

In: Lüder Gerken (Hrsg.), Competition among  
Institutions. MacMillan Press LTD,  
Basingstoke, Hampshire and London und  
St. Martin's Press INC., New York, 1995,  
S. 209-229.

# 8 Competition among Jurisdictions: The Idea of FOCJ\*

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## 1 MONOPOLY VS COMPETITION OF GOVERNMENTS

The single European *economic* market has been a great success. The four freedoms relating to the movement of goods, services, labour and capital have without doubt significantly increased the welfare of the citizens within the European Union. With respect to *politics*, including economic policy, the picture is rather different. Essentially, one institution, the European Commission and its bureaucracy, has established itself as a *monopoly government* for European affairs, despite its so far limited powers. This paper argues that similar welfare improvements as in economic affairs could be reached in political affairs as well, provided the European Constitution allows for, and actively supports, *competition between governments at all levels*. The competition between already existing governments must be preserved but in addition a future European Constitution should foster the emergence of competitive new jurisdictions best serving individual preferences. These new governmental units are called FOCJ. The acronym relates to its four major characteristics:

- F = *functional*, i.e. the new political units extend over areas defined by the tasks to be fulfilled;
- O = *overlapping*, i.e. in line with the many different tasks (functions) there are many different governmental units extending over different geographical areas;
- C = *competing*, i.e. individuals and/or communes may chose to what governmental unit they want to belong, and they have political

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\*We are grateful to Iris Bohnet, Isabelle Busenhardt, Lüder Gerken, Felix Oberholzer, Dieter Schmidchen, Jürg de Spindler and Christophe von Werdt for helpful remarks. Financial support by COST A7 is gratefully acknowledged.

rights to express their preferences directly via initiative and referenda;

J = *jurisdictions*, i.e. the units established are governmental, they have enforcement power and can, in particular, raise taxes.

While these FOCJ are in stark contrast to the concepts of federalism currently existing and proposed in the European Union, we intend to show that they are well-grounded in economic theory, and that successful precursors exist in European history. Indeed, we argue that Europe owes its rise as a dominant economic and intellectual centre to the competition among governmental units. A federalism imposed from above, on the other hand, cannot meet this requirement. We also intend to show that such functional competing units partially exist in present-day Europe and elsewhere, and that they perform well within the room accorded to them.

The second section of this paper specifies the concept of FOCJ more precisely and puts it into theoretical perspective. The third section outlines the major advantages of federalism based on FOCJ, and contrasts them to all-purpose jurisdictions confined to one particular, non-overlapping geographical area. The fourth section deals with partially existing FOCJ in Europe today, and discusses similar types of jurisdictions in the history of Europe. The relationship to US special districts and in particular to functional communes in Switzerland are also pointed out. Concluding remarks are offered in the fifth section.

## 2 THE CONCEPT OF FOCJ

The kind of federalism here suggested is based on theoretical propositions advanced in the economic theory of federalism but it nevertheless leads to a very different governmental system than is suggested in that literature. The economic theory of federalism (see Prud'homme, 1991, Bird, 1993, Breton, 1994, for surveys on its present state) starts from *existing* political units at the different levels of government (Weingast, 1993, p. 292), whereas we propose that jurisdictions should *emerge* in response to the '*geography of problems*'.<sup>1</sup> 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 Functional

In order for a political unit to optimally provide public services, the benefits and costs have to geographically match, i.e. spillovers have to be

evaded. The different units are thus able to cater for differences in the population's preferences or, more precisely, to its demands. Moreover, the political 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. This is the central idea of 'fiscal equivalence' as proposed by Olson (1969) and Oates (1972). This endogeneity of the size of governmental units constitutes an essential part of FOCJ. However, fiscal equivalence is little concerned with decision-making in those 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) induces these units to cater for individual preferences. The same argument may be used against a concept closely-related to fiscal federalism, 'voting by foot' (Tiebout, 1956). In this process, political units grow in size if they are below optimum size, and if they are more efficient suppliers than the other units, and vice versa. According to this model of federalism, the political jurisdictions are exogenously given, are multi-purpose, do not overlap, and the political supply process is 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 also have the possibility to raise voice in the form of voting.

Buchanan's (1965) 'clubs' are similar to FOCJ because their size is determined endogenously by the benefits and costs of the club members (see Sandler and Tschirhart, 1980). Single-purpose districts as they exist in the United States (see Zax, 1988), or *Zweckverbände*, as they are aptly called in German-speaking countries, can be considered to be such clubs, except that the members do not consist of individuals but rather of communes, or even of cantons or provinces (in which case they are called '*Konkordate*'). However, in most countries such districts as clubs are not legally independent political entities (US and Swiss single-purpose communes are exceptions, see Mehay, 1984).<sup>2</sup> Club theory does not analyze the political process within the clubs, and the clubs as such do not have jurisdictional power as our FOCJ do. Moreover, FOCJ are not restricted to public goods but may also provide private goods as indeed many governments factually do.

Many privately arranged organizations performing a restricted 'public' function (and as such often receiving government subsidies) are flexible enough to adjust to the geography of problems. Examples are, in addition to social clubs and sports clubs, political parties and religious groups. In

contrast, existing political jurisdictions perform many functions (they could be called APJ for All-Purpose Jurisdictions), and are therefore not designed to minimize functional spillovers and to maximally exploit economies of scale with respect to particular functions. An example are the regions as they exist in the European Union: their size is essentially historically determined. The politically much-propagated 'Europe of Regions' thus certainly does not meet federalism based on FOCJ.

Cross-national communes serving both allocative and distributional functions have been suggested for the European Union by Teutemann (1992). They differ in an important respect from FOCJ because they are determined and imposed from outside and from above whereas FOCJ emerge in response to the demand by individuals or, in a more aggregate way, by communes as the smallest existing political unit.

## 2.2 Overlapping

FOCJ may overlap in two respects. In the narrow sense two or more FOCJ catering to the same function may geographically intersect (e.g., a multitude of school FOCJ may exist in the same geographical area). In a wider sense FOCJ catering to different functions may overlap. As a result, an individual or a political commune normally belongs to various FOCJ at the same time. FOCJ need not be physically contiguous. They depart wholly from the identification of jurisdictions with a monopoly over a certain area of land. Thus they are an extreme counterproposition to archaic nationalism fighting about pieces of land.— as we regrettably experience in former Yugoslavia and elsewhere. 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 FOCJ are similar to Buchanan-type clubs which may well intersect.

A good example for overlapping as a characteristic of FOCJ are religious groups of which several coexist in the same area, and between which individuals may freely chose. In many countries they are organized as legally public institutions. Swiss *Bürgergemeinden* ('citizens' communes') are another example for existing overlapping jurisdictions: in contrast to *Einwohnergemeinden* ('inhabitants' communes') they are composed of individuals with citizenship in a particular commune (there is no Swiss citizenship as such but it derives from citizenship in a commune), irrespective of where they live. *Bürgergemeinden* are thus separated from a particular geographical area but they entail a number of rights (e.g., in addition to voting, social welfare, housing support, scholarships for students and artists) and duties. They overlap in many respects with the

*Einwohnergemeinden* whose membership is defined by residency. Obviously single-purpose districts (for many examples from the United States see Tullock, 1993) or *Zweckverbände* are yet another case where governmental tasks are provided by overlapping public institutions.

### 2.3 Competing

Two mechanisms serve to induce the managers of FOCJ to conform closely to their members' preferences: the possibility to *exit* mimics market competition (Hirschman, 1970), and to *vote* establishes political competition (see Mueller, 1989). Migration is only one means of exit; membership in a particular FOCUS (which we take to be the singular of FOCJ) can be discontinued without changing one's location. Neither is exit restricted to individuals or firms; political communes as a whole, and even parts of them may also exercise this option.<sup>3</sup> Exit may moreover be total or only partial. In the latter case, an individual or commune only participates in a restricted set of FOCUS activities. For 'voting by foot' to function properly, it is necessary that exit is facilitated, and in particular that one can do so in part also. Otherwise the cost of exit may be so high that this competitive mechanism does not fulfil its task.

The importance of 'secession', that is the possibility for exit of jurisdictions (such as communes) to act as a restriction on the power of central states has been recognized in the literature (e.g., Zarkovic Bookman, 1992, Drèze, 1993), and 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 concept of a state where this is strictly forbidden and often prevented by force. (Well-known examples are the American Civil War (1861–1865), the Swiss 'Sonderbundskrieg' (1847), or more recently Katanga (1960–63), Biafra (1967–70), Bangladesh (1970–71), and presently ex-Yugoslavia, all of which have been very bloody affairs.) 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 free as possible; the conditions are to be regulated in a contract between the FOCJ's members. 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. The existing members of the

FOCUS have to collectively decide by democratic voting, whether a new member is welcome, i.e. whether their net benefits thereby increase.

Competition of this sort already exists today among public suppliers (e.g., between government hospitals) and, of course, private suppliers (e.g., between postal and other communication services). An individual as well as, say, a commune, may leave a particular supplier and become a customer of a competitor, therewith inducing some pressure for efficient supply. A similar competition exists between some sports organizations (for example, there exist three professional boxing organizations in the same market) and religious organizations. In the absence of monopoly powers these organizations have to make an effort to care for the demands of their actual and prospective members.

As has been pointed out, empirical evidence suggests that the exit option does not suffice to induce governments to act efficiently. Competition further needs to be secured by political institutions. The citizens should directly elect the persons managing the FOCJ, and should be given the right to initiate popular referenda on specific issues. These institutions are known to raise efficiency in the sense of caring well for individual preferences (for elections, see Downs, 1957, Mueller, 1989; for referenda Frey, 1994). Apart from American special districts and Swiss communes, existing overlapping jurisdictions such as the Swiss *Zweckverbände* or *Konkordate* have no such elements of *direct* democracy; they are only indirectly controlled by the fact that the managers of such units are delegated by democratically-elected bodies.

## 2.4 Jurisdictions

A FOCUS is a democratic governmental unit with authority over its citizens, including the power to raise taxes. Two cases can be distinguished: (a) Membership may be defined by the lowest political unit (normally the commune), and all corresponding citizens automatically become citizens of the FOCJ to which their unit (commune) belongs. In that case, an individual can only exit via mobility. (b) Individuals may freely choose whether they want to belong to a particular FOCUS but, while they are its citizens, they are subject to its authority. Some FOCJ may be non-voluntary in the sense that one must belong to at least one FOCUS, e.g., to one school district, 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 a FOCUS devoted to education may, for example, decide that everyone must pay taxes in order to finance a particular school, irrespective of

whether one (or one's children) attends the school. In this respect a minimal regulation by the central government may be in order so that citizens without children do not join 'school-FOCJ' which in effect do not offer any schooling but have correspondingly low (or zero) taxes.

The FOCJ as jurisdictions have the power to raise a price for entry. They provide particular services but do not necessarily produce it themselves if contracting-out to a public or private enterprise is advantageous. Existing overlapping institutions (special districts, *Zweckverbände*, etc.), on the other hand, normally do not have the legal status of governments; they are purely administrative units. Outsourcing or contracting-out by communes also differs from FOCJ as the former is restricted to production while FOCJ care for provision. As to theoretical concepts, Buchanan-type clubs differ from FOCJ because they are purely voluntary while FOCJ might not be.

FOCJ are far away from the jurisdictions of regions envisaged in the European treaties (see, e.g., Adonis and Jones, 1991). The major difference is that FOCJ emerge from below while the establishment of 'European regions' tend to be from above; they are a case of '*imposed subsidiarity*', and their existence is strongly induced by the subsidies flowing from the European Union. In contrast, the concept of FOCJ corresponds to Hayek's (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 communes; the central European constitution must only make sure that no other government units, in particular the nations, may obstruct the emergence of FOCJ. 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.

The discussion of the characteristics of FOCJ should reveal that this concept of federalism and competition among governments differs basically from *existing European institutions*. 'Subsidiarity' as proclaimed in the Maastricht Treaty is generally recognized to be more a vague goal than a concept with content (see, for instance, Centre for Economic Policy Research, 1993, p. 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 competencies; they heavily depend on the central state and the European Union from which they receive subsidies as their major source of income.

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 the Schengen Treaty concerning the free movement of persons) are granted reluctantly, and are indeed seen as damaging to the 'spirit of Europe'. In a system of FOCJ, in contrast, such functional units not covering everyone are taken as the welcome expression of heterogeneous demands among Europeans.

FOCJ also differ in many crucial respects from the *proposals* advanced for a future European constitution. Among scholars, one of the most prominent was Buchanan's (1991) concept which 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 a constructivist proposal concerning 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. Another group of researchers (see 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) criticizing 'subsidiarity' (as used in the Maastricht Treaty) as an empty concept argues 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 briefly raised (pp. 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 systems (the houses of parliament and the national vote weights) and to a

substantial extent accepts the existing treaties 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 favour of 'co-operation' between governments.

It might be argued that the idea of FOCJ is exotic and has no chance of ever being put into practice. A careful consideration of policy-making in Europe reveals, however, 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, but 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.

The possibility for FOCJ to emerge is 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 also the Swiss university of Basle and the German university of Freiburg. 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 which suggests that one or several FOCJ, e.g., according to ethnic or language boundaries, or especially focused on its economic problems as an island, provide a better solution (partial instead of total exit). A further example would be a FOCUS on tourism policy of the eastern Mediterranean including Asia Minor's coastline of Turkey, the Ionic islands of Greece and the divided island of Cyprus. An important area for FOCJ are with respect to transport issues, in particular railroads. Despite the membership of various countries in the (then) European Community,

railroad policy was not co-ordinated to exploit possible economies of scale, but a FOCUS may constitute a well-suited organization to overcome such shortcomings.

### 3 THE CASE FOR FOCJ

#### 3.1 Advantages

Various strong points of FOCJ have already been mentioned while describing the concept. On the *demand* side, the possibility and incentives to satisfy heterogeneous preferences of individuals are crucial. Due to 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 limited geographic area, FOCJ are usually small which is also helpful for voters' evaluations. The exit option opened by the existence of overlapping jurisdictions is an important means to make one's preferences known to governmental suppliers.

On the *supply* side, FOCJ are able to provide public services at low cost because they are formed in order to minimize interjurisdictional spillovers and to exploit economies of scale. The specialization on one function further contributes to cost efficiency due to the advantages of specialization. As FOCJ raise 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, and thereby push up government expenditures, because taxation is a public good (or bad) and therefore need not be considered as a cost to any particular jurisdiction. The incentive to economize in a FOCUS induces its managers to contract-out whenever production costs can thereby be reduced which leads to a stronger market orientation of FOCJ than of APJ. The threat of dissatisfied citizens or communes leaving, and the benefit of new citizens and communes joining, gives an incentive to take individual preferences into account, i.e. FOCJ are not only cost-minimizers but have an incentive 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 in All-Purpose Jurisdictions persons with broad and non-specialized knowledge are attracted to become politicians, in FOCJ it is rather persons with a well-grounded knowledge in a particular functional area (such as education or refuse collection).

The possibility to form FOCJ helps to deal with issues raised by fundamentalist sentiments. In contrast to a system of all-purpose governments, political movements focused on a single issue (such as ethnicity, religion and environment) are not forced to take over governments *in toto* but can concentrate on those functions they are really interested in. The 'Greens', for example, do not have to take a stand on foreign policy (for which they are dogmatically ill-equipped) but can devote their energy to FOCJ dealing with environmental issues. Similarly, an ethnic group need not disassociate itself from the state they live in as a whole, but may found FOCJ which care for their preferences, especially with respect to schooling. South Tyroleans, for example, unhappy with the language domination imposed by the Italian state, need not leave Italy in order to fulfil their demands for cultural autonomy but may establish corresponding FOCJ.

The possibility to exit partially (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).

With respect to a future Europe, a federal system 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. On the other hand, the scheme does not purport to do away with nations (this would anyway seem to be a hopeless endeavour at present) but seeks for multinational alternatives where they are desired by the citizens. In those areas where native states perform according to the voters' preferences, they will remain.

### 3.2 Alleged Problems

In a federal system of FOCJ, each individual is a citizen of various jurisdictions, according to the number of functions differentiated. It might be argued that the individuals are overburdened by voting in elections and referenda taking place in each FOCUS and consequently would respond by political abstinence.

There are three reasons why this view is unwarranted. First of all, low political participation does not constitute a problem as such as rational citizens do not vote if they are satisfied with the public services provided by a FOCUS. What matters is that vote participation is variable, and in particular that it increases when individuals are dissatisfied. The costs of organizing the vote can be reduced by bundling elections and referenda of various FOCJ. Secondly, the break-up of government activity in several

functional dimensions helps citizens to identify issues more clearly than when they have to evaluate complex, multi-functional public supply. Formal voting theory assumes that the voters evaluate separately each part of government activity which affects their preferences (e.g., Downs, 1957 or, for a survey, Mueller, 1989). This breakdown according to various dimensions is to a substantial extent performed by FOCJ. Finally, the burden of having to vote at many different elections and referenda is alleviated by institutions which arise to deal with the problem. At elections, citizens may vote for one delegate who sits in various FOCJ, or may simply follow parties' recommendations.

A second alleged problem of the federal system here suggested concerns *co-ordination* between the large number of FOCJ. It should be made clear that co-ordination between governments is not good as such (as assumed by many political scientists) but often serves as a cartel among the members of the 'classe politique' to evade, or even exploit, the population's wishes (see Vaubel, 1986, 1992, CEPR, 1993, Frey, 1994). As far as welfare-increasing co-ordination is concerned, its need is reduced compared to APJ because the FOCJ emerge so that externalities are minimized, i.e. a Coasian process of endogenous adaption works. If major spillovers between FOCJ exist, new FOCJ will emerge taking care of these externalities. As the number of FOCJ is restricted due to the transactions costs involved, less important externalities between FOCJ will remain. However, spillovers also exist in a system of APJ, and the crucial question therefore is in what system they can be better dealt with. Some spillovers explicitly existing between FOCJ take a different form in APJ where they are implicit between administrative units, e.g., between the department for environment and the department of transport. The respective civil servants have a muted incentive to take these spillovers into account. Interministerial commissions need to be established, but then the decision situation is similar to co-operation efforts between FOCJ.

A third alleged problem with FOCJ is that the separation along functions prohibits vote trading and therefore restricts the expression of different preference intensities. In a system of APJ in contrast, minorities with strong preferences in one dimension (function) can exchange votes with groups who have strong interests in other functions, leading to a Pareto-superior outcome. First of all it should be noted that vote trading does not always induce a Pareto-superior outcome. 'Log-rolling' is only beneficial to those groups involved – it may well damage others. According to the vote trading paradox (see Riker and Brams, 1973), log-rolling may even be costly for all the groups involved, when government activity is not

effectively limited to allocative functions. Furthermore, preference intensities can generally be expressed by higher vote participation and/or by a higher probability to vote for a desired alternative (see on probabilistic voting, Lafay, 1993). Finally, a federal system based on FOCJ is flexible enough to allow minorities with intensive preferences to establish new FOCJ which care for their preferences.

A final major objection against FOCJ is that redistribution based on solidarity is claimed to break down and that FOCJ emerge on the basis of income. (Of course, this criticism also holds against Tiebout's model of voting by foot.) One solution would be that the constitution gives the European central government the power to impose income redistribution. Alternatively, a FOCUS specialized on interregional redistribution may emerge but this presupposes barriers to entry (in analogy to insurance systems with cross-subsidization). Recent empirical research (Gold, 1991, Kirchgässner and Pommerhne, 1993) suggests that 'local' redistribution is feasible, as mobility by persons (and to a lesser extent also by firms) is sufficiently costly to allow a significant amount of redistributive action by governments.

### 3.3 Why has the System of FOCJ not Emerged?

In view of the major advantages outlined, and the futility of much of the criticism of FOCJ the economist's standard question arises: if this type of federalism is so good, why does it not exist?

There are two major reasons why the organization of states does not follow the model of FOCJ. An obvious, but crucial, one is that individuals and communes are prohibited to establish such jurisdictions, and in many countries of the European Union communes are not even allowed to formally collaborate with each other without the consent of the central government. When spillovers exist, the normal procedure in all member countries is to shift the task to a higher level which leads to increasing centralization (an example is environmental protection which to a considerable extent is local but where the existence of partial externalities have led to a centralized administration).

The second reason why the system of FOCJ is not observed is that it violates the interests of politicians and public officials at the higher levels of government. The emergence of FOCJ reduces their power because they control public supply to a lesser extent. As politicians' discretionary room and therefore the rents appropriable are the larger, the higher the federal level, they favour a shift of competencies in this direction, and oppose local decision-making, especially by FOCJ.<sup>4</sup>

It follows that under existing constitutional conditions in the countries of the European Union (and elsewhere) a federal system of FOCJ is unlikely to arise.

### 3.4 Creating a Favourable Environment

A system of government where the federal jurisdiction emerges from below as a response to citizens' preferences, and is not dictated from above, requires a *constitutional decision* (see Buchanan and Tullock, 1962 and more recently Frey, 1983, Mueller, 1994). A minimum provision – one would name it 'the fifth freedom' – must ensure that the emergence of FOCJ may not be blocked by existing jurisdictions, be it by competitors or governments on a higher level. Every citizen and commune must have the right to directly appeal to the European Court if barriers to the competition between governments are established.<sup>5</sup> Positively, the European constitution must give the lowest political units (communes) 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 by the institution of popular initiatives. The FOCJ themselves must be granted the right to raise taxes to finance the public services provided.

## 4 HISTORICAL PRECURSORS AND PARTIAL EXISTENCE OF FOCJ

Decentralized, overlapping political units have 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, was intensive. Many of these governments were of small size. Several scholars have attributed 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, Schwarz, 1993, Weede, 1993 and Baumol and Baumol, 1992, 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, 1993, Rosenberg and Birdzell, 1986). The unification of Italy and Germany in the nineteenth 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. Some smaller states escaped unification; Liechtenstein, Luxembourg, Monaco, San Marino and Switzerland stayed politically independent, and at the same time grew rich. Today, there is a tendency to disintegrate again, as the division of Czechoslovakia, and the strong centrifugal movements in Belgium, Spain and Italy show. These governmental units were not FOCJ in the sense outlined above but they shared the characteristic of competing for labour 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 Rhode, 1960 and Haumann, 1991). The highly successful *Hanse* prospered from the twelfth to the sixteenth 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 (today British), Bruges and Antwerp (today Belgian) and Novgorod (today Russian) were *Handelskontore* or associated members. It clearly was a functional governmental unit serving trade and was not geographically contiguous.

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 and Japan. In many other respects there emerge 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 congruent 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 areas like European culture, education and crime-prevention. 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 requirements of FOCJ specified above).

*US special districts.* Single-purpose governments play a significant role in the American federalist system. Their number has rapidly increased; 1967-72 by 30.4 per cent, 1972-84 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 eighteen states prohibit new municipalities within a specified distance from existing municipalities (ACIR, 1982, Zax, 1988, p. 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).

*Swiss Communes.* 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 million, an area of 1700 km<sup>2</sup> and tax revenue of SFr. 2800 million) there are 171 political communes (with a tax revenue of SFr. 3900 million) which in themselves are composed of three to six independently-managed, democratically-organized communes devoted to specific functions and raising their own taxes. A typical example will illustrate this. The political commune of Niederhasli (population 5900, size 11 km<sup>2</sup>) finances its expenditures of SFr. 11 million (in 1991) by raising a tax equivalent to 38 per cent of the cantonal tax rate (in addition it raises various charges and receives a limited amount of subsidies from the canton). A commune devoted to the education from years 1 to 6 of schooling has expenditures of SFr. 5.8 million and raises a tax of 55 per cent of the cantonal tax. A corresponding commune concerned with education from years 7 to 9 spends SFr. 4.9 million and raises 22 per cent of the cantonal tax rate. There are two church communes having tax rates of 10 per cent and 11 per cent of the cantonal tax rate, respectively. The two school communes and the two religious communes are essentially self-financing. The sixth commune (*Zivilgemeinde*) is devoted to providing water, electricity and a TV antenna, and finances itself solely by user charges. These communes often overlap with neighbouring political communes. In the case of Niederhasli, the advanced school commune also comprises the political commune of Niederglatt (pop. 3300) and parts of Oberglatt (pop. 4300) (where the other part of pupils attends school in yet another school commune). The

Zurich canton is no exception concerning the multitude of types of functional communes. A similar structure exists, e.g., in the Glarus or Thurgau cantons (for the latter, see Casella and Frey, 1992). Various efforts have been made to suppress this diversity of functional communes, usually initiated by the cantonal bureaucracy and politicians. However, most of these attempts were thwarted because the population is most satisfied with the public supply provided. The example from 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 merely a theorist's wishful thinking but has also worked well in reality.

## 5 CONCLUDING REMARKS

Europe owes its position as an economically rich and intellectually and artistically powerful continent in large measure to the great variety of governmental jurisdictions in competition with each other. This basic insight was overshadowed by the unification movements especially in Italy and Germany. The European movement follows the historic lesson by opening up trade barriers and supporting economic competition, and this with great success. However, the historic lesson has not been followed with respect to establishing competition between existing and new governments.

This paper proposes that the future European constitution should allow, and actively promote, the evolution of functional, overlapping and competing governmental jurisdictions (FOCJ). They fulfil many of the welfare-enhancing qualities of theoretical concepts such as Tiebout's voting by foot, Olson's and Oates' fiscal equivalence, or Buchanan's clubs. It is shown that FOCJ are feasible, that there are successful historical examples, and that they partially exist in the form of US special districts and Swiss functional, democratic and overlapping communes.

## Notes

1. There are precursors to FOCJ in the economics literature though the concept has, to our knowledge, not been applied to the European Union. As in several other areas of economics, Tullock (1985, 1994) has been one of the inventors; he somewhat misleadingly calls it 'sociological federalism'. See also Casella and Frey (1992) and the literature cited therein. A recent Centre for Economic Policy Research Publication (CEPR, 1993) shortly refers to the possibility of establishing overlapping jurisdictions in Europe (pp. 54–5) but does not work out the concept nor is there reference to previous research (except to Drèze 1993 on secession).

2. In the Swiss canton Zurich which has 171 political communes (and in addition many hundreds of functional communes, see below Section 4) there are (in 1991) 174 *Zweckverbände* of which 30 care for waste water and purification plants, 21 for water provision, 15 for cemeteries, 14 for hospitals, 10 for regional planning, 10 for refuse collection etc.
3. Again there are many examples in Switzerland: Communes decided by referendum, whether they wanted to join the new canton Jura established in 1978, and in 1993 communes in the Laufental could opt between staying in canton Basel-Land or Solothurn. Communes also frequently change districts (the federal level below cantons) by referendum.
4. A formal reason is that vote cycling is more prevalent, the more alternatives (functions) there are (see, e.g., Kramer, 1973). Normally, lower level jurisdictions have more institutions for citizen participation, and they are used more widely, so that the politicians' discretionary room and rents are lower (see, e.g., Oakerson and Parks, 1988, Cronin, 1989).
5. As mentioned above, the central government should be able to impose some restrictions on FOCJ to guarantee minimum standards. The European constitution must explicitly limit such intervention because they may well serve the purpose of undermining competition.

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