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Regulatory state building in fiscal surveillance: the U.S. and the EU contrasted

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Abstract: This contribution analyzes, first, how the EU regulatory state has expanded into fiscal surveillance and how this contrasts with the U.S., a contrast that is more subtle than is often acknowledged. The paper shows that the EU has a more developed 'fourth branch of government' in budgetary policies than the U.S. where the notion of the regulatory state was first developed. The paper then looks into whether and, if so, how this can explain the different responses to the ongoing economic and financial crisis in Europe and in the United States. I conclude that member states in the EU allow more intrusive regulation of budgets because the EU is not a full-fledged competing government level. In the United States, by contrast, the balance of power in the federation would be completely upset by a federal government with its enormous budget if it were given strong rights of regulatory oversight as well. The conclusions address the critique that the EU regulatory state poses a threat to political sovereignty and social protection in member states.

Key words: EU, federalism, financial crisis, fiscal policy, regulatory state, Stability and Growth Pact, United States

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Regulatory state building in fiscal surveillance: the U.S. and the EU contrasted

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1 Introduction: The regulatory state and its discontents

The interpretation of the EU as a regulatory state is meant to be an alternative to integration theories that see the EU either as a federal state in the making (supranationalism) or as a set of government agencies controlled by the member states as principals (intergovernmentalism). Majone (1993a, 1996) interpreted the EU as a regulatory state in the sense that the EU has become effectively a 'fourth branch of government' which acts as an independent agent or even as a trustee of national democracies. Majone's theory of the regulatory state is functional and normative, implying that the EU has been invented for good governance of the multi-level executive, specifically to enhance the credibility of governments' commitment to open markets. Majone (1996) draws on the observation of the rise of the regulatory state in the U.S. Yet, there it has been the result of a power political struggle between the Presidency and Congress, in which Presidents successively gained control rights over the federal bureaucracy from the legislature and established a 'managerial presidency' (Pildes and Sunstein 1995: 11-15). This raises the question how fundamental the economic rationale for the regulatory state really is.

Skeptics point out that even if the regulatory state would live up to its normative function, it amounts to prioritising commercial interests and economic policy goals over concerns for collective welfare and social safety. There are at least two complementary variants of this skepticism which prove relevant for the U.S.-EU comparison. There is a political-institutional variant that criticizes the 'democratic deficit' implied, for instance in the disguise of a 'negative integration bias' (Scharpf 1999). This bias stems from the need for super-majorities in the Council to counter the liberalizing stance of the Commission which in turn favours the removal of market barriers over coordinated market regulation. This entrenched pro-competition thrust arguably does not reflect the democratic consensus in most member states.

Another skeptic variant is the socio-economic critique that has its roots in Karl Polanyi's (1944) analysis of the 'Great Transformation' which claimed a direct link between the emergence of capitalist markets for labour and other 'fictitious commodities' on the one hand, and the catastrophes of the first half of the 20th century, on the other. After the war, economic processes have been 're-embedded' in social reproduction and, thanks to generous public welfare and institutions of corporatism, capitalism and (social) democracy in Europe were reconciled (Esping-Andersen 1990: 36-54). European integration therefore makes sense as a way of safeguarding this post-war settlement under conditions of globalizing markets which have the potential of undermining these de-commodifying and embedding arrangements (Caporaso and Tarrow 2008: 1-2). Yet, the regulatory state may be a Trojan horse of globalizing market forces.

In contrast to these two criticisms, I do not see the regulatory state as an overpowering or encroaching level of government but as a differentiated governance function that mature democracies may find useful to develop. Yet, there is nothing that forces them to develop it and this governance function may be politically too controversial since a market bias and 'disembedding' is indeed its very core. The creation of the regulatory space consists of separating public interventions that can be justified on economic grounds, notably efficiency-enhancing allocation or systemic stabilisation, from those that can be justified on political grounds, above all redistributive norms. It is based on the view that policies that are positive-sum games, ie increase the pie for society – such as free trade, fiscal prudence or environmental protection -- need parliamentarian approval only as regards their (uncontroversial) goals. The detailed implementation is and should be left to expert deliberation and the oversight of courts, so as to avoid special interest group politics to distort their implementation. Redistributive policies, by contrast, are zero-sum games, taxing some and giving subsidies or transfers to others. Hence, by their very nature, redistributive policies are in need of majoritarian decision-making, subject to some protection of minorities against exploitation, say in the form of high taxation.

In contrast to Majone's original concept, this paper has as a point of departure that the creation of the regulatory state is a contentious political process and that there is no overriding functional imperative that would make it succeed in the long run. In fact, this is the message of a special issue on 'The politics of conflict management in EU regulation', to be published as issue 4 (July 2009) in *West European Politics* (Mabbett and Schelkle 2009). The contributors analyze instances in which regulation under an economic imperative has to be asserted continuously but remains contested (Susanne Schmidt on the Services and Posted Workers Directive), instances where economic regulation has to concede some space for the pursuit of social and developmental goals (Michael Blauberger on state aid, Achim Kemmerling and Eric Seils on taxation) as well as instances where the creation of a regulatory state failed (Deborah Mabbett on occupational pensions, Dorte Martinsen on health care services). But there are also cases in which regulatory state building has made deep inroads into policy areas traditionally considered to be about redistribution and hence taboo (David Natali on Open Method Coordination of public pensions, Waltraud Schelkle on budgetary policy).

In line with the framework outlined in Mabbett and Schelkle (2009), I will analyse to what extent the regulatory state has developed, taking the EU as a benchmark and compare it with the United States. Then I will look at the response of these fiscal unions to the ongoing crisis. If the critics of a democratic deficit, a negative integration bias or social disintegration are right, we should see the regulatory state either retreat because crisis management requires the dominance of budgetary-distributive politics. Or the regulatory state asserts itself to the detriment of effective crisis management, mainly with constraints on government intervention that would lead to large increases in public debt. The latter is what well-known economists have accused the EU of, contrasting its supposedly timid response unfavourably with that of the U.S. Treasury (eg Blanchard 2009, Buiter 2009, Krugman 2009, Wyplosz 2009). The conclusions sum up my findings.

2 The regulatory state in fiscal policy: The EU and the US contrasted

This section analyzes how the EU regulatory state has expanded into fiscal surveillance and how this contrasts with the U.S., a contrast that is more subtle than is often acknowledged. I look at a) the construction or formulation of the regulatory problem, b) the use of regulatory techniques, in particular information management, and c) the empowerment of delegated authority.

2.1a) The formulation of the regulatory problem in the EU

The attempt at regulatory state building in fiscal policy can be seen in the emphasis on a conspicuously economic rationale, rather than a political. In the EU, externalities or 'spillovers' of member states fiscal policies was initially the overriding argument for some coordination in the Council[1] and the surveillance of each member state's compliance delegated to the Commission. The Dublin Presidency Conclusions (1996: par.18) which decided on the institution of a Stability and Growth Pact (SGP) summarized the rationale thus: 'Sound government finances are crucial to preserving stable economic conditions in the Member States and in the Community. They lessen the burden on monetary policy and contribute to low and stable inflationary expectations such that interest rates can be expected to be low.' Monetary and financial market integration was taken to create free-riding incentives: members enjoy low risk premia on the common interest rate and thus find borrowing cheap; current account deficits that are largely incurred with other members of the monetary union cannot lead into currency crises; and each fiscal authority may speculate that the central bank is reluctant to counter the inflationary pressures from excessive deficits by rising interest rates because she would have to punish the defecting and the compliant members alike. Fiscal rules had to prevent these incentives from materialising (Public Finances 2004: 127-128).

The underlying assumption that the incentive for freeriding was pervasive justified an explicit 'no-bail out' clause in the Treaty (Art.104b, Art. 103(1) in the consolidated Treaty) and responsibilities for fiscal policy devolved to the national level: a common budget would have only increased the moral hazard. The original Pact therefore focused on the fiscal envelope, concentrating on the general government deficit (which is the net or consolidated borrowing requirement of national and sub-national governments and social insurances). It must not exceed 3 percent except for severe recessions, so as to contain an explosive growth of public debt (preferably below 60 percent of GDP) and hence the spillover on interest and inflation rates. This would leave enough room for the automatic stabilisers, built-into the tax-transfer systems of member states, to do the main job of stabilising asynchronous cycles and country-specific shocks, thus minimising the need for discretionary, politically motivated intervention (Artis and Buti 2000). The structure of spending and taxation was left for national democracies to decide.

Moreover, the stick of an Excessive Deficit Procedure (EDP) was needed to sanction governments that break their commitment repeatedly (Public Finances 2004: 127-128). It should be noted that all EU members have to comply with the major stipulations of the Pact

[1] Either in ECOFIN, the Council of Economic and Finance Ministers of the EU, or the Council's sub-formation Eurogroup, made up of the Economic and Finance Ministers of Euro area member states.

– specifically to avoid an 'excessive' deficit and to have a budget 'close to balance or in surplus' over the medium-term, that is the entire business cycle. But a non-EMU member that violates the excessive deficit rule cannot be fined under the EDP and no country can be punished for violating the Medium-Term Objective.

In the revision of the Pact in March 2005, the original separation of the policy problem into allocation (overall deficit to prevent negative externalities) and redistribution (budget structure to implement choices over the secondary income distribution) gave way to a 'sustainability' rationale. To be precise: macroeconomic fiscal discipline has become more and more justified on reasons of long-term viability while the spill-over rationale for fiscal surveillance lives on in the control of state aid.[2] This shift in emphasis can still be construed as concerned with efficiency and stability, namely the efficient allocation of fiscal resources between generations that does not need to take recourse to inflation. However, this shift has extended the mandate of fiscal surveillance to the structure of member states' budgets, specifically to control 'age-related spending' on pensions, public health, long-term care and education. This has massively increased information requirements as outlined below. At the same time, the EDP has been considerably weakened, by providing exemptions like systemic pension reforms or a sustained period of low (not negative) growth that governments can invoke – under specified conditions – to postpone or repeat steps towards pecuniary sanctions.

The sustainability rationale is a long-term goal that does not require emergency measures, agreed upon by Council summits in the spotlight of the mass media. Instead, this goal shifts emphasis on how to account for the contingent and implicit liabilities in budgetary accounts, measures that are too technical for continuous scrutiny by the mass media and agreed upon in low-key consultations between fiscal experts. This has not 'de-politicized' EU fiscal surveillance because the attempt at forcing governments to consider the consequences of their budgetary decisions over a long time horizon and in considerable detail is potentially a nuisance and a challenge to their sovereignty they will resist. But resistance then comes in the disguise of sloppy reporting and fiscal gimmickry, rather than in the form of conspicuous arm twisting of Council members.[3]

2.1b) The formulation of the regulatory problem in the U.S.

The U.S. regulatory state in fiscal policy is obviously not as easy to locate as there is no SGP for its monetary union. To make the task manageable, I take the comparison with the EU as a lens through which the formulation of the regulatory problem is identified. This lens directs our attention, first, to the fiscal rules from which I infer whether there is an underlying perception of a regulatory problem, ie whether there is an economic rationale

[2] In Memo /05/195, the immediate answer to the question for the basic rules of state aid policy reads: 'State aid policy is an important part of EU competition policy. State aid control comes from the need to maintain a level playing field for all undertakings active in the Single European Market, no matter in which Member State they are established, and to avoid Member States getting locked into a contest where they try to outbid each other to attract investment.' I come back to this in the section on the financial crisis.

[3] The latter is what Germany and France managed in order to avert an EDP in November 2003. This led the Commission to take the Council to Court which annulled the Council conclusion in July 2004 and triggered a revision of the Pact in March of the following year. For an overview of the evidence on fiscal gimmickry see Schelkle (2007: 727-730).

for constraints on budgetary policies. Second, the EU comparison directs our attention to the role of federal oversight over state spending.

The use of fiscal rules is an apparent similarity between the EU and the U.S. at the (member) state level, from which we can infer the understanding of the underlying policy problem.[4] Virtually all U.S. states have balanced budget rules (NASBO 2008: table 11), at first sight resembling the non-enforceable 'close-to balance or in surplus' rule in the EU. But these balanced budget rules in U.S. states apply annually[5] and there is no spending without appropriation, hence no need for an EDP. These balanced budget rules relate to the operational budget only, ie to current revenue and expenditures. Capital outlays for multi-year public investments may be debt-financed but then debt or debt service limits apply. They are neither as pervasive nor as uniform as the 60% rule in the EU, however (NASBO 2008: table 12). Typically they are capped (debt must not exceed a particular dollar amount) or tied to revenues (debt service or debt level must not exceed a certain share or small multiple of current revenues), not to state income. Finally, two thirds of states have expenditure or revenue limits, typically restraining their growth to general income or population growth. Revenue increases often require a supermajority of 2/3 or 3/5 of the legislature (NASBO 2008: table 13).

The nature off these fiscal rules suggest that their aim is not to avoid spillovers of fiscal policy in a monetary union: the rules are neither harmonized nor is there a federal agency that is responsible for their enforcement. This is left to state legislatures that are not preoccupied with the wellbeing of the union as a whole. Nor does long-term sustainability, the containment of an explosive debt dynamic, seem to be an equally prominent motive of fiscal regulation, given that there is no consensus on debt limits and they are not tied to the fiscal capacity of states as determined by Gross State Product or total taxable resources (GAO 2004: 4). It seems more pertinent to interpret these rules as being concerned with the prudence of fiscal policy. The norm of prudent fiscal behaviour asks state governments to observe a budget constraint on living expenses analogous to private households. Even debt (service) limits can be justified in this way in that future generations should not inherit debt because their predecessors/ parents lived beyond their means. Keeping debt service payments within bounds prevents the need for higher taxes.

The isolation of a policy problem of prudent fiscal behaviour may or may not be regulatory, ie it may or may not have a conspicuously economic rationale which democracies have a hard time to uphold. Golden Rule type restrictions that contain debt finance to public investment can have an economic-regulatory rationale. For instance, they can be based on arguments that public demand and debt may crowd out the private sector's demand, and that future expenditure may have a higher return than present expenditure on infrastructure because needs are less uncertain and technological progress leads to a better

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[4] There has also been a balanced budget rule for the federal budget, the so-called Gramm-Rudman-Hollings Act of 1985. The Act did not achieve its aim of a balanced budget by 1991 and was replaced by the Budget Enforcement Act in 1990 and the Balanced Budget Act in 1997, which required to offset the costs of new legislation instead of focusing on the deficit directly. When the federal budget got into surplus since 1999, the constraints on new programmes were circumvented and the Act expired in 2002. All three Acts were congressional initiatives (Savage and Verdun 2007: 847-857).

[5] In some states, a deficit may be carried over to the following year (NASBO 2008: table 11).

cost-benefit ratio. However, economic rationales do not figure very prominently in the legislative and constitutional provisions for balanced budget rules and debt (service) limits. The borrowing limits in U.S. states originated in the 19th century when financial excesses of governments led to widespread default on state bonds. Their idea is to constrain government power generally: "Constitutional debt limitations were part of a general movement that entailed also restrictions on the length of legislative sessions, and the salaries of state legislators, and should be understood in these terms." (Eichengreen and von Hagen 1995: 12)

In other words, these rules are the tangible expression of political liberalism and its support for small government even if this requires to forego some benefits of public intervention. In fact, strict balanced-budget rules are known to be counterproductive for counter-cyclical stabilisation in that they create boom-bust cycles to contain borrowing and makes the fiscal impetus of state budgets overall pro-cyclical (NASBO 2004, Follette et al 2008), a feature that the 'close to balance or in surplus over the cycle' rule of the EU tried to avoid but finds hard to enforce. The moral hazard problem is located in the relationship between the electorate and the government of the day, not in the one between states. The sanction for non-compliance with the fiscal rules is that there will be no appropriation for state-run programmes or public investment because state legislatures will not pass the budget.

There is no explicit federal bailout for states (Eichengreen and von Hagen 1995: 12), yet this is only superficially similar to the EU. There is disaster relief and temporary fiscal aid that the federal government may grant in times of economic recessions (GAO 2004). The budget stabilization funds that virtually all states maintain are often non-existent or quite limited, for instance capped to not exceed 10% of current revenue, and hence are too limited for smoothing expenditure and revenue in a prolonged down-turn (NASBO 2008: table 19, 50). The use of temporary fiscal aid is unrestricted and allocated on the basis of population size, ie per capita, not on the basis of fiscal capacity or need. If anything, this federal stand-by worsens the moral-hazard problem in that state governments may not care for building up sufficient rainy day funds, a critique that has been levelled repeatedly against federal antirecession aid and disaster relief (GAO 2004: 5). It is exactly for this reason that the EU has abstained from any support for member states in recession, supposedly so as to force them to good, precautionary governance.

Federal fiscal oversight in the U.S. is strictly tied to budgetary flows, ie the federal administration can attach strings only to transfer programmes by which it is funding states. The oversight over state aid is left to courts.[6] The strings attached to federal grants are in turn controlled by the appropriations committees of Congress. For instance, two major programmes for elementary and secondary education, the No Child Left Behind Act and the Individuals with Disabilities Education Act, condition federal aid on the requirements, respectively, that school districts design and implement statewide achievement tests and prepare individualized education plans for disabled children (CBO 2005: 3). Such stipulations are attached to all big federal programmes, such as social assistance under

[6] Under the so-called 'dormant Commerce Clause' to which we come back in the section on the financial crisis.

TANF (Temporary Relief for Needy Families) and Food Stamps. Congressional appropriations bills are more detailed and extensive than in any other OECD country, parliamentary control 'often dictates specific management decisions' (Blöndal et al 2003: 25). Hence, the U.S. government ends up regulating particular expenditures but not the fiscal envelope for the members of the monetary and fiscal union. But unlike the 'age-related' spending categories in the budgets of EU member states, the policy problem thus addressed is one of political accountability to federal taxpayers, not a concern for the long-term economic viability of the union.

2.2a) Regulatory techniques of control in the EU

As indicated, the Pact was originally based on the 'two nominal anchors of the Pact - the 3% of GDP reference value for the deficit ratio and the 60% of GDP reference value for the debt ratio' which are 'the centre piece of multilateral surveillance' (ECOFIN Council 2005: 3). These anchors signaled the arms-length nature of fiscal surveillance, that subsidiarity was observed, and that the only issue of common concern was the debt dynamic in member states' public finances. If this had remained the state of affairs, we could hardly speak of the emergence of an EU regulatory state in fiscal surveillance, the Pact would simply resemble a legal constraint on debt or deficit levels that many countries have given themselves.[7]

It is the annual Stability and Convergence Programmes (S&CP) that are a paradigmatic regulatory state instrument – Stability programmes have to be submitted by EMU members, Convergence programmes by non-EMU members of the EU. For instance, new governments are 'invited', after they have taken office and submit the first update of their Programme, 'to show continuity with respect to the budgetary targets endorsed by the Council on the basis of the previous update of the Stability/Convergence Programme and - with an outlook for the whole legislature - to provide information on the means and instruments envisaged to reach these targets by setting out its budgetary strategy' (ECOFIN Council 2005: sect.1.4) This requirement treats the most sensitive political issue for an incoming government as a matter of common administration, urging it to take a view of a non-majoritarian agency with a time horizon that is not determined by considerations for the electoral cycle.

S&C Programmes are based on a non-binding 'code of good practice' that gets its force from the peer review in the Economic and Financial Committee (EFC, the COREPER equivalent for the ECOFIN Council) and the ECOFIN Council itself. Moreover, it can be taken up by national parliaments. For instance, the UK government was pressed about the Council's Opinion on the UK's programme by the House of Commons' Select Committee on European Scrutiny, an Opinion 'which suggested dissatisfaction about data provided by the Government' (Select Committee 2006: par.4.2). Such examples of parliamentary scrutiny are, however, rare in practice.

[7] In the OECD/ World Bank database on Budget Practices and Procedures, 29 out of 40 countries responded in the affirmative to the question 2.1.a.1: 'In developing the budget, are there fiscal rules placing limits on Executive fiscal policy discretion?' See http://ocde.dyndns.org/ and Public Finances (2007: part II.5) for results from this dataset for 9 EU countries. The majority of rules is enshrined in the constitution or a budget law, not in political ad hoc agreements.

The Commission has vigorously gone down the route of ever closer supervision and detailed data collection, with mixed success. A case in point is the ‘quality and sustainability of fiscal policy’ agenda. It was launched in 2000 at the Lisbon Council which asked the ECOFIN Council and the Commission to present a report to the Spring Council of 2001 on ‘the contribution of public finances to growth and employment’. The report was duly prepared by DG Ecfin and the two Committees that bring together the top civil servants from economic and financial ministries in member states, the EFC and the Economic Policy Committee (EPC). This ‘new step in the fiscal policy agenda of EMU’ (Public Finances 2001: 45) consisted mainly of looking not only at the level of the budget but also at its composition.

DG Ecfin and the EPC in particular have since then engaged in a Herculean effort to operationalise the notion of quality and sustainability of public finances. There is obviously no consensus on how to measure the quality of a budget since ‘available classifications of “productive” expenditure in the EU range between 5 and 44% of total public expenditure, depending on which expenditure categories are seen as “productive”.’ (Public Finances 2004: 181) New data requirements were added to the Code of Conduct. The informal Ecofin Council of April 2008 discussed the quality issue again based on a Task Force report that asks for more budget information, such as breaking down all government expenditures into 68 classifications (Kastrop 2008: 24). At this stage, it is not obvious what this quality agenda has added to fiscal surveillance beyond additional reporting obligations. In the assessment of the S&CP, the Commission hardly ever comments on a country’s statements in the quality section.

This is arguably different for the sustainability aspect. It gets considerable attention in the Commission assessments of the S&CP and is the subject of high-profile reports. There is an Age Working Group attached to the EPC that brings together experts from the Commission and the member states to develop and refine a common methodology for sustainability projections, the accounting for implicit liabilities from pension entitlements etc. Two more sustainability indicators with an explicit economic and policy rationale have been used since 2004 and they are estimated for two different scenarios to deal with the uncertainty underlying long-term projections. In the S&CP, the revised Code of Conduct asks governments to project over a 50 year time horizon ‘the government expenditure categories which are most affected by demographic changes, that is, old-age pensions, health care, long-term care for the elderly and education, as well as the assets set aside to cater for the ageing-related increase in expenditure.’ (Public Finances 2006: 82) These projections must be consistent with the common long-term projections by the Commission and the Age Working Group. A Sustainability Report was prepared by the Commission Services and the EPC at the request of the Council. It was submitted by the end of 2006 and contains the age-related expenditure projections using models of national authorities but based on commonly agreed assumptions about population and economic developments (European Economy 2006: 7). The EU regulatory state is now developing a methodology for estimating the implicit liabilities in member states’ budgets and make them the basis for calculating the country-specific MTOs under the revised Stability Pact (Public Finances 2007: 82).

The economic assessment of sustainability is not a straightforward, technical task, however. For instance, it is not obvious whether a similar stock of public pension obligations relative to GDP in Poland, 287% in 2006, is more, less or as sustainable as in Germany, where it was 289% in 2005 (CMFB 2008: 9). An assessment would have to make precise numerical assumptions about the life expectancy of retirees, future growth of the tax base, the appropriate discount rate for countries in or out of the Euro area etc. In long time series as these, results are extremely sensitive to small changes in the underlying assumptions.

If it is economically no less problematic to assess fiscal sustainability than to evaluate the growth quality of budgets, the difference in prominence between the two is all the more significant. With respect to the quality aspect, fiscal surveillance seems to be on shaky ground as it can be seen as interfering with political priorities of national democracies. It is also of little strategic relevance for budgetary decisions in member states: nobody can hold governments accountable for generating too little growth. The pursuit of sustainability, by contrast, can claim to tackle market and government failures. It has become a highly technical process of estimating sustainability indicators and implicit liabilities. Interviews confirmed that Treasuries watch this with some trepidation as the esoteric exercise in indicator construction seems to be driven by a clear intention to come up with new accounting rules for pension entitlements. The revised Pact has prepared the ground for this uncomfortable extension of the regulatory state.

2.2b) Regulatory techniques of control in the U.S.

The use of fiscal rules restraining political discretion over revenue raising and public expenditure is even more prevalent in the United States than in the EU. This setting of rules may be seen as a regulatory technique since it imposes strict parameters on the discretion of policymakers and legislatures that can be justified on economic efficiency grounds. But I have argued that the rationale seems to be political, namely to rein in state expansion even if the economic effects are counter-productive.

There is no U.S. equivalent to the annual Convergence or Stability Programmes that ministries of finance in the EU have to submit for scrutiny by the Commission and peer review in the ECOFIN Council. But U.S. states and the federal government use a number of other techniques that have been developed or are in line with prescriptions of New Public Management. Performance budgeting is the most prominent and defined as containing three elements (Blöndal et al 2003: 31): first, an explicit statement and quantification of outcomes/ outputs for each programme, agency or ministry; second, managerial flexibility and less emphasis on input controls; and third, some link between outcomes/ outputs and funding. The U.S. was a front-runner in developing performance budgeting, 25 states practice it, typically in conjunction with other budgeting techniques. Even more states have performance measures at the programme or agency (ministry) level and 41 publish these performance measures online (NASBO 2008: tables 14-15). For the federal government, performance budgeting has been prescribed by law in the Government Performance and Results Act (GPRA) of 1993. It requires each agency (department, ministry) to come up with performance measures.

So far performance budgeting results in a collection of agency documents, there is ‘no whole-of-government plan’ (Blöndal et al 2003: 32).[8] This regulatory technique has predictable limitations when its effectiveness relies on powerful legislatures making use of it: ‘While the executive branch has made great strides in generating performance information, GPRA has not lived up to the rhetoric associated with its passage, and Congress has failed to make performance a significant factor in the budget decision-making.’ (Blöndal et al 2003: 30) The shift to results-based budgeting would imply a considerable shift of power to the executive overseeing performance at the cost of the legislative overseeing conformity with legislation ((Blöndal et al 2003: 28). Not surprisingly, Congress has resisted this move to the regulatory state in fiscal policy. This is unlikely to be different at the state level, even though it has become firmly institutionalised. In 39 states, performance measures have to be included in an agency’s budget request to be passed by state parliaments (NASBO 2008: table 16). But again, state legislatures are reluctant to base their decisions on performance measures (GAO 2005: 9-11).

One is reminded of the ‘quality of fiscal policy’ agenda that the EU pursues without generating more than new information requirements that are of little strategic value for fiscal allocations in practice. Two noticeable differences are, however, that in the U.S. this attempt of ‘budgeting by results’ is ultimately directed at parliaments and that there is a strict separation between state and federal level. In the EU, this exercise is led by the executive (some Treasuries) and directed at the executive (the Council), aiming at EU guidelines on how member states should allocate budgetary resources. These differences correspond to the contrast in the revealed perception of the fiscal policy problem: in the U.S., it is accountability to taxpayers that revenue has been spent prudently, in the EU it is the sustainability of national public finances on which the viability of the union supposedly rests.

The use of projections is less wide-spread and uniform in the U.S.. Many states require by statute some revenue projection beyond the current budget cycle but only oil-revenue dependent Alaska requires to extend this projection over 10 years, most call for revenue projections between 1 and 4 years (NASBO 2008: Table 7). In addition, two thirds of U.S. states ask for forecasts of current expenditures and in 34 states this includes all programmes, not only particular agencies. But the time horizon never exceeds 5 years beyond the current budget cycle and is shorter in most (NASBO 2008: table 30). Again, this regulatory technique is aligned with the goal of ensuring prudence and accountability to current taxpayers and voters. The projections cannot provide a corrective for the short-termism of representative democracy as they are arguably meant to do in the EU regulatory state.

[8] ‘Agency’ here means any government entity, from ministry (‘department’) to operating body of a programme (Blöndal et al 2003: 42).

2.3a) The empowerment of delegated authority in the EU

The authority for EU fiscal surveillance is split between the self-regulatory ECOFIN Council, including the Eurogroup consisting of economic and finance ministers of the Euro area only, and the delegated regulator in the guise of the Commission. Within the Commission, DG Ecfin is responsible for fiscal governance and Eurostat for statistical governance, both reporting to the same Commissioner for Economic and Financial Affairs.

Most observers have interpreted the revision of the Pact in 2005 as revealing a fundamental problem of delegated authority. In this view, the Council does not come in harshly enough because of its self-regulatory features ('The turkeys deciding on the menu for Christmas'). Delegated authority has been further weakened by the 'escape clauses' introduced into the EDP. The perception of participants is somewhat different. For those inside, a standoff in the Council is full of political drama. Interviews with Treasury officials suggest that such standoffs are a real threat and civil servants have failed seriously in their duty if the Finance Minister is not amused. My interpretation sees the Pact revision as a further step in regulatory state building. The spillover rationale proved too political in the sense that it required to call on the Council as adjudicator of first resort each time a country incurred a budget over 3 percent of its GDP. The threat of opening an EDP, at a time when a country was typically in recession and public finances in dire straits, made this a very salient issue that could hurt a government domestically. The politically salient adjudication in the Council has now given way to a low-key process in which fiscal and statistical experts talk to each other more often. For instance, every country that is about to be notified under Article 104 for an excessive deficit will be visited by a special mission beforehand, at the level of the Commissioner or the Director General of DG Ecfin.

EU fiscal surveillance is characterized by an internal division of labour between the policymaking arm, DG Ecfin, and the technical arm, Eurostat. While the policymaking role depends on a plausible economic justification, the technical role depends on controllable statistical measures. The two are not always compatible. Eurostat's role has gone largely unnoticed in the literature, except for the excellent primary research by Savage (2005). Yet, in legal terms, Eurostat is a more authoritative regulator than DG Ecfin. Its rulings on the European System of Integrated Economic Accounts (ESA), in particular on how certain transactions affect the deficit or debt of general government, constitute secondary case law, are final and cannot be overruled by the Council (Savage 2005: 62; 192). If a member state refuses to comply by new accounting rules, Eurostat can decline certification of its biannual reports which constitutes a breach of the Maastricht Treaty and can trigger an EDP. Eurostat has done this in the case of Portugal and France (Savage 2005: 149). Eurostat's role was strengthened even more in 2004, when a Statistical Code of Conduct was issued in response to misreporting by the Greek authorities. It strongly endorses independent statistical assessments. Eurostat now has a mission to Treasuries at least every two years, but is allowed to visit any time in between. Eurostat has thus become an 'independent auditor' as one Treasury official put it in an interview. This 'auditing dimension' evolved over time and is remarkable since it was not intended in the original set-up (Savage 2005: 52, 43-44).

Eurostat's authority and autonomy is backed up by a strong advisory body, the Committee on Monetary, Financial and Balance of Payments Statistics (CMFB). This committee consists of the representatives of national statistical institutes and national central banks of the European Economic Area, including Norway, Iceland and Liechtenstein, with observer status for candidate countries like Turkey and supranational institutions like the IMF and the OECD. The CMFB is 'the premier body within the statistical community for setting policy on the requirements and methodologies in providing statistical services to the EU' (Savage 2005: 63). The CMFB has become such a powerful body that some Ministries of Finance tried to replace their national statisticians on the committee; yet Eurostat and national statistical institutes managed jointly to fend off these demands (Savage 2005: 64).

The run-up to EMU was dominated by Eurostat's decisions on how fiscal transactions account towards deficit and debt reduction -- or not. DG Ecfin managed to 'get back into the game'[9] after 1999, in particular through the structural (cyclically adjusted) measurement of deficits. This requires econometric methods and economic models that are not the realm of statisticians. At the request of the ECOFIN Council in May 2004, DG Ecfin developed the production function approach to cyclical adjustment which it argues has a sound economic, not merely statistical, foundation (Denis at al 2006). Another way for DG Ecfin to assert its role is to base fiscal surveillance on projections, rather than historical data for which Eurostat is responsible. The sustainability and quality agenda requires exactly that. Projections make more economic sense since prevention is the goal, yet their inherent uncertainty makes them less suitable for regulatory control.

DG Ecfin is seen by some member state governments as interested in directly influencing policymaking rather than in the technicalities of budgetary surveillance (Savage 2005: 52; 177). An example for this tendency of DG Ecfin to stretch its regulatory role to the limit was the proposal to synchronize budgetary calendars between EU and national levels. In an overwhelming majority of countries, the draft budget is endorsed by the government and submitted to parliament between September/ October. The S&CP are prepared simultaneously and then submitted so that the 'programmes are examined by the Commission and the Council only after national budgets have definitively been passed by national authorities.' (Public Finances 2007: 69) DG Ecfin wanted to make the S&CP 'a real *ex ante*-process' by shifting their submission to before summer, and shortly after the medium term planning for all economic policies under the Broad Economic Policy Guidelines (BEPG) is finished: '[T]his step could be envisaged as the national transposition into a national perspective of the multi-annual guidelines provided in the BEPGs [..]. In that way, the BEPGs and the opinions on the programmes would provide the framework for the preparation of national budgets by governments and for its final adoption by the parliament.' (Public Finances 2004: 127) This proposal would constitute a step away from regulatory state building towards fiscal federalism with shared budgetary responsibilities and national parliaments as the principals of the process. Bringing national parliaments into the process would undermine the claim that EU fiscal surveillance is mending failures of national democracies but address the 'democratic deficit' in EU fiscal surveillance. This

[9] This is a quote from a DG Ecfin official in Savage (2005: 148).

proposal was not included by the Council in the revision of the Pact and interviews in Treasuries do not suggest that any efforts go into changing budgetary calendars.[10]

The difference between Eurostat and DG Ecfin highlights opportunities and limitations of the regulatory state in fiscal surveillance. Eurostat is quietly harmonizing fiscal accounting all over Europe, even beyond EU borders, while mostly escaping public attention, even in the scholarly literature. It has achieved this by using the advisory process to its advantage in that Eurostat's decisions go with the majority in the CMFB, bringing national technical experts on its side (Savage 2005: 142). Secondary legislation thus looks as if it were generated by an apolitical regulatory process, built on a consensus enshrined in ESA and continuously developed in rational deliberations. By contrast, the attempt at 'blinding with science' by DG Ecfin, adding ever more sophisticated data and reporting requirements has little strategic value for domestic policymaking. Nor does it attract the interest of national parliamentarians even though DG Ecfin has tried to offer itself as a faithful agent for the joint monitoring of governments by proposing to streamline budgetary calendars.

2.3b) The empowerment of delegated authority in the U.S.

The contrast between the two federations or multi-governance systems is quite stark in this respect. The U.S. has regulatory agencies for budgetary policy both at the federal and the state level, but in contrast to the EU the fiscal regulators are confined to either the federal or the state administration and they have to share their power of oversight with the parliament, ie Congress or state legislatures. Finally, the 'managerial presidency' is not confined to regulatory-allocative intervention in contrast to budgetary-redistributive tasks, unlike the EU Commission. This raises the question whether the set-up for the delegation of authority is compatible with a regulatory state interpretation at all.

The powerful Office of Management and Budget (OMB) is the incarnation of the U.S. regulatory state in fiscal policy (Pildes and Sunstein 1995: 14-16; Blöndal et al 2003: 12). For the budgetary process, this independent agency in the presidential administration assumes the policy-making functions that in most countries are assigned to the Treasury.[11] The OMB initiates the federal budgetary process in April, 18 months before the respective fiscal year starts, by issuing a letter to all ministries ('departments') specifying funding levels and management issues, such as the need for performance measures (Blöndal et al 2003: 11-15). Ministries make their requests for funding to the OMB by September. They receive information about budget totals from the OMB by November against which they can appeal; the final decision lies with the President. In December/ January, the OMB and the departments finalise budget documentation. The President's budget proposal goes to Congress before the second Tuesday of February. There the requests have to go through the almighty appropriations committees for each department, in both the House and the Senate.

[10] Two years later, the Commission finds that the involvement of national parliaments in preparing or endorsing the S&CP is minimal. In three quarters of all member states, the programmes are not voted on or not even submitted to parliament. Just a minority of about one in five member states attach the programme or a preliminary version to their draft budget law (Public Finances 2007: 70-71).

[11] The Department of the Treasury is concerned with the daily cash management of the federal government and plays a secondary, perhaps even tertiary role for policy-making, given that the Council of Economic Advisors is also part of the Executive Office of the President (Blöndal et al 2003: 14, 47). This has dramatically changed in the crisis since October 2007.

The parliament has six months to pass the budget that starts on 1 October. The OMB then has 'a key role to play in overseeing the co-ordination and management of the entire executive branch for the President' (Blöndal et al 2003: 12).

The OMB thus combines the policy-making functions of a ministry and the regulatory functions of an agency with considerable managerial flexibility. The director of OMB is a ministerial level position and a member of the President's Cabinet (Blöndal et al 2003: 12). As indicated above, the regulatory state in the U.S. originated in the institutional power play between Presidency and Congress (Pildes and Sunstein 1995: 11-16). '[T]he President and the Congress "co-manage" the executive branch.' (Blöndal et al 2003: 39) In this co-management, the President is ex officio a guardian of the welfare of the Union, even if elected not in the same sense prone to electoral politics as a member of parliament who represents a particular constituency, an electoral district in the House or a state in the Senate. Once the budget is passed, the OMB plays an analogous regulatory role to the EU Commission, monitoring the compliance with detailed rules at the programme and agency level.[12] It is the meta-regulator of programmes run by federal agencies and ministries, especially through its Office of Information and Regulatory Affairs (OIRA). But the combination with a leading role in the preparation of the President's budget and a presidential review process of agencies' performance has made the OMB a controversial body (Pildes and Sunstein 1995: 24-28), prone to politicization analogous to the Council in its regulatory function.

The federal budgetary process led by the OMB is not synchronised with the budgetary calendars of the states. It was mentioned that the federal fiscal year begins in October while in most states it begins in July, so 'federal revenue or spending changes may affect decisions already enacted by the states.' (NASBO 2004: 9). This creates considerable uncertainty for state budgets (Blöndal et al 2003: 51-52). On the revenue side, states have complete autonomy on taxes but 'for simplicity' they have tied some state taxes to federal laws so that changes in federal taxes may also affect state revenues. On the expenditure side, about one quarter of all state and local spending stems from the 600 categorical and block grants that the federal government sends. These grants can be both matched and unmatched but the largest programmes have to be matched by state funds, for instance Medicaid which accounts for 40% of all federal grants to subnational governments. Rainy day funds can be used to compensate for unexpected shortfalls in tax revenue or federal grants.

The solution to this interdependency between fiscal levels has, as far as I know, never been sought in a synchronization of budgetary calendars. Rather, legal provisions are meant to contain the largest source of uncertainty for state budgets, namely unfunded federal mandates.[13] It prohibits federal legislation to that effect. It is a matter for parliaments and

[12] The closest comparison would be state aid or accounting rules in the EU, enforced by DG Competition or Eurostat, respectively.
[13] Since 1995, explicit unfunded mandates are prohibited and the Congressional Budget Office (CBO) is required to screen legislation to determine whether it mandates unfunded spending by states if likely costs exceed a certain threshold. Some programmes, in particular Medicaid, are exempt from such screening (NASBO 2004: 9). Any member of Congress can raise 'a point of order', that is object to a piece of legislation which might violate the prohibition of placing an unfunded mandate on lower levels of

their supporting budget offices, not the executive, to internalize the externalities of multi-level policy-making and an expression of an inherent distributive conflict: 'Because of constraints on state spending, the federal government is often a release valve for states as they try to shift state-funded costs to the federal government principally in open-ended entitlement programmes. Cost shifting happens in reverse as well. As new federal funds have been scarce, the federal government has tried to mandate spending in sub-national governments to address national goals.' (Blöndal et al 2003: 51) It is remarkable that only the cost-shifting in reverse is constrained, formally and explicitly.

2.4 Summary

Table 1 summarizes the last three sections and indicates, somewhat to my own surprise, that there is a more developed regulatory state in fiscal surveillance in the EU. The EU regulatory state in the making addresses more explicitly problems of fiscal governance in national democracies. In the U.S., regulatory state building in fiscal policy has not really separated out a 'fourth branch of government' but is introducing New Public Management type of regulatory techniques into budgetary politics at most. It is thus more an attempt at rationalizing the budgetary process with its strong role for legislatures and reaches across government levels only to a very limited extent.

Table 1: Summary of the contrasts between regulatory states in fiscal policy

	European Union	United States
Formulation of the policy problem	*Regulatory:* Internalising spillovers from profligate state fiscal policies; long-term sustainability of each national fiscal policy	*Only partly regulatory:* Prudence in the sense of matching current expenditure with current revenue and limiting debt burden for future generations
Regulatory techniques	Stability and Convergence Programmes; Statistical Code of Practice; fiscal rules; long-term projections; regular consultations between EU and national fiscal or statistical experts	Performance budgeting at federal and state level; fiscal rules (but goal not regulatory); medium-term projections [federal oversight tied to budgetary relations]
Delegated regulatory authority	DG Ecfin and Eurostat; Council as adjudicator of last resort (after Pact revision)	Office of Management and Budget (after federal budget has passed)

The fiscal constitution of the United States arguably limits its ability to develop a regulatory state in budgetary surveillance: the federal budget is the elephant in the room of state fiscal policies, financing about a quarter of all state expenditure and helping them out with federal loans when they cannot meet their balanced budget requirements. To guard their sovereignty, states will therefore not accept much oversight from the federal executive. This is left to strong legislatures. In the EU, it is the states that have big fiscal

government; such a point of order can only be waived with a majority in Congress (Blöndal et al 2003: 22). In addition, representations of state interests in Washington, DC, 'monitor federal actions that may impact on state finances.' (NASBO 2008: 3) muscles. The budget control rights of national parliaments vary widely but tend to be weaker than in the U.S. (Public Finances 2007: part II). An EU regulatory state in fiscal surveillance has arisen whose powers of general inspection exceed anything that the federal government in the U.S. can exercise (Sbragia 2004: 59). This is hard to explain for any comparison in terms of fiscal federalism; one would have to take recourse to questionable conjectures, for instance that for some reason EU member states do not guard their sovereignty as jealously as U.S. states. My interpretation is rather that the EU regulatory state is not a competing government level but a branch of government, possibly a nuisance for other branches but reined in by a functional division of responsibilities. It is politically contested but typically within the executive rather than between governments or between executive and legislature.

3 Fiscal policy in the EU and the U.S. contrasted: Responses to the crisis

The financial and economic crisis since October 2007 is a stress test for any fiscal framework that wants to ensure 'economically sound' or 'prudent', in contrast to politically expedient, budgetary policies. At the time of writing in March 2009, no government has found a way to stop the crisis despite considerable fiscal resources devoted to it. My interest here is to analyse whether the contrasting responses can be traced back to the extent to which the regulatory state manages to commit governments to economically justifiable policies – assuming that democracies have problems to keep such commitments. Three issues seem to be relevant for this analysis and I put them deliberately in terms that support crisis management by the regulatory state:

1. Are there explicit or in-built precautions against distributive, interest group and electoral politics or is 'pork-barrel' the price to pay for getting crisis management approved quickly?
2. Are there observable attempts at keeping the debt dynamic and contingent liabilities for future taxpayers within bounds or is short-term crisis fighting, 'gambling for electoral resurrection', the order of the day?
3. Are there ways of forcing members to take the union's welfare into account when designing interventions or is there little to stop protectionist or discriminatory measures of member states?

3.1 Precautions against distributive politics

Explicit precautions against distributive politics taking over crisis management can be seen in attempts at following economically sensible, agreed guidelines and ask for transparency in the allocation of funds. The Obama administration has set up a dedicated website[14] which allows to track the use of funds (of $787 billion over two years, of which $275 billion go to the states) from the American Recovery and Reinvestment Act (ARRA), signed into law in mid-February 2009. Apart from the usual guidance by the OMB which is developing standard terms and conditions for all grants and contracts, a Recovery Accountability and Transparency Board has been created which entrusts a board of inspectors general with overseeing the disbursement of funds by federal agencies. The European Economic Recovery Plan (€200 billion in 2009), agreed in mid-December 2008,

[14] At URL: www.recovery.gov

is much more decentralised, basically adding up and providing a common framework for what member states spend to fight the crisis in 2009. The EU budget provides only a fraction of this sum (€30 billion). The Commission is more engaged in preventing policy disasters, such as the competitive offer of deposit insurance or discriminatory support for national car industries, proposing common guidelines for the recapitalisation of banks and coordinating emergency support to some new member states like Hungary and Romania. DG Ecfin maintains a dedicated website[15] that has a chronology of measures taken at member state level and approved by the Commission, mostly under the pretext of state aid rules but also under the Stability Pact.

An in-built precaution against distributive politics dominating crisis management is reliance on automatic stabilisers, ie budget items that make the fiscal balance vary counter-cyclically with booms and recessions without the government taking discretionary action. Ceteris paribus, automatic stabilisers are more effective the larger the size of government, the more progressive the income tax system, and the larger the share of cyclically responsive budget items such as corporate taxes on profits or unemployment benefits. On all these accounts, Europe's more generous welfare states and more burdensome tax states do structurally better than the U.S. (OECD 2005: 20-25).[16] Table 2 gives the contribution of automatic stabilisation, based on the latest OECD measures for the counter-cyclical responsiveness of budgets to a 1% change in the output gap and estimated output gaps 2008-2010 by the IMF. For reasons of clarity, only the biggest EU member states are listed, counting for about 80% of EU GDP. The budgets of European countries are about 25-40% more responsive than in the United States and the comparison with similar output gaps in Italy shows how much difference this makes. This is also due to the fact that the stabilising effect of the U.S. federal budget is partly undone by the pro-cyclical effect of state and local fiscal policies (Follette et al. 2008). The EU budget has to be balanced annually, hence does not vary with the business cycle and is, at about 1% of GDP, in any case too small to make a difference.

[15] At URL: http://ec.europa.eu/economy_finance/focuson/focuson13254_en.htm

[16] General government expenditure in the U.S. is about 30% of GDP, below the OECD average of over 40%. The federal government counts for two thirds of all public spending, states for the other third (Blöndal et al 2003: 52).

Table 2: Estimated Contribution of Automatic Stabilisation (as % of GDP)

	Overall budget responsiveness[a]	2008		2009		2010	
		OGap	**AutStab**	OGap	**AutStab**	OGap	**AutStab**
France	**0.53**	0.0	**0.0**	-2.2	**-1.2**	-2.5	**-1.3**
Germany	**0.51**	1.1	**0.5**	-1.1	**-0.5**	-1.5	**-0.8**
Italy	**0.53**	-1.2	**-0.6**	-3.5	**-1.9**	-4.0	**-2.0**
Spain	**0.44**	-1.2	**-0.5**	-4.7	**-2.1**	-6.2	**-2.7**
UK	**0.45**	0.3	**0.1**	-2.4	**-1.1**	-3.3	**-1.5**
USA	**0.33**	-0.3	**-0.1**	-3.6	**-1.2**	-4.2	**-1.4**

Source: OECD (2005: table 9), OECD (2008: table 10), own calculations

a Sum of the elasticities for corporate, personal income and indirect taxes, social security contributions and for all current expenditure (mostly unemployment compensation).

OGap Output Gap is the deviation of actual output from estimated potential output, as % of potential GDP, published by the OECD in November 2008.

AutStab Automatic Stabilisation, ie the estimated annual change of the budget balance as % of GDP; calculated by multiplying the measure of overall budget responsiveness by annual output gaps.

The U.S. federal government was first in passing bold discretionary measures, the estimated size of which is given in table 3 which does not include bail-out measures for the financial sector (IMF 2009, table 1). This was partly due to the fact that the U.S. recession started in December 2007, earlier than in most European countries (Economist 2009: 72).[17]

Table 3: Estimated Contribution of Discretionary Measures (as % of GDP)

	2008	2009	2010	Total
France	0.0	0.7	0.7	1.4
Germany	0.0	1.5	2.0	3.5
Italy	0.0	0.2	0.1	0.3
Spain	1.9	2.3	n.a.	4.2
UK	0.2	1.4	-0.1	1.5
United States	1.1	2.0	1.8	4.9

Source: IMF (2009: Table 4)

Note: 'The figures have been corrected for: (i) "below-the-line" operations that do not impact the fiscal balance; and (ii) the fact that in some countries part of the announced stimulus included measures that were already planned for.' (IMF 2009: 13)

Given the pro-cyclical stance of state policies, it is noteworthy that the stimulus package devoted considerable resources to increase state spending on unemployment benefits in terms of compensation levels (by $25 per week), eligibility (eg to part-time workers) and duration (up to 18 months instead of 6 months).[18] This is against the background that by December 2008, thirty states were bound to run out of funds for their employer-financed unemployment insurance, two (Indiana and Michigan) had already become insolvent (Herald Tribune 2009). States are then forced to restrict access, raise contributions from

[17] To get the contribution from both automatic stabilisation and discretionary measures, only the absolute numbers of table 2 should be added to the respective numbers of table 3. For instance, in 2009 Spain's budget is estimated to contribute (2.1+2.3=) 4.4% to aggregate demand that would almost offset the output gap of 4.7%.

[18] This is Title II of ARRA, the so-called 'Assistance for Unemployed Workers and Struggling Families Act'. For a summary see http://www.naswa.org/recovery/

employers or borrow from the federal government, the latter at a cost of 4.7% interest if not repaid within the fiscal year. To avoid pro-cyclical measures, the federal stimulus package of February 2009 created a new programme (Federal Additional Compensation) that offers interest-free loans to states until June 2010. In other words, the federal budget provides ad hoc emergency safety nets that are permanent entitlements in European welfare states. Inevitably, there were press reports about obvious pieces of pork (Washington Post 2009), hardly surprising when mayors all over the country submit almost 12,000 projects in anticipation of funding.-- What is noteworthy of the figures for Europe is the diversity of responses, contradicting the widely held belief that the fiscal framework imposes a one-size-fits-all policy which is inevitably too timid. Discretionary measures in Spain and Germany were of comparable size to the United States as soon as the recession made itself felt.

3.2 Concerns about the dynamic of public debt

As regards the second question for attempts at reining in the long-term consequences of massive fiscal interventions: we see at the moment little effort in this regard in the U.S. while the EU is, at least in rhetoric, more cautious and restrained. Against the backdrop of a projected budget deficit of 12% in 2009 and almost 9% in 2010 (IMF 2009: table 6), the Obama administration still puts its emphasis on the accountability to the current taxpayer: '[t]he President has made it clear that every taxpayer dollar spent on our economic recovery must be subject to unprecedented levels of transparency and accountability'.[19] In the EU, the governments of big member states propose to wait for the outcome of the first wave of fiscal interventions and to shift attention to coordinated regulatory intervention, to the extent that the chief economist of the IMF has criticised them for being too concerned about their debt-to-GDP ratios (Blanchard 2009). Likewise, the Commission keeps on emphasizing that the maxim of all interventions must be to avoid negative spillovers, and that the revised Stability Pact provides flexibility and guidance for a 'timely, targeted, temporary and co-ordinated' demand stimulus to the tune of 1.5% of EU GDP (CEC 2008: 8). The Commission recommended on 24 March to open an EDP against countries which had an excessive deficit in 2008 already, France, Greece, Ireland, and Spain, and to reach a Council decision on the UK's insufficient efforts to rein in projected budget deficits of around 10% for 2009/10. The press statement [IP /09/458] stresses that member states 'rightly adopted' discretionary measures but that the SGP should be seen as a framework for an 'exit strategy' from rapidly increasing debt burdens.

This difference in rhetorical emphasis does not, however, translate into systematic differences on the substance of stimulus measures. As table 4 reveals, all packages combine temporary expenditure increases with largely permanent revenue reductions; with the exception of Italy, all support infrastructure investment, social safety nets and environmentally-friendly technology and reduce personal income taxes. None has announced to increase public employment. That is, we can discern a clear attempt to avoid lasting expenditure increases, a startling optimism that tax revenues can be cut permanently, but no big difference as regards either between advanced OECD countries (treating Italy admittedly as a dysfunctional outlier).

[19]At URL: http://www.recovery.gov/?q=content/accountability-and-transparency

Table 4: Types of Stimulus Measures, 2008-2010 (as announced by 28 February 2009)

	FR	GE	IT	SP	UK	US
Expenditure measures						
Infrastructure investment	T	T		T	S	T
Support for SMEs		T				
Social safety nets	T	T	T	T	T	T
Housing/construction support	T	T		T	T	
Strategic industries support		T		T		
Public employment						
Other (green technology subsidies etc)	T	T		T	T	T
Revenue measures						
Corporate tax reduction/ depreciation	P	P/T				P
Personal income tax reduction	T	P		P	P	P
Indirect tax reduction (VAT etc)		P		S	S	
Other					P	

Source: IMF (2009: Table 5)

T: Temporary measures (with explicit sunset provisions or time-bound spending)

S: Self-reversing measures (measures whose costs are recouped by compensatory measures in future years)

P: Permanent measures (with recurrent fiscal costs)

3.3 Prevention of discrimination and protectionism

Finally, the problem of negative spillovers from states' crisis management is tackled very differently by the two fiscal unions. In the U.S., it depends almost entirely on the generosity of federal budget support to what extent counterproductive state measures are prevented. About half of the projected shortfalls of state budgets, to the tune of $250 billion through 2011, are covered by $135 billion federal grants and distributed on the basis of existing formulas (Scheppach 2009). These additional general funds[20] primarily free up states' matching funds for Medicaid and education which can then be re-programmed. In particular the Medicaid formula guarantees that federal funds go to states that are hardest hit by unemployment in the course of which individuals lose occupational health care insurance. Only a few small, energy-rich states seem to enjoy windfall gains this time (Scheppach 2009). What this indicates is the notorious tradeoff between generosity and targeting that all federal emergency relief encounters: since it has to go to all states, the less generous, the better targeted, but also the higher the pressure on states to engage in pro-cyclical adjustment – and vice versa.

The EU budget cannot provide generous support although it can target its meagre funds on particular countries or regions. Within the Economic Recovery Programme, the Commission offers additional transfers through the European Social Fund and the structural funds for infrastructure development but member states have to apply. While skeptics have reason to suspect that this is simply renaming already planned expenditure, the Commission claims that this makes additional funds available in the sense of easier access to the European Social Fund and of bringing forward the spending of structural funds within its multi-year financial framework (CEC 2008: 11-17). Its negligible

[20] In contrast to the remaining $140 billion ARRA funds for states that go to specific programmes controlled by the federal government.

contribution of about 0.3% of EU GDP means, however, that the Commission's main contribution to crisis management consists of regulating budgetary emergency measures in member states.

An immediate test for regulations to prevent negative externalities came in early October 2008 when the Irish Parliament passed legislation to give a blanket guarantee for two years to all deposits and bonds held in six Irish banks, worth an estimated €400 billion. Greece followed suit. The British, French and German authorities protested vehemently against the discriminatory measures. Yet, a few days later Germany went on to guarantee savings in all banks operating in Germany and although this was deemed non-discriminatory by the Competition Commissioner (EUbusiness 2008), it raised the spectre of competitive bidding for savings and a spread of banking crises all over Europe. The Commission moved quickly and got, by mid-October, the agreement from the ECOFIN Council for an amended Directive on Deposit Guarantee Schemes[21]. It stipulates a minimum amount to be guaranteed (€100,000 at the end of 2009; possibly confined to 90% of the deposit) and accelerated pay-out (within 3 days rather than 3 months). The difference to the budgetary solution in the U.S. is telling: there the Federal Deposit Insurance Corporation provides a nation-wide guarantee which precludes a destabilising competition for deposits. However, the Geithner-Summers plan to relieve banks from toxic assets, announced on 23 March 2009, shows the problem that then arises: given the imperatives of crisis management, the executive seems to have felt that is should avoid parliamentary control of its bailout plan, it is designed as an off-balance operation because it is at risk of being turned down by Congress. Jeffrey Sachs portrayed the plan as an attempt at 'raiding' the FDIC that Congress must obstruct (Sachs 2009).

A last revealing issue to contrast is the control of state aid. In the U.S., the Dormant Commerce Clause is the legal device that the Supreme Court has developed ever since the 19th century to prohibit discriminatory and protectionist regulation by states in favour of the economic interests of its citizens (Redlich et al 2005: ch.5).[22] This body of case law applies in areas that are not explicitly covered by the Commerce Clause which gives the federal government the power to regulate all areas relevant to interstate commerce. But there is an important exception to this dormant Commerce Clause: the 'market participant exception' says that when a state acts as a seller or buyer of goods and services, rather than as a market regulator, it may favour its own residents. The rationale for this exception to the Dormant Commerce Clause is contested. Regan (1986: 1193-1195) gives two reasons: the exception allows protection and discrimination whenever the state does not use traditional protectionist instruments, such as a tariff, and when the intervention involves spending of the states' own funds because, in comparison to regulation and levying a tax, spending is less coercive and has an inherent limited tendency, even if protectionist in purpose. Case

[21] The draft directive is available at:
http://ec.europa.eu/internal_market/bank/docs/guarantee/dgs_proposal_en.pdf

[22] Another is the Privileges and Immunities Clause of Article IV of the Constitution. It prohibits discrimination against out-of-state citizens in the exertion of basic rights (privileges and immunities are 'activities which are "sufficiently basic to the livelihood of the nation"' like freedon of speech or police protection) and does not apply to corporations which is why this clause is not prominent in the area of state aid (Redlich et al 2005: 136-138; Regan 1986: 1202-1206).-- I am grateful to Deborah Mabbett for alerting me to this body of legislation.

law has thus allowed states to buy from local providers only, waive taxes (ie forego revenue) on new manufacturers locating in the state or require construction firms to hire local workers for state-funded building works. It is not surprising therefore that in the initial OMB guidelines of the stimulus plan, I could not find any explicit prohibition of states' discriminatory use of federal grants.[23] Activists like OMB Watch or the 'Coalition for an Accountable Recovery' have criticised that '[t]he guidance only requires the first subsequent recipient (the sub-recipient) of federal recovery money to report on the use of the funds. For example, if the federal Department of Transportation gives a grant to the state of Georgia to repair and build roads, and Georgia then gives some portion to the city of Atlanta for area roads, there would be no requirement for companies receiving contracts from the city to report on the use of the money or the number of jobs created.' (OMB Watch 2009) Regulation tries to guard against waste and fraud but not against spending that privileges in-state residents.

The state aid rules of the EU prescribe that public procurement must normally observe strict non-discrimination. Exceptions can be granted only if there is a justifiable public interest goal, in EU parlance a 'horizontal' objective such as environmental protection or social cohesion, in contrast to a sectoral objective, ie subsidizing employment in ailing industries (Blauberger 2009). These state aid rules were immediately tested when governments in France, Spain, Britain, Italy, Germany and Sweden rushed to the rescue of their national car industries (EUobserver 2009). State aid for, say, Opel in Germany or Vauxhall in Britain, both subsidiaries of GM, is as politicized in Europe as the rescue packages for the three big car industries in the U.S. The French government triggered a storm of protest in Central Eastern Europe when it initially conditioned its €6.5 billion support for Renault and Peugeot on the stipulation of no plant closures in France for five years, which would incentivise these firms to close plants in the Czech Republic instead (the French government withdrew the condition on 25 February). The Commission stepped in resolutely, presenting a Communication on guidelines for admissible support of the car industry.[24] For instance, subsidies to households for scrapping their old car must not discriminate against any supplier but leave households the right to choose. Yet, given the heated atmosphere in which the regulatory state cannot thrive, the Commission had to be uncomfortably outspoken when presenting these guidelines on 25 February 2009: 'We will not accept any economic nationalism, rather we will make a decisive use of the instruments at our disposal to combat such nationalism and we will also ensure that the competition rules are in force, both within and outside of the internal market.' (Verheugen, quoted in: EUobserver 2009) Presumably to avoid a standoff with governments that regulators cannot win, it took to outspoken criticism of the industry for its failure to deal with long-term structural problems. The guidelines propose to limit aid to firms with liquidity problems that did not have well-known problems pre-dating the crisis, preferably through indirect measures that support consumer demand and make banks providing credit. But state aid

[23] There is no reference to 'protection' and only one reference to 'discrimination' which asks to distribute funds in accordance with the Civil Rights Act and other statutes that prohibit discrimination on the basis of ethnicity, gender, disability etc (OMB 2009: para.1.6)

[24] See URL: http://ec.europa.eu/enterprise/automotive/pagesbackground/competitiveness/com_2009_0104.pdf , annexes and other documents can be found at URL: http://ec.europa.eu/enterprise/automotive/pagesbackground/competitiveness/index.htm.

rules regarding public guarantees or subsidised loans for the industry have also been relaxed for a limited time of 2-3 years.

3.4 Summary

The response to the ongoing crisis seems to confirm that the 'fourth branch of government' is indeed more developed in the EU than in the U.S. There is more reliance on regulation, if only for lack of a sizeable union budget, and automatic stabilisation in EU member states. Conspicuous federal activism, with the Treasury rather than the OMB in the helm, is at the centre of crisis management in the U.S., bringing distributive politics to the fore. European governments are also more concerned about the public debt consequences of crisis management and prefer a stronger focus on regulatory coordination to a joint stimulus plan. However, the scale of the stimulus measures in the EU and the U.S. is not as big as one would expect given media reports, and there is a considerable overlap in the concrete measures taken.[25] Finally, crisis management in the EU is more sensitive to negative spillovers from discrimination and protectionism by states, eg with respect to deposit guarantees and rescue packages for the car industry. In the U.S., the federal budget is the risk manager of first resort, providing both, concerned mainly about fraud and waste in the devolved allocation of federal funds. All this is remarkable given that a severe crisis with its political drama is not the best environment for effective regulation, one might have expected that the EU regulatory state retreats for a while. Yet it has just about managed to stay low key and act effectively behind the scenes. Its fiscal surveillance also has not obstructed varied and decisive responses by member states, in line with their political priorities and perceived economic needs.

Concluding remarks

In this paper, I have argued that an EU regulatory state has effectively emerged in the area of fiscal policy while it is rudimentary in the U.S. where budgetary politics dominates. The reason for this was located in fundamental differences as regards the federal set-up and the budgetary control in the two unions. The U.S. has a strong federal level that requires countervailing protection for the political sovereignty of states; strong control rights vis-à-vis the executive are exercised by legislatures. In the EU, a fourth branch of government, not a full-fledged government level with its own three branches, is allowed to remind the member states constantly of all matters of common concern and to exercise oversight over budgets parallel to national parliaments. Comparisons that treat the EU as an underdeveloped fiscal federation have a hard time to explain why member states accept much more intrusive federal inspection if the union level is at the same time fiscally so weak. My interpretation, in the tradition of Majone (1996), also suggests that the U.S. cannot develop a regulatory state in fiscal matters across governance levels without completely upsetting the balance of power between states and federal government in favour of the latter.

[25] It is beyond the scope of this paper to explain fully why there is such a discrepancy between rhetoric and action. It has created the impression in the U.S. that Europe is freeriding on its stimulus while most Europeans feel they are drawn into cleaning up a mess that is primarily the responsibility of the U.S. From an economic point of view, one might also consider that European countries have more reason to be concerned about a weakening of their currencies and hence downplay their fiscal activism. By contrast, a strong and rapid devaluation of the dollar can become part of the solution, given that the U.S. is indebted in her own currency.

Critics of the regulatory state may read this analysis as yet more evidence for how dangerous the EU is for the political sovereignty of member states or for the social taming of market processes. Yet, the contrast with the U.S. suggests that one can't have it both ways. The protection of political sovereignty, to the point where state spending is allowed to discriminate openly in favour of residents, is easier to prioritise when social protection is much more limited than in the EU. Otherwise, the difference in the generosity of safety nets and in the ability to subsidize employment becomes a very divisive issue, both if discrimination is allowed (within limits) and if it is prohibited (with specified exceptions). This safeguard of political liberalism comes at the cost of less economic stability and social security. It induced the federal government now to strengthen social safety nets of the states in health, unemployment and education.

The EU asks members to give up some political sovereignty and treat their spending decisions as a matter of common concern. Yet the states have not granted to the Commission what ultimately bestows sovereignty to a political entity, namely the right to tax and spend based on its own majoritarian legitimation. For that reason, member states can allow the very same body to be as intrusive as it can justify on economic grounds. The construction of good economic grounds is important in my view, because it promises (but obviously does not guarantee) that the constraints on political sovereignty and the infringement on the right to discriminating social protection can be weighed up against gains in economic stability and efficiency.

The response to the financial crisis brought into sharp profile the strengths and weaknesses of either fiscal arrangement. In the U.S., it exposes the dependency of states and their economic stability on the federal budget. Crisis management hinges completely on how the drama of distributive politics plays itself out between the White House and Congress. Yet the federal government can mobilise enormous fiscal resources, internalises potential spillovers through centralisation and has a better chance to overcome coordination problems in its response. In the EU, the crisis exposes the fragile political foundation of solidarity in the union that is not helped by the unequal size and hence ability of countries to provide economic stability. Crisis management depends largely on big member states' willingness to engage in constructive measures that benefit everybody, not only themselves. But the decentralised response allows for more tailored measures sensitive to heterogeneous political preferences, while the institutionalised venues of rational deliberation do force governments to argue their case and submit their plans for scrutiny. Given the unprecedented challenges that this crisis poses for every government, it seems only fair to say that both the United States and the EU have proven their ability to act, albeit in very different ways.

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Quotes: "It was bloody. I loved it. It was the action. The regulatory staff is at the interface of capitalism and the government. Working there was exhilarating."
"Looking back, I would say it was a hell of a ride," Tozzi said. "You got a high, man. Every time you went to work. You could feel it. You were going to regulate the regulators."

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