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Abstract

In the current debates on the future European order, the European Union (EU) is often described as an 'emerging federation'. The article claims that federalism is not only useful in deliberating about the future of the EU, but also a good tool for understanding the current structure and functioning of the European system of multi-level governance. Non-state centric conceptions of federalism provide a better understanding of the current structure and functioning of the European system of multilevel governance than most theories of European integration and International Relations do. We combine political and economic perspectives of federalism to analyze the 'balancing act' between effective political representation and efficient policy-making in the EU. Drawing on the examples of Germany and Switzerland in particular, we argue that the increasing delegation of powers to the central EU level needs to be paralleled by either strengthened patterns of fiscal federalism or an empowered representation of functional interests at the European level. Without such 're-balancing', the current legitimacy problems of the EU are likely to intensify.

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I. Introduction

In an attempt to re-launch the discussion on the future shape of the European order, Germany's Foreign Minister, Joschka Fischer, has described the European Union (EU) as a 'European Federation'.¹ His intervention provoked a heated political debate on how to organize the division and sharing of sovereignty rights among the different levels of government within the EU.² The debate has gained further momentum with the Declaration of Nice, which calls for a wide-ranging discussion on the future of the EU, resulting in the European Convention which is expected to propose new structures for the EU.³ In this paper, we show that the concept of federalism is not only useful for reflecting about Europe's *finalité politique*, but it also provides a good tool for understanding the current structure and functioning of the European system of multi-level governance. A number of studies have invoked different concepts of federalism to assess the European 'balancing act' between the representation of territorial and functional interests on the one hand (Sbragia 1993a; Schmitter 1991; Egeberg 2001), and the efficiency and rationality of policy-making on the other hand (Scharpf 1988, 1993; Dehousse 1992; Majone 1993). Yet, the political and economic dimensions of federalism are rarely linked, nor is their relationship explored systematically. Combining the two perspectives points to an inherent tension between effective political representation and efficient policy-making. Whereas arguments for economic efficiency often provide powerful incentives for centralization, counterbalanced in this by the logic of fiscal federalism and competition among local jurisdictions, the accommodation of territorial interests and political reasoning justifies decentralization mainly in order to enhance legitimacy and democratic accountability.

Our paper explores the somewhat ambivalent relationship between effective political representation and efficient policy-making for the EU. In order to do this, we combine two important strands of literature on federalism: economic federalism, mainly concerned with an optimal distribution of policy competencies among the different levels or tiers of government, and political federalism, with its focus on different modes of political representation (section II). We will use this 'integrated approach' in order to analyze the balancing of policy making efficiency and effective political representation in the European system of multi-level governance (section III). Drawing on the examples of Germany and Switzerland in particular, we finally argue that the increasing delegation of powers to the central EU level needs to be paralleled by either strengthened patterns of fiscal federalism or an empowered representation of functional interests at the European level. Without such 're-balancing', the current legitimacy problems of the EU are likely to get worse.

II. Economic and Political Perspectives on Federalism: Combining Two Approaches

The Political Economy of Federalism

Theoretical concepts helpful to judge on the appropriate assignment of policy competencies to different government levels, viewed from a political-economy perspective, have mainly been developed in the framework of the economic theory of federalism and, more specifically, fiscal federalism⁴. The aim of this normative-analytical approach is the determination of an optimal

structure of the public sector in terms of the allocation of jurisdiction and fiscal powers to different layers of government.

In the framework of such approaches, despite variations among authors, there appears to be a consensus that functions of (macroeconomic) stabilization⁵ and of distribution⁶ are best exercised on the central level, but the provision of public goods more generally may be located at different levels of government. For some public goods, central provision appears to be more suitable (such as defense), whereas others (e.g. streetlights) may efficiently be provided by lower levels of government. Musgrave (1959) and Oates (1972) have illustrated how an appropriate assignment of jurisdictions over public goods and taxes can lead to increases in social welfare. Many 'public goods' provided by lower levels of government, however, are rather 'congestable public goods' in practice, i.e. public goods that are rivalrous in character. As Cooter (2000: 106) points out, subnational governments are generally better informed and better motivated to supply efficient quantities of congestable public goods than is the central government (also see Hong 2002: 25).

Musgrave recently reiterated that distribution should indeed be a matter of interest to the entire nation and primarily to be dealt with by the central government.⁷ By comparison, even in some policy areas in which local provision appears to be both feasible and desirable, such as elementary school education and partially also health care, the quality of these public goods is of course nonetheless of crucial relevance to the federation as a whole.⁸

Generally, in federal systems, problems of collective action are likely to be present, since individual jurisdictions may attempt to benefit as much as possible from collective goods within the federal structure while aiming to assume a relatively low share in the costs of their provision. This incentive mainly stems from political pressures, as representatives may want to satisfy the policy preferences of their local constituencies on the basis of a minimum of financial contributions of their own taxpayers, in an effort to increase their re-election prospects.

Generally, the provision of public goods relevant to the entire federation may be facilitated by the existence of asymmetric interests among the constituent federal units. In the extreme, one unit may benefit from the provision to such an extent that it is ready to meet the full costs of the public (or 'congestable') good, in accordance with reasoning along the lines of Mancur Olson (1965). Moreover, generally, smaller numbers of actors tend to increase prospects for successful cooperation.⁹ Translated to the current situation in the EU, this hints towards the possibility that the provision of public goods may be rendered more difficult on the basis of an increased number of member states, providing additional incentives for decentralization in the EU and the delegation of political and regulatory competencies to lower government levels.

Fiscal federalism aims to ensure that the provision of public goods meets the preferences of (local) residents in an optimal way. Aiming at a decentralized distribution of public goods, Olson emphasized the concept of 'fiscal equivalence': according to this approach, public goods are essentially to be provided to the group of actors willing to pay for their provision (Olson 1969). This reasoning provides incentives for the provision of local (congestable) goods that satisfy the preferences and demands of local residents, and are paid by them. However, according to the logic of 'fiscal equivalence', jurisdictions may also be overlapping instead of

being geographically separate units. In fact, a whole network of jurisdictions may co-exist – both horizontally and vertically regarding the different levels of government – each being responsible for the provision of a particular public good. This idea has been elaborated by the notion of ‘overlapping political jurisdictions’ (Casella and Frey 1992) and ‘FOCJ’: ‘functional, overlapping and competing jurisdictions’ (Frey and Eichenberger 2002).

Charles Tiebout (1965), in his seminal article, presented a model of inter-jurisdictional competition considered to be beneficial to overall social welfare,¹⁰ mainly because it allows for the provision of a mix of tax levels and public goods most representative of local citizens’ priorities. Generally, citizens prefer lower taxes and the provision of public (or congestable) goods meeting their own preferences. Whereas his model has faced criticism over time, it still constitutes a good ‘benchmark’ to explore the potential benefits of fiscal decentralization.

On the one hand, according to the logic of the Tiebout model, tax competition tends to decrease overall costs within a federal setup, as inter-jurisdictional competition forces (local) government to provide services efficiently. If government is not viewed as a ‘benevolent actor’, competitive forces among jurisdictions may prevent government bureaucracies from drawing ‘rents’ to the detriment their taxpayers (Brennan and Buchanan 1980). Likewise, lobbying groups lose some of their leverage when inter-jurisdictional competitive forces are in effect, as the fear of losing taxpayers gives local government an incentive to provide the kinds and levels of public goods optimally reflecting taxpayers’ priorities.

On the other hand, benefits are maximized according to this model, because citizens and companies acknowledge ‘best practice’ in the provision of public goods and competitive regulatory decision-making (‘yardstick competition’, see Besley and Case 1995). ‘Laboratory federalism’, hence, induces a beneficial search for optimal regulations. Citizens can ‘vote with their feet’ and move to the jurisdiction providing their most preferred combination of taxes, regulations and public or congestable goods, thus reinforcing patterns of inter-jurisdictional competition. Generally, inter-jurisdictional competition, therefore, may alleviate ‘government failure’ (e.g. Brennan and Buchanan 1980; Wintrobe 1987). In addition, it has been argued that decentralization of information and authority, in addition to inter-jurisdictional competition, can provide more credible commitments to secure economic rights and preserve markets. ‘Market-preserving federalism’, accordingly, is a key concept (e.g. Weingast 1995; Quian and Weingast 1997).

Linked to this discussion is the question to which extent regulatory activities – in the domain of products and services, for example – should be harmonized in the framework of federal systems and to which extent there may be competition among jurisdictions regarding regulations. In the absence of negative externalities and of a possible ‘race to the bottom’, scholars have highlighted the positive aspects of such competition in terms of leading to a search for more efficient regulations, and constraining effects on regulatory activities favoring special interest groups. This concept has been transferred to the analysis of competition among regulations within the EU, for example.¹¹

These approaches, while dealing with political aspects of federalism, are rooted in economic reasoning on the efficient allocation of policy competencies among different levels of

government. In more positive political-economic analyses, it turns out that the degree of fiscal centralization and decentralization, in practice, is largely determined not only by (normative) efficiency considerations, but also by political factors such as electoral dynamics on sub-national levels of government.¹² In addition, in recent literature, the trade-off between economic efficiency and political participation has been focused on more explicitly (e.g. Inman and Rubinfeld 1997). A comparison between different concepts of political federalism – especially dual and cooperative federalism – addresses issues of political representation in more detail, and the question of balancing territorial and functional interests. Hence, it may be most fruitful indeed to combine economic and political reasoning to the study of federalism, an approach promising to be helpful not least for a description and analysis of the current system of multi-level governance in the EU.¹³

The Federal Dichotomy: Dual and Cooperative Federalism

Comparative Federalism¹⁴ draws on a distinction between two models of federalism, going back to different interpretations of Montesquieu's ideas about organizing political power as *séparation des pouvoirs and distribution des pouvoirs*.

Séparation des pouvoirs, or 'dual federalism', to which the model of the United States most closely corresponds, emphasizes the institutional autonomy of different levels of government, aiming at a clear vertical separation of powers.¹⁵ Each government level has an autonomous sphere of responsibilities. Competencies are allocated according to policy sectors rather than policy functions. For each sector, one level of government holds both legislative and executive powers. As a consequence, the entire government machinery tends to be duplicated, as each level manages its own affairs autonomously. The sectoral or dual allocation of policy competencies is complemented by a rather weak representation of the federal units at the central level of government. The second chamber of the federal legislature tends to be organized according to the 'senate principle': the federal units are represented by an equal number of directly elected senators, irrespective of the size of the geographical unit they represent. As a result, and in contrast to the *Bundesrat* principle, the senate does not reflect the territorially defined interests as represented by the executives of the federal units, but the functional preferences of the electorate or the political parties within the federal units. The federal units articulate their interests through voluntary co-ordination and co-operation with the central government (the federal level), usually in the framework of intergovernmental conferences. Institutional autonomy of each government level, finally, presupposes a fiscal system granting states sufficient resources in order to exercise their competencies without financial interventions of the central level. This pattern is usually strengthened by the establishment of relatively comprehensive fiscal autonomy for the federal units, allowing them to levy their own taxes and hence, to have independent sources of revenue.

Distribution des Pouvoirs or *cooperative federalism*, a concept for which Germany serves almost as a 'prototype', is based on a functional division of labor among different levels of government: while the central level makes the laws, the federal units are responsible for implementing them. In this system, the vast majority of competencies are 'concurrent' or 'shared'. This functional division of labor requires a strong representation of the interests of the federal units at the central level, not only in order to ensure an efficient implementation

of federal policies, but also in order to prevent federal units from being reduced to mere ‘administrative agents’ of the federal government. Their reduced capacity of self-determination is compensated, however, by strong participatory rights in the process of federal decision-making (mainly in the framework of the second chamber of the national legislature). Major policy initiatives usually require the consent of both the federation and a majority of the federal units. The chamber of territorial representation is organized according to the *Bundesrat* (Federal Council) principle, where federal units are represented by their governments, and in relation to their population size, but smaller states usually enjoy over-representation. The sharing of policy competencies is complemented by a joint tax system. The federal government and the federal units share the most important tax revenues, which allows for a redistribution of financial resources between federal units with stronger to those with weaker spending power (fiscal equalization). The functional and fiscal interdependence of the two main levels of government not only gives rise to ‘interlocking politics’ and ‘joint decision-making’, but also favors the emergence of a policy-making system in which policies are formulated and implemented by the administrations on both levels of government (‘executive federalism’). Unlike in dual federalism, functional (non-territorial) interests are only weakly represented in federal decision-making and rely on alternative forms of interest intermediation, such as the party system and/or sectoral associations.

Each of the two political models of federalism presents a particular solution to balancing the effective representation of territorial and functional interests at the central level (cf. Egeberg 2001). The institutional choice for either model usually reflects the underlying socio-economic, cultural and political conditions of a society (Schultze 1992; Benz 2002: 20-25).

From this overview, it seems that ‘dual federalism’ resonates more with economic approaches of federalism as outlined above, emphasizing concepts such as fiscal equivalence and inter-jurisdictional competition. Yet, economic federalism does not always justify decentralization and separation of government responsibilities. The optimal allocation of polity competencies to different levels of government, generally, has to balance potential costs of centralization (such as costs stemming from federal decision-making, information processing, implementation, and potentially insufficient accommodation of local interests) and the costs of decentralization (including possible negative externalities among local jurisdictions, foregone economies of scale and possible territorial inequalities). Such trade-offs may provide incentives for certain degrees of joint decision-making among different levels of government or a functional division of competencies (e.g. regarding decision-making, implementation and financing),¹⁶ elements usually more characteristic of cooperative federalism.

III. Moving Toward a Federal Structure: Challenges to the European Union

The EU may be described as a system of multi-level governance, where sovereignty rights are shared and divided between supranational, national, and subnational institutions.¹⁷ While traditional theories of International Relations and European integration have difficulties capturing the multi-level nature of the emerging European polity,¹⁸ the constitutional language of federalism appears to be helpful in order to analyze and discuss the ways in which the division of power is organized among the different levels of government in the EU.

Generally, federalism refers to a spatial or territorial division of power between two (or more) levels of government in a given political system.¹⁹ Both levels have to hold some autonomous decision-making powers which they can exercise independent of each other. Finally, the federal units are represented in central decision-making processes. In a nutshell, a federal system is characterized by sovereignty being shared and divided between different levels of government rather than being located at one level exclusively.

While discussions on European federalism often imply or even advocate the transformation of the EU into a federal state,²⁰ federalism as a principle of organizing political authority and power is not necessarily wedded to statehood (Elazar 1987: 12). It is commonly agreed that the EU has developed into more than an international organization or confederation of states, without having become a federal entity, however. Only few expect the EU to develop into a full-fledged federation in the sense of a federal state. But federalism examines a wide variety of federal arrangements between confederation and federation as the two opposite ends of the ‘federal continuum’ (cf. Burgess 1986). In this view, federalism provides a better way of understanding political relationships that are neither purely domestic nor purely international than most theories of International Relations or European integration do, precisely because federalism does not rely on a state-centric ontology (Koslowski 2001).

Certainly, the founders of the European Community did not envisage a truly federal structure. Originally, the European Community was set up and conceptualized primarily as a functionally circumscribed organization of economic integration (*‘Zweckverband funktionaler Integration’*), based on neither fixed territorial boundaries nor a direct link between its citizens and its institutions (Ipsen 1972: 196). Nevertheless, European institutions have always entailed federal elements. For example, the High Authority of the Coal and Steel Community was not an intergovernmental executive body, but it held autonomous powers and was accountable to a European Common Assembly. When it developed into the European Commission with the Treaties of Rome (1957), it continued to enjoy broad powers within the European Economic Community (EEC). While supranational competencies remained under the control of the (intergovernmental) Council of Ministers, the Single European Act (1986) introduced majority voting in the Council and increased the powers of the European Parliament (EP). With subsequent treaty revisions, the EU acquired sovereignty rights in a wide variety of policy areas. They reach from exclusive jurisdiction regarding European economic and monetary union (EMU) for the participating EU states, to far-reaching regulatory competencies in sectors such as industry, trade, transportation, energy, and environmental and consumer protection. In addition to this, increasingly, EU regulations are penetrating even the core of traditional state responsibilities – including internal security in the framework of the *Schengen* agreements and *Europol* – and, albeit to a lesser extent, foreign and security policy (cf. Bogdandy 1999: 2-28). In most policy areas, Community law not only has supremacy over national law, but it also deploys ‘direct effect’, giving citizens the option to litigate against their states for violating rights attributed to them by Community law. With the Treaties of Maastricht (1993) and of Amsterdam (1998), the Single Market and the EMU became embedded into a political union with emerging external boundaries²¹ and a more clearly defined citizenship.²²

Hence, the EU has developed into a political community with comprehensive regulatory powers and a proper mechanism of territorially defined exclusion and inclusion (Union citizenship).

By now, in fact, it shares most features of what is usually defined as a federal system (see e.g. Wheare 1963; Bakvis and Chandler 1987). Let us outline some of these aspects.

- a) The EU is a system of governance based on at least two orders of government, each existing under its own right and acting directly to its citizens;
- b) The European Treaties allocate jurisdiction and resources to these two main orders of government (but also levels below the state are increasingly gaining leverage and institutional representation, e.g. through the Council of Regions);
- c) There are provisions for 'shared government' in areas where the jurisdiction of the EU and the member states overlaps;
- d) Community law enjoys supremacy over national law;
- e) European legislation is increasingly made on the basis of majority decisions, partially obliging individual states to accept decisions against their own priorities;
- f) The composition and procedures of EU institutions are based not solely on principles of majoritarian representation, but allow for the representation of 'minority' views, as smaller entities (i.e. smaller EU states) tend to be over-represented in both the EP and the Council of the EU (despite recent adaptations agreed upon in the framework of the Treaty of Nice);
- g) The European Treaties are not unilaterally amenable by one order of government alone, but require the endorsement by the governments and a given proportion of the voters or of a majority in the legislatures of the member states;
- h) The European Court of Justice (ECJ) serves as an umpire to adjudicate conflicts between the European institutions and EU member states, as well as between citizens and their domestic governments;
- i) The EC (EU), since 1979, has a directly elected Parliament, which, over the last decades, has managed to significantly increase its leverage in the framework of the EU's inter-institutional procedures.

In spite of this, however, the EU currently lacks two significant features of a federal polity. First, EU member states remain the 'masters' of the treaties, in terms of holding the exclusive power to amend or change the constitutive treaties of the EU on the basis of unanimity rule (and domestic ratification is mandatory). Second, the EU has no real 'tax and spending' capacity. In addition, rather importantly, it lacks an essential element of democratic control: the composition of the European Commission as the 'EU executive' is not determined by the European citizens, neither directly, through the election of a president, nor indirectly (i.e. by the EP).

If we nonetheless accept that the EU has developed into a kind of federal system in practice, where sovereignty is divided and shared between the central level and the member states, the focus of the analysis shifts to another question: how the allocation of policy competencies and the representation of territorial and functional interests should be organized among the different levels of government in the EU in order to be both effective and perceived as 'legitimate'.

The Distribution of Policy Competencies in the EU

The current distribution of policy competencies in the EU appears to correspond more closely to the model of cooperative than to dual federalism: the EU does not have an autonomous

sphere of competencies in the sense of holding both legislative and executive responsibilities in selected policy sectors. Even in the areas of its 'exclusive competencies', the EU cannot legislate without the consent of the member states (as represented in the Council of the EU). There is no area in which the member states have completely ceded sovereignty to the EU, to the extent of excluding their direct participation in decision-making. This is even true for the domain of trade policy (cf. Nicolaidis and Meunier 1999) and for competition policy. Similarly, in the area of agriculture, member states still hold significant leverage, mainly through the institution of the Council of Agricultural Ministers.

To which extent have policy competencies been delegated to the EU? It seems that relatively encompassing and swift integration in the EU in economic policy areas has been accompanied by more modest progress in inherently political domains, such as foreign and security policy (including defense). However, despite EMU, the EU, at this stage, still lacks efficient tools for macroeconomic stabilization. Coordination between member states in the area of macroeconomic policy still occurs on a largely voluntary basis. Similarly, in contrast to federal systems, the EU is not endowed with an overall redistributive responsibility at the central level, despite the existence of the structural and cohesion funds. Hence, the EU's current setup clearly differs from most existing federal systems by the lack of a general income redistribution scheme.

In fact, the EU neither levies direct income taxes nor corporate taxes. It holds a few independent sources of revenue which mainly derive from customs duties, levies charged on imports of third countries, a small percentage of VAT collected by the member states, and financial contributions based on a fraction of EU countries' Gross Domestic Product (GDP). In relative terms, EU expenses tend to be high in the domain of agriculture, despite a decrease in expenditures in this area since the implementation of the MacSharry reforms of the early 1990s. 'Structural operations' – most notably the structural and the cohesion funds – assume a considerable percentage of the total budget. As compared to expenditures in established federations allotted to redistribution, however, this share is still quite modest.

In the EU, responsibilities for redistribution and stabilization measures mainly rest with the member states. The virtual absence of taxation and macroeconomic policy as functions exercised on the central EU level might prove to be problematic in the medium-term future (while the EMU is aiming to establish its leverage – and credibility – in international monetary and financial affairs; see below). For example, currently, there is no true EU-wide policy to combat unemployment. At the same time, individual member states are no longer able to provide a stimulus to their economy by lowering interest rates, for example, as this responsibility has been shifted to the collective level (i.e., to the European Central Bank, ECB). Member states aim to coordinate macroeconomic policies to a certain extent, but this coordination still falls short of usual macroeconomic policy coordination on the central government level within existing federations, such as the U.S., Germany or Switzerland.

In the EU (and earlier the EC), in the area of goods and services provision, the tension between regulatory activities conducted at the central level and the generation of competition among national regulations has gradually shifted in favor of the principle of 'mutual recognition' (Pelkmans 1987), and increased competition among national rules more generally (e.g. Nicolaidis

1992; Siebert and Koop 1993). This ‘new approach’ was especially used in the framework of the single market program regarding product regulations and provisions in areas such as banking and insurance. Keywords for the approach were ‘mutual recognition’, ‘regulatory competition’, ‘home country control’, and ‘harmonization of minimal requirements’.²³ The strategy based on this approach was later reinforced and applied to a broader range of policy areas by means of the introduction of the ‘subsidiarity principle’ in the Treaty of Maastricht.²⁴

There are areas of jurisdiction in which policy competencies have not been transferred to the EU level. This is true, for example, for elementary school education, and cultural and religious affairs. But all in all there are only a few policy domains left which have not been subjected to European regulation. The growing necessity for transborder regulation in the framework of the EU’s single market, in order to ensure the smooth operation of market forces, internalize externalities, and to allow for the attainment of economies of scale – strengthened by an expansive interpretation of EU competencies by the European Commission and the ECJ – have clearly decreased the range of exclusive member state competencies. This even holds true for traditionally ‘national’ policy domains such as communication and the media (regulations on advertising of alcohol and tobacco products being cases in point).

While the vast majority of legislative competencies in the EU are currently at least *de facto* shared or concurrent, responsibilities for policy execution mostly rest with the member states. The EU has an administrative machinery that is too small in size in order to be able to implement the EU’s policies. This functional division of competencies and the sharing of legislative powers grant member state governments a strong role in European institutions, which is not balanced, however, by an effective representation of functional interests.

The Dominance of Territorial over Functional Interests in the EU

From the perspective of comparative federalism, the EU not only corresponds to the model of cooperative federalism because of the functional distribution of competencies, but also because the Council of the EU resembles a *Bundesrat*-type second chamber of the European legislature: in the Council of the EU, member states are represented by their executives, and their voting power is weighed according to population size (cf. Börzel and Risse 2000; Hosli and Wolffenbuttel 2001).

Like in other cooperative federal systems, interlocking of policy competencies, the functional division of labor, and a *Bundesrat*-type second chamber all work in favor of a certain asymmetry in political representation, where territorial interests dominate over functional interests (cf. Watts 1988; Smiley and Watts 1985). The constrained financial autonomy of the EU vis-à-vis its member states underpins the dominance of territorial interests in European policy-making.

Certainly, the European Commission, the EP, and the ECJ represent functional rather than territorial interests in the EU (cf. Sbragia 1993b; Egeberg 2001). Yet, members of these institutions are appointed, or elected, on the basis of territorial representation. Most prominently, even the President of the Commission is nominated by member state governments – despite the EP’s increased leverage in the approval of Commissioners – and the Council President is determined by governments by definition (on the basis of the rotating principle among

member states). Moreover, although the three major supranational EU institutions were able to gradually expand their powers, the Council of the EU, in practice, still is the EU's most 'weighty' decision-making body. Its relationship with the Commission and the EP, in spite of the Treaties of Amsterdam and Nice, continues to be based on a somewhat asymmetrical balance of power.

The European Commission, as the 'executive arm' of the EU, has limited autonomy vis-à-vis the Council of the EU, despite its agenda-setting power which is based on its right of legal initiative. As mentioned above, it neither derives its authority from the EP nor from direct elections, however, as a result of which it suffers from weak political legitimacy. Moreover, the Commission strongly depends on the member states for financing and implementation of its policies. Hence, it enjoys little 'strategic autonomy' as regards designing and pursuing bargaining strategies against the Council (Scharpf 1988: 255). The EP as a 'nascent first chamber' of an EU legislature has managed to gradually increase its co-decision powers in European policy-making. But nonetheless, EU policies cannot be adopted without the consent of the Council. And even within the EP, territorial politics are important, because an effective system of European party alliances has not developed as of yet (e.g. Irwin 1995; Hix 1999: 180-184).

Finally, the system of 'comitology' -- the extensive network of committees linked to the Council and partially to the European Commission -- enhances the extent of territorial interest representation in the EU: experts represented within these commissions are usually selected by national governments and often members of national administrations.

The dominance of territorially defined executive interests in the EU may be even more pronounced than in established systems of cooperative federalism, where some countervailing remedies usually exist. In Germany, for example, the *Länder* enjoy strong representation in central level decision-making through the institution of the *Bundesrat*, the second chamber of the federal legislation. But the federation represented by the *Bundestag* (first chamber) and the federal government provide powerful counterweights to this, based not least on the political identity and legitimacy the federation generates, its dominance in the legislature, and its spending power. By comparison, neither the European Commission nor the EP are able to counterbalance the dominance of the Council. Moreover, political interest representation in Germany is based on a well-established system of vertical party integration in both chambers of the federal legislature. Finally, neo-corporatist forms of interest intermediation grant German economic interests privileged access to the policy process. The EU, by comparison, lacks an effective system of vertical party integration. There is no central arena of party competition -- neither within the legislature nor within the executive. Nor do European top industrial associations, such as UNICE or ETUC, effectively aggregate and represent the interests of European employers and employees in the European policy process.

Swiss federalism offers a different set of remedies for counterbalancing territorial interests in central policy-making. The *Ständerat*, the Swiss chamber of territorial representation, unlike the Council of the EU, is directly elected by citizens, as a result of which its members tend to act as representatives of the electorate rather than as defenders of cantonal interests (Bogdanor

1986). Unlike the German *Länder*, Swiss cantons have only limited influence on federal policy-making (cf. Lehbruch 1993). But they enjoy significant financial and legislative autonomy vis-à-vis the federal government, compensating for their weak representation at the federal level. Finally, direct democracy - with referenda on the federal, cantonal and municipal levels - allow citizens to express or 'voice' their preferences over policy choices directly.

The EU appears to combine elements of Swiss and German federalism by granting the member states an even stronger role in the legislation and implementation of central policies than the German *Länder* have, while leaving member states more financial and legislative autonomy than even the Swiss cantons have. This combination has certainly favored the dominance of member state governments in EU policy-making, not counter-balanced by an effective representation of functional interests through a European party system, European interest associations, and/or EU-wide referenda.

IV. Brussels between Bern and Berlin

We have argued that the EU largely resembles a system of cooperative federalism in which competencies are mostly shared among government levels and where territorially defined executive interests dominate over functionally defined societal interests. But EU policy-making is also characterized by intense inter-administrative coordination and deliberation among national bureaucrats. While such interadministrative networks are highly exclusive and tend to blur political responsibilities, they facilitate the high level of consensus necessary for effective joint decision-making in multi-level systems of governance. Frequent personal contacts and similar professional perspectives allow for a depolitization in formulating and preparing decisions to be adopted by member state governments within the different constellations of the Council of the EU, for example. Restricted participation (generating problems of 'input legitimacy') and weak accountability have been largely justified by the achievement of efficient policy outcomes ('output legitimacy'; cf. Scharpf 1999).

The efficiency of European policy-making is indeed quite extensive in some policy areas, given the diversity of interests among the member states (Héritier 1996). Yet, the EU does not have the power to perform important federal policy tasks such as macroeconomic stabilization and redistribution. At the same time, it increasingly inhibits member states from maintaining such functions (Scharpf 1996): the EMU largely deprives member states of the capacity for national macroeconomic stabilization, whereas the EU as a whole does not (yet) possess these instruments. Asymmetric 'shocks' occurring in one part of the EMU, which might, for example, sharply increase unemployment in some EU member states, are difficult to address by the collective strategies of the centralized institutions (e.g., the ECB). Interest rates are now determined collectively for all EU states participating in EMU. The EU may face difficulties in achieving economic efficiency as long as national business cycles in the EMU area are not yet developing in a harmonized way. As a result, considerable legitimacy problems of the EU on the input side may be exacerbated by legitimacy problems on the output side.

From the perspective of comparative federalism, the EU has two basic options to escape this double 'legitimacy trap': it can move towards the German model of cooperative federalism. Accordingly, the Council of the EU would develop into a second chamber of the EP, and the EP would be set on an equal footing with the Council in the EU legislative process (i.e. co-decision

and qualified majority voting in the Council would be default procedures). The European Commission would turn into a true European government, with its President being elected either directly by the European citizens or by the EP as the first chamber in a new EU bicameral setup. In addition, the EU would acquire competencies of stabilization and redistribution. This would, however, also presuppose a tax and spending capacity of the EU which is independent from the member states.

Cooperative federalism as a model for the EU currently finds support in the positions the German government has advanced in the debate on the future of the EU.²⁵ While the French government has rejected what it perceives to be a German attempt to 'export' its own federal state structure to the EU, the former French Prime Minister, Lionel Jospin, suggested the establishment of a permanent Council of Ministers to become a co-legislator of the EP, which would turn it into a Bundesrat-type of second chamber. According to this model, the European Council would act as the EU executive, together with the European Commission, whose President would be appointed by a majority of the EP.²⁶ While Jospin's proposal aimed at empowering the role of member state governments within the European institutional structure, a Commission supported by a majority in the EP might help to counterbalance an even more pronounced dominance of territorial interests in the EU policy process than the cooperative federal model as favored by the Germans. At the same time, the French and the German governments appear to agree on the necessity to strengthen economic policy coordination at the European level. While a further policy transfer does not seem to be politically unrealistic, the real issue at stake may be the weak taxation and spending capacity of the EU. Its redistributive capacity is currently limited to 1.27 percent of the Gross Domestic Product (GDP) generated by all member states (de facto, however, it lies at only 1.09 percent). A spending power comparable to the German federation, for example, would correspond to a share of about 20 percent of European GDP. An almost twenty-fold increase of the EU's redistributive capacity might certainly strengthen the output legitimacy and effectiveness of European governance, but it is highly unlikely member states would agree to such a sharp decrease in their revenues.²⁷ Finally, a move towards the German system of cooperative federalism would require some additional balancing of territorial interests by an effective representation of functional interests at the EU level, by means of an integrated European party system and a working structure of European interest intermediation.

Alternatively, the EU may move towards the Swiss model of federalism. This would also entail a further transfer of policy competencies to the European level. Such centralizing effects, however, could be balanced by allowing for a considerable extent of competition among jurisdictions. Member states would hold significant autonomy in exercising their competencies and would essentially retain their own power to tax. With an increased mobility of citizens within the EU, fiscal federalism and regulatory competition might then increase policy efficiency at the member state level by reducing 'government failure'.

Inter-jurisdictional competition among the member states would require the EU to move towards a model of dual federalism. Its current structures of cooperative federalism favor European regulations that leave little room for true competition. As long as their constituencies have a preference for maintaining the high level of social regulation and societal redistribution that characterizes the European (continental) welfare state, member state governments have strong incentives to harmonize national standards at the EU level in order to avoid competitive

disadvantages to their domestic industries. Thus, for example, both the French and the German governments have called for a certain degree of European tax harmonization in order to avoid 'tax dumping'.²⁸

Dual federalism would not only grant the EU member states more fiscal and regulatory autonomy, but weak representation of the member states at the EU level through a directly elected Senate would certainly render the harmonization of national (tax) regulations less likely. Yet, the idea of a second chamber of the EP, in which each member state would be represented by an equal number of directly elected representatives, has found little support among the member states. Their governments can hardly be expected to favor a senate model, largely depriving them of their current political influence in the EU legislative process. Nor do the member states seem to be able to agree on a clear delimitation of policy competencies which would help to disentangle EU and national responsibilities and might give each government level more autonomy in exercising these functions. The call of the German *Länder* for a 'Kompetenzkatalog', which would once and for all clarify the distribution of power between the EU and the member states, conflicts with a political structure in which competencies are shared rather than divided (cf. Börzel and Risse 2001). French resistance against German proposals for a 're-nationalization' of agricultural policy, for example, indicates that a clear separation between EU and national competencies faces dire prospects of gaining political consensus among the member states.

Re-nationalization and explicit limitations of EU competencies as alternative ways of solving the EU's 'double legitimacy trap' are further impaired by the constitutional asymmetry between European and national law. The demands of the French government and the German *Länder* to 'ring-fence' national and regional responsibilities for public services (e.g., '*Daseinsvorsorge*'), infrastructure, and industrial policy face the legal constraints of internal market rules. National restrictions on the free-movement of goods, services and capital partially conflict with economic pressures of regulatory and tax competition within the Single Market. At the same time, limiting EU competencies could hamper efforts to establish market-correcting policies at the European level in the areas of environmental, social, and employment policy, where purely national solutions are no longer adequate (cf. Scharpf 2002: 22-24).

To sum up, the EU is likely to continue its gradual move towards the system of (cooperative) federalism. The logic of market integration, paralleled by a strong preference for preserving the welfare state, favors increasing centralization of national policy competencies at the EU level. As a compensation for their losses in sovereign decision-making powers, EU member states retain strong co-decision powers in European policy-making, as exercised by their governments. The transfer of stabilization and redistribution competencies to the EU level, complemented by a strengthening of the taxation and spending capacity of the EU, might help to increase policy efficiency and, hence, alleviate the EU's legitimacy problems on the output side. Yet, problems of input legitimacy are likely to increase, since the mechanisms of functional interest representation remain weak. Additionally, there seems to be a perception that empowering the EP might not significantly improve the situation, as there is skepticism that 700 European deputies could be able to effectively represent the interests of some 500 million citizens within an enlarged Union. It remains to be seen, however, whether the EP might in fact play such a significant role in the future.

Currently, most hopes for increasing the democratic legitimacy of the EU seem to concentrate on an enhanced role of national parliaments. The British Prime Minister, Tony Blair, has called for a second chamber of the EP composed of members of national parliaments that would review the EU's work in the light of an agreed 'Statement of Principles'.²⁹ Likewise, the former French Prime Minister, Lionel Jospin, suggested a 'permanent conference of parliaments' that would monitor Community institution compliance with the subsidiarity principle and hold an annual 'State of the Union' debate.³⁰ And the President of the European Convention, Giscard d'Estaing, suggested a 'Congress of the Peoples of Europe', bringing together the Members of the EP with representatives of national parliaments. In its annual meetings, this Congress would be consulted on the 'deepening and widening' of the EU and the appointment of political offices.³¹ But in order to bring the Union closer to its citizens, this measure may not be sufficient. There is a need for intermediary institutions that are regularly involved in the everyday decision-making processes of the EU. Around 80 percent of national socio-economic regulations originate at the European level. Citizens should have the possibility to effectively voice their opinions before political decisions are made, since European law enjoys supremacy over national law and, hence, cannot be overruled at the national level.

The EU has developed into a kind of federal system, but in order to function properly, it needs to be both effective and democratic. The most recent Irish referendum, rejecting the Nice Treaty, forcefully demonstrated that EU citizens are no longer willing to accept political decisions their governments have negotiated behind closed doors.

V. Conclusions

In this paper, we have argued that linking the economic and political analyses of federalism may be helpful not only in order to analyze and understand the current workings of the EU, but also in order to reflect upon its potential future shape, in a primarily normative sense.

Despite the reluctance of several EU governments (and maybe several EU citizens) to move towards an actual federal structure for the EU, we find that the EU has already developed into a kind of federal system. This is explicitly acknowledged by the Preamble of the Draft Constitutional Treaty (Art. 1). Adopting a comparative perspective combining economic and political perspectives on federalism not only allows to describe and understand the functioning of the EU system of multi-level governance, but also points to the (normative) need for a 'double re-balancing' of the EU in order to render it more effective and legitimate. On the one hand, the EU has only weak competencies for macroeconomic stabilization and redistribution. Its shortcomings in addressing major macroeconomic challenges may increasingly undermine the problem-solving capacity of the EU, which used to be its primary source of (output) legitimacy. On the other hand, the EU is characterized by a strong representation of territorial interests on the central level, while citizens have little direct 'voice' regarding EU decision-making. The failure of European institutions to adequately respond to the preferences and demands of the citizens generates serious problems of 'input legitimacy', which can no longer be compensated on the output side.

We argue that in order to escape this 'double legitimacy trap' the EU requires broader stabilization and redistribution competencies, complemented by a strengthening of its tax and

spending powers. But in order to counter-balance this centralization of policy competencies, inter-jurisdictional competition should be enhanced, and the voice of European citizens has to be significantly strengthened at the European level.

The EU still lacks a working European party system and effective structures of transnational interest representation at the EU level. Giving the European Parliament the power to elect the President of the Commission who would serve as the head of the EU might be a first important step in promoting European party competition. Finally, putting the European Parliament onto an equal footing with the Council and turning the Commission into a true European government would certainly help to shift the focus of functional interest representation from the national to the transnational and hence, to the European level.

Notes

¹Joschka Fischer: From Confederacy to Federation: Thoughts on the Finality of European Integration, speech at the Humboldt University, Berlin, May 12, 2000, printed in Joerges, Mény and Weiler 2000.

²See, for example, Fischer's discussion with Jean-Pierre Chevènement in *Die Zeit*, June 21, 2000, pp. 13-18, and his speech of July 7, 2000 for the EP. On the latter, see 'Fischer fordert Entscheidungen über die Zukunft der EU', *Süddeutsche Zeitung*, July 7, 2000 or 'Fischer Proposes Directly Elected European President,' *International Herald Tribune*, July 7, 2000.

³For the various contributions to the debate see the website of the EU on the 'Future of Europe Debate' www.europa.eu.int/futurum and the website of the European Convention <http://european-convention.eu.int>.

⁴Cf. Musgrave 1959; Oates 1972. For a good overview of formal approaches to the study of federalism and a review of the respective literature, see Bednar 2000. A recent overview of fiscal federalism more generally is given in Oates 1999.

⁵When a constituent unit of a federation experiences macroeconomic difficulties, fellow jurisdictions most likely are reluctant to provide 'horizontal' financial assistance. A central authority, by comparison, may be able to provide the necessary support and hence, generally, to apply macroeconomic stabilization measures (e.g. control of interest rates). In most federal setups, indeed, lower-level governments do not possess powers to conduct macroeconomic (or monetary) policy independently.

⁶The power to redistribute income within a federal system needs to be located on the central government level mainly in order to avoid 'exit' by more well-off individuals and firms from selected units of the federation. As Okyeon Yi Hong (2002: 26) puts it: "The effects of redistributive policies are dissipated in the presence of mobility of people and economic resources." On the concepts of 'exit' and 'voice' more generally, see Hirschman 1970.

⁷... distribution policy must be a matter of national concern' (Musgrave 1997: 67).

⁸Deeper difficulties arise in determining just what should be viewed as local, statewide, or national public goods. At first, for example, it may seem that education and elementary education in particular are eminently local functions. However, although education is conducted locally, its quality is also of national concern.' (Ibid. 67). Subsequently, the author applies similar reasoning to the domain of health policy.

⁹For a general discussion of the relationship between group size and prospects for cooperation, in the framework of international relations theory, see Milner 1992.

¹⁰In his analysis, 'spillovers' or (negative) externalities among jurisdictions are assumed to be absent. Moreover, mobility of citizens is viewed as not inducing transaction costs.

¹¹See, for example, Siebert and Koop 1993; Hosli 1992; Woolcock 1995.

¹²For a study of the influence of elections on sub-national levels on the extent of fiscal decentralization in a number of advanced industrial societies, see Hong 2002. An analysis of the influence of political variables on the level of public debt in the OECD area is Franzese 1998.

¹³The concept of multi-level governance has been introduced by Marks 1993 in his analysis of the EC's structural policy and addressed in more detail, and for a broader range of policy areas, by Marks, Hooghe and Blank 1996. Hooghe and Marks 2002 continues this tradition. The latter paper also provides an overview of 'islands of theorizing' regarding the analysis of the EU from both political and economic perspectives.

¹⁴Cf. Loewenstein 1957; Duchacek 1970; Elazar 1987, 1994; Watts 1999.

¹⁵Another advanced industrial society being based on this principle is Switzerland. However, it seems that in recent years, the Swiss model has started to increasingly resemble German cooperative federalism (see Wälti 1996).

¹⁶Cf. Ostrom, Tiebout, and Warren 1961; Peterson 1995; Mieszkowski and Musgrave 1999.

¹⁷E.g. Marks 1993; Marks, Hooghe and Blank 1996.

¹⁸For a critique of more traditional theories see Marks, Hooghe, and Blank 1996; Risse-Kappen 1996; Jachtenfuchs and Kohler-Koch 1996.

¹⁹In the framework of fiscal federalism, however, units may partially be overlapping, and not be strictly defined territorially (see above).

²⁰Also see the work of (early) European ‘federalists’ on this theme (e.g. Coudenhove-Kalergi 1938).

²¹Article 11 of the Treaty on the European Union (TEU) refers to the protection of the integrity of the Union and of its external boundaries.

²²The material substance of Union citizenship is rather weak, but it may serve as an indicator for the self-perception of the EU as a political community of its own citizens (Bogdandy 1999; Wiener 1998).

²³The latter were largely introduced in order to avoid a ‘race to the bottom’.

²⁴E.g. see Hosli 1995.

²⁵See the speech of the German President, Johannes Rau, to the EP, ‘Plädoyer für eine Europäische Verfassung’, Strasbourg, April 4, 2001, (www.europa.eu.int/futurum/congov), and ‘Leitantrag – Verantwortung für Europa’, draft party programme of the German Social Democrats, April 30, 2001. For the position of the German Länder, see the speech of the former Prime Minister of Northrhine-Westfalia, Wolfgang Clement, ‘Europa gestalten – nicht verwalten. Die Kompetenzordnung der Europäischen Union nach Nizza’, at the Forum Constitutionis Europae of the Walter-Hallstein-Institute for European Constitutional Law, Humboldt University, Berlin, February 12, 2001, www.nrw.de/europa/titel_europa.htm.

²⁶See the speech of the French Prime Minister, Lionel Jospin, ‘On the Future of an enlarged Europe’, Paris, May 28, 2001, www.europa.eu.int/futurum/congov.

²⁷The plea of the President of the European Commission, Romano Prodi, for granting the EU a strong taxation and spending capacity, has so far been ignored by the member states; see Romano Prodi, ‘For a strong Europe, with a grand design and the means of action’, speech given at the Institut d’Etudes Politiques, Paris, May 29, 2001, (www.europa.eu.int/futurum).

²⁸See the speech of the French Prime Minister, Lionel Jospin, ‘On the Future of an enlarged Europe’, Paris, May 28, 2001, www.europa.eu.int/futurum/congov.

²⁹See Tony Blair’s speech to the Polish Stock Exchange, Warsaw, October 6, 2000, www.europa.eu.int/futurum/congov.

³⁰See Lionel Jospin’s speech ‘On the Future of an enlarged Europe’, Paris, May 28, 2001, www.europa.eu.int/futurum/congov.

³¹See Giscard d’Estaing, ‘Europas letzte Chance’, *Süddeutsche Zeitung*, 23 July 2002.

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