

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

Donnelly, Shawn

Veröffentlichungsversion / Published Version

Zeitschriftenartikel / journal article

Empfohlene Zitierung / Suggested Citation:

Donnelly, S. (2023). Clocks, Caps, Compartments, and Carve-Outs: Creating Federal Fiscal Capacity Despite Strong Veto Powers. *Politics and Governance*, 11(4), 92-101. <https://doi.org/10.17645/pag.v11i4.7250>

Nutzungsbedingungen:

Dieser Text wird unter einer CC BY Lizenz (Namensnennung) zur Verfügung gestellt. Nähere Auskünfte zu den CC-Lizenzen finden Sie hier:

<https://creativecommons.org/licenses/by/4.0/deed.de>

Terms of use:

This document is made available under a CC BY Licence (Attribution). For more information see:

<https://creativecommons.org/licenses/by/4.0>

Article

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

Shawn Donnelly^{1,2}

¹ Section of Public Administration, University of Twente, The Netherlands; s.donnelly@utwente.nl

² Institute of Political Science, Leiden University, The Netherlands

Submitted: 30 May 2023 | Accepted: 6 September 2023 | Published: 27 October 2023

Abstract

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

Keywords

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

Issue

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

© 2023 by the author(s); licensee Cogitatio Press (Lisbon, Portugal). This article is licensed under a Creative Commons Attribution 4.0 International License (CC BY).

1. Introduction

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

The absence of common fiscal capacity and the reliance on member state resources generates uneven abilities across the EU to meet grand societal challenges like pandemic-capable health provision, military expenditure (to meet Russia’s war on Ukraine), infrastructure and industrial policy (the reindustrialisation, greening and

energy transition of Europe), and of dealing with the aftermath of financial crises to stabilise European Monetary Union. Well-off member states or those with good credit can channel finance into these needs and subsidise private investment easily, while others cannot, leading to the undersupply of public goods and the undermining of EU public policy efforts (Howarth & Quaglia, 2021). Nevertheless, there are instances in which piecemeal and temporary financial instruments have been established without it leading to a federal budget that some desire.

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

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

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

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

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

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

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

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

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

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

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

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

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

Compartments, finally, soften the link based on ideology, and particularly of identity. Federal spending programmes can be designed to apply to “deserving” constituents while leaving others outside the programme’s perimeter. They can also be designed to allow the member states of the union to pick and choose whether to par-

ticipate in what otherwise would be national standards and programmes (Skocpol, 1995).

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

3. Identity and Budget Politics in Canada

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

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

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

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

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

As a general grant, the province receives “equalisation payments” out of the Canadian federal budget (officially known as Equalization and Territorial Formula Financing). Equalisation payments were instituted in the 1950s alongside the introduction of universal health care to help minimise extremes in the ability of provinces to pay for public policy programmes (Government of Canada, 2011). There are in principle no strings attached, so the money can be spent on any item the province chooses, and the programme was designed to run in perpetuity. The province of Québec receives payments since it counts as a have-not province since the flight of financial and industrial capital after the first independence referendum in 1980. It also claims the special need for transfers to compensate for its ownership and pro-

vision of major social services in the country’s largest province (Government of Canada, 2006). Informally, the equalisation payments are also thought to be a means of holding the country together politically, with Québec extracting rents out of the federal budget to compensate for the post-1977 decline in population, economic activity, and associated tax income. This in turn has caused ire among have provinces, particularly Alberta, with its rich hydrocarbon resources. In the early 2000s, to appease protests from the provinces of Alberta, as well as the Atlantic province of Newfoundland and Labrador, these provinces were granted carve-outs of hydrocarbon revenue from the equalisation formula, reducing their transfers. The Atlantic provinces benefitted as well from this adjustment. In sum, carve-outs became essential to keeping the equalisation payments programme in line with political demands and economic developments over time.

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

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

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

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

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

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

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

do it collectively at the federal level. Carve-outs provide a way for Québec to remain “master of its own destiny” while offering a pension plan along with the rest of the country (Béland & Weaver, 2019).

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

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

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

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

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

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

with the latter framing social welfare in terms of the damage it would do to white supremacy and segregation (Lavin, 1972; Skocpol et al., 1988). It also enjoyed lasting political support as long as the recipients were children and pregnant women (Blank & Ellwood, 2001).

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

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

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

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

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

Also notable is that the high degree of political polarisation in American politics based on ideology and identity leads to efforts to use caps retroactively to roll back spending (and taxes) that had already been agreed in the past by a previous Congress. In the 1980s, political willingness to accept progressive taxes and spending programmes came to an end with the Reagan administration, which initiated pushback against Great Society programmes that continue within the Republican Party to this day. Tax rollbacks were features of the Reagan and Trump administrations in particular. In the 1990s, Republican lawmakers sought caps on the overall borrowing capacity of the US government (debt ceiling), which they used repeatedly as leverage to demand

further caps on a range of government spending programmes to which they are ideologically opposed. While Republicans spared pensions (social security) and health care for seniors (Medicare) and veterans, they targeted other forms of social security by imposing time limits on eligibility for unemployment insurance. A more radicalised party later demanded the complete dismantling of most social security programmes like the Affordable Care Act and provisions of the Inflation Reduction Act, using the potential of forcing a default on US government debt to push through reductions.

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

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

5. Identity, Ideology, and Budget Politics in Europe

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

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

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

The 2020 Recovery and Resilience Facility (RRF), cobbled together with other funds to form the Next Generation EU fund, attracted attention due to the willingness of member states to support collective borrowing for a limited time, and up to a limited amount, for a limited range of public policy investments. The EU borrows collectively and makes funds available to member states as a combination of grants and loans for a period of four years to support investments in public health, greener economies, and digitalised public administrations. While limited in size and time horizon, Next

Generation EU represents a breakthrough in EU member states willingness to contemplate fiscal transfers across national borders and to fund these transfers with collective debt. It does not, however, and is not intended to displace the EU's system of macroeconomic coordination involving budget restraint (Hodson & Howarth, 2023; Vanhercke & Verdun, 2022).

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

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

6. Conclusions

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

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

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

Acknowledgments

The author gratefully acknowledges the helpful comments from Thomas Christiansen, Federico Fabbrini, Sergio Fabbrini, Thomas Woźniakowski, and Tiziano Zgaga.

Conflict of Interests

The author declares no conflict of interests.

References

- Barrilleaux, C., & Rainey, C. (2014). The politics of need: Examining governors' decisions to oppose the "Obamacare" Medicaid expansion. *State Politics & Policy Quarterly*, 14(4), 437–460.
- Béland, D., Marchildon, G. P., Medrano, A., & Rocco, P. (2021). Covid-19, federalism, and health care financing in Canada, the United States, and Mexico. *Journal of Comparative Policy Analysis: Research and Practice*, 23(2), 143–156.
- Béland, D., & Weaver, R. K. (2019). Federalism and the politics of the Canada and Québec pension plans. *Journal of International and Comparative Social Policy*, 35(1), 25–40.
- Beramendi, P. (2007). Inequality and the territorial fragmentation of solidarity. *International Organization*, 61(4), 783–820.
- Blank, R. M., & Ellwood, D. T. (2001). *The Clinton legacy for America's poor* (NBER Working Paper No. 8437). National Bureau of Economic Research. <http://www.nber.org/papers/w8437>
- Blight, D. (1993). What will peace among the whites bring? Reunion and race in the struggle over the memory of the civil war in American culture. *The Massachusetts Review*, 34(3), 393–410.
- Bounds, A. (2023, March 3). Ukraine asks EU for 250,000 artillery shells a month. *Financial Times*. <https://www.ft.com/content/75ee9701-aa93-4c5d-a1bc-7a51422280fd>
- Buti, M., & Fabbrini, S. (2023). The political determinants of the EU fiscal governance: Towards a new equilibrium. *Politics and Governance*, 11(4), 112–121.
- Cameron, D., & Simeon, R. (2002). Intergovernmental relations in Canada: The emergence of collaborative federalism. *Publius: The Journal of Federalism*, 32(2), 49–72.
- Christiansen, T., & Reh, C. (2009). *Constitutionalizing the European Union*. Bloomsbury Publishing.
- Donnelly, S. (2021). Failing outward: Power politics, regime complexity, and failing forward under deadlock. *Journal of European Public Policy*, 28(10), 1573–1591.
- Donnelly, S. (2023). Political party competition and varieties of US economic nationalism: Trade wars, industrial policy and EU–US relations. *Journal of European Public Policy*. Advance online publication. <https://doi.org/10.1080/13501763.2023.2226168>
- Dyson, K. H., & Featherstone, K. (1999). *The road to Maastricht: Negotiating economic and monetary union*. Oxford University Press.
- Fabbrini, F. (2023). Funding the war in Ukraine: The European peace facility, the macro-financial assistance instrument and the slow rise of an EU fiscal capacity. *Politics and Governance*, 11(4), 52–61.
- Fabbrini, S. (2013). Intergovernmentalism and its limits: Assessing the European Union's answer to the euro crisis. *Comparative Political Studies*, 46(9), 1003–1029.
- Fleming, S. (2023, April 25). Brussels set to rebuff German calls for tougher debt-reduction targets. *Financial Times*. <https://www.ft.com/content/286a3ec3-b647-4ff2-b665-211ddb155d4b>
- Goodin, R. E., Goodin, R. E., Headey, B., Muffels, R., & Dirven, H. J. (1999). *The real worlds of welfare capitalism*. Cambridge University Press.
- Government of Canada. (2006). *Achieving a national purpose: Putting equalization back on track*. <https://publications.gc.ca/collections/Collection/F2-176-2006E.pdf>
- Government of Canada. (2011). *Equalization program*. <https://www.canada.ca/en/department-finance/programs/federal-transfers/equalization.html>
- Hall, P. A. (1986). *Governing the economy: The politics of state intervention in Britain and France*. Oxford University Press.
- Hallerberg, M., Strauch, R., & Von Hagen, J. (2007). The design of fiscal rules and forms of governance in European Union countries. *European Journal of Political Economy*, 23(2), 338–359.
- Heaman, E. A. (2017). *Tax, order, and good government: A new political history of Canada, 1867–1917* (Vol. 240). McGill-Queen's University Press.
- Hodson, D. (2022). The institutions of economic and monetary union: From the euro crisis to Covid-19. In D. Hodson, W. Puetter, S. Saurugger, & J. Peterson (Eds.), *The institutions of the European Union* (pp. 251–275). Oxford University Press.
- Hodson, D., & Howarth, D. (2023). The EU's Recovery and

- Resilience Facility: An exceptional borrowing instrument? *Journal of European Integration*. Advance online publication. <https://doi.org/10.1080/07036337.2023.2243378>
- Howarth, D., & Quaglia, L. (2021). Failing forward in Economic and Monetary Union: Explaining weak eurozone financial support mechanisms. *Journal of European Public Policy*, 28(10), 1555–1572.
- Kelemen, R. D., & McNamara, K. R. (2022). State-building and the European Union: Markets, war, and Europe's uneven political development. *Comparative Political Studies*, 55(6), 963–991.
- Khan, A. (2002). Budgets as portfolios. In A. Khan & W. B. Hildreth (Eds.), *Budget theory in the public sector* (pp. 188–201). Quorum Books.
- Lavin, M. T. (1972). *The Dixiecrat Movement of 1948: A study in political conflict* [Unpublished Master's thesis]. College of William and Mary. <https://scholarworks.wm.edu/cgi/viewcontent.cgi?article=4391&context=etd>
- Levi, M. (1988). *Of rule and revenue*. University of California Press.
- Lexchin, J. (2022). After more than 50 years, pharmacare (and dental care) are coming to Canada. *International Journal of Health Services*, 52(3), 341–346.
- Loepky, R. (2014). Canada, health and historical political economy. *Journal of Australian Political Economy*, 2014(73), 172–199.
- Matthijs, M., & Merler, S. (2020). Mind the gap: Southern exit, Northern voice and changing loyalties since the euro crisis. *JCMS: Journal of Common Market Studies*, 58(1), 96–115.
- McNamara, K. R., & Kelemen, R. D. (2022). Seeing Europe like a state. *Journal of European Public Policy*, 29(12), 1916–1927.
- Palmer, K. S. (2023). *A brief history: Universal health care efforts in the US*. Physicians for a National Health Program. <https://pnhp.org/a-brief-history-universal-health-care-efforts-in-the-us>
- RAMQ. (2023). *Annual premium*. <https://www.ramq.gouv.qc.ca/en/citizens/prescription-drug-insurance/annual-premium>
- Rose, S. (2015). Opting in, opting out: The politics of state Medicaid expansion. *The Forum*, 13(1), 63–82. <https://doi.org/10.1515/for-2015-0011>
- Scartascini, C. G., & Stein, E. (2009). A new approach. In M. Hallerberg, C. G. Scartascini, & E. Stein (Eds.), *Who decides the budget? A political economy analysis of the budget process in Latin America* (pp. 1–17). Harvard University Press.
- Scharpf, F. W. (1988). The joint-decision trap: Lessons from German federalism and European integration. *Public Administration*, 66(3), 239–278.
- Skocpol, T. (1994). *Social revolutions in the modern world*. Cambridge University Press.
- Skocpol, T. (1995). *Protecting soldiers and mothers: The political origins of social policy in the United States*. Harvard University Press.
- Skocpol, T., Weir, M., & Orloff, A. S. (1988). The limits of the new deal system and the roots of contemporary welfare dilemmas. In M. Weir, A. S. Orloff, & T. Skocpol (Eds.), *The politics of social policy in the United States* (pp. 293–311). Princeton University Press.
- Stevenson, G. (2006, September 26–28). *Fiscal federalism and the burden of history* [Conference Proceedings]. Fiscal federalism and the future of Canada. Queen's Institute of Intergovernmental Relations, Ontario, Canada.
- Taylor, C. (1993). *Reconciling the solitudes: Essays on Canadian federalism and nationalism*. McGill-Queen's University Press.
- Tilly, C. (1992). *Coercion, capital, and European states, AD 990–1992*. Blackwell.
- Tilly, C. (2017). War making and state making as organized crime. In E. Castañeda & C. L. Schneider (Eds.), *Collective violence, contentious politics, and social change: A Charles Tilly reader* (pp. 121–139). Routledge.
- Tsebelis, G., & Chang, E. C. (2004). Veto players and the structure of budgets in advanced industrialized countries. *European Journal of Political Research*, 43(3), 449–476.
- Vanhercke, B., & Verdun, A. (2022). The European semester as goldilocks: Macroeconomic policy coordination and the recovery and resilience facility. *JCMS: Journal of Common Market Studies*, 60(1), 204–223.
- Versel, M. J. (1978). Zero-base budgeting: Setting priorities through the ranking process. *Public Administration Review*, 38(6), 524–527.
- Wade, R. (2004). *Governing the market: Economic theory and the role of government in East Asian industrialization*. Princeton University Press.
- Woźniakowski, T. P. (2022). *Fiscal unions: Economic integration in Europe and the United States*. Oxford University Press.
- Woźniakowski, T. P., Zgaga, T., & Fabbrini, S. (2023). Comparative fiscal federalism and the post-Covid EU: Between debt rules and borrowing power. *Politics and Governance*, 11(4), 1–5.

About the Author



Shawn Donnelly (University of Twente and Leiden University) is the author of *Reshaping Economic and Monetary Union* (Manchester University Press), *The Regimes of European Integration* (Oxford University Press), *Power Politics, Banking Union and EMU* (Routledge), and *European Banking Nationalism* (Routledge). He specialises in American and European economic strategy, industrial policy, and financial markets.