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The European Expenditory State: an emerging mode of economic governance?

Abstract:
Taking a cue from Majone's notion of the regulatory state, this paper puts forward the concept of the '*expenditory state'* as an emerging form of governance characterised by a mix of rules and institutional developments that constrain the autonomy of governments in the conduct of fiscal policy. It argues that more binding fiscal rules and resort to fiscal council have combined with new powers assigned to EU level institutions to provide opportunities for the latter to play a more extensive role in economic governance. Although the euro crisis has demonstrated the need for closer coordination of national policies, these changes raise tricky problems of legitimation and accountability in the politically sensitive areas of tax and expenditure policies. The paper explains the influences behind the emergence of the expenditory state and discusses some of the ramifications of the resulting governance framework.

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1 Background

In his seminal article on the Regulatory State, Majone (1994: 77) argued that the *dirigiste* state of the past was giving way to a regulatory mode of governance. His contention was that, because of the very limited size of the EU budget, the European level of governance (in his analysis, essentially the Commission) saw regulatory powers as the means to expand its influence. In so doing it established a novel approach to governance through which it was able to acquire a much more extensive role.

Subsequently, and despite the consolidation of economic integration around monetary union, the supranational level in Europe has been obliged to temper its ambitions, with various forms of coordination of national policies being introduced. This erosion of the Community method in favour of inter-governmental agreements manifestly reduced the Commission's influence and can be interpreted as a resurgence of inter-governmental forms of governance. The characteristics of these new modes of governance have been extensively studied (see, for example, Héritier and Rhodes, 2011; Héritier and Lehmkuhl, 2008), and include being dependent on soft law, largely devoid of disciplining mechanisms and subject to pervasive problems of implementation (Hodson and Maher, 2001; Barcevicius et al., 2014).

More recently, further new approaches have come to the fore in economic governance, prompted in part by the need to resolve the succession of crises since 2007, but also by the emergence of distinctive policy preferences. They are particularly noticeable in various developments which, taken together, are resulting in a de-politicisation of fiscal policy, arguably following the lead offered by monetary policy from the 1980s. One interpretation of the drift of EU governance, according to Bellamy and Weale (2015) is that rules have become the antidote to the fiscal irresponsibility of politicians inclined to buy votes. In essence, this is a time inconsistency argument (Kydland and Prescott, 1977), although they add the twist that it is a Hayekian form of neo-liberalism. However, they suggest that this conceptualisation omits the fact that there is a two-level game. One facet of this is its 'disregard of the existence of reasonable differences in political judgement over the principles that should govern a monetary union made up of different sovereign states, each with their own traditions of economic and monetary policy' (Bellamy and Weale, 2015: 260).

Taking a cue from Majone's notion of the regulatory state, this paper puts forward the concept of the '*expenditory state'* as an emerging form of governance which has arisen as the result of distinct but overlapping developments. The term is intended to capture the facts that democratic decisions on fiscal policy have become increasingly constrained, but also that it has provided an opening for new forms of regulatory influence in a significant policy arena. The euro crisis triggered by the implosion of Greek public finances in the autumn of 2009, and its spread to other Member States, exposed a range of shortcomings in the governance not just of the single currency, but also in the management of the EU economy as a whole. After the Greek problems came to a head in May 2010, there followed a frenetic period of governance reform during which far-reaching shifts in the balance of powers among tiers of government were agreed.

The contention of this paper is that these shifts are leading to a further reinvention of the EU level as a vector of governance by conferring considerably greater power over public finances on EU level actors, even though the latter will not have responsibility for tax or spending decisions. Instead, the new model encompasses rule-based policy-making with coordination rooted in much harder law than hitherto and extensive Commission and Council oversight of Member States. This recasting of policy in the EU coincides with wider, though not always coherent, efforts to circumscribe governments' control and the exercise of political choice over fiscal policy. These include resort to rules that constrain discretion (Kopits, 2001; Schaecter et al., 2012), the establishment of fiscal councils with varying degrees of independence from government (Calmfors and Wren-Lewis, 2011) and efforts to enhance transparency (summarised by Begg, 2014). In the European Union, mechanisms for the oversight of national policy were established and have now been considerably strengthened as part of the reforms prompted by the crises of 2008-13. The reduced scope for discretionary fiscal policy therefore raises awkward questions about legitimacy and the autonomy of national parliaments in what remains a fundamental state function of determining tax and spending.

While elements of the 'expenditory' approach can be found in many jurisdictions, the distinctive EU (and, more so, Eurozone) fiscal 'constitution' offers especially fertile ground in this regard. The next section of the paper tries to relate the emergence of new demands on fiscal governance to the responses to the succession of crises since 2008. Section 3 of the paper looks in more detail at the underlying influences on fiscal policy, then section four discusses the implications for the legitimacy of the policy framework. A concluding section summarises the resulting tensions and considers some of the messages for policy-makers.

2 The influence of the crisis on EU economic governance

As many commentators have shown (for example, Wallace, 2016), the diagnosis of flaws in the architecture of the euro lies behind many of the changes in governance recently enacted. It has also seen evolution in approaches. Thus, Bickerton et al. (2015) observe the paradox that although a substantial transfer of powers in key areas of economic governance has occurred in response to the years of crisis, it has been through what they call the 'new intergovernmentalism' in which many of the solutions have been adopted without fundamentally changing the constitutional order established by the Maastricht treaty. Instead of resort to supra-nationalism, devices have included separate inter-governmental treaties subject to public international law (the Treaty on Stability, Coordination and Governance, and the European Stability Mechanism), assigning new functions to existing institutions (notably the ECB) and a much more overt role for the European Council in steering economic policies. They suggest that deliberation has become a much more explicit form of governance, but no longer with the aim of arriving at supranational powers.

Developments have included the six-pack of legislation covering fiscal discipline and monitoring of imbalances, the two-pack on budget oversight, the establishment of the European Stability Mechanism as a rescue fund and a more extensive engagement by the ECB in governance

functions outside its core mandate of price stability. The Treaty on Stability Coordination and Governance (TSCG), of which the Fiscal Compact is one part, also emphasises coordination of national policies and refers to ex-ante discussion of 'all major economic policy reforms' (Art. 11). New governance arrangements include discussion of 'the euro area and the rules that apply to it, and strategic orientations for the conduct of economic policies' (Art. 12.2). While not very prescriptive, the text imparts a sense of a search for more extensive management from above of the euro area. More is in the pipeline through a succession of proposals culminating in the Five Presidents' report (Juncker et al., 2015) and its follow-up (Commission, 2015a).

2.1 The macroeconomic challenge

The economic crisis, both in Europe and in the US, led to intense scrutiny of fiscal policy and exposed a litany of problems about how it is conducted and monitored. In recent years, the flashpoints have included the sovereign debt problems affecting several euro area countries, together with battles between the branches of government in Washington D.C. over the debt ceiling and avoiding the 'fiscal cliff'. In a conventional macroeconomic policy mix, the two principal instruments – monetary policy and fiscal policy – interact with each other, and can, to some extent, be traded-off. A tight fiscal policy, for example, may be balanced by a looser monetary policy (as happened in the United States during the Clinton/Greenspan years) or vice versa (consider the Reagan/Volcker era). Typically, the central government is the arbiter of the stance of fiscal policy and, in the better designed fiscal constitutions, is able to exercise sufficient oversight of lower levels of government to ensure that the latter's budgetary balances are consistent with the overall macroeconomic strategy. Even where there is an independent central bank, some tacit co-ordination between the fiscal and monetary authorities takes place.

However, in the euro area, the principal decisions on fiscal policy are taken by Member States and not centrally decided, leaving the aggregate position to be the unplanned outcome of the (currently) 19 separate national decisions on the budgetary balance. Even the Stability and Growth Pact (SGP), generally seen as the core of fiscal coordination in the Eurozone, only prescribes limits and broad orientations, rather than an aggregate position. Consequently, it is entirely possible that the aggregate of the separate national decisions will result in an inappropriate collective fiscal stance.

The normative question behind this is whether better economic governance could be achieved if there were a mechanism to arrive at a collective fiscal stance. For some commentators, the answer is 'no' on the grounds that so long as each policy authority 'keeps its own house in order' the system as a whole will be satisfactory. On this logic, the monetary authority should concentrate on achieving price stability, while budgetary policy-makers should maintain sustainable public finances. While a theoretical case for an explicit policy mix is recognised in this logic, the concern usually expressed is that by inducing policy-makers to deviate from their core goals, co-ordination between fiscal and monetary policy will lead to bad policy for political economy reasons.

Many critics of the EU's handling of the euro crisis have argued from a largely Keynesian standpoint for a more active role for a common Eurozone fiscal policy. In addition, a number of the reforms already enacted, as well as some of those in the pipeline, are about redressing this balance. But they necessarily also require that the freedom of manoeuvre of countries be restricted. It is this restriction that gives rise to the top-down and coordination obligations posited as a facet of the expenditory state. Irrespective of views on the merits, of fiscal coordination or of the 'austerian'/Keynesian debate, a special case may arise in periods of severe turbulence, such as after the euro crisis erupted in 2010, when it rapidly became clear that both monetary and fiscal responses were needed.

However, it is not only in periods of recession or crisis that cross-border co-ordination of fiscal policy is warranted. Even in good times, the collective budgetary position can influence monetary policy: too loose a collective fiscal policy will lead to pressure to raise interest rates and vice versa. Other than the indirect mechanisms of the 3% deficit limit of the SGP, its medium-term aim of 'close to balance or in surplus' and the much looser surveillance of national fiscal positions under the macroeconomic components of the EU's Europe 2020 strategy, there was no overt means of aggregating national fiscal positions. Some recent changes, as well as some of the further proposals in the Five Presidents' report (Juncker et al., 2015), may lead to change in this regard.

2.2 Towards effective EU fiscal policy

Concerns about fiscal policy are nothing new and there have been frequent disputes between governments and international financial institutions and organisations (notably the IMF and the OECD) about the macroeconomic and budgetary orientations of national policies. While the focus has conventionally been on the fiscal stance, the institutional framework also matters. For example, Dyson (2014: 42) argues that managing the euro crisis was 'institutionally encumbered by absence of an EU or euro area fiscal state', prompting the question of whether the 'expenditory turn' described in this paper could be enough to overcome these lacunae. Dyson also asserts that the way the crisis has evolved left the ECB exposed in ways that are likely to be inimical to the future good governance of the Eurozone, and that a further encumbrance is the narrow interpretation of fiscal rules with respect to what might be considered exceptional events, such as dealing with bank failures. These difficulties are accentuated by the continuing contest between Germany and the ECB as to which should be the principal creditor.

Citizens, too, have become increasingly suspicious of governments that act rashly, fail to confront budgetary realities or exhibit 'Leviathan' tendencies (Buchanan and Tullock, 1962). Part of the background to the evolution of the context in which fiscal policy is made is the recognition that the postwar state can no longer go it alone in policy-making, yet that one-size-fits-all approaches will fail to reflect national diversity. As the title of the book by Bickerton (2012) signals, nation-states have had to become member states, engendering obligations to respect oversight from EU bodies. However, as Bickerton et al. (2015) show, these are not necessarily the core EU institutions (notably the Commission) exercising their traditional functions.

Even so, the shift of power is extensive and continues apace with the prominence given to the European semester and the ostensible toughening of enforcement. That it may be a new kind of centralisation does not detract from the expenditory state thesis. Pisani-Ferry (2014: 167) describes the responses to the crisis – at least until the recent steps to establish banking union – as 'mutual insurance'. As he describes it:

> 'The difference between the federal and the mutual assistance models is conceptually simple. The federal model relies on a vertical division of labour between the centre and the constituent entities—in Europe's case—the member countries. Whenever participating entities have to act in common, they do it by delegating competence to the centre, thereby tilting the power balance in its favour. In the mutual insurance model that has emerged, instead, states support each other horizontally. Instead of a federation, they organize themselves in a sort of cooperative, but without a strong centre'.

Some key features can be identified. Thus, the Stability and Growth Pact model of governance appears to be at the heart of the post-crisis approach and has largely been adopted for the new Macroeconomic Imbalances Procedure as well as the additional constraints in some of the other governance innovations. It consists of the following four main elements:

- First, there is a rule embodied in hard law. For the SGP the details have varied somewhat over time, but the Pact has encompassed a medium term target and 'normal times' thresholds for the public deficit and public debt. For the MIP, the criteria are less precise and the attempts to introduce symmetry between excessive current account deficits and surpluses as sources of imbalance had to be watered down[1], but
- Second, the primary responsibility for monitoring is assigned to the European Commission, but there is also a role for the Council of Ministers in validating the process of determining when there is a breach. The post-2010 reforms alter the balance by reducing the capacity of the Council to block a decision, thereby responding to the acknowledged shortcoming that the Council would routinely block criticism of its own members.
- The third component is a prescriptive one in which the delinquent Member State is given guidance and a timetable for how it should deal with the breach. In previous iterations, this proved to be far from satisfactory because the whole process took too long to have any effect on redressing macroeconomic imbalances.
- Sanctions constitute a fourth arm of the model, but have been bedevilled by the perception that when they reach the stage of imposing financial penalties on delinquent Member States, they were a 'nuclear' option, intended never to be used. Financial sanctions, moreover, could become perverse by imposing a financial penalty on a state already struggling to meet public finance norms. The post-2010 reforms introduced more graduated sanctions, in the hope that

[1] This is a problem that has long been recognised, though never convincingly solved, in international economics

they will be more credible, but triggered a heated – and far from fully resolved – debate about automaticity in resorting to them[2].

In practice, the various new or recast governance mechanisms embrace these four components in differing ways. The revised SGP has all the elements as described, but has been subject to qualification as a result of the guidance issued to Member States about how the rules will be interpreted, for example if public investment is raised (Commission, 2015b). There is some inconsistency in the post crisis approach to monitoring other macroeconomic imbalances through the Macroeconomic Imbalances Procedure (MIP), notably from allowing surplus countries greater leeway before formal correction mechanisms are triggered. A current account surplus has to exceed 6% of GDP before it is deemed an imbalance, whereas the threshold for a deficit is 4%.

3 From the fiscal policy 'problem' to the 'expenditory' state

The principal macroeconomic concern in fiscal policy is the budgetary balance, a concern that stems from the presumed deficit bias of decision-makers who put electoral advantage ahead of economically optimal policy. Fiscal rules that restrict the size of the deficit, require the budget to be balanced or impose ceilings on public debt are widely used. Because the justification is to assure stability, measures under this heading are contested primarily on the grounds of effectiveness in achieving a stable macroeconomic trajectory. The disputes between overt Keynesians and proponents of tough fiscal consolidation are undoubtedly heated. But although these debates highlight the social costs of alternative approaches and the interplay between short-term and longer-term effects, they are essentially about what is the right macroeconomic policy.

A second facet of fiscal policy that has become especially prominent in EU discourse is the quality of public finances. Here again, the motivation is principally macroeconomic insofar as 'quality' is linked to the growth rate: put simplistically, public finances should be structured to stimulate higher growth by building up physical, human and social capital. Implicit in this standpoint is a sense that some current expenditures are misguided or even frivolous, although the notion of quality avoids a crude distinction between current and capital spending. Education, for example, is measured as current spending, but can be interpreted as a necessary condition for growth. Nevertheless, there is an unavoidable distributive element.

However, the quality of public finances can also be interpreted to mean sustainability, and can encompass policy decisions that alter the long-term position. The cost to the public purse of pensions is an obvious target and is a topic frequently highlighted in Commission recommendations. Similarly, when Sweden set a fiscal target in 1997 of a 1% surplus (subsequently eased) as a rule, it was partly in anticipation of a rising pensions burden as the population ages (Jonung, 2014).

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[2] Representatives of the European Central Bank championed automaticity, but some Member States fought hard to prevent automaticity

The most contentious forms of intervention in the conduct of fiscal policy are on entitlements and the distribution of the tax burden, where normative considerations are much more critical. Electorates, manifestly, look at the programmes offered by political parties partly through the lens of their own prosperity. Consequently, any external recommendations (such as those from the EU level or, indeed, international agencies such as the IMF) concerning the distribution of costs and benefits of fiscal policy intrude much more directly into the domestic political process and therefore pose the greatest legitimacy challenges.

3.1 Fiscal rules

Fiscal rules have a chequered history and, as Wyplosz (2012) observes are especially vulnerable to contingencies that would make them very costly to respect. The years of economic crisis are, nevertheless, leading to a general intensification of fiscal rules and to an increase in their complexity. As Schaechter et al. (2012) argue, the balancing act that many governments are now seeking is between rules that will be effective in assuring fiscal sustainability and provisions for some flexibility in times of crisis. Use of structural deficits as opposed to nominal values is one means of doing so, but Schaechter et al. point out that new challenges are to be expected in explaining and monitoring rules. Similarly, Wyplosz (2012) emphasises how much more difficult it is to legitimate fiscal rules compared with assigning independence to monetary policy. Given that fiscal promises tend to be at the heart of election campaigns, rules remove a core element of politics.

For most Member States, fiscal rules were, nevertheless, already being strengthened between 1991, when they were first measured by DG ECFIN of the European Commission, and 2011, in several cases very substantially. The DG ECFIN index of the strength of fiscal rules uses five criteria:

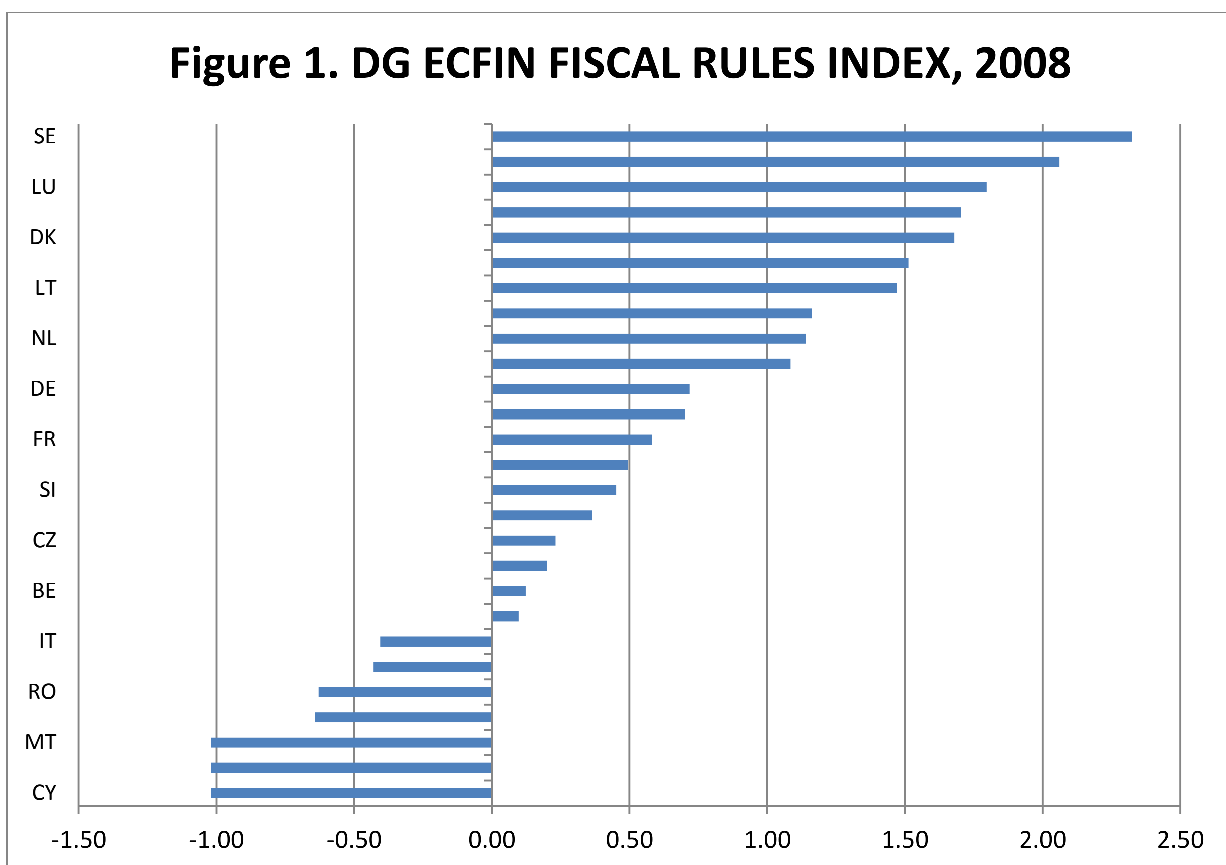
- The statutory base – ranging from fully enshrined in the constitution to a political commitment by the government
- The room for adjusting the rule
- The degree of independence from government of the body monitoring and enforcing the rule
- The automaticity of enforcement of the rule
- Media visibility of the rule

A composite index of fiscal rules is then constructed, taking into account the coverage of the rules on public expenditure. Figure 1 shows that in 2008, and thus before the eruption of the euro crisis, the countries with the lowest values on the index were Cyprus, Greece and Malta, while Ireland, Romania, Portugal and Italy also have negative scores. The implication is that weak or absent fiscal rules are associated with a higher risk of difficulties in fiscal policy. A possible explanation, derived from work by Iara and Wolff (2014) who find that stronger rules are associated with lower bond spreads, is that more effective fiscal rules reduce sovereign risks of the sort that were only too visible in the euro crisis.

Indeed, in 1991, only Germany (still the country in the Eurozone with the most favourable bond ratings) had a positive score on the Commission's composite index. At the same time, many governments devote considerable effort to finding ways round rules, especially those associated

with EU coordination. For example, the Italian and French governments have, latterly, sought to bend some of the rules to which they are subject, and political considerations manifestly lie behind the Commission (2015b) guidance on the circumstances under which the rules can be eased.

Apart from numerical constraints on deficits or debt to GDP ratios, rules have also focused on capping expenditure or imposing hard budget limits. Eurozone countries are subject to a rule on expenditure growth and also have their annual budgets scrutinised and judged by the Commission. Top-down monitoring of public expenditure has surfaced as a public policy issue in many countries in which lower tiers of government either constitute a sizeable proportion of public spending or are not subject to strict fiscal rules such as an obligation to balance the budget. The economic rationale can be simply explained: the general government fiscal balance is an aggregation of all levels of government, so that any macroeconomic target can be affected by the actions of any level of government. In a number of EU Member States – Spain being the striking example in 2012 – fiscal precarity at sub-national level has contributed to sovereign debt problems, and the predictable response has been to seek ways of tightening controls.



Source: own elaboration from DG ECFIN data

In other polities, curbs on lower tier of government include balanced budget rules, strong control by the centre on fiscal resources (through 'ownership' of the tax system and the distribution of inter-governmental grants, or prescription by the central level of the criteria to be applied for

determining spending by lower tiers of government. In such systems, the federal or central level's direct responsibility for stabilisation policy often means a battle to rein-in spending by lower tiers and tensions around how much autonomy should be given to lower tiers. All US state governments except Vermont have variations on balanced budget rules, but as Gordon (2012) shows, these rules are framed in ways that give degrees of flexibility when the state is confronted with a pronounced economic downturn. According to Shah (2008), there is natural tendency for central governments to want to interfere in the detail, even though the logic of decentralisation of spending is to allow lower tiers to reflect local needs in their decisions.

There is also an extensive literature about inter-governmental transfers, typically consisting of flows from central government to lower tiers to make up for the limited revenue-raising capacity of the latter (for an overview, see Shah, 2006). The focus of this literature tends to be on how best to ensure that lower tiers spend money efficiently and target it appropriately, rather than on how to achieve macroeconomic fiscal goals. A related literature looks at the role of inter-governmental transfers in stabilising regional economies hit by asymmetric shocks (well summarised by von Hagen, 2008). In much of this work, design of mechanisms to counter adverse incentives is a crucial issue. The effects of transfers between regions are shown by von Hagen to bear on macroeconomic stabilisation, especially in circumstances where the monetary authority acts to counter a fiscal policy induced rise in demand resulting from asymmetric regional responses to a fiscal stimulus.

Fabbrini also notes that the constitutionalisation of fiscal rules could confer significant new powers on constitutional courts over fiscal decisions made by executives or voted by Parliaments, taking these courts into areas where their influence has hitherto been negligible. The ECJ will, in addition be empowered as well as the Commission, although there is ambiguity about whether the ECJ power is only to ensure that the golden rule is enacted or also implemented.

3.2 Fiscal councils

Fiscal councils or equivalent bodies have become increasingly visible as a component of policy-making. These vary in character and mandates, but have in common, according to Simon Wren-Lewis[3] that they can boost government credibility and expose either profligacy or austerity measures that have long-term adverse consequences. Most such bodies are set up to be independent from government, although they usually receive funding from the state and their members are appointed by ministers. The principal justification for them is to counter the deficit bias in fiscal policy-making by providing politically independent analyses of fiscal positions, with many assigned the task of making or collating forecasts.

According to a review by Calmfors and Wren-Lewis (2011), fiscal councils only have advisory roles and none of those they examined has any direct role in setting budget deficits. They consider whether a council can be an alternative to explicit fiscal rules, but find that in nearly all cases they

[3] http://www.policy-network.net/pno_detail.aspx?ID=4370&title=The-case-for-Fiscal-Councils

are complementary to rules. Noting that political conflict between the government and the fiscal council is probable, with the result that governments have incentives to constrain what councils do, they also argue that governments can gain from having effective councils.

There is an evident tension for any fiscal council. On the one hand, they need to be constructive and supportive of governments in trying to define an appropriate fiscal policy. On the other, they need to be critical and to demonstrate their independence if they are to avoid the charge of providing a fig-leaf for unpopular or partisan policies. In Sweden, where the fiscal council has been in place since 2007, there have been several instances of public disagreements between the council and the government, as well as opposition objections, while in Hungary, a new government took steps to neuter the council in order to forestall criticism. An evaluation of the Irish Fiscal Advisory Council (Jonung et al., 2015) found that although it had conducted analytically well-founded assessments, its voice was sometimes not heard.

Many of the functions of a fiscal council are, effectively, being replicated by the European Commission in its oversight of national policies, and there is now the prospect of yet more complexity being introduced by the establishment of new Fiscal Board with a pan-Eurozone remit. With several layers of independent input into policy-making there is obvious potential for conflict between rules, what fiscal councils recommend and what the Commission proposes, given added spice by the Commission's possession of sanctions. By contrast, the power of fiscal councils relies much more on their ability to damage the reputation of the government for sound policy. Now that most EU Member States have introduced fiscal councils, procedures for reconciling their recommendations with those emanating from the EU level will need to be devised. Without them, incoherence in policy orientations offered to government would be likely, undermining the whole thrust of the emerging governance framework, but also having consequences for electoral politics.

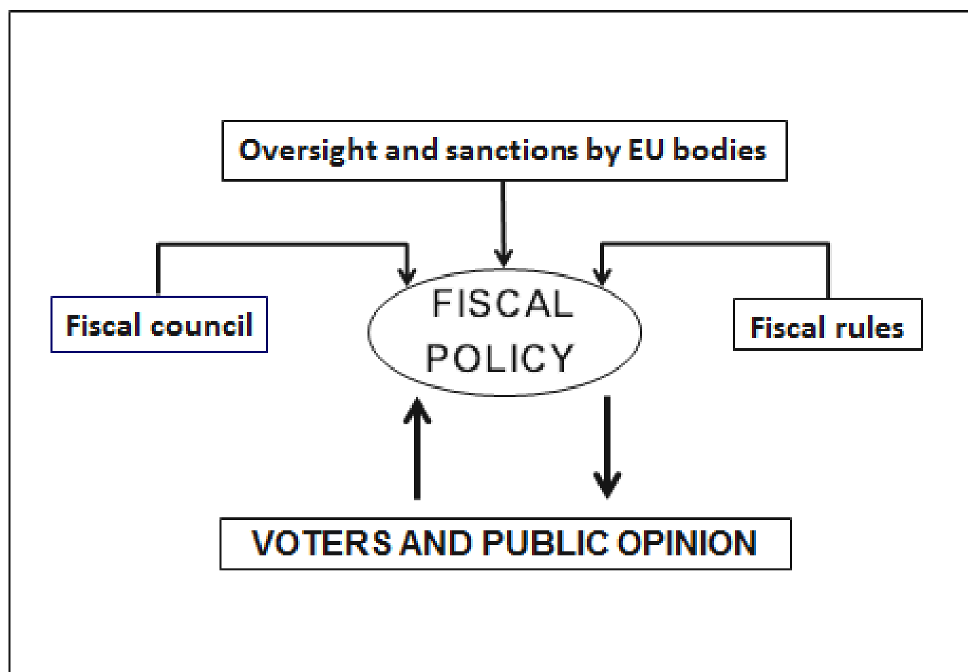
Among the political advantages of a formal fiscal council (as opposed to forecasts or recommendations produced by research institutes, think-tanks or private actors) is that governments cannot easily ignore their officially endorsed watchdog. The corollary is that the fiscal council has to show that its work is rigorous and that, even when it is wrong, that it is for credible reasons. Kopits (2011: 19) emphasises the importance for an effective council of having good communication strategies and being held in high esteem by markets: 'ultimately, in a free society, the media are the closest allies and promoters of the institution'.

3.3 Explaining a new form of governance

The conjunction of fiscal rules, fiscal councils and the increased role of the EU level in constraining national budgetary policies can be seen as a wide-ranging transformation of the governance of fiscal policy, altering the relationship between voters, governments through the actions of other actors (figure 2). A key finding of research on the new modes of governance is that they allowed decision-making to become less hierarchical and put a premium on building consensus. However, the thrust of the governance reforms emanating from the crisis is to restore hierarchy in the sense of constraints on national autonomy. These constraints are most binding in the case of the Member States subject to 'austerity' programmes, but also apply with what appears to be

increasing intensity to other Eurozone states and to somewhat to those that have opted-in to the Fiscal Compact.

Figure 2. The emerging 'expenditory state' fiscal framework in the EU



The emergence of this new *expenditory state* In the EU can be explained partly as a response to the crisis, but also derives from a wider concern about the propensity of decision-makers to take the soft options, as predicted in the time inconsistency literature (Kydland and Prescott, 1977; Rogoff, 1985). Time inconsistency is the simple proposition that despite announcement of a policy goal or rule, the policy-maker will not respect them when the time comes to implement the policy. The reforms of economic governance that underpin the expenditory state can, in part, be traced to this notion. The temptation to adopt time-inconsistent policies typically arises when the incentives to make a commitment are weaker than the incentives to renege on it, and arises most egregiously at different points in the electoral cycle. A tough stance is easy to announce just after an election, but becomes progressively harder to keep as the next election approaches and votes have to be won.

In the EMU setting, governments have additional incentives to renege on commitments because of the potential for free-riding: because of fiscal spillovers, only part of the costs will fall on citizens of the delinquent country and it is also easier to blame Brussels. This is a classic collective action problem. The euro crisis has also exposed clear differences among Member States – notably France and Germany – about the well-rehearsed issue of rules versus discretion and the sequencing of policy actions.

The extent of recent EU reforms means that some of the consequences for the conduct of governance in practice are not yet either visible or assimilated into the routines of policy-making. In something of a paradox, the speed with which these changes have occurred is also striking, in spite of the image of procrastination projected by the EU's leaders. The extent of the new approach can be grasped by looking at the recent innovations summarised in figure 3. As Aizenmann (2015) observes, it took decades for some of the equivalent key elements of the US system to evolve – not to mention several defaults by states, the Civil War and the great depression – and he also stresses the time needed for institutional learning and adaptation.

Figure 3. Components of the emerging EU expenditory state

MECHANISM	MONITORING AND ENFORCEMENT
Stability and growth pact	Council on Commission proposal
Macroeconomic imbalances procedure	Council on Commission proposal
European semester	Commission
National fiscal framework	National government
Budget approval	National parliaments, following Commision
ESM conditionality	Council
Fiscal Compact	Council
Macro economic adjustment programmes	"Troika" of Commission, IMF and ECB
Macro-prudential supervision	ECB, through European Systemic Risk Board
Prudential supervision of banks	ECB and national supervisory network

4 Legitimating the expenditory state

Concern about how to justify the role of governments has long been a focus of political economy (for example, Buchanan and Tullock, 1962) and can be expected to arise in new forms in the expenditory state. In the EU, there has been an extended, though inconclusive debate about the democratic deficit, leading Corbett (2012: 157) to argue that although the Union fulfils democratic principles, it does so in a way that is 'more complex and less visible to the public than is the case at national level' – see, also, Vibert (2014). This debate is primarily about legislative acts, yet even in Majone's regulatory state, there is an established legal procedure for transposing European rules into national law, after which implementation is at the national level. The logic behind pooling sovereignty is that the collective effort will lead to better outcomes, but the corollary is that participants have to be confident that the other parties will adhere to the rules of the collective. Bellamy and Weale (2015: 263) connect this with legitimacy by arguing that 'only if states enjoy democratic legitimacy will other states have reason to believe that their commitments are credible'.

Governance without government is how Weiler (2013: 116) characterises the EU and he goes on to bemoan the lack of a recognised means of legitimating it: 'the two primordial features of any

functioning democracy are missing – the grand principles of accountability and representation'. Indeed, he asserts that the EU 'is not designed for accountability'. Habermas (2012), too, has expressed deep concerns about this drift towards what he calls 'executive federalism'. Crum (2013) argues that what is occurring is a manifestation of the trilemma of globalisation identified by Dani Rodrik (2011). In all these analyses, the underlying message is that the democratic oversight of what the EU does or plans to be is being challenged.

4.1 Forms of legitimacy and channels of accountability

What is striking about the expenditory state is that extensive powers over public finances are taken out of democratic control – at least as exercised by national legislatures. As the EU level, and especially the Commission, takes on new 'expenditory' responsibilities, linking them to the incidence of fiscal rules, it is pertinent to ask these actions can be legitimated. The difficulties may be most acute in explaining how the EU level reaches its judgements in a context in which the governments receiving these judgements then have to implement unpopular policies. The latter will often, as the protests in Member States subject to programmes as a result of being bailed-out during the sovereign debt crisis show, lead to Brussels being blamed, even where it is failures at the national level that are the root of the problem. But there is also a challenge among governments: for Bellamy and Weale (2015) it becomes a question of trust in partners and in their analysis of monetary policy they point out that there is no reason to expect a national consensus among different interests on the optimal policy stance. This reasoning arguably also applies to fiscal policy insofar as decisions with far-reaching impacts cannot be relegated to technical discussions,

Here, it is pertinent to revisit the debates between input legitimacy (in short: citizens voted for it) and output legitimacy (it works). Yet there are two interpretations of current developments. One is that the systemic failures of political control of fiscal policy fully justify resort to external agencies and rules, and that what is lost in democratic oversight is more than compensated by the gains in welfare. Output legitimacy, in other words, trumps input legitimacy. An associated reason can be found in Scharpf's observation that the EU governs governments rather than citizens (Scharpf, 1999), leading to the obvious question of why governments acquiesce in unpopular obligations.

The second is that it constitutes an unacceptable assault on one of the core functions of the modern state and is thus unacceptable. The most contentious forms of intervention in the conduct of fiscal policy are on entitlements and the distribution of the tax burden, where normative considerations are much more critical. Electorates, manifestly, look at the programmes offered by political parties partly through the lens of their own prosperity. Consequently, any external recommendations concerning the distribution of costs and benefits of fiscal policy intrude much more directly into the political process and therefore pose the greatest legitimacy challenges (Habermas, 2012).

The further notion of throughput legitimacy (Zürn, 1998; Risse and Kleine, 2007) may, however, be more relevant for the EU as an expenditory state, because of the assignment of potentially strong

monitoring and sanctioning powers to EU bodies. As Schmidt (2012: 663) explains it, the processes adopted need to be accountable, transparent and sufficiently open if they are to possess throughput legitimacy: in her words, supplementing Abraham Lincoln's dictum, it has to be 'government *with* the people', not just 'for' , 'by' and 'of', if legitimacy is to be achieved. In Schmidt's notion of *with* the people, a prominent role is assigned to civil society in legitimating policy by ensuring that plural views are heard, although she point to the dangers of a clash with input legitimacy.

There is, as Lord (2011) points out, also a misapprehension that agreement by the Member State is sufficient to ensure indirect legitimacy unless the processes and decisions also resonate with citizens. As the euro crisis has unfolded, there has been growing popular disenchantment with tough policies imposed by a remote 'Brussels-Frankfurt' axis to resolve economic imbalances, apparently without the consent of citizens affected by them. A concern is that, in relying on something between output and process legitimacy, the Commission risks fighting an uphill battle to demonstrate that its policy prescriptions make sense. Even if the austerity/structural reform mix applied to today's 'programme' countries is accepted as the only solution, it is one that citizens in creditor countries might regard as legitimate, but much harder to justify to citizens in countries subject to these strictures, especially in the short-term. New and more challenging questions for indirect legitimacy inevitably arise where the external agency is, in effect, adopting the stance of TINA (there is no alternative) famously ascribed to Margaret Thatcher, while also implying that domestic actors have to be saved from themselves.

While noting the many obstacles to a satisfactory resolution of the democratic trilemma posed by input, output and throughput legitimacy, Schmidt (2012) is reasonably sanguine about the opportunities for a virtuous circle outcome. But it is hard to avoid the conclusion that the new expenditory functions the Commission has acquired will be testing. A national fiscal council or national fiscal rules are, at least, at the same level as national elections, such that there is a 'logic of appropriateness' in compliance (Risse and Kleine, 2007). But it is harder to hold a body outside the national arena to account, the more so when its actions have potential distributive consequences not just within the national sphere but between the Member State subject to them and other Member States.

The standard answer that the European Parliament is the body to hold the Commission to account for its new powers of oversight was made by the Future of Europe Group, but even so the Group goes on to state that the responsibility of the Member States for the composition of their budget has to be fully respected' (Future of Europe group, 2012: 4). Others are more sceptical about the EP's ability to provide a bridge between 'normal' politics and decision-making at the EU level because, in Habermas's felicitous phrase[4], 'this bridge is almost devoid of traffic'.

[4] Lecture on 'Democracy, solidarity and the European crisis' at the University of Leuven, 26.04.2012
http://www.kuleuven.be/communicatie/evenementen/evenementen/jurgen-habermas/en/democracy-solidarity-and-the-european-crisis

The risks have manifestly been understood by the Commission and the European Council, and addressed in the successive proposals for completing economic and monetary union, all of which include sections on legitimacy and accountability. Thus, the Four Presidents' Report (European Council, 2012) argued that the European Parliament should ensure accountability for decisions at European level, but then rather blurs the message by referring to the pivotal role of national parliaments. The Commission (2012) blueprint takes a similar line in a much longer discussion of democratic legitimacy and accountability headed 'Political Union', but then its enthusiasm for national parliaments appears to wane:

> Interparliamentary cooperation as such does not, however, ensure democratic legitimacy for EU decisions. That requires a parliamentary assembly representatively composed in which votes can be taken. The European Parliament, and only it, is that assembly for the EU.

4.2 Why accede to the expenditory state?

The original conception of monetary union was that, although monetary policy necessarily became supranational, responsibility for fiscal policy would remain at the level of the Member State. Monetary policy would be the principal instrument for dealing with union-wide economic developments – encompassing 'normal' cyclical fluctuations that affect price stability as well as more severe shocks, such as the crises since 2007 – while fiscal policy would be available to deal with asymmetric shocks affecting individual Member States (Artis and Buti, 2000). It was also expected that the disciplines of a single currency would oblige Member States to be more attentive to the supply-side of the economy, failing which they would progressively lose competitiveness. This latter expectation proved to be wildly optimistic and the consensus now is that the immediate reduction in debt service costs accruing to previously inflation-prone Member States generated a windfall gain so great that pressures for structural reform evaporated – according to the literature surveyed by Leiner-Killinger et al. (2007). What, then, has changed?

The main rationale for acceding to the demands of the expenditory state is that, without it, there would be increasingly destabilising macroeconomic developments. As macroeconomic imbalances became more acute, the trajectory of the EU (euro area) economy in aggregate became unsustainable. But it is abundantly clear that the system as a whole lacked sufficient mechanisms to prevent a crisis that would spill over to all members. The 'soft' surveillance processes lacked bite and even where they identified risks, could easily be disregarded by Member States, especially if their macroeconomic indicators were flattering. The logic of the expenditory state is therefore to forestall such spillovers in the interests of macroeconomic sustainability.

Citizens and politicians are not, however, the only relevant stakeholders. From the perspective of markets, much of what the expenditory state brings is attractive. Technocratic motivations for fiscal policy changes tend to be viewed more favourably by markets than politically motivated ones. However, what could be seen as subjugating a deeply political process to what pleases markets is bound to be contentious.

Compliance and what influences it are critically important for the success of policy coordination and legitimacy plains looms large in this regard. The ECB is, as Scharpf (2009: 177) describes it, 'immunized against political intervention'. He argues that the European Commission and the ECJ also enjoy greater autonomy in certain areas, although he goes on to note the 'extremely high consensus requirements of EU legislation' and its inhibiting effect on collective action to solve problems that Member States cannot resolve on their own. For Scharpf, the absence of a collective European identity is at the root of these problems. Compliance in many EU domains, in turn relies on the willingness of national governments to ensure implementation.

A further important distinction Scharpf makes is between what he calls 'political' and 'non-political' modes of policy making. The former include treaty change and decisions requiring unanimity, but also policy areas for which lighter decision-making (for example qualified majorities in the Council) nevertheless give all Member States a voice in the process. The latter, by contrast, offer no role to either the Member States (or, as Scharpf asserts, the European Parliament), examples being ECB monetary policy decisions or Commission prosecution of Treaty violations.

In the public finance literature, the issue of central government control over sub-national government concentrates on how to curb destabilising behaviour, but is usually predicated upon a strong and large central government which, through its power over inter-governmental grants, has a potent means of assuring compliance. Indeed, it is instructive that some federal or quasi-federal systems that have given substantial autonomy to sub-national government are now struggling to control public expenditure.[5] In fiscal constitutions that give more autonomy, the risks are correspondingly greater. Rodden and Wibbels (2010) find, moreover, that the outcome is pro-cyclical.

4.3 Absence of mechanisms for political choice

The EU is a curious hybrid as an economic entity. It has substantive quasi-federal institutions, including a legislature able to make laws that have wide-ranging economic consequences, a currency and a central budget, yet has only limited provision for political choice on many key policy choices. In part, this is because the constitutional settlement was deliberately designed to tie the hands of political decision-makers, most obviously in monetary policy through independence for central banks, and in fiscal policy through the conjunction of the formal Treaty articles on excessive deficits and the hard law of the Stability and Growth Pact. But it also stems from an institutional framework which has few bodies in which political choices on economic policy can be made. Even the most politicised of such bodies – the Eurogroup – has limited authority and scope for action.

Although there are sound analytic reasons for independence of central banks and for stability-orientated fiscal policy, both can have distributive implications. Obvious cleavages are between lenders and borrowers, tax-payers and welfare recipients and different age cohorts. Some might

[5] For example, in Spain where a government already struggling to cope with the funding problems of its savings banks, found in 2012 that a number of autonomous regions also required central government support

prefer more government, some less, while the composition of both taxes and spending affects different social groups in different ways. Yet at EU level, none of these sorts of issues has much influence on decision-making, in contrast to nation-states where substantial changes can occur over time in distributive matters. For many commentators, the lack of choice at EU level is regarded as desirable, insofar as they view discretion in macroeconomic policy-making as chronically prone to manipulation by special interests or other distorting forces, leading to sub-optimal outcomes. But others argue that an absence of mechanisms for political choice is profoundly un-democratic and puts too much power in the hands of unelected officials, however benevolent their approach.

The euro crisis brought a number of these issues to the fore. To the extent that a choice can be made between countering unemployment by riskier monetary or fiscal policy or sticking rigidly to stability-orientated policy rules and approaches, the governance framework of the euro area inclines towards the latter. The system does not encourage public debate on the options and citizens have no direct means of shaping EU policy. Nor do elected representatives in the European Parliament have any real say on macroeconomic policy preferences. Instead, the main decisions are taken behind closed doors by finance ministers (or, increasingly now, by the European Council, as Bickerton et al., 2015, emphasise) with little input from ministers representing other sectoral policy areas. An economic government at EU or euro area level might choose to make many of the same pro-stability policy choices, but what is largely absent in the present system is a transparent system for making such political choices, or of mediating their potential distributive ramifications.

4.4 Bases for support

In a perceptive essay, Eichengreen (2012) argues that although budget and external deficits are highly visible symptoms of the euro crisis, an underlying problem is a deficit of trust, born of dissembling by political leaders, back-tracking on commitments, and suspicion among social groups who fear that they are being asked to shoulder and unfair share of the burden of adjustment – the last slowing down reform momentum. While emphasising the long shadow of history in shaping social attitudes, Eichengreen nevertheless argues that a period of severe crisis affords an opportunity to rebuild trust. By so doing, there may be greater scope to break out of path dependency.

Similarly, when the EU level acquires greater powers to impose sanctions on Member States, as it has done with the recent governance reforms, it has to ‘deal with the problem that legitimacy depends in part on actors with confidence in the compliance of others’ (Lord, 2011: 99). Given that a political justification for the EU imposition of fiscal constraints is to solve a collective action problem, the justification for doing so will be badly undermined if there is non-compliance. Yet fiscal cooperation will often impose burdens that interests within Member States will find onerous. Lord (2011) argues that a ‘Coasian’ bargaining logic can resolve this dilemma and lend support to the notion of indirect legitimacy that is so central to how the EU operates, although he adds the rider that if it does not, the only answer would be direct legitimation.

Bellamy and Weale (2015) go so far as to suggest that excessive constitutional obligations built into agreements such as the fiscal compact may, almost paradoxically undermine state commitments. There is also, in the way governance is evolving, great scope for differing sources of legitimacy to be in conflict, as explained by Commissioner Pierre Moscovici[6]: what a Greek government adduces to justify its actions will rarely correspond to what the governments of creditor nations rely on; nor is it clear how the EU level fits into the picture.

The nub of the legitimacy challenge is that in trying to ensure macroeconomic stability, the expenditory state is imposing cooperative behaviour on actors who might otherwise be tempted to free-ride. As in any prisoner's dilemma, cooperation is in the common interest (Scharpf, 2009) but there are inevitable caveats about distributive effects and – especially in the specific circumstances of fiscal policy – uncertainties about whether free-riding will be punished. But there is clearly also the potential for a backlash from citizens. As Scharpf (2009: 188) puts it: 'the capacity of member states to comply with EU law reaches its limits when doing so would undermine their own legitimacy in relation to their national constituencies'.

The notion of limited statehood discussed by Börzel and Risse (2010) suggests that where states lack capacity (for whatever reasons, and not just because of having failed in some respect), non-state actors concerned to forestall anarchy have an incentive to provide governance. They note, further, that in the absence of the state, an external agency or international organisation can offer hierarchical control. Because the EU level has neither the legitimacy of an elected central government nor the capacity to 'sweeten the deal' by distributing inter-governmental grants, clashes with lower tiers are likely to be magnified where curbs on national governments are under consideration, witness some of the disputes around the successive Greek bailouts. Jeff Sachs, who has a long experience of debt crises in the developing world, asserts that 'Germany has treated Greece badly, failing to offer the empathy, analysis, and debt relief that are required. And if it did so to scare Italy and Spain, it should be reminded of Kant's categorical imperative: Countries, like individuals, should be treated as ends, not means'.[7]

5 Accommodating the expenditory state: where next; what tensions?

The argument in this paper is that a new form of governance is gradually being introduced in the EU, mainly motivated by the aim of making the euro robust and resilient, but also reflecting the influence of dissatisfaction with the political economy of fiscal policy. While it has extensive reach and ramifications, it can be seen as lacking a grand design: the expenditory state has emerged almost by stealth. In addition to the explicit legitimacy worries discussed in the previous section, none of which will be easy to deal with, a number of other concerns can be identified around the expenditory mode of governance. They range from the conceptual to the pragmatic.

[6] http://www.institutdelors.eu/media/discoursmoscovicimacifenjdisep2015.pdf?pdf=ok
[7] http://www.project-syndicate.org/commentary/greek-debt-crisis-creditor-approach-by-jeffrey-d-sachs-2015-07

5.1 Conceptual challenges

At the conceptual level, there are evident divisions between different EU actors about the underlying economic model. Austerity and rules as guiding principles, very much in the ordo-liberal tradition, constitute one approach, while a 'gouvernement économique' philosophy with at least some Keynesian orientations has long characterised French preferences, but seems to be less in tune with the expenditory turn. An evident difficulty for the emerging EU model is that, unlike the obvious federal comparators (not only the US, but also Germany, Canada, or even Switzerland despite the huge disparity in size), the central level in the EU/euro area does not have a budget that enables it to engage in counter-cyclical spending. Nor is there any credible scenario under which such a capacity will be introduced.

A reason for examining the wider governance context implicit in the term expenditory state, rather than just the shift of policy competence to the EU level is that the separate developments discussed above would not, on their own have, made so much difference. This ties in with the suggestion that, for example, it is not fiscal rules that are decisive in inducing fiscal discipline but rather a myriad of factors such as a strong consensus in both government and electorate in support of fiscal prudence. According to Scharpf (2009: 176), who notes that there are differences of degree between what he calls the liberal and republican traditions of governance, 'the Union appears as the extreme case of a polity conforming to liberal principles which, at the same time, lacks practically all republican credentials.

Although a time inconsistency logic lies behind the expenditory drift, the phenomenon can be hard to identify empirically. As someone who has spanned the academic and policy worlds, Blinder (1997: 13) offers the intriguing opinion about time inconsistency that 'academic economists have been barking loudly up the wrong tree and could learn a great deal from listening to practitioners'. Indeed, referring to monetary policy, he argues that policy-makers have shown how to reduce inflation simply by discretionary policy choices. By contrast, Blinder suggests that policy-makers have been prone to adopt policies that markets expect. He points to the irony (it might be a Catch-22) that despite the long time horizon which is the principal rationale for an independent central bank, a central banker who takes cues from market is likely to overdo the short-term. Blinder therefore argues that it is just as important for a central banker to be independent of markets as of political pressures. Whether his critique extends to time inconsistency in fiscal policy is an open question.

5.2 Policy in practice

A fundamental challenge for the EU expenditory state is how to reconcile its averred aim of achieving effective stabilisation with accountability in shaping national policy choices. It has to do so in a context in which there are inevitable economic spillover effects from one Member State to another, yet in which the EU level lacks input legitimacy, with all that entails. Nevertheless, there is undoubtedly growing pressure on governments to come up with much better frameworks for the governance of fiscal policy (Milesi-Ferretti, 2004). Tensions between objectives abound in fiscal policy and can become even greater where external pressures (such as IMF conditionality) or

a supranational rule collide with domestic imperatives. The EU's Stability and Growth Pact has been one of the most widely scrutinised (and often criticised – for example, see Buiter, 2006) of fiscal rules, yet did not prevent indiscipline in public finances and, as Alt et.al (2012) show, it was unable to prevent frequent misrepresentation of the true position of Member States' fiscal positions.

A further new approach in the EU is the somewhat guarded introduction of macro-economic conditionality in relation to payments to Member States for cohesion and related policies. Conditionality, defined by Bini Smaghi (2015: 756) as 'setting conditions in order for certain decisions to be implemented, typically by other institutions or countries, in a form of quid pro quo' has manifestly become a feature of European governance. It is most extreme in the case of the macroeconomic adjustment programmes for the countries bailed out during the euro crisis, but has become part of normal practice in other ways. For example, in the negotiation of the regulations for cohesion policy for the 2014-20 period, this issue was hotly contested. The regulations include provisions for suspension of payment where the Member State is adjudged not to have met conditions under a range of headings that are outside the remit of the cohesion policy programmes as such, including macroeconomic imbalances and the excessive deficit procedure. The ultimate sanction of withholding of spending is, *de facto*, a fine.

Possible complications in extending the expenditory mode could also stem from questions of technical capability. Whether it is fiscal councils in the national context or the Commission at supranational level, there could be doubts about how well they can perform if they lack staff and resources, so that even if they are competent, they face overload. Capability could, however, also be compromised if the formal economic models (including those used for forecasting and simulation purposes) they employ or the paradigm they adopt are flawed. The notions of market and government failure are familiar, but one of the lessons of the financial crisis is that the rules and their implementation by technocrats can also fail. It follows that the potential for *regulatory/expenditory* failure cannot be excluded. What is also clear is that it is a system subject (in its current form) to heavy transactions costs because each stage of decisions requires layers of agreements, rather than executive action of the sort that a federal agency might undertake. It is also prone to what can be damaging procrastination, as became evident during the saga leading up to the third Greek bailout in the summer of 2015, a process that, in the end had damaging effects on Greek citizens as a result of the miscalculations of their leaders.

5.3 Deepening the expenditory state?

To the extent that formal rules derived from the six-pack and the two-pack, together with the hardening of governance embodied in the Fiscal Compact limits national stabilisation capacity, the application of the expenditory state in Europe removes a potent macroeconomic policy instrument that remains available to other economies. It also highlights a fundamental theoretical and ideological concern about whether Keynesian policies can be implemented in the euro area, as they manifestly were in the US after 2008. There are two main solutions to this dilemma. The first is to create a fiscal capacity at EU/euro area level explicitly aimed at achieving stabilisation

objectives and the second is to ensure that there is enough 'wriggle-room' in the implementation of the expenditory state.

An additional fiscal capacity (and it is important to be clear that the existing EU budget cannot fulfil a stabilisation function, not least because it is required to be balanced every year) has been proposed by the Commission (2012), albeit in rather tentative terms. The arguments are far from new, having been carefully explained in the MacDougall Report (1977), and various stability tools have been proposed over the years. But a corollary of restricting the Member States is that the proposals for fiscal union will have to encompass such a capacity, despite the evident hostility of so many national leaders and, indeed, national parliaments. The cautious tone of the Five Presidents' report (Juncker et al., 2015) again emphasises the extreme sensitivity of moving in this direction.

An irony is that, as Pisani-Ferry (2014: 177) explains, 'in the last decade, the EU has seen that the aims put forward by its founding fathers – from Robert Schuman's peace to Altiero Spinelli's post-national state – have been neither reached nor discarded'. This theme is also highlighted by Fabbrini (2013: 4), who argues that 'although, in reforming the EMU, state governments have consistently discarded the federal model as being too centralized and centripetal for Europe, they have ended up establishing a regime that is much less respectful of state sovereignty than the U.S. federal one'.

Whether it is a form of integration or federalism (whether executive, as defined by Habermas, or other) that is durable and appropriate is a core question that will be elaborated further in subsequent work under the Firstrun project.

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