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## Beyond Traditional Borders: A New Proposal for Federalism

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### Summary

A federal, i.e. decentralized, state is superior to a centralized one because it fulfills the preferences of the citizens more effectively. However, it is also faced with major problems. Therefore, a new kind of democratic federalism for Europe is proposed which maintains the great advantages of federalism but which overcomes its most important weaknesses. Functional, overlapping, and competing jurisdictions (FOCJ) emerge in response to the 'geography of problems'. This concept suggests that prospective new member countries of the European Union should have the possibility of partially entering the EU with respect to functions where they expect positive net benefits.

**KEYWORDS:** Federalism, European Union, Citizens' Preferences, Efficiency

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This year, the citizens of several European countries will decide whether or not they want to accept the proposed constitution of the European Union. This is an important event, as the number of people in the EU already exceeds the number of people in the United States. The EU is destined to play an even greater economic role in the world.

The essential concept of the proposed EU constitution is based on the traditional concept of territorial states. The constitution maintains the various nations as the actors and the central EU authorities see to it that compliance is enforced. Already now, the EU commission has promulgated an immense number of regulations and directives, and acceptance of the proposed constitution will strengthen this tendency even more. The basic idea of having a decentralized (federal) unification of countries is excellent. However, the proposed EU constitution undermines this idea in two ways. First, there are marked centralist tendencies. This may even lead the citizens of certain countries, in particular the United Kingdom, to reject the proposed constitution. Second, the traditional national borders are taken to be sacrosanct, although in many cases economic activity develops according to totally different rules. Accepting nations as the only relevant actors makes cooperation from sub-national actors nearly impossible. As a consequence, future economic challenges cannot be adequately met. I therefore propose a new democratic federalism for Europe, designed to overcome these problems, and leading the discussion on federalism in a completely new direction. Proponents of a decentralized state rightly argue that it is superior to a centralized one because it fulfills the preferences of the citizens more effectively. Federal units (provinces, states, cantons or communes) with sufficient decision-making rights and the right to impose taxes have major advantages over a unitary state.

First of all, decentralized units are *more flexible*. Due to differences in tradition, culture or language, or due to unequal economic conditions, citizens differ considerably in what services they require from the government. If citizens' preferences are to be fulfilled, these differences in the demand for public services need to be met by differentiated supply policies. Federal subunits are best able to meet this challenge. The politicians in charge are familiar with the local requirements. They have incentives to provide these services according to the preferences of the citizens, because they are directly accountable for local policy.

A second major advantage of federal countries is that they are *more efficient*. Efficiency is enhanced by facilitating people's exit and entry. Individuals and firms not satisfied with the balance between the supply and cost

of public services may move to jurisdictions where this balance is more favorable. Exit and entry thus establish competition among the various local suppliers of public services, giving them a strong incentive to be efficient.

Federal systems are also *more innovative*. Innovations in the supply of public goods, or in the area of taxation, can be implemented first in those local units where the conditions are most likely to guarantee success. Moreover, 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 not successful, little will have been lost. However, if it proves to be successful, it will be quickly adopted by other jurisdictions.

In spite of these marked advantages, federalism is not an ideal system. But then there is *no* ideal system. Compared to a centralized state, opponents emphasize that a federal constitution is faced with two major problems.

Positive and negative externalities may *spill over* beyond the federal boundaries. As a result, there are systematic distortions in the allocation of publicly supplied goods and services. "Fiscal equivalence" is not secured: some benefits of local public supply go to citizens of other jurisdictions who have not paid the corresponding taxes (which induces under-supply); some costs are carried by citizens outside of a particular jurisdiction (which induces oversupply). Such spillovers may be substantial: part of the fiscal crises of cities can be attributed to that factor.

The second major problem of federal jurisdictions is that they are often *too small to exploit economies of scale*, and to be run at low cost. Nuclear power plants or public universities are examples.

As a consequence of these shortcomings of federalism, it is often concluded that the future lies in even larger political units. This is indeed what has happened in several European countries. One example is Southern Germany (the Land of Baden-Wuerttemberg), where the number of independent communes has been drastically reduced in an attempt to reap economies of scale. In many areas, such a policy is considered to indicate dynamism and future orientation. In actual fact, however, the abolishing of independent jurisdictions rarely, if ever, produces the expected cost reductions in administrative costs. But, in every case, political decision-making is removed from the citizens.

The new kind of federalism proposed here departs from the notion that national and sub-national borders are sacrosanct. It maintains the great advantages

of federalism and, at the same time, attempts to overcome its main weaknesses. This concept, developed jointly with Reiner Eichenberger of the University of Fribourg, is called FOCJ, according to the four essential characteristics of our proposal:

- *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 which 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, can be enforced and can, in particular, levy taxes to finance the public services they provide.

These *functional, overlapping, and competing jurisdictions* form a federal system of governments that is not to be dictated by some high place, but emerges from below as a response to citizens' preferences. It must be ensured that the emergence of FOCJ is not blocked by existing jurisdictions, such as direct competitors or higher levels of government. The citizens should be given the right to establish FOCJ by popular referenda, and political entrepreneurs should be supported and controlled by the institution of popular initiatives. The FOCJ themselves must have the right to levy taxes. The concept of FOCJ leads to a governmental system that is completely different to the one suggested in the literature. While the economic theory of federalism analyzes the behavior of *given* political units at the different levels of government, FOCJ *emerge* in response to the "*geography of problems*."

Due to its four essential characteristics, FOCJ compare favorably to traditional forms of federalism. As a result of the concentration on one functional area, the citizens of a particular FOCUS are better informed about its activities, 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, FOCJ will often be small, which is also helpful when it comes to 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 is also a way of strengthening the citizens' incentives to be informed about politics.

Furthermore, FOCJ are able to provide public services at low cost, because they are formed in order to minimize inter-jurisdictional spillovers and to exploit economies of scale. When the benefits of a specific activity extend indivisibly over large areas, and there are decreasing costs, the corresponding optimal FOCUS may cover many communities or even several nations. The threat of dissatisfied citizens or communities exiting a particular 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 as efficiently as possible.

Functional, overlapping, and competing jurisdictions exist to some extent in two countries, which are generally considered to be well-organized and well administered. In the United States, single-purpose governments, in the form of special districts, play a significant role. In Switzerland, many cantons have a structure of overlapping and competing functional jurisdictions that share many features of FOCJ. The example of Switzerland suggests that a multiplicity of functional jurisdictions under democratic control are not just a theorist's wishful thinking, but have proved to work well in reality.

### **Applying FOCJ to the European Union**

The new federalism concept of FOCJ can be illustrated by the example of integration into the European Union. In its present form, EU-enlargement solves some old problems, but at the same time creates many new problems. With progressing enlargement, the economic, social and institutional disparities increase among the member countries. The promised integration of Turkey will soon be followed by Bulgaria and Rumania, and most probably by several other countries (for instance in North Africa), which are even more diverse than the existing 25 members.

Such prospective new member countries cannot meet, in due course, the formal requirements regulating the entry into the European Union. These requirements stipulate that acceding states must politically have a stable democracy, follow the rule of law and observe human rights; and economically must have a functioning market economy. Moreover, they must fully accept the "acquis communautaire," containing all the directives issued so far.

The present EU member states are unlikely to offer poorer and poorer applicant countries the free movement of labor, and integrate them into the EU income redistribution mechanisms. The negotiations will therefore extend over a far longer period than desired by the applicants. Long adjustment periods will have to be granted. Most importantly, the free movement of labor will be blocked, while the countries applying for membership will ask for exemptions from the free movement of goods, services and capital.

This concept of FOCJ suggests a basically different approach to integration. Countries should have the possibility of *partially* entering the European Union, rather than the all or nothing decision to accept the whole *acquis communautaire* in one go. Countries wanting to be more integrated with the EU should have the option of entering with respect to functions where they expect positive net benefits, and staying out with respect to functions where this is not the case. An example would be the Maghreb countries of North Africa (Morocco, Algeria and Tunisia), who at the present time are not ready to become full members of the European Union. But the concept of FOCJ would allow them, for instance, to form a free trade union with the EU. Another example is Switzerland (it is not an EU-member, mainly because the Swiss consider the EU not to be democratic enough and to be too centralist), which could partly join the EU with respect to the law on competition, but not with respect to other functions. The concept of FOCJ would also allow a particular canton of Switzerland to join the Schengen-agreement on border controls in order to intensify its contacts with neighboring jurisdictions within the EU, but allow the same canton to remain in the Swiss context with respect to other functions. As a result of such partial, functional associations extending beyond present borders, a web of overlapping jurisdictions would emerge. With FOCJ, variable geometry is a desirable feature of integration rather than a shortcoming.

FOCJ provide a feasible institutional procedure to integrate whole countries, or parts of countries, which want to be more closely integrated into the EU, but which cannot achieve, or do not want to have, full membership. FOCJ allow for partial integration on the basis of economic efficiency and democratic rules. The functional jurisdictions proposed to straddle areas of the European Union and non-members alike may not only overcome the huge economic and financial obstacles, but may also introduce a democratic element helping to rectify the "democratic deficit" of the EU.

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### **References and Further Reading**

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