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7. FOCJ: Creating a Single European Market for Governments*

Bruno S. Frey and Reiner Eichenberger

1. LIBERALISED ECONOMIC AND RESTRICTED POLITICAL MARKETS IN EUROPE

European integration was outstandingly successful at granting the four freedoms related to the movement of goods, services, labour and capital. As a result of establishing a single, competitive European *economic* market, the citizens of the countries forming the European Union (EU) have certainly experienced a significant increase in welfare. However, no such open and competitive *market for politics* has been established. On the contrary: the competition between governments was successfully restricted by the various European treaties and institutions. While the European Union's power in politics, including economic policy, are still quite limited, no steps have been undertaken to actively institutionalise competition between governmental units at all levels. Such competition has only been considered for national governments. However, from a constitutional perspective other forms of political competition should be envisaged, too. We argue that welfare can be improved substantially by promoting competition between newly emerging jurisdictions that are organised along functions instead of territories. The *fifth freedom* we suggest allows for such *functional, overlapping and competing jurisdictions*. They will be called by their acronym FOCJ (one such jurisdiction will be called FOCUS). FOCJ form a federal system of governments that is not dictated from above, but emerges from below as a response to citizens' preferences. This fifth freedom requires a *constitutional decision* (see, for example, Frey 1983, Mueller 1996) which ensures that the emergence of FOCJ is not blocked by existing

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jurisdictions such as direct competitors or higher level governments. Every citizen and community must have the right to appeal directly to the European Court if barriers to the competition between governments are established. The European Constitution must give the lowest political units (communities) a measure of independence so that they can engage in forming FOCJ. The citizens must be given the right to establish FOCJ by popular referenda, and political entrepreneurs must be supported and controlled by the institution of popular initiatives. The FOCJ themselves must have the right to levy taxes to finance the public services they provide.

These FOCJ strongly contrast with the concepts of federalism currently existing or being proposed in the European Union. We intend to show that FOCJ are well-grounded in economic theory. Successful precursors of these institutions existed in European history. Indeed, Europe owes its rise to a economic and intellectual centre to the competition among governmental units. Moreover, such functional competing units already partially exist in present-day Europe and elsewhere, where they perform well within the space accorded to them. The idea of continuing European integration at different speeds, and thus having various subgroups of countries within the European Union, is also related though it is far more restrictive than our concept of FOCJ.

The chapter is organised as follows: section two specifies the concept of FOCJ and puts it into theoretical perspective. The third section compares FOCJ to existing federal institutions in the European Union. The next section analyses the working of FOCJ and discusses how the problems related with this type of jurisdiction may be overcome. For this purpose, our concept of competitive federalism is contrasted to all-purpose jurisdictions confined to one particular geographical area. The fifth section asks why FOCJ do not yet exist in reality on a large scale. However, section six shows that FOCJ partially exist in both European history and today. The relationship to US special districts and in particular to functional communities in Switzerland is emphasised. Concluding remarks are offered in the last section.

2. CONSTITUTING ELEMENTS

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

- *Functional (F)*, that is, the new political units extend over areas defined by the tasks to be fulfilled;

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

FOCJ are based on theoretical propositions advanced in the economic theory of federalism. They nevertheless form a governmental system completely different to the one suggested in that literature. While the economic theory of federalism (see Bird 1993 and Breton 1996 for surveys on its present state) analyses the behaviour of *given* political units at the different levels of government (Weingast 1993: 292), FOCJ *emerge* in response to the 'geography of problems'.¹

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

2.1. Functions

A particular public service which benefits a certain geographical area should be financed by the people living in that area, that is, there should be no spillovers. The different governmental units can cater to differences in the populations' preferences or, more precisely, to its demands. To minimise cost, these units have to exploit economies of scale in production. As the latter may strongly differ between functions (for example, between schools, police, hospitals, power plants and defence) there is an additional reason for uni-functional (or few-functional) governmental units of different sizes. 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 theory has been little concerned with decisionmaking within functional units. The supply process is either left unspecified or it is assumed that the mobility of persons (and of firms, a fact rarely mentioned) automatically induces these units to cater to individual preferences. This criticism also applies to a closely related concept of fiscal federalism, namely 'voting by foot' (Tiebout 1956). This preference-revealing mechanism makes comparatively efficient suppliers grow in size, and the others shrink. According to this model of federalism, the political

jurisdictions are exogenously given, are multi-purpose, and do not overlap, while the political supply process is left unspecified. In contrast, we emphasise the need to study explicitly the political supply process. In line with Epple and Zelenitz (1981), exit and entry is considered insufficient to eliminate rent extraction by governments. Therefore, individuals must have the possibility of raising voice in the form of voting. There is a certain similarity between Buchanan's (1965) 'clubs' and FOCJ because the size of both is determined endogenously by the benefits and costs of the club members (see Sandler and Tschirhart 1980). Another concept related to FOCJ are functional parliaments serving both allocative and distributional functions. Such institutions have been suggested for the European Union by Teutemann (1992), yet they differ in an important respect from FOCJ. They are determined and imposed from outside and above whereas FOCJ emerge in response to the demand by individuals or, in a more aggregate way, by communities as the smallest existing political unit.

2.2. Overlaps

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

2.3. Competition

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

may be total or only partial. In the latter case, an individual or community only participates in a restricted set of FOCUS activities. This enlarged set of exit options makes 'voting by foot' function properly.

The importance of 'secession' (that is, exit of jurisdictions such as communities) for restricting the power of central states has been recognised in the literature (for example, Zarkovic Bookman 1992, Drèze 1993). Secession has been suggested as an important ingredient for a future European constitution (Buchanan 1991, European Constitutional Group 1993). The right to secede stands in stark contrast to the prevailing concepts of nation states and federations where this is strictly forbidden and often prevented by force, as is illustrated, for example, by the American Civil War 1861–65, by the Swiss 'Sonderbundskrieg' 1847, or more recently by the wars in Katanga (1960–63), Biafra (1967–70), Bangladesh (1970–71), and presently in former Yugoslavia. Current European treaties do not provide for the secession of a nation from the European Union, and *a fortiori* for part of a nation. The possibility of lower-level jurisdictions to exit at low cost from the European Union as a whole as well as from particular subunits (nations, states, Länder, autonomous regions, and so on) thus depends strongly on the future European constitution.

For FOCJ to establish competition between governments, exit should be as unrestrained as possible. In contrast, entry need not necessarily be free. As for individuals in Buchanan-type clubs, jurisdictions and individuals may be asked a price if they want to join a particular FOCUS and benefit from its public goods. The existing members of the particular FOCUS have to decide democratically whether a new member pays an adequate entry price and is thus welcome. 'Free' mobility in the sense of a disregard for the cost imposed on others is overcome by internalising the external cost of movement. In addition, FOCJ do not have to restrict entry by administrative and legal means such as zoning laws. Explicit, openly declared entry fees substitute implicit restrictions resulting in high land prices and housing rents. The commonly raised concern that pricing could be exploitative and mobility strongly curtailed is unwarranted as FOCJ are subject to competitive pressure. Moreover, the possibility to impose an explicit entry fee gives incentives to FOCJ-governments to care not only for the preferences of actual, but also of prospective members.

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

2.4. Jurisdictions

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

FOCJ as jurisdictions provide particular services but do not necessarily produce them themselves if contracting-out to a public or private enterprise is advantageous. But present-day outsourcing by communities does not lead to FOCJ as the former is restricted to production while FOCJ care for provision (and are directly democratically controlled). In this respect, Buchanan-type clubs differ from FOCJ, too, because they are always voluntary while membership in a FOCUS can be obligatory.

3. FOCJ AND EUROPE

3.1. Comparison to Actual and Proposed Federalistic Institutions

FOCJ differ in many crucial respects from scholarly *proposals* for a future European constitution. One of the most prominent was Buchanan's (1991) who stresses an individual nation's right to secede but, somewhat surprisingly, does not build on Buchanan-type clubs. The European Constitutional Group (1993) focuses on the example of the American constitution, and presents constructivist proposals with respect to the houses of parliament and the respective voting weights of the various countries. Overlapping jurisdictions and referenda are not allowed for, and the exit

option is strongly restricted. Other economics scholars (for example, Blöchliger and R.L. Frey 1992, Schneider 1992) suggest a strengthening of federalism in the traditional sense (that is, with multi-purpose federal units) but do not envisage overlapping jurisdictions. The report by the Centre for Economic Policy Research (1993) criticises 'subsidiarity' (as used in the Maastricht Treaty) as an empty concept arguing that good theoretical reasons must be provided for central government intervention. But the report does not deal with the institutions necessary to guarantee that policy follows such theoretical advice. The idea of overlapping, not geographically based jurisdictions is shortly raised but is not institutionally or practically worked out, nor is the need for a democratic organisation and the power to tax acknowledged.

The recent proposal from politicians (Herman report of the European Parliament, 1994) mainly deals with the organisation of the parliamentary system (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 'cooperation' between governments.

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

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

(examples are The Netherlands, France or Sweden). The 'regions' existing in the European Union (examples are Galicia and Cataluña in Spain, or South Tyrol and Sicily in Italy) are far from being units with significant autonomous functional and fiscal competencies.

The Council of Ministers is a European decisionmaking institution based on federal principles (but nations only are represented) and organised 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 legitimised by the representative system) and the deliberations are not public. Exit from the European Union is not formally regulated, and exceptions to specific aspects of agreements reached (as in the Maastricht Treaty concerning the European Monetary Union and the Protocol on Social Policy, or in the Schengen Treaty concerning the free movement of persons) are granted reluctantly. Indeed, they are seen as damaging the 'spirit of Europe'. Whether differential degrees of European integration are framed as models of variable geometry, multi-track, multi-speed, two-tier, hard core, concentric circles, or as *Europe à la carte* (*The Economist*, 1994, 22 October, 'Survey of the European Union', p. 15; Pitschas 1994), it always evokes fierce opposition. In a system of FOCJ, in contrast, functional units not covering everyone are taken as a welcome expression of heterogeneous demands among Europeans.

3.2. Applications

It might be argued that the idea of FOCJ is exotic and has no chance of ever being put into practice in Europe. A careful consideration 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 collaborate directly with each other, not even to exchange information. Rather, they must advise the police ministries of the Länder and cantons, which then have to notify the respective central governments which then interact with each other. Obviously, such a formal procedure is in most cases vastly inefficient and unnecessarily time consuming. In actual fact, the problems are dealt with by direct contact among the local police commissioners and officers. However, this is outside the law and depends to a substantial extent on purely personal relationships (which may be good or bad). A FOCUS committed to policing the lake would allow a pragmatic,

problem oriented approach within the law – and would, moreover, be in the best ‘spirit’ of Europe.

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

4. HOW FOCJ WORK

4.1. Beneficial Effects

FOCJ compare favourably to traditional forms of federalism. One aspect concerns the governments’ incentives and possibilities of satisfying heterogeneous preferences of individuals. 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 quite limited geographic area, we envisage FOCJ to be often small which is also helpful for voters’ evaluations. The exit option opened by the existence of overlapping jurisdictions is also an important means to make one’s preferences known to governmental suppliers.

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

The specialisation in one or a few functions further contributes to cost efficiency due to the advantages of specialisation. As FOCJ levy their own taxes to finance their activity, it pays to be economical. In contrast, in APJ (All-Purpose Jurisdictions) financed from outside lacking such fiscal equivalence, politicians have an incentive to lobby for ever increasing funds, thereby pushing up government expenditures. The incentive to economise in a FOCUS induces its managers to contract-out whenever production cost can thereby be reduced. While FOCJ are more market oriented than APJ, they reduce the size of the public sector. However, they differ from today's one-shot privatisation, which usually does not impact on the governments' basic incentives and thus is subsequently often reversed by deregulation and deprivatization. In contrast, in a system of FOCJ privatisation emerges endogenously and is sustainable, as the politicians' incentives are changed fundamentally.

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

The possibility to form FOCJ helps to deal with issues raised by fundamentalist sentiments. Political movements focused on a single issue (for example, ethnicity, religion, environment, and so on) 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 particular preferences. South Tyroleans, for example, unhappy with the language domination imposed by the Italian state, need not leave Italy in order to have their demands for cultural autonomy fulfilled, but may establish corresponding FOCJ. Such partial exit (for instance, only with respect to ethnic issues) does not lead to trade barriers often associated with the establishment of newly formed all purpose jurisdictions. FOCJ thus meet the criterion of market preserving federalism (see Weingast 1993).

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

4.2. Overcoming Problems

Up to this point we have emphasised the beneficial effects of FOCJ. However, there are also some alleged problems with our concept which will now be discussed.

Overburdened citizens

In a federal system of FOCJ, each individual is a citizen of various jurisdictions. As a consequence, individuals may be overburdened by voting in elections and referenda taking place in each FOCUS. However, citizens in a direct-democratic FOCUS find it much easier to politically participate as they have only to assess one or a few concrete issues at a time. In contrast, in representative-democratic APJ citizens have to evaluate all political aspects simultaneously, and they have to speculate what position a political candidate will take over the next election term. Formal voting theory indeed assumes that the voters evaluate each dimension of government activity or of a candidate's policy separately (for example, Downs 1957, or for a survey Mueller 1989). This breakdown according to various aspects is to a substantial extent performed naturally by FOCJ. If the citizens find it none

the less burdensome to vote on each governmental function separately, they can rely on institutions emerging to deal with the problem. For instance, in referenda they may simply follow parties' recommendations. A more innovative solution would allow citizens to voluntarily transfer the voting right on specific functions to a political agent, be it a party or an interest group, who then decides on the behalf of the citizens concerned. This kind of 'representation' is chosen by each citizen according to his or her individual preference, and can be recalled at any time.

Overburdened consumers

An individual is confronted with a multitude of suppliers of public services which is argued to make life difficult. This is the logical consequence of having more options to choose from, and is similar to supply in the private sector. If citizens find it nevertheless to be a problem, a governmental or a private advisory service can be established which offers information and support for the consumers' decisions. It should, moreover, be observed that in APJ the same problem exists. There is no all-enhancing administration managing all public services. Rather, the responsibility is divided up among specialised government departments so that the citizens/consumers are also effectively confronted with many different agencies supplying public services.

'Need' to coordinate the activities of FOCJ

While coordination is obviously often needed, coordination between governments is not a good as such. It sometimes serves to build cartels among the members of the 'classe politique' who then evade or even exploit the population's wishes (see CEPR 1993, Vaubel 1994, Frey 1994). As far as welfare increasing coordination is concerned, its need is reduced compared to APJ because the FOCJ emerge in order to minimise externalities. If major spillovers between FOCJ exist, new FOCJ will be founded taking care of these externalities. As the number of FOCJ is restricted due to the transactions cost involved, less important externalities between FOCJ will remain. However, spillovers also exist in a system of APJ between administrative units, for instance, between the department for environment and the department of transport. The crucial question therefore is in what system N-player Coase-type interfunctional bargaining is more likely to arise. The respective civil servants in APJ have a muted incentive to take these spillovers into account by bargaining. On the one hand, their sphere of influence may be curtailed if they coordinate decisions among various departments effectively. On the other hand, their income and other benefits are essentially unconnected to the possible benefits to the citizens. To overcome externalities within an APJ the respective government needs to

establish interministerial commissions with appropriate incentives. In contrast, the political managers of a FOCUS have a self-interest to engage seriously in Coasian bargaining as the support received from the members of their FOCUS depends on how much they raise their members' utility. This responsiveness is achieved by the institutions of re-election and by popular initiatives and referenda on specific issues. To the extent that the citizens of some FOCJ value coordination, it behoves the FOCJ governments to provide it. Thus, coordination among FOCJ is not inherently different from coordination in economic markets, where similar problems occur all the time and are analysed in depth by much recent research in industrial organisation (see Farrell and Saloner 1988, Milgrom and Roberts 1990). Some of the solutions found there, for example, for the development of industry wide standards, might well apply to FOCJ as well.

Vote trading

In FOCJ the separation along functions prohibits vote trading and therefore restricts the expression of different preference intensities. In contrast, in a system of APJ, 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. However, vote trading does not always induce Pareto-superior outcomes. Log-rolling is only beneficial to the groups included in the deals, but tends to 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. 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.

Redistribution

It is claimed that all forms of federalism – including FOCJ – undermine redistribution. Moreover, FOCJ are said to emerge on the basis of income. As far as redistribution is based on the citizens' solidarity or on insurance principles, this fear is unwarranted. Only as far as redistribution is a pure public good, and thus must be enforced to prevent free-riding, may a problem arise. However, recent empirical research (Gold 1991, Kirchgässner and Pommerehne 1996) suggests that substantial redistribution is feasible in federal systems. In the US and especially in Switzerland, lower level and even local governments strongly engage in redistribution activities and are responsible for a substantive share of redistribution. In these countries, mobility is obviously not high enough to render redistribution impossible. As

concerns Europe, mobility is also quite low. Less than five per cent of EU-citizens live outside their country of citizenship. This low level of mobility can be interpreted in two ways: (i) In decentralised systems mobility by persons (and to a lesser extent also firms) is countervailed by strong local attachment. (ii) Redistribution does not constitute a pure public good but provides localised benefits. However, if decentralised redistribution is considered insufficient, a FOCUS specialised in interregional redistribution may emerge but this presupposes barriers to entry (in analogy to insurance systems with cross-subsidisation). Moreover, centralisation of redistribution is still possible, of course. The European constitution may give central government the power to impose a limited amount of income redistribution.

5. WHY HAVE FOCJ NOT YET SUCCEEDED?

In view of the major advantages outlined, and the futility of much of the alleged problems of FOCJ the economist's standard question arises: if this type of federalism is so good, why is it not more successful? The organisation of states today does not follow the model of FOCJ for two major reasons. An obvious, but crucial one, is that individuals and communities are prohibited from establishing such jurisdictions, and in many countries of the European Union communities are not even allowed formally to collaborate with each other without the consent of the central government (for empirical evidence, see Sharpe 1993, esp. p. 123ff.). When spillovers exist, the normal procedure in all member countries is to shift the task to a higher level of government which leads to increasing centralisation. An example is environmental protection which to a considerable extent deals with local issues but where the existence of partial externalities have lead to a centralised administration.

Secondly a system of FOCJ is not observed because it violates the interests of politicians and public officials at the higher levels of government. The emergence of FOCJ reduces the public suppliers' power and increases citizens' influence by the newly introduced mechanisms of competition by exit and entry and by direct democratic elements. Both are regularly opposed by the *classe politique* (see, for example, Vaubel 1994 for the case of the EU). Politicians' discretionary room and therefore the rents appropriable are the larger, the higher the federal level.² Thus, they favour a shift of competencies in this direction, and oppose local decisionmaking, especially by FOCJ.

In the countries of the European Union (and elsewhere) a federal system of FOCJ will not arise if these barriers are not overcome. A necessary condition is new constitutional rules allowing the formation of FOCJ and

giving the citizens and the governments the right to appeal to the Constitutional Court if they are blocked.

6. ILLUSTRATIONS

6.1. European History

Decentralised, 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, has been intensive. Many of these governments were of small size. Not a few scholars attribute the rise of Europe to this diversity and competition of governmental units which fostered technical, economic and artistic innovation (see, for instance, Hayek 1960, Jones 1981, Weede 1993 and Baumol and Baumol 1994 who also give a lively account of how the musical genius of Wolfgang Amadeus Mozart benefited from this system of government). While the Chinese were more advanced in very many respects, their superiority ended with the establishment of a centralised Chinese Empire (Pak 1995, 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, leading to deadly struggles between nation states.³ Some smaller states escaped unification; Liechtenstein, Luxembourg, Monaco, San Marino and Switzerland stayed politically independent, and at the same time grew rich.

The above mentioned governmental units were not FOCJ in the sense outlined in this chapter 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 organised 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 (England), Bruges and Antwerp (today Belgian) and Novgorod (today Russian) were *Handelskontore* or associated members. It clearly was a functional governmental unit providing for trade rules and facilities and was not geographically contiguous.

6.2. Contemporary Examples

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

Most of these functional units are not contiguous with the area of the European Union. Some are smaller (for example, those organised 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, for instance, European culture, education or crime. FOCJ of the nature understood in this chapter may therefore build upon already existing structures, and are in the best of European traditions.

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

United States

Single-purpose governments in the form of 'special districts' play a significant role in the American federalist system (ACIR 1982, 1987). Their number has strongly increased, between 1967 and 1972 by 30.4 per cent, between 1972 and 1984 by 19.7 per cent, in both cases more quickly than other types of jurisdictions (Zax 1988). There are both autonomous and democratically organised as well as dependent special districts (for instance, for fire prevention, recreation and parks). Empirical research suggests that the former type is significantly more efficient (Mehay 1984). Our theoretical hypothesis of the opposition of existing jurisdictions against the formation of special districts is well borne out. In order not to threaten the monopoly power of existing municipalities, statutes in 18 states prohibit new municipalities within a specified distance from existing municipalities (ACIR 1982, Zax 1988: 81); in various states there is a minimum population size required and various other administrative restrictions have been introduced (see, for example, 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 (DiLorenzo

1981, Deno and Mehay 1985), and tend to push upwards the local government expenditures in those municipalities which have introduced LAFCOs (Martin and Wagner 1978).

Switzerland

Many Swiss cantons have a structure of overlapping and competing functional jurisdictions which share many features of FOCJ. In the canton Zurich (with a population of 1.2 million in 1991, a size of 1700 km² and tax revenue of SFr. 3000 million) there are 171 political communities (with a tax revenue of SFr. 3800 million) which in themselves are composed of three to six independently managed, democratically organised communities devoted to specific functions and levying their own taxes. Take a typical example for the purpose of illustration: the political income community of Niederhasli (population 5900, size 11km²) 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 levies various charges and receives a limited amount of subsidies from the canton). A community that exclusively provides for elementary schools (years 1–6 of schooling) has expenditures of SFr. 5.8 million and levies a tax of 55 per cent of the cantonal tax. A corresponding community specialising in education of years 7–9 spends Sfr. 4.9 million and levies 22 per cent of the cantonal tax rate. There are two church communities having tax rates of 10 per cent and 11 per cent of the cantonal tax rate, respectively. The two school communities and the two religious communities are essentially self-financing. The sixth community (Zivilgemeinde) is devoted to providing water, electricity and a TV antenna, and finances itself solely by user charges. These communities often overlap with neighbouring political communities. In the case of Niederhasli, the advanced school community also comprises the political community of Niederglatt (pop. 3300) and parts of Oberglatt (pop. 4300) (the rest of the pupils attend school in yet another school community). In addition there are 174 functional units (*Zweckverbände* as they are aptly called in German-speaking countries) whose members are not individual citizens but communities.⁴ Thirty of these *Zweckverbände* 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, and so on. The canton Zurich is no exception in Switzerland concerning the multitude of types of functional communities. A similar structure exists, for example, in the canton Glarus or Thurgau (for the latter, see Casella and Frey 1992). Various efforts have been made to suppress this diversity of functional communities, usually initiated by the cantonal bureaucracy and politicians. However, most of these attempts were thwarted because the population is mostly satisfied with the public supply provided. The example of

Switzerland – which is generally considered to be a well-organised and administered country – shows that a multiplicity of functional jurisdictions under democratic control is not a theorist's wishful thinking but has worked well in reality.

7. CONCLUSIONS

Europe owes its position as an economically rich and intellectually and artistically powerful continent in a 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 chapter 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 communities.

NOTES

1. As always, there are precursors to FOCJ. The general idea has already been brought up by Montesquieu (we owe this information to one of the referees), but it has, to our knowledge, not been applied to the EU. In the economics literature a related concept has been pioneered by Tullock (1994), who somewhat misleadingly speaks of 'sociological federalism'. Casella and Frey (1992) discuss the concept and refer to relevant literature. A recent Centre for Economic Policy Research Publication (CEPR 1993) briefly mentions the possibility of establishing overlapping jurisdictions in Europe (pp. 54-55) but does not work out the concept nor does it refer to previous research (except for Drèze 1993 on secession). In contrast, Schmidt-Trenz and Schmidheini (1994) focus on the role of territoriality in the framework of optimum legal areas.
2. A formal reason is that the more vote cycling is prevalent, the more alternatives (functions) there are (see, for example, 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, for example, Oakerson and Parks 1988, Cronin 1989).
3. According to Sperber (1994, p. 24), in the first half of the nineteenth century average income was higher in strongly decentralised Germany than in strongly centralized France, which may at least partly be attributed to the difference in the degree of centralisation.

4. Zweckverbände also exist between cantons in which case they are called Konkordate. However, these units (clubs) are not legally independent political entities, that is, the US and Swiss single purpose communities are exceptions (see Mehay 1984).

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Edited by

Dieter Schmidtchen

*Professor of Economics,
Universität des Saarlandes, Germany*

Robert Cooter

*Professor of Law,
University of California at Berkeley, US*

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Edward Elgar

Cheltenham, UK • Lyme, US