Title:
Towards Fiscalization of the European Union? The US and EU Fiscal Unions in a Comparative Historical Perspective

Author:
Wozniakowski, Tomasz P., UC Berkeley

Publication Date:
Spring

Series:
Other Recent Work

Permalink:
http://escholarship.org/uc/item/667699tw

Towards Fiscalization of the European Union? The US and EU Fiscal Unions in a Comparative Historical Perspective*

Tomasz P. Woźniakowski

Fulbright-Schuman Fellow
Department of History
University of California, Berkeley

ABSTRACT

This paper shows that the emergence of the federal power to tax is the result of a sovereign debt crisis at the state level. I analyse the fiscal history of the early United States (US) to demonstrate how the institutional flaws of the Articles of Confederation, mainly the central budget based on contributions from the states, so-called 'requisitions', led to a sovereign debt crisis on the state level, which triggered taxpayers' revolts in 1786/1787. This social unrest, in turn, was perceived by the political élite as an endogenous threat to the union and paved the way for the fiscalization of the federal government, i.e. the creation of a genuine fiscal union with the federal power to tax based firmly in the Constitution of 1789. This analysis is complemented with lessons for the European Union (EU) on how to handle such a debt crisis if the union is to be preserved.

KEY WORDS EU fiscal union; euro crisis; sovereign debt; US history; US federal power to tax; US fiscal union

> Sir, if we have national objects to pursue, we must have national revenues. If you make requisitions and they are not complied with, what is to be done? It has been well observed that to coerce the States is one of the maddest projects that was ever devised. A failure of compliance will never be confined to a single State: This being the case, can we suppose it wise to hazard a civil war?
>
> Alexander Hamilton[1]

1. INTRODUCTION

The lack of the ability of a federal government to raise revenues from its own sources has been identified as the main factor underpinning the lack of sustainability of a federation (Kincaid 2014: 292-293; Riker 1975: 111). In order to become viable, central governments

* This is a revised version of the paper, which won the first College of Europe - Arenberg European Prize 'Exploring Federal Solutions'. This paper was presented at the Institute of European Studies at the University of California, Berkeley on April 23, 2015.

must therefore at some point become financially independent. This lack of sustainability can also be applied to the EU, and indeed can be viewed as its main flaw (for example, Moravcsik describes it as 'an exceptionally weak federation' [2001: 169-170]). While the idea of giving EU institutions the power to tax in order to overcome this weakness has been around for many years (see, e.g., Eichengreen 1991: 25-26), taxing would be difficult to implement because 'it implies a fundamental transfer of sovereignty from the nation-states to European institutions' (De Grauwe 2013: 169). It was precisely this same reason that, in eighteenth-century US, made it very difficult to give the federal government the power to tax. As Ferguson (1961: 290) accurately notes about the struggle for the federal power to tax in the late 1780s: '(n)othing testifies more to the audacity of the founding fathers than their demand that the people relinquish what they had fought Britain to preserve (…)'. The American states needed a trigger to agree on such a 'fundamental transfer of sovereignty'. This paper shows that the sovereign debt crisis constituted just such a trigger and activated the causal chain that ultimately led to the federal power to tax. The US can thus be seen as an example of successful fiscalization, a process that I define in the section on conceptualization, whereby the federal tax power was firmly based in the Constitution. It thus constitutes a benchmark for comparison with the EU.

The rationale for such a comparison lies in the fact that both cases are examples of the so-called 'coming together' type of federation, where previously independent states decide to pool part of their sovereignty to the higher level in order to better protect themselves against common threats (Riker 1964; Stepan 1999). A number of scholars have already compared the EU with the US from the point of view of federalism (Fabbrini 2007; Nicolaidis and Howse 2001; Sbragia 1992; Schütze 2009; Trechsel 2005; Weiler 1986). Moreover, in the wake of the Eurozone crisis a number of studies has been conducted in which scholars have looked at US fiscal history in search of potential solutions for the EU (Bordo et al. 2011; Hallerberg 2013; Henning and Kessler 2012; Kingreen 2015; Sargent 2012); In comparing these two polities, this paper therefore falls within a well-established tradition.[2] The focus of this paper on the *emergence* of federal tax power is inspired by the conclusion in Rodden's (2006: 281) seminal book on fiscal federalism: 'students of comparative federalism must try harder to understand the conditions under which the wide variety of fiscal and political structures around the world emerge and become stable. (…) As authority continues to shift (…) up to higher level entities like the European Union, the questions addressed by Alexander Hamilton, James Madison, and John Jay are more interesting and crucial than ever.' Hence, this paper aims at answering the following research question: What are the conditions under which the federal power to tax is likely to emerge?

The importance of the federal power to tax for the viability of a union has been recognised in classical studies of federalism (see, e.g., Riker 1964). However, recent studies focus on a 'fiscal union' with the implicit assumption that such fiscal union implies a large central budget, regardless of the way in which the funds are obtained (contributions vs. own resources). For instance, even though Bordo et al. (2011: 26) conclude their comparative study of five federations with the idea that the economic crisis in all of these countries increased the fiscal capacity of the central government and 'instituted a system of transfers and equalization payments', these authors did not study *how* the federal government acquired such fiscal capacity in the first place. This is precisely the problem of the EU - such independent fiscal capacity does not exist, and so the EU cannot fiscally expand in times of crisis. As a result, one of the five lessons that these authors provide for the Eurozone is that the recent European crisis may also lead to an increase of such fiscal capacity and financial transfers. However, they do not specify what they mean by 'fiscal capacity' - is it simply a large budget or does it also relate to the *mode* of obtaining revenues?

In the EU case, such genuine fiscal union would also make it difficult to calculate each state's contribution to the common budget and, as a consequence, the use of the rhetoric of net payers and net recipients, which can be perilous for the viability of the EU. For this reason studying the mechanisms of the emergence of such genuine fiscal union is more salient now than ever. I show that the US in the 1780s and the EU in the 2010s both faced exactly the same problem - the sovereign debt crisis of their member states. However, the solutions they chose to solve this problem were fundamentally different: whereas in the US this debt crisis triggered the process of *fiscalization of the federal government*, i.e. the emergence of a federal tax power, in the EU we witnessed only attempts to reach such solutions by the EU institutions (see, e.g., Commission 2012: 31-34) and the member states (Macron and Gabriel 2015). In the place of a federal tax power, the European sovereign debt crisis instead accelerated the process of strict regulation of the 'core power' of the member states – in the form of their fiscal policies (Genschel and Jachtenfuchs 2013).

This paper sheds light on the mechanism of the emergence of a federal power to tax, making two main contributions to the theoretical and empirical literature. In reference to the former, it introduces the concept of *fiscalization*, which defines the emergence of a tax power on the part of central government, and of a 'fiscal union', a concept which is often used, but is rarely defined.[3] Concerning the latter, it develops two main bodies of empirical literature, adding, first, to the historiography of the period: while federal fiscal policy under both the Articles of Confederation (Becker 1980; Brown 1993; Dewey 1907; Ferguson 1961) and the Constitution (Edling and Kaplanoff 2004; Einhorn 2006; Studenski and Krooss 2003) has been well researched, historians have largely overlooked the issue of how the federal power to tax emerged.[4] Second, by analysing the Confederation period of the US and the link between the sovereign debt crisis and the *emergence* of federal tax power, it adds to the US-EU comparative federalism literature. As Thomas J. Sargent remarked in his Nobel Prize lecture, 'The fiscal institutions of the EU today remind me of those in the U.S. under the Articles of Confederation' (2012:3). However, the US-EU comparative federalism literature has largely overlooked the critical juncture period in the US, from 1776-1789, when the system of financing the US federal government resembled that of the modern EU, and has focused instead on the US federal fiscal policy *after* the Constitution was ratified (Bordo et al. 2011; Henning and Kessler 2012; Gaspar 2015). This paper sets out to rectify these gaps in the scholarship.

This paper proceeds as follows: in the next section I present the theoretical and conceptual framework of analysis. Then, in Section Three, I investigate the fiscal history of the early US and provide empirical evidence for the main argument of this paper, which links the emergence of a federal power to tax with the sovereign debt crisis. Finally, in Section Four I conclude with some lessons for the EU in forging a genuine fiscal union taken from the US confederation.

2. THEORETICAL AND CONCEPTUAL FRAMEWORK OF ANALYSIS

In this paper I build on the theory of federalism developed by William H. Riker (1964, 1975), in which he cited military threats as a necessary precondition for federalism, which I use as a point of departure as well as an analytical framework of analysis.[5] This paper explores whether, just as the emergence of a federation is the result of exogenous military threats, the origins of the fiscalization process lie in endogenous economic threats – represented in the case of the US as the sovereign debt crisis of the states. These states may agree to give a federal government the power to tax in order to tackle such a crisis. In that sense, we can say that this kind of debt crisis constitutes a critical juncture: once the sovereign debt crisis is over, the taxing power acquired during this period continues to provide an independent source of revenue.

In conceptualising the fiscalization process, I build on Riker's classic definition of federalism: 'Federalism is a political organization in which the activities of government are divided between regional governments and central government in such a way that each kind of government has some activities on which it makes final decisions' (Riker 1975: 101). Thus, I define the concept of fiscalization as follows:

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

The concept of vertical fiscal imbalance (contributions/transfers as a per centage of total revenue) has usually been used to analyse the financial (in)dependence of the member states of the union from the central government (Rodden 2002: 672). In this paper I use it to show the *financial (in)dependence of a central government* from the member states and the consequence of such dependence for the viability and stability of the union. For the purposes of this paper, the fiscalization process is limited to the central government - by central I refer to either federal (US) or supranational (EU) levels of government - and, if successful, it leads to the emergence of a *genuine fiscal union.* I have added an adjective 'genuine' in order to differentiate such a fiscal union from many other uses of this concept (Fuest and Peichl 2012). Therefore, a central budget that consists of contributions from its constituent units cannot be recognised as part of the fiscalization process, even though its size may be significant. The fiscalization process is also limited to the "getting money" side of the budget (Riker 1964: 54) and does not concern the spending side.

3. FISCALIZATION IN THE US - HOW DID THE FEDERAL POWER TO TAX EMERGE?

This section provides the background to the American fiscal history of the pre-Constitution period, showing the origins of federal tax power and the consequences of the lack thereof. The period can be divided into two phases. The first, 1774-1781, concerns the First (1774) and Second (1774-1781) Continental Congress, which were attended by representatives from the North American British colonies (after 1776 – states). Congress' main aim was to co-ordinate the actions of the colonies in their struggle against Britain. This struggle – which turned into the American Revolution - started as the result of taxes which the British imposed on the colonies without their consent, by means of the British Parliament, where the colonies were not represented. The First Congress formed the 'Continental Association' in 1774 to co-ordinate the boycott of British goods. As a result of the unresponsiveness of King George III to the colonists' petitions, Congress went on to draft the Declaration of Independence in July 1776, followed by the American Revolutionary War, which lasted until 1783, when Britain was finally defeated. Congress drafted the first US constitution, the Articles of Confederation, already in 1777, but this was not ratified until 1781. This is when the second phase of the period started, the phase which concerned the Confederation Congress of 1781-1789, when the Articles governed the United States. Despite their different legal grounds, the Continental and Confederation Congresses had one thing in common – a lack of power to levy taxes.

The first Continental Congress gathered in September 1774. At that time it was a loose association of the representatives of the states-colonies, as a real government did not exist. There was no federal executive or judiciary. Congress did not have any tax powers and in financing its activities it relied on three main sources: printing money ('bills of credit'), contributions from the states, called requisitions, and borrowing (both domestic and foreign). The states were extremely reluctant to provide Congress with financial means; as a result, the main component of its revenues was 'paper money' ($38 million out of $68 million of the total income between 1775 and 1783) and loans of $19 million (Dewey 1907). It is not surprising that Americans were reluctant to give the power to tax to theCongress, since they were accustomed to deal only with their respective colonial governments. However, it was given some, albeit limited, competences (the establishment of post offices, co-ordination of states' war efforts, and later the creation of a Continental Army, among others), and these activities had to be financed in some way. At this stage, the Congress could only make recommendations to the states - it did not have any power of coercion. Thus, in order to finance its expenditures, it had to ask for requisitions from the states, and the classic free rider problem emerged, as all the states looked to each other in the hope that their neighbour would pay the bill. The requests made by Congress were quite large, but it should be remembered that these requests were made at a time of significant inflation, the result of the depreciation of the paper currency. However, the states failed to meet these obligations. For instance, between November 1777 and October 1779 Congress asked for four requisitions amounting to $95 million, but the states provided just $54.7 million. Moreover, from three calls between August 1780 and March 1781 amounting to $10.6 million, the states provided just $1.6 million. In total, before 1784, the states contributed only $5.8 million in specie value, i.e. cash in the form of gold or silver coins, to Congress, which fell far short of the amount needed to finance its expenditures (Dewey 1907: 44-45).

As a result, between 1775 and 1779, Congress was forced to authorise as many as forty issues of bills of credits amounting to over $241 million. This enormous sum was borrowed on the credit of the states. Moreover, instead of rendering the Continental bills of credit (according to a special formula, based mainly on the value of land), states were making their own issues. The result was a strong depreciation in the value of the federal currency. In fact, there was such a fear in Congress that the currency would not be accepted that it asked states to enact laws that would treat anybody who refused to accept Continental bills of credit as 'an enemy of his country' (Dewey 1907: 39); this time the states followed its recommendation. The Articles of Confederation were finally ratified in 1781, but did not alter the specifications for the financial provisions of the general government, which still lacked the power to tax. In its expenditures for 'the common defence and general welfare', Congress thus still had to rely on the contributions of the states, which were expected to be in proportion to the value of land and improvements', in addition to borrowing and emitting bills of credit. All other sources of revenues, including tariffs, were left to the individual states. At the beginning of the 1780s, there was a common understanding among the states that this system simply was not working and some proposals for establishing a national tax were put forward in Congress. In 1781, Congress recommended a 5 per cent duty on imports. However, this proposal required constitutional amendment and, under the Articles of Confederation, the unanimous consent of all the states was required.

All but one state agreed on such a measure. This was Rhode Island, which objected to such a duty on the grounds that the burden for commercial states from the North would be higher; that Congress could spend its revenues on any expenditure for an indefinite period of time; and that collectors would only be responsible to Congress and not to the states. In addition, proposals on a land tax, poll tax and excise tax failed in both 1781 and 1782. A proposal from

1781 that had been rejected by Rhode Island was put on the table again in 1783 as a national tariff. This time the concerns of Rhode Island were addressed - state, and not national, officers were to collect the revenues and the tariff was designed for a 25-year period in order to pay only for the interest of the national debt. Thus, its aim was strictly limited and the revenues coming from this tariff could not be spent on anything else. It took several years for the states to deliberate this plan, but finally, in 1786, all the states but one agreed on it. This time, New York vetoed the proposal, and, as a result, the Congress was still fiscally powerless (Studenski and Krooss 2003). Congress proved unable to amend the Articles in the 'vital particular upon which all else depended— federal power of taxation', which showed its inherent difficulty of securing unanimous agreement to any proposal (Ferguson 1961: 334, 337). This simply confirmed the perception that Henry Know expressed a few years later, when he wrote in a letter to George Washington that 'Every State considers its representatives in Congress not so much the Legislator of the whole union, as its own immediate Agent or Ambassador' (Maier 2010: 14).

The argument

The sovereign debt crisis that emerged in the mid-1780s had its roots in the long and expensive Revolutionary War with Britain. As Congress did not have any tax power, and as the borrowing (on the credit of the states) and the policy of monetary financing the expenditures of government had reached its limit (inflation was so great that the term was coined 'not worth a Continental', which referred to the national currency), the fiscal burden of financing the war efforts fell on the states. In a majority of these, at least two-thirds of tax revenues were devoted to the payment of war bonds, many of which were in the possession of speculators, both Americans and foreigners. In order to pay off these debts, between 1781 and 1790 (when they were assumed, or taken on, by the federal government) states imposed heavy taxes that 'averaged three or four times those of the colonial era' (Holton 2005: 445). What is more, during this fiscal crisis there was not yet a monetary union, and so states were free to use monetary means to finance their needs, such as devaluation and depreciation of their currencies. Yet despite these monetary tools, the states still had to use unpopular taxes to pay off the debts (Sylla 2006: 73-95).

I argue that the sovereign debt crisis of the states in the mid-1780s triggered the chain of events which ultimately led to the emergence of the federal power to tax. The federal budget based on contributions created a system in which states had to tax heavily in order to pay off the debt in 1780s. In addition, there was a strong feeling that state legislators only defended their interests as creditors and that they passed laws that protected their personal wealth (for instance, in Massachusetts '(t)he county conventions in 1786 frequently complained that the creditors got the cream of the state's revenue'(Ferguson 1961: 247). These taxes and the general perception of injustice led to popular unrests, such as the one led by Daniel Shays, a revolutionary hero who rebelled against the tax policy of the government of Massachusetts in 1786/1787. This kind of rebellion was seen as an existential threat for the young republic. The perception of such threat helped the Federalists (or the Nationalists, as they are sometimes called) to convince the political élite from almost all the states that the federal power to tax was inevitable for the peaceful existence of the Union. Indeed, as one historian observes: 'Shays's Rebellion was consciously exploited by leading Nationalists in search of a common danger to unite the country' (Ferguson 1961: 249). Certainly, a five-year-long post-war economic crisis (1783-1788) did not help to ease the situation of taxpayers.[6]

What is still controversial, however, is the question of what the main task of the new federal government was intended to be. Was it to limit the legislatures of the states, especially those of the lower chambers, which were believed to be too responsive to popular demands for tax relief, and therefore at putting limits on the excess of democracy? But if that were the case, why was the Massachusetts' legislature not at all responsive to these demands for tax relief, even on the eve of a rebellion which started precisely because of the unresponsiveness towards such demands? If the thesis of 'excessive democracy' is true, it should be also true in the most likely case – that of Massachusetts - because this was the most democratic of all the American states and had a long tradition of citizens' participation in state politics (Raphael 2013). It also had one of the best-designed state constitutions. The logical conclusion was that if a rebellion erupted in a state where its citizens enjoyed the highest level of democratic participation, it was even more likely to happen in states whose legislatures were controlled by a small élite and whose citizens (not to mention slaves) had very limited opportunities to influence their decisions. This was precisely how Shays's Rebellion was perceived by the American élite, including the most important figure, the 'Father of the Nation' George Washington: if such a rebellion could take place in New England, it could easily happen in Virginia, where plantation owners controlled the state governments and small farmers had little say in politics. John Jay was not the only one who was reporting to Washington that the situation in the summer of 1786 was so serious that it may lead to some revolution of unprecedented consequences for the young republic: 'Our affairs seem to lead to some crisis - some Revolution - something I cannot foresee, or conjecture'.[7] As a prominent historian of that period points out about the US in 1788/1787: 'The situation amounted to a crisis of unprecedented importance of the young republic. For those caught up in that frame of mind, the entire future of the United States was at stake' (Maier 2010: 17).

Washington was one of those 'caught up' in the conviction that this crisis was a threat to the future of the US and only a more energetic federal government (and the power to tax was the most important authority proposed for this new government) could provide a permanent solution. As he wrote to Henry Knox, a man who was reporting to him about the 'Lamentable' developing of the 'Insurgents of Massachusetts' in December 1786:

> *If the powers are inadequate amend or alter them, but do not let us sink into the lowest state of humiliation & contempt, & become a byword in all the earth—I think with you that the Spring will unfold important & distressing Scenes, unless much wisdom & good management is displayed in the interim.*

He also feared that Britain would take advantage of 'disorders' which have arisen in these states: 'That G.B. [i.e. Britain - TW] will be an unconcerned spectator of the present insurrections (if they continue) is not to be expected.' Moreover, he wrote that '(t)here are combustibles in every State, which a spark may set fire to' and in Virginia, the most populous and affluent state, an American equivalent of Germany in the EU, 'disposition to support, and give energy to the fœderal system is discovered' and so 'it seems very desirous of a General Convention to revise and amend the federal Constitution'.[8] I argue that it was the tax-motivated political turmoil that convinced the élite in 1787 to 'revise' the Constitution - the Articles of Confederation, so soon - only six years after it was ratified. Indeed, we have a lot of evidence to suggest that Washington decided to attend the federal convention in Philadelphia after learning about Shays's Rebellion from the Knox's letters.[9] It was, in fact, Washington's presence that was crucial to the success of the convention in drafting the Constitution that was later ratified by the states (he had been elected to the role of president of the convention). And within the Constitution, the biggest transformation was the federal power to tax, as Hamilton reminded his fellow New Yorkers during the battle for ratification:

'I have applied these observations thus particularly to the power of taxation, (…) because it is the most important of the authorities proposed to be conferred upon the Union'.[10]

The key to my argument, and it is in line with Riker's theory, is not so much the '*objective'* economic or military situation of the period, but the *perceptions of the key actors*. I argue that these perceptions in 1786/1787 centred on a sovereign debt crisis followed by heavy state taxes that led to popular unrest, which was perceived as an internal threat. This threat undermined the *status quo* and triggered the emergence of the federal power to tax. Hamilton was not the only person to warn against the dangers of the tax rebellions and the inability of the federal government to act:

> *Without a guarantee, the assistance to be derived from the Union in repelling those domestic dangers, which may sometimes threaten the existence of the State constitutions, must be renounced. Usurpation may rear its crest in each State, and trample upon the liberties of the people; while the national government could legally do nothing more than behold its encroachments with indignation and regret. A successful faction may erect a tyranny on the ruins of order and law, while no succor could constitutionally be afforded by the Union to the friends and supporters of the government. The tempestuous situation, from which Massachusetts has scarcely emerged, evinces that dangers of this kind are not merely speculative. Who can determine what might have been the issue of her late convulsions, if the mal-contents had been headed by a Caesar or by a Cromwell? Who can predict what effect a despostism established in Massachusetts, would have upon the liberties of New-Hampshire or Rhode-Island; of Connecticut or New-York?*[11]

Hamilton was afraid that the social unrest, like Shays's Rebellion - the 'tempestuous situation' as he called it, would lead to 'tyranny' or 'despotism' in the state, and that these 'convulsions' might spill over to other states. He complained about inability of the federal government to act to help states in 'repelling those domestic dangers' which would threaten not only 'the existence of the state constitutions', but also the liberties of other states. The fact that '(…) the situation in Massachusetts was an extreme case if a widespread problem' shows that those fears were justified (Maier 2010: 15).

By linking the debt and power to tax, I have shown the mechanism of the emergence of the federal power to tax: 'As the states laid hands on the public debt they undermined the basis for a constitutional enlargement of federal powers' as a leading historian observes about the situation in the mid-1780s (Ferguson 1961: 221). However, the way in which the states decided to pay off this debt - through onerous direct taxation - changed the political dynamics and paved the way for the enlargement of the federal powers. As a consequence, it can be said that the process of fiscalization of the central government had begun. Importantly, fiscal policies of states' governments fueled the feeling of injustice and consequently had caused widespread social unrest, whereby the cause of such a feeling of injustice lay in 'state legislatures, many of which imposed disastrous austerity policies simply to pay wealthy bondholders' (Mihm 2012: 342). I claim that in this way states helped to spark the process of fiscalization of central government. As Brown (1993: 234) accurately observes: 'state taxation holds the key to the Framers' decision to reconstitute the Republic rather than amend the Articles of Confederation'. Such a 'reconstituted' union would have a more 'energetic' federal government, with a bigger army, which could help states to suppress tax rebellions (as they did with the Whiskey Rebellion in 1791, when a protest against federal tax on spirits was squashed).

More importantly, however, the federal government could levy and use taxes (and pay for 'common defense' and other duties that states had had to pay for until now) that were not such a burden for the average citizen. Simplifying greatly, there were two types of taxes: direct and indirect. For centuries, people were much more concerned with the former type - they feared the knock of a tax collector on the door, asking for tax payment in 'specie'. Indeed, this had been the main cause of Shays's Rebellion, because the government of Massachusetts imposed heavy direct taxes. Indirect taxes were usually feared less, as they were included in the price of goods, and, in general, they could be avoided by not purchasing those goods. The first clause of Section 8 of Article I of the Constitution gave the federal government virtually unlimited power to tax: 'The Congress shall have Power To lay and collect Taxes, Duties, Imposts and Excises, to pay the Debts and provide for the common Defence (…)'. However, both unsuccessful federal tax proposals from the Confederation period concerned the impost (i.e. a tax on imported products, which is a form of tariff, with the latter serving also a purpose of protectionism, see Einhorn 2006) and even during the Ratification of the Constitution it was also widely assumed that the impost would normally be sufficient to cover federal expenditures. And so it was - until the Civil War this impost provided over ninety per cent of the federal revenues. This federal tax had the advantage of being an indirect tax; it was collected at the ports from merchants, who then included it in the prices of the goods they imported. Einhorn (2006: 149) has indeed shown that this impost was widely seen as an appropriate tax for federal government.

In many states, people who were Revolutionary War heroes were now turning their arms against state governments because of the heavy tax burdens. Ferguson brilliantly demonstrates how widespread both the actual unrest and the *fear* thereof (that is to say, the perception of a threat) were: 'Madison saw Shaysism emerging in Virginia. (…) Mobs besieged the legislature of New Hampshire and stopped courts in eastern Connecticut; an "insurrection" was put down in Vermont. Trouble was expected in New York, where the militia was readied to intercept refugees from Massachusetts' (Ferguson 1961: 249-250). There was a risk that such tax revolts, like Shays's Rebellion,[12] would spill over to the other states and would put the very existence of the union in jeopardy. Hamilton was convinced that the cause of this social unrest laid in the onerous tax burden of the state legislature - he wrote that 'the insurrection was in a great degree offspring of this [tax (TW)] pressure' (Chernow 2004: 225). And in order to prevent such social unrest from happening again, action had to be taken with regard to its cause – relieving the heavy state tax burden.

This relief was done by granting the federal government the power to tax, and later - by mutualisation (or assumption, as it was then called) of the states' debt. This tax power was crucial for various reasons. First, it helped to lighten the burden of states' taxation, because states were no longer obliged to collect money for the federal government; because the anticipated federal tax, the impost, was an indirect tax and was thus paid only by 'monied' men who could afford imported goods; and because there was a strong indication that the states' debts would be assumed by a new federal government, so about two-thirds of the states' fiscal needs would be lifted and they would only have to collect taxes to pay for the remaining one-third of their current level of expenditures. Indeed, as Chernow notices, 'Hamilton wanted the federal government to take over state debts left from the war. (…) The rural uprising [i.e. Shays's Rebellion (TW)] vindicated his sense that the federal government had to distribute the tax burden equitably across the states' (2004: 225). State spending would thus be even lower because it would not be used to pay for the common defence, since this would be a federal duty, paid for through federal taxes. Consequently, the states would need only a fraction of the current revenues, and so the tax burden would be much smaller and tax rebellions would be much less likely. Second, by proving to investors that American debts would be paid off it helped to provide credit to the economy and to help distressed economy to growth again. Third, by assuming the state debts, it helped to resolve the source of internal threat to a new federation which future tax rebellions would constitute.

A detailed analysis of the arguments surrounding perhaps the most controversial clause of the Constitution - the federal power to tax – and which were used during the ratification process is beyond the scope of this paper (see however: Woźniakowski 2016). It is, nevertheless, worth noticing that there was an agreement among the élite of the US about the need for a federal power to tax, that even the Anti-Federalists, who were opposed to the new Constitution, supported it. For instance, Brutus, who was the author of one of the finest essays by the Anti-Federalists, agreed that the impost should be given to federal government, and he provided similar arguments to those of Hamilton in 'The Federalist' papers and during the state ratification convention in New York State. In other words, he too believed that this mode of taxation would be safe because by its nature it placed a limit on the degree of burden that could be imposed (otherwise, smuggling or a decline in tax revenues would ensue), and he also claimed that it would not be dangerous for the people.[13]

To sum up, the sovereign debt crisis during the post-war economic recession in the mid-1780s was one of the main reasons behind the drafting of the Constitution and it was the single-most important cause of the federal power to tax clause. The social unrest in form of the tax protests of 1786-1787 constituted an internal threat for the new union. As Maier points out, 'Popular unrest in the fall and winter of 1786-1787 brought those fears (of a dissolution of the democratic union - TW) to a peak' (2010: 15). Indeed, the élite, including George Washington and Alexander Hamilton, feared that people would turn away from such a union if it only seemed to bring them economic hardship. Tax protests could easily spill over to other states and it was only because Shays, the leader of the most serious rebellion, was not 'Cromwell or Caesar', to use Hamilton's comparison, that the rebellion was suppressed. This fear over protests united the élite from the states, who formed a coalition in favour of a strong federal government: "the movement for constitutional revision derived much of its impetus from conservative fear of social radicalism" (Ferguson 1961: 337). The federal tax power was viewed as the most important means of preventing such crises from threatening the existence of the union in the future.

4. CONCLUSIONS

Both the US in 1780s and the EU in 2010s experienced a sovereign debt crisis in their member states. The lesson that the EU can learn from the US experience in forging a *genuine* fiscal union is twofold. First, the sovereign debt crisis may be the necessary condition pushing the fiscalization of the central government process to take place and, hence, leading to the creation of a genuine fiscal union. Second, the lack of a federal power to tax, and thus the existence of a vertical fiscal imbalance, so that central government is financially dependent on contributions from states, may trigger a chain of events leading to popular protests that can threaten the very existence of the Union. If states are the only bodies with the power to tax, they will end up paying for polices which should be (or are) allocated to the central level, such as common defence in the US case or the bailouts of large banks in the EU case. As a result, they can run up huge debts. Consequently, states have to impose high tax burdens (or to cut spending) on their citizens to pay off these debts. Indeed, in the mid-1780s in the majority of states in the US, at least two-thirds of the tax revenues were devoted to debt payment. The high tax burdens led to tax protests (such as Shays's Rebellion). This kind of protest can threaten the very existence of a union. One solution to such a crisis is the creation of the more 'energetic' federal government with the power to tax as its most important competence.

The perception of member states' sovereign debt crisis as a threat for the union is not a sufficient condition for the fiscalization process to start, but it may be the necessary one. In an attempt to tackle the threat to the union which a sovereign debt crisis constitutes, the US in 1780s and the EU in 2010s opted for two fundamentally different approaches. The US went for the *fiscalization of the federal government*, in which the new Constitution granted central government the power to tax. A sovereign debt crisis at the state level was the single-most important reason for this. The regulation, or coercion, to use Hamilton's words cited at the beginning of this paper, of the fiscal policies of the members states was ruled out, because of the high probability of non-compliance and the danger that the coercion of states would lead to a civil war. The EU, on the other hand, followed the paradigm of regulation of the fiscal policies of its member states. However, this paradigm may change, as we observe a growing number of reports and proposals calling for an adjustment in the way that the EU is responding to the Eurozone crisis, and, ultimately, to use Jean Monnet's famous formulation,[14] for an adjustment to the form that Europe will take, as it will be forged as the result of this response.[15]

Biographical note: Tomasz P. Woźniakowski is a PhD Candidate in Political Science at the European University Institute in Florence and was a Fulbright-Schuman Fellow at the Department of History, University of California, Berkeley (January-July 2015).

Address for correspondence: Tomasz P. Woźniakowski, Department of Political and Social Sciences, European University Institute, Via dei Roccettini 9, I-50014 San Domenico di Fiesole (FI), Italy. email: tomasz.wozniakowski@eui.eu

ABBREVIATIONS

DHCR	Kaminski, J. P. et al. (eds) (1976-), *The Documentary History of the Ratification of the Constitution*. Madison, Wisconsin.
PAH	Syrett, H. C. (ed.) (2011), *The Papers of Alexander Hamilton Digital Edition*, Vol. IV-V, Charlottesville: University of Virginia Press.
PGWCS	Abbot, W. W. (ed.) (1995), *The Papers of George Washington, Confederation Series*, Vol. II-IV, Charlottesville: University of Virginia Press.

NOTES

1 PAH V: 19.
2 See Tortola 2014, for an overview of this literature.
3 For instance Fuest and Peichl (2012) provide five different elements of a fiscal union - it is sometimes difficult to know which elements or definitions scholars use when they write about a 'fiscal union' or 'fiscal integration' (see e.g. Daniele and Geys 2015).

[4] The controversy over the federal power to tax during ratification process is mentioned briefly in the following: Maier (2010), pp. 179-182, (in Massachusetts), 362-369 (in New York); Einhorn (2006) pp. 162-173 (on the federal convention in Philadelphia), 173-183 (on ratification in the states); Rakove (1996), pp. 193-196.

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

[6] Holton (2005, p. 445) argues that in the historiography of the economic origins of the Constitution private debt used to play a crucial role, but that 'today more and more scholars contend that the Constitution was also rooted in a struggle between taxpayers and investors in government bonds'

[7] 'To George Washington from John Jay, 27 June 1786', PGWCSIV: 130-132.

[8]'From George Washington to Henry Knox, 26 December 1786', PGWCS IV:481–484.

[9] See Maier (2010:.11-26), where she provides excellent analysis of the letters Washington was receiving about the popular unrest from John Jay, James Madison and Henry Knox, among others, which confirmed his fears that the Union is on a brink of collapse.

[10] PAH IV: 466.

[11] PAH IV: 397-398.

[12] For the history of this rebellion see Richards (2002).

[13] Brutus V, New York Journal, 13 December 1787, DHRC XIX: 415.

[14] 'Europe will be forged in crises, and will be the sum of the solutions adopted for those crises'

[15] See for instance: Macron and Gabriel (2015), where French Economy Minister and German Vice-Chancellor called for the creation of a Eurozone budget with the tax and borrowing powers.

REFERENCES

Becker, R.A. (1980) *Revolution, Reform, and the Politics of American Taxation, 1763-1783*, Baton Rouge and London: Lousiana State University Press

Bordo, M.D., Markiewicz, A., and Jonung, L. (2011) *'A fiscal union for the euro: some lessons from history'*, *NBER working paper series*, *Vol. 17380*

Brown, R.H. (1993), *Redeeming the Republic: Federalists, Taxation, and the Origins of the Constitution*, Baltimore.

Chernow, R. (2004) *alexander Hamilton,* New York: Penguin Press

Daniele, G. and Geys, B. (2015) Public support for European fiscal integration in times of crisis, Journal of European Public Policy, 22 (5): 650 – 670

De Grauwe, P.(2013) 'The Political Economy of the Euro', *Annual Review of Political Science* 16 (1): 153-70.

Dewey, D.R. (1907): *Financial History of the United States*, New York 1907

Edling, M. (2003), *A Revolution in Favor of Government: Origins of the U.S. Constitution and the Making of the American State*, OxfordEichengreen, B. (1991), 'Is Europe an Optimum Currency Area?', NBER working paper No. 3579, January

Einhorn, R. L. (2006) *American Taxation, American Slavery,* Chicago: University of Chicago Press.

European Commission (2012) 'A blueprint for a deep and genuine economic and monetary union: launching a European Debate', *COM (2012) 777 final/2,* 30 November, Brussels, avalaible at http://ec.europa.eu/archives/commission_2010-

2014/president/news/archives/2012/11/pdf/blueprint_en.pdf (accessed April 2013)

Fabbrini, S. (2007) *Compound Democracies: Why the United States and Europe are becoming similar*, Oxford, New York: Oxford University Press.

Ferguson, E. J. (1961) *The Power of the Purse: A History of American Public Finance, 1776-1790*, Chapel Hill: Univerisity of North Carolina Press.

Fuest, C. and Peichl, A. (2012) 'European Fiscal Union: What Is It? Does It Work? And Are There Really 'No Alternatives'?, in *European Fiscal Union*, CES info Forum, Spring, 13 (1).

Gaspar, V. (2015) 'The Making of a Continental Financial System: Lessons for Europe from Early American History', *Journal of European Integration*, 37(7): 847-859.

Gray, E.G. and Kamensky J. (eds) (2013) *The Oxford Handbook of the American Revolution,* New York: Oxford University Press.

Genschel P. and Jachtenfuchs M. (eds) (2013) *Beyond the Regulatory Polity? The European integration of core state powers*, Oxford: Oxford University Press.

Hallerberg, M. (2006) 'Fiscal Federalism in the United States and in the European Union' in A. Menon and M. Schain. (eds) *Comparative Federalism: the European Union and the United States in Comparative Perspective*, Oxford: Oxford University Press, pp. 293–310.

Hallerberg, M. (2013) 'Why Is there Fiscal Capacity but Little Regulation in the US, but Regulation and Little Fiscal Capacity in Europe? The Global Financial Crisis as a Test Case', in P. Genschel P. and M. Jachtenfuchs

Henning, C. R. and Kessler, M. (2012) 'Fiscal Federalism: US History for Architects of Europe's Fiscal Union', in *The Bruegel Essays And Lectures Series*.

Holton, W. (2005) 'Did Democracy Cause the Recession That Led to the Constitution?', *The Journal of American History*, 92 (2) Sept: 442-469.

Kincaid, J. (2014) 'The Federalist and V. Ostrom on Concurrent Taxation and Federalism', *Publius: The Journal of Federalism* 44 (2): 275-297.

Kingreen, T. (2015) 'A New Federalist Deal for the European Union', forthcoming.

Macron, E. and Gabriel, S. (2015) 'Europe cannot wait any longer: France and Germany must drive ahead', *The Guardian*, 3 June, available at http://www.theguardian.com/commentisfree/2015/jun/03/europe-france-germany-eu-eurozone-future-integrate (accessed 3 June 2015)

Maduro, M. P (2012) 'A New Governance for the European Union and the Euro: Democracy and Justice', *Robert Schuman Centre for Advanced Studies Policy Paper 2012/11*, Florence: European University Institute.

Maier, P. (2010) *Ratification*: *The People Debate the Constitution, 1787-1788*, New York: Simon and Schuster.

Mihm, S. (2013) 'Funding the Revolution: Monetary and Fiscal Policy in Eighteenth-Century America', in E. Gray and J. Kamensk(eds), pp. 327-351.

Moravcsik, A. (2001) 'Federalism in the European Union: Rhetoric and reality', in K. Nicolaïdis and R. Howse (eds), pp.161–187.

Nicolaïdis, K. and Howse, R. (eds) (2001) *The Federal Vision: Legitimacy and levels of governance in the US and EU*, Oxford: Oxford University Press.

Oates, W.E., *Fiscal federalism*, Cheltenham Edward Elgar Pub., 2011 (1972).

Rakove, J.N. (1996) *Original Meanings: Politics and Ideas in the Making of the Constitution*, New York: Easton Press.

Raphael, R. (2013) 'The Democratic Moment: The Revolution and Popular Politics', in G. Gray and J. Kamensky (eds)

Richards, L.L. (2002) *Shays's Rebellion: 'The American Revolution's Final Battle*, Philadelphia: University of Pennsylvania Press.

Riker, W.H. (1964) *Federalism: Origin, operation, significance*, Boston: Little Brown.

Riker, W.H. (1975) 'Federalism', in F.I. Greenstein, N. W. Polsby (eds) *Handbook of Political Science*, Reading Mass: Addison-Wesley Pub. Co, pp. 93–117.

Rodden, J. (2006) *Hamilton's Paradox: The promise and peril of fiscal federalism*, Cambridge, New York: Cambridge University Press.

Rodden J. (2002) The Dilemma of Fiscal Federalism: Grants and Fiscal Performance around the World", American Journal of Political Science, 46:3.

Sargent, T. J. (2012) *United States then, Europe now*, Nobel Lecture, Stockholm, available at https://files.nyu.edu/ts43/public/research/Sargent_Sweden_final.pdf (accessed 18 April 2015)

Sbragia, A. (ed.) (1992), *Euro-Politics: Politics and Policymaking in the "New" European Community,* Washington, D.C.: The Brookings Institution.

Schütze, R. (2009) *From Dual to Cooperative Federalism: The Changing Structure of European Law*, Oxford: Oxford University Press.

Stepan, A.C. (1999) Federalism and Democracy: Beyond the U.S. Model', *Journal of Democracy* 10 (4): 19-34.

Studenski, D.P. and Krooss, H.E. (2003) *Financial History of the United States,* Washington, DC: Beard Books.

Sylla, R. (2006) 'The transition to a monetary union in the United States, 1787–1795', *Financial History Review*, 13 (1), April: 73-95.

Tortola, P.D. (2014) 'The Limits of Normalization: Taking Stock of the EU-US Comparative Literature', *Journal of Common Market Studies* 52(6): 1342–1357.

Trechsel, A. (2005) 'How to Federalise the European Union… and Why Bother', *Journal of European Public Policy* 12 (3): 401–418.

Weiler, J. (1986) *The Future of the European Community in the Light of the American Federal Experience*, Bonn: Deutsch-Amerikanische Juristen-Vereinigung.

Woźniakowski, T.P. (2016) 'The Most Important Authority: A Debate Over the Federal Power to Tax During the Ratification of the Constitution in New York State, 1787-1788', forthcoming.

Ziblatt, D. (2014) 'Between Centralisation and Federalism in the European Union', in: P.E. Peterson, D. Nadler (eds) *The Global Debt Crisis Haunting US and European Federalism*, Washington, DC: Brookings Institute, pp.113-133.