly useful in federations with strong asymmetry and identity politics, allowing a distinct member state or province to handle things in its own way, as we see in Canada. Carve-outs are also increasingly used to allow states in the US to water down budget commitments that they are opposed to on ideological and/or identitarian grounds. The strength of those objections is confirmed by the fact that by opting out of federal programmes or redesigning them, those states

often eschew federal grants that would otherwise benefit them. We further see that compartments are particularly useful tools in a wide variety of objections and settings, whether identity, ideology-based, or both.

We also see that caps and clocks are particularly useful when ideological objections are the highest, even being used retroactively in the case of the US, where polarisation is particularly high. Spending programmes are not linear trajectories, but politically determined, and what goes up can come down. However, the ability of EU institutions to use caps retroactively appears to be small compared to the possibility of not renewing existing caps and clocks. Given the unanimity requirement for EU spending appropriations, these will remain at the mercy of the Union's ideological politics.

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Conflict of Interests

The author declares no conflict of interests.

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Article

The Coexistence of Fiscal Sovereignties: The Post-Pandemic European Union in Comparative Perspective

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Abstract
Thanks to the recovery fund Next Generation EU, the EU considerably increased the size of its fiscal capacity by increasing its borrowing power. Yet, the post-pandemic EU has left the key issue of how to distribute fiscal sovereignty across the EU and the member states unsolved. Departing from influential concepts in the political science literature, this article argues that we still lack a thorough analytical framework to operationalise the coexistence of two fiscal sovereignties—the fiscal sovereignty of the centre (here, the EU) and the fiscal sovereignty of the units (here, the member states). By resorting to comparative federalism, the article first operationalises fiscal sovereignty as the power to collect, administer, and spend resources. A level of government (the centre or the units) is fiscally sovereign if it can decide on its revenues, the administration of its resources, and its expenditures alone or together with the other level of government (what I call "fiscal self- or co-determination"). The coexistence of fiscal sovereignties becomes impossible if one level systematically and unilaterally encroaches upon the other ("fiscal out-determination"), as is still the case with the post-pandemic EU. On the contrary, in a union of states by aggregation like the EU—namely, Switzerland—the centre (Confederation) has its own fiscal powers, while the units (cantons) retain most of their fiscal sovereignty: The coexistence of fiscal sovereignties is thus possible. The article concludes by outlining which "fiscal features" of the Swiss system could not work in the EU and which could instead potentially work.

Keywords
comparative fiscal federalism; European Union; fiscal capacity; fiscal regulation; fiscal sovereignty; Switzerland

Issue
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1. Introduction

This article deals with the distribution of fiscal sovereignty between the EU and its member states (MSs) after the adoption of the recovery fund Next Generation EU (NGEU) during the Covid-19 pandemic. Under NGEU, the European Commission can borrow an unprecedentedly high amount of money and distribute funds to the MSs under conditionality. This borrowing capacity was made possible by not only raising the own resources' ceiling of the EU budget from approximately 1.2 to 1.4% of the EU's MSs' combined gross national income (GNI) but also by adding a temporary increase of 0.6% of EU GNI to the Council's own resources decision to cover the EU's liabilities when borrowing on international capital markets (Council Decision of 14 December 2020, 2020). In addition, the EU planned new own resources for the EU budget. Some part of the literature considers these steps a paradigmatic change through which the EU moves closer to becoming a proper fiscal union. Other authors are more cautious and stress that NGEU is a temporary programme that lasts until 2026 and does not structurally change the EU budget, which remains, for more than 60%, dependent on transfers from the MSs.

The political science literature—to which this article primarily seeks to contribute—has adopted a number of useful concepts, such as fiscal capacity, fiscal regulation, and fiscalisation, to assess the changes that EU fiscal integration underwent over time, including after NGEU.

Thus, while before the pandemic the EU was considered to have strong fiscal regulation and weak fiscal capacity, the literature has stressed that the post-pandemic EU fiscal capacity has become larger in size and more diversified in composition. Yet, it is still uncertain which type of fiscal integration the EU will pursue after the end of 2023 (when the Stability and Growth Pact [SGP] re-enters into force) and after 2026 (when NGEU expires). Importantly, the EU has left the crucial issue unsolved about how to distribute fiscal sovereignty across the EU and the MSs, and how to organise the coexistence of two fiscal *sovereignties*—the fiscal sovereignty of the EU and the fiscal sovereignty of the MSs.

This article argues that the existing analytical concepts are ill-equipped to deal with this crucial issue for two main reasons. First, they focus on specific constitutive elements of EU fiscal integration, such as borrowing, spending, or regulatory power. Second, they often refer to the fiscal power of either the EU or the MSs, without approaching them as part of a system in which fiscal sovereignty is distributed between the two levels of government. Hence, so far, we lack an analytical framework that brings together the different constitutive elements in order to come up with the operationalisation of the coexistence of fiscal sovereignties. This is surprising and problematic because the EU is currently in a "fiscal limbo": It has significantly changed compared to the time prior to the pandemic but it has not yet set the next direction. How many new fiscal powers will the EU get (fiscal sovereignty of the centre [FSC]) and how will this impact the MSs (fiscal sovereignty of the units [FSU])?

Against this background, the article first develops a new analytical framework that allows us to systematically and thoroughly assess which fiscal powers each level of government (EU and MSs) has and how the two fiscal sovereignties coexist. By building an innovative "fiscal sovereignty toolkit," the article extends and complements the existing analytical concepts which provide only a partial and incomplete picture of the distribution of fiscal sovereignty. Then, the article applies the new analytical framework to answer the following research questions: How does the EU organise the coexistence of two fiscal sovereignties after the Covid-19 pandemic? Are we still in a context of no fiscal sovereignty of the EU and constrained fiscal sovereignty of the MSs?

Afterwards, I investigate the coexistence of fiscal sovereignties in unions of states through federal comparison by asking: How does a union of states by aggregation like Switzerland make the FSC (the Confederation) coexist with the FSU (the cantons)? Unlike another case of union of states by aggregation which is the United States, Switzerland has been compared less often to the EU. Yet, as a strongly decentralised union of states, Switzerland resembles the EU and can thus offer useful insights.

The article is organised as follows. Section 2 reviews the existing literature and shows the gap that the article aims to fill. Section 3 presents the analytical framework developed to operationalise the coexistence of two fiscal sovereignties. Then, Section 4 applies the framework to the post-pandemic EU after the adoption of NGEU. Based on this analytical framework, Section 5 analyses the coexistence of fiscal sovereignties in Switzerland. Section 6 compares the EU to Switzerland. The article concludes by outlining which "fiscal features" of the Swiss system could not work in the EU and which could instead potentially work.

2. Research Gaps and Contribution to the Existing Literature

The aim of this article is to contribute to the political science literature on EU fiscal integration through the lens of comparative federalism. A rich political science literature exists on EU fiscal integration. This literature is centred on the influential distinction between fiscal regulation and fiscal capacity (Genschel & Jachtenfuchs, 2013). Fiscal regulation means the ability of the EU level to adopt binding legal rules that regulate the discretion that MSs retain in their spending policy. Prominent examples are the well-known 3% ratio of deficit to gross domestic product (GDP) or the obligation to submit the draft of the national budgetary law to the European Commission for approval. Fiscal regulation implies that MSs retain their fiscal powers, which are, however, constrained by the EU fiscal rules (Zgaga et al., 2023). The EU, instead, has only a weak fiscal capacity, defined as the ability to collect and spend resources—either directly at the EU level or through transfers to the MSs. Since the creation of the Economic and Monetary Union, MSs have pursued fiscal integration through regulation as a way to retain their fiscal sovereignty (Buti & Fabbrini, 2023). As a result, the EU's fiscal capacity has remained weak: Until today, the EU budget is very small (around 1.4% of EU GNI) compared to the budget of consolidated federations such as the United States or Germany (Bauer et al., 2017).

"Fiscal regulation" and "fiscal capacity" have been explicitly or implicitly applied to explain the development of EU integration through crises. The EU has approached the euro crisis by strengthening fiscal regulation, while only slightly strengthening its fiscal capacity through weak financial support mechanisms (Howarth & Quaglia, 2021). There is general agreement that the EU's response to the Covid-19 pandemic marked an unprecedented increase in the EU's fiscal capacity (F. Fabbrini, 2022). Learning from the shortcomings in dealing with the euro crisis, the EU mobilised large resources to help MSs recover (Ladi & Tsarouhas, 2020). However, scholars have pointed out that, although significant, the NGEU does not represent a "paradigmatic change" to EU fiscal integration comparable to what the Hamiltonian moment was for the United States. Through the general escape clause, the EU has suspended some provisions of the SGP until the end of 2023, but other parts of fiscal regulation are still in place as part of the conditionality related to the use of the NGEU (Schelkle, 2021).

The article identifies three main gaps in this literature. Firstly, the key terms "fiscal regulation" and "fiscal capacity" are only broadly defined but their constitutive elements have not been properly spelt out and operationalised. For example, which type of fiscal regulation can we concretely distinguish (numerical rules, expenditures rules, rules on providing information about the national budgetary law, debt issuance, etc.)? Similarly, what does "fiscal capacity" entail in terms of the amount and composition of resources that the EU can collect and on which items it can spend money? Secondly, the two terms focus, on the one hand, on the power to collect and spend resources, and, on the other hand, on the power to regulate, but they neglect the important component of administering the resources and implementing the rules. Thirdly, fiscal regulation and fiscal capacity do not account for the institutional dimension. To analyse and explain EU fiscal integration, we need to outline which institutions play which role in each constitutive element of both fiscal regulation and fiscal capacity. If an intergovernmental institution like the Council is the crucial decision-making actor on most of these constitutive elements, then EU fiscal integration will be subject to the influence of competing national interests. Fourthly, and crucially, fiscal regulation and fiscal capacity do not provide information about the EU's fiscal sovereignty. Stronger fiscal regulation will further limit MSs' fiscal sovereignty, but this does not tell us much about EU fiscal sovereignty. Similarly, the EU can increase the size of its fiscal capacity but if the additional resources that it can collect and spend mainly come from national transfers, then the dependence on the MSs persists (Woźniakowski et al., 2023). To overcome the limitations of the term fiscal capacity, Woźniakowski (2022, p. 10) coined the concept of fiscalisation, defined as "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," namely the dependency on national transfers. This is a useful concept that underlines that, in order to be independent of the MSs, a central level of government like the EU needs to collect resources that legally and undisputedly belong to it (and not to the MSs). Yet, the concept points to the FSC but does not include information on the FSU.

In light of the above, this article argues that we need an analytical toolkit—which the literature lacks—to perform an in-depth and comprehensive analysis of the EU's fiscal powers *in relation to the fiscal powers of the MSs*. To do so, the article resorts to comparative federalism.

3. Operationalising the Coexistence of Fiscal Sovereignties

3.1. Analytical Framework

Following Riker (1975), a federation is a political system made of two main levels of government—the federal centre or federation and the constituent units or units—each of which has some policy competences for which it bears exclusive responsibility. Prominent examples of federations are the United States, Canada, Germany, and Switzerland. The key feature of federations is that sovereignty is vertically divided and shared across the two levels of government (S. Fabbrini, 2019). The federal division of sovereignty also applies to fiscal sovereignty. In its simplest form, in a federation, fiscal sovereignty can be defined as the ability of a level of government to raise and spend a significant amount of its own resources, without depending on another level of government for its financing (Zgaga, 2023).

Federations are systems of dual sovereignty (Rodden, 2006), where two fiscal sovereignties coexist: the FSC and the FSU. This means that both the centre and the units have the ability to obtain revenues and perform expenditures to finance the exercise of their competences (Kelemen, 2004). For the units, fiscal sovereignty is the quintessence of their sovereignty and serves for national spending. For the centre, it serves three main purposes: creating stabilisation policies, supplying public goods, or providing transfers to the units (Buti & Fabbrini, 2023). Elements of the two fiscal sovereignties are connected and partially overlap. For example, the revenues from the income tax may be shared across the centre and the units.

But what are the constitutive elements through which to operationalise two fiscal sovereignties? Based on the political science literature on comparative fiscal federalism (see, for instance, Hallerberg, 2006; Hueglin & Fenna, 2015; Rodden, 2006; Shah, 2007), this article proposes an essential operationalisation that includes three fundamental fiscal powers from which all the other related fiscal powers derive: collecting resources, managing (administering) resources, and spending resources. Each of these powers applies to both the centre and the units. Each of them has a number of *constitutive elements*.

I start with FSC. With regard to revenues, the *amount* refers to how many resources a level of government can collect. The amount is connected to the competences the centre has, which can vary based on the political system. Hence, in order to compare the amount of resources that the centre has regardless of its competences, the article considers the revenues of the centre as a share of the GDP. This can be regarded as one measure of the degree to which the centre controls the economy's resources. The *composition* of revenues indicates the type of resources that the centre can raise. The main revenues usually come from taxes (personal income tax, wealth tax, social security contributions, value-added tax [VAT], excises, corporate income tax, etc.). An important factor concerns the *ownership*, i.e., to whom the resources belong. This can be represented by the share of resources that the centre owns over the resources that the units transfer to it. If the centre receives many transfers, it depends on the units for its financing. Transfers

are not resources owned by the centre because they originally belong to the units. Resources consisting of transfers are first generated by—and then made at disposal through—the units. Taxes are instead an example of revenue ownership because there is agreement—within the federation—that specific revenues formally (for instance, based on the constitution) belong to the centre and not to the units. Besides revenues, an important element pertains to the extent to which the centre is able to *administer* its revenues without relying on the units. In terms of expenditure, we distinguish how many resources the centre directly spends and on which items. Other than *ordinary expenditures*, the centre can transfer resources to the units, for instance as part of a so-called *equalisation mechanism* aimed at reducing disparities across the units. Expenditure can also take place in *extraordinary cases* and/or through the issuance of *debt*. In terms of FSU, the same indicators apply to revenues (amount, composition, and ownership) and the management of resources as for FSC. With regard to expenditures, besides ordinary expenditures, units may transfer resources to the centre and/or to other units. Moreover, they may issue debt.

Once I have provided an essential operationalisation of FSC and FSU, the key question is under which conditions each of the two exists. I argue that fiscal sovereignty (be it FSC or FSU) exists if a level of government can decide on each of the above constitutive elements of its fiscal sovereignty—alone or together with the other level of government (fiscal self- or co-determination)—and is not subject to unilateral decisions (meaning decisions that it cannot substantially change) by the other level of government (fiscal out-determination). Hence, this article provides a requirement for fiscal sovereignty based on institutional governance. Federations have institutions representing the interests of the centre or the federation as a whole (its citizens) and institutions representing the units. For example, in Switzerland, the National Council represents the Swiss citizens, while the Council of States represents the units (the cantons). Fiscal self- or co-determination implies that each level of government has full decision-making—or shares decision-making—on all elements of its fiscal sovereignty through the institutions that represent it. For instance, in Germany, the federal legislative (Bundestag) and the federal executive (Bundesregierung), as institutions representing the German federal centre (Bund), decide on the FSC, with the legislative institution representing the Länder (Bundesrat) being involved in the decisions but being unable to unilaterally determine the FSC.

But when, then, can two fiscal sovereignties (FSC and FSU) coexist? When they display fiscal self- or co-determination, and not out-determination. In other words, each level of government needs to have a say on each constitutive element of its fiscal sovereignty. If out-determination applies to one or both levels of government, the coexistence of fiscal sovereignties becomes impossible because one level systematically and unilaterally encroaches upon the other. This is in line with federalism's core assumption of two levels of government that coexist without any of the two dominating, meaning restricting the competences, of the other.

3.2. Case Studies, Data, and Methodology

The analytical framework of the coexistence of fiscal sovereignties has been designed for federations. Federations differ in the way in which they allocate fiscal sovereignty to the centre and to the units. Some federations, such as Germany and Austria, are overall centralised and, thus, grant strong fiscal sovereignty to the centre. In other federations, the units retain strong fiscal sovereignty while the centre is fiscally weak. This is the case of federations that were historically born through the aggregation of states that had previously been independent for a long time. In these systems, also called unions of states by aggregation, since "the states or cantons were the source of the process of federalization, they tried to retain as much power as possible from their previous independent status" (S. Fabbrini, 2017, p. 583). In these systems, the centre has only a few, enumerated competences. Examples of unions of states are the United States and Switzerland.

What about the EU? Formally, it is not a federation. Yet, it is a union of states by aggregation (S. Fabbrini, 2019) because it has two distinct levels of government (EU and MSs), each with its own exclusive competences, but at the same time, it remains decentralised, if one considers the "competences not conferred upon [it] in the treaties remain with the member states" (Consolidated Version of the Treaty on European Union, 2016, Art. 4). Hence, it is possible to apply the new analytical framework in order to assess the post-pandemic coexistence of fiscal sovereignties in the EU.

By adopting the most similar comparative research design (Berg-Schlosser & De Meur, 2009), the article compares the coexistence of fiscal sovereignties in two unions of states by aggregation: the EU and Switzerland. By doing so, it goes beyond the well-established literature comparing the EU and the United States (for an overview, see Tortola, 2014). Switzerland is one of the most decentralised unions of states by aggregation worldwide. As such, it can potentially deliver particularly useful insights to the EU as a similarly very decentralised system. The EU and Switzerland have been the object of comparison in the past (for an overview, see Hueglin & Fenna, 2015). Yet, this article brings in what, to the best of my knowledge, is a so-far unexplored comparison between the EU and Switzerland because it concerns the coexistence of fiscal sovereignties.

The article does a systematic content analysis of EU treaties and legislation as well as policy documents that are relevant to the EU's fiscal sovereignty. With regard to Switzerland, I consider the constitutional provisions on fiscal powers. In both cases, I complement these sources with data on revenues and expenditures. Systematic

content analysis is a methodology used to carry out descriptive inference (King et al., 1994) from the data, i.e., to scientifically extract information from them which provides us with a deeper knowledge, in this case with regard to the EU's fiscal sovereignty. Systematic content analysis takes place through coding, i.e., by assigning conceptual labels (categories) to text passages (segments) that foster an understanding of the data. This article adopts the constitutive elements of fiscal sovereignty presented in Section 3.1 as deductive categories, i.e., categories developed from the research question and from existing literature (Mayring, 2014). I use them to assess the EU's fiscal sovereignty and to perform comparisons with Switzerland. The research is not historical: I consider fiscal sovereignty in the three cases at the time of writing.

4. Fiscal Sovereignties in the Post-Pandemic EU

I start with the fiscal sovereignty of the EU. Through the recovery fund NGEU, MSs in the Council unanimously authorised the Commission to borrow more money (€806.9 billion, in current prices) than ever before in the history of the EU's crisis management. Hence, the EU's fiscal capacity grew in size, moving from the Multiannual Financial Framework (MFF) worth €1,287 billion prior to the pandemic to €2,018 billion, made up of the MFF 2021–2027, equal to €1,211 and NGEU equal to €806.9 billion. If the annual EU budget is equal to roughly 1.4% of the EU's GNI, NGEU is "the equivalent of 6% of 2020 EU GDP" (Freier et al., 2022). Hence, although NGEU represents a significant addition to the MFF 2021–2027, its resources are temporary.

Before NGEU, the ceiling of own resources that the EU could annually allocate to cover appropriations for payments and commitments could not exceed, respectively, 1.23% and 1.29% of the sum of the MSs' GNI. To make NGEU possible, the EU's own resources ceilings were raised to 1.40% for payments and 1.46% for commitments, and a temporary increase of 0.6% of EU GNI was introduced until the year 2058 to cover the EU's liabilities when borrowing on international capital markets to address the consequences of the Covid-19 pandemic (Council Decision of 14 December 2020, 2020).

In January 2021, a new own resource based on non-recycled plastic waste was introduced. Moreover, the Commission proposed three other own resources as revenues for the EU budget: They are based on the EU Emissions Trading System, on the Carbon Border Adjustment Mechanism, and on the reallocated profits of very large multinational companies (European Commission, 2021). Even if these resources were introduced, however, the EU budget would remain small compared to the budget of consolidated federations. In 2021, revenues of the EU budget were equal to approximately €240 billion (in current prices; European Commission, 2023); the EU's GDP in 2021 was equal to €14,500 billion (Eurostat, 2023b). Hence, the revenues of the EU budget in 2021 were equal to 1.65% of the EU's GDP. In comparison, the 2021 ratio of government revenues as a percentage of GDP was 32.2 in Austria, 13.1 in Germany, 11.6 in Switzerland, and, on average, 22.1 in the European MSs (Eurostat, 2023a). With regard to a revenue source, in 2021, out of the EU's €240 billion total revenues, €140—equal to 58%—consisted of national contributions. The other revenues (42%) were customs duties, a rate of the VAT collected by MSs and a contribution based on the non-recycled plastic packaging waste. As a result, the post-pandemic EU budget remains dependent on transfers from the MSs. During the negotiations of the MFF 2021–2027, MSs tried to limit their contributions to the budget and keep its overall size small.

Most (about 80%) EU resources are jointly managed by the Commission and national/regional authorities; the rest (roughly 20%) are directly managed by the Commission (European Commission, 2023). Hence, owing to its small public administration, the EU depends on its MSs for the management of its fiscal capacity. Under NGEU, the Commission was empowered because it assesses the National Recovery and Resilience Plans through which MSs explain how they spend resources from the Recovery and Resilience Facility (RRF), the largest part of NGEU, but the final decision on the disbursement of funds remains within the Council.

The maximum amount of allowed EU expenditures under the MFF is slightly lower than the revenue ceiling in order to avoid MSs having to contribute more than the own resources ceiling. In the face of unforeseen events, resources of flexibility and special instruments can be spent also beyond the expenditure ceiling of the MFF, but they cannot exceed the own resources ceiling. The EU spends resources in different policy areas organised under the current headings: the single market, cohesion, environment, migration and border management, security and defence, neighbourhood and the world, and European public administration. Due to its small public administration, the EU transfers most resources to the MSs rather than directly spending them at the European level. The "transfer capacity" also makes up the RRF, worth €723.8 billion out of the overall €806.9 billion of NGEU. The no-bailout clause prevents transfers from the EU to the MSs or between MSs in order to finance national debts or in the form of a large-scale equalisation mechanism (see Consolidated Version of the Treaty on European Union, 2016). Cohesion funds aim to reduce disparities between European regions but are not targeted at the MSs as a whole.

The Commission can borrow resources, as it did, for instance, recently to support Ukraine under the Macro-Financial Assistance+ programme (€18 billion); or in the past through the Support to Mitigate Unemployment Risks in an Emergency (€100 billion). However, to borrow large-scale resources like NGEU, or to extend NGEU by a similar amount after 2026, the unanimous agreement of the MSs and the subsequent ratification by national parliaments is needed. This is because NGEU is part of the so-called own resources decision. The own resources

decision is the Council's decision on the amount and composition of resources that the EU budget can collect and spend. Although the own resources decision foresees an initial proposal from the Commission and the opinion of the European Parliament, the Council retains the last decision-making power.

NGEU does not alter the fiscal sovereignty of the MSs as operationalised in this article. The MSs retain full discretion on the amount and type of revenues they can collect. Their expenditures are quantitatively limited by the deficit and debt to GDP rules of the SGP, currently suspended until the end of 2023. Yet, MSs retain full discretion towards what they can spend resources on, with the obligation set by the treaties to report large plans for investments and debt issuance to the Commission. Moreover, in order to receive RRF funds, MSs need to comply with the so-called Country-Specific Recommendations that the Commission issues to them under the SGP (F. Fabbrini, 2022). Under the RRF, those MSs most severely hit by the Covid-19 pandemic, such as Italy, Spain, France, and Germany, received unprecedented resources not only in the form of loans but also grants (money not to be repaid).

5. Fiscal Sovereignties in Switzerland

Switzerland has two main levels of government: the centre (Confederation) and the units (cantons). The country has a strongly decentralised organisation of power because the cantons are sovereign insofar as their sovereignty is not constrained by the constitution (Mueller & Fenna, 2022). Switzerland is a federal union that emerged as the aggregation of the previously independent cantons. As a result, the Confederation has only the tasks expressly assigned to it in the Swiss Constitution (see Swiss Confederation, 2022, Art. 42), specifically those "that the cantons are unable to perform or which require uniform regulation by the Confederation" (Swiss Confederation, 2022, Art. 43). Unlike in the EU treaties, in the Swiss Constitution, there is no list of exclusive or shared competences. The distinction exists, but it is spread over the constitution.

I first deal with the fiscal sovereignty of the Confederation. The Swiss Constitution does not have a provision explicitly guaranteeing the Confederation the necessary means to exercise its competences. Since 1941, the cantons have agreed on temporarily providing the Confederation with the power to collect a federal income tax and a VAT with maximum rates enshrined in the constitution. Although such tax capacity has never become permanent, it has been constantly renewed over time—lastly from 2020 to 2035—through popular referenda preceded by a political debate in the country. Thus, formally, the federal income tax, today called direct federal tax (DFT), and the VAT are limited in time. De facto, however, DFT and VAT have become permanent confederal taxes. While the DFT is shared between the Confederation and the cantons, VAT is an exclusively confederal tax. DFT is levied on the income of natural persons and on the net profit of legal entities. Together, in 2022, both DFT (32.7%) and VAT (34.9%) represented 67.6% of confederal revenues. The other revenues were the withholding tax (5.1%), the mineral oil tax (5.8%), the stamp duty (3.2%), the tobacco duty (2.7%), other tax receipts (9.4%), nontax receipts (5.4%), and extraordinary receipts (2.1%; Federal Finance Administration, 2022). Hence, the constitution assigns a number of specific revenues to the Confederation. These resources encompass the most important (in terms of revenues) taxes, specifically income, corporate, and VAT. The units do not transfer resources to the Confederation. The constitution foresees upper tax rates that the Confederation can levy: up to a maximum of 11.5% on the income of private individuals, up to a maximum of 8.5% on the net profit of legal entities, and a standard rate of a maximum of 6.5% "on the supply of goods, on services, including goods and services for personal use, and on imports" (Swiss Confederation, 2022, Art. 130). Moreover, Art. 128 of the Swiss Constitution enumerates items on which the Confederation has the right to levy taxes. VAT is charged for the acquisition of domestic goods, services, and imports but not exports. The Confederation can legislate on "customs duties and other duties on the cross-border movement of goods" (Swiss Confederation, 2022, Art. 133). Since Switzerland is a case of perfect or symmetric bicameralism, when the Confederation legislates, the agreement of both the National Council (directly elected and representing citizens) and the Council of States (directly elected and representing the cantons) is needed (Swiss Confederation, 2022, Art. 156).

The expenditures of the Confederation in 2022 included social welfare (32.7%), finances and taxes (14%), transportation (13.2%), education and research (9.7%), security (7.9%), agriculture and food (4.5%), international relations (4.7%), and remaining task areas (institutional and financial conditions, culture and leisure, health, protection of the environment and spatial planning, economic relations, 13.2%; Federal Finance Administration, 2022). Art. 126 of the Swiss Constitution foresees a debt brake: The Confederation can borrow and spend to the extent that expected receipts, after taking account of the economic situation, cover expenditures. In extraordinary circumstances, such as natural disasters and recessions, the Confederation can exceed the expenditure ceilings, but this expenditure must be compensated for in the following years. The Swiss budget is jointly adopted by the National Council and the Council of States. The Federal Tax Administration, subordinated to the Federal Department of Finance, is in charge of collecting and managing the revenues of the Confederation. Like the EU budget, the Swiss budget is also a transfer budget, meaning that:

> Hardly one-third of the total expenditures of the [Con]federation is used for the tasks of the [Con]federation. More than two-thirds consist of

> transfers to sub-national government (cantons and municipalities), the social security funds (old age and war victim pensions, disability insurance) and other semi-autonomous public institutions. (Kraan & Ruffner, 2005, p. 48)

The Confederation may financially support regions that are facing an economic threat (Swiss Confederation, 2022, Art. 103). An equalisation system with the aim of better horizontal (intercantonal) and vertical distribution of resources (Swiss Confederation, 2022, Art. 135.1) is in place. The constitution details the objectives of the equalisation system: It should reduce economic disparities between the cantons, guarantee them a minimum level of financial resources, support those cantons that have particularly strong burdens due to their geographical or demographical situation, encourage intercantonal cooperation, and maintain their tax competitiveness (Swiss Confederation, 2022, Art. 135.2). Both the Confederation and the cantons shall contribute to the equalisation mechanism with the necessary funds (Swiss Confederation, 2022, Art. 135.3), but the Confederation should contribute more.

What about the fiscal sovereignty of the cantons? The Confederation harmonises direct taxes imposed by the three levels of government (Swiss Confederation, 2022, Art. 129). However, the cantons are free to decide their amount and types of revenues—specifically, to set their tax rates. They do not depend on transfers from the Confederation. Given that "the cantons…exercise all rights that are not vested in the Confederation" (Swiss Confederation, 2022, Art. 3), the cantons retain control over potentially all resources not constitutionally assigned to the Confederation. The cantons also retain large discretion on how much they spend and for what. Their capacity to issue debt is not limited by the Confederation. Since Art. 100 of the Swiss Constitution mentions that "the cantons shall consider the economic situation in their revenue and expenditure policies" (Swiss Confederation, 2022, Art. 100), most cantons have adopted debt brake rules. However, unlike MSs in the EU, cantons in Switzerland are not subject to a debt brake rule originating from the Confederation.

6. Comparing the Coexistence of Fiscal Sovereignties: The EU and Switzerland

This article argued that the well-established political science concepts of fiscal regulation and fiscal capacity are ill-equipped to analyse EU fiscal integration after the Covid-19 pandemic and the adoption of NGEU for three main reasons. First, they are only broadly defined and their constitutive elements have not been properly operationalised. Second, they neglect the administrative dimension: What do these concepts tell us about how EU resources are managed? Third, fiscal regulation and fiscal capacity do not shed light on the distribution of fiscal sovereignties in the EU.

To overcome the limitations of these concepts, the article operationalised fiscal sovereignty as the power to collect, administer, and spend resources. For each of these powers, it proposed a number of constitutive elements derived from the political science literature on comparative fiscal federalism. Fiscal sovereignty (be it FSC or FSU) exists if a level of government can decide on each constitutive element of its fiscal sovereignty alone or together with the other level of government (fiscal self- or co-determination) and is not subject to unilateral decisions (meaning decisions that it cannot substantially change) by the other level of government (fiscal out-determination).

Based on the involvement of institutions representing the interests of each level of government, FSC and FSU can coexist if each of them displays self- or co-determination, but not out-determination. Each level of government needs to have a say on its own fiscal sovereignty. If its fiscal sovereignty is entirely determined by the other level of government, then the two fiscal sovereignties cannot coexist.

Has the post-pandemic EU evolved towards a condition of coexistence of two fiscal sovereignties? Under NGEU, the post-pandemic EU strongly increased its fiscal capacity. Yet, this is a temporary step. Moreover, the EU budget remains extremely small in relation to GDP also after the introduction of the plastic-based own resource in 2021 and the prospect of new own resources. No proper taxes able to generate significant revenues have been introduced—National contributions still represent more than 60% of budgetary revenues. In addition, the EU transfers most resources to the MSs and directly spends only a small part on proper European public goods. Crucially, also after NGEU, MSs, through the Council, retain the ultimate decision-making power over changing the revenues of the EU: Unanimity among national governments and parliamentary ratification by all MSs is required. Hence, to increase the size of the EU budget or to engage in further large-scale borrowing modelled on NGEU, the institution representing national interests—the Council—is the crucial veto player. The Commission and the European Parliament as institutions representing European interests are involved—the former as proponent of new own resources and the latter in the adoption of the annual budget—but they do not have a say on how many and which resources the EU has at its disposal. At the same time, the fiscal sovereignty of the MSs has not been undermined by NGEU. On the contrary, MSs temporarily retain more discretion in spending thanks to the suspension of the SGP. Moreover, some of them can rely on an unprecedented amount of transfers as part of the RRF. In sum, the post-pandemic EU is characterised by a scenario of substantial FSU and still no proper FSC. Based on our analytical framework, the FSC displays out-determination: The MSs are the key decision-makers on the revenues and expenditures of the EU; notwithstanding the empowerment of the Commission in the management of the RRF, the EU still needs the MSs

when administering most of its resources. Since FSC is subject to out-determination, FSC and FSU still do not properly coexist in the post-pandemic EU. This leaves a fundamental issue with the future of European integration unresolved.

In Switzerland, the constitution assigns specific revenues to the Confederation. The Confederation is also entitled to a portion of revenues from VAT, income, and corporate taxes. Unlike in the EU, in Switzerland, there is no upper revenue ceiling. The Confederation does not depend on the cantons for its financing but resources are allocated to it on a temporary basis (currently, from 2020 to 2035). However, the Confederation can only raise a maximum tax rate specified in the constitution. This still leaves the Confederation with enough resources to spend on a number of public goods, such as transport, education and research, but also a significant amount on social welfare (32.7% in 2022). Yet, like in the case of the EU, most resources are transferred to the units. However, fiscal administration at the central level is more developed than in the EU: The Confederation has its own Federal Tax Administration that collects and manages the revenues of the Confederation.

To change the revenues of the Confederation, a constitutional amendment is required. In order for the referendum to pass, both the cantons and the People (meaning the Swiss citizens) would need to agree. Hence, the crucial difference to the EU is that the units (the cantons) cannot determine the resources of the centre (the Confederation) alone, as it happens with the MSs in the EU. The institutions representing both interests (centre and units) have a say in the financing of the centre (co-determination). The same holds true for the adoption of the budget where both the National Council and the Council of States need to agree.

Hence, this analysis showed that Switzerland is characterised by a scenario of substantial FSU *and* substantial FSC. Based on our analytical framework, the FSU displays self-determination. This is in line with a union of states by aggregation being decentralised systems where most competences lie within the units. Yet, the Confederation has a limited but constitutionally well-defined fiscal sovereignty that allows for self-financing and rules out financial dependence on the cantons. Since FSC is subject to co-determination and FSU to self-determination, FSC and FSU can coexist in Switzerland. The EU can learn something from this.

7. Conclusions: Lessons from Switzerland for the EU

The comparative approach of this article does not imply that the EU should become more like Switzerland. This is not only politically unfeasible but also analytically misleading. Each political system has its own peculiarities which cannot simply be "exported." Hence, there are "fiscal features" of the Swiss system that could not work in the EU, while others potentially could. I will discuss them briefly.

I start with four points on what could not work. First, Switzerland's unique feature is direct democracy. The people are an important source of representation of the interests of the whole Confederation, next to the National Council. The people also vote—together with the cantons—on the system of revenues of the Confederation. Such a large-scale use of referenda across the EU to vote on the EU's revenues would be rather politically impossible, or at least it would require time and first be "tested" on less politicised issues. Second, income tax is probably the most sensitive type of tax because it is symbolically associated with national sovereignty and it also generates large revenues. If the EU gets a taxing power, it should start with less sensitive taxes, such as VAT. Third, in Switzerland, the Confederation spends the most on social welfare (32.7% of confederal expenditures in 2022, equal to approximately 30% of the country's GDP). In the EU, social policy is the responsibility of the MSs which consider it a competence closely related to national citizenship. Fourth, the lack of strict rules on budgetary discipline at the central level to prevent the units from profligate spending would face strong distrust among those European MSs which attach crucial importance to budgetary discipline, especially Germany and the so-called "Frugal Four" countries. In other words, a debt brake at the level of the units as in Switzerland would arguably not be enough in the case of the EU.

What features of the Swiss system could work in the EU? First, if the EU has to increase its source of revenues and get access to taxes, this should be enshrined in the founding treaties—as it occurs in Switzerland with the constitution. Through a "constitutional codification," some (new) revenues would be legally guaranteed to the EU and, thus, removed from the realm of political negotiations, but this would require a thorough amendment of the treaties. To be sure, the EU treaties also currently provide for legal guarantees on the EU's financing. However, not only does the EU lack the power to tax but MSs also periodically (at the beginning of the MFF) engage in long and tough negotiations on their contributions to the budget. Afterwards, they are committed to contributing, but before, they seek to minimise their contributions. Second, instead of having (comparatively very low) revenue ceilings, the EU should follow the Swiss example and not limit the maximum amount of overall revenues of the centre, but rather grant the EU access to taxes by clearly fixing upper tax rates. So, for example, the EU could levy up to a fixed maximum rate on the net profit of legal entities, a standard rate on the supply of goods and services and—perhaps in the longer term—a fixed maximum rate on the income of individuals, while MSs would be free to set much higher rates. So, for instance, citizens would pay most of their income tax to their MSs and a small part to the EU. This makes sure that citizens and legal entities mostly remain subject to taxation at the level of the units, but they also still contribute to the financing of the centre, without the units losing

revenues. Third, MSs could grant the EU new revenues on a temporary basis, establishing a term like 15 years in Switzerland (the DFT has been renewed from 2020 to 2035). Hence, the EU could plan its expenditures based on the new resources but, before any renewal, a political debate could take place on how well resources have been used and which resources are needed in the future. Fourth, the EU should grant the institutions representing the interests of the centre the same role as the institutions representing the units when it comes to deciding the amount and type of revenues. This means that the European Parliament and the Commission should co-decide the EU's revenues together with the Council. This would mark the end of the fiscal dependence of the EU on the MSs and would contribute—together with other changes to the status quo—to the coexistence of fiscal sovereignties in the EU.

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Conflict of Interests

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Article

The Political Determinants of Fiscal Governance in the EU: Towards a New Equilibrium

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Abstract
The article investigates the political determinants of fiscal governance in the EU. Since the outset of the Economic and Monetary Union, the EU adopted a model of fiscal regulation which attempted to keep government debt and deficit in check to avoid "fiscal dominance." With the 2020 pandemic, the EU suspended the fiscal rules and adopted a program, Next Generation EU, having some features of a central fiscal capacity. On the bases of comparative federal analysis, the article discusses the political conditions that preside over the formation of a stable central fiscal capacity, here conceptualized as the "triple-T model." We argue that, in unions of states, the determinants of a central fiscal capacity consist in the appearance of an existential threat, in the reciprocal trust among national governments for answering the threat with central resources, and an adequately long time planning horizon of national policymakers to apprehend the benefits of those common resources for all member states. On these bases, the article outlines the contour of a new EU fiscal set up which encompasses an EU central fiscal capacity and robust budget rules framing the fiscal choices of national authorities.

Keywords
central fiscal capacity; Economic and Monetary Union; European Union; fiscal equilibrium; fiscal governance; fiscal policy

Issue
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1. Introduction

The article investigates the political determinants of fiscal governance in the EU. For fiscal governance, we understand the specific form adopted by and within the EU for governing the activities of fiscal extraction and distribution. In unions of states, as in the EU or in a federal aggregation of previously independent states (such as the US and Switzerland; Kelemen, 2013), that form has registered different relations between the competencies (and the powers) of the union's center and those of the union's states (hereinafter, member states). If it is true what Weber (1920/1997) argued, namely who controls taxes controls power, then one should assume that independent states, when they decided or were obliged to aggregate, have tried to keep under their control as much fiscal sovereignty as possible. Following Riker (1975, p. 116), however, one might argue that the preferences of the states constituting the union or of the states already members of the union change in "the case that a significant external or internal threat or a significant opportunity for aggression is present, where the threat can be forestalled and the aggression carried out only with a bigger government." In fiscal governance's terms, a bigger government means a center endowed with a fiscal capacity independent from the vagaries of member states' financial transfers. Thus, historically, it was the perception of a threat (in the form of an internal or external crisis calling into question the very existence of the union, thus definable as existential crises) that led

the union's member states to change their original preferences and to allocate a fiscal capacity to the center (in the US case, through the change of the constitution, from the 1781 Articles of Confederation—but adopted in 1777—to the 1787 Constitution). However, we argue that Riker's model, if applied to the EU case, is insufficient to explain the formation of a central fiscal capacity. The latter implies also a mutual trust that giving the center the resources for promoting a collective answer would benefit all the member states, a trust, moreover, that requires time for being interiorized by the member state elites. The conceptualization of these three factors constitutes our contribution to the debate on fiscal governance in the EU.

Following the literature on the EU economic and fiscal governance (F. Fabbrini, 2016; S. Fabbrini, 2016; Gordon, 2022; Hallerberg, 2013; Hinarejos & Schütze, 2023; Juncker et al., 2015; Schelkle, 2017; Woźniakowski, 2018, 2022), we focus on the distinct concepts of "fiscal capacity" and "fiscal regulation." A preliminary conceptual clarification is necessary. The fiscal capacity (adopted by the US) is defined as the possibility recognized to the federal center to autonomously extract and distribute fiscal resources, while fiscal regulation (adopted in the EU) is defined as the possibility recognized only to the member states to extract and distribute fiscal resources, although their fiscal policies should then be regulated by commonly agreed rules. Although the EU is not a constitutional federation, it is however a union of states by aggregation, as is the case for the US (Stepan, 1999). Comparing the EU with the US, thus, can give useful information on the political conditions determining the structuring of fiscal governance (Sbragia, 1992) and more in general of the central institutions of governance. Comparative federalism shows that the post-1787 American experience has epitomized the model of a fiscal capacity divided between the federal center and the member states. Both levels of government have been assigned an autonomous power to extract and distribute fiscal resources. Allocating a fiscal capacity to the center was considered necessary to deal with both internal (fiscal rebellion) and external (European powers) threats, whose magnitude would have been unmanageable (so it was thought by the main political elites) by the single member states. The EU has instead epitomized the model of fiscal regulation. With the Economic and Monetary Union (EMU), the EU has adopted a model consisting in preserving the fiscal sovereignty of the participating member states but regulating it through strict rules (starting with those of the 1997 Stability and Growth Pact [SGP]; Tuori & Tuori, 2014). The regulation of member state fiscal policies has constituted the strategy for accommodating national fiscal sovereignty within the EMU interdependence, with the goal of avoiding "fiscal dominance" in a currency area with one monetary policy and multiple fiscal policies. By "fiscal dominance," we refer to the constraints that irresponsible fiscal policies would put on the conduct of the single monetary policy (see, e.g., Sargent & Wallace, 1981). In the model of fiscal regulation, member state governments are the only actors who extract and distribute fiscal resources, thus transferring few of them to the supranational center, whereas in the US model of multilevel fiscal capacity, both member states and the federal center separately control the extraction and distribution of fiscal resources.

Having comparatively identified the rules-based model of the EU fiscal governance, the article will discuss the conditions that led to it, and then to its partial and temporary revision during the 2020 pandemic (with approval of the program of Next Generation EU, hereafter NGEU) and, finally, to its stalemate during the economic and security crises induced by the Russian invasion of Ukraine. If the 2010s sovereign debt crisis led to the strengthening of the fiscal regulation model, the 2020s crises have called into question that model and its conceptual premise, that the responsibility for dealing with the crisis is exclusively national. In 2020, NGEU was approved, financed via the issuance of EU debt, monitored by the supranational center, and guaranteed by the EU budget and by prospective new own resources (EU taxes). Facing the Russian war of aggression, the issuance of EU debt was used to financially and militarily support Ukraine (through the Macro-Financial Assistance Instrument or MFA+), but several member states resisted the idea to replicate NGEU for dealing with the domestic economic consequences of that war. The outcome is an unstable model of fiscal governance. We elaborate a "triple-T model" for conceptualizing the reasons for that fragile arrangement and, thus, the political conditions under which it could evolve towards a more stable equilibrium.

2. Comparative Models of Fiscal Governance

If unions of states are understood as aggregation of previously independent territorial units, it seems consequential to assume that their constituent states have an interest, in setting up the union, to preserve as much as possible of their previous control of the activities of fiscal extraction and distribution. Being the main actors in the process of aggregation, national governments have an inevitable preference for maintaining the integrity of their core state powers (Genschel & Jachtenfuchs, 2013), even in the new context of institutional aggregation. Taxation constitutes the core of statehood, the activity which makes possible the financing of state power, exercised towards both the domestic society and the international system. In any voluntary aggregation of states, the decision on where to locate fiscal sovereignty has been one of the most controversial (Parent, 2011).

In the American experience (Woźniakowski, 2022), it was the war which triggered the process of "fiscalization" (as defined in the introduction to this thematic issue; Woźniakowski et al., 2023). With the 1787 Constitution, the federal center took over the debt accumulated by the

states for fighting the British empire, also because the payment of the debt led to an increase in domestic taxes and subsequent domestic fiscal revolts. Because the federation was motivated (according to Riker's model) by the need to guarantee the security of the union from economic or military threat, the 1787 Federal Constitution recognized to the federal center the power to extract fiscal resources and to use them autonomously for purpose of collective defence, thus substituting the 1781 Confederal Constitution (the Articles of Confederation) where the center depended entirely on the states' financial transfers. The 1787 Constitution, making the federal center fiscally independent, fulfilled the promise of the (anti-English) revolution which was made "in favor of government" (Edling, 2003). However, the federal center did not become the cashier for state debts. Indeed, during the recession of 1839–1842, eight states and the territory of Florida defaulted on their commitments and four repudiated their debt. As Congress refused to bail them out, member state elites, for assuring the financial markets, decided to introduce balanced budget amendments in their constitutions. Today, 49 out of 50 member states have balanced budget constitutional rules and can resort to rainy-day funds only in exceptional circumstances (Kessler & Henning, 2012; Sargent, 2012; Wallis, 2000). With the 1787 Constitution, fiscal sovereignty was thus divided between the member states and the federal center, although the former could control a larger share of it than the latter. Not only fiscal sovereignty was divided vertically between member states and the federal center, but, at the latter's level, it was put under the governance of "separated institutions sharing governmental power" (the House of Representatives, the Senate, and the president; Neustadt, 1991, p. 29). Thus, in the US, both levels of government enjoy an autonomous fiscal capacity, with the latter differently regulated. The member states have come to regulate their fiscal capacity through constitutional rules imposing balanced budgets under the pressure of the markets, the center regulates its fiscal capacity through congressional rules negotiated by the leaders of the separated institutions. The US case is interesting (for the EU) because it shows that there is a complementarity between fiscal capacity and fiscal rules.

The process of European integration started from different political premises than the process of American federalization (Fossum & Jachtenfuchs, 2017; Kelemen & McNamara, 2022). Because the military security of the union and the member states was guaranteed, since the 1950s, by an external actor (the US through NATO), the European states focused on economic security, aggregating around a project of market integration. The market project was promoted through a regulatory activity which abolished national barriers and introduced transnational rules. Integration through regulation does not require, for its implementation, the extraction and distribution of fiscal resources by a supranational centre. The costs of regulation, in fact, are mainly borne by the regulated actors and not by the regulators (Majone, 2014). Thus, the regulatory approach to a common and then the single market has justified the permanence of a weak center in terms of fiscal and military capabilities (Genschel & Jachtenfuchs, 2011). Certainly, during the integration process, several proposals were advanced for empowering the supranational center with some form of fiscal power. The 1970 *Werner Report* proposed to create a new authority at the supranational level with the power to determine national budgets "as regards the level and the direction of the balances and the methods for financing the deficits or utilizing the surpluses" (Werner, 1970, pp. 12–13), an authority thus accountable to a supranational legislature. The *MacDougall Report* (MacDougall, 1977) proposed to move from an indirect to a direct fiscal power of the supranational center, creating a Community budget of 2.5% of total GDP as the premise for the introduction of a single currency. *The Four Presidents Report* (Van Rompuy, 2012) proposed to create a central fiscal capacity, the first time that such a proposal was made in an official EU document. The report of the High Level Group on Own-Resources (Directorate-General for Budget, 2016), written under the chairmanship of the former commissioner and Italian Premier Mario Monti, advanced the idea to create an EMU budget based on common borrowing. However, all these proposals were never followed up at the political level. Fiscal power remained exclusively in member states' hands (Beetsma & Giuliodori, 2010; Eichengreen, 1993).

Following Riker's model, one might argue that the preferences of supranational and national governmental leaders in favor of national fiscal sovereignty have not been challenged by a threat to the economic and military security of both the EU and its member states. The adoption of the single currency with the 1991 Maastricht Treaty was not motivated by an immediate existential challenge (to the EU). In the literature, two were the main reasons for adopting a single currency: First, there was a need to preserve the integrity of the newly created single market against competitive devaluations; second, there was a need to contain the economic power of the post-1990 reunified Germany, substituting the latter's monetary sovereignty with a new single currency (Bulmer & Paterson, 2010; James, 2012). In Maastricht, a compromise was made, subtracting monetary policy from the control of member states, leaving however to the latter the control of national fiscal policies (S. Fabbrini, 2015). The institutional outcome has been a policy regime combining supranationalism in monetary policy (because managed by the independent ECB) and intergovernmentalism in fiscal policies (because remained under the control of the member states, coordinating in the Eurogroup of the economic and financial ministers of the EMU). However, with the ensuing introduction of the SGP in 1997, a macroeconomic regulatory framework was set up for enforcing discipline on the decentralized member state budgetary policies (Heipertz & Verdun, 2010).

3. The Fiscal Regulation Model and the Crises

The fiscal regulation model was tested to the core by three existential crises that hit the EU in the last 15 years: the global financial crisis (2009–2010) that morphed into a sovereign debt crisis (2011–2013), the pandemic crisis (2020–2021), and the Russian war of aggression that triggered a major energy and security crises (after 2022). In Table 1, we provide a snapshot of the main features of these three crises and the policy and institutional responses to them.

The sovereign debt crisis of the first half of the 2010s did not create the conditions for questioning the principle inspiring the rules-based fiscal governance model. Instead, it led to a further strengthening of fiscal rules, either through new intergovernmental treaties signed outside the EU (such as the 2011 European Stability Mechanism [ESM], or the 2012 Treaty on Stability, Coordination, and Governance in the EMU, better known as the Fiscal Compact) or through legislation approved according to different EU legislative procedures (such as the 2020 European Semester, the 2012 Six Pack, and the 2013 Two Pack). Such a strengthening of the fiscal regulation model found its roots in the predominant interpretation of the crisis according to which the latter was due to the budget's misbehavior of southern member states, a misbehavior to rectify through stronger and more intrusive rules (Buti, 2021). The sovereign debt crisis had large distributive effects on EMU member states (strengthening the creditors and weakening the debtors), and at times it was perceived as a real threat to the viability of the euro by national and EU leaders. However, the moral hazard paradigm prevented the setting up of a central fiscal capacity (if not for crisis management purposes as with the ESM), leaving to the centralized balanced-sheet policy of the ECB ("whatever it takes") the role of making up for the lack of a central budget. It was risk-sharing by stealth (Buti, 2021). ECB intervention was deemed politically less costly, also in Germany and in the traditionally frugal countries, than building a central fiscal capacity.

In the first decade of EMU existence, thus, the main political actors (national and EU policymakers), although they perceived a possible threat to their individual and collective economic security, thought that the threat could be met through a centralized monetary policy and the working of automatic fiscal stabilizers at the national level, rather than through the adoption of a central fiscal capacity. The sovereign debt crisis of the first half of the 2010s showed the limits of that framework. Facing a crisis with distributive implications, and given the prevailing moral hazard paradigm, national governments split between creditor and debtor states, with the former

Table 1. Comparing three crises.

	Features of the crises		
	EMU crisis	Covid-19 crisis	War/energy crises
Source	Endogenous and policy-induced	Exogenous and common	Exogenous and common
Nature	Combined demand and supply shock	Combined demand and supply shock	Supply shock
Impact	Severe and long-lasting, asymmetric on member states	Very severe, asymmetric on member states and sectors	Less severe, but long-lasting; asymmetric at the global level and on member states
	Policy responses		
Monetary policy	Slow till "whatever it takes" (2012)	Expansionary: Quantitative easing, pandemic emergency purchase programme	Restrictive: Quantitative tightening
Fiscal policy	Restrictive	Expansionary	Broadly neutral
	Institutional changes		
Supranational	• *6/2 Pack* • Single Supervisory Mechanism as part of the banking union • Launch capital market union	• *General Escape Clause* • *State Aid Temporary Framework* • *NGEU* • *Temporary Support to Mitigate Unemployment Risks in an Emergency (SURE)*	• *General Escape Clause* • *State Aid Temporary Framework +* • Price cap on gas • Platform for joint gas purchases • *Commission proposed reform of EU fiscal rules**
Intergovernmental	• *Fiscal Compact* • *ESM*	• *ESM Pandemic Facility*	

Notes: * proposal under discussion; fiscally relevant decisions in italic.

imposing on the latter their policy choices. During existential crises, intergovernmentalism might end up generating domination (S. Fabbrini, 2016). Moreover, in a situation of limited trust, in the subsequent developments of the regulatory framework—with the reforms of 2005 and 2011–2012—the attempt to prevent the risk of moral hazard behavior by national governments, led to an increasingly detailed and complex set of rules, codes of conduct, and guidelines. This lack of transparency contributed to the discredit of the fiscal rules.

4. Fiscal Regulation is not Enough

Things changed with the 2020 pandemic crisis and the post-2022 Russian war and its consequences (as the energy and security crises; Buti, 2021; F. Fabbrini, 2022). As pointed out in Table 1, the pandemic crisis was exogeneous and symmetric, affecting all the EU member states, none of which could be considered responsible for it. Therefore, the moral hazard paradigm could not be used for explaining it or for devising a solution to it. NGEU aimed at helping member states recover from the pandemic through funds raised in the financial markets by the European Commission (European debt), guaranteed by the EU budget and (prospective) new own resources (EU taxes). However, NGEU does not epitomize a pure central fiscal capacity because the funds can be used only by the member state governments, the only actors authorized to spend them although within commonly agreed guidelines (regulating the achievement of targets and the implementation of reforms) negotiated with the European Commission. That notwithstanding, NGEU "constituted an unprecedented integrative step for the EU since it involved the European Commission undertaking massive borrowing on the capital market for the first time" (Ferrera et al., 2021, p. 13).

The suspension between 2020 and 2023 of the adjustment requirements of the SGP made evident that the EU and member state leaders clearly perceived the pandemic as an economic and political threat whose consequences could not be dealt with within the regulatory framework of the SGP. With the adoption of NGEU, the EU fiscal governance has made an important step—although temporary and partial—towards the acquisition of a fiscal capacity by the supranational centre. The pandemic crisis obliged traditionally reluctant national governments to change their preferences, giving up the principle of exclusive national fiscal sovereignty, although the common fiscal resources could not be spent autonomously by the supranational centre. With the de facto suspension of the SGP, the main rules conditioning the fiscal behaviour of member states were essentially reflected in the contract negotiated by each national government with the European Commission regarding its own National Resilience and Reform Plan.

The pandemic was different than the sovereign debt crisis. Whilst the sovereign debt crisis was dealt with within the fiscal regulation model (further strengthening it), with the adoption of SURE and NGEU, the Covid-19 crisis prompted a revision of the fiscal regulation model. Whilst learning from the populist reaction to the social consequences of the fiscal regulation model adopted for dealing with the sovereign debt crisis played a role (Matthijs & Blyth, 2015; Schmidt, 2020), it was the scale and nature of the pandemic, hence its threat's potential, that led EU and member state authorities to revise the rules-based fiscal governance model and to launch a form of fiscal capacity with NGEU (Buti & Fabbrini, 2023; S. Fabbrini, 2022). Indeed, the governance of the latter, based on the interplay between the European Commission and national governments, was designed for favoring the alignment of preferences among previously divided countries' elites, increasing the likelihood of delivery of the reform and investment commitments enshrined into the National Resilience and Reform Plans.

One could have expected that the war of aggression by Russia, for its energy and economic consequences, would have further pressured towards the formation of a central fiscal capacity. However, it has not happened. Buti and Messori (2023) argue that at least three reasons have hindered the leap forward. First, the Franco-German motor, which worked well in the launch of NGEU, has been less effective in tackling the economic fallout of the Russian war, so it has proven difficult to take bold decisions that are positive in the long run, but not always in the short run. Second, a large share of NGEU funds is still to be spent, which has strengthened the reluctance of the euro-sceptical national governments in committing additional EU resources. Third, the reduced focus on joint initiatives was reinforced by the nature of NGEU as a one-off program: The emphasis on the temporariness of common debt issuance has reduced its attractiveness to financial portfolio managers, with the effect of weakening its liquidity and worsening issuance conditions. More generally, national and EU leaders seem to have operated under a "lump sum of political capital": Given the huge amount of political capital needed to ensure a common front on sanctions vis-à-vis Russia, other important but politically divisive topics fell by the wayside. Thus, whilst important decisions have been made (see Table 1), the domestic implications of the war have been met mainly through national answers. The heterogeneity of the national energy mixes prompted national responses to the spike in gas prices and it took a long time before member states and EU institutions could agree on a cap on gas prices. The setting up of an EU Sovereignty Fund, to support the energy transition and the competitiveness of the EU industry, advanced by the president of the European Commission Ursula von der Leyen in January 2023, was downgraded to a platform with very limited additional resources in the European Commission's proposed review of the multi-annual EU budget in June 2023 (European Commission, 2023b).

5. Complementarity and Substitutability

From the previous analysis, one can frame the evolution of the EU fiscal governance along two dimensions: the degree of stringency of the budget fiscal constraints (fiscal regulation) and the role (or lack thereof) of a central fiscal capacity. This is represented in a simplified way in Table 2. The combinations of the two variables allow us to trace the evolution of fiscal governance over the past 15 years.

The global financial crisis was tackled without putting in place central fiscal instruments or resources, apart from the creation of an intergovernmental crisis management tool (the 2010 European Financial Stability Facility transformed in 2012 into the ESM). Instead, fiscal regulations were tightened, and budget constraints were enforced based on market-driven austerity. Indeed, the sovereign debt crisis was interpreted as a fiscal crisis due to the ineffectiveness of the existing rules. The latter were thus strengthened to avoid similar episodes in the future. The moral hazard paradigm was on full display. Consequently, the premature fiscal restraint during this period put an excessive burden on the shoulders of the ECB, with the result that "fiscal dominance" prevailed not out of fiscal laxity, as postulated by the literature (Sargent & Wallace, 1981), but as the outcome of excessive fiscal prudence (Buti, 2021, Chapter 38). In short, in times of stress, the combination of "no central fiscal capacity, yes binding fiscal rules" did not prove a satisfactory *economic equilibrium*.

In the aftermath of the global financial crisis, after the famous "whatever it takes" by the then-president of the ECB in July 2012 had stabilized the markets, fiscal rules were implemented in a more flexible manner. The new flexibility mode was codified in a European Commission communication at the beginning of the Juncker Commission in January 2015 (European Commission, 2015). The fading of market worries on the redenomination risks prevented an operational discussion on creating a central fiscal capacity. The issue was mentioned in the *Report of the Five Presidents* (Juncker et al., 2015) and in the *Report of the Commission on the functioning of EMU* (European Commission, 2017), but it did not gain significant traction. The French sponsored the creation of an anti-cyclical EMU budget, but the proposal was downgraded during the negotiations to a loan facility to support investment (European Commission, 2018) and eventually abandoned. However, a combination of "no binding rules, no central fiscal capacity" does not appear as an adequate manner to manage a currency union: As such, it cannot be considered a satisfactory *institutional equilibrium*. The eruption of the pandemic in March 2020 led to a de facto suspension of the rules via the application, for the first time, of the so-called General Escape Clause, with the creation of a temporary central fiscal capacity in the form of both NGEU and SURE, regarding this time the entire EU and not only the EMU. Whilst adequate as a response to the emergency, the combination "no fiscal rules, yes central fiscal capacity" does not appear to foster trust amongst EU member states and, as such, does not qualify as a *political equilibrium*.

Whilst comparisons with the evolution of the US fiscal governance need to be pursued with caution, the EU trajectory shows important similarities with the US. The absence of a central fiscal capacity was combined with binding budget constraints of the US states via market discipline and international arrangements in the years preceding the 1776–1781 American War of Independence. The war led to the formation of a significant debt by the US states to finance it, with all the budget constraints fading. The inability of the 1781 Articles of Confederation to deal with the state debts led to the Federal Constitution of 1787 and the bailout of US states debt in 1790 through a central fiscal capacity. However, it was only the adoption of balanced budget amendments by US states following the 1839–1842 recession, after the decision not to bail out US states debt, that provided the conditions for a stable fiscal arrangement between the federal center and the member states (so moving in the direction of "yes/yes" in the quadrant of Table 2).

In sum, whilst the combination of no binding fiscal rules and a central fiscal capacity, albeit temporary and sui generis like NGEU, has proven an effective way to address an existential crisis such as the pandemic, it cannot be considered a stable arrangement to organize the vertical fiscal relations in the EU. At the same time, going back to the situation with strict budget constraints and no central fiscal capacity or loose rules enforcement and no central fiscal capacity do not appear adequate for dealing with future crises or consistent with the aim of delivering on key EU priorities. This is even more evident in light of the threats linked to Russia's war of aggression. In the long run, the only viable equilibrium appears as one where a central fiscal capacity goes hand in hand with binding fiscal rules (quadrant "yes/yes" in Table 2).

Table 2. The evolution of the EU fiscal governance.

		Central fiscal capacity	
		No	Yes
Binding fiscal constraints	Yes	Global Financial Crisis (2009–2013)	Post-war (?) (2024–)
	No	Sovereign debt crisis aftermath (2014–2019)	Pandemic (2020–2023)

A central fiscal capacity that should be at the service of the EU as such, not devised as financial transfers to national governments or as a mere stabilization tool. This would alleviate the risks of moral hazard, that is the allegation that the EU operates as a transfer union, but also the risks of the *juste retour*. A central fiscal capacity should supply European public goods, like supporting the energy transformation, the green transition, the research in new technologies, the delivery of common health provisions, the building of digital infrastructure, and the investment in security and defence (Buti & Messori, 2022).

6. Going Beyond Riker: The Triple-T Model

As Riker argued, threat matters in creating the conditions for central fiscal capacity. A threat is not an objective fact, but a constructed political phenomenon. It is necessary to create a shared perception of an internal or external threat for helping to cross long-established red lines (or better for incentivizing EU and national leader to change their consolidated fiscal preferences). Certainly, the Russian war of aggression represents the threat asking for the creation of a central fiscal capacity to respond to its economic and security implications. However, although necessary, threats are not sufficient for activating a process of "fiscalization," as shown by the EU experience during the crises here examined. Two other factors, trust and time, are necessary to transform a possibility into a reality.

Trust concerns the convergence of member state governments' preferences towards policy and institutional solutions benefitting all of them. In the EU case, to build trust, it requires the enforcement of a credible set of fiscal rules that ensure national fiscal discipline. For this reason, the ongoing reform of the EU fiscal rules (European Commission, 2023a), together with the effective implementation of NGEU, are not only important per se but have also a broader relevance for the evolution of the fiscal governance of the EU. Credible fiscal regulation would alleviate political concerns of moral hazard and a proper delivery of reforms and investments of the National Resilience and Reform Plans would show that setting up a form of central fiscal capacity might be a positive (or convenient) political investment. As argued by Buti and Messori (2021), the closer the needle that remains to the national fiscal responsibility, the more the fiscal rules will have to foresee flexibility to allow the necessary room for manoeuvre at the national level; the closer the central budget moves to a substantive fiscal capacity, the stricter the respect of the EU requirements will have to be at the national level (a correlation confirmed by the US experience).

The EU experiences shows, also, the importance of the time factor. Time consists in letting national decision-makers interiorize the advantages of a supranational solution, like the creation of a central fiscal capacity. This requires that national governments find a way to protect their preferences from short-term political changes for apprehending the medium-to-long-term benefits of a central fiscal capacity. A sufficiently long-time horizon is needed to apprehend the positive effects of a central fiscal capacity as mutual insurance. Those positive effects would imply the awareness that the future pattern of risks will imply that the winners of yesterday and today are not necessarily the winners of tomorrow. Such a combination emerged in the response to the pandemic when the three main decision-making actors were sufficiently protected from short-term constraints: The German chancellor, having decided not to seek reelection, could pay less attention to short-term domestic concerns; the French president was in the middle of his first term, with a strong European agenda and a high probability of reelection for a second term; finally, the new European Commission had just been installed with a strong mandate of pursuing a green new deal. From here comes our triple-T model (see Figure 1).

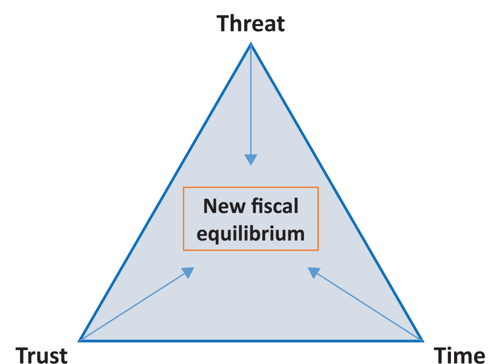

Figure 1. The triple-T model.

How does the triple-T model fare in understanding the policy response to the three major crises that have affected the EU in the past 15 years? In Table 3, we tested such policy responses through the prism of our model. During the global financial crisis, the moral hazard paradigm dominated and, notwithstanding the danger to the integrity of the EMU due to redenomination risks, the policies were characterized by a short-term bias. More structured institutional reforms (such as the creation of the ESM or the launch of the banking union) came late in the day and in a half-hearted manner. As a result, the crisis response to the *threat* of redenomination risks did not go hand in hand with the requirements of *trust* and *time*. The response to the threat of the pandemic was much more adequate. The EU dissolution concerns were palpable should have countries gone on separate tracks. Trust was fostered by the exogenous nature of the shock, hence not attributable to national policy mistakes. The response was large and decisive. However, due to its temporary nature and the focus on transfers rather than on common projects, the longtime horizon in policy planning—and hence the requirement of time—was only partly met. Finally, the response to the energy and security crises triggered by the Russian war of aggression was perceived as a slow-burning threat.

Table 3. The triple-T model at work.

	Global Financial Crisis	Covid-19	War/energy	Lessons
Threat	Redenomination risks	EU dissolution concerns	Slower burning crisis	Reactive attitude
Trust	Policy-induced, moral hazard	No policy-induced shock	Heterogeneity of preferences	Necessary, not sufficient condition
Time	Short-term bias	Large but temporary response	Time incongruence	Insurance-based approach needed
Outcome	Sub-optimal crisis strategy	Semi-optimal crisis strategy	Structural uncertainty, no leap forward	Political leadership wanted

It highlighted the heterogeneity of preferences due to the different national energy mixes and different views on the geopolitical role of the EU. Maintaining trust proved a constant challenge and the necessary long-term horizon underpinning the time dimension proved lacking. Consequently, structural uncertainty prevailed and, whilst important decisions were made, there was no leap forward towards a central fiscal capacity.

As indicated in the last column of Table 3, looking at the three Ts across these crises shows that the EU was reactive, rather than proactive, in the presence of threats; that it had difficulties in building trust among national authorities and that it has had limited time for letting the latter to interiorize the advantages of a central fiscal capacity as an insurance-based approach to solidarity. Overcoming those limits would certainly require strong political leadership at the EU and national level.

7. Conclusions

We have argued that the fiscal regulation model that characterised the EU, and the EMU since the latter's inception, has not overcome the test of time. The experience of the global financial crisis and the subsequent sovereign debt crisis have shown that the absence of a central fiscal capacity led to an overburdening of monetary policy and a much higher loss of output. Different was the fiscal approach in tackling the pandemic. The creation of NGEU marked a substantive shift in the EU fiscal governance towards a form of central fiscal capacity. However, the temporary nature of this instrument and the fact that it is mainly focused on transfers to national governments imply that the EU has not yet embraced a new and stable model of fiscal governance, combining fiscal regulation with fiscal capacity. We argue that a stable model of fiscal governance should combine a credible set of fiscal rules with a central fiscal capacity.

New fiscal governance, combining national fiscal regulation with central fiscal capacity, would theoretically emerge from the shared view on the threat represented by the Russian crisis and its structural implications, from mutual trust between national governments and from their learning that lengthening their time horizon entails a policy mix which is convenient for all of them. There is a complementarity between fiscal regulation and fiscal capacity, although that complementarity can take different forms (being the outcome of the federal bargain, to use Riker's model again, between national and supranational authorities). Any consideration of a more permanent central fiscal capacity will need to go hand in hand with an agreed regulation of national fiscal sovereignties. The literature on federations by aggregation shows that fiscal rules and central fiscal capacity are both necessary, although their combination varies according to the broader institutional arrangements of those federations. We have argued that the triple-T model (threat, trust, and time) provides an analytical framework for conceptualizing the evolution of the EU towards a new model of fiscal governance and identifies the conditions for making the latter stable because satisfying the preferences of both national and supranational authorities.

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Conflict of Interests

The authors declare no conflict of interests.

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