

The Political Economy of Secession

A Source Book

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The New Democratic Federalism for Europe: Functional, Overlapping and Competing Jurisdictions

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If one thinks of the state as being the main provider of public goods, one cannot fail to notice that public goods and their provision rarely coincide with political jurisdictions. This point was already made by Sydney and Beatrice Webb in their Constitution for a Socialist Commonwealth of Great Britain before the advent of formal public goods theory. From this very basic observation it follows, however, that one should build jurisdictions around the provision of public goods. This is the suggestion made by Frey and Eichenberger. Obviously, this notion pushes the concept of secession to its logical limits. The state is eventually decomposed in its public goods elements, as the competing jurisdictions overlap. Whenever a new demand for a public good arises, a new jurisdiction can form, thereby «seceding» from the larger composite, yet still remaining within it or attached to it through overlapping.

Chapter 1: Functional, Overlapping and Competing Jurisdictions (FOCJ)

The Basic Concept

Benevolent attempts to inform politicians and governments of how to undertake the right policy must necessarily fail: all too often the interests of government (which is composed of selfish individuals) are in conflict with the interests of the citizens. Politicians have little reason to hold back their own interests. Elections, taking place only once every four years, are not able to sufficiently restrict politicians' selfish behaviour. Therefore the institutional conditions have to be designed so that stronger incentives are imposed on politicians and governments to fulfil citizens' preferences. This can only be achieved by strengthening the *political* competition at all levels of government. Strong political com-

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petition makes governments suppliers of policies that take care of citizens' demands and thus increase welfare – no less than economic competition makes suppliers of goods and services take consumers' wishes into account. Nevertheless political competition has often been disregarded, especially in today's EU. There is a wide consensus that a «democracy deficit» exists at the European level. This gap could be bridged and large welfare gains could be attained if the market for government services were opened for competitive public jurisdictions focusing on the production of particular services instead of yielding power over a particular territory.

The concept of a new federalism proposed here is called FOCJ (Functional, Overlapping and Competing Jurisdictions). It allows the emergence of political bodies whose size corresponds to the tasks to be fulfilled. Examples are functions such as education, public transport, waste water treatment, public security or defence. The geographic extension of a FOCUS (as the singular of FOCJ is to be called) is driven by the present and future physical extension of a problem rather than by historical, more or less randomly established, boundaries.

FOCJ are characterized by four properties:

1. A FOCUS is determined by the goal or function to be fulfilled. Its size has to match its task.
2. FOCJ are overlapping, that is, each function requires a corresponding geographical extension.
3. FOCJ compete for communes and citizens, and they are subject to democratic political competition. Popular referenda, and possibly citizens' meetings, may be used for that purpose in addition to the normal representative political institutions.
4. FOCJ are jurisdictions with the power to raise taxes with which they finance the expenditures needed to fulfil their functions.

FOCJ emerge because they are desired by the citizens as they can be well monitored and controlled by them. The concept is based on ideas received from «public choice», «constitutional economics» and various elements of the «economic theory of federalism». It differs completely from the existing federalism of the EU and from various reform concepts, in particular, the principle of subsidiarity. FOCJ bear some similarity to a European integration proceeding with «different speeds» and «variable

geometry» whereby integration can take place in a differentiated way – a concept vigorously rejected by most European politicians.

The traditional economic theory of federalism takes the extension of jurisdictions as a given. The analysis is concerned with which activities are allocated to what levels of government; the existence of an optimal degree of centralization is presumed. This study breaks with this concept. The «optimal degree of centralization» varies according to functions and changes over time. In addition it is taken into account that decisions made in the current politico-economic process systematically tend to lead to over-centralization because many political actors have a self-interest in a strongly centralized state. The concept of FOCJ is, therefore, process-oriented: FOCJ form an adaptable federal network of governmental units that depend closely on citizens' preferences and adjust to the «geography» of problems – as long as the citizens dominate the formation process of the FOCJ.

The *fifth freedom* suggested here goes beyond the four economic freedoms (the free mobility of goods, services, labour and capital) and is based on a constitutional decision. The European Constitution or a related treaty must provide the lowest political units (the communes), and possibly also individual citizens, with a guarantee of participation in FOCJ. The citizens must have the right to decide for themselves whether their commune should join a particular FOCUS, and what its constitution should look like. At the same time they must have the right to leave the jurisdictions they belong to either totally or with respect to particular functions. When they decide to exit they must receive a tax rebate corresponding to the cost of the services they no longer consume. The emergence of FOCJ must not be blocked by the existing political institutions. Every citizen and commune must be able to place a formal complaint with the European Constitutional Court if they feel that the foundation of FOCJ is hindered.

In the following section the four characteristics of FOCJ are discussed more extensively.

FOCJ are Functional

Jurisdictions perform their activities more efficiently the closer the match between the consumers and those who pay for services, that is, the smaller the «spillovers» are, the more these units are able to exploit «economies of scale», and the more closely the supply can be adapted to the

demand exerted by the citizens. The various public services (for example parks, schools, waste treatment plants, national defence and so on) extend very differently over physical space and have different degrees of scale economies (or diseconomies). Moreover demand varies strongly over space because it depends on several factors which can differ strongly according to location. As a consequence it is efficient when not all services are provided by the same governmental unit but are instead supplied by specialized functional jurisdictions adjusted to the corresponding tasks. In FOCJ functions are not defined in a technical way but in a manner relevant to citizens. Thus a FOCUS does not necessarily specialize in fire fighting in a narrow sense, that is, by putting out existing fires. Rather it will pursue an integrative approach by combining fire prevention (for example through government intervention), fire fighting (by the fire brigade), and reducing the utility losses caused by fires (by public and private insurance).

FOCJ are Overlapping

FOCJ that perform different tasks overlap. A citizen is, therefore, a member of several jurisdictions. FOCJ, moreover, need not have a monopoly of supply for a particular function. Several FOCJ providing the same functions may offer their services in a particular geographic area. This kind of overlap extends the choice set of citizens and strengthens competition among the suppliers of public services. Such overlapping, non-contiguous jurisdictions contrast with the traditional notion of federal and national states which presume the geographical unity of the state. The two kinds of overlap just sketched reinforce each other.

FOCJ are Competitive

The governments of FOCJ are subject to two mechanisms forcing them to cater to the preferences of their members: the option for citizens and communes to *exit* FOCJ establishes competition similar to markets, and in addition their *voting rights* establish political competition. Exit from FOCJ does not necessarily require geographic mobility; citizens or communes may switch membership without moving physically. The threat of exit is, therefore, particularly effective. The importance attributed to exit in our concept of FOCJ strongly contradicts the prevailing concept of national

and federal states which prohibits exit. Secession has indeed often been prevented by brute force, the American civil war (1861–65) or the Swiss Sonderbundskrieg¹ being pertinent examples.

The European treaties so far do not contain any concrete conditions for exiting the EU, nor do they specify the division of jurisdictions at lower levels (nations, states, Länder, provinces, regions and so on). The concept of FOCJ and of the fifth freedom could fill this gap in the future European Constitution. Exit should be restricted as little as possible in order to strengthen competition between governments. The exact conditions for exit can be regulated by contract among the members of a FOCUS, which would then have the nature of a constitution. For entry, in contrast, a FOCUS must be allowed to ask for a price. As is the case in <clubs>, entry cost may serve as prices for the use of public goods and for internalizing the cost of external migration. Such explicit prices are more efficient than mobility restrictions and regulations such as <zoning laws> which lead to higher real estate rents and prices. Entry prices also serve to capture the consumer rents of the people and communes entering the FOCUS. This also provides the governments of a FOCUS an incentive to offer attractive services to potential members. It should not be feared that such entry prices will be set strategically and at too high a level because the competition among FOCJ calls for prices that are in line with the value of the corresponding services.

Under realistic conditions, exit is not sufficient to secure efficiency. As long as individuals have no political rights the governments have considerable discretionary power and can deviate from the preferences of the citizens. Thus FOCJ guarantee political competition by their democratic institutions. The citizens can elect the legislative and the executive of the various FOCJ they belong to. In addition they should also have access to direct-democratic instruments to control government. This allows them to participate in agenda-setting in the political process (the right for initiatives) and to demand vote on the decisions taken by the government (the right for referenda). These popular rights lead to a better fulfilment of citizens' wishes in the political process. When the citizens have the right to initiate propositions, the institutional details of a FOCUS need not be determined by a higher governmental level. The citizens themselves can create the democratic institutions of the various FOCJ they belong to.

FOCJ are Jurisdictions

A FOCUS is a formal political unit with powers to regulate and to tax. The membership of a FOCUS can be defined in two different ways. In the first case the smallest political units, normally the communes, may be the members. In that case an inhabitant of a commune automatically becomes a citizen of those FOCJ to which his or her commune belongs. Exit is possible only by leaving the commune. In the second case an individual citizen can decide freely whether he or she wants to be a member of a particular FOCUS. An example are FOCJ for the supply of basic education, which may well have individuals as members. Individual or communal membership may be the more appropriate solution, depending on the function. A strong form of individual choice opportunities may undermine public redistribution schemes. If desired, redistribution and a minimum level of public services can be guaranteed by a higher political unit. Membership in a FOCUS offering the public service in question can be made obligatory, and the quality may be prescribed. Citizens can be given the option of choosing which school-FOCUS to enter but in order to ensure that people without children contribute to school taxes, every citizen must be a member of some school-FOCUS. In order to prevent the founding of school-FOCJ without services and taxes (designed for citizens without children), minimum service levels can be prescribed.

Advantages of FOCJ

Based on the four main characteristics discussed above FOCJ have various advantages over traditional forms of public organization. Strengthening the democratic instruments and exit options helps the citizens to express their demands and to effectively control the government. The concentration of a FOCUS on one or at most a few public services makes it easier for the citizens to evaluate efficiency and to compare it to other FOCJ. As many public services have a relatively small number of users, most FOCJ are likely to be smaller than many of today's jurisdictions which further reduces the information problem. The easier it is for individuals to exit, the more political information transforms itself into a private good, and the stronger are the incentives of the citizens to acquire knowledge about the political issues at hand. This in turn improves the functioning and efficiency of the democratic institutions.

FOCJ strengthen the ability of governments to fulfil citizens' preferences. Due to their spatial flexibility FOCJ are able to exploit economies of scale and minimize spillovers, that is, services unpaid by the users. The public services can, therefore, be supplied at a particularly low cost. If the benefits of a particular function spread over a large area and falling average cost prevails, FOCJ can adjust. Thus, for example, a FOCUS for defence might embrace large parts of Europe and even countries beyond.

The tax autonomy of FOCJ gives strong incentives to use the financial means in an economic way. FOCJ will, therefore, not automatically produce the services offered themselves but concentrate more on their provision. If it is less expensive they will rely on outsourcing, that is, they will buy the service from the cheapest supplier. In this respect FOCJ help to strengthen markets and to redress the public sector. But the concept of FOCJ does not just amount to privatization. In the case of FOCJ, the decision to produce privately develops endogenously as a result of the incentives the governments of FOCJ face. Privatization is not imposed from outside and is, therefore, less subject to ideological vagaries.

The concentration of a FOCUS on one public service does not only result in the advantages of specialization. FOCJ are a means to open political markets which are otherwise strongly dominated by the cartel of politicians, the *classe politique*. Competent outsiders have a chance to offer their services. While in today's jurisdictions most politicians are above all generalists catering for a multitude of services, in contrast, the government of a FOCUS will be run by specialists in a particular function. The narrower tasks to be fulfilled in FOCJ allow many political posts to be occupied part time or by volunteers, which further opens political markets. The functional focus on particular tasks also helps groups devoted to one theme to enter the political process. They no longer have to try to gain political power over many different issues but can instead concentrate on issues they really care for. Ecologically oriented parties, for example, need no longer take a position on foreign policy but can fully devote themselves to a FOCUS concerned with the natural environment. A minority (for instance, an ethnic group) which disagrees only with some aspects of government policy relevant to them can establish a FOCUS devoted to these special public activities. A particular advantage of such a partial exit is that fewer trade restrictions are erected than when a new jurisdiction is founded which cares for all activities. In this respect FOCJ are an institution of «market-preserving federalism».

The fifth political freedom strongly changes the nature of the national states. FOCJ do not destroy them but establish new alternatives. FOCJ will only fulfil those public services delegated by the citizens because they are able to provide them more cheaply and more consonant to the citizens' wishes. The national states will still perform those functions which they provide more efficiently. The primacy of the national state over lower level units (provinces, Länder, regions, communes) is, however, ended.

Claimed Disadvantages

As mentioned above the strengths of FOCJ have been stressed. Now some of the (presumed) weaknesses are discussed.

Exit is Costly

When individual citizens and whole communes leave a FOCUS, there is not only a (welcome) allocation effect but income distribution may be negatively affected. Exit will, therefore, never be agreed to by all persons involved. In some cases serious political and even military conflict may result. When FOCJ are founded it is, therefore, necessary to set the procedural rules under which exit takes place. In contrast to what is often feared, the experiences with exit, new foundations and mergers of communes and even whole cantons in Switzerland and of various types of jurisdictions in the USA, demonstrates that in most cases these changes take place in a democratic and peaceful way. These jurisdictional changes are, of course, preceded by long political negotiations whose efficiency is determined by the legal and institutional rules existing. The fifth freedom suggested here will be more effective when the various jurisdictions are forced by constitutional decree to indicate their tax price menu. These menus show how much tax revenue is needed to perform a particular public service. These tax prices can then be used to calculate the tax rebates granted when a citizen or commune leaves a jurisdiction.

Citizens are Overburdened

In a federal network of FOCJ every person is a citizen of many jurisdictions. It may be thought that the many elections and referenda in the various FOCJ may overburden the citizens who then react with political

abstinence. This fear is unwarranted. First, a low rate of vote participation is not a problem as such. Rational citizens do not vote as long as they are satisfied with the services provided by the (FOCJ) governments. The same holds if they have no clear preferences among the alternatives offered to them. In contrast citizens with particularly strong views as well as those dissatisfied with the government's activities are more likely to participate politically. What matters is that the citizens react when they dislike what the persons in charge of the FOCJ offer.

Second, in a network of FOCJ the citizens find it easier to evaluate the public services provided. Today, it is nearly impossible to compare the services between jurisdictions because there is a large amount of cross-subsidization between the various departments and public services offered, and public bookkeeping is difficult to comprehend. In contrast, when FOCJ exist, the citizens automatically see the tax prices of the various public services. Third, the citizen's scope for participating in the political process in the case of FOCJ should be compared to their implicit abstinence in the traditional system. Many dimensions of services which in FOCJ are highly visible and can be easily evaluated, are hidden in today's jurisdictions where a voter must simultaneously evaluate all dimensions. Finally, the task of making political decisions can be made easier by new institutions which emerge for that purpose. For example, the timing of the various elections in various FOCJ can be synchronized. Delegates of the citizens may be active in several FOCJ, and in referenda the citizens may follow the recommendations offered by the parties and interest groups they trust.

Co-ordination is Needed

It often proves useful to co-ordinate the activities of various FOCJ but co-ordination is not necessarily good as such. It often benefits governments and politicians to establish cartels and to exploit the voters. In a network of FOCJ the need for (welfare-enhancing) co-ordination is reduced because they emerge exactly in order to minimize spillovers and to use economies of scale. As long as there are spillovers between FOCJ there are incentives to adjust accordingly the extension of the respective FOCJ or to found new ones. FOCJ can thus be interpreted as democratic and competitive mechanisms of co-ordination. As changes in size are always costly, not all externalities between FOCJ will be internalized. However,

from a comparative point of view, it should be noted that externalities also exist between the administrative units in traditional all-purpose jurisdictions. There are, for instance, many aspects which must be co-ordinated between the ministry of transport and the ministry of the environment. The question therefore arises in which system are there stronger incentives to negotiate and when are the bargaining costs smaller. The public officials in the various ministries have only weak incentives to co-ordinate their activities. They dislike the fact that their discretionary power is reduced by effective co-ordination. Bureaucrats in traditional ministries are, moreover, not dependent on following the citizens' wishes. In contrast politicians in FOCJ are given strong incentives to negotiate with other governments because their re-election and the chance of having referenda approved directly depends on citizens' satisfaction with their policy. As long as the citizens desire more co-ordination, it is likely to be supplied by the governments of FOCJ. There is a close analogy between the co-ordination among FOCJ and among firms. The latter is an everyday phenomenon typical for markets as the newer industrial organization literature shows. Some of the ideas discussed there, for example, the development of industry standards, can be transferred to the concept of FOCJ.

Intensive Preferences are Difficult to Reveal

The functional separation among FOCJ renders vote trading and therefore with a welfare-enhancing revelation of intensive preferences more difficult. In traditional jurisdictions, groups with strong preferences for particular public services can trade their vote with groups particularly interested in other public services. However vote trading does not necessarily increase welfare. It is beneficial for the participants but disadvantageous for those groups left out. According to the vote trade paradox, an exchange of votes can worsen the utility of all participants when public activity also involves redistributive effects (which is the rule).

Preference intensities can to some extent also be revealed in popular votes and in elections for positions in FOCJ. Intensive preferences raise vote participation and make it more likely that a citizen casts his or her vote in favour of the preferred alternative. Moreover an individual can allow himself or herself to take into account the particularly intensive demands of other persons, as its influence on the result of a vote is small.

Finally, minorities with intensive preferences can establish a FOCUS designed to care for their special interests.

Redistribution is Impossible

An important critique of FOCJ argues that in such a network, income cannot be redistributed because the recipients of higher incomes evade the respective taxes by exiting to a FOCUS with low tax rates and little support for the poor. This argument is also relevant for traditional federalism. New empirical research has, however, established that redistribution is also feasible in strongly decentralized states. Thus a considerable part of redistribution in Switzerland takes place at the level of cantons and even communes. One of the major reasons that redistribution is feasible at this level is due to the stronger local identity of citizens in strongly decentralized political systems. A strong local identity supports the inclination to redistribute income in favour of the disadvantaged members of the community, and to bear the respective taxes. (Small) communities even foster co-operative behaviour, as has also been argued by Bowles and Gintis (1998). The mobility of persons and firms is, therefore, lower than normally assumed. In the EU, for instance, mobility between the member states is rather low. Only five per cent of EU citizens live outside their mother country.

If the possibility of redistribution is considered to be too small by the citizens, a higher-level political unit (such as the government of the EU) can be granted limited power for redistribution by constitutional consent. Alternatively a special FOCUS designed to redistribute income may emerge; in order to survive it needs to establish barriers to exit and entry. After all the existing national states and lower units are undertaking redistribution on the basis of democratic decisions by the citizens; the same outcome may be expected to emerge in the case of FOCJ – provided the electorate is satisfied with the redistribution process taking place.

Procedure

Our proposal of functional, overlapping and competing jurisdictions with a large amount of autonomy may appear radical at first sight. Its chances of realization seem rather small under present conditions in Europe. It is certainly true that FOCJ deviate strongly from federalism as

it is practised today, for example, in Germany or Austria. As the Länder, and also the communes, have only very restricted taxing power, they depend on central government to a large extent.

The arguments in this study are developed in the following way. Chapter 2 develops the strength of FOCJ with respect to decentralization and democratization. Chapter 3 discusses how FOCJ can be implemented. Chapter 4 compares FOCJ to theoretical federalism and deals with the alleged problems. Chapter 5 looks at the already existing, 'bastard' FOCJ, that is, governmental units which share one or several of the characteristics of FOCJ.

Part II of the study is more specifically devoted to FOCJ in Europe. Chapter 6 discusses federalism as it exists in Europe today, and Chapter 7 analyses how FOCJ can be applied in Europe.

Part III looks at how the concept of FOCJ can be used beyond Europe. Chapter 8 considers the relationships of Europe with the rest of the world. Chapter 9 shows how FOCJ can be of great use in developing countries. The study ends with general conclusions (Chapter 10).

Suggested Further Reading

The institutions of the EU are the subject of many books. See, for example,

Marks, Gary, Fritz W. Scharpf, Philippe C. Schmitter and Wolfgang Streek (1996), *Governance in the European Union*, London: Sage.
Nugent, Neill (ed.) (1997), *The European Union*, 2 vols, Aldershot: Dartmouth.

Factual aspects of the EU are collected in

Roney, Alex (1998), *EC/EU Fact Book*, 5th edn, London: Kogan Page.

The economic aspects are discussed, for instance, in

Artis, Mike J. and Norman Lee (1997), *The Economics of the European Union*, 2nd edn, Oxford: Oxford University Press.
Jones, Robert A. (1996), *The Politics and Economics of the European Union*, Cheltenham: Edward Elgar.
Tsoukalis, Loukas (1997), *The New European Economy Revisited*, Oxford: Oxford University Press.

Europe's democracy deficit is dealt with in

Andersen, Svein S. and Kjell A. Eliasson (eds) (1995), *The European Union: How Democratic is it?*, London: Sage.
Føllesdal, Andreas and Peter Koslowski (eds) (1998), *Democracy and the European Union*, Berlin: Springer.

An analysis of European unification on the basis of Constitutional Economics is provided in

Mueller, Dennis C. (1997), 'Federalism and European Union: a Constitutional Perspective', *Public Choice*, 90, 255–80.
Vibert, Frank (1995), *Europe. A Constitution for the Millennium*, Aldershot: Dartmouth.

Various contributions are collected in

Vanberg, Viktor and Richard Wagner (eds) (1996), 'Europe: A Constitution for the Millennium', *Constitutional Political Economy*, Special Issue, 7, 253–338.

Strongly committed to the position of Friedrich von Hayek is the analysis by

Streit, Manfred and Stefan Voigt (1997), 'Towards ever closer union – or ever larger?', in Dieter Schmidtchen and Robert Cooter (eds), *Constitutional Law and Economics of the European Union*, Cheltenham: Edward Elgar, 223–47.

The possibility for simultaneously sustaining tax competition, public goods and income distribution is shown in

Kirchgässner, Gebhard and Werner W. Pommerehne (1996), 'Tax Harmonization and Tax Competition in the European Union: Lessons from Switzerland', *Journal of Public Economics*, 61, 66–82.

The idea of FOCJ was conceived in

Frey, Bruno S. and Reiner Eichenberger (1995), 'Competition among Jurisdictions. The Idea of FOCJ', in Lüder Gerken (ed.), *Competition among Institutions*, London: Macmillan, 209–29.

Some aspects of FOCJ were previously discussed in

Casella, Alessandra and Bruno S. Frey (1992), 'Federalism and Clubs:

Towards an Economic Theory of Overlapping Political Jurisdictions», *European Economic Review*, 36, 639–46.

The concept has been further developed in

Frey, Bruno S. and Reiner Eichenberger (1996), «FOCJ: Competitive Governments in Europe», *International Review of Law and Economics*, 16, 315–27.

Chapter 4: FOCJ Compared

No institution is in all respects optimal; each one has its strengths but also its weaknesses. This also applies to the concept of FOCJ. For that reason it is important to compare FOCJ to institutions designed to deal with similar issues and to perform similar tasks instead of identifying the non-optimal aspects and leaving it at that. This procedure constitutes the essence of the *comparative institutional approach* which has proved to be successful in economies for a considerable number of years.

First FOCJ are compared to the theoretical alternatives of federalism proposed in the literature (section 4.1). FOCJ are then examined with regard to how they deal with particular problems and compare how alternative institutions cope with them (section 4.2).

Comparison to Theoretical Federalism

The economic theory of federalism has developed diverse models dealing with particular aspects of federalism. In various aspects, the idea of FOCJ can be considered to be a further development as well as an integration of these various models or building stones.

Spatial competition

A model developed by Tiebout (1956) focuses on the competition between jurisdictions triggered by the mobility of the citizens. The analogy to democratic competition is sought by calling this process «voting by foot». This model deals exclusively with the «exit and entry» mechanism. Governmental units can be seen as enterprises offering public services in exchange for tax revenue. A citizen is assumed to move without incurring any cost to that jurisdiction which offers the most advantageous combi-

nation of services and taxes to him or her. As a result of competition, perfectly responsive governmental units are led to fulfil the citizens' preferences effectively, and to offer public services at the lowest possible cost. Under these restrictive conditions it can be shown that local public goods are provided efficiently.

The concept of FOCJ also emphasizes competition between public units and uses it to provide the necessary incentives to politicians and managers to take care of the citizens' preferences. In contrast to the «voting by foot» model, the governments of FOCJ do not have a monopoly of supply over a particular geographical area but various public suppliers may compete against each other in the same area. As a consequence the citizens do not have to move geographically when they switch from one public supplier to another. While the assumption of costless mobility for the citizens is obviously unrealistic in Tiebout's model, it is much more appropriate for FOCJ. Hence mobility will *ceteris paribus* be stronger in a net of FOCJ, and competition between jurisdictions more intensive.

Another difference to «voting by foot» is that the geographical extension of FOCJ is not predetermined but adjusts to the extent of spillovers and economies of scale. This fact provides another advantage of FOCJ over the Tiebout concept: other things being equal, FOCJ are able to provide a given public service at lower cost because there are less inefficiencies due to a non-identity of consumers and taxpayers, and the size of production can be chosen so that economies of scale can be exploited and average cost minimized.

Yet another difference is that Tiebout's governments provide the whole set of public services demanded by the population (they are APJ) while FOCJ are restricted to one function each. They can, therefore, exploit the advantages of specialization and the corresponding cost savings.

Finally, Tiebout assumes that the competition via mobility suffices to bring about a public supply conforming to the wishes of the citizens. Political competition via elections and referenda, which in FOCJ plays a crucial role, is implicitly considered to be superfluous. This is correct in a model with costless mobility and perfect competition between governmental units which are taken to be «black boxes» without lives of their own. As these assumptions certainly do not apply in reality it seems reasonable to complement competition via mobility by competition via democratic institutions as envisaged in FOCJ.

Our concept of FOCJ attributes a crucial role to competition via exit and entry but puts it into a more realistic setting. FOCJ work, and do so even more efficiently without having to make the strongly restrictive assumptions of the Tiebout model.

Exit and Voice

The concept of competition by mobility has been joined with political competition by Hirschman (1970). He coined the corresponding terms <exit> and <voice> which have become common currency in economics. Voice may take place within (elections and referenda) or outside (illegal, demonstrations, uprisings, revolutions) a constitutionally regulated framework. Originally Hirschman looked at exit and voice as substitutes. On the basis of the insights gained from the breakdown of the German Democratic Republic (GDR) he changed his views: the two mechanisms may well support each other (Hirschman, 1993). When a government is forced to tolerate exit (as was the case with the government of the GDR in the form of emigration through Hungary to the West), the citizens remaining in the country tend to interpret it as a sign of weakness. Voice in the form of demonstrations is then considered to be more effective and less dangerous than before which leads to mass participation. This in turn may induce the police to tolerate the demonstrations (as it did in the last days of the GDR).

The concept of FOCJ builds on both exit (and its correlated entry) as well as on voice in its institutionalized variant. The two forms of competition are mutually reinforcing. It is taken for granted that the threat of exit is not sufficient to force the governments of FOCJ to fully meet the citizens' preferences. As a result of decisions and transaction costs, citizens may be unwilling to leave the FOCJ they presently belong to. Though it suffices that exit is undertaken by a few <marginal> citizens, the barriers to switching may still be so large that governments of FOCJ enjoy considerable discretionary power. This may especially happen when members of FOCJ are composed of communes rather than individuals because an implicit, and even explicit, coalition among the various politicians involved may not be excluded. Political competition via elections and referenda then helps to further reduce politicians' discretionary power.

Clubs

In the economic theory of federalism, clubs are private institutions that provide their members with public goods. The respective services are thus freely available to all club members but not to those outside the club, that is, they have a local dimension. The optimal club size in terms of members is reached when the marginal cost caused by an additional member corresponds to the marginal utility of the consumption made possible by this additional entry. This model according to Buchanan (1965) postulates a club size corresponding to the extension of the public good in question. The number of club members is a control variable as only those who are ready to pay the corresponding marginal cost are admitted.

The club concept is closely related but not identical to FOCI. It is also emphasized that a FOCUS provides for one particular public good or service, and in particular, that its size adjusts to the economic conditions revealed by benefits and cost. <Local> public goods are also considered in the sense that members of FOCJ may enjoy their benefits while outsiders do not. However the term <local> does not necessarily mean small scale; some FOCJ (an example is defence against outside aggression) may extend over a large area (in the case of defence, for example, certainly beyond the national states and even beyond Europe, as the North Atlantic Treaty Organization (NATO) shows).

In contrast to Buchanan's clubs, FOCJ attribute a large role to the formal political participation rights of the citizens. Clubs are private; their membership is based on a private contract while FOCJ are public jurisdictions with the constitutional power to impose taxes.

Fiscal equivalence

This idea focuses on the requirement that an optimal allocation presumes that those benefiting from a public service should also pay for it. If public services can be consumed without paying, or alternatively, if citizens have to pay for public services not consumed by them, biased decisions result. Fiscal equivalence (Olson, 1969, 1986; Oates, 1972) minimizes these spatial external effects or spillovers. For every public good there is a different optimal size because their benefits and costs normally extend over different areas. Fiscal equivalence requires overlapping areas of supply.

This concept is again closely related to FOCJ where fiscal equivalence also leads to overlapping jurisdictions. Fiscal equivalence does not, however, spell out the aspects of spatial competition, the dynamic adjustment processes by exit and entry, nor political participation rights.

Comparative Problem Solution

In the following, three problem areas are discussed where the institutional conditions tend to lead to inefficiency in the allocation of resources. The way FOCJ cope with these problems is compared to how alternative institutions do so.

Spillovers

Citizens paying taxes for public services they do not consume, or enjoying public services to whose provision they do not financially contribute, is a recurrent problem with the organization of states. The present arrangement where historically given governmental units have a monopoly in the supply of a large variety of public services tends to lead to large spill-ins and spill-outs. Even if the size of the governmental unit had been adjusted in the (distant) past to minimize spillovers, it is most unlikely to hold when times have changed (the benefits and costs of a public good have shifted over space), and when there is more than one public good.

This statement can be illustrated with the case of the national state. Even if it were true that the particular size of a nation was reasonably well adjusted to the extension of the benefits and cost of the public goods then relevant, conditions have changed since. Just consider the examples of defence, natural environment and trade policy, for which the existing national states in many respects are too small. Decisions made by any one national state have strong positive or negative spillovers on other nations. It is no accident that in all three areas attempts have been made to reach collective agreements at a supranational level. For defence, European co-operation has been sought (with little success so far) and NATO has been founded which now extends far beyond the countries at the border of the Atlantic. To prevent unwelcome climate changes, co-operation has been sought via international treaties, such as the Rio Convention. A mutually beneficial move towards free trade has not only been successfully undertaken in the European Free Trade Area (EFTA) and much more so in the

EU, but also on a worldwide level by the General Agreement on Tariffs and Trade (GATT) and now by the World Trade Organization (WTO).

These efforts to reduce spillovers go well beyond national states, and in several respects reduce their sovereignty. The various supranational treaties and associations may be interpreted as a step in the direction of FOCJ: they tend to be (at least initially) focused on one function, and they overlap. However several of these supranational organizations have become multifunctional (especially the EU), and they tend to make competition difficult by claiming a monopoly, and by making exit and entry difficult (again the EU is a pertinent example). Moreover almost all of these supranational organizations lack strong democratic features and taxing power.

Reality also shows that existing nations tend to break up when spillovers are too large. Then minorities hope to be better able to solve their problems without intervention from the existing central government. Former Yugoslavia, Czechoslovakia and the Soviet Union are examples, but similar tendencies exist also in Belgium, Spain (Basque Lands and Catalunya), France (Corsica), Italy (Padania), or Canada (Québec). This adjustment in size also points in the direction of FOCJ but the resulting new governmental units are, of course, far from FOCJ: they are not functional, not overlapping and often not competitive.

FOCJ are an *institutional* way to vary the size of public jurisdictions in order to minimize spillovers. A change in size is, therefore, a normal occurrence. Neither are FOCJ so slow and often ineffective as the cooperation between nations discussed above, nor accompanied by bitter strife as is often the case when countries threaten to, or actually do, break up.

Economies of Scale

When the average cost of *production* falls with size (economies of scale) or rises with size (diseconomies of scale), it is efficient to adjust the respective production outfit (plant). This does not mean, however, that the size of the jurisdiction using the respective product has to adjust. Indeed it normally makes sense to divorce production from provision. A jurisdiction in charge of the supply of a given public service may well source out the production, that is, buy the required goods or services from a producer located elsewhere.

What matters are the economies (or diseconomies) of scale in the *provision* of public services. Most often the optimal size from that point of view differs from the optimal size with regard to production. Often the cost of production exhibit economies of scale while geographical differences in demand and the cost caused by spillovers merit small jurisdictions. This trade-off must be faced. As a result of the competition enforced by exit and democratic participation rights, the politicians and managers in charge of a FOCUS have an incentive to evaluate and take into account the respective cost. In contrast, traditional jurisdictions identified with a particular territory find it difficult to solve these problems. The effort to exploit the economies of scale in *production* by establishing special districts or (as they are aptly called) *«Zweckverbände»* is a step in the direction of FOCJ. But these new units are typically purely administrative, that is, they lack democratic legitimacy, and cannot raise their own taxes to finance the expenditure.

Public Goods

The concept of FOCJ relies on the idea that many, if not most, public goods are local. Thus it is possible to draw the borders of a FOCUS so that non-members and, therefore, non-payers are excluded from the use of the services provided. There are but a few public goods where such exclusion is not feasible. It is even argued that most public goods are best provided in small units because this best caters to the heterogeneous preferences of citizens. A large number of FOCJ are expected to be rather small, even smaller than today's communes. Many of the public services, for example, can be provided on the level of city quarters or even blocks.

Within a FOCUS the public good objective behind many public services requires citizens to agree collectively to pay taxes which finance these services. FOCJ are, therefore, governmental units with the power to impose taxes. This feature distinguishes FOCJ from a purely private provision of public services. Admittedly many public services could be privatized (examples are schools, electricity or telephone companies), others do have significant public good characteristics, that is, non-payers cannot be excluded. An example is, for instance, police services providing order and security which everyone living in a respective area benefits from. The concept of FOCJ, therefore, differs from the suggestion of privatizing public services. As it has already been pointed out the public good motive also

requires that a citizen has to be forced to belong to *some* FOCUS that provides a particular service but he or she is free to choose among the FOCJ active in this function. A pertinent example is elementary school which benefits all citizens, and not only those with children of that age.

Suggested Further Reading

More general aspects of competition among states, governments and other political units are discussed in

Gerken, Lüder (ed.) (1995), *Competition among Jurisdictions*, London: Macmillan.

The effects of spatial competition are surveyed in

Dowding, Keith, Peter John and Stephen Biggs (1994), *«Tiebout: A Survey of the Empirical Literature»*, *Urban Studies*, 31 (4-5 May), 767-97.

The concept of exit and voice has been developed by

Hirschman, Albert O. (1970), *Exit, Voice and Loyalty*, Cambridge, MA: Harvard University Press.

Hirschman, Albert O. (1993), *«Exit, Voice, and the Fate of the German Democratic Republic»*, *World Politics*, 45 (January), 173-202.

The role of clubs is analysed in

Cornes, Richard and Todd Sandler (1996), *The Theory of Externalities, Public Goods, and Club Goods* (2nd edn), Cambridge: Cambridge University Press.

Economies of scale in local public government production are analysed in Hochman, Oded (1990), *«Cities, Scale Economies, Local Goods and Local Governments»*, *Urban Studies*, 27 (1), 45-65.

The problem of interregional spillovers is analysed from a theoretical perspective by

Wellisch, Dietmar (1994), *«Interregional Spillovers in the Presence of Perfect and Imperfect Household Mobility»*, *Journal of Public Economics*, 55 (2 October), 167-84.

The European Union (EU)

The Three Bodies

The unification of Europe is in principle based on the idea of federalism and decentralization though it contains strong elements of a centralized state. Each member state has a fixed number of seats and votes in the most important institutions of the EU – the European Commission (EC), the Council of Ministers and the European Parliament (for the European Court with its 15 judges elected for six years, such quota do not formally exist but are effective in practice).

Table 6.1 provides a survey of the weight of the individual members in the European institutions mentioned above.

The *European Commission* is a supranational unit whose members are required to act in the interests of the EU as a whole. They may not follow any orders by the national governments. They are elected with the approval of the governments of the member countries and they must be confirmed by the European Parliament. Once elected, the governments cannot recall them. The fact is that the members of the commission tend to follow their national rather than any other country's interests.

The present 20 Commissioners are elected for four years. The five largest countries – Germany, the UK, France, Italy and Spain – delegate two members each, all other countries one each. The EC acts as a unity; if a vote is necessary, the rule is a simple majority. The president is *primus inter pares* and does not have any special decision powers.

The EC must guarantee that the law and the political decisions of the EU are correctly applied. It can take legal action against member countries which violate them, and often does so. The EC also has the duty to strengthen European integration and, therefore, has the right to undertake appropriate activities.

The *Council of Ministers* is the most important legislative unit in the EU. It is not a standing body but an assembly of the national ministers responsible for the respective policy areas. If, for instance, a decision on agricultural policy is to be taken, the national ministers of agricultural affairs participate. Of course these national ministers pursue their national inter-

Table 1: The weight of the member states in the institutions of the EU, 1998

Member country	Population (1995) (million)	Members in the Commission	Votes in the Council of Ministers	Seats in the European Parliament
Germany	81.9	2	10	99
UK	58.5	2	10	87
France	58.1	2	10	87
Italy	57.2	2	10	87
Spain	39.2	2	8	64
Netherlands	15.5	1	5	31
Greece	10.5	1	5	25
Belgium	10.1	1	5	25
Portugal	9.9	1	5	25
Sweden	8.8	1	4	22
Austria	8.1	1	4	21
Denmark	5.2	1	3	16
Finland	5.1	1	3	16
Ireland	3.6	1	3	15
Luxemburg	0.4	1	2	6
Total	372.1	20	87	626

Source: Jones (1996, p. 64).

ests. The presidency of the council changes in a fixed sequence after six months in order to prevent the domination of any country.

The Council of Ministers constitutes an intergovernmental body. It differs in two respects from national legislatures. Its members are delegated by the government and are not elected by popular vote. Moreover the decisions are taken unanimously provided the European Treaty does not stipulate a qualified majority. A qualified majority requires 62 of the total 87 votes; thus, a blocking majority is 26 votes. However an overruled national government can resort to the 'Luxemburg compromise' of 1966, according to which every country has a veto vote if an issue is of 'foremost national interest'. There are no criteria for this 'foremost national interest'. The existing rules and vote distributions (Table 1) clearly favour the small member countries.

Since 1979 the *European Parliament* has been directly elected for a period of four years. It represents the population of the member countries,

not the voters of the EU. The small nations are again overrepresented. Decisions are taken by simple majority, only the dismissal of the EC requires a two-third's majority. The competence of the European Parliament is quite restricted compared to national parliaments or to the EC and the Council of Ministers.

Subsidiarity

The principle of subsidiarity was established in the Maastricht Treaty in 1992 and refined in the Amsterdam Treaty which was signed in 1997 and is effective in 1999. Subsidiarity stipulates that the EU should only become active in a certain area if the member countries are less capable of taking actions. The EU, moreover, should not extend beyond what is strictly necessary in order to reach the goals established in the EU treaties. Political decisions and responsibilities are to be taken at the lowest possible governmental level. This would at the same time restrict and relieve the workload of the institutions of the EU. Subsidiarity thus seems to strengthen the federal element in the EU.

However, the EC, as expected, interprets the principle of subsidiarity to its own advantage and turns its logic on its head. As soon as a problem can be approached at the European level, or if there are any problems at the national level, the EC takes it for granted that it must intervene. Moreover it does not accept that subsidiarity limits the competencies accorded to it; it takes subsidiarity to deal only with how *common* competencies are to be divided up.

The EC tends to interpret the competencies exclusively given to it in a very broad way. In a legalistic definition its competencies are restricted to trade policy and the protection of the seas. The EC considers itself to be responsible whenever the four freedoms – the free movement of goods, services, capital and labour – are touched. It thus not only considers the removal of restrictions to these freedoms to fall within its competencies, but also all policy areas connected with the four freedoms such as trade policy, competition policy, agricultural policy and transport policy.

This clearly makes the EC claim a very wide area of policy. The principle of subsidiarity proves to be much too general to counteract the increasing centralization at the European level. The Amsterdam Treaty does not change this fact. It only stipulates that the EC, while

extending its fields of activity, is bound to argue that the extension of its tasks is consistent with the principle of subsidiarity. However this is not a strong constraint to centralization. There is hardly a government activity for which it cannot be argued that it causes some transnational spillovers or overcharges at least one national government. Therefore the EC can always argue that centralization is compatible with the subsidiarity principle. Moreover there is no institution which is in charge of judging the soundness of the EC's arguments. However even a strict interpretation of subsidiarity would not be sufficient to give Europe a really federalist structure because in many of today's (and future) member states, governments at lower levels are insufficiently developed and, in particular, do not have the tax bases to finance their own expenditures.

Tendencies for Centralization

The EU has in many areas taken over competencies from the member countries. The tendencies to centralize are most marked in the following policy areas:

- internal trade and factor mobility;
- industrial and research policy (in particular telecommunication, energy and other public service areas);
- competition policy (the country competencies are restricted to aspects which do not touch on trade between EU members, and only applies for unimportant activities);
- agriculture (the instruments for price supports and structural programmes take place in the context of the Common Agricultural Policy (CAP). They benefit mostly the farmers living in the North and occupies roughly 50 per cent of the EU budget);
- environment (the EU has issued directives with regard to atmospheric pollution, dangerous chemicals, water pollution, the protection of flora and fauna, noise emissions and animal experiments which strongly restrict member countries);
- trade policy (the EU has largely exclusive competencies with regard to custom treaties. A large number of bilateral and multilateral treaties have been concluded, for example, with the USA, Japan and EFTA and a common external tariff has been established);

- transport policy (the EU has fixed entry conditions and prices for suppliers of road transport and controls air traffic regulations);
- monetary policy (the Economic and Monetary Union (EMU) and the common monetary unit (Euro) was mainly decided by the EU);
- social policy (the Social Charter has now been accepted by almost all member countries; the European regulations in general are less extensive than the national laws but a large number of directives to set minimum standards and to harmonize the conditions for health and security have been issued);
- redistributive policy (the Structural Fund and the Cohesion Fund support infrastructure and transport projects with the goal of helping the poorer nations of the EU. In 1993 Greece and Ireland, for instance, received almost 3 per cent of their GNP via such supports (outside the Common Agricultural Policy and the Social Fund). For Portugal; this share reached 3.7 per cent of BIP (Centre for Economic Policy Research 1993, p. 26)).

As illustrated in Table 2, centralization tendencies in the EU are not so much reflected by the number of public officials (it more than tripled from approximately 5,000 in 1970 to 17,000 in 1991), or by the budget (it increased from 0.54 per cent of the GNP of the six EC countries in 1975 to 1.28 per cent of GNP of the 12 EU countries in 1994). Rather increasing centralization can be seen in the number of interventions. Table 2 shows the number of decisions of the European Court which grew almost eight times from 240 in 1970 to 1780 20 years later.

Perhaps an indirect indicator is even more revealing. The more important the decisions taken by the EU, the greater the number of interest groups seeking to influence them and, indeed, their number increased from approximately 300 (1970) to 3,000 (1990). This indicates that this rent-seeking is now of a large magnitude. In particular the rapid increase over the last decade clearly reflects a shift of power towards the EU.

Comparison to FOCJ

«Federalism» as practised in today's EU differs strongly from the concept of FOCJ. The Maastricht Treaty has fixed the *acquis communautaire* stipulating that no member country may renounce particular parts of the legal framework which forms the basis of the EU. In particular new members

Table 2: Centralization tendencies in the EU

	1970	1980	1990
Number of employees with the EC	5 000	11 000	17 000
Number of judgments by the European Court	240	830	1 780
Number of interest groups with the EU	309	410	3 000

Source: Molle (1994) and CEPR (1995, p. 27).

must completely accept the *acquis communautaire*. There are two areas where some flexibility is allowed because a common policy has proved impossible to achieve. Exceptions to the treaties such as those concerning the EMU, the Protocol of Social Policy, or the Schengen Treaty concerning border controls, have been granted reluctantly, only. Thus the UK and Denmark have opted out of the EMU, and Sweden has also decided not to join for the time being.

Opting out is generally seen by European politicians and public officials as damaging the spirit of Europe. Concepts related to FOCJ such as «variable geometry, multi-track, multi-speed, two-tier, hardcore, concentric circles» or as «Europe à la carte» always evoke fierce opposition. In a system of FOCJ, in contrast, functional units not covering everyone are taken as a welcome expression of heterogeneous demands among Europeans.

The Amsterdam Treaty which is due to come into effect in 1999 is often interpreted to allow more flexibility for member countries. However the treaty asserts that the *acquis communautaire* cannot be touched. Flexibility refers to further steps of integration only. Thus a majority of member countries are allowed to engage in closer union, provided no other member vetoes such a step. This is, of course, a far cry from the concept of FOCJ where those jurisdictions which desire to co-operate or to (partially) disintegrate are free to do so.

Various people have advanced concrete ideas for a future European Constitution in which federal elements play a major role. They go beyond constitutional proposals which essentially strengthen federalism in the EU by doing away with elements which hamper the working of federal institutions. The new proposals endeavour to overcome the vague definitions of subsidiarity by explicitly and clearly stating the competencies of each level of government. Equally the existing confusion caused by the increasingly complicated web of tax and transfer payments should be clarified.

The possibility of a regulated exit of member countries from the EU plays a central role in Buchanan's (1991) constitutional proposal. The right to secede should guarantee that the European government adheres to only those activities which its citizens desire. Today's EU does not formally envisage exit. It could be argued that it is difficult to conceive that the European institutions or member countries would forcefully prevent the exit of a country, let alone a group of countries. However secession would inflict great harm on the EU and would inflict huge cost because procedural rules are lacking. Thus, exit is highly improbable and thus does not constitute a constraint to EU policy. Although Buchanan focuses on the exit option in his constitutional proposals, he somewhat surprisingly does not apply his own theoretical model of clubs (Buchanan, 1965) to this context. For this reason Buchanan's proposal differs greatly from our concept of FOCJ.

To our knowledge only one constitutional proposal for Europe deals with the functional separation of tasks. Teutemann (1992) proceeds, however, quite differently from FOCJ by suggesting a European Parliament in which *individual chambers are responsible for the various functions*. These functions are allocated by experts or by the government. The citizens have no say in this respect. Teutemann's innovative proposal is embedded in a rather constructivist and technocratic tradition. It is not to be expected that these parliamentary chambers are well suited to make decisions on the various functions which correspond to the voters' preferences.

The constitutional proposal of European parliamentarians (in the so-called Herman Report of the European Parliament, 1994) accepts the existing federal and geographic division of the EU and almost exclusive-

ly suggests changes to *parliamentary institutions*. In particular the number and structure of chambers and the national voting rights must be adjusted to changing conditions. As is to be expected in a report which must suit the differing interests of parliamentary groups, only marginal changes to existing institutions are proposed.

The European Constitutional Group, among whose members are Peter Bernholz, Roland Vaubel and Frank Vibert, goes in many respects farther than the Herman Report. Important goals are the openness of the EU, the removal of inner frontiers and barriers, as well as the protection of cultural variety. These goals are to be reached by a competitive system of taxes, laws and social security. The centre of the EU has to fulfil two essential tasks: a common foreign and defence policy and the free mobility of citizens, goods and services, and capital. Free competition, not only with regard to the exchange of goods but also with regard to social programmes (labour market, social security), stands at the centre of this constitutional proposal. An independent European Central Bank is responsible for price stability. The proposal of the European Constitutional Group regulates some issues in depth and thereby tends to determine outcomes, and not rules. Thus it stipulates that the budget of the EU must be in balance, and public expenditure may not exceed a certain percentage of GNP. Every state which makes a net contribution to the EU budget has a veto right.

With regard to institutions, the Group proposes a legislature composed of two chambers. The chamber of parliamentarians is composed of 175 members and has the right to control new laws, to initiate new laws, to approve the budget and international treaties as well as the entry of new members (the latter with a qualified majority of at least 80 per cent of the votes). The members of this parliament are selected from the members of the parliaments of the member states. The second chamber, the Union Chamber, has the right to initiate laws, decide on laws and the budget, monitor their execution and control the activities of the executive, that is, of the EU administration. Its members are directly elected and may serve a maximum of two terms of five years.

The proposal of the European Constitutional Group intends to strongly restrict the competencies of the EU. It wants to confine them to the execution and support of the decisions of the European Council which is composed of the heads of governments or heads of state of the member countries.

As the proposal is outcome-oriented (by fixing, for instance, the maximum budget size), its main goal is to set limits on the European state, but not to strengthen the participation of the citizens or of federalism. Thus one of the chambers of parliament is not directly elected and direct democratic elements in the form of popular initiatives and referenda are missing. The idea of FOCJ proposed here is process-oriented in contrast. Only a few general institutional rules are fixed; in particular FOCJ may form freely and may raise their own taxes. As far as possible, material aspects remain unregulated. As the decisions in FOCJ are made in a democratic way, they are to be accepted and should not be limited or even determined from outside. It is difficult to see what the legitimacy for such an outside interference is based on.

Another important proposal for a European Constitution has been worked out in the context of the Centre for Economic Policy Research (CEPR, 1995), as has already been briefly discussed in Chapter 5. The main task of the authors (among them Mathias Dewatripont, Francesco Giavazzi, Jürgen von Hagen, Torsten Persson, André Sapir and Guido Tabellini) is to combine greater flexibility with greater political integration. They propose a 'flexible integration' starting from policy areas instead of countries. The Common Base has to be observed by all the members of the EU. It contains well-defined goals of policies, the most important of which is the unified market. It is not restricted to a guarantee of the four economic freedoms but also contains transfer programmes, the Structural Fund and CAP which serve to make the common market politically acceptable. Moreover the measures to harmonize capital taxes and to co-ordinate monetary policy also belong to the Common Base to be included in the European Constitution.

While participation in the Common Base is mandatory, member countries can choose to participate in those Open Partnerships from which they hope to benefit. The policy areas include the common currency and the Social Charter. The report does not envisage that member countries which are not (yet) ready to participate may co-determine what these Open Partnerships look like. Conversely particular Open Partnerships may prescribe 'rules of good behaviour' to other EU countries. Thus, for example, no monetary policy may be undertaken which would lead to competitive devaluation of currencies.

The constitutional proposal designed by the CEPR shares some characteristics of FOCJ, in particular the focus on functions or policy areas.

The same holds for the basic rules which have to be accepted by all. The concept of FOCJ presumes, however, a much smaller set of conditions to be included in this base, namely above all the four economic freedoms and the fifth political freedom to freely form new overlapping jurisdictions. Programmes for redistribution and standardization imposed from above are inconsistent with FOCJ. If such programmes are desired by the citizens, corresponding FOCJ will emerge. However neither co-ordination nor redistribution needs to be prescribed by any higher authority. Neither is it necessary nor desirable to fix the competencies of the various levels once and for all. The constitutional proposal by CEPR seeks to add content to the otherwise rather empty concept of subsidiarity, but the report puts much less weight on the major advantages to be gained by decentralization and the direct participation of citizens than does our proposal of FOCJ.

Suggested Further Reading

The federal elements in the EU and the European Nation States are discussed, for example, in

Hesse, Joachim Jens and Vincent Wright (1996), *Federalizing Europe? The Costs, Benefits, and Preconditions of Federal Political Systems*, Oxford: Oxford University Press.

Vaubel, Roland (1995), *The Centralisation of Western Europe. The Common Market, Political Integration, and Democracy*, London: Institute of Economic Affairs.

The extent of decentralization of government in the various EU-member countries is analysed in

Goldsmith, M.J.E and K.K. Klausen (eds) (1997), *European Integration and Local Government*, Cheltenham: Edward Elgar.

The concept of subsidiarity has been widely discussed. See, for example, Centre for Economic Policy Research CEPR (1993), *Making Sense of Subsidiarity. How much Centralization for Europe?*

Feld, Lars E and Gebhard Kirchgässner (1996), 'Omne Agens Agendo Perficitur. The Economic Meaning of Subsidiarity', in Robert Holzmann (ed.), *Maastricht: Monetary Constitution without Fiscal Constitution?*, Baden-Baden: Nomos, 195-226.

Hösli, Madeleine (1995), 'The Political Economy of Subsidiarity', in F Loursen (ed.), *The Political Economy of European Integration*, Amsterdam: European Institute of Public Administration, 63–89.

A politico-economic analysis of the tendencies for centralization in the EU is provided by

Vaubel, Roland (1994), 'The Political Economy of Centralization and the European Community', *Public Choice*, 81, 151–90.

Harmonization versus competition with respect to taxes is discussed with opposite conclusions by

Frey, Bruno S. and Reiner Eichenberger (1996), 'To Harmonize or to Compete? That is not the Question', *Journal of Public Economics*, 60, 335–49.

Kirchgässner, Gebhard and Werner W. Pommerehne (1996), 'Institutional Competition vs Centralization: Quo Vadis Europe?', *Oxford Review of Economic Policy*, 9, 15–50.

Sinn, Hans-Werner (1994), 'How much Europe? Subsidiarity, Centralization and Fiscal Competition', *Scottish Journal of Political Economy*, 41, 85–107.

The increasing importance of interest groups in the EU is documented in Andersen, Srein S. and Kjell A. Eliasson (1991), 'European Community Lobbying', *European Journal of Political Research*, 20, 175–87.

Mazey, Sonja P and Jeremy L. Richardson (1993), 'Interest Groups in the European Community', in Jeremy L. Richardson (ed.), *Pressure Groups*, Oxford: Oxford University Press, 191–215.

A survey of some proposals for a European Constitution from the politico-economic and legal point of view is given by

Petersmann, Ernst-Ulrich (1995), 'Proposals for a New Constitution for the European Union: Building Blocks for a Constitutional Theory and Constitutional Law of the EU', *Common Market Law Review*, 32, 1123–75.

Schmidtchen, Dieter and Robert Cooter (eds) (1997), *Constitutional Law and Economics of the European Union*, Cheltenham: Edward Elgar.

The various proposals discussed in the text are

Buchanan, James M. (1991), 'An American Perspective on Europe's Constitutional Opportunity', *Cato Journal*, 10, 619–29.

Centre for Economic Policy Research (CEPR) (1995), *Flexible Integration: Toward a more Effective and Democratic Europe*, London: CEPR.

European Constitutional Group (1993), *A Proposal for a European Constitution*, London: European Policy Forum.

Herman, Fernand (rapporteur) (1994), 'Zweiter Bericht des institutionellen Ausschusses über die Verfassung der Europäischen Union', Europäisches Parlament, Sitzungsdokumente (A5-0064/94).

Teutemann, Manfred (1992), *Rationale Kompetenzverteilung im Rahmen der europäischen Integration*, Berlin: Duncker & Humblot.

Further proposals for a European Constitution have been made by a variety of institutions and interest groups. Examples are

Weidenfeld, Werner et al. (eds) (1994), *Europe '96. Reforming the European Union*, Gütersloh: Bertelsmann.

Schneider, Friedrich (1996), 'The Design of a Minimal European Federal Union: Some Ideas using the Public Choice Approach', in Jose C. Pardo and Friedrich Schneider (eds), *Current Issues in Public Choice*, Cheltenham. UK: Edward Elgar, 203–22.

Chapter 7: FOCJ in Europe

In this chapter the concept of how FOCJ can be applied to Europe is examined. In particular how far the policy of the EU strengthens federalism and especially the regions, and the conditions necessary for the emergence of FOCJ are analysed. It then evaluates what opportunities exist for a stronger federalism, and in particular, for the concept of FOCJ within the EU.

Federalism and Regionalism in the EU: The Present State

EU Policy

Regional policy is an important task in the EU and is actively undertaken. Its major goal is to reduce disparities in income levels between the member countries and to subsequently achieve a 'harmonic develop-

ment. While this goal already forms a part of the preamble of the Roman Treaty, not much was undertaken until the mid-1970s mainly because the European Agricultural Fund used up a considerable part of total expenditures. In 1975 a European Regional Development Fund was established. Its main purpose was to support the national governments in their respective regional policies. After a reform in the 1980s income criteria for potential recipients were fixed. An effort was made to stimulate rather than to substitute national investments. The Single European Act of 1985 strengthened the commitment to an active redistribution policy among the various parts of the EU (article 130A). In 1988 Structural Funds were introduced, several of which are explicitly geographically oriented. The corresponding financial means are granted to the regions only indirectly through the mediation of the national governments, that is, the regions must rely on their governments and cannot pursue an independent policy. The Structural Funds are attributed after extensive consultations with the national governments of the member countries. However the EU Commission makes an effort to establish direct relationships with the regions of Europe. As a result of the Maastricht Treaty, a Committee of Regions was formed for the purpose of establishing contacts.

Several Structural Funds of the EU are devoted to cross-border regions. In 1990 an initiative was started with the goal of overcoming the national as well as the EU borders and to establish a network for closer co-operation.

As it has become clear from this short discussion, the regional policy in the EU is top-down and works by handing out monetary transfers. No effort is made to encourage the regions to develop from the bottom. This is reflected in the fact that it is mainly the national governments which determine the distribution of the funds while the interests of the local population are of little concern. The regional policy in the EU is not directly rooted in any democratic process, and it does not intend to develop political structures at a decentralized level. The contrast to our concept of FOCJ thus could not be larger.

Regional Activities

Several associations have expressed the demand of the regions to be heard in the political process within and beyond the EU. It started in 1971 with the Association of European Border Regions which in 1985 led to the

foundation of the «Assembly of European Regions» comprising today of about 300 members from 23 countries. In the EU, the regions gained formal influence with the Maastricht Treaty. When the Committee of the Regions (COR) was established. This is an advisory body of 222 representatives from local and regional authorities which provide consultation on matters affecting regional interests and before decisions are made on regional matters. Policies concerning education, culture, public health, trans-European networks and economic and social cohesion, and according to the Amsterdam Treaty, employment, environment and transportation policies must all be consulted on. In these organizations of the regions the term «region» does not refer to a particular geographic area but rather to the administrative districts below the national state, that is, the German or Austrian «Bundesland», the Italian «regione», the Spanish «region autónoma» or the Swiss «canton». However, these units differ greatly with regard to size and responsibilities although their competencies and especially their tax autonomy are heavily restricted almost everywhere.

In Austria and Germany, which are at least formally federal countries, the Länder can pursue their own policies within the constitutional provisions. The limits imposed are, however, rather strong. In this instance, as elsewhere, the power to tax is decisive. The Austrian and German Länder have no tax autonomy but live mainly from the transfers and the tax shares they receive from the central government. As a result the politicians at the Länder have a marked central orientation as they try to get as many financial means as possible from the federal government by lobbying.

Italy has 20 regions of which the two large islands of Sicily and Sardinia and three border regions have a special status. There are even demands for a cross-border «European region Tyrole» to be composed of South Tyrole, Trentino and the Austrian Bundesland Tirol. The Italian Regions (so far) have only limited financial independence in terms of their own power to tax. There are continuous efforts to gain more financial autonomy but it is doubtful whether the central authorities in Rome will be prepared to make a decisive step in this direction. It would constitute a major break from the concept of a highly centralized national state that has been cherished since the unification.

Alsace in France which in the past was at times German and at other times French has always taken a special position. Savoy with its present-day departments Savoie and Haute-Savoie has also asked for more auton-

omy from Parisian centralism. The announcement of a «sovereign state» in 1996 was not to be taken seriously but showed that regional demands gained in importance. In Corsica the movement towards regional autonomy even makes use of terrorist means.

In Belgium the Walloons and the Flemish seem to have drifted far apart. There is even a possibility that the national state may break up. The initiative derives mainly from the Flemish. Over the last 25 years they have achieved a regionalization of the central state. After increasingly extensive revisions of the constitution Flandria (Flanders), Wallonia and Brussels received an autonomous status, a parliament and a government with economic, cultural and even foreign policy competencies. Brussels, the capital of Europe, is in the uncomfortable position of an enclave (with up to 90 per cent French-speaking inhabitants) within the predominantly Flemish-speaking region of Flandria. Decentralization in Belgium is thus predominantly along «ethnic» (or at least language) lines.

In another classical central state, Spain, the regions have strongly gained in importance. In Catalunya and Galicia this special position has been reached mainly by peaceful means while terrorism played an important role in the Basque Lands. Violence has also occurred in the UK for decades: with regard to Northern Ireland, the hope for a peaceful and enduring solution has grown only recently. In contrast, no such regionalist tendencies exist in Scandinavia and the Netherlands.

FOCJ as a Solution

The discussion of federal and regional policy in the EU leads to four conclusions:

1. The regional policy pursued by the EU consists mainly in handing out subsidies. This has little to do with taking regional preferences into account. No effort is made to improve the citizens' possibilities to politically participate at the regional level, and it is unlikely that such efforts will prevail in the future because the national governments of the EU member countries have an interest to oppose it.
2. Within the EU there are three important regional conflicts, the Basque Lands, Corsica and Northern Ireland. They have occurred for years and all sides operate by the use of force. It could be said, in fact, that there are «wars» taking place within the EU. The EU is in no way capa-

ble of offering a peaceful solution to these bloody conflicts, or even to mitigate them.

3. The peaceful regional movements have also little to do with the EU. They do not understand themselves as regions within the formal structure of the EU but largely endeavour to pursue their own course. The existing constitution of the EU offers them few options to reach their goal of greater local autonomy.
4. The EU is not necessary at all for establishing cross-border associations. Switzerland which stands outside the EU provides a good example. After rejecting entry into the European Economic Area by a popular vote in 1992, the cantons which lie at the border of the country have made efforts to overcome the isolation threatening them. Switzerland is at present linked to all its neighbouring countries via cross-border associations:

- The «Regio Oberrhein» previously known as the «Regio Basiliensis». It includes regional units in Germany, France and Switzerland;
- The «International Conference of the Lake of Constance» («Internationale Bodenseekonferenz») composed of the Austrian land Vorarlberg, the German Baden-Württemberg, and Bavaria, as well as five Swiss cantons;
- The evolving «Region Raetia» which connects the Swiss cantons Graubünden with the neighbouring regions in Austria and Italy;
- The «Regio Insubrica» with the Italian Varese, Novara and Como and the Swiss canton Ticino;
- The «Conseil du Léman» consisting of the French Haute-Savoie and Ain and three Swiss cantons;
- The emerging «Communauté de Travail du Jura» with the French Franche-Comté and four Swiss cantons.

The importance of these cross-border associations is not large so far. What matters is that their emergence takes place outside the formal, top-down structure of the EU.

The regional movements, associations and jurisdictions previously discussed have one thing in common: they refer to territories. Die FOCJ which we suggest present an alternative way of establishing cross-border contacts. They are based on co-operation with respect to specific *functions*. Above all they do not require territorial separation from existing

national states. Thus Corsica, for example, need not leave the French state in order to co-operate closely with Italian (or Spanish) local units with regard to particular functions or policy areas, most importantly, culture and language. A break with the «motherland» which would unnecessarily evoke emotions and prevent solutions is evaded. It could be similarly envisaged that some Northern Irish communes forming jurisdictions with communes of the Irish Republic with regard to some functions, but with regard to other functions, may form jurisdictions with British communes and regions.

It is impossible to say *ex ante* what such FOCJ in crisis areas would look like because this must be left to the participants and cannot be determined from above and from outside. Rather the *preconditions* must be set to enable the emergence of such FOCJ. At present this is impossible because the respective communes have insufficient competencies to make such a step. In particular, they lack (sufficient) power to tax. Only if these preconditions are firmly established can it be hoped that a functional task (say refuse or waste water collection) is solved by forming FOCJ. It can well be expected that such concrete functions can be undertaken more successfully by FOCJ than by national states which tend to mix up functions with political, religious or ethnic ideologies. An analysis of wars has indeed revealed that the people affected were at least to some extent able to establish cooperation along functional lines. For instance, during World War I the soldiers spared each other's line of communication in order to safeguard the provision of food (Axelrod, 1984). In most wars, prisoners are exchanged (Frey, 1992, chap. 8), and a black market for trade in urgently needed goods emerges. It may even be hoped that such functional cooperation helps to reduce ideological barriers because the participants experience that their welfare is raised by cooperation. Of course, one should not have too high an expectation; there is normally no easy solution to bloody conflicts. However it is certainly more promising to pursue the functional co-operation suggested here than to stick to the nationally oriented approach which has failed dismally in the past.

FOCJ are, of course, also useful under peaceful conditions. Again it is not possible to determine concretely which policy areas will be covered and what the jurisdictions will look like because this lies in the hands of the individuals and communes involved. However it is possible to think of a variety of FOCJ. An example is a FOCUS which provides language education for the children of communes in the Alsace and Baden on the left

and right side of the Rhine. Whether such FOCJ will indeed emerge depends on the conditions for their establishment which we now turn to.

Conditions for the Emergence of FOCJ

As the concept of FOCJ is process-oriented, it is only possible to identify the conditions under which they can emerge, as well as the likelihood of them emerging. It cannot be determined a priori in which policy areas FOCJ actually form and how they perform their functions. Our proposal thus follows the Economic Theory of Constitutions which focuses on the process of policy decisions which in turn determine the outcomes.

It is useful to distinguish the conditions which we call the Common Base that FOCJ have to meet, and the conditions that are necessary for FOCJ to emerge.

Common Base

FOCJ require economic and political competition to perform properly. Only if the markets are open can FOCJ achieve the benefits discussed above, in particular, fulfilling the individual preferences of the local population. As it is true for all markets, many actors have incentives to subvert the free play of competition and to establish monopoly positions that damage others. For this reason the constitution must make sure that economic and political competition remains vigorous. A «competition authority» has to be established which monitors whether the two kinds of market remain sufficiently open:

- a) The *economic* markets must allow the entry of new competitors. In particular the four freedoms of the free movement of goods, services, capital and labour must be guaranteed.
- b) The *political* markets must be based on the unconstrained competition for the votes of the citizens, that is, the basic human and democratic rights have to be ensured. The «competition agency» must fix general rules that determine the maximum prices for entry into, and exit from, a FOCUS. If these prices are set too high, mobility is hindered and monopolistic positions appear. Prices are, however, necessary to ensure that citizens or communes entering or exiting cannot profit at the cost of others, as this would undermine the emergence of FOCJ.

Each citizen should be prevented from failing to participate in the solidaric responsibility of providing particular public services. Individuals without children, as well as those whose children are no longer in education, for instance, must be forced to participate in the financing of general education. It is not sufficient to make the membership in a school-FOCUS obligatory. FOCJ may emerge which deal nominally with schools only, but which essentially offer no educational services, but correspondingly raise low taxes. In such cases an obligatory membership to a FOCUS with a (minimal) supply must be stipulated. The competition authority must have the power to intervene when these conditions are not met; a task which has to be formally included in the constitution. It would be wrong to assign the task to national, political or administrative authorities. They have an interest in making the life of FOCJ as difficult as possible, and preventing their emergence in the first place. Rather the institution charged with this task should be as objective as possible. One possibility would be the Constitutional Court (in the case of the EU, the European Court of Justice) though it somewhat tends to favour national over regional and local interests. Nevertheless such a Court is likely to fulfil the tasks of a competitive authority more objectively than a national unit.

Freedom to Establish FOCJ

FOCJ can only emerge if a positive and a negative condition are met:

- a) The *formation* and *functioning* of FOCJ must be *constitutionally* guaranteed. It should be possible for the units to incorporate themselves as jurisdictions with (limited) power of enforcement. Without any doubt the power to impose taxes is crucial in order to provide services. This right will always be challenged by other jurisdictions at all levels (nations, provinces and so on) because they have to give up part of their tax base. It is, therefore, of great importance that the tax power of FOCJ – of the existing as well as of those that will only emerge in the future – is fully guaranteed.

Both individuals and communes (as the lowest political unit) should have the possibility of establishing FOCJ. Who the members are depends on the functions concerned. Thus it can well be conceived that individual citizens would form a FOCUS for a particular public

school. In other policy areas, such as collection of waste water; communes would most likely come together to establish a FOCUS. The constitution should not fix in advance whether FOCJ are to be based on individuals or communes but should allow both types to form.

- b) Existing governmental units at all levels may *not block* the emergence of FOCJ. This means that, in particular, the members of a FOCUS which newly provides particular public services need no longer pay the respective taxes in the former jurisdiction. The competition authority must force the suppliers to make the cost of provision known and to correspondingly reduce taxes for members who are partially exiting and entering a FOCUS. The potential competition by FOCJ gives the existing public suppliers an incentive to reveal the precise cost of providing their services. It is certainly advantageous to them to state the cost of a given service low in order not to make partial exit look too favourable. However the setback is that the other services become more attractive for exit as, of course, the various tax prices should sum up to the full tax.

The competition authority should enforce that the appropriate tax reduction for individuals and communes is granted. In order to make the market transparent and to further strengthen the incentives to reveal the true prices, it may be useful to enforce that the tax price for the various public services be revealed and applied to those not only exiting but to all citizens including those who newly enter. As a result existing suppliers lose the incentive further to grant too low a tax rebate to those exiting because they would at the same time lose tax revenue from their present and future members. It should, of course, be taken into account that the traditional political units will employ much *creative bookkeeping* to put their new competitors at a fiscal disadvantage. The competition authority thus has no easy task to fulfil.

Again the Constitutional Court seems well-suited for the role of a competitive authority. Because a large number of tax prices have to be monitored, it must rely on the support of a specialized agency such as the Court of Account which has the necessary economic knowledge.

The chances for FOCJ to be part of the government structure depends strongly on the future of federalism in Europe, in particular, in the context of the EU.

The success of integration via the EU cannot be disputed, especially when it is compared to the demise of EFTA. The EU was economically very productive by achieving the four freedoms concerning the mobility of goods, services, capital and labour. The opening of these markets has raised the growth rate permanently. According to the few existing studies, integration has increased the growth rate by between 0.2 and 0.5 percentage points per year, although it is important to note that the growth impact of EU and EFTA membership has been about equal (Henrekson *et al.*, 1997). While such changes in growth do not appear to be very large, they have led to a marked rise in per capita incomes in the member countries in the long run.

With regard to employment, the EU's record is less favourable. The average unemployment rate in 1997 was around 11 per cent, with Spain far above 20 per cent, and Finland and Italy at the top with clearly above 12 per cent. Unemployment is also a serious problem in the core countries; France (around 12 per cent) and (West) Germany (around 9 per cent). The rates of unemployment should be compared with the current low rates in the USA (around 4.5 per cent) and Japan (around 4 per cent), but also with the comparatively low rates in the former EFTA countries.

The integration could be considered successful from the political point of view because it prohibited wars *between* the European nations. It is, however, also plausible that the causation runs in the opposite direction. It may well be that it was the absence of strong conflicts between the nations that allowed integration to take place. As it has been pointed out, the EU contributed little or nothing to prevent warlike conflicts *within* the member states. The terrorism existing in Northern Ireland, the Basque Lands and also in Corsica is still considered to be a purely national issue, a view that has not changed with the existence of the EU.

The insufficient democratic legitimacy of the EU is generally acknowledged. Moreover the support of the EU by the citizens of the member countries is far from overwhelming. Table 3 gives an overview based on a Eurobarometer survey for November 1997.

Table 3: Evaluation of the EU in the various member states, November 1997

	EU membership is a good thing	a bad thing
Ireland	83	3
Netherlands	76	9
Luxemburg	71	10
Italy	69	6
Greece	60	8
Portugal	56	6
Spain	53	9
Denmark	53	22
France	48	14
Belgium	42	18
Finland	39	25
Germany	38	15
UK	36	23
Sweden	31	46
Austria	31	24

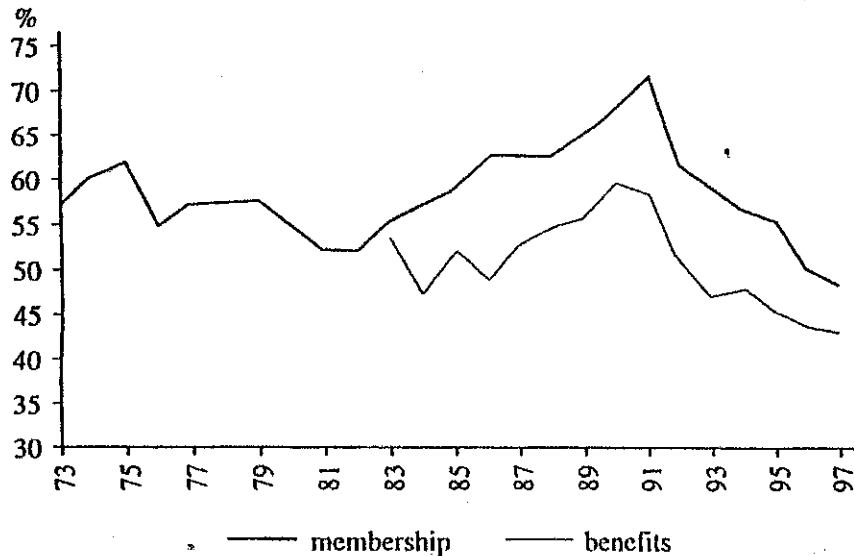
Source: Eurobarometer no. 48, 1998.

This table reveals that in seven countries – France, Belgium, Finland, Germany, the UK, Sweden and Austria – less than half of the persons questioned considered «EU membership to be a good thing». However it must also be said that in almost all countries – with Sweden as an exception – a smaller share considered the EU to be a «bad thing». After 1991 the previously rising support for the EU drastically fell as two different indicators of the Eurobarometer reveal. Figure 1 shows this development for the time period from 1973 to 1997.

The indicator «membership» captures positive answers to the question, «Do you find the membership of your country in the EU (Community), generally speaking, to be a good (thing), or a bad (thing), or neutral?»

The indicator «benefits» measure positive answers to the question, «All considered, would you say that your country has had a net benefit from the membership in the EU (Community)?» After 1991 the two indicators reveal a marked reduction in the approval of the EU. In fact both indicators fell to historical lows in 1997. This alarming trend is in no way confined to new members but holds for almost every member country. In Belgium, for

Figure 1: The development of the approval of the EU over time, yearly average, 1973-97



Source: Eurobarometer 1974-98.

instance, the positive evaluation of membership rose from 1981 to 1991 from 53 per cent to 73 per cent but fell until November 1997 to 42 per cent. In Germany it increased from 54 per cent to 68 per cent and decreased to 38 per cent, and in France it rose from 52 per cent to 67 per cent and fell to 48 per cent. It seems likely that this is due to the problems discussed above, which were made more acute with the Maastricht Treaty.

Such surveys are of limited use for various reasons. They may depend on short-run influences, and there is a tendency for superficial answers. Some of the questions are also not concrete enough so that the respondents may interpret them quite differently. For example when the common currency, Euro, was introduced, it was a disputed political issue; between 55 per cent and 60 per cent of the Germans were against the Euro. However only 10 per cent of the Germans found 'EU membership a bad thing', despite the Euro being almost a necessary consequence of EU membership (at least for Germany). Such inconsistencies are also obvious for other EU countries where an average 35 per cent of the respondents rejected a common currency and somewhat more than 50 per cent sup-

ported it (Eurobarometer, 1992-95). Nevertheless there exists empirical evidence (Gabel, 1998) that the responses to Eurobarometer surveys are influenced by the utilitarian consequences of integration policy.

In addition to the 'democracy deficit', the wastefulness and lack of efficiency that occur within the large-scale redistribational programmes have often been criticized: The same holds for the increasing use of unnecessary and somewhat ridiculous regulations of the Eurocracy. One of the most crucial shortcomings of the EU is its neglect of federal structures. As has been shown the EU accords the individual nations a strong position. However the EU does not endeavour to strengthen the local and regional decision-making structures and interests. Even the European regional policy contributes little to improve this situation. On the contrary it may even worsen it because the regional policy proceeds top-down and increases the dependence of the lower levels of government.

FOCJ represent a *radical* alternative: they emerge from below and finance their activity themselves. They, therefore, do not depend on the goodwill of the higher levels of government but can pursue the interests of the local citizens. As has been demonstrated in Chapter 5, concepts similar to FOCJ have a long tradition in Europe. Above all the diversity which has always characterized Europe is taken seriously. More concretely FOCJ take up and extend the often discussed concepts of 'Europe à la carte', 'variable geography', 'concentric circles' or 'Europe of different speeds'.

FOCJ are a promising means of *integrating Europe further without having to sacrifice democracy and diversity*. They present a viable option to enlarge and to deepen European integration. In the following chapter, it is argued that the countries of Eastern Europe cannot possibly become members of the EU under the existing *acquis communautaire*. The income differences to today's member countries are far too large. The transfer necessary to effect an integration in the present style appears impossible to raise. The EU has thus the choice to either maintain its present structure or to exclude most of the East European countries. As an alternative the EU could allow a flexible integration in a way similar to FOCJ.

FOCJ may also help to deepen European integration. In contrast to the prevailing view, this is not understood to be an ever-increasing harmonization (equalization) of social and economic policy but the goal instead is increased diversity. FOCJ could achieve this goal of increased integration by cutting across existing political boundaries, and in particular across national borders.

The new kind of federalism proposed here for Europe builds strongly on developed direct participation rights of the citizens. It can be interpreted as a third historic transformation of democracy. The first transformation occurred in the first half of 500 BC. The authoritarian rules of the Greek city states were transformed into democracies by citizens' assemblies. The second grand transformation took place at the end of the eighteenth century when large-scale countries became democracies that required a representation of citizens by parliamentarians. It is now time in a third transformation to accord citizens effective democratic participation. From this point of view the EU is moving in the wrong direction. The same holds for reform proposals which endeavour to strengthen the European Parliament and the European Court of Justice. FOCJ are a promising possibility of strengthening the direct participation of citizens in an effective way by transferring political decisions to the levels most appropriate for the respective problems.

Suggested Further Reading

The regional policy of the EU is discussed in

Commission of the European Communities (1991), *The Regions in the 1990s*, Luxembourg: Office for Official Publication of the European Community.

Scientific analyses are provided by

Cappelin, Ricardo and P.W.J. Batey (eds) (1995), *Regional Networks, Border Regions and European Integration*, London: Pion.

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The goals and activities of the European border regions are discussed in Association of

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The possibilities and shortcomings of courts of account are analysed by Frey, Bruno S. (1994), 'Supreme Auditing Institutions: A Politico-Economic Analysis', *European Journal of Law and Economics*, 1, 169-76.

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Notes

- 1 The Sonderbundskrieg in 1847 brought the conservative Catholic cantons in the centre of Switzerland against the progressive (radical) Protestant cantons. The attempt at secession by the Catholic cantons was prevented by the Protestant army which proved to be victorious in several battles.

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Frey, Bruno S./Eichenberger, Reiner: *The New Democratic Federalism for Europe – Functional, Overlapping and Competing Jurisdictions*, Edward Elgar: Cheltenham, Northampton, 1999, 3–14, 36–43, 57–81. (With the kind permission of the publisher.)