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A New Federalism for an Enlarged Europe

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I. Federalism is good

The Economic Theory of Federalism is based on methodological individualism and therefore demands that citizens' preferences should be fulfilled as far as possible. It yields one clear and overriding result: a federal (i.e. decentralized) state is superior to a centralized one. A federal constitution has three major advantages over a unitary state, provided the federal units (provinces, Länder, states, cantons or communes) have sufficient decision-making rights and taxing power:

(1) *A federal constitution is closer to citizens' preferences.* In all societies, citizens differ widely in their demand for services provided by the state. These differences in demand are not only the result of heterogenous tastes due to differences in tradition, culture, language etc, but also of unequal economic conditions. The latter are caused by, for example, leads or lags in the general business cycle and, of course, special structural conditions such as differences in infrastructure, unemployment, the concentration of particular industries etc.

These differences in the demand for public services must be met by differentiated supply policies if citizens' preferences are to be fulfilled. Federal subunits are best able to meet this challenge because they are better endowed with information about the local requirements. Even more importantly, the politicians in charge have the incentives to provide these services, and to do so in an efficient way, as they are directly accountable for the local policy and their reelection depends on the satisfaction of the voters they represent.[1] In contrast, centralized

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[1] It could be argued that locally elected politicians in central states face also incentives to care for local preferences. However, in many countries, the members of the national parliament are only partly, or not at all, elected in local precincts. In the Federal Republic of Germany, for instance, a substantial share of the members of the Bundestag are not elected by winning in a particular precinct but because they are placed on a list which is controlled by the party they belong to. Moreover, in national parliaments, a local

states tend to produce unitary policies which do less respond to differences in local demands. To take the public education systems as an example, the particular curriculae are homogenized in many centralized countries, even when it is obvious that, e.g., in tourist regions, it would be most important to teach students additional language skills.

(2) *A federal constitution provides public services at a lower cost.* The efficiency of the public sector is extremely important due to the very large size of today's public sectors in terms of the share of government in national income, the proportion of public officials in total employment, the dependence of a substantial portion of the population on income redistributed by government (e.g. in the form of subsidies, social security and old age pensions) and, of course, the many resources that go into tax collection. In federally- organized states, the mechanism of exit and entry gives to the local governmental units incentives to provide the services at lower costs. Individuals and firms which are not satisfied with the balance between the supply and cost of public services may move to jurisdictions where this balance is more favourable. Exit and entry thus establish competition among the various local suppliers of public services, giving them a strong incentive to be efficient. The exit/entry-mechanism does not depend on the full mobility of individuals or firms (there are, of course, costs of moving); it suffices if *some* such mobility is induced (in analogy to the marginal traders leading to equilibrium prices on normal goods markets). Indeed, spatial competition between jurisdictions in a federal system mimics competition among firms for the supply of private goods and services (Tiebout, 1956).

(3) *Federal systems allow more innovation.* A particular local unit finds it less risky to undertake innovations in public goods supply or taxation because the effects are limited and can be better observed and controlled. If the innovation is unsuccessful, not much is lost. However, if it proves to be successful, it will be quickly adopted by other jurisdictions and eventually the entire nation. For this Hayekian process to take place, the innovators must reap at least some of the benefits. This is much more the case when the innovation starts from a clearly-defined local jurisdiction where the success (or failure) can be clearly attributed to the politicians in charge.

Federalism is not an ideal system; there is *no* ideal system. Following the well-established *Comparative Analysis of Institutions,* it is fruitless to judge any existing system with a theoretical optimum (which all are lacking). Rather, a comparison must be made with systems existing in reality. In the case of federalism, it is appropriate to compare it with a centralized state. From this point of view, it has often been alleged that a federal constitution has four major disadvantages compared to a unitary national state:

(1) *Spillover effects, i.e. spatial positive and negative externalities, produce systematic distortions in the allocation of publicly supplied goods and services.* "Fiscal equivalence"

delegates' accountability is low as he is only one of several hundred parliamentarians.

(Olson 1969, Oates 1972) is not secured: some benefits of local public supply go to citizens of other jurisdictions who have not paid the corresponding tax cost (which induces under-supply); some costs are carried by citizens outside a particular jurisdiction (which induces oversupply).

This cause for the distorted allocation of public services cannot be neglected. In reality, it can often be observed that such spillovers are substantial. Part of the fiscal crises of cities can be attributed to that factor. As an example, the cultural institutions (e.g. the opera house) whose costs are carried by the local tax payers but whose benefits are enjoyed by many people living and paying taxes outside the city. Acknowledging that such positive and negative spillovers may be serious under many circumstances, we hereby propose a solution: the size of the jurisdiction should correspond to the "geography of the problems". The distortions caused by spillovers indeed constitute a major reason why we are advancing a new kind of federalism.

(2) *Federal jurisdictions are often too small to exploit economies of scale.* This is a serious problem with existing federalism. Think, for example, of nuclear power plants or universitites, which normally require heavy capital investments for a local jurisdiction (city, commune) to run efficiently.

In our proposal for a new federalism, we are trying to confront the problem directly. We envisage flexible (functional) jurisdictions which are able to adjust to the lowest cost size of investments.

(3) *Federalism makes cooperation difficult or impossible.* This disadvantage of decentralized organization as claimed is only part of the real problem. In federal states, cooperation among the various national sub-units emerges endogenously because it is obviously advantageous for all actors concerned. Moreover, it should be noted that coordination problems also exist within unitary states, in particular among the various national ministries whose competencies and interests overlap. Thus, a unitary state is neither a necessary nor sufficient condition for cooperation to take place.

(4) *Redistribution of income is possible only in a unitary state.* This argument against federalism maintains that when a local unit tries to tax the rich in order to support the poor, the rich will leave and the poor will enter. The redistribution policy therefore cannot be maintained for fiscal reasons.

This argument seems to be quite convincing, and there is certainly much truth in it. However, empirical evidence shows that federalist structures allow for a substantial amount of income redistribution (see, e.g., Gold 1991). An example is Switzerland where the (partly very small) 26 cantons together with about 3000 communities levy more than 80% of total income and capital taxes. Although each canton is free to set its own tax schedule, all cantons rely on

strongly progressive taxes and engage heavily in income redistribution (see Kirchgässner and Pommerehne 1996). Nevertheless, quite a large amount of redistribution exists between rich and poor cantons.

The problem of redistribution in a decentralized governmental system is taken seriously in our proposal for a new kind of federalism. We argue that this may be one of the functions for which the national state is an appropriate jurisdiction (but most likely not the only one).

This contribution pursues two major goals. The *first* is to develop a *new type of federalism* which exploits the strong advantages of federalism spelled out above, but which at the same time avoids the problems as discussed. The *second* goal is to suggest an *application to the case of the European Union*. We believe that our concept - called *FOCJ* - is well-suited for a future European Constitution designed to meet the wishes of the citizens (but not the ones of the classe politique). The present state, as well as the future plans for the European Union have led to considerable dissatisfaction among the population of the various countries in the Union, most notably the new members Austria, Sweden and Finland (see the regular public opinion surveys in the *Eurobarometer*). The problems cannot possibly be solved within the existing "constitution" when the European Union is to be enlarged to the East. Even if the present institutional structure *were* satisfactory - which, from a politico-economic perspective, it is definitely *not* - an increase from 15 to 25 members (the three Baltic states, Poland, Czekia, Slovakia, Slovenia, Hungary, Bulgaria and Romania) *absolutely requires new institutional structures*. A reformed constitution should take into account the widely different level of development as well as the different economic structure of the new members. If this requirement is not met, the European Union will either completely change its nature by becoming a loose association, or will dissolve itself over time. Our proposal suggests a new way to effectively deal with the basic issue of integrating unequal units while maintaining democratic rights and fostering economic development. The new kind of *Eurofederalism* we put forward may seem radical in various respects. But we will show that the concept has been successful in the past as well as today. Thus, we believe that it constitutes an idea worthy of serious consideration.

The paper is organized as follows. Section two specifies the concept of FOCJ, puts it into theoretical perspective, and discusses its main beneficial effects. The third section compares FOCJ to actual and proposed federal institutions in the European Union. The next section shows that FOCJ partially exist in European history and today. The relationship to US-special districts and in particular to functional communities in Switzerland is emphasized. The fifth section discusses how FOCJ can be institutionalized in Europe. Concluding remarks are offered in the last section.

II. Functional federalism is better: FOCJ

FOCJ stands for *functional, overlapping competing jurisdictions*. FOCJ form a federal system of governments that is not dictated from above, but emerges from below as a response to citizens' preferences. For this to become reality, a fifth freedom has to be enacted, which in some way is the political counterpart to the four economic freedoms. It simply allows for such FOCJ. Such a fifth freedom requires a *constitutional decision* (see, e.g., Frey 1983, Mueller 1996) which ensures that the emergence of FOCJ is not blocked by existing jurisdictions such as direct competitors or higher level governments. Every citizen and community must have the right to directly appeal to the European Court if barriers to the competition between governments are established. The European Constitution must give the lowest political units (communities) a measure of independence so that they can engage in forming FOCJ. The citizens must be given the right to establish FOCJ by popular referenda, and political entrepreneurs must be supported and controlled by the institution of popular initiatives. The FOCJ themselves must have the right to levy taxes to finance the public services they provide.

The federal units here proposed have four essential characteristics: they are

- *Functional (F)*, i.e. the new political units extend over areas defined by the tasks to be fulfilled,
- *Overlapping (O)*, i.e. in line with the many different tasks (functions) there are corresponding governmental units extending over different geographical areas;
- *Competing (C)*, i.e. individuals and/or communities may choose to what governmental unit they want to belong, and they have political rights to express their preferences directly via initiatives and referenda;
- *Jurisdictions (J)*, i.e. the units established are governmental, they have enforcement power and can, in particular, levy taxes.

FOCJ are based on theoretical propositions advanced in the economic theory of federalism. They nevertheless form a governmental system completely different to the one suggested in that literature. While the economic theory of federalism (see Bird 1993, Breton 1996, and Inman and Rubinfeld 1997 for surveys on its present state) analyzes the behavior of *given* political units at the different levels of government (Weingast 1993: 292), FOCJ *emerge* in response to the '*geography of problems*'.[2]

[2] As always, there are precursors to FOCJ. The general idea has already been advanced by Montesquieu (we owe this information to one of the referees), but it has, to our knowledge, not been applied to the

The four elements of FOCJ are now related to economic theory as well as to existing federal institutions, pointing out both similarities and differences to existing concepts.

2.1. Functions

A particular public service which only benefits a certain geographical area should be financed by the people living in this area, i.e. there should be no spill-overs. Under this rule, the different political units can cater for differences in the populations' preferences or, more precisely, to its demands. To minimize cost, these units have to exploit economies of scale in production. As these may strongly differ between functions (e.g., between schools, police, hospitals, power plants and defence) there is an additional reason for uni-functional (or few-functional) governmental units of different sizes. While this idea is central to 'fiscal equivalence' as proposed by Olson (1969) and Oates (1972), the endogeneity of the size of governmental units constitutes an essential part of FOCJ.

However, fiscal equivalence theory has been little concerned with decision-making within functional units. The supply process is either left unspecified or it is assumed that the mobility of persons (and of firms, a fact rarely mentioned) automatically induces these units to cater for individual preferences. This criticism also applies to a closely related concept of fiscal federalism, namely 'voting by foot' (Tiebout 1956). This preference revealing mechanism makes comparatively efficient suppliers grow in size, and the others shrink. According to this model of federalism, the political jurisdictions are exogenously given, are multi-purpose, and do not overlap, while the political supply process is left unspecified. In contrast, we emphasize the need to explicitly study the political supply process. In line with Epple and Zelenitz (1981), exit and entry is considered insufficient to eliminate rent extraction by governments. Individuals must have the possibility to raise voice in the form of voting. Buchanan's 'clubs' (see Buchanan 1965, Sandler and Tschirhart 1980) are similar to FOCJ because their size is determined endogenously by the benefits and costs of the club members.

2.2. Overlaps

FOCJ may overlap in two respects: (i) two or more FOCJ catering for the same function may geographically intersect (e.g., a multitude of school FOCJ may exist in the same

European Union. In the economics literature a related concept has been pioncered by Tullock (1994), who somewhat misleadingly speaks of 'sociological federalism'. Casella and Frey (1992) discuss the concept and refer to relevant literature. A recent Centre for Economic Policy Research Publication (CEPR 1993) shortly mentions the possibility of establishing overlapping jurisdictions in Europe (pp. 54-55) but does not work out the concept nor does it refer to previous research (except for Drèze 1993 on secession).

geographical area); (ii) FOCJ catering to different functions may overlap. The two types of overlap may coexist; however, a constitutional decision can be taken to restrict FOCJ of specific functions to the second type because this alleviates free-riding problems (see below). An individual or a political community normally belongs to various FOCJ at the same time. FOCJ need not be physically contiguous, and they need not have a monopoly over a certain area of land. Thus, this concept completely differs from archaic nationalism with its fighting over pieces of land. It also breaks with the notion of federalist theory that units at the same level may not overlap. On the other hand, in this respect it is similar to Buchanan type clubs which may intersect.

2.3. Competition

The heads of FOCJ are induced to conform closely to their members' preferences by two mechanisms: while the individuals' and communities' possibilities to *exit* mimics market competition (Hirschman 1970), their right to *vote* establishes political competition (see Mueller 1989). It should be noted that migration is only one means of exit; often, membership in a particular FOCUS can be discontinued without changing one's location. Exit is not restricted to individuals or firms; as said before, political communities as a whole, or parts of them may also exercise this option. Moreover, exit may be total or only partial. In the latter case, an individual or community only participates in a restricted set of FOCUS activities. This enlarged set of exit options makes 'voting by foot' to function properly.

The importance of 'secession' (i.e. exit of jurisdictions such as communities) for restricting the power of central states has been recognized in the literature (e.g., Zarkovic Bookman 1992, Drèze 1993). Secession has been suggested as an important ingredient for a future European constitution (Buchanan 1991, European Constitutional Group 1993). The right to secede stands in stark contrast to the prevailing concepts of nation states and federations where this is strictly forbidden and often prevented by force, as is illustrated, e.g., by the American Civil War 1861-1865, by the Swiss 'Sonderbundskrieg' 1847, or more recently by the wars in Katanga (1960-63), Biafra (1967-70), Bangladesh (1970-71), and in this decade in Ex-Yugoslavia. Current European treaties do not provide for the secession of a nation from the European Union, and *a fortiori* for part of a nation. The possibility of lower-level jurisdictions to exit at low cost from the European Union as a whole as well as from particular subunits (nations, states, Länder, autonomous regions, etc.) thus depends strongly on the future European constitution.

For FOCJ to establish competition between governments, exit should be as unrestrained as possible. In contrast, entry need not necessarily be free. As for individuals in Buchanan-type clubs, jurisdictions may be asked a price if they want to join a particular FOCUS and

benefit from its public goods. The existing members of the particular FOCUS have to democratically decide whether a new member pays an adequate entry price and thus is welcome. 'Free' mobility in the sense of a disregard for the cost imposed on others is overcome by internalizing the external cost of movement. In addition, FOCJ do not have to restrict entry by administrative and legal means such as zoning laws. Explicit, openly declared entry fees substitute implicit restrictions resulting in high land prices and housing rents. The commonly raised concern that pricing could be exploitative and mobility strongly curtailed is unwarranted as FOCJ are subject to competitive pressure. Moreover, the possibility to impose an explicit entry fee gives incentives to FOCJ-governments to care not only for the preferences of actual, but also of prospective members.

Competition needs to be furthered by political institutions as the exit option does not suffice to induce governments to act efficiently. The citizens should directly elect the persons managing the FOCJ, and should be given the right to initiate popular referenda on specific issues. These democratic institutions are known to raise efficiency in the sense of caring well for individual preferences (for elections, see Downs 1957, Mueller 1989; for referenda Cronin 1989, Frey 1994).

2.4. Jurisdictions

A FOCUS is a democratic governmental unit with authority over its citizens, including the power to tax. According to the two types of overlap, two forms of membership can be distinguished: (i) The lowest political unit (normally the community) is a member, and all corresponding citizens automatically become citizens of the FOCJ to which their community belongs. In that case, an individual can only exit via mobility. (ii) Individuals may freely choose whether they want to belong to a particular FOCUS, but while they are its citizen, they are subject to its authority. Such FOCJ may be non-voluntary in the sense that one must belong to a FOCUS providing for a certain function, e.g., to a school-FOCUS, and must pay the corresponding taxes (an analogy here is health insurance which in many countries is obligatory but where individuals are allowed to choose an insurance company). The citizens of such a school-FOCUS may then decide that everyone must pay taxes in order to finance a particular school, irrespective of whether one has children. With respect to FOCJ providing functions with significant redistributive effects, a minimal regulation by the central government may be in order so that, e.g., citizens without children do not join 'school-FOCJ' which in effect do not offer any schooling but have correspondingly low (or zero) taxes. In this respect, Buchanan-type clubs differ from FOCJ, because they are always voluntary while membership in a FOCUS can be obligatory.

FOCJ as jurisdictions provide particular services but do not necessarily produce them themselves if contracting-out to a public or private enterprise is advantageous. It is

noteworthy that present-day outsourcing by communities does not automatically lead to FOCJ. The former is restricted to production, while FOCJ care for provision and are directly democratically controlled. FOCJ also differ from existing functional and overlapping institutions such as the various kinds of specific administration unions (or *Zweckverbände* as they are aptly called in German speaking countries). These institutions normally do not have the legal status of governments but are purely administrative units. The same applies to the many types of corporations which usually have no power to tax but have to rely on charges.

2.5. Beneficial Effects

Due to its four essential characteristics, FOCJ compare favorably to traditional forms of federalism. One aspect concerns the governments' incentives and possibilities to satisfy heterogeneous preferences of individuals. As a consequence of the concentration on one functional area, the citizens of a particular FOCUS have better information on its activity, and are in a better position to compare its performance to other governments. As many benefits and costs extend over a quite limited geographic area, we envisage FOCJ to be often small which is also helpful for voters' evaluations. The exit option opened by the existence of overlapping jurisdictions is not only an important means to make one's preferences known to governmental suppliers but it also strengthens the citizens' incentives to be informed about politics (Eichenberger 1994).

On the other hand, FOCJ are able to provide public services at low cost because they are formed in order to minimize interjurisdictional spill-overs and to exploit economies of scale. When the benefits of a specific activity indivisibly extend over large areas, and there are decreasing cost, the corresponding optimal FOCUS may cover many communities, several nations, or even Europe as a whole. An example may be defence against outward aggression where the appropriate FOCUS may most likely extend over the whole of Europe (even beyond the European Union). That such adjustment to efficient size is indeed undertaken in reality is shown by the Swiss experience. Communities decided by referendum whether they wanted to join the new canton Jura established in 1978, and in 1993 communities in the Laufental opted to belong to the canton Basel-Land instead of Berne. Communities also frequently change districts (the federal level below cantons) by referendum vote, which suggest that voters perceive the new size of jurisdictions and the new bundle of services to be more efficient. The same holds for American special districts.

The specialisation on one or a few functions further contributes to cost efficiency due to the advantages of specialisation. As FOCJ levy their own taxes to finance their activity, it pays to be economical. In contrast, in APJ (All-Purpose Jurisdictions) financed from outside lacking such fiscal equivalence, politicians have an incentive to lobby for ever

increasing funds, thereby pushing up government expenditures. The incentive to economize in a FOCUS induces its managers to contract-out whenever production cost can thereby be reduced. While FOCJ are more market oriented than APJ, they reduce the size of the public sector. However, they differ from today's one-shot privatization, which usually does not impact on the governments basic incentives and thus is often reversed by reregulation and deprivatization. In contrast, in a system of FOCJ privatization emerges endogenously and is sustainable, as the politicians incentives are changed fundamentally.

The threat of dissatisfied citizens or communities to exit the FOCUS, and the benefit of new citizens and communities joining, gives an incentive to take individual preferences into account and to provide the public services efficiently. Quite another advantage of FOCJ is that they open up the politicians' cartel ('classe politique') to functionally competent outsiders. While all-purpose jurisdictions attract persons with broad and non-specialized knowledge to become politicians, in FOCJ rather persons with a well-grounded knowledge in a particular functional area (say education or refuse collection) are successful.

The possibility to form FOCJ helps to deal with issues raised by fundamentalist sentiments. Political movements focused on a single issue (e.g., ethnicity, religion, environment, etc.) are not forced to take over governments *in toto* but can concentrate on those functions they are really interested in. An ethnic group need not disassociate itself from the state they live in as a whole but may found FOCJ which care for their particular preferences. South Tyroleans, for example, unhappy with the language domination imposed by the Italian state, need not leave Italy in order to have their demands for cultural autonomy fulfilled, but may establish corresponding FOCJ. Such partial exit (e.g., only with respect to ethnic issues) does not lead to trade barriers often going with the establishment of newly formed all purpose political jurisdictions. FOCJ thus meet the criterion of market preserving federalism (see Weingast 1993).

A federal web composed of FOCJ certainly affects the role of the nation states. They will certainly lose functions they presently do not fulfil according to the population's preferences, or which they produce at higher cost than FOCJ designed to exploit cost advantages. On the other hand, the scheme does not purport to do away with nations but allows for multi-national as well as small scale alternatives where they are desired by the citizens. Nation states subsist in so far as they provide functions efficiently according to the voters' preferences.

III. FOCJ vs. other visions of Europe

FOCJ differ in many crucial respects from scholarly *proposals* for a future European constitution. One of the most prominent was Buchanan's (1991) who stresses individual nation's right to secede but, somewhat surprisingly, does not build on Buchanan-type clubs. The European Constitutional Group (1993) focuses on the example of the American constitution,

and presents constructivist proposals with respect to the houses of parliament and the respective voting weights of the various countries. Overlapping jurisdictions and referenda are not allowed for, and the exit option is strongly restricted. Other economics scholars (e.g., Blöchliger and R.L. Frey 1992, Schneider 1992) suggest a strengthening of federalism in the traditional sense (i.e. with multi-purpose federal units) but do not envisage overlapping jurisdictions. The report by the Centre for Economic Policy Research (1993) criticises 'subsidiarity' (as used in the Maastricht Treaty) as an empty concept arguing that good theoretical reasons must be provided for central government intervention. But the report does not deal with the institutions necessary to guarantee that policy follows such theoretical advice. The idea of overlapping, not geographically based jurisdictions is shortly raised (p. 54-5) but is not institutionally or practically worked out, nor is the need for a democratic organization and the power to tax acknowledged.

The recent proposal from politicians (Herman report of the European Parliament, 1994) mainly deals with the organization of the parliamentary system (the houses of parliament and the national vote weights) and to a substantial extent accepts the existing treatises as the founding blocks of the European constitution. The idea of competition between governments (which is basic for FOCJ) is neglected or even rejected in favor of 'cooperation' between governments.

FOCJ are also quite different from the regions envisaged in existing *European treaties* and *institutions* (see, e.g., Adonis and Jones 1991). A major difference is that FOCJ emerge from below while the 'European regions' tend to be established from above. Moreover, their existence strongly depends on the subsidies flowing from the European Union and the nation states (Sharpe 1993). In contrast, the concept of FOCJ corresponds to Hayek's (1960) (and Buchanan's) non-constructivist process view. It cannot a priori be determined from outside and from above which FOCJ will be efficient in the future. This must be left entirely to the competitive democratic process taking place at the level of individuals and communities. The central European constitution must only make sure that no other government units, in particular the nations, may obstruct the emergence of FOCJ (see section V). In contrast to Hayek, however, our scheme allows for a (closely restricted) set of central regulations, as mentioned above. Moreover, Hayek measures efficiency by survival in the evolutionary process while we define efficiency more directly in terms of the fulfilment of citizens' demands.

'Subsidiarity' as proclaimed in the Maastricht Treaty is generally recognized to be more a vague goal than a concept with content (see, e.g., Centre for Economic Policy Research 1993: 19-23). Even if subsidiarity were taken seriously, it would not lead to a real federal structure because many (actual or prospective) members of the European Union are essentially unitary states without federal subunits of significant competence (examples are the Netherlands, France or Sweden). The 'regions' existing in the European Union (examples are Galicia and Cataluña in

Spain, or South Tyrol and Sicily in Italy) are far from being units with significant autonomous functional and fiscal competencies.

The Council of Ministers is a European decision making institution based on federal principles (but nations only are represented) and organized according to functional principles (or at least according to the corresponding administrative units). However, this Council is only indirectly democratic (the ministers are members of governments which are democratically legitimized by the representative system) and the deliberations are not public. Exit from the European Union is not formally regulated, and exceptions to specific aspects of agreements reached (as in the Maastricht Treaty concerning the European Monetary Union and the Protocol on Social Policy, or in the Schengen Treaty concerning the free movement of persons) are granted reluctantly. Indeed, they are seen as damaging the 'spirit of Europe'. Whether differential degrees of European integration are framed as models of variable geometry, multi-track, multi-speed, two-tier, hard core, concentric circles, or as Europe à la carte (The Economist, 1994, Oct. 22, Survey of the European Union, p. 15, Pitschas 1994), it always evokes 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.

IV. Future FOCJ and their predecessors

4.1. Opportunities for the Future

A careful consideration reveals, that there is a wide range of functional issues to which FOCJ could profitably be applied. A practical example is the policing of the Lake of Constance (which borders on two German Länder, two Swiss Cantons, and one Austrian Land) which involves the regulation of traffic, environmental protection, the suppression of criminal activities and the prevention of accidents. Formally, the various local police departments are not allowed to directly collaborate with each other, not even to exchange information. Rather, they must advise the police ministries of the Länder and cantons, which then have to notify the respective central governments which then interact with each other. Obviously, such a formal procedure is in most cases vastly inefficient and unnecessarily time consuming. In actual fact, the problems are dealt with by direct contact among the local police commissioners and officers. However, this is outside the law and depends to a substantial extent on purely personal relationships (which may be good or bad). A FOCUS committed to policing the lake would allow a pragmatic, problem oriented approach within the law - and would, moreover, be in the best 'spirit' of Europe.

FOCJ are not restricted to such small-scale functional issues but are relevant for all levels of government and major issues. An example would be Alsace which, while remaining a part of France in other respects, might partially exit by joining, say, the German social security or

school system (with German as the main language), or might join a university-FOCUS involving the Swiss university of Basle and the German universities of Freiburg and Karlsruhe. Actually, the first steps for establishing such a university-FOCUS are under way. But these efforts contrast with the idea of regions as set out in the Maastricht Treaty (and elsewhere), not least because one of the participants (the university of Basle) is not part of the European Union. Another example refers to Corsica which according to Drèze's (1993) suggestion should form an independent region of Europe because of its dissatisfaction with France. However, most likely the Corsicans are only *partially* dissatisfied with France. This suggests that one or several FOCJ provide a better solution in this case; they may, e.g., especially focus on ethnic or language boundaries, or on Corsica's economic problems as an island. This allows the Corsicians to exit France only partially instead of totally. Quite generally, tourism and transport issues, in particular railroads, are important areas for FOCJ. It should be noted that, despite the membership of various countries in the (then) European Community, railroad policy was not coordinated to exploit possible economies of scale; a FOCUS may constitute a well-suited organization to overcome such shortcomings.

4.2 Contemporary and historical Examples

The European Community started out as a FOCUS designed to establish free trade in Europe, and was from the very beginning in competition with other trade areas, in particular North America, Japan, and EFTA. Due to its economic success, it has attracted almost all European countries. But entry has not been free but the nations determined to enter had to pay a price. They have (with partial exceptions) to accept the 'acquis communautaire' as well as to pay their share to the Communities' outlays which to a large extent serve redistributive purposes. In several respects there exist FOCJ-like units within Europe such as with respect to police, education, environment, transport, culture or sports though they have been prevented to become autonomous jurisdictions with taxing power.

Most of these functional units are not contiguous with the area of the European Union. Some are smaller (e.g., those organized along ethnic or language functions), and some are larger. Several East European countries and Switzerland which are not EU-members are certainly fully involved in, e.g., European culture, education or crime. FOCJ of the nature understood in this paper may therefore build upon already existing structures, and are in the best of European traditions.

There are two countries in which functional, overlapping and competing jurisdictions exist (though they do not in all cases meet the full requirements of FOCJ specified above).

United States. Single-purpose governments in the form of 'special districts' play a significant role in the American federalist system (ACIR 1982, 1987, Burns 1994). Their number has

strongly increased, between 1967 and 1972 by 30.4 per cent, between 1972 and 1984 by 19.7 per cent, in both cases more quickly than other types of jurisdictions (Zax 1988). There are both autonomous and democratically organized as well as dependent special districts (e.g., for fire prevention, recreation and parks). Empirical research suggests that the former type is significantly more efficient (Mehay 1984). Our theoretical hypothesis of the opposition of existing jurisdictions against the formation of special districts is well borne out. In order not to threaten the monopoly power of existing municipalities statutes in 18 states prohibit new municipalities within a specified distance from existing municipalities (ACIR 1982, Zax 1988: 81); in various states there is a minimum population size required and various other administrative restrictions have been introduced (see, e.g., Nelson 1990). Empirical studies reveal that these barriers imposed by Local Agency Formation Commissions (LAFCO) tend to reduce the relative efficiency of the local administration (Di Lorenzo 1981, Deno and Mehay 1985), and tend to push upwards the local government expenditures in those municipalities which have introduced LAFCOs (Martin and Wagner 1978).

Switzerland. Many Swiss cantons have a structure of overlapping and competing functional jurisdictions which share many features of FOCJ. In the canton Zurich (with a population of 1.2 mio), e.g., there are 171 geographical communities which in themselves are composed of three to six independently managed, direct-democratically organized communities devoted to specific functions and levying their own taxes on personal income: besides general purpose communities, there are communities that exclusively provide for elementary schools and other ones specializing in junior high schools, and there are the communities of three different churches. All these governmental units have widely differing rates of income taxes. Moreover, there is a vast number of 'civil communities' (Zivilgemeinden) providing water, electricity, TV antennas etc. which are direct-democratic but finance themselves by user charges. These communities often overlap with neighbouring political communities. In addition there are 174 functional units (*Zweckverbände* as they are aptly called in German speaking countries) whose members are not individual citizens but communities. These Zweckverbände care, e.g., for waste water and purification plants, cemeteries, hospitals and regional planning. The canton Zurich is no exception in Switzerland concerning the multitude of types of functional communities. A similar structure exists, e.g., in the canton Glarus or Thurgau (for the latter, see Casella and Frey 1992). Various efforts have been made to suppress this diversity of functional communities, usually initiated by the cantonal bureaucracy and politicians. However, most of these attempts were thwarted because the population is mostly satisfied with the public supply provided. The example of Switzerland - which is generally considered to be a well-organized and administered country - shows that a multiplicity of functional jurisdictions under democratic control is not a theorist's wishful thinking but has worked well in reality.

Decentralized, overlapping political units have also been an important feature of European history. The competition between governments in the Holy Roman Empire of German Nations, especially in today's Italy and Germany, has been intensive. Many of these governments were of small size. Not few scholars attribute the rise of Europe to this diversity and competition of governmental units which fostered technical, economic and artistic innovation (see, e.g., Hayek 1960, Jones 1981, Weede 1993 and Baumol and Baumol 1994 who also give a lively account of how the musical genius of Wolfgang Amadeus Mozart benefited from this system of government). While the Chinese were more advanced in very many respects, their superiority ended with the establishment of a centralized Chinese Empire (Pak 1995, Rosenberg and Birdzell 1986). The unification of Italy and Germany in the 19th century, which has often been praised as a major advance, partially ended this stimulating competition between governments and lead to deadly struggles between nation states.[3] Some smaller states escaped unification; Liechtenstein, Luxembourg, Monaco, San Marino and Switzerland stayed politically independent, and at the same time grew rich.

The above mentionned governmental units were not FOCJ in the sense outlined in this contribution but they shared the characteristic of competing for labor and capital (including artistic capital) among each other. However, history also reveals examples of jurisdictions close to FOCJ. The problems connected with Poland's strong ethnic and religious diversity (Catholics, Protestants and Jews) were at least partly overcome by jurisdictions organized along these features, and not along geography (see, e.g., Rhode 1960, Haumann 1991). The highly successful Hanse prospered from the 12th to the 16th century, and comprised inter alia Lübeck, Bremen, Köln (today German), Stettin and Danzig (today Polish), Kaliningrad (today Russian), Riga, Reval and Dorpat (today parts of the Baltic republics) and Groningen and Deventer (today Dutch); furthermore, London (England), Bruges and Antwerp (today Belgian) and Novgorod (today Russian) were *Handelskontore* or associated members. It clearly was a functional governmental unit providing for trade rules and facilities and was not geographically contiguous.

V. How to institutionalize FOCJ in Europe?

The concept of FOCJ is purely process-oriented. Thus, it is neither possible to determine at the European nor at the national level all the functions which should be provided by FOCJ and how these entities should be organized. The internal organization of a particular FOCUS lies alone in

[3] According to Sperber (1994, p. 24), in the first half of the 19th century average income was higher in strongly decentralized Germany than in strongly centralized France, which may at least partly be attributed to the difference in the degree of centralization.

the competence of the communities and individuals who decide to found such a jurisdiction. Nevertheless, it is possible to specify the conditions for FOCJ to emerge and to fulfill their tasks effectively. Thus, our proposal follows the logic of constitutional economics which aims at designing beneficial decision processes without closely defining the outcomes (Buchanan and Tullock 1962, Mueller 1996).

FOCJ, however, have to match one condition with respect to content: They have to guarantee economic and political competition. Only then will markets emerge which work properly. Not only traditional governments, but also the governing bodies of FOCJ pursue their own interests and tend to undermine competition and to build cartels or even monopolies. Therefore, a "competition supervisory board" has to monitor the respective rules:

(1) The economic markets have to be open; in particular, the four freedoms referring to the free movement of goods, services, and capital, and the free mobility of individuals have to be secured.

(2) The political markets have to be competitive, i.e. the human rights and the fundamental democratic rights have to be secured to the full extent. This includes the right of the citizens to make use of the instruments of direct democracy. The competition supervisory board has also to fix rules for determining the ceiling on entry and exit fees. If they are too high, mobility is hampered. However, such prices for mobility prove effective in preventing individuals from exploiting the redistributive policies in FOCJ.

Regulative measures may also be necessary to enable FOCJ to supply public services effectively - as has been discussed above for the case of school-FOCJ. In such cases, it may be advantageous to declare membership in a FOCUS to be obligatory, and to fix minimum levels for the services to be supplied. The competition supervisory board must be given the competencies to step in if such regulations are violated. This board has to be empowered in a constitutional decision at the European level. It would be mistaken to delegate the monitoring of competition among FOCJ to the national bureaucracies which are interested in restricting FOCJ. Rather, an independent agency seems appropriate. A possible solution is a constitutional court (in the European Union the European Court). Although even such institutions tend to favor national at the cost of regional and local interests, they tend to decide less biasedly than national governments.

Functional jurisdictions can only be founded if two conditions are met:

(1) The foundation and the operation of FOCJ must be a constitutionally guaranteed right - the *fifth freedom*, as we would like to call it. The newly founded political units must be allowed to operate as jurisdictions with (restricted) enforcement rights. The power to tax in order to

finance a clearly specified service is the key to efficiency. However, this right of FOCJ will be disputed by other political units of all levels because part of their tax base will be lost.

Principally, the communities (as the lowest level political units) as well as individuals in the constitution should be allowed to form FOCJ. However, depending upon the function to be fulfilled, membership may be restricted to the former. It is, e.g., well possible that individuals form a FOCUS which provides a special type of schooling; for other services, especially for those with stronger public good appeal, e.g., waste water treatment or local police, communities or parts of them are the "natural" agent. It is important to note that it must not be decided at the European level to which of those two classes a function belongs. This decision can be left to the local level itself.

(2) The formation of FOCJ may not be blocked by existing political units. As a most important consequence, the higher level political units have to appropriately reduce the taxes of those citizens who become members of a FOCUS or of various FOCJ providing governmental services. The competition supervisory board has to force the existing units to openly declare the cost, i.e. the tax prices of the various services they provide. These "tax price lists" can then serve to fairly rebalance the tax rate of the citizens who receive services from newly emerging FOCJ instead of from traditional political units. The existing governments' tendency to underrate the cost in order to minimize tax reductions to FOCJ members can be broken simply by demanding that the tax prices for a specific service not only serves to compensate exiting citizens, but also to tax former and newly entering service recipients. This rule makes the market for politics contestable. The potential existence of FOCJ is enough to compel all levels of government to give an account of the real cost of their services.

It need not be said that existing political units will use all possible measures to impede the new competitors. The competition supervisory board has no easy job. Again, the constitutional court seems to be the appropriate institution to undertake this task. It has, however, to rely on the competencies of the "Rechnungshof" to control the calculations of the tax prices. This latter institution has the necessary knowledge which has so far been wasted as the "Rechnungshof" was only allowed to formulate non-binding recommendations.

VI. Summary

Functional, overlapping, and competing jurisdictions provide a radical alternative to today's policy in Europe. FOCJ emerge from below and finance their services themselves. Nevertheless, they are "European" with several respects. Most importantly, this concept relies on diversity as a main characteristic of Europe. Thus, it takes up the favorable properties of a Europe of variable geometry, multi-speed, concentric circles, flexible integration or even of Europe à la carte.

FOCJ provide an opportunity to promote European integration without abandoning democracy and diversity. They allow to broaden and deepen Europe at the same time. It seems impossible for the many Eastern European countries to enter European Union by accepting the "acquis communautaire". The differences in income between them and today's members are much too wide; the transfers necessary to integrate them in the "old stile" cannot be financed. The one remaining alternative to the EU - to maintain its structure and exclude the Eastern countries - threatens to end in stagnation and even disintegration. In contrast, the other alternative - to foster flexible integration - seems much more promising. Such flexible integration can be favorably achieved by FOCJ.

European integration can also be deepened by FOCJ - provided that integration is not understood as progressive standardization of political, societal, and economic conditions but as reciprocal recognition of diversity and the cooperation in catering for diverse preferences. Functional, overlapping, and competing jurisdictions are able to brake up dividing national borders and separating political structures. The fifth freedom gives Europe a unified framework to foster the political influence of the citizens directly concerned by designing the map of political authority according to the geography of problems.

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