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Abstract

The EU's decision to allow the European Commission to emit some 850 billion euros in debt backed by the EU budget in order to fund transfers and cheap loans to member states has been hailed by some, most notably the German finance minister Olaf Scholz, as Europe's 'Hamiltonian moment', in reference to the first Treasury secretary of the United States. This historical comparison has been widely used over the last decade when discussing the historical meaning of the EU's attempts to deal with the eurozone crisis and its aftermath. However, commentators pick and choose those aspects of the original 'moment' that suit their own analysis of the historical import of EU developments. The original 'moment' is, however, best described as a wholesale 'financial revolution' involving a series of reforms that transformed financial and fiscal conditions in America. In this paper, I show the relevance but also the limits of this historical comparison by 'unbundling' the original Hamiltonian moment and comparing each of its fiscal components to the contemporary EU experience. I conclude by arguing that the Eurozone's development is best compared with the period beginning with the New Deal in American political history.

Keywords: federal union; fiscal policy; debt mutualization.

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Introduction

Unlike the 2010–2012 eurozone crisis, the 2020 crisis prompted quick and decisive monetary and fiscal policy action by the European Union (EU). The hype about the policy response included references to a 'Hamiltonian moment' once the EU moved to introduce centralized borrowing to fund recovery spending by member states (known as Next Generation EU).

The 'Hamiltonian moment' comparison is significant because it broaches in comparative fashion the broader issue of the historical significance of NGEU. The reference to the early constitutional, financial and fiscal history of the United States serves to underscore the key issues involved in assessing that significance: the role of public finance and taxation in the emergence and subsequent development of a federal polity.

The comparison is not new. It first emerged in 2011, when former Federal Reserve Board chairman Paul Volcker quipped that 'Europe is at an Alexander Hamilton moment, but there's no Alexander Hamilton in sight' (Wheatley, 2012). Nobel Prize Laureate for Economics Thomas Sargent used his acceptance speech to highlight how Hamilton had engineered through the federal assumption of state debts a rapid decline in American sovereign bond yields – precisely the outcome that European policymakers were striving to attain throughout the Eurozone crisis (Sargent, 2012). The same reference was dug up by the German Council of Economic Experts in its 2011 annual report, in which it proposed a redemption fund, providing Hamilton's reorganization of American sovereign debt as an example of the benefits the fund would have.

At the time, the 'Hamiltonian moment' comparison stressed what was lacking and focused entirely on the assumption of state debts, as the obvious necessity was to restore the creditworthiness of several member-states by some kind of debt mutualization scheme. This time, the debate is about the positive sense in which NGEU amounts to a Hamiltonian moment. The debate was rekindled by German finance minister Olaf Scholz. In an interview with *Die Zeit* (Bundesministerium der Finanzen, 2020), he referred to Hamilton's role in centralizing taxation and borrowing powers at the federal level as a 'model' for what the EU was trying to do. This sparked a wave of contributions in the press and the think tank bubble (Beck, 2020; Hall, Fleming, & Chazan, 2020; Kirkegaard, 2020; Schwarzer & Vallée, 2020; *The Economist*, 2020; *The International Economy*, 2020). This time, commentators scanned the early years of the United States for examples that could prove, in the negative or in the positive, their particular views of the EU initiative.

Contrast, then, the specifics of the Volcker and Scholz parallels. These involve three distinct aspects of the early financial and fiscal history of the United States, namely the federal assumption of state debts, the creation of federal taxation powers and the federal government's independent borrowing capacity. Scholz was actually wrong to argue that the last aspect was in any way associated with Hamilton. The US Congress had the power to borrow from the very beginning of the Continental Congress in 1775. But irrespective of the historical accuracy of Scholz's claims, the fact that the two most prominent individuals responsible for making comparisons of the EU to the early United States fashionable have referred to three distinct features of that history suggests that the parallel is much more complex than usually thought. While it is true that each case can be judged according to the extent to which various steps taken in the financial and fiscal realm reflect a decisive thrust towards a fully-fledged federal union, there is much more to it at an institutional as well as a political-economic level. This calls for a more detailed comparison of the two cases, one based on 'unbundling' the original 'Hamiltonian moment' and comparing each of its dimensions to the EU case.

Following economic historian Richard Sylla (2011), one can conceive of the original 'Hamiltonian moment' as a financial revolution that modernized America's system of public (and private) finance. Sylla identifies at least five distinct innovations instigated by Hamilton that had revolutionary consequences: the new fiscal regime based on federal taxation, the restructuring of the revolutionary war debt stock, the federal assumption of state debts, the creation of a quasi-central bank (the Bank of the United States) and the promotion of a national banking system and securities markets.

This paper does two things. First, it 'unbundles' the various fiscal aspects of Hamilton's financial revolution and compares them with the recent financial and fiscal history of the EU. Second, the paper uses the 'unbundled' Hamiltonian comparison to address a methodological issue in the flourishing field of comparative historical analyses looking at the political economic history of the United States for lessons for contemporary Europe (examples include, Frieden, 2016; Henning & Kessler, 2012; Kirkegaard & Posen, 2018), namely comparability and periodization.

This literature was stimulated by the Eurozone crisis. Almost all the contributions have been the result of requests extended by policymakers wishing to see the EU move towards some kind of fiscal federalism. The requests came either directly from the Commission or through the semi-official Brussels think tank bubble that generally shares the outlook of Commission officials. Policymakers were generally interested in uncovering examples in the history of American political development that could be used to provide support for the reform agenda they espouse.

One consequence of this is that the contributions lack an 'academic' preoccupation with methodological issues such as periodization and analytical questions such as which socio-economic actors pushed for particular developments, when and why. They rather focus on policy-oriented questions about what kinds of institutions produce what kinds of economic outcomes. Accordingly, the literature has not generated a consensus about what is actually comparable – much of it reads as a speculative excursion into American history in search for examples of institutional innovations that can resonate with the issues faced by the contemporary EU. The implicit starting point is that the United States has (long ago) reached some kind of politico-fiscal endpoint and equilibrium sorely lacking in Europe today and towards which the EU should be striving.

The challenge for academic scholars is therefore to appropriate the comparative strand of scholarship about EU fiscal issues and conduct comparative historical analysis of the politico-fiscal development of the United States and the European Union. The question that necessarily arises to begin with is that of comparability. Is all of American politico-fiscal history comparable to the EU's own such history? Or only a subset of it? In relation to the 'Hamiltonian moment' fashion, the question is whether it is actually comparable at all, and if so, at what level.

My claim is that the most meaningful way of delimiting the comparison is to look at the socio-historical substance of the political economic regimes found in each polity and look for parallels that highlight the historical similarities of the two processes of politico-fiscal development in cases where the substance is similar. To put it succinctly, fiscal policy does not have the same purpose in a loose collection of rural communities at the dawn of the industrial revolution largely engaged in agriculture and employing slave labour at a large scale, as it does in one of the most advanced capitalist economies of the early twenty-first century, in which large-scale production dominates and has welded into an organic economic unit an entire continent.

The paper's claim is that the Hamiltonian comparison only superficially helps us to think about the historical significance of the contemporary European experience with fiscal restructuring. It only offers a rather shallow parallel at a very general political level – a set of fiscal events signalling the hardening of a federal union – and some limited (and selectively isolated from the broader reform effort led by Hamilton) parallels at the institutional level whose value is largely formalistic. The 'Hamiltonian' comparison does more in the negative than in the positive: it highlights that the issues faced by the contemporary EU are of an entirely different nature than the ones faced by the early United States because the fiscal regime and the fiscal policy functions involved in each case bare no similarity. This leads to the claim that the relevant comparison for the EU is with the period beginning in the 1930s in American politico-fiscal history because that is when the United States cobbled together a fiscal regime that features the fiscal policy functions that the EU has been attempting to centralize over the past decade.

Altogether, the paper's claims point to the fact that the political uses of historical comparison are not necessarily aligned with its explanatory usefulness. The analytical shortcomings of the 'Hamiltonian' comparison even suggest that prioritizing the political uses of historical comparison can lead to analytical distortions. Although I share the political motivations of those who have pushed the Hamiltonian comparison and stimulated the policy-oriented comparative literature, I believe that the order of priorities should be reversed. Comparative analyses of the United States and EU should first proceed on purely academic grounds; if they yield parallels that can be used for political purposes, political entrepreneurs will readily find useful arguments to back their normative agendas. Distorting historical reality for political ends may be a useful expedient but it also leads to bad social science.

The rest of the paper is broken into three separate sections, each of which presents Hamilton's reforms and compares them to the EU's contemporary experience. The first looks at the reorganization of the taxation system enabled by the creation of federal fiscal powers under the new Constitution. The following section looks at Hamilton's reorganization of the revolutionary war debt stock, involving both the assumption of state debts as well as the restructuring of the existing federal debt. This reorganization was instrumental in bringing about the restoration of the federal government's creditworthiness – which was the fundamental objective of everything Hamilton attempted to achieve as Treasury secretary.

The final section looks at what some scholars have referred to as the United States' first fiscal regime or system of government finance erected on the basis provided by Hamilton's reforms in the early 1790s. The regime was based almost exclusively on federal customs duties on the revenue side and on war-related expenditures on the spending side. This aspect of the Hamiltonian moment provides the chief contrast between the early American experience and the EU's contemporary experience. Accordingly, the rest of the section argues for privileging comparisons with the New Deal and Second World War period in the United States' political and fiscal history. That period saw the emergence of the third fiscal regime based on a steep increase in public spending to carry out Musgravian fiscal policy functions, mostly conducted by the federal government. My comparison is that the EU is attempting to replicate that regime by completing the second leg of the transformation that took place in the 1930s–1940s in the United States, namely by raising the level of centralization of fiscal policy.

New federal fiscal powers and the new structure of taxation after 1789

The literature on the making of the 1787 Constitution is naturally huge, but a specific and recent subset of it looks directly at the links between fiscal policy, the constitutional distribution of powers and the drive to reform the Articles of Confederation (Dougherty, 2001; Edling, 2003; Irwin & Sylla, 2011; Pollack, 2009). The general conclusion from these studies – and irrespective of the relative causal significance that they attribute to military threats and international power politics (Edling, 2018) or popular discontent with direct taxation at the state level (Brown, 1993) in forcing constitutional and fiscal reform – is that the defining flaw of the Articles of Confederation was the inability of Congress to procure itself sufficient fiscal revenue to fund the war effort. This included the inability at key turning points to provide sufficient supplies to troops at the front, to reimburse the debts contracted to fund the war effort and to prevent the paper currency issued by Congress (the Continental dollar) from depreciating precipitously.

The core of the problem was the constitutional distribution of fiscal powers under the Articles of Confederation. Congress enjoyed the power to issue debt (and paper currency) but not the power to levy taxes. It was therefore dependent on the system of requisitions, whereby it asked the states to pay up their share of the total federal expenditures. Revenue collection and the setting of specific taxes were left with the states. Dougherty (2001) has applied collective action theory to the Articles of Confederation to show how that constitutional distribution of taxation powers created a structure of incentives unfavourable to the collection of sufficient federal fiscal revenue. States had an incentive to free-ride by withholding their respective shares of the requisitions demanded by Congress. As a result, only a fraction of the total demands made by Congress was handed over by the states.

The requisitions system and the lack of federal taxation powers was identified early on by the Federalists as the cardinal sin of the Articles of Confederation. In particular, the key problem was the federal government's lack of control on customs duties on imports, which were collected by and remained with the coastal states in which the ports of entry of foreign goods were located (McCraw, 2012, p. 49, pp. 70–73). Hamilton made the point as early as 1780 in various long letters he wrote to policymakers while working as a close assistant to General George Washington (McCraw, 2012, p. 45 ff; Sylla, 2011, p. 63). He repeated the point many times later, including in the *The Federalist* essays. James Madison, in notes in preparation for the federal convention in Philadelphia referred to the requisitions system as the 'radical infirmity' of the Articles of Confederation (Dougherty, 2001, p. 140).

Various amendments to the Articles were considered throughout the 1780s that would grant Congress enforcement powers without however granting it outright taxation power (Dougherty, 2001, chap. 7). None seemed satisfactory and none was adopted. The decisive breakthrough (Dougherty, 2001, pp. 149–150) came at the federal convention in Philadelphia with the compromise between the Virginia and the New Jersey plans that resulted in a bicameral Congress representing both the people (House) and the states (Senate). This allowed the transfer of taxation powers to the federal government since the principle of 'no taxation without representation' could now be respected due to the directly elected House. In particular, all the proceeds from customs duties on imports would now accrue to the federal government as the Constitution prohibited states from laying such duties while granting that power to the federal government.

When Hamilton became Treasury secretary in 1789, he set about using the new federal taxation powers to reorganize the American fiscal regime (Edling, 2007a; Edling & Kaplanoff, 2004). One of the very first acts of the new Congress in 1789 was the Tariff Act that provided the basis for the new system (McCraw, 2012, p. 89). Hamilton's aim was more to create a revenue source than to erect a protective wall behind which to nurture infant industries (the tariff would become a major bone of contention only a few decades later). The tariffs were therefore moderate and covered the range of goods imported in the country.

Hamilton's fiscal reforms had three major effects. First, they allowed the states to vastly reduce the direct taxes they had tried to raise throughout the 1780s in order to meet Congress's requisitions demands and to pay off their own debts. With Congress now having its own source of revenue and assuming liability for state debts, the states were rid of these two expenditure items. This had the benign effect of pacifying fiscal politics and defusing the brewing feeling of fiscal revolt. Second, the relative share of the states and the federal government in the fiscal sphere flipped, with the federal government now becoming the dominant player. Third, this also entailed a sharp shift in the relative importance of various types of taxes. Whereas the fiscal regime under the Articles of Confederation was mostly based on direct taxation levied by the states, under the Constitution it quickly came to depend almost entirely on customs duties on imports levied by the federal government. These accounted for 94 per cent of total federal revenue in 1792–1795 (Edling & Kaplanoff, 2004, p. 738). Customs revenue would provide the bulk of federal revenue for more than a century. Indeed, it wasn't until the 16th amendment in 1909 that Congress gained the power to raise income taxes, which would go on to form the basis for the dramatic expansion of federal government revenue and outlays from the 1930s onwards, in what would become the third American fiscal regime (or system of government finance as identified by Wallis, 2000).

How does this compare with the EU experience? The parallels are quite obvious: in terms of the constitutional distribution of fiscal powers, the EU resembles the pre-Constitution United States: taxation powers remain the prerogative of the states. The EU budget has, over the decades, come to resemble the requisitions system in that the great majority of its resources comes from member-state contributions while the rest of its revenue has to be decided unanimously by the member-states. The EU, however, unlike Congress, has a judicial enforcement mechanism, although one could argue about how hard an enforcement mechanism that amounts to in the absence of a federal revenue collection agency and federal police. To some extent too, the debate in the EU over a federal fiscal capacity is about relieving some member states from their own public debt burdens and the task of servicing these through tighter fiscal policy, including higher taxes (although post-2010, this was mostly done through spending cuts).

Although the EU can issue bonds, this has only ever been done during emergencies and never as a matter of course. Indeed, the treaties contain several articles that appear to prohibit deficits (articles 310–312 TFEU). It remains a matter of dispute among legal scholars as to whether this means that the EU has the permanent power to borrow, with some arguing that this is not the case and that NGEU lacks legal basis in the treaties (Kerber & Naulot, 2020). However, the Commission has argued that it is empowered by the treaties to borrow and the EU has a forgotten, although arguably negligible, history of own borrowing (Horn *et al.*, 2020). However, in all of these cases, the decision to borrow is part of the Own Resources Decision and therefore requires unanimity of member states. It is therefore not a clear-cut case that the EU has 'normal' federal borrowing powers.

The lack of federal taxation powers in the EU arguably has similar consequences in terms of collective action problems as those experienced by the United States under the Articles of Confederation – although this does not translate into undersupplied requisitions. Examples of collective action problems stemming from the lack of federal taxation powers include the stagnation of the EU budget over the decades, the regular squabbles over rebates and the failure of the EU to enact a carbon and other energy taxes (debated as early as 1992) to fight climate change. I include the stagnation of the EU budget in this list because when the budget first came into its own in the 1970s, the common expectation (Commission of the European Communities, 1975, 1977) was that it would gradually grow in size and assume the functions of modern budgets (as first theorized in Musgrave, 1939: redistribution of income, allocation of capital and macroeconomic stabilization). After the Single European Act came into effect and the EU budget was broadened to include the cohesion and structural funds (whose function can be described as allocative), Commission president Jacques Delors worked on the assumption that by the time the single currency would be introduced in the late 1990s, the EU budget would have increased to 3 per cent of EU GDP (James, 2012). None of this has come to pass, despite most commentators taking it as axiomatic that monetary union requires a substantial federal budget fulfilling the macroeconomic stabilization function as per the prescriptions of optimal currency area theory (Mundell, 1961), and the debate is not whether but when and how this can be achieved. The lack of such a federal fiscal capacity was a major factor behind the eurozone slipping into a double-dip recession in 2011–2013, while the United States pursued its recovery, because the uncoordinated fiscal tightening in member states was not counterbalanced by fiscal expansion at the centre. If a federal fiscal capacity tasked with macroeconomic stabilization has not yet eventuated, despite the broad intellectual consensus that it is necessary, that can only be attributed to the constitutional distribution of taxation powers, which makes it incredibly difficult to reach a unanimous position on the matter. The EU's lack of a 'normal' federal borrowing capacity has added to these difficulties. Even in the case of NGEU, the unanimity requirement was exploited by the opponents of federal borrowing and redistribution (the 'frugal four' of Austria, Denmark, the Netherlands and Sweden) who succeeded in limiting the scope of the new fund as well as of the grants component.

Clearly, then, the EU has not experienced a 'Hamiltonian moment' in terms of a constitutional redistribution of fiscal powers in favour of the federal level. The recent developments may act as a catalyst for such change in the near future, as some voices are now calling for treaty revision in order to bring EU taxation and borrowing under the ordinary legislative procedure (Gozi, 2020). Indeed, this may even be what the German finance minister had in mind when he referred to Hamilton in connection to new European taxes. But we are certainly not there yet.

The paradox in this comparison is that the kind of federal taxation that came into being as a result of constitutional reorganization – a small federal budget funded by customs duties on imports – is exactly the kind of federal taxation that has existed in the EU since 1968 and the completion of the customs union. This is clearly not what commentators who compare the EU to the early United States have in mind when they make the comparison. The question is how come this fundamental difference be treated as irrelevant. As I argue in the section on the first American fiscal regime, this is because the socio-economic context and the fiscal policy functions that it entailed are abstracted from the comparison, in favour of its purely institutional features.

Reorganization and assumption of war debts

The second item in my 'unbundled comparison' is Hamilton's reorganization and federal assumption of war debts, i.e. that part which dealt with the structure of fiscal liability in the new Republic. Crucially, the attempt to restore the creditworthiness of the United States revolved just as much, if not more, on Hamilton's restructuring of the already existing federal debt as well as on the plans he made for setting aside specific revenue for gradually paying down that debt. This is a remarkable observation because the entire fashion of comparisons of the EU with the early United States began with advocates of debt mutualization during the eurozone crisis pointing to Hamilton as a model, in a context where debt restructuring and debt mutualization were actually considered as policy alternatives (I highlight the extent to which policy debate in 2010–2012 revolved around the opposition of restructuring and mutualization in Georgiou, 2019). I will come back to this at the end of this section.

When Hamilton became Treasury secretary in 1789, the United States was 'effectively bankrupt' (Sylla, 2011, p. 59), government bonds circulated at a small fraction of their face value and many of the states faced major difficulties in collecting the taxes necessary to pay back their own war debts, let alone being able to supply their share of Congressional requisitions necessary for paying off the federal debt. Hamilton believed that the cornerstone of a strong government and the ultimate aim of his efforts was the 'restoration of public credit' (Edling, 2007b; McCraw, 2012, chaps 5, 7–9). Historians have ascribed various motives to Hamilton's quest to put the American public debt market on a solid footing: doing so would ensure the trust and loyalty in the new government of the financial elites who held the debt, would provide the federal government with an efficient means of quickly mobilizing fiscal resources in case of war without unduly burdening a population that was particularly averse to taxation and would help promote economic growth by creating a whole new class of safe assets on which financial activity could be based.

To do this, the federal government had to prevent state defaults as well as find a way of lowering the burden of servicing the debt, given the meagre revenue at its disposal and dire projections about future revenue. The assumption of liability for state debts by the federal government generated the most political heat at the time, and has acquired greater posterity because it was only settled by the famous dinner bargain in New York City between Hamilton and Madison (organized by Thomas Jefferson). In that dinner, Madison agreed to procure congressional votes for the Hamilton's assumption plan in exchange for the Treasury secretary's support for moving the federal capital on the banks of the Potomac (McCraw, 2012, pp. 105–109), in what would become Washington D.C. However, state debts were less than a third of the total public debt of the former colonies, the rest being already the liability of Congress.[1]

Consequently, reducing the cost of servicing the debt may be regarded as the more consequential of the two planks of Hamilton's plan for restoring the public debt market and the government's creditworthiness. Hamilton's solution, against radicals who wanted to repudiate some of the debt, was to get bondholders to 'voluntarily' accept what today would be called 'debt restructuring' (altering the terms of repayment and the yield of the debt). His opposition to plans to not repay the face value of the bonds was argued along the lines of honouring contracts as a way of preserving investor confidence in the government's creditworthiness.

Hamilton's first step was to decide that federal debt was perpetual, thus postponing the repayment of the principal until fiscal revenue could be put on strong foundations while also guarantying that government bonds remained negotiable on the secondary market (Edling, 2007b, p. 309). The second step was to define a maximum amount of payments that the federal government could make every year to the bondholders, thus extending the promise that the bonds would remain a revenue-yielding asset for a few decades. Lastly, he presented an array of options to be offered to domestic bondholders for effectively cutting the interest rate to be paid on government bonds. Congress finally chose the solution whereby the interest on the bonds would be lowered from 6 to 4 per cent, rising back to 6 per cent again in 1801. Two thirds of the bonds would earn interest right away and the remaining third 10 years later, whereas the accumulated interest on the principal was also converted into 3 per cent-yielding bonds (Sylla, 2011, p. 67; Edling, 2007b, pp. 310–311).

How does this compare with the EU experience with public debt? Clearly, the debate on assumption bears a striking similarity with the debate during the Eurozone crisis. If the fiscally weaker member states were not to default or provoke fiscal revolts at home through sharp spikes in taxation, some part of their debts had to be mutualized. I mentioned the German Council of Economic Experts' 2011 proposal of a redemption fund and the explicit parallel it drew with the federal assumption of state debts. Although member states did set up a kind of redemption fund in the European Stability Mechanism, they failed to agree to let it purchase member state bonds on the secondary markets. Instead, it was the European Central Bank (ECB) that finally stepped in the breach, through its president Mario Draghi's famous 'Whatever it takes' comment in July 2012 and the subsequent announcement of the Outright Monetary Transactions (OMT) programme in September 2012.

Although the ECB purchased exactly zero bonds under the OMT, the announcement not only provided a guarantee to bondholders that a mechanism for mutualizing member state debt now existed, it also paved the way for later purchasing massive amounts of member state bonds as of 2015, through the ECB's Public Sector Purchase Programme (and since March 2020, the Pandemic Emergency Purchase Programme). Crucially, the ECB accumulating such bonds on its balance sheet is 'fiscal integration by default' (Schelkle, 2013): the ECB's shareholders being the member states, it is their own balance sheets that are ultimately put on the line when the ECB purchases member state bonds.

The parallel between the eurozone crisis and the ECB's role in bolstering the government bond market and the federal assumption of state debts orchestrated by Hamilton also works pretty well in terms of the broader financial dynamics both cases involved. Edling has summarized these succinctly as follows: 'Funding would create capital out of thin air as almost worthless bonds suddenly appreciated in value and then stabilized around par' (2007b, p. 294). This is very much what was at stake during the eurozone crisis. The prospect of several member states defaulting on their own debt meant that, until a collective solution was found to underwrite that debt, their bonds were circulating at a heavy discount and that, more broadly, the status of government debt as a safe asset around which to structure the financial system and bank balance sheets was called into question. The banks and other investors holding those bonds in 2010–2012 found that they were suddenly staring at billions of euros in potential losses. Draghi's promise to underwrite those bonds 'create [d] capital out of thin air as almost worthless bonds suddenly appreciated in value and then stabilized around par'. Banks could then resume normal operations on the basis of the restoration of confidence in the solvency of member states. And in the eurozone, the linchpin of the restoration to par of government bonds was exactly the same as the one described by Edling: 'Hamilton's plan to restore public credit began with the need to restore the faith of present and future creditors in the ability and readiness of the government to service its debts according to contract' (2007b, p. 303). This was precisely what was at stake during the eurozone crisis: offering investors a credible promise that all member state bonds would be repaid, which entailed 'assumption' – or 'mutualization' as it was called in the EU context. Seen in this light, the EU's 'Hamiltonian moment' took place in the summer of 2012 and its author was not a finance minister but a central banker.

However, when it comes to NGEU, the parallel with the assumption part of Hamilton's restoration of public credit no longer holds. NGEU, although hailed by some commentators as being the leap towards fiscal federalism that the EU was unable to make in 2010–2012, does not involve anything resembling the assumption of pre-existing member state debts. Instead, it involves for the first time the issuance of substantial amounts of federal bonds that will be repaid by new European taxes that are yet to be set. If there is one aspect of NGEU, then, that resembles the original 'Hamiltonian moment', it is the promise of new federal taxes to back the new federal debt – although we know that these new taxes will not be anything like the new federal taxes (customs duties on imports) introduced by Hamilton, which have existed in the EU since 1968. In this sense, the EU's protracted 'Hamiltonian moment' is still unfolding.

The key difference between Hamilton's reorganization of public debt and the contemporary EU experience is, however, equally important. The crucial ingredient in Hamilton's plan to restore public credit (restructuring the debt held domestically) was the very denouement that the EU sought to prevent in 2010–2012, namely debt restructuring. For Hamilton, debt restructuring and assumption (mutualization) went hand in hand; in the EU, they were seen as mutually exclusive. If there has to be one example of the way in which Hamiltonian parallels with the contemporary EU experience make selective use of early American history to bolster normative arguments about how the EU should act fiscally, then Hamilton's handling of the debt wins the prize.

Socio-economic context and fiscal policy functions: The first and third American fiscal regimes

The fiscal regime introduced by Hamilton

Beyond the immediate matter of stabilizing government bond markets and restoring the creditworthiness of the United States, what was the fiscal policy purpose of the original 'Hamiltonian moment'? In other words, what political economic purpose did the new fiscal regime serve and what were the policy functions it was tasked with fulfilling in line with that purpose?

Edling (2007a) and Wallis (2000) refer to the first five decades after the adoption of the Constitution as the first American 'fiscal regime' or 'system of government finance' respectively. The system had a number of structural features. The first was the very low level of both overall and federal government spending (around 2 per cent of GDP throughout the period). Edling (2007a) estimates that one way or another, 88 per cent of total federal spending in 1789–1837 was war-related. The second was the gradual extinction of the federal debt by the 1830s coupled with the predominance of public debt at the state level, as states became the main conduits for infrastructural investment. Indeed, Wallis calls this the 'era of active state government' (2000, p. 66). It was a boom in such spending funded by borrowing that led to the defaults of the 1840s (English, 1996; Grinath *et al.*, 1997), which established the principle of no bail out by the federal government, reversing any precedent that might have been set by the 1790 assumption. In terms of revenue, the system's main feature was the overwhelming dependence of the federal government on customs duties on imports (70 per cent of total federal revenue in 1789–1837; Edling, 2007a, p. 33) and the absence of any direct taxation. (See Figure 1).

In a nutshell, the fiscal regime established by the original 'Hamiltonian moment' essentially served to pay down a historical liability that was considered a one-off: paying for the war of independence and then preserving the nation's sovereignty. The operating expenses of the federal bureaucracy were almost non-existent, reflecting the minuscule size of that bureaucracy itself. Only a very small fraction of public spending was for infrastructural investment and this was not done by the federal government. The fiscal regime, then, was almost invisible, given that the revenue came from sources that did not saliently affect the income and wealth of citizens.

Fiscal policy in this regime matched the logic of the night-watchman state that then prevailed in the United States. It had no countercyclical macroeconomic management nor redistributive functions and hardly any allocative ones. Moreover, the United States was deeply divided along sectional lines, most importantly between the North and the agrarian, slave-holding South. Any infrastructural investment that took place only did so at a local level and was not geared towards the welding together of the former colonies into a single market, which only eventuated towards the end of the nineteenth century (Egan, 2008, 2015). Indeed, during most of the nineteenth century, including until long after the end of the Civil War, the basis of the American political economy was what legal historian Harry Scheiber has described in a widely cited article (1975) in legal-economic history as a decentralized legal system of 'rivalistic state mercantilism'. A national state apparatus worthy of

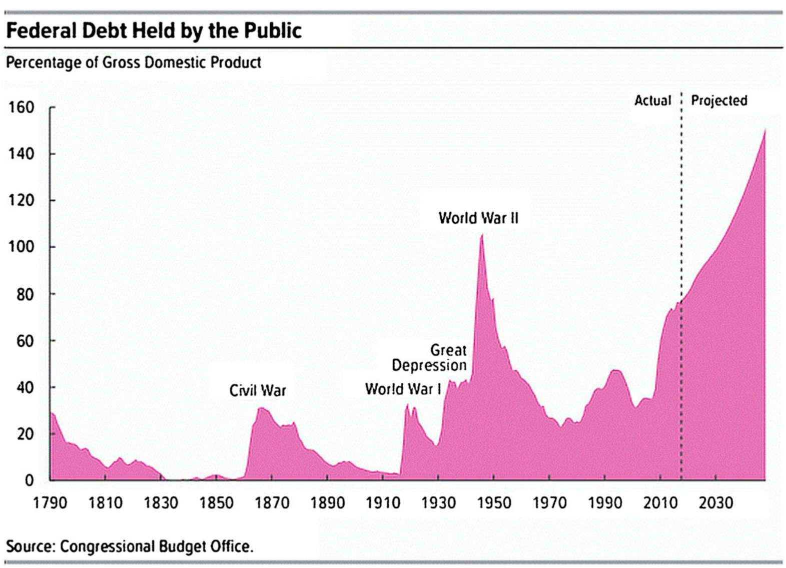

Figure 1 Federal debt as a percentage of GDP
Source: Brookings institution https://www.brookings.edu/blog/up-front/2019/01/04/the-hutchins-center-explains-how-worried-should-you-be-about-the-federal-debt/.

the name only emerged around the turn of the twentieth century (Johnson, 2007; Skowronek, 1982). That development came in the wake of the American single market being welded together by federal District and Supreme Court case law (Freyer, 1979; Miller, 1968), the rise of a national capital market (Davis, 1965; Sylla, 1969), the completion of modern transportation (rail) and communication (telegraph) networks in the 1880s and, most importantly, the rise of national-scale corporations operating across state boundaries (Chandler, 1990, chap. 3; Bensel, 2000, chap. 5, is an excellent account of the overall process that brings together the many political, judicial and economic factors involved).

The third American fiscal regime introduced during the New Deal and World War II

Although Wallis identifies a second system of government finance, lasting from the 1840s to the New Deal, in which municipal governments were responsible for most spending, the more consequential break came with the rise of the third such system in the 1930s and 1940s with the Keynesian revolution (Brownlee, 2016; Stein, 1969). Total spending only rose modestly under the second system, and did not take on to any great extent the three Musgravian functions of modern public finance, except to a limited extent by local governments of the allocative function. Figure 2 shows both the slightly higher level of overall government spending that prevailed following the Civil War and the rise in local government spending that accounted for the bulk of the overall rise. In particular, local governments began making investments in public education, transport infrastructure and health services as well as instituting the very first social safety nets. All of this spending is functionally associated with the processes of industrialization, urbanization and the advent of corporate capitalism (North, 1985). To fund this spending, local governments began moving away from their past reliance on property taxation and groped for alternative sources of revenue, which ultimately led to the generalized use of corporate income taxation (Higgens-Evenson, 2003). Property taxation made sense so

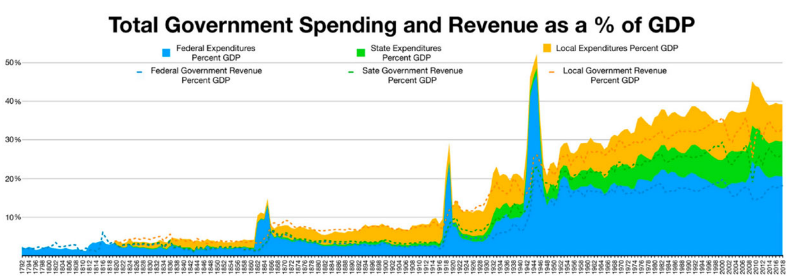

Figure 2 Wikipedia page 'Government spending in the United States'
Source: https://en.wikipedia.org/wiki/Government_spending_in_the_United_States

long as economic activity was predominantly agricultural and the vast majority of wealth was made up of landholdings that were relatively easy to value accurately. But with the onset of industrialization and the associated development and rise to prominence of securities markets (O'Sullivan, 2016), a greater share of overall wealth came in forms whose valuations were not stable. Income taxation, on the contrary, was much easier to implement.

The third fiscal regime involved two developments. First, a substantial deepening of the fiscal trends that first appeared under the second regime. Second, a much greater share of overall fiscal activity for the federal centre. The break of the 1930s involved a sharp rise in spending and income taxation to fulfil the three functions referred to above as well as a steep increase in the federal share of fiscal activity. The rise in fiscal activity also meant that income taxation moved centre stage to become the main pillar of the system. Moreover, even after military spending started declining as a share of total federal spending after the mid-1950s, the federal budget continued to grow, largely due to the role of welfare spending and automatic stabilizers, which fulfil the redistributive and stabilization functions respectively.

Two civilian items drove the rise in spending during the New Deal and in subsequent decades. First, federal infrastructural spending that was both used to supply public goods and deepen the integration of the American single market (think of the array of public works schemes in the 1930s and the Interstate Highway System and the Federal Aid Highway Act of 1956). Second, federal social security legislation, the most important piece of which was the 1935 Social Security Act that instituted mandatory federal old-age pension and unemployment compensation. The Great Society social reforms of the 1960s broadened this trend further.

As for the revenue side of the equation, a constitutional amendment was first necessary to explicitly grant the federal government the power to levy direct taxes. The Supreme Court had ruled unconstitutional such taxes at the federal level in its 1895 *Pollock v. Farmers' Loan & Trust Co.* decision. Congress resolved the issue in 1909 by adopting the 16th amendment. Income taxes on corporations and top earners were gradually introduced, but crucially, income taxation was broadened in the 1940s to include middle-class households. The 1942 Revenue Act marked the fundamental transformation of the federal taxation regime (Brownlee, 2016, pp. 139–148) through the adoption, according to the pre-eminent historian of federal taxation, of 'what became the core of [the] new tax regime – a personal income tax that was both broadly based and progressive'. The number of individual taxpayers grew from 3.9 to 42.6 million between 1939 and 1945. The Federal income tax in 1940 was responsible for 16 per cent of all fiscal revenues, whereas by 1950 that figure was 51 per cent (Brownlee, 1996, pp. 91–93). The generalized use of income taxation, in combination with mandatory unemployment benefits, made possible the rise of automatic stabilizers tasked with upholding consumer spending in times of recession and thus performing the countercyclical macroeconomic stabilization function.

Which American fiscal regime provides the more relevant comparison to the EU?

When one looks at the original 'Hamiltonian moment' in this light, the contrast with the contemporary EU experience is particularly stark. The debate on fiscal federalism in the EU is all about how best to restructure the fiscal regime in order to better fulfil the three Musgravian functions of public finance, which the federal budget in the United States only began performing in the 1930s with the onset of the third fiscal regime. To the extent that the fiscal regime ushered in by the original 'Hamiltonian moment' had nothing to do with the purpose and functions of fiscal policy in a modern, advanced economy, it is irrelevant for comparisons with the fiscal issues faced by the EU today.

The more relevant question is how exactly the third American fiscal regime compares to the EU's own fiscal regime and the challenges it has been facing over the past decade or so. Income redistribution, capital allocation and macroeconomic stabilization are all done extensively in the EU today and have been for a number of decades, but only negligibly by the federal level of government. All the specific spending items that were newly introduced under the third American fiscal regime (social insurance, investment in health, education and public transport) are solidly established and account for the bulk of government spending. Income taxation is also used for countercyclical macroeconomic management, although the greater generosity of social benefits in the EU as compared to the United States, arguably plays a greater role than automatic variations in income taxation in the EU's automatic stabilizers. The EU budget does revolve around redistributive (the common agricultural policy) and allocative (the structural, cohesion and R&D funds) functions, but these remain negligible in relation to what member state budgets do. Crucially, the EU budget does not at all perform stabilization functions, while the debate on fiscal federalism since 2010 has precisely been about the need for the EU level to perform such functions. The rationale behind NGEU is primarily stabilization (the main motivation is to prevent an 'asymmetric' recovery and help the hardest-hit member states), although this will overlap with capital allocation (funds will need to be spent on specific investment projects, namely the green and digital transitions).

In this sense, the EU's fiscal regime has only undergone half the transformation that the American fiscal regime did in the 1930s and 1940s, namely total outlays have grown massively in order to perform modern Musgravian public finance functions. But there has not been any of the redistribution among levels of government in favour of the federal centre that one observed in the 1930s and since in the United States. While the rise in total outlays and the redistribution in favour of the federal centre were contemporaneous in the United States in the 1930s and 1940s, they have been historically decoupled in the EU. This is probably the main reason for the political difficulties facing the EU in crafting a substantial federal budget. This is not about creating new functions from scratch, but about centralizing already existing decentralized fiscal functions –

which comes with all the attendant vested interests that have to be accommodated or played against each other for centralization to be politically feasible.

Conclusion

Let me first summarize the various parallels and contrasts that the paper has highlighted.

At the most general level of analysis, the first parallel is the putative similarity in terms of political development. The original 'Hamiltonian moment' reflected a decisive forward movement toward centralization of political power in a federal union. It is at least plausible to ascribe a similar political significance to fiscal developments since 2010 in the EU. However, the parallel cannot be circumscribed to events that took place in 2020 and the process is by no means over yet.

The second parallel highlights why. There is indeed a striking similarity between the federal assumption of state debts in 1790 and the gradual process of 'fiscal integration by default' via the accumulation on the ECB's balance sheet of member state debt. Both processes restored the confidence of investors in public debt, bolstered that debt's status as the main safe asset in the financial system and relieved the constituent units of the federal union from the political difficulties of having to crank up taxes to pay for their debts on their own.

That, however, is only half the story as well as the point at which the parallel ends and the contrasts begin. In the early United States, the restoration of government creditworthiness revolved at least as much if not more around debt restructuring of the existing stock of public debt, two thirds of which was already a federal liability. On these two points, the contrast with the EU is stark. The EU's aim in mutualizing member state debt was to avoid having to restructure it, while the entire stock of the public debt was the liability of the member states and none of the federal centre. This point is methodologically important to the extent that the commentators who pushed the Hamiltonian comparison in 2011–2012 used it to back their normative view that what the eurozone needed to do was mutualization. That was a selective use of historical comparison and therefore disingenuous, especially because telling the whole story would have actually provided support for the alternative policy option (debt restructuring).

The second major contrast is the constitutional distribution of powers. The Hamiltonian moment was all about a shift in that distribution: the federal government received full fiscal powers and Hamilton used them to entirely revolutionize American public finance. This has not happened in the EU. There is also the additional difficulty that the revenue stream that Hamilton set up in the wake of the redistribution of fiscal powers has existed in the EU for more than 50 years now, despite the lack of independent federal taxation powers.

This leads to what I wish to argue is the decisive contrast, from an analytical if not a normative point of view at least, namely the kinds of fiscal regimes at stake and the political economic purposes they serve in the two cases. My main methodological claim is that for the historical comparison to be meaningful, one needs to start from this political economic substance and attempt to gain insights into the historical and political processes that shape political and fiscal development in polities like the United States and the EU.

Hamilton's revolution created an almost invisible federal fiscal policy, one that in no way performed the policy functions of a modern fiscal policy corresponding to a political economy based on large-scale production and oligopolistic corporations. The role of federal finance in the first fiscal regime was exceptional and had an expiry date: it was set up to liquidate the liabilities incurred in the course of making the United States an independent polity. It had no role to play in the daily workings of the political economy of that newly independent polity. The United States experienced a sharp break in politico-fiscal development in the 1930s and 1940s. An entirely new fiscal regime or system of government finance was gradually put together, whose two distinctive features in relation to what went before were the sharp rise in total outlays to perform Musgravian policy functions and a radical redistribution of the relative shares in total fiscal activity from the sub-federal to the federal level of government. It was this sharp rise in total outlays that led to an entirely new tax base in the shape of the mass income tax and the marginalization of the historic federal revenue source represented by customs duties on imports. This is why accounting for the seemingly strange case of the similarity of federal revenue sources in the post-Constitution United States and the EU is an awkward question for commentators who wish to use the history of the early American republic as a model for contemporary Europe.

In the EU, only half of the revolutionary transformation that took place in the United States in the 1930s and 1940s has occurred: total outlays have expanded to perform Musgravian policy functions. This, however, has taken place entirely at the sub-federal level of government. The more analytically interesting research question from a comparative point of view is what explains this discrepancy between the United States and the EU, and whether that also explains why over the past decade functional and political pressure has been building up in favour of the transfer of substantial fiscal capacity from the member state to the federal level of government. Is there something intrinsic in large-scale federal polities presiding over modern corporate political economies that entails a substantial level of fiscal federalism?[2] This, I argue, should be the main question that defines the research agendas of comparative historical analyses of American and European processes of politico-fiscal development.

Finally, I will conclude with a reflection on the political uses and analytical usefulness of historical comparison. The commentators who have pushed the Hamiltonian comparison in EU policy debates overwhelmingly belong to a school of thought that holds that the EU should (and will, one way or another) develop into a fully-fledged federation with a system of fiscal federalism necessary to provide macroeconomic stability. Using the Hamiltonian comparison has been a way of highlighting the momentous import of the political decisions that EU leaders had to make over the past 11 years, as well as the direction in which those decisions had to go. However, the selectiveness and disingenuousness of the Hamiltonian comparisons underscore how the normative aims of policy entrepreneurs looking for historical precedents to back up their preferred policies lead to analytical bias that distorts historical reality and muddles the terrain of comparative analysis.

That may be fine in terms of political expediency, but for scholars looking to develop explanatory models based on comparative historical analyses, that is a trap to be avoided. The political uses of historical comparison should not be confused with its analytical usefulness. The Hamiltonian comparison may be useful politically, but it is certainly deficient as an analytical tool. My alternative of using the third American fiscal regime as a comparative standard for the challenges faced by the EU offers at least as good, if not better, arguments for politicians arguing for fiscal federalism because it highlights the social purposes that fiscal federalism is to be geared towards. These include the broadly progressive goals of income redistribution, public investment and macroeconomic stabilization that formed the basis for the New Deal's fiscal policy innovations and the attendant rise of fiscal federalism in the United States. The reference to the New Deal is another fashionable historical comparison. It can also be used to good effect in the debate over common debt and spending in the EU.

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Notes

1 The total public debt amounted to around 40 per cent of GDP, which by contemporary standards may seem low, but it must be borne in mind that revenues were also much less than they are today. In 1790, after federal revenues started flowing in, they only amounted to about 36 per cent of the total cost of servicing the debt (without

including the government's own operating expenses – calculation based on the figures in Sylla, 2011).

2 For my attempt to answer this question, see Georgiou, 2021.

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