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European Unification Based on Flexibility and Diversity

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European unification has a noble aim but is endangered by encompassing egalitarianism and bureaucratization, and is moreover subject to a major democracy deficit. This paper argues that flexible and dynamic entities whose territoriality is determined by issues are appropriate for a Europe of the 21st century. The first step must be to constitutionally allow the emergence and existence of corresponding political entities with taxing and spending power. Over time these flexible, democratic, and diverse political units will take over those activities national states and the EU do not fulfill well.

Keywords: European unification, flexibility, diversity, systems competition, national states

JEL classification: D 02, H 1, H 77, P 4, K 20

1. Propositions

This paper advances two propositions:

Proposition 1 European unification has been wrongly constructed in that it is built on nation states.

Proposition 2 The future of Europe lies in flexible, dynamic political units caring for diversity.

These propositions are radical in the sense of being unorthodox and a taboo theme in the public discourse. It has been explicitly stated that “there is no alternative to the European Union” (Chancellor Merkel).¹ At the same time it is obvious that the EU is in a deep crisis.²

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1 See Bloss (2008), p. 10 citing Angela Merkel: “Ich möchte, dass diese EU erfolgreich ist. Es gibt keine Alternative.”

2 Among the huge literature see, e.g., Talami (2016); Dinan et al. (2017).

There already exist similar ideas to those proposed here for the European unification process. More flexible procedures such as “Europe à la carte,” “multi-speed Europe,” “variable geometry,” or “North and South EU” have been suggested.³ While the ideas may appear radical compared to the present discourse about Europe, the flexible dynamic units here proposed can be introduced gradually, without destroying the existing national states.

I wish to emphasize that I do not in any way want to criticize the founders of the European unification process, persons such as Monnet, Adenauer, or Spaak. But they were children of their time – as we all are. They had experienced the terror of the Second World War and wanted to lay the foundations for peace among European nations – and that meant reconstructing the national states in a democratic and nonaggressive way. Even Winston Churchill, in his talk at the University of Zurich in 1946,⁴ suggested a “United States of Europe” – of course, without the United Kingdom!

I have great admiration for the postwar founders of Europe; indeed, I share their fundamental conviction that there should be a European unification process – but in a totally different way. We live in the 21st century, and since the first efforts to bring Europe together much has changed, not least the revolution due to the digitization of much of our lives.

Section 2 shortly discusses the successes and shortcomings of the existing unification process by the European Union composed of nation-states, in terms of six goals. The following section presents an alternative in the form of flexible, dynamic units caring for diversity. It is argued that this approach has many striking advantages. Section 4 applies the concept of flexible political entities to the goals envisaged in the European unification process. Section 5 concludes.

2. Successes and Failures of the Present European Unification Process

I consider three broad areas: political, economic, and technological.

3 See, e.g., CEPR (1995), Holzinger and Knoepfel (2000), Warleigh (2002), Koelliker (2006), and Harstad (2006). In economics, the idea of variable geometry goes back to Tiebout (1956) and Olson (1969).

4 Speech delivered at the University of Zurich, 19 September 1946: “... If Europe were once united in the sharing of its common inheritance there would be no limit to the happiness, prosperity, and glory which its 300 million or 400 million people would enjoy. ... We must build a kind of United States of Europe.”

2.1. Political Goals

2.1.1. Peace

Preventing military conflict has rightly been the most important goal of the European unification process. Following the havoc of the two world wars in the 20th century, we have had 70 years of peace between European nations – a great achievement.

Nevertheless, the European Union (EU, which in the following is taken to include previous names such as EEC) has not been totally successful with regard to peace if internal strife is also considered.⁵ One would think that under the umbrella of the EU it would be much easier to solve the internal conflicts in Northern Ireland, Spain (the Basque Country and Catalonia), Corsica, and Scotland. But as a matter of fact, the EU has not been helpful in solving or even mitigating these conflicts. Neither was the EU very successful in reducing the military conflicts immediately outside their borders, in the Balkans.

There is also a causality issue. It may well be that the EU has fostered friendship among the European nations, most importantly between France and Germany. But it may also well be that the causality runs in the opposite direction: because France and Germany became close allies, the foundation and development of the EU was possible. Probably, there was a mutual causality, but that means that the EU cannot legitimately claim to be the only force securing peace in Europe.

2.1.2. Power

One of the purposes of the European unification for Europe is to be able to act in concert, and therefore to have greater weight in international politics. This sounds convincing at first sight. However, it is not clear whether the total influence would be smaller if France, Spain, Italy, Germany, or the United Kingdom acted independently. The issue is open, and one would like to see a serious empirical study on this question. Such a study would have to analyze in what areas of politics joint action was indeed necessary and successful, and in what other areas independent action would overall have brought about better results. This issue is most difficult to analyze, as there is no counterfactual.⁶

5 See, e.g., Kriesi et al. (2012), Dotti Sani and Magistro (2016), and an early discussion by Feldstein (1997).

6 To my knowledge, such a study has not yet been undertaken. For a general discussion of the working of the European Union see, e.g., Nugent (2017).

2.1.3. Democracy

The European unification process has always been under the flag of democracy. However, the EU itself is faced with a well-discussed *democracy deficit*,⁷ as well as perceived excessive regulation by laws and directives enshrined in the *acquis communautaire*, published in close to 200,000 pages.⁸ The EU is hardly a shining example of democracy designed for the 21st century in which citizens are actively and constructively engaged.

2.1.4. European Identity

Today, in several parts of society people perceive that there is a joint European identity. This applies fully to culture and sports. But exactly these areas are not connected with the EU as an institution but exist independently. This becomes obvious when considering Norway or Switzerland. They are fully integrated in these areas but are not members of the EU.

Within the EU, it is a grave concern indeed that there is rather weak identification with the EU institutions and with the other member states. European identification seems to have fallen, at least judging from the declining participation rates in European elections, among other things.⁹

2.2. Economic Goals

Here we have the great success of the EU. It can well be argued that the freedoms of trade, of services, and of the movement of labor and capital would not have been achieved without the EU.

But there are major problems.¹⁰ There is now wide consensus that the euro was introduced too early, and that it has been extended too quickly to too many countries. It has created a dangerous north–south divide within the Union, and has opened new, even bitter, conflicts between some members, in particular between Greece and Germany. There is also an east–west divide with respect to major issues such as migration, the independence of the judiciary, and corruption. Some such conflicts can be “solved” by ever increasing monetary transfers (a policy pursued by the European Central Bank in response to the major public-debt problems between member states), but it is questionable whether such a policy can succeed in the medium and long run. There are

7 See, e.g., Bang et al. (2015), Atlantic (2014), and House of Commons Library (2014), but notice also the response by Habermas (2012).

8 For instance, Pegan (2017), Eppink (2008), and Stevens (2000).

9 Eurostat (2018), Herrmann et al. (2004), Serricchio et al. (2013), Verhaegen et al. (2014), Nicoli (2016).

10 See, e.g., Kraeussl et al. (2016), Ruščáková and Semančíková (2016), Lane (2012).

conflicting views in this regard, but it is fair to state that with respect to free trade there are great dangers lurking in the future.

2.3. Technological Goals

EU politicians and public officials have on many occasions officially stated and emphasized that the EU aspires to be at the front of technology. Accordingly, the EU has launched massive monetary programs – in the case of ICT involving one billion euros, in the case of the Brain Project 79 billion euros (EU, n.d.). These are huge projects initiated and governed by the EU.

From a Hayekian perspective such programs, coming from above, are ill advised and a typical example of bureaucrats claiming to know what will be important in the future (Von Hayek, 1975). The history of innovation provides hundreds of examples where future development has been forecast wrongly. Who would have predicted fifty years ago that most persons in Europe would use their own computer? Who would have predicted thirty years ago that we would communicate largely by digital media (cell phones, e-mail)? These technological advances have been developed due to decentralized efforts, such as start-ups in the garages of Silicon Valley. Serendipity, i.e., the unplanned advent of innovations, plays a large role in real innovations (in contrast to just pushing further an already known innovation). If one follows this line of thought, there is only one way to push innovation: establish diversity so that every inventor and researcher has a chance to develop his or her idea. In almost all cases this will result in failure, but in a few cases a successful technological advance will take place.

3. Flexibility, Dynamism, and Diversity

I wish to argue that the manifold problems indicated in the three areas (polity, economy, technology) *cannot be solved by a central state* such as a “United States of Europe.” Attempts, for instance, to become more democratic or to advance technology cannot be undertaken from above. But I also want to argue that these problems cannot either be solved by independently acting national states.

We need to consider a totally new concept of how political units are to be organized. They must fulfill three crucial criteria:

1. The political units must be flexible. They must be able to adjust to new issues, problems, and conflicts constantly emerging. Their size can be small or large, or anything in between, but their organizations should follow democratic principles. This means, in particular, that they should emerge from below, and not be imposed from above.

Moreover, they must be able to take up new ideas such as, for example, the construction of new cities in international waters (Friedman and Taylor, 2012), or the creation of chartered cities (Romer, 2010).

2. The political units must be dynamic, allowing both entry and exit.
3. The organization of the political units must cater for diversity in order to allow social and technological progress. New ideas must be able to emerge, and to be experimented with. There must be a multiplicity of political entities, in contrast to a monopoly power that tends to force the lower units to follow its rules and interests. To introduce two well-suited German words: The political units must correspond to *Vielfalt* (variety, diversity) rather than be reduced to *Einfalt*. The latter word does not merely mean that there is only one dimension. Rather, being reduced to one dimension is identified with being stupid (*einfältig*) – and rightly so.

In order to be able to put these flexible, dynamic political units into operation, new ground rules – or a new constitution for the unification process of Europe – need to be established.¹¹ They must totally reverse the procedure existing today. Instead of using the national perspective to address issues, problems, and conflicts, one must first focus on the issues, problems, and conflicts, and then choose the appropriate size of the political entities. Once this has been said, it seems obvious. How can one expect that the national states whose borders have been formed by historical chance events will be able to solve the many issues that today increasingly straddle national borders?

The concept of flexible and dynamic political entities committed to diversity has been developed in the specific form of FOCJ,¹² standing for

- F = Functional, i.e., focusing on problems and conflicts. They may apply to a great variety of issues, and they may extend voting power to anybody affected by a particular issue, including foreigners. The political units are not formed according to a historically determined territoriality, but according to the extent of the problems to be dealt with. These problems often diverge from the national areas established (often by a fluke) in history but in many cases extend over national borders.
- O = Overlapping, an aspect directly following from the fact that issue-oriented entities necessarily overlap. The territorial extension of, say, public security normally differs from that of, say, the public provision of fresh water. A commune, or in some cases even an individual citizen, therefore normally belongs to many different political units. This is often the case in

¹¹ See Blankart (2000), Eusepi (2000), Brennan and Eusepi (2004).

¹² Frey and Eichenberger (1996a, 1996b, 1999), Frey (1997, 2001). See also Casella and Frey (1992). For a general discussion of nonterritorial states see Tucker and de Bellis (2016).

Switzerland, where a citizen may at the same time belong to various political corporations, e.g., with regard to schools, the church, electricity supply, or the cemetery. This means that, unlike national states, various political entities may act on the same level.

C = Competitive in two regards:¹³ (a) Several units may offer the same or similar public services. The individual consumers or political communes may freely decide which suits them best by having the most adequate combination of public service and corresponding taxes. (b) The decisions by the politicians and public officials running the FOCJ are subject to democratic control by voters.

J = Jurisdictions, meaning that the entities may raise taxes for the public services they provide. The total tax bill of individuals is composed of the various specific taxes corresponding to the diverse public services rendered.

The concept of FOCJ does not claim to provide an ideal solution for all the problems arising, but it promises to be a better institution than the national states acting independently or in the confines of the European Union. An important quality of FOCJ is that they can be introduced gradually. The existing structure of national and European institutions need not be dismantled, but specific flexible political jurisdictions can be introduced that care for specific problems across national borders. This has already been done by the Schengen Agreement establishing the free movement of persons across a selection of members of the EU, but also including countries beyond the EU such as Switzerland and Norway. The major difference is, of course, that the actors of the Schengen Agreement are nations, and not small units, or even persons, such as envisaged in the concept of FOCJ.

The most often raised objections to FOCJ are four:

1. The citizens are said to be overburdened by the multitude of political entities to which they belong. There is, however, no empirical evidence that individuals would be unable to judge what happens in more than one political entity. This is particularly true as each one focuses on one issue and therefore it is not difficult for the citizens to decide whether that particular service is well done or not. Moreover, the social media are able to provide the information sought rapidly and at no cost to the citizens.
2. It is argued that the many different FOCJ cannot be administered. This counterargument does not take into account that we live in a digitized world in which much more is possible than in earlier times.
3. The inhabitants are said to lose their sense of identity, as the national states are no longer the only political unit with which to associate. In the modern

¹³ See, e.g., Schneider (1992), Fuest (1995), and Friedrich (2002).

world individuals have many different identities at the same time: not only their country, region, or city, but also their profession, language, ethnicity, culture, or sports club (many people strongly identify with Barcelona, Chelsea, or Juventus). Sen (2006, 2008) strongly argues that today people have multiple identities.¹⁴ It should also be remembered that national states may perform a role in the concept of FOCJ – if they efficiently perform a public service within their territory (but it is not easy to see which ones these are, because the borders of all national states have been shaped by historical chance events).

4. FOCJ are claimed to be impossible. This is, of course, an argument always raised against any new idea by prospective losers or conservative thinkers. However, political units resembling FOCJ have existed and have been viable over extended periods of time. Examples existed in antiquity, in the Middle Ages (e.g., the *Hanse* and many other communes),¹⁵ and exist today (several types of Swiss political communes referring to, e.g., inhabitants, citizens, school districts, and church districts; special districts in the U.S.). A more important argument against FOCJ is that they are “impossible” in the sense that the politicians and public officials in national states and the European Union oppose FOCJ because they would lose power. This concern is correct – but this is exactly one of the reasons why FOCJ should be introduced in order to give power back to the citizens.

The advantages and disadvantages of FOCJ will not be further explored here.¹⁶ Rather, an attempt is made to apply the concept to the issues forming the goals of the European Union listed in section 2 of this article.

4. FOCJ Applied

I suggest that the six major goals of European unification can, to some extent and to different degrees, be achieved by FOCJ. Here, for reasons of space, the applications cannot be extensively discussed; only hints are provided. The purpose is to show that FOCJ are a practical institutional innovation to overcome some of the major shortcomings of the EU.

¹⁴ See also, for instance, Young (2000), Appiah (2007), and Gutman (2004).

¹⁵ An example is the Tagwen, which existed between the 14th century (if not earlier) and 2011 in the Swiss canton Glarus; see Laupper (2018).

¹⁶ This has already been done in, for instance, Frey (1997), Frey and Eichenberger (1999). A forerunner is Tullock (1969). See also the critical analyses by Vanberg (2000), De Spindler (1998), and Kyriacou (2006).

4.1. Meeting Political Goals

4.1.1. Peace

FOCJ allow flexible solutions for the independence movements presently occurring. Thus, Scotland could become sovereign in some dimensions (e.g., purely political and cultural) but stay a member of the United Kingdom in other respects (e.g., economically). The same applies to Catalonia and the Basque country with respect to Spain, and Corsica with respect to France. Somewhat surprisingly, the EU institutions have not been helpful in this regard. The former president of the Commission, Barroso, has explicitly said that an independent Scotland would no longer be part of the EU, and could join it only with great difficulty, if at all. The same attitude of the EU can be observed with respect to Catalonia. The reason is, not surprisingly, that the EU is formed by national states that want to keep their territories intact by all means.

FOCJ would also easily allow countries, regions, and communes wishing to have closer relations with other countries to partially integrate.

4.1.2. Power

FOCJ can have any size; they need not be small but can be large, according to the requirements. Thus, defense can extend to NATO and beyond if deemed necessary. Other supranational policies, such as some environmental issues, can be undertaken in appropriate entities. Therefore, FOCJ do not prevent activities at the global level. If the citizens want to exercise military power with respect to other nations, a corresponding FOCUS (to introduce the singular of FOCJ) can be established, but it will most likely to be larger than the existing EU, comprising also the United States and other nations.

4.1.3. Democracy

FOCJ are based on political power coming from below, the individuals. The governors of FOCJ are to be elected, and parliaments can be formed, or – preferably – popular initiatives and referenda can be instituted.¹⁷ An example may be Lake Constance. Bordered by three nations, two German *Bundesländer*, one Austrian *Land*, and at least three Swiss cantons, a FOCUS could cater for tourist and/or water affairs, raising its own taxes to fulfill the corresponding tasks.

¹⁷ See, e.g., Feld and Savioz (1997), Feld and Kirchgässner (2001), Eichenberger and Frey (2002), and Feld et al. (2008).

4.1.4. Identity

As discussed above, today it is normal to have many different identities. Thus, a person living near Lake Constance can well feel a member of this region, and at the same time feel German, Austrian, or Swiss, or identify with his or her profession.

4.2. Meeting Economic Goals

Following economic theory, a free-trade zone should extend to as many areas as possible. Ideally it should extend over the whole globe. A free-trade FOCUS could cover many more territories than the present EU does. It could, for instance, integrate Turkey or North Africa without involving political issues.

4.3. Meeting Technological Goals

FOCJ allow developing alternatives to the massive research programs presently undertaken in the EU directed from above. They take the fundamental idea seriously that nobody can foresee the future. As the future is, and remains, uncertain, the only possibility is to support diversity by furthering the free flow of ideas (see Pentland, 2015) and to extend credit opportunities to a wide range of would-be inventors.

5. Problems of Systems Competition

The analysis here undertaken, and the proposals made, are based on the theory of fiscal federalism originating with Tiebout (1956), Olson (1969), Oates (1972), and Ostrom (1990), and extensively surveyed in, e.g., Oates (1999) and Inman and Rubinfeld (1997, 2017).

Two quite different theoretical approaches can be distinguished. The first is rooted in neoclassical public finance, where the performance of decentralized political systems is studied assuming that there are benevolent social planners at every stage, i.e., at the national and federal levels of government. The governments and public administrations maximize aggregate social welfare.

The second approach is rooted in modern political economy or public-choice theory and analyzes the behavior and performance in a decentralized system based on the incentives facing governments and public officials.¹⁸

¹⁸ Weingast (2009) makes the distinction between “first generation fiscal federalism” and “second generation fiscal federalism.”

Both approaches, however, take the subnational borders as given. This paper deviates from that assumption and unconventionally proposes variable sizes of subnational units.

It is useful to compare the second approach, i.e., focusing on the incentives to politicians and public administrators given by the particular public institutions, with the formal analyses on the consequences of competition between subnational units based on the social welfare maximization of benevolent governments. For that purpose Sinn's (1997) article on "systems competition" is used.¹⁹ This paper explicitly "adopts a Public Finance rather than a Public Choice view of the state . . . the state is seen as a rational institution which corrects market failure and acts in the interest of citizen"(pp. 249–250). Sinn takes government behavior as given and does not consider that the form and extent of competition influences government behavior. In contrast, the approach used in this paper proposes that governments take individuals' preferences more efficiently into account because there is a closer relationship between the executive and the citizens. The politicians are more dependent on the wishes of the voters, and the voters are better informed due to the flexible public units devoted to well-defined issues.

Sinn assumes that governments are subject to a fundamental behavioral bias called the *selection principle*. They only undertake activities in which private markets are unsuitable (the classical market failure). Sinn is aware that his analysis is based on two "strong assumptions," namely that the selection principle strictly holds and that governments solely act on behalf of their respective people and help them "overcome the collective irrationalities associated with the individual choices" (p. 270). Sinn considers three different aspects of system competition.

Firstly, the supply of *congestion-prone public goods* used by a mobile factor of production, in particular public infrastructure (e.g., a highway) as a club good (pp. 250–258). Sinn considers a small country behaving competitively in the international capital market. It is therefore faced by a given rate of interest net of taxes. It turns out that such public infrastructure cannot be supplied without running a deficit if the technology is characterized by increasing returns to scale. Sinn clearly states that "The problem of systems competition is not the underprovision of public goods" (p. 257), but rather the financing problem. As a consequence, the central government will undertake the provision of goods with scale economies (p. 255).

In the concept of FOCJ, the size of public institutions responds to the existence of increasing returns to scale. If a particular public good is produced with marked increasing returns, the size of the FOCUS will be increased to

¹⁹ See also Sinn (2003). I am grateful to a referee for proposing Sinn's article as a point of reference.

such an extent that returns to scale totally disappear or become unimportant. When there is no limit to increasing returns to scale, there will be only one political jurisdiction, corresponding to Sinn's central government. However, as a result of having flexible borders for specific public goods, there are fewer public goods whose technology exhibits increasing returns to scale. To some extent the undermining effect on systems competition is checked.

Secondly, Sinn deals with the possibilities of redistribution and public insurance in a system of fiscal competition (pp. 258–264). With respect to insurance, governments must be able to select the “good risks” to be paid by taxes, but the good risks tend to leave the jurisdictions, so that there is no equilibrium. This is an important and well-known problem in a competitive environment.²⁰

FOCJ can therefore limit exit by imposing a tax on those persons not prepared to act in a way conforming to solidarity. Another possibility for which jurisdictions especially created to deal with redistribution and with public insurance are well suited is to encourage voluntary contributions. FOCJ devoted to redistribution are likely to be relatively small, so that there may exist valuable personal interactions as well as discussions between givers and recipients, strengthening redistributive norms. A large literature²¹ based on field and experimental studies shows that individuals can indeed be encouraged to voluntarily contribute to redistribute income to persons with lower income. It cannot be expected that such a procedure will maximize social welfare, but it comes nearer to it. The possibility of establishing FOCJ helps to ameliorate the fundamental problem of redistribution in competitive systems.

Thirdly, Sinn shows that, under the assumptions made, competition undermines quality standards (pp. 262–270). In particular, the *Cassis-de-Dijon* judgment – ruling that a good legally produced in one country of the European Union can be freely exported to any other country of the community – raises the level of competitiveness in the system because it hinders any single state from engaging in protectionist practices. But this also tends to erode consumer protection, because individual countries endeavor to give their industries a competitive advantage by relaxing their regulations. The competitive system will therefore be trapped in a low-quality equilibrium.

FOCJ are able to ameliorate this unfortunate outcome. Sinn's result depends crucially on the assumption that consumers are unable to distinguish between product qualities. As the flexible democratic units focus on one par-

²⁰ Empirical research suggests, however, that the effects are not as drastic as theoretically presumed; see, e.g., the studies by Kirchgässner and Pommerehne (1996), Feld and Kirchgässner (2001), and Feld and Schaltegger (2017).

²¹ For example, Ostrom et al. (1994), Ledyard (1995), Sethi and Somanathan (1996), Bohnet et al. (2001), Ostrom (1990, 2000), and Meier (2006).

ticular issue – in this case product quality – people are better informed about the characteristics of goods because they are explicitly discussed and communicated in these specialized units. Such units already exist and need not necessarily be undertaken by public jurisdictions. Various examples are discussed in Frey et al. (2018).

This discussion of the problems faced by system competition suggests that democratic and flexible political units are able to mitigate some of the major difficulties produced. These problems are reduced mainly because the borders of FOCJ are formed with the intention (1) to reduce increasing returns to scale and therewith the financing problem of independent governmental units; (2) to strengthen solidarity and therewith reduce the incentives for good risks to exit in order to evade redistribution and public insurance; and (3) to improve the information of consumers by establishing governmental units specifically devoted to that purpose.

6. Rethinking Europe

European unification is a noble aim, but should not be achieved by an ever more centralized, bureaucratic institution subject to a major democracy deficit. This paper argues that flexible and dynamic entities called FOCJ, able to overcome national borders and nationalistic feelings, are appropriate for a Europe of the 21st century. A great advantage is that FOCJ can arise gradually; the existing European Union need not be dismantled. Entrenched politicians and bureaucrats will, however, muster much resistance against this new idea, both at the national and at the European level. The first step must be to constitutionally allow the emergence and existence of the needed political entities, including their taxing power. Over time the FOCJ (or other flexible political units) will take over those activities national states and the EU do not perform well. National states, as well as the EU as it now exists, will make room for a web of flexible and dynamic political units based on democratic rule and diversity.

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