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Strategies of Flexible Integration and Enlargement of the European Union: a Club-theoretical and Constitutional Economics Perspective

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Walter Eucken Institut, Goethestr. 10, D-79100 Freiburg i. Br.
Tel.Nr.: +49 +761 / 79097 0; Fax.Nr.: +49 +761 / 79097 97
<http://www.walter-eucken-institut.de>

Institut für Allgemeine Wirtschaftsforschung; Abteilung für Wirtschaftspolitik;
Albert-Ludwigs-Universität Freiburg, D-79085 Freiburg i. Br.
Tel.Nr.: +49 +761 / 203 2317; Fax.Nr.: +49 +761 / 203 2322
<http://www.wvl.uni-freiburg.de/fakultaet/wipo/>

Strategies of Flexible Integration and Enlargement of the European Union.

A Club-theoretical and Constitutional Economics Perspective

Michael Wohlgemuth <wohlgemuth@walter-eucken-institut.de> and

Clara Brandi <clara.brandi@googlemail.com>^{*}

1. Introduction	1
2. A Larger and More Heterogeneous Union and the Need for Flexibility	2
3. Political Concepts of Flexible Integration	2
3.1. Multi-Speed Europe	3
3.2 Europe of Concentric Circles	3
3.3 Europe à la Carte	3
4. Deepening versus Widening	4
5. The Theory of Clubs and the EU as Political Multi-Purpose Club	6
5.1. Club Theory and Club Goods	6
5.2. The EU as a Club Providing Multiple Integration Club Goods	7
5.3 Club Size, Club Intensity, and “Interdependence Costs”	10
6. Alternative Models of Integration	14
6.1. Status Quo and “Ever Closer Union”	14
6.2. Status Quo and Multi-Speed Integration	14
6.3. Status Quo and Concentric Circles	15
6.4. Status Quo and “Enhanced Cooperation”	16
6.5. Minimal Union and Clubs for “Enhanced Cooperation”	16
6.6. Pure Club Solution and the EU as club-Referee	18
6.7. Pure FOCJ Solution	18
6.8. Which Integration Model for Europe?	19
7. The European Union as Club of Clubs around a Common Core	20
7.1. Obligatory and Optional Policy Fields	20
7.2. The Core- <i>Acquis</i>	20
7.3. The Clubs within the Club	21
8. Evaluation of the Clubs-within-the-Club Approach	22
8.1. Disadvantages	22
8.2. Advantages	23
9. Flexibility and “Enhanced Cooperation”	28
9.1. A Brief History of Flexibility	29
9.2. Reforming “Enhanced Cooperation”	29
10. A Competitive Order and Meta-institutions for Club Competition	31
11. Conclusion	33
References	35
Appendix	

^{*} Dr. Michael Wohlgemuth is Managing Research Affiliate at the Walter Eucken Institute, Freiburg i.Br.;
Dipl.Volkswirtin Clara Brandi is researcher at the European University Institute, Florence.

"I have often been struck by the prevailing view in Community circles that the worst that can happen is any movement towards what is called and Europe à la carte. This is not only somewhat odd for someone who likes to make his own choices, but also illustrates that strange Puritanism, not to say masochism, which underlies much of Community action: Europe has to hurt in order to be good."

Ralf Dahrendorf 1979

1. Introduction

Today, in times of institutional crisis following the French and Dutch rejection of a constitutional treaty, in times of economic stagnation following the Lisbon agenda's failure to deliver results, and in times of growing uncertainty about the identity and limits of Europe, Lord Dahrendorf's statement seems no less relevant than it may have been in the times of widely felt "Eurosclerosis". The recent enlargement of the EU, even if it was hardly greeted with great enthusiasm by European citizens, has a potential to bring a new dynamic to the European common market. At the same time, the EU-wide *acquis communautaire* menu of uniform laws and regulations is today even more likely to cause "indigestion" as it has been expanded to an almost "unswallowable" amount of pages, which are "served" to 25 member states regardless of their "gusto" and regardless whether they have actually "ordered" what they are "dished up" or whether they were overruled when the present "chefs" composed the menu by qualified majority vote or via log-rolling behind closed doors. We believe that this "one-size-fits-all" philosophy has been taken too far already and is not sustainable in the future. The agents of European politics ought to devote much more time and energy during the self-imposed "period of reflection" to also discuss various forms of flexible integration and enlargement.

The recent enlargement of the European Union has added significantly to the heterogeneity of EU membership. This rise in diversity increases both (i) "decision-making costs" and (ii) "external costs", that is to say, the costs a citizen has to bear in case his preferred decision is *not* the one reached by the EU (Buchanan/Tullock 1962). Thus, since a more diverse EU makes it all the more difficult and costly to jointly develop policy, the Union's future will depend on its capacity to cope with disagreement owing to divergent national socio-economic capabilities and preferences. Against this background, the essential question is: *How can a more flexible, economically efficient and politically feasible mode of integration be put into operation that is compatible with the heterogeneity of economic structures as well as political, social and cultural preferences throughout the EU?*

Our paper proceeds as follows: As a point of departure, *part two* highlights the heterogeneity among EU member states following the recent enlargement, while *part three* reviews three main alternative conceptions of flexible integration as they were discussed in political circles. *Part four* applies Buchanan's and Tullock's *Calculus of Consent* (1962) to the tension between deepening and widening the EU. *Part five* introduces basic elements of the economic theory of clubs, analyzes the notion of the EU as a club and examines flexible integration in a club-theoretical framework. *Part six* considers several alternative integration models in view of the conclusions of both club theory and constitutional economics, while *part seven* focuses more specifically on a club-of-clubs approach that we tend to favour as an ideal-type model for a European Union of the future. *Part eight* evaluates the relative weaknesses and strengths of flexible integration according to the club-of-clubs approach and *part nine* advocates some further institutional recommendations before *part ten* concludes.

2. A Larger and More Heterogeneous Union and the Need for Flexibility

The European Union is performing regulatory functions in ever wider policy fields in ever more member states. The recently enlarged EU of 25 countries and almost 500 million people will expand even further when Bulgaria and Romania and probably Croatia and possibly Turkey join. The structural indicators shown in table 1 (see appendix) give a sense of the increase in economic heterogeneity as a result of the 2004 enlargement and display the diversity of the recently admitted Central and Eastern European Countries (CEECs) relative to the countries of the former EU-15. The first feature to emerge from the table is the wide income dispersion and the gap in economic development between the EU-15 and the CEECs. Moreover, the table displays very large unemployment figures in some of the CEECs and illustrates that inflation rates are higher among the CEECs than among the former EU-15 countries. In addition, the economic structures differ significantly (on average, the relative importance of the CEEC's agricultural sector is more than three times higher than within the EU-15).

To be sure, heterogeneity as such is not a problem; to the contrary, with respect to the Internal Market it creates benefits, for example through a more efficient division of labour.¹ On the other hand, more diverse EU membership will make it all the more difficult and costly to develop policies aimed at specific common purposes. The growing heterogeneity not only with respect to economic structure and performance but also with respect to political objectives, social needs, cultural preferences and financial constraints and the fact that the willingness as well as the capacity of individual EU member states to participate in accomplishing integration varies greatly, causes more flexible integration to be almost unavoidable.²

3. Political Concepts of Flexible Integration

The discussion of flexible integration is far from novel; various modes of flexible integration have gained considerable prominence in the political debate. Although each of the proposed models conveys a series of often subtle distinctions and implies different strategies for action, all stem from a similar diagnosis of the EU's malady: namely, that of seeking to apply excessively and unrealistically strict common goals and disciplines to countries which in fact are strikingly diverse in terms of both political-economic preferences and capabilities.

According to the terminology used in the context of European integration, *flexibility*, sometimes used interchangeably with the expression *differentiation*, constitutes the general term for the possibility of member states to have different rights and obligations with respect to certain common policy areas and refers to the possibility of the temporary or permanent existence of different levels of integration within the EU. This section briefly outlines three main categories of flexible integration, 1. *multi-speed*, 2.

¹ In addition, some new member states, fuelled by radical pro-market, low-tax reforms were able to generate remarkable growth and to lay the foundations of fiscal stability and sound social security systems that may in the longer run outperform some overregulated sclerotic states in "old Europe".

² Alternative methods to accommodate the increased diversity will presumably not do; for instance, buying off recalcitrant member states or eliminating diversity through assistance programs can be expected to soon expose the limits of budgetary solidarity.

concentric circles and 3. *à la carte* integration, and seeks to disentangle these generally less clearly defined sub-categories of flexible integration that have surfaced in the political debate.³

3.1 Multi-Speed Europe

Already in the context of the first enlargement of the European Community and the introduction of transition phases of adjustment in 1973, Willy Brandt spawned a greater discussion about a two-speed Europe in 1974, followed by the Tindemans Report in 1975 with further proposals for differentiated development. Models of multi-speed integration can be defined as modes of integration whereby the pursuit of common objectives is driven by a group of member states which are both capable and willing of progressing at a higher pace towards deeper integration in certain policy areas, while the remaining member states are obliged to follow according to specific criteria as soon as they can (Stubb 1996: 287). In other words, the multi-speed approach clearly preserves the fundamental idea that there should be a *common level of integration* and that exemptions from it are *temporary* and *exceptional*. As ultimate objectives remain common to all members, it adds flexibility only in the implementation stage. Since multi-speed models do not allow some countries to opt for a deeper level of integration and others to be exempted from it, they fail to deal with the underlying logic and the fundamental reason of the drive for flexibility: the existence of difference.

3.2 Europe of Concentric Circles

The concentric circles or *Kerneuropa* approach, has gained substantial prominence in the political debate during the recent past. Eduard Balladur, as France's prime minister, was the first to raise the idea of a Europe of concentric circles in 1994. Shortly afterwards, the "Schäuble-Lamers-Paper" (1994) made a similar proposal in greater detail.⁴ Moreover, the concentric circles model of integration is the basis of the notion of forming avant-garde or pioneer groups that has been favoured by Joschka Fischer, Jacques Delors and Jacques Chirac in 2000 and was again put forward (in an attempt to isolate Tony Blair) by Jacques Chirac and Gerhard Schröder in December 2003. In the concentric circles concept, a highly integrated hard core consisting of member states cooperating on an extensive range of activities, say economic, monetary and political union, is pictured to be surrounded by numerous rings of ever less integrated groups of countries. In contrast to multi-speed models, the approach of a Europe of concentric circles admits unattainable differences by allowing *permanent* separation between the hard core and lesser developed integrative units (Stubb 1996: 287).

3.3 Europe à la Carte

Integration *à la carte*, termed by Dahrendorf (1979), admits member states to freely pick and choose, as from a menu, in which policy area they would like to participate and cooperate more closely, while at the same time holding only to a minimum number of common objectives (Stubb 1996: 288).⁵ *À la carte* models, like the concentric circles models, envisage the possibility of *permanent* division, but do so by allowing member states to opt out and opt in with respect to individual *policies* rather than according to a

³ The use of terms like "variable geometry" or "multi-speed" is neither precise nor consistent. As Stubb (1996: 283) puts it, the debate about flexible integration, "is characterized by an excess of terminology which can give even the most experienced specialist of European integration a severe case of semantic indigestion".

⁴ The "Schäuble-Lamers-Paper", published in 1994 and revised in 1999, proposed that the Union's "existing hard core" of five countries (Germany, France, Belgium, Luxembourg and the Netherlands) should press on quickly towards closer co-ordination of monetary, fiscal, industrial and social policies.

⁵ As Dahrendorf (1979: 29) puts it: "Europe *à la carte*, that is common policies where there are common interests without any constraint on those who cannot, at any given point in time, join them, must become the rule rather than the exception".

predetermined package corresponding to membership of a given geographical “division” of the Union into a hard core and surrounding peripheries (Warleigh 2002: 79). Thus, the à la carte concept is *functional* rather than geographical and, in contrast to the concentric circles approach, the focus is on *policies*, not on countries.

4. Deepening versus Widening

Many scholars tend to be pessimistic about the possibility of reconciling the aims of widening and deepening the EU arguing that “widening the EU will require current members to abandon efforts to further deepen integration, while further deepening will be possible only at the expense of further enlargement” (Brewster et al. 2002: 49). By applying the “constitutional calculus”, developed by James M. Buchanan and Gordon Tullock in their Public-Choice classic *The Calculus of Consent* (1962) to decision-making in the Council of Minister and the European Commission, we now want to shed some more light on this tension.

The “constitutional calculus” weighing up (1) the risk of political measures not being undertaken that would, in fact, serve the common interest of all citizens, and (2) the risk of political measures being undertaken that run against the interest of part or all of the citizenry, is what Buchanan and Tullock have described as the “logical basis of constitutional democracy”. By distinguishing between (i) *decision-making costs* and (ii) *external costs*, Buchanan and Tullock provide a helpful tool to further analyze the “constitutional calculus”. (i) Decision-making costs, on the one hand, are the “costs which the individual expects to incur as a result of his own participation in an organized activity” (Buchanan/Tullock 1962: 45), that is, the costs of making a decision that is desired. (ii) External costs, on the other hand, are “the costs that the individual expects to endure as a result of the actions of others over which he has no direct control” (ibid: 45), namely the costs of bearing the consequences of a decision, which was not desired, that is, the costs of being forced to comply with legislation that one opposes. Buchanan and Tullock call the sum of these costs the *cost of social interdependence*, or, for a shorter term, *interdependence costs*, and argue that the *minimization* of these overall costs of collective choice is a suitable goal for social or political organizations (ibid: 46).

Applying these considerations to the EU yields the following conclusions regarding the consequences of a larger and more heterogeneous EU (Streit/Voigt 1995: 19; Brewster et al. 2002: 50ff): (i) For any given collective choice rule, for example qualified majority voting, *decision-making costs* will be higher in units with a more heterogeneous population than in those with a more homogenous one: enlargement will raise the costs of decision-making in the EU by increasing the number and heterogeneity of member states. (ii) Moreover, for any given collective choice rule, *external costs* will also be higher in more heterogeneous units than in more homogeneous ones, for instance, owing to a larger number of people having to live with a centralized decision made on the EU-level of policy-making which does not comply with their order of preferences. As a result, given that every additional member makes the EU more heterogeneous, each entrant causes *both* decision-making *and* external costs to increase (ibid: 115). Hence, there is a *trade-off* between decision-making and external costs:

- (i) Since decision-making costs rise with more heterogeneous membership, given a maximum level of tolerable decision-making costs, increased heterogeneity should be accompanied by *less* inclusive decision-rules to counterbalance the higher decision-making costs owing to more

heterogeneous EU-membership (see Fig. 1). In fact, in the Constitutional Treaty draft, for about 26 decision-making areas, unanimity voting in the Council has been changed to qualified majority voting in terms of both member states and citizens. However, decision-making costs are not the only relevant cost category: external costs will increase as a result of a *less* inclusive decision-rule. Thus, from the viewpoint of external costs we again arrive at a dilemma, since:

- (ii) External costs also increase with more heterogeneous membership. Accordingly, if we assume that a randomly chosen individual in the EU will accept only some maximum level of external costs, increasing the heterogeneity of EU membership should, from the perspective of external costs, be complemented by *more* inclusive decision-rules (see Fig. 2). These, in turn, will increase decision-making costs. Thus, there is a trade-off between decision-making and external costs: the reduction of one of these cost categories will cause the other type of costs to increase.

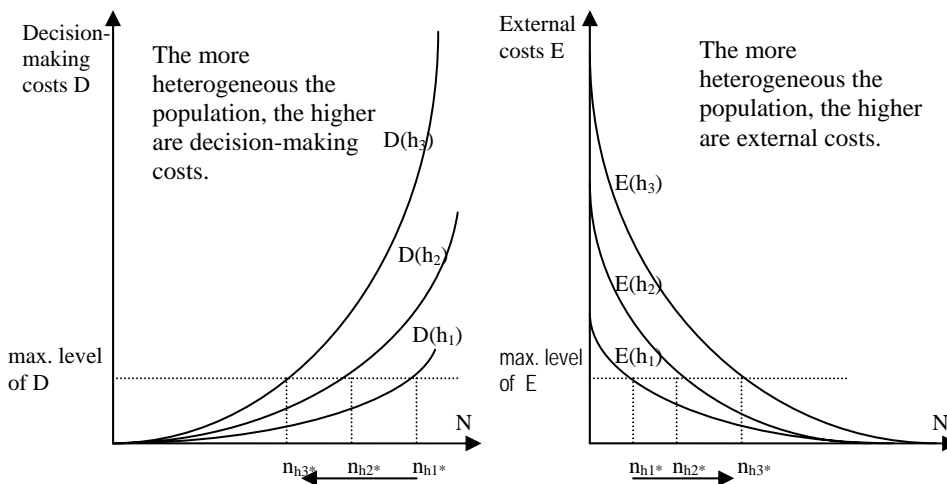


Fig. 1: Optimal decision rules under a given maximum decision making costs and different degrees of heterogeneity, $h_3 > h_2 > h_1$ heterogeneity. $h_3 > h_2 > h_1$

Fig. 2: Optimal decision rules under a given maximum of external costs and different degrees of

In light of this trade-off, it becomes obvious that abandoning the unanimity rule in favour of a qualified majority decision rule in the Council does not only decrease decision-making costs, as the political debate has emphasized, but simultaneously raises external costs, which in turn potentially threatens the acceptability of the Union, with its declared aim to be “closer to the citizens”. Thus, the increase in heterogeneity generates an ambivalent result with respect to a potential change in decision-rules. Depending on the actual functions describing external and decision-making costs, their aggregation as interdependence costs, might either suggest a *less* inclusive (see Fig.3) or a *more* inclusive decision-rule (see Fig.4) in order to better cope with more heterogeneous EU-membership.

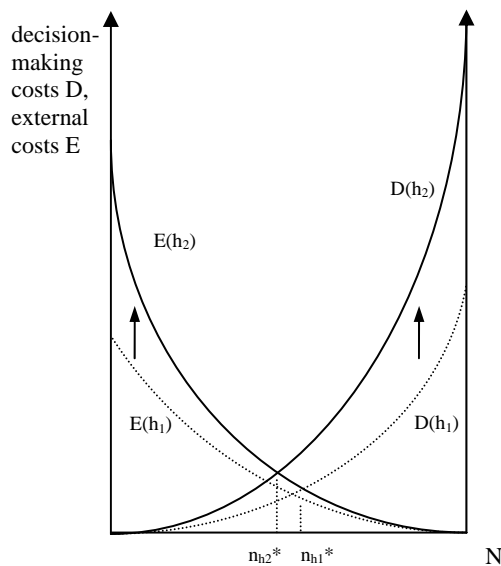


Fig. 3
A less inclusive decision-rule is optimal.

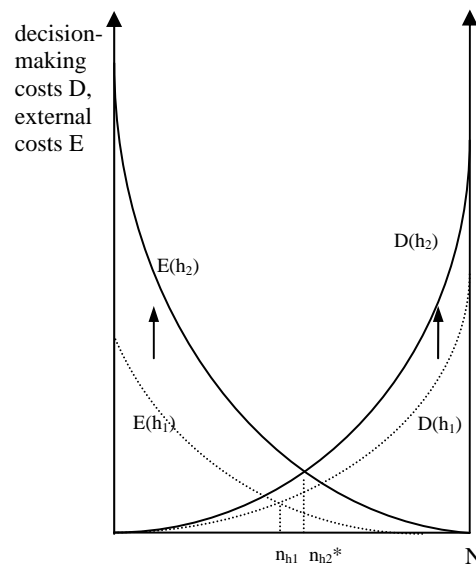


Fig. 4
A more inclusive decision-rule is optimal.

But one result can be said to hold in any case: Given a certain decision-making rule, the more heterogeneous the European Union, the larger are decision-making costs *and* external costs. Increased heterogeneity therefore always leads to an increase in interdependence costs no matter how the actual functions look like. From this perspective, the EU appears to be “too big”, (i) in terms of too many members having to agree on certain policies causing *decision-making costs* to be very high and (ii) in terms of too many harmonized policy fields resulting in a potential for high *external cost* due to the large number of individuals having to obey collective decisions. This implies that all constitutional provisions should be welcomed that reduce one type of cost without increasing the other, or that bring the two costs in a more favourable balance, as judged by the citizens.

Thus, the fundamental question to be discussed, when analyzing the problematic tension between deepening and widening, is the following: *Can the rules of the game be altered such that a new reasonable trade-off between external and decision-making costs can be generated and both costs are brought into what the citizens themselves consider to be the most favourable balance? Or, to put it differently: How could one enhance the compatibility of the recent enlargement with further integration?* The remainder of this paper attempts to develop an answer to this question.

5. The Theory of Clubs and the EU as Political Multi-Purpose Club

5.1 Club Theory and Club Goods

The evidence of de facto club creation in Europe during the last twenty years as well as the introduction of provisions for “enhanced cooperation” into the European Treaties indicate that the application of club theory to EU integration can yield fruitful insights into the mechanics of further integration of the Union. The economic analysis of club formation started with the contribution of James M. Buchanan (1965). His seminal paper “An Economic Theory of Clubs” initiated an immense club-theoretical literature.

Since then Buchanan's club theory has been applied to several economic and political issues such as community size, production of local public goods or political coalitions.⁶ While Buchanan focused on one club good only, more recent approaches analyze clubs that produce multiple goods.⁷ Moreover, club theory has been applied to international issues and international organizations such as the EU⁸.

As a simple definition, clubs are voluntary groups formed by individuals to pursue a common goal – the provision of a club good. Originally, the theory of clubs was meant to overcome Samuelson's dichotomy between pure public and pure private goods with club goods ranging somewhere in between (Buchanan 1965: 1f). Accordingly, club goods display two defining attributes (ibid: 2ff): (i) they are *non-rival* (or only partially rival, i.e. non-rival up to a certain number of members) in their consumption to club members, that is, if one member benefits this does not reduce the benefits going to other members; (ii) the benefits of club goods cannot be enjoyed by non-members, i.e. *exclusion* is possible. As a result, club members are required to fund the production of such goods in order to enjoy these benefits. The excludable attribute of club goods prevents free-riding; if a member does not pay his dues, that member can be deprived of the benefits of club membership.

The purpose of inquiry of the theory of clubs is to identify the optimal level of club goods to be produced and the optimal number of club members. The optimal club size is reached when marginal benefits for the club members from accepting an additional member are just equal to the marginal costs that are incurred from adding one more member to the club (Buchanan 1965: 5). Traditional club theory often assumes partial rivalry of club good benefits implying that a large number of members will result in "crowding" or "congestion" effects reducing the quality of the goods and services provided by the club. Moreover, traditional club theory assumes that *per capita* costs of producing the club good *decrease* with an increase in the number of club members because provision expenses associated with the club good, assumed to be independent of club size, will be shared among more members. It remains to be discussed whether these assumptions, certainly appropriate in the case of swimming pools or golf clubs, will also be adequate in the context of European club goods.

5.2 The EU as a Club Providing Multiple Integration Club Goods

Further insights into the club notion can be gained by examining the legal rules for private clubs, for example golf clubs (Blankart 1994). In the case of private clubs, only two restrictions have to be observed by law (see for example §§ 27 and 28 BGB):

- (1) Every member must have the right of leaving the club.
- (2) The power granted to the board of the club must not be irrevocable.

In analogy to private clubs, jurisdictions can be viewed as clubs providing club goods to their citizens.⁹ The idea that the EU and other international trade, monetary and defence

⁶ The literature on club theory has been surveyed by Sandler/Tschirhart (1980), Cornes/Sandler (1996) and Sandler/Tschirhart (1997).

⁷ E.g. Brueckner/Lee (1991), Sandler/Tschirhart (1993) and Cornes/Sandler (1996: 404ff).

⁸ E.g. Padoan (2001), Sell (2000), Fratianni (2003), Ohr (2003), Ahren/Hoen/Ohr (2005).

⁹ When the constitutional economics literature refers to democratic jurisdictions as "clubs", this does not imply that this comparison disregards that membership in a jurisdiction cannot be viewed as equally "voluntary" as in typical private clubs, e.g. tennis clubs. Rather, the comparison is intended to point to the fact that jurisdictions are, similar to private clubs, producers of club goods and that the exit option, like in private clubs, plays an important role in ensuring the protection of the jurisdiction member's interests. However, in contrast to typical private clubs, states are organised intergenerationally and territorially. For a discussion of the main differences between membership in a state, on the one hand, and in a voluntary private club, on the other hand, see for example Vanberg (2003a: 14f).

arrangements can be conceived as such a club almost suggests itself. But before we can proceed to applying club theory to the European Union, the following questions have to be confronted: (1.) Who are the *members* of the EU club? (2.) What are the *club goods* produced? (3.) What type of costs are incurred in providing them, what type of benefits in consuming them and what can be said about optimal club size?

5.2.1 European Club Members

In what follows, this paper conceives the EU to be a club of *states*, not of individuals. Conceived in this manner, the EU club currently consists of 25 members. This is not meant to disregard the fact that states are formed by individuals and that governments are simply agents of their population, the principal. If we assume the EU member states' national constitutions to be principal-agent-contracts, the EU club could also be conceived as a club comprising ca. 500 Million members who are represented by 25 agents, i.e. the governments of 25 member states. While bearing this in mind, the remainder of this paper will refer to the EU club consisting of 25 member states.

5.2.2 European Club Goods

The following examples of European club goods demonstrate that the EU can indeed be conceived as a club that provides a variety of club goods to its members: Club goods provided by the EU include the guarantee of the “*Four Freedoms*”, i.e. the free movement of goods, services, persons and capital through the Internal Market; a *single currency* through membership in the EMU; *external and internal security* through a common foreign and security policy (CFSP) and *police and judicial collaboration* in criminal affairs. Further examples of European club goods are the *definition of environmental and product standards* securing consumer protection, the *Schengen Agreement and Convention* and the *Western European Union (WEU)*.¹⁰ Additionally, stronger coordination in social, employment, industrial and education policies has been put on the European agenda striving for EU-wide harmonized standards and centrally provided policy instruments. All of the above goods have in common that they are (i) *non-rival* (or only partially rival) in consumption and (ii) that non-subscribers to the respective agreements (be that within-EU-treaties or bilateral treaties of third countries with the EU) are *excluded* from their consumption. Therefore these goods qualify as club goods.

5.2.3 Club Benefits, Club Costs and Optimal Club Size

Our basic premise is that integration areas can be conceptually conceived as distinguishable clubs. In each of these areas, members participate in the *benefits* of integration but at the same time have to contribute to the *costs* of financing the provision of the relevant integration club goods. As sketched above, the size of an integrated area is optimal when the marginal benefits of the admission of a new member are just offset by the marginal costs a newly admitted member causes, for instance by making decision procedures more cumbersome. In the following passages we briefly discuss three remarkably different integration areas of the EU in order to demonstrate in which ways *both* benefits *and* costs of economic regional integration are contingent on the size of the area of integration, i.e. the number of club members.

(i) The Internal Market Club

¹⁰ Whether “Common Agricultural Policy” or “access to structural and cohesion funds” can be regarded as European-wide public goods, remains controversial in the literature. Streit and Voigt (1995: 13) argue that they cannot qualify as club goods because the corresponding funds are used in a redistribute way resulting in obvious rivalry in consumption.

The European club goods corresponding to the Internal Market include reciprocal access to the “peace dividend” of international division of labour and knowledge: the absence of impediments to trade, access to a common market, the guarantee of the “Four Freedoms” and a set of uniform competition rules. A representative member derives benefits from being in the Internal Market club by making use of the “Four Freedoms” resulting in static and dynamic efficiency gains due to enhanced allocation efficiency. These efficiency gains are larger, the larger the Internal Market is, i.e. the more members the Internal Market club has. As already Adam Smith (1776) knew: “the division of labour is limited by the extent of the market”. With respect to the Internal Market, there is no direct rivalry in club usage; to the contrary, additional members tend to generate economies of scale resulting in even larger efficiency gains (Ohr 2003: 120). Moreover, new growth theory suggests that economic integration resulting in intensified competition may lead to a permanent increase in the economic growth rate of the area through a positive interaction between innovation and integration (Fratianni 1995: 11).

If the EU were only a free trade area, then the determination of the optimal size of the European club would be relatively easy: from the perspective of trade theory, the optimal size of a trade agreement is the world.¹¹ Also, if there were no costs associated with operating the Internal Market or if the regulatory framework necessary for its functioning were independent from the number of member-countries making up the Internal Market club, it would follow that the Internal Market should be as large as possible. However, trade theory is of limited use in determining the optimal size of the Union because the EU is much more than a free trade area.

The costs corresponding to a pure disarmament club or the costs of entry into a predefined club consisting of the prohibition of intervention are likely to be low and hardly rising with club size; thus average costs will decrease as new members join. Respecting and enforcing *negative* liberty rights of the citizens is barely dependent on scarce resources like money and the consent of the citizens or (control) knowledge of politicians, as Hayek already argued in 1939 (Hayek 1939/80). But *positive* regulations concerning political integration, which can – at least partly – be useful for the functioning of the Internal Market, are a different matter.

With respect to positive regulations such as competition rules, consumer protection rules or production standards within the EU, active collective choices are necessary and political views and capacities diverge. As a consequence, decision-making costs rise. These costs are kept relatively low by delegation to the Commission. However, the natural centralization and harmonization drive of a central bureaucracy that is exempt from democratic competition can result in increasing external costs as the EU-club becomes larger, more heterogeneous and more actively interventionist. A “complete” Internal Market à la Brussels, therefore, can have a finite optimal club size.

(ii) The Economic and Monetary Union Club

The club good corresponding to the EMU club is the *single currency*.¹² Monetary integration yields several benefits and positive welfare effects to club members such as reductions of transaction costs and of currency risks which in turn leads to more trade,

¹¹ In addition, the more members the Internal Market club has the stronger would be the incentives for non-member to become members; this reasoning also applies to the WTO and other preferential trade agreements. However, this is not the case for all kinds of international cooperation clubs: for instance, the more states have committed to and signed the Kyoto Protocol, the better for the outside free rider (see Wohlgemuth 2003).

¹² Frey (1984: 133) argues that monetary integration corresponds to the notion of club goods because money as unit of account, a medium of exchange and a store of value is an excludable public good without rivalry to all members of the monetary union.

economies of scale and intensified competition and thus general welfare gains. Hence it seems reasonable to assume that each additional member of the common currency club will yield benefits for the common currency region. However, the EMU club also results in organisation, information and decision-making costs. What is more important, EMU members are deprived of an independent monetary and exchange rate policy and thereby suffer the loss of two important national economic policy instruments. And the more heterogeneous the economic structures of the EMU member countries are, the more their economic policy objectives diverge and the more dissimilar the endogenous and exogenous economic shocks affecting EMU member states are, the less will the common inflation goal, the uniform interest rate policy and the common external currency value be consistent with the optimal strategy of the respective individual member states (Ohr 2003: 123).¹³ As a result, the costs of expanding the currency union are higher the more current members the union has and the more heterogeneous these member states are.

On the one hand, there is no rivalry in consumption regarding the club good common currency; rather, there are economies of scale regarding the utility of EMU membership in the case of increasing club size. On the other hand, an increase in club size is likely to result in a more than proportional increase in production costs of a stable common currency – except if all members were absolutely homogeneous, which is not the case.¹⁴ In sum, enlargement presents more difficulty for monetary union than for the Internal Market. For this reason, the optimal EMU club is expected to be smaller than the optimal Internal Market club.

(iii) The Common Agricultural Policy Club

Absurd and harmful policies like the Common Agricultural Policy (CAP) have an optimal club size of zero. There is no economic mutual benefit of a policy that deliberately brings about increased consumer prices, overproduction, and administrative costs. Due to subsidies and elevated EU-prizes for agricultural products, which are comparatively high especially from the viewpoint of the newly admitted CEECs, agricultural excess production is likely to increase even more as a consequence of the recent enlargement. Because these enormous costs of the CAP are likely to exceed any potential particular benefits by far, from the perspective of club theory, the optimal size of the CAP club is somewhere between zero (if the abolition of protectionism, privilege and waste is argued to be in the general interest) and one (if a large majority of citizens in one country wants to satisfy redistributive preferences of a minority, they can be allowed to tax *themselves* accordingly).

5.3. Club Size, Club Intensity, and “Interdependence Costs”

Based on Buchanan’s (1965) original theory of clubs, several authors have come forward with interesting technical models that *simultaneously* determine optimal club size *and* optimal degree of integration in the European Union.¹⁵ These models arrive at the conclusion that different policy clubs would demand different optimal membership

¹³ The inability to vary the exchange rate represents a cost, which is higher the more unevenly distributed the shocks are in the EMU area. Moreover, the more inflation preferences among members states differ, the more expensive will be the denial of an autonomous currency policy for each individual country which will have to surrender to one common policy for the entire currency club.

¹⁴ Whether the EMU club should be large or small depends on two different views on money (see for example Casella/Frey 1992: 644). If money is understood to be primarily legal tender, i.e. as a means of payment and accounting standard, then money is a public good and the optimal currency area comprises all of the countries in the world. However, if money is understood to be an instrument of price stability policy, optimality would require a currency area with only a limited number of members who all have similar stability preferences.

¹⁵ See Ohr (2003) but also Buchanan (1965), Cornes/ Sandler (1996) and Ahrens/Hoen (2002).

sizes suggesting the formation of various smaller sub-clubs within the EU club to be an efficient future integration strategy for the European Union. The optimal club size will vary from one club good to another contingent on respective policy fields and degrees of integration. In other words, in order to achieve optimality, different policy areas would require different membership sizes in order to be able to account for the needs and capacities of potential members. Inversely, it follows that one *single* overall EU-club providing *numerous* club goods to *all* its members at one *single* degree of integration will be comparably sub-optimal from a theoretical point of view.

Hence, applying the economic theory of clubs to the question of EU integration, one might draw the conclusion that the future European integration process can only be efficient if it is based on differentiation rather than harmonization: In the case of the EU, providing various separable club goods and comprising 25 heterogeneous club members having different preferences concerning their provision, it will be welfare-enhancing to realize flexible integration and allow for the creation of various smaller sub-clubs within the overall EU-club, each with an endogenously determined size. Welfare-enhancing allocative and dynamic efficiency gains within the EU can be achieved if one could accomplish a certain form of devolution of the “one size fits all” EU-club into several smaller EU sub-clubs consisting of comparatively homogenous members, allowing members of such sub-club to coordinate their activities pursuing their own preferred policies according to their specific needs and capabilities.

5.3.1 Reducing interdependence costs

Let us return to question of part four: Can external and decision-making costs in the European Union be brought into a more favourable balance in order to better prepare the enlarged (and further enlarging) Union to make policy choices and cope with the increased tension between widening and deepening? As discussed above, for a given decision-making rule, increased heterogeneity of EU-membership leads to an increase in interdependence costs, i.e. the sum of (i) decision-making and (ii) external costs, at the EU-level of collective choice. From this perspective, and given the way the EU is presently organised, the Union appears to be “too big” in terms of too many diverse members and in terms of too many decisions taken at the overall EU-level of policy-making causing interdependence costs to be very high.

If we dismiss the option of reducing EU membership size again, but rather take the current number of EU-members as given, the only way to diminish interdependence costs seems to be to reduce the number of club goods provided by the EU on a once-and-for-all basis. This seems promising because every increase in interdependence costs on the EU-level of policy-making can be expected to make the provision of the club good under consideration comparatively less costly on the level of a smaller and more homogeneous sub-club than on the level of the overall heterogeneous EU-club: The more homogenous membership of the various smaller sub-clubs decreases (i) decision-making costs *as well as* (ii) external costs (see Fig. 5).

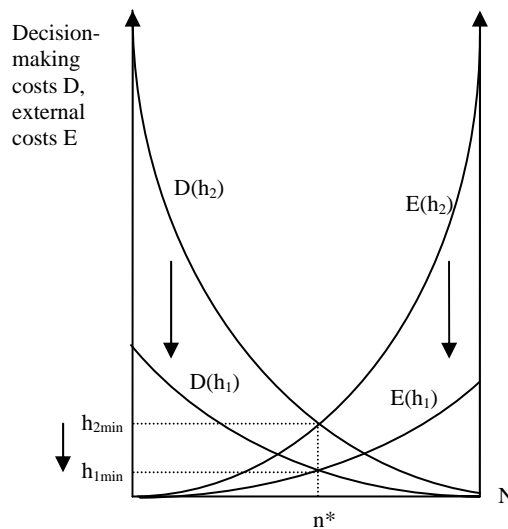


Fig. 5

The *less* heterogeneous the population ($h_1 < h_2$), the *lower* are decision-making and external costs (for a given decision-rule, here corresponding to n^*).

Fig.5 Interdependence costs for two different degrees of heterogeneity ($h_2 > h_1$) at a given decision-making rule n^* and for collective choices made on *one* level of collective action, the harmonized EU-level.

5.3.2 Optimal Allocation of Competencies

The question of an optimal European club size and the issue of allocating political competencies to different levels of decision-making within the EU can also be approached from a slightly different point of view. As Buchanan and Tullock argue, in order to achieve the optimal size of a jurisdiction, “[t]he group should be extended as long as the expected costs of the spillover effects from excluded jurisdictions exceed the incremental costs of decision-making resulting from adding the excluded jurisdictions” as well as the additional external costs caused by the likely increase in preference variety in a larger jurisdiction (Buchanan/Tullock 1962: 11). This line of reasoning can be further clarified by pointing to a similar trade-off, the trade-off between centralization and decentralization (Ahrens/Meurers 2004: 4). Exploiting scale economies or internalizing EU-wide external effects is welfare-enhancing but it necessitates EU-wide policy harmonization. And harmonization or centralization of policy-making in an increasingly diverse Union, as pointed out above, raises decision-making costs and makes it progressively less feasible for political authorities to account for diverse political objectives, economic problems and social needs.

Thus, on the one hand, policy centralization creates benefits resulting from the exploitation of scale economies or the internalization of different forms of cross-country externalities; on the other hand, it increases both decision-making and external costs (Alesina et al. 2001b, 2001c).¹⁶ The decision to centralize the provision of a club good on the EU-level of policy making is conditional on this trade-off between external cost stemming from heterogeneity in preferences and needs opposed to benefits resulting from the internalization of positive cross-country spillovers. In their model, illustrating the trade-off between centralisation and decentralisation by using and extending a model developed by Alesina et al. (2001b), Ahrens and Meurers (2003: 8) demonstrate that the more heterogeneous EU membership is, the larger the spillovers have to be for centralised decision-making to be welfare improving (see Fig 6).

¹⁶ Persson et al. (1997: 23) emphasize the advantage of decentralised decisions, which in their view, typically rely on better knowledge of local preferences and conditions and, accordingly, refer to a trade-off between information and internalization instead of to the aforementioned trade-off between external costs and internalization.

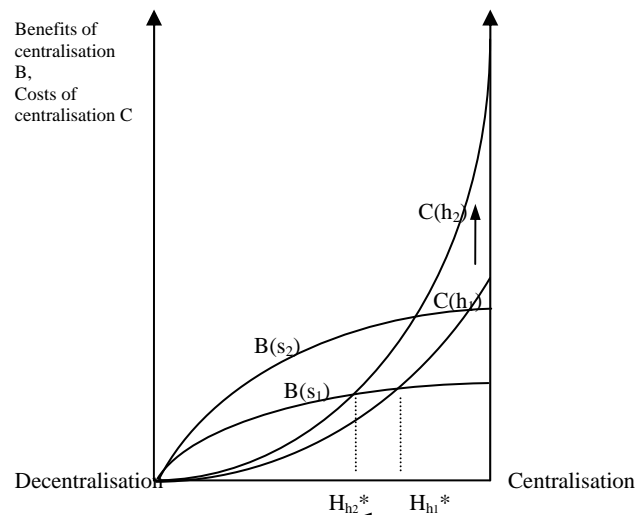


Fig. 6 For a given policy field, the more heterogeneous the EU-members are, the less likely it is for centralized decisions taken on the EU-level of policy-making to be optimal.
And, the more heterogeneous the EU-members are, the larger the spillovers s have to be for centralized decision-making to be welfare improving ($s_2 > s_1$).

Hence, economic theory offers a clear-cut rationale for the assignment of political responsibilities to different levels of governance within the EU: EU-wide harmonization and centralization are justifiable only when the object of potential harmonization possesses the characteristics of a public good throughout the integrated area (Schäfer 1995: 53). Thus, the EU should leave or hand down those policy areas to sub-EU-clubs or even national governments, in which decision-making costs and external costs associated with heterogeneous political and social preferences and economic structures overshadow the benefits of harmonization.¹⁷

Comparing reality with the preceding theoretical considerations reveals that the de-facto assignment of competencies in the EU is inconsistent with economic reasoning. In some cases, such as agriculture, EU involvement is too extensive, whereas in other cases, such as the environment, EU action appears to be too limited.¹⁸ In the course of European integration, the EU has drawn into its sphere of influence a range of interests that cannot adequately be served by a one-size-fits-all philosophy.

Although closer examination of Buchanan's theory of clubs uncovers its limitations as a heuristic tool due to strong assumptions, it still has analytical appeal when applied to the question of future European integration. The conclusion that can be drawn from club theory in this context can be summarised as follows: Since the cost and utility functions of various club members vary across different club goods, i.e. policy fields, optimal

¹⁷ Based on these considerations, Alesina et al. (2001a) examine nine policy fields in order to identify the optimal allocation of competencies. According to them, (I.) policy making should be assigned to the EU level (or even the global level) for "international trade policies", the "Internal Market" and "non-sectoral business relations", i.e. preserving competitive markets through anti-trust policy; (II.) "international relations", the "environment", and "money finance" should be addressed by both national authorities and the EU, e.g. contingent on the scope of externalities; and (III.) "education, research, and culture", "sectoral business relations" (i.e., agriculture and fishing, industry and transportation), and "citizen and social protection" should exclusively be decided upon by national or local governments.

¹⁸ Because empirics suggest that the current EU voting rules might be an inadequate mechanism to generate an allocation of policy responsibilities that satisfies the normative criteria for the optimal assignment of political competences, Ahrens/Hoen (2002: 38) or Feld (2003: 307), among other authors, argue in favour of a catalogue of exclusive and concurrent competencies in order to avoid excessive centralization of competences.

club size will also vary conditional on respective policy realms. Hence, the central message of club theory is that different policy areas require different membership sizes. This finding supports a flexible approach to future European integration and calls for the adoption of a clubs-within-the-club strategy. The preceding considerations concerning external and decision-making costs and the benefits and costs of policy harmonization also support the emerging political consensus that greater flexibility is an unalterable prerequisite to adequately cope with the enlargement-cum-deepening challenge and the problem of increasing heterogeneity associated with the recent enlargement of the EU.

6. Alternative Models of Integration

More flexibility is often feared because of its seeming potential to undermine part of the substantial gains already achieved by European integration. Constitutional commitment, as prerequisite to stable expectations, is needed to protect the existing benefits from cooperation, in particular those attributable to the Internal Market. The difficult task ahead is to introduce more flexibility into the system without completely emasculating the *acquis communautaire* and to find a constitutional framework with a proper blend of flexibility and commitment that meets this challenge. In order to better be able to examine and categorise alternative ways of realising more flexible integration and to evaluate the idea of creating clubs within the club suggested by the above club-theoretical findings, this part briefly presents seven basic alternative integration models (see fig. 7).

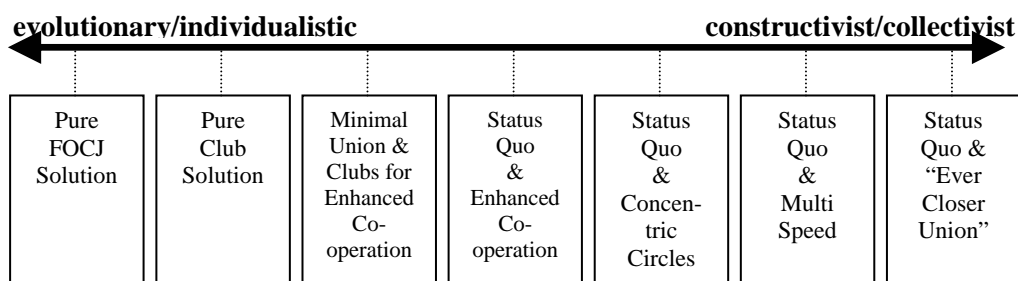


Fig. 7 Alternative Models of European Integration

6.1 Status Quo and "Ever Closer Union"

Aiming at a uniform "ever closer Union" used to be the rather constructivist-collectivist approach to integration for decades, especially before the provisions for "enhanced cooperation" were introduced into the Amsterdam Treaty signed in 1996. But as indicated above, one *single* overall EU-club providing *numerous* club goods to *all* its members at one *single* degree of integration is necessarily sub-optimal. Moreover, decision-making costs as well as external costs are excessively high in a heterogeneous Union with 25 and more members seeking to agree on each and every policy rule and regulation with each and every member state. Therefore, the model "status quo and ever closer Union", a "pan-European picnic" at which "all participants enjoy the same cuisine as if they had equal tastes and the same dietary restrictions" (Ahrens/Hoen 2002: 40), is likely to "hurt" (Dahrendorf 1979) by "causing abdominal pain" and is not likely to be able to cope with the challenge of integration in an enlarged Union.

6.2 *Status Quo and Multi-Speed Integration*

The usefulness of multi-speed integration as an instrument for reducing the problem of increased decision-making and external costs attributable to a larger and more heterogeneous EU is limited. (i) Since ultimate integration objectives stay the same for all members and therefore have to be debated and agreed upon by every single country, the problem of increased decision-making costs remains more or less as before: 25 plus x member states have to agree on common objectives and when they are to be reached by which countries. (ii) Since member states are allowed to proceed with integration at different speeds according to their capability, within some limitations, external costs might possibly be postponed, that is, *temporarily* reduced. But because the multi-speed approach does not permit member states to opt-out through choice rather than incapacity and because of the obligatory common integration endpoint for all members, the multi-speed approach cannot permanently decrease external costs. Moreover, the common integration goal for all member states across all policy realms is inconsistent with the optimal club-theoretical solution derived above and – again – implies the disadvantages of an equal integration “menu” across the EU regardless of “taste” or “willingness and ability to pay”, even though in the multiple-speed case, member countries can at least take some more time to adapt to the new “cuisine”. In sum, the concept of multi-speed integration is not capable of permanently resolving the problems caused by a larger and more heterogeneous Union.¹⁹

6.3 *Status Quo and Concentric Circles*

The concentric circles approach has some advantages over the multi-speed approach in that it allows countries to choose *permanent* different degrees of membership without requiring member states to achieve one common endpoint of integration. The main weakness of the concentric circles proposal lies in identifying a centre and peripheries in terms of *countries* rather than in terms of *policy areas* by telling apart a centre including countries that want to cooperate on virtually all aspects of integration and peripheries including countries that desire limited cooperation instead. Imposing clear and enduring boundaries between the groups of member states in the centre and in the predefined peripheries, instead of allowing for flexibility in terms of policy fields as recommended by the club-theoretic model outlined above, implies a danger of geographical divisions within the EU. In addition, the concentric circles approach pictures integration to follow a certain precise sequence and thereby rules out the formation of competing functional areas or clubs; instead, all member countries have to agree *ex ante* on a set of entry rules (for instance, the Maastricht criteria for EMU) and on a sequence of integration steps (for example, whether EMU should occur before or after integrated regulatory functions).

While decision-making and external costs can be expected to decrease to some extent by allowing countries that only want limited integration depth to belong to one of the periphery circles, the concentric circles approach still entails relatively high external costs: By requiring countries to choose between one sort of membership or another, namely core membership or membership in one of the peripheries, some countries would have to commit themselves in the future to certain forms of integration (for example, monetary union), which they do not regard as in their best interest, in order to benefit from other forms (for example, a common defence policy), which *are* in their interest. Conversely, some governments might decide to stand aside from forms of integration they regard as desirable in order to avoid those they could not accept. Where this happened, an opportunity would have been missed to advance cooperation of a sort that all parties wanted.

¹⁹ See Warleigh (2002: 83ff) for a more extended discussion of the shortcomings of multi-speed models.

Overall, the concentric circles notion, which has obtained substantial attention in political circles, cannot be considered as a suitable and efficient way to account for country-specific heterogeneities with respect to different areas of integration. Owing to the above considerations, it seems to be more productive and less divisive to discuss flexible integration in terms of policy areas rather than in terms of countries (Fratianni 1995; Harrop 2000: 309).²⁰

6.4 Status Quo and “Enhanced Cooperation”

As demonstrated above, club-theoretical findings call for the formation of multiple integration clubs exhibiting various sizes and degrees of integration. Flexible integration of this type could theoretically be made possible on the basis of the instrument of “enhanced cooperation”. Allowing for “enhanced cooperation” is the present-day integration strategy as well as the mode of future integration currently intended by the Treaty establishing a Constitution for Europe, whose condition is more than critical after the French and Dutch referenda veto.²¹

In principle, we argue, easing the criteria for “enhanced cooperation” and permitting the establishment of coexisting integration clubs in addition to the *acquis* would be a suitable and politically feasible possibility to cope with current and future integration challenges. The formation of multiple “enhanced cooperation” clubs would be an appropriate way to realize the clubs-within-the-club approach recommended by the club-theoretical framework presented above. Moreover, admitting numerous “enhanced cooperation” arrangements among smaller and more homogeneous subsets of countries would lead to considerable reductions in external and decision-making costs. However, as will be spelled out in more detail below, the existing provisions for “enhanced cooperation” as proposed by the Constitutional Treaty are too restrictive to realize flexible integration of this sort. Without modifying the requirements for “enhanced cooperation”, external and decision-making costs will remain high and the “enhanced cooperation” provisions will not be able to resolve the problem of integration in a heterogeneous Union comprising 25 and more member countries.

6.5 Minimal Union and Clubs for “Enhanced Cooperation”

As sketched out above, allowing for the formation of various “enhanced cooperation” clubs around an obligatory *acquis communautaire* can be regarded as a suitable way to make future integration more flexible. However, contrary to the previous option, the common base does not necessarily have to include all of the current *acquis*. As suggested by the above centralisation-decentralisation-trade-off-considerations in

²⁰ See Warleigh (2002: 86f) for a thorough discussion of the insufficiency of the concentric circles approach. The reason why – despite their inadequacy – both the multi-speed and the concentric circles approach have influenced the political debates, may be that both models match the interests of certain key players in the European integration process, for multi-speed, for instance, the Commission, the Parliament and more federally minded member states and for concentric circles, certain German and French politicians.

²¹ The fact that the constitutional draft as a whole must be considered “dead” (Barroso) since it cannot be ratified as such, does not preclude, of course, that certain elements of it – especially those that seem uncontroversial amongst heads of state – can be adopted through normal treaty-amendment procedures. The dead body may still contain healthy organs that could be transplanted into the sick body of the Nice Treaty. Many political actors, however, regard any attempt to revitalise parts of the constitution as “cherry picking” of an almost illegitimate sort. They point at the complex compromise-finding and package-dealing process that lead to the draft which, they say, cannot be unbundled without opening “Pandora’s Box” of fruitless re-negotiations. To an external observer, however, such a take-all-or-leave-it attitude is exactly the cause of most inefficient log-rolling outcomes that characterise the EU from its start. If taken to its extreme, it would preclude all piecemeal improvements in terms of institutional reform that would resemble any element contained in the constitutional draft.

section 5.3, one could argue that the extent of current policy harmonization in the *acquis* is too extensive because it includes policy fields in which the benefits resulting from the exploitation of scale economies and the internalization of externalities are overshadowed by external costs caused by policy centralisation. This in turn implies that sticking to the status quo may not be optimal from a theoretical point of view. Rather, it might be efficient to reduce the number of integration domains currently included in the *acquis communautaire* and transform the current *acquis* into a *core-acquis* comprising only those policy fields for which harmonization is considered to be efficient and essential.

In this context, the Union would act as “guard” of the *core-acquis* on the one hand, on the other hand as “broker”, “monitor” and “arbiter” of a variable structure of open, flexible, competing integration clubs. According to this approach, all members of the EU are members of the core; membership in the various sub-clubs is optional. Thereby, the club-of-clubs approach allows for different intensities of membership in the EU, but, in contrast to the concentric circles model, the focus is on policies, not on countries. In other words, contrary to the concentric circles approach, the concept of creating different policy field clubs around a *core-acquis* is *functional* rather than geographical.

It could be argued that the difference between concentric circles integration and flexible integration according to the club-of-clubs approach is only a matter of semantics. Of course, the core of countries under the model of concentric circles could be a group of countries which, under flexible integration à la club-of-clubs, would choose to belong to all existing clubs. It is not unlikely that such an outcome would occur. However, there are important differences between the two models. The concentric circle approach is much more rigid than the club-of-clubs strategy. According to the concentric circles approach, flexibility is implemented only through negative choices by a system of derogations and opt-outs and the integration sequence is fixed in advance. The clubs-within-the-club-approach, on the other hand, would be more flexible by giving member states complete freedom to create new forms of cooperation or deepen existing ones and by keeping no member from leaving any sphere of integration (with the exception of the *core-acquis*). Moreover, in contrast to the concentric circles concept, the clubs-within-the-club strategy pictures Europe to consist of several different clubs, treating member countries as members of different clubs rather than as one single club with different classes. At first sight, this difference may seem small; in fact, it is fundamental. As sketched out above, the concentric circles approach requires countries to choose between one sort of membership class or another entailing the risk of missing out on opportunities of cooperation of a sort that is in the interest of all parties involved. Accounting for every single opportunity of collaboration that is in each party’s interest and exploiting mutual gains from cooperation is exactly what the club-of-clubs approach aims at. For instance, in contrast to the concentric circles approach, the clubs-within-the-club concept would allow a country to join in “enhanced cooperation” in the realm of security without adopting the single currency – or vice versa. In sum, a Union of different clubs therefore looks preferable to a union of different classes.

Flexible integration according to the clubs-within-the-club strategy, a process by which all member states agree to disagree about their priorities but permit their members to surge ahead with an objective which they share as a sub-group, caters both to the legitimately particularist needs of individual member states and to the disparities of economic and political endowments in a heterogeneous group of 25 and more countries. Every country would be allowed to choose, which parts of the integration process it would like participate in; thus, choice would become the key principle of participation in the Union. At the same time, the clubs-within-the-club approach breaks down one high integration hurdle – the *acquis* – into a lower hurdle – the *core-acquis* – and

various optional hurdles. In fact, previous experiences with flexibility, which aimed at fostering deeper integration, have been quite successful and in many cases have had centripetal effects. Thus, flexibility has not always been the end stage but often a stepping stone towards further integration of all member states.²²

According to the clubs-within-the-club model, members would have complete freedom to create new forms of cooperation or deepen existing ones and no barriers would keep a member from leaving an integration club. Since no member is constrained to accept any common policy that it dislikes, external costs would be reduced significantly. Moreover, decision-making costs will be considerably lower for decisions made in various smaller and more homogeneous clubs than for decisions made in the overall Union. If the Union is to have a core, this core should not be a group of countries pretending to agree about everything, but rather issues on which all members genuinely agree, for example, the need to preserve and extend the Internal Market. Apart from the core, there should be room for choice; however, not country by country in an all-or-nothing way, but issue by issue, according to national needs and interests. Thus, the “minimal union plus enhanced cooperation” model is composed of a “multiple-course menu consisting of main courses to be shared by everybody and additional ones that can be consumed according to individual preferences” (Ahrens/Hoen 2002: 41).

6.6 Pure Club Solution and the “EU” as Club- Referee

Like the preceding concept, the pure club solution is based on the formation of numerous competing integration clubs. But in contrast to the previous option, it does not envisage a set of core policy fields that is obligatory for all EU members such that countries can freely “pick and choose” from European laws and regulation menu. The pure club solution without a common base reduces the role of the “EU” to that of a “mediator”, an “arbitrator” or a “referee” of the numerous European clubs. This approach allows for even more flexibility than the aforementioned concepts and is likely to reduce external and decision-costs even further.

However, the pure club solution implies several shortcomings. First of all, such an option may lead to an entirely fragmented Union. Besides, the pure club solution might erode the Internal Market and other crucial accomplishments of the integration process to date by unravelling fundamental compromises. In addition, with the pure club solution the EU risks evolving into a network of bilateral and multilateral agreements among states, with no clear role for EU institutions. Moreover, in light of all the sunk costs involved in agreeing on the current common base of the Union, the *acquis*, it seems questionable whether politicians would be willing to dissolve this base entirely. Furthermore, while considering the cost efficiency of the pure club solution, one also has to take into account that the costs of reorganizing the current Union into an assembly of clubs might be considerably high. Last but not least, the pure club solution may not be feasible because it seems doubtful that all relevant European policy issues can be organised and decided on separately from each other in different clubs respectively. In light of these disadvantages and problems, it seems doubtful whether the pure club solution represents an appropriate and politically feasible solution.

6.7 Pure FOCJ Solution

In its extreme, the ultimate outcome of flexible integration may resemble the concept of “Functional, Overlapping, Competing Jurisdictions” (FOCJ) that has been elaborated by

²² Pointing to the fact that some of the most significant steps towards deeper integration in the 1990s were linked with flexible arrangements either within or outside the framework of EU law, Kölliker (2001: 30f) and Grieser (2003: 256) arrive at the conclusion that flexibility has resulted in resolving national reluctance and lead to significant integration progress.

Bruno Frey and Reiner Eichenberger (1999). In that case, like in the pure club solution, there is no common base for all member states. In addition, club goods are not necessarily provided for by clubs consisting of national states, but by *sub-national* jurisdictions (municipalities, regions, etc.) that cooperate in order to address common political concerns and provide their preferred level and type of public goods.

To be sure, the implementation of the FOCJ concept in the EU would imply even stronger fragmentation and complexity than the pure club solution. Moreover, the FOCJ concept not only involves several practical shortcomings, it is also controversial from a theoretical point of view.²³ First of all, the FOCJ solution implies extensive information and transaction costs. Moreover, it is not clear who has the right to choose between different FOCJ, individuals or communes. The problem is that some of the advantages that Frey and Eichenberger (1999) stress with respect to their concept, for instance, exit at minimal costs, only apply to cases in which *individuals* have the choice to enter or exit FOCJ. Such an individual FOCJ approach, however, can only be realised with respect to excludable goods. But if exclusion is feasible, then the question is why the function in question is not being privatised. Nevertheless, the FOCJ solution can be seen as a potentially useful supplement to the club model.

6.8 Which Integration Model for Europe?

The brief discussion of the above integration models suggests the option “minimal union plus enhanced cooperation clubs” to be the most adequate and efficient strategy for future integration. According to this club-of-clubs concept, flexibility should be complemented by an agreement about core policy areas which must be dealt with by the entire EU. Thus, the clubs-within-the-club approach combines firm commitment by all members to a common base, including a well-defined set of policies related to the Internal Market, with optional integration in the remaining integration areas through open clubs.

The clubs-within-the-club approach neither takes for granted that all EU members aspire the same goal nor rules that out. Besides, it does not relegate certain member states to the periphery classifying as core subject policies those which they are incapable or unwilling to implement. Rather it accounts for permanent variety between member states’ capability and wish to participate on an issue-by-issue basis, even within a policy area.

As sketched out above, the EU seems to be “too large” in terms of too many decisions made on the EU-level of policy making and in terms of disproportionate high external cost because of the large number of heterogeneous individuals having to live with the same decisions and obey the same rules and regulations. From the perspective of club theory and taking account of the trade-off between centralisation and decentralisation, it is not apparent why each and every policy field should be fully harmonized across all member states. Given club theoretical considerations and research on multi-product clubs, quite the opposite seems to be true: partitioning the overall EU-club into various smaller clubs exhibiting different degrees of integration and transforming the EU into a “club of clubs”, that is, into “an association of sovereign states, which pool their sovereignty in very restricted areas or to varying degrees” (Siedentop 2000: 1) promises to be a suitable strategy to resolve the future integration challenges in a larger and more

²³ See Vanberg (2000) for a detailed critique of the FOCJ concept. Holzinger (2001) discusses why it would be premature to *fully* give up the traditional link of policies to territories and to introduce functional jurisdictions in its stead; she favours a concept of optimal regulatory areas, which are designed to re-establish the congruence of functional areas and territorial jurisdictions.

diverse Union. In sum, the club-of-clubs approach is the most realistic way of coping with the much-enlarged EU and overcoming the paralysis of the Union.

7. The European Union as Club of Clubs Around a Common Core

It is in fact not only the idle product of ideal-type economic reasoning to imagine several different-sized EU-sub-clubs with various members across different policy fields instead of one single overall EU-club comprising 25 and more heterogeneous members. Even though they are still exceptions, there already are a number of different-sized “sub-clubs” within the EU. While, for instance, the Internal Market covers *all* EU members, some of the by now existing clubs comprise only a subgroup of EU-members, such as the EMU, and some embrace several EU-members as well as non-EU-members, such as the WEU. In what follows, we will discuss how flexibility can be made to work if a kind of clubs-within-the-club approach is applied to the integration process. Before addressing the question of how the club-of-clubs strategy could be institutionalised, let us now discuss the basic theoretical elements of the clubs-within-the-club concept in more detail and examine the notion of permitting the formation of various facultative, open integration clubs around a core comprising certain obligatory policy fields.

7.1 *Obligatory and Optional Policy Fields*

The flexible integration approach presented in this paper proposes to distinguish European policies and the corresponding goods and services to either be provided (a) by the *obligatory overall EU-club-core* or (b) by *optional EU-sub-clubs*.

- (a) As already sketched out in the discussion of the centralisation-decentralisation-trade-off, for goods with a high degree of externality or for goods exhibiting increasing returns, the optimal club size is likely to be large and in the case of EU-wide public goods EU-wide harmonised policies and regulations can be considered as efficient (Fратиanni 2003: 14). Accordingly, obligatory deepening is optimal with respect to such supranational EU-wide public goods: the gains from internalizing external effects and scale economies will outweigh increased decision-making and external costs as a result of policy harmonisation.²⁴
- (b) No obligatory EU-wide harmonization but instead the realization of modes of flexible integration are efficient if the benefits caused by the internalization of external effects and scale economies are overshadowed by the rise in external and decision-making costs in a larger and more heterogeneous integration area.²⁵

Therefore, the adoption of the clubs-within-the-club approach proposed in this paper requires one to specify (a) the *core* of the EU-*acquis*, which provides non-excludable and non-rival European-wide public goods to *all* its members, and (b) the *periphery*, comprising facultative policy fields.

7.2 *The Core-Acquis*

The *core-acquis* would have to be observed by each and every member of the EU; it is the minimum requirement for participation in the EU and, at the same time, the largest common denominator of the Union. It should contain well-defined integration areas for which integration is regarded as essential, the most important of which are the basic,

²⁴ Compulsory membership is necessary concerning EU-wide public goods, for example to protect the Internal Market or conduct defence policy and prevent free-riding..

²⁵ For example, this could be the case in policy fields such as social welfare, regional aid, sectoral business relations, and labour-market policies, where Ahrens/Meurers (2004: 31) found that the newly admitted EU members are likely to tip the scales toward inefficient centralization.

“universalisable” provisions of the Internal Market.²⁶ With the exception of the Internal Market there is no theoretically unchallenged consensus over which policy fields should be in the core (Harrop 2000: 308; Warleigh 2002: 64).²⁷ This hard core should also be politically unchallenged. However, past and present relapses into economic nationalism even within the EU (e.g. fending off a free trade in services, protecting “national champions” from EU-takeovers) show that national governments and members of the European Parliament often enough are caught in a Prisoners’ Dilemma situation in which only a credible constitutional commitment or the power of independent authorities in the Commission can be trusted to ensure the viability of long-term common interests. In addition to the Internal Market with the guarantee of the “Four Liberties”, the core-*acquis*, as proposed by the analysis conducted by Alesina et al. (2001a), should also include international trade policy and competition policy preserving competitive markets. Moreover, it may also contain the guaranteed convertibility of currencies, the Common Foreign and Security Policy (CFSP) as well as police and judicial cooperation of all EU members in those criminal matters that show cross-country externalities.²⁸

The main reason to have a common core with obligatory policy fields is that in those policy fields the benefits of internalizing externalities and scale economies will exceed the costs that result from common policies and regulations when national needs and preferences are heterogeneous. Another advantage of the existence of a core-*acquis* is that European integration would otherwise potentially be at risk to fall apart. The existence of an obligatory core will prevent flexibility to be “an impulse towards fragmentation which will ultimately tear the Union apart” (Weatherill 2000: 2).

7.3 The Clubs within the Club

While participation in the core-*acquis* is mandatory, in the remaining policy fields member countries, can freely choose to participate in those clubs from which they hope to benefit. In contrast to the obligatory common base of the overall EU-club, the EU sub-clubs are voluntary arrangements for cooperation in the policy fields outside the core. Not every country must participate in every sub-club, and members can, under some rules, set up new sub-clubs or close existing ones. The clubs-within-the-club approach allows for multiple overlapping and non-overlapping clubs.²⁹ The number of overlapping and non-overlapping integration areas depends on the number of club goods for which the EU citizens, according to their preferences, have a demand (Schäfer 1995: 56). An example for multiple clubs may be three environmental clubs to protect the water quality of the Mediterranean, the Baltic Sea and the North Sea, respectively (Dewatripont et al. 1995). Given its location and ambitions, a country may prefer to join none, one or more than one of these clubs. In essence, voluntary sub-clubs introduce the flexibility needed to adapt the Union to the heterogeneity of its members. Moreover, they create opportunities for experimenting with new forms of cooperation.

²⁶ Wohlgemuth and Sideras (2004: 20f) argue that the provisions of the Internal Market contain key elements of an universalisable order resembling Hayek’s (1938/39) vision of “Interstate Federalism”.

²⁷ For example, Dahrendorf’s list of core policies in his discussion of Europe à la carte includes foreign policy, trade, monetary policy and overseas development; Ahrens and Hoen (2002: 35) suggest the Internal Market, indirect taxation policies, the CFSP as well as police and judicial cooperation in cross-country criminal matters to be in the core.

²⁸ For instance, it may be a useful means to strengthen the operational side of cooperation in the field of security policy via trans-national police forces, border guards, a European judicial area and intelligence cooperation. See also Feld (2003: 308) on judicial cooperation in cross-country criminal matters like protection against terrorism and Persson et al. (1997: 26) on political economy reflections on why there is reluctance to centralize defence policy.

²⁹ On overlapping clubs, see Casella/Frey (1992), Schäfer (1995) as well as Frey/Eichenberger (1999).

8. Evaluation of the Clubs-within-the-Club Approach

After the brief outline of the clubs-within-the-club concept, this part attempts to discuss potential strengths and weaknesses of flexible integration and club formation within the EU.

8.1 Disadvantages

8.1.1 Complexity and Management Challenges

Possibly the utmost and most apparent disadvantage of the clubs-within-the-club approach – and flexibility in general – is that it would aggravate the already striking complexity of the EU system and would cause considerable challenges of manageability. On the other hand, one could argue that the member states will be more likely to confer the additional necessary management and administrative capacities to the EU if the rules and regulations, which they agree to, and their involvement in general corresponds more closely to their national preferences, interests and needs (Warleigh 2002: 88). Still, management and administrative costs are likely to increase in total, partially offsetting some benefits of the more efficient club-of-clubs solution outlined above.

8.1.2 Flexibility and the Principle of Uniformity

One of the cornerstones upon which the Treaties of Paris and Rome have based the three European Communities was the principle of equal rights and obligations for all member states.³⁰ The introduction of more and more elements of flexibility and legal differentiation has challenged the orthodox doctrine of legal uniformity. Many authors, including Grieser, argue that the differentiation of law is a necessary consequence of the increase in heterogeneity among the EU member states (Grieser 2003: 176). According to this view, uniform rules cannot, sad as it may be in terms of coherence and transparency of the Union's legal framework, do justice to these differences and differentiation is therefore inevitable.

Becker (1998: 42), among others, argues that the attempt to impose uniformity for its own sake is undesirable because legal uniformity is not intended to be an end in itself but rather a *tool for integration*. Therefore, since in the course of fostering flexibility, the principle of uniformity will only be weakened *in order to enhance integration*, from this perspective, the principle of legal uniformity does not prohibit the differentiation of the European legal framework.

8.1.3 Further Problems

Flexible integration according to the club-of-clubs approach may also lead to problems of separability because the disentanglement of European club goods and their separate provision in different clubs may be problematic in some cases due to interdependencies between certain policy fields. A further problem is that flexibility might possibly cause legal uncertainties, which, then again, would have to be weighed against the current legal uncertainties in the EU. Another potential danger is that the various integration-clubs would evolve into fortresses within the “Fortress Europe” and degenerate into

³⁰ This principle and the idea that EU institutions and rules had to be accepted by all member countries and that EC law should be a means of harmonization was a good working principle so long as countries had common objectives and the economies had similar structures (Fratianni 2003: 20f).

political cartels. It could also be argued that flexible integration might result in a deterioration of the Internal Market and other achievements of the EU to date. However, it is unlikely that member states which have – economically and politically – invested so heavily in the Internal Market and the Euro would suddenly want to drop out of both and in so doing get no return from their sunk costs and their freely chosen but in many cases painful commitments.

8.1.4 The Need for Rule-Based Flexibility

In sum, it cannot be repudiated that flexibility creates risks and challenges, for instance administrative challenges in terms of assuring the more differentiated Union is “policied” effectively or legal challenges in terms of how to cope with a more differentiated legal framework.³¹ Flexibility can be seen as the key to reconvening the “widening or deepening” debate, since it promises both, albeit at the now seemingly inevitable price of abandoning an all-embracing uniformity of application of the law. Nevertheless, one can also argue that the greatest risk is that, much like in the case of subsidiarity, flexibility will turn out to be still one more potentially valuable principle of Union governance which falls short of becoming adequately operationalized because European integration is to a large extent characterized by a process of “muddling through” and the ad-hoc reaction to pressing needs rather than the elaboration of a detailed strategy for action over the medium to long term (Warleigh 2002: 57).

However, if flexibility, even though it is likely to increase complexity, is in fact inevitable, then it should – at least – not be applied in an ad-hoc manner but rather in a systematic and rule-based way. Conversely, most flexibility realized so far, has generally not been attained according to certain transparent rules, rather it has been realized by granting exceptions as the often unintentional outcome of the bargaining hassle of day-to-day politics. Accordingly, many of the various existing forms of flexible integration, namely the exceptions and opt-outs regarding, for example, the Monetary Union and Schengen, are incoherent, non-transparent, unsystematic, ambiguous, confusing and unclear (Grieser 2003: 255).

This lack of transparency with respect to flexible integration may in turn cause lack of citizens’ acceptance due to incomprehensibility (Martenczuk 2000: 359). Moreover, the decision to grant a country an exception with respect to uniform integration and allow for opt-outs has so far been essentially contingent on the bargaining power of the respective member state (Grieser 2003: 255). Concerning the goal of a “Europe of citizens”, the tendency to cope with differences by making exceptions and granting certain – most likely more powerful – countries a special status is precarious. If – as is the growing consensus – more flexibility is inescapable, then it is preferable to attain flexibility according to a conscious and transparent strategy instead of accepting it as an unintended consequence arising out of an accumulation of pressures within the Union. The crucial issue is to provide flexibility without ad-hoc arrangements and without creating so many exceptions and special cases that ultimately it distorts and discredits the whole Union (Harrop 2000: 307). As is intended by the combination of graduated and differentiated integration in the club-of-clubs approach, flexible integration should instead transparently offer systematic choices, be rules-based and predictable.

8.2. Advantages

As economic theory suggests, the clubs-within-the-club approach is, at least on paper, an appropriate means to resolve the increased tension between deepening and widening. As it turns out however, conceiving the EU as a club of clubs is not only consistent with neo-classical economic theory; rather, it is also compatible with the basic “mutual

³¹ See Warleigh (2002: 57ff).

gains” notion of the contractarian constitutional paradigm and appears to be a suitable strategy in light of the constitutional economics approach.³² According to Vanberg, one of the most important messages of the contractarian constitutional paradigm is that, “compared to its feasible alternatives, seeking to explore potential gains from cooperation” is “the socially more productive strategy” (Vanberg 2003b: 18). Since “seeking to explore potential gains from cooperation” is at the heart of the formation of voluntary policy clubs within the EU, the clubs-within-the-club approach, relative to its feasible alternatives, can be regarded as the “socially more productive strategy” from the perspective of constitutional economics. In view of this paradigm, we can identify various additional advantages of a “socially productive strategy” of club formation within the EU and show that there are good reasons to view flexible instead of one-size-fits-all integration, not only as inevitable but also as desirable.

8.2.1 Commitment - Flexibility Combination

First of all, the advantage of the club-of-clubs procedure is that it allows for greater variety and diversity without endangering the great achievements of European integration, namely the Internal Market and the “Four Liberties”. Defining obligatory core policies and allowing for the formation of optional clubs in the remaining policy realms introduces more flexibility to accommodate the heterogeneous interests and needs in Europe without risking the gains attained through past integration. Thus, the club-of-clubs approach yields a combination of commitment and flexibility that is superior both to the *status quo* and to other proposals for flexible integration like multi-speed or concentric circles.

8.2.2 Reduction of Integration Costs

Although, as discussed above, administrative costs might increase as a consequence of transforming the EU into a club of clubs, the clubs-within-the-club approach, according to economic theory, still has the advantage of being relatively cost efficient and may even result in a reduction of overall costs. By permitting the formation of overlapping, competing clubs, the costs of future integration could be reduced for the following reasons:

- (1.) Competition among the various integration clubs does not only imply higher allocative but also larger dynamic efficiency gains, which eventually lead to a cutback in costs for providing European club goods and to welfare improvements in the EU member states (Ahrens/Meurers 2004: 31).
- (2.) Since decision-making costs will decrease due to the more homogeneous population in the smaller sub-clubs, the club-of-clubs approach would reduce the costs of finding consensus and making agreements.
- (3.) A decentralized, competitive process of club formation with more homogeneous populations would lower external costs because countries, and possibly sub-national units, can search for cooperation in those functions in which they have a real demand for cooperation, and they are not forced into cooperation with respect to functions on which they want to stand alone.
- (4.) The clubs-within-the-club approach could possibly attenuate political power and bargaining struggles and thereby further reduce political transaction costs.

³² As Vanberg (2003a: 8) argues, the contractarian-constitutional-economics notion of mutual gains from joint commitment suggests a political organisational structure, “in der Bürgergenossenschaften in vielfältigen Abstufungen und Überlappungen, von rein lokalen bis hin zu weltumspannenden Interessengemeinsamkeiten, wechselseitige Vorteile durch geeignete Regelbindungen realisieren können”, z.B. durch “eine flexible föderale Struktur, in der die für die Realisierung gemeinsamer Vorteile erforderlichen Regelbindungen jeweils auf der gebietskörperschaftlichen Ebene erfolgen (und die dadurch geschaffenen Entscheidungskompetenzen jeweils der Ebene zugeordnet werden), die sich mit den Grenzen der in Frage stehenden Interessentengruppe am ehesten deckt”.

For instance, the application of the club-of-clubs idea reduces the risk of blackmailing by veto-players and decreases the necessity for mutual haggling over privileges via log-rolling against the common interests of citizens; it also reduces the threat of inefficient package deals and discriminatory rules benefiting some and harming others (Wohlgemuth/ Sideras 2004: 23).

- (5.) Flexible integration will alleviate the trade-offs between efficiency, legitimacy and enlargement: Due to the increase in decision-making costs as a result of enlargement, from the Buchanan/Tullock (1962) perspective, more majority decisions are necessary; this, however, requires the overruled minority to accept decisions contrary to its preferences, which in turn requires a minimum of European identity and solidarity, which will, however, be less probable with a (further) enlarged Union

In sum, the club-of-clubs concept compares favourably to the traditional form of integration undertaken in the EU: a systematic and institutionally safeguarded partitioning of the overall European club into competing sub-clubs promises to yield more efficient economic outcomes and contribute to ease persistent political power struggles.

8.2.3 Responsiveness to Citizens' Preferences

The freedom of citizens to choose between the institutional arrangements of numerous clubs that involve different costs and benefits corresponding to diverse needs and tastes, alongside the freedom of clubs to modify and differentiate their institutional supply, generates institutional competition among the various integration clubs. Such competition can help to enhance *citizen sovereignty*, that is, make self-interested politicians and government bureaucrats more responsive to citizens' interest (Vanberg 2000: 363). The key incentive to increase responsiveness to citizens' preferences is the "exit" option (Hirschman 1970), that is, the possibility for citizens to express their preferences by "voting with their feet" (Tiebout 1956) and leave the club ("institutional arbitrage"). For politicians, the threat of dissatisfied citizens' opting out – thereby foregoing their net contribution to the club good – provides an incentive to take individual preferences into account and to provide the respective club good efficiently.

In addition to the choice for individual citizens to enter or exit a club, club competition generates the possibility for entire jurisdictions to collectively join or exit one club or another or to establish a new club of nation states. Thereby, competition between integration clubs can cause inefficient clubs to be crowded out and new efficient clubs to be formed (Schäfer 1995: 57). Moreover, since the club-of-clubs approach increases both the governments' incentives *and* possibilities to satisfy individual preferences, policies will be better directed at and take account of heterogeneous preferences at national and possibly sub-national levels.

A further advantage in this context is that the focus of the club-of-clubs approach is on *functions* or *policy areas*. Due to the concentration of clubs on one functional area, the citizens of that particular club are likely to have better information on its activity and are in a better position to compare its performance to other clubs (Frey/Eichenberger 2000: 12). This in turn further increases club competition, which again will increase the politicians' responsiveness to citizen's preferences.³³

³³As Schäfer (1995: 61) argues, politicians' appeal to endorse a uniform EU potentially disregards that emotional ties are more likely to be cultivated in smaller clubs rather than in large centralized structures, and that supposedly they are stronger in clubs that are organised functionally "from bottom up" than they are in political structures that are imposed on citizens "from above".

8.2.4 Flexible Integration as Evolutionary “Discovery Procedure”

Another major advantage of the club-of-clubs concept is that it is *process-oriented*: while it specifies the process of club formation (for example, how new clubs may be established), it does *not* determine the club-of-clubs *outcome* (for instance, what functions are to be provided by which club). The procedural nature of the concept implies an important advantage with respect to knowledge. This is crucial because, as noted in part three, one must bear in mind that the reduction of the risk of undesirable decisions being made and the risk of decisions, which would benefit all, not being made, not only involves preference-related problems, but also severe knowledge problems and “limits of reason” as it is not always apparent where the common interests of the citizens lie or how to serve them in the most efficient manner (Vanberg/Buchanan 1991). In this context, competition among the various clubs can, by stimulating “desirable experimentation”, resolve the “limits of reason” challenge by serving as knowledge-creating “discovery procedure” of such political preferences and problem solutions “as, without resort to it, would not be known to anyone, or at least would not be utilized” (Hayek 1968/78: 179).³⁴

By allowing the formation of various competing clubs, the clubs-within-the-club approach promotes decentralised competition between different forms and practices of cooperation allowing citizens and politicians to learn about their advantages and disadvantages. Thereby, club competition helps to “discover” which institutional framework is considered to be advantageous in the eyes of resource owners, mobile voters and political entrepreneurs. Whereas “experiments in innovative regulation opportunities are lost under the stifling impact of exhaustive harmonization” (Weatherill 2000: 4), under flexible rules of integration, individual member states, and possibly also sub-national units, are free to experiment with a range of integration clubs.

Without competition between voluntary, flexible modes of integration, the different and fluctuating opportunity costs of European policies would remain unknown and the different and fluctuating integration capacities of individual regions would not be used. In other words, “since the discovery of common citizens’ interests and the best methods of advancing them depends on the initiative of political entrepreneurs and the ability of citizens to assess relevant alternatives”, system competition among clubs can, “apart from its motivating force, play a useful role in generating information to help political entrepreneurs solve the problem, and to facilitate citizens’ evaluation of political performances by providing them with standards of comparison” (Vanberg 1999: 8). In sum, for mobile citizens and agile politicians club competition is likely to result in better protection against exploitation by the majority and will yield better insight into suitable policies.

8.2.5 Parallel and Consecutive Experimentation

A further advantage of competition between numerous European integration clubs becomes obvious by looking at the distinction between parallel and consecutive experimentation discussed by Vanberg and Kerber (1995). A European Union with fully

³⁴ The significance of political competitive dynamics for yielding knowledge on how governments can serve the interests of their citizens better is noted by Hayek (1944: 325; 1848: 255-69; 1960: 184f, 263f). The role of competition among jurisdictions as a „discovery procedure” is also discussed, for example, by Kerber/Vanberg (1995: 42ff) and Wohlgemuth (2006). Institutional competition among clubs can be expected to assist, in its role as a discovery procedure, “governments and citizens in solving the by no means trivial problem of ascertaining precisely” which club “characteristics and services best serve the common interests of citizens”, and how they “can be provided most efficiently” (Vanberg 1999: 36). Moreover, competition among clubs can serve as “salutary check” on the states’ interventionist intentions (Hayek 1939/80: 268).

harmonized policies is restricted to *consecutive* experimentation and *consecutive* learning by trial and error. Club competition, on the other hand, will create a real “parallel process” à la Hoppmann enabling *parallel* experimentation and *parallel* learning by direct comparison of the problem-solving-qualities of *simultaneously* tested policy “hypotheses” (Hoppmann 1967: 88f). Which integration alternatives exist and which steps towards integration are desired, suitable and feasible for which states and which regions has to be discovered by parallel experimentation. Thus, compared to its realistic alternative, club competition appears to be a more promising and less risky procedure to identify and correct political aberrations and to react to a continuously changing variety of preferences and problems. Without competition among different forms of integration inaptly “harmonized” or centralized “policy-hypotheses” are – for lack of observable and selectable alternatives – hard to identify. Moreover, the existence of irreversible path dependence is more likely because – due to complex logrolling agreements – mistakes, even if they are detected, can hardly be revised in “integrated”, interwoven policy cartels.

8.2.6 Club Competition and Democracy

Forming clubs within the club and thereby increasing the complexity of the EU does not only imply potential manageability challenges; it might also make the Union less transparent: as each member state would belong to different clubs, country-specific rights and obligations in the Union might be difficult to comprehend.³⁵ As transparency problems will make it less obvious who is responsible for what, a flexible EU system may be even more difficult to understand and to hold responsible; this in turn, one could argue, may reduce the degree of popular participation, since citizens who cannot comprehend the system are less likely to get involved (Warleigh 2002: 70). Since its democratic legitimacy has been exposed to increasing and continual criticism, these are undeniably important concerns for the EU. However, one would expect that citizens will be *more* likely to participate and take active part in a flexible Union whose range and degree of integration and governance is more in accordance with their social and economic circumstances, cultural traditions and public opinions.³⁶

In order to analyse and evaluate competition among EU-sub-clubs in terms of its consequences for democracy from the view point of constitutional economics, it is first necessary to clarify which performance criterion should be used to assess democracy and democratic polities such as the EU or EU-sub-clubs. For this purpose, it is helpful to view jurisdictions – such as the EU or EU-sub-clubs – as “territorial enterprises”, that is to say, as organisations that offer jurisdiction services and characteristics – such as European goods – to the inhabitants and users of their respective territorial realms (Vanberg 1999: 3). If we think of jurisdictions as “territorial enterprises” in this sense, we can describe *democratic* jurisdictions as “cooperative venture[s] for mutual advantage” (Rawls 1971: 84), that is, as “territorial enterprises”, which are owned by

³⁵ For a discussion of flexibility resulting in lack of transparency see Warleigh (2002: 70ff). Although one could argue that there are reasons for anxiety about the injection of intransparency into the system, it is important to keep in mind, that the present-day European institutional and legal system is neither easy to understand nor transparent; the complexity of the rules of the integration game in the EU has already spun a complex web of EU institutions that defy simple categorization and has already become almost forbiddingly difficult to understand (Weatherill 2000: 3; Fratianni 2003: 13).

³⁶ Moreover, the matter of fact that flexibility allows for and enshrines diversity can be seen to have normative value for at least two reasons (Warleigh 2002: 72): First, because it does not aim at a homogeneous and uniform integration end result but allows member states to experiment with several types of governance, it allows member states to focus on what unifies and connects them rather than what separates them. Second, flexibility also tolerates that some discrepancies between the positions of the member states and their citizens on the desirable final outcome of the integration process may be permanent; given the existence of such discrepancies, trying to enforce and inflict uniformity, instead of arriving at reciprocally agreeable outcomes, can be seen to be normatively objectionable.

their members, namely their citizens (Vanberg 1999: 4). From this perspective, the fundamental defining criterion of democratic polities is that their members or citizens are the *principals* or ultimate *sovereigns* of their collective enterprise (ibid: 4; Vanberg 2001: 3). Just as it is, in general, the objective of member-owned organisations to advance the interests of their members, we can say that democratic polities should serve the common interests of their members, that is to say, their citizens (Vanberg 1999: 4).

Accordingly, the performance of democratic polities like the EU-club is to be evaluated in terms of how well they serve the *common interests of the citizens* and how well they enable them to realize *mutual gains*. This criterion for the efficiency of democratic polities, analogous to consumer sovereignty as a criterion for the efficiency of markets, may be defined as *citizen sovereignty*. Ensuring citizen sovereignty can be understood to mean to organize a democratic polity such that the government is, on the one hand, capable of implementing policies which benefit all citizens (“enabling constitution”), while it is, on the other hand, prevented, as far as possible, from acting against the interests of some or even all of its citizens such they are protected against exploitation (“limiting constitution”) (Vanberg 1999: 4f).

According to Vanberg, competition among jurisdictions is not incompatible with the notion of democracy as specified above; to the contrary, it can make a valuable contribution to “the improvement of democracy” (ibid: 35). In analogy to Vanberg’s argument with respect to jurisdictions in general, it can be argued that competition among policy clubs within the EU can be expected to improve democracy: As far as the first task of democratic constitutions is concerned, namely the ability of governments to implement measures that do in fact conform with the common interests of all citizens, competition among EU-sub-clubs – in its capacity as “discovery procedure” (Hayek 1968/69) – can be expected to resolve the problem of determining which European goods and services best serve the common interest of which European citizens and how they can be provided most efficiently. In terms of the second task of democratic constitutions, namely preventing governments from conducting ventures that clash with the interests of some or all citizens, club competition can also improve democracy. The reason is that, “to the extent of their own mobility and of their resources”, competition among clubs offers citizens and club-members a safeguard against exploitation by privileged groups or by those with political decision-making power by making it more difficult for governments to perform tasks that benefit some citizens at the expense of others (Vanberg 1999: 35f). In sum, competition among clubs can enhance the capacity of democratic governments to serve the common interests of their constituents by limiting the scope for rent-seeking and by serving as a “discovery procedure”. Thus, flexibility and democracy do not necessarily have to be in opposition; to the contrary, flexibility can also be seen to facilitate and favour democracy.

9. Flexibility and “Enhanced Cooperation”

The idea that underlies the Treaties of Rome and their modifications as well as the present-day Union is that the integrated area should become as homogeneous as possible and that integration means creating uniformity.³⁷ But as the above considerations should have made clear, the uniformity principle can hardly be an adequate concept for a Union characterised by growing diversity. As the pressure to introduce more flexibility into EU integration mounts, this section, focusing on

³⁷ See Schäfer 1995: 50. For a detailed analysis of the uniformity principle see Grieser (2003: 252ff).

“enhanced cooperation” as one potential way to implement a more flexible integration process and allow for the creation of EU-sub-clubs, briefly examines what role flexibility has played in the history of European integration to date and how it was envisaged in the Constitutional Treaty.

9.1 A Brief History of Flexibility

The history of European integration shows that flexibility is far from novel in the development of the EU.³⁸ Already in the 1980s several exceptions to the uniformity principle were made, for example concerning the Schengen Agreement,³⁹ the Western European Union and the Social Charter. The Treaty of Maastricht (1992) explicitly allowed for ad-hoc solutions in order to foster flexibility, the most pronounced example being the agreement on the Economic and Monetary Union that opened the door for a Europe of different speeds and offered to the UK and to Denmark the freedom not to participate in the third stage of EMU even if they complied with the economic convergence criteria stipulated by the Treaty. Still, it took until the late 1990s, until flexibility was – at least to some degree – institutionalised. Finally, in the Treaty of Amsterdam (1997) the instrument of “enhanced cooperation” was codified in the common legal framework in the first and the third pillars, while the Nice Treaty facilitated the application of “enhanced cooperation” and extended its scope to the second pillar, namely foreign and security policy.

9.2 Reforming “Enhanced Cooperation”

This section sets out in more detail how flexibility was planned to be codified in the future European legal framework and demonstrates that the provisions on “enhanced cooperation” specified in the Treaty establishing a Constitution for Europe are insufficient to meet the requirements for club formation within the EU and should be reformed in order to become an essential tool of diversity management in the Union.⁴⁰

According to the Constitutional Treaty, “enhanced cooperation” refers to the option that a number of member states, being willing and capable of advancing further than others in deepening distinct policy areas, are enabled to foster the integration process within the Union’s institutional framework. Although the prerequisites for making use of the possibility of “enhanced cooperation” have already been modified, its requirements are still very restrictive and demanding if not prohibitive and seem “apt to preclude most, if not all, imaginable forms of closer cooperation” (Weatherill 2000: 11). Thus, even though the instrument of “enhanced cooperation” can in theory operate as an adequate device to master the increasing heterogeneity of member states, it still displays crucial deficiencies and is therefore, as of yet, not likely to become a successful tool for flexible integration through club formation.

- (1.) While the initial decision to launch “enhanced cooperation” can be essentially taken by those willing to cooperate, consequent policy decisions of the “cooperation club” are contingent on the relevant provisions of EC law, which

³⁸ That the rise of Europe can be attributed to its diversity resulting in competition among various governmental units, which in turn fostered technical, economic and artistic innovation has been observed by many philosophers, historians and economists throughout the history of ideas. See Vaubel (2006) for a comprehensive survey of the literature.

³⁹ The Schengen agreement, which was initially signed in 1985 by France, Germany and the Benelux countries, pressing ahead to the goal of “open borders”, is a successful example of flexibility of more progressive countries pressing ahead to abolish frontier controls. First, the Schengen system operated in a formal sense outside the EU system; in 1997 it was incorporated into the Treaty of Amsterdam.

⁴⁰ For evaluations of the “Treaty establishing a Constitution for Europe” see European Constitutional Group (2004) or Wohlgenuth (2003). See Warleigh (2002: 53ff) and Berglöf et al. (2003: 73f) for reform proposals concerning the provisions on “enhanced cooperation”.

in turn implies that there still exists a right to veto in those realms in which the Treaties dictate unanimity (Ahrens/Hoen 2002: 29f).

- (2.) The current requirements for “enhanced cooperation”, for example that it has to respect “social and territorial cohesion”, must be modified, or at least clarified, since they could easily be construed as a barrier to starting “enhanced cooperation” should a sufficient number of member states, the Commission or the Parliament so choose (Warleigh 2002: 55).
- (3.) Although the possibility for “enhanced cooperation” has been extended to the second pillar of the EU, this broadening in scope remains inadequate because in this case the right to veto even the launch of “enhanced cooperation” still exists (Ahrens/Hoen 2002: 30).
- (4.) Flexibility using the instrument of “enhanced cooperation” remains an exception because it can merely be used as a means of last resort (ibid: 30).
- (5.) Even if the last-resort-requirement would be met, the use of “enhanced cooperation” is restricted to the creation of relatively large cooperation clubs because it has to involve one third of all EU member states.
- (6.) “Enhanced cooperation” can only be applied by national governments and differentiated integration involving sub-national jurisdictions is not envisaged (ibid: 30).
- (7.) While “enhanced cooperation” allows a sub-group of member states to advance further than others, it aims at eventually involving all EU-members as participants and thereby causes an inherent tendency to over-centralization in rule and policy making.

Moreover, “enhanced cooperation” cannot be applied to existing parts of the *acquis*. Thus, member states cannot unravel their existing commitments in the name of flexibility, not even inefficient policies such as the CAP. Another crucial issue is the fact that “enhanced cooperation” cannot be used to add new competences to the Union’s remit (Warleigh 2002: 55). Thus, much of the potential of flexibility is not likely to be tapped via its incarnation as “enhanced cooperation”: despite the fact that EMU shows that flexibility can be used to deepen integration and carry with it the great majority of member states, currently, the use of flexibility still requires the sanctions of an intergovernmental conference and Treaty reform. Much can of course be achieved via cooperation under existing policy competences but it is clear that “enhanced cooperation” will not be able to allow groups of member states to take the Union in radical new directions.

In sum, flexibility is still not adequately institutionalized and the instrument of “enhanced cooperation” as it was reformulated by the Convention and its modifications since then – in particular by the heads of state and the heads of government – remains insufficiently elaborated and is hardly appropriate to overcome the difficulties of increased diversity in a Union with 25 plus x members: Hardly any innovative elements and mechanisms in favour of more flexibility and hence problem-solving capacity of the European integration process have been incorporated into the Constitutional Treaty. Since the current conditions imposed upon flexible integration inside the Treaties persist to be strict, “enhanced cooperation” is unlikely to be able to prevent member states from embarking upon projects and cooperating outside the treaties and the Union institutions.

Therefore, the rules for “enhanced cooperation” ought to be clarified and simplified. “Enhanced cooperation” should be allowed in any policy field without the possibility of individual outsider countries to veto. Non-club-members should not be allowed to interfere with the production of alternative or competing club goods. The Commission should only have a (non-exclusive) right of initiative, but neither it nor the Council nor

the Parliament should have gate-keeping authority with respect to “enhanced cooperation”; on the contrary, individual countries should be allowed to initiate the process and to have access to the administrative services of the Commission for that purpose (Berglöf et al. 2003: 73f). In addition, the requirement for a certain minimal number of members for the launch of “enhanced cooperation” should be reconsidered.

Admitting numerous enhanced cooperation arrangements among subsets of countries or even sub-national units by easing the conditions required for such cooperation could make flexible forms of integration of the clubs-within-the-club type discussed in this paper possible and help overcome the challenges a larger and more diverse Union poses.

10. A Competitive Order and Meta-institutions for Club Competition

The central aim of this final part is to set out a few basic elements of an institutional framework for the successful realisation and operation of flexible integration through club formation according to the clubs-within-the-club approach and in order to safeguard the competition among these clubs. As with all evolutionary competitive processes, the working properties of competition among clubs depend on the nature of the “rules of the game” under which it operates. And like market competition, institutional competition among clubs can be expected to work to the benefit of the persons involved only if it is constrained by appropriate rules (Kerber/Vanberg 1995: 51ff). If the working properties of competitive processes are to a considerable degree contingent on the rules under which they work and if we can ascertain which types of rules are more likely than others to make these processes operate as desired by the citizens involved, then, it would seem, endeavours to establish and uphold a suitable framework of rules should be one of the principal means by which we can hope to improve our social condition (ibid.). As a consequence, the emerging consensus that more flexible rules for the EU are inevitable brings up the essential question how to safeguard the future integration process and how to place the process of club formation and club competition within certain clear confines of a competitive order or “*Wettbewerbsordnung*”. While it is beyond the scope of this paper to thoroughly investigate how a suitable competitive order for a European club of clubs could be conceptualised and put into practice, we can sketch some suggestions for institutional and meta-institutional arrangements, which can at least potentially be more successfully and effectively operationalized than at present.⁴¹

As sketched out above, the club-of-clubs approach envisages the European Union to consist of numerous overlapping integration clubs around a common core-*acquis*. Membership in the overall “EU-club”, implying the right to representation in all “EU-club” institutions, would require the adoption of the core-*acquis*, while EU member governments are granted the choice to opt in or out of the policy-specific sub-clubs.⁴² The various policy-specific integration clubs would operate under the EU institutions, which could be made use of within each club. As it would not be assured that each EU

⁴¹ Of course, the following rough draft, based on Warleigh (2002), is vulnerable to charges of fragmentariness, naivety and idealism and is supposed to be merely a basis for discussion.

⁴² Warleigh (2002: 91ff.) considers membership in individual policy clubs to be open not only to the current EU member states but to *any* European country. She suggests that non-EU member states would have to be admitted to a club by the relevant participant club members, for instance by simple majority vote; however, countries from outside the EU would have no say over the creation of a new club. The EU budget could be organised as follows (Warleigh 2002: 92): All EU member states are obliged to a compulsory contribution to the general EU budget, which finances the “EU-Club” institutions as well as the costs of any policies which happen to be agreed upon by all member states, whereas each separate policy club would be financed equally by participant states, for example by explicit levy.

member state is part of every policy club, the Presidency of the Council would be abolished; instead leadership, coordination and an ability to liaise between the member states and the various policy clubs could be provided by the Secretary General, whose powers and scope of functions would thus be amplified, for instance by heading a Council department responsible for liaising between member states in each club and the relevant EP committee under co-decision (Warleigh 2002: 93f).

Disputes between members of different clubs could be resolved by the Court of Justice, which would also be empowered to warrant that each club follows the rule of EC law (ibid: 94). Within a European club of clubs the European Parliament could use its Rules of Procedure to make its committees more powerful by granting the relevant committee in each policy realm the opportunity to operate as if it were the entire Parliament, liaising with both the club member governments and their national parliaments as adequate in the context of the respective issue of legislation (ibid: 94). Plenary votes in the Parliament would only be required for core-*acquis* matters or for issues such as accession of new member states and the approval of treaty or constitution reforms (ibid: 95). For the coherence and success of external representation and action of the EU, a single voice to express common positions would be a crucial asset. The elaboration of a European Security Strategy and the envisaged creation of the new position of Foreign Minister point in this direction.

The potential institutional arrangement outlined above would have to be complemented by meta-institutions that would form the basis of an order for the “clubs-within-the-club” concept (Ahrens/Hoen 2002: 38f):

- (1.) One essential element of the order for the club-of-clubs approach may be an independent supranational *subsidiarity agency*, which could administrate the competence-competence and supervise the vertical assignment of political competencies in the Union (ibid: 38; Feld 2003: 307).
- (2.) In addition, an *anti-trust agency*, assuring both political and economic competition within the EU and enforcing the club competition order, could yield positive effects for inter-jurisdictional competition within the EU (Ahrens/Hoen 2002: 38). Possibly, this task could be carried out by the Commission: Just as it has rather successfully proceeded against competition constraints and misuse of cartel power as “guardian of the treaties”, the Commission could presumably protect a club competition order and act as “guardian of the club constitutions”. On the other hand, one could consider to functionally separating competition policy from the numerous other tasks performed by the Commission and instead delegating this task to a specialized “European Competition Authority” (Dewatripont et al. 1995; Persson et al. 1997: 29).
- (3.) In order to further promote club formation at and below the national level to address economic, social, and political problems that show cross-jurisdictional externalities, territorial federalism could be complemented by *functional federalism*, through which jurisdictions within a country or across countries could cooperate in certain policy fields or execute specific functions (Frey/Eichenberger 2000). Under territorial federalism the force of the exit option is confined by the costs of geographic mobility; under functional federalism, however, assuming all those public services that do not require territorial monopolies are separated out from the service-package traditionally provided by territorial governments and are provided on a functional basis, competing suppliers operate in the same area such that citizens are free to choose among competing clubs without the need to move physically from one jurisdiction to another.

- (4.) In order to institutionally frame and safeguard the process of club creation and club functioning, it is a key requirement that policy clubs within the EU established on the basis of *club constitutions*, which, deposited at the Commission, transparently regulate club *entry* and *exit* as well as *voice* options and help settle potential disputes (Ahrens/Hoen 2002: 38). Constitutional regulations should also include provisions to avoid “closed shops” in the process of club formation and measures that concern migration between clubs as well as tradable club memberships. Once having chosen to join a policy club, all club member governments would have to abide by its constitution or strive for its reform by agreement among all governments participating in the club and, in pillar one, by the relevant committee of the European Parliament (Warleigh 2002: 93).
- (5.) Elements of *direct democracy*, such as popular initiatives, referenda, and rights to file an action could contribute to lowering citizens’ external costs, improve political accountability and transparency and encourage civic participation (Ahrens/Hoen 2002: 39).⁴³ They may be applied to supranational, national and sub-national jurisdictions – including overlapping policy-specific integration clubs – and thereby add to the strength of governance structures of the EU at different levels (ibid: 39). According to Frey and Eichenberger (2000: 8), direct elections and popular referenda are known to increase efficiency in terms of caring well for individual preferences. In addition, with respect to European policy clubs, referenda could play an important role in safeguarding against the derogation of clubs into cartels (Vaubel 1999).

These institutional arrangements are only examples of a great range of potential institutions, which could form the foundation of a European “meta-constitution” that grants the choice between different alternative regimes and club constitutions and thereby permits not only economic competition between different economic actors but also political competition between political jurisdictions.⁴⁴

11. Conclusion

The aim of this paper was to find a mode of integration that is capable of coping with the challenge of diverse economic structures as well as heterogeneous political, social and cultural preferences throughout the EU.

First, Buchanan’s and Tullock’s *Calculus of Consent* served as a valuable tool in order to conceptualise the consequences of growing EU-membership-heterogeneity in terms of the costs of collective action in the European Union: the application of the *Calculus of Consent* to the current situation in the EU showed that both external and decision-making costs increase as a result of the recent enlargement.

Then, the application of the theory of clubs to the EU demonstrated that one single overall EU-club providing various club goods to all its members at one single degree of integration is sub-optimal from a theoretical point of view. For example, even if it is optimal for the EU-25 plus x to have a common foreign and security policy, this does not imply that having a currency union for the same countries is efficient; and whether or not the formation of a social union in the EU is at all desirable is contingent on very different factors than the establishment of a competition union, juridical union, transport union and so on.

⁴³ On direct democracy in the EU, see Feld (2003: 297ff), Feld/Kirchgässner (2004) and Frey (2004).

⁴⁴ For a discussion of a European competitive order, see also Vaubel (1999).

Therefore, from the club-theoretic perspective it will be welfare-enhancing to make European integration more flexible and allow for the formation of various smaller and more homogeneous sub-clubs within the overall EU-club, each with an endogenously determined size. Moreover, partitioning the EU-club into multiple, more homogeneous sub-clubs eases the trade-off between external and decision-making costs and can be expected to reduce external *as well as* decision-making costs. Thus, both from the perspective of Buchanan's and Tullock's *Calculus* as well as from the perspective of the theory of clubs, the main conclusion of this paper is that in order to cope with the challenge of growing heterogeneity of EU-membership, rules of integration ought to be made more flexible.

A fully fledged adaptation of a flexible model of the EU as a club of clubs, for instance by reforming the provisions on "enhanced cooperation", would lead to a net of clubs with different tasks and geographical extensions and, as noted above, is likely to put strains on the policy and legal coherence of the Union. However, a Union of 25 and more countries will only be able to act effectively if its institutional structure accounts for the diversity of its members. Moreover, from the view point of constitutional economics, transforming the Union into a club of clubs consisting of numerous voluntary, overlapping and competing integration clubs around a common core-*acquis*, has the following advantages: Competition among clubs increases politicians' responsiveness to citizens' preferences and can help determine which European goods and services best serve the common interest of which European citizens by operating as knowledge-creating "discovery procedure" and allowing for consecutive *and* parallel experimenting with different forms of integration.

The concept of functionally overlapping clubs put forward in this paper may as of yet seem too abstract to meet with any broad acceptance in the current real world of politics. Public Choice Theory provides a number of possible explanations for this, all of which boil down to the fact that politicians and bureaucrats are primarily involved in reaching their own goals, and these do not harmonize with the competitive principles of club-of-clubs integration (Schäfer 1995: 60).

However, the EU is bound to change its integration rules as expansion has taken place and the challenges of increased heterogeneity present an outstanding prospect to return to sober-minded solutions, including overdue reforms, and to provide Europe as a whole with a structure which is economically and politically viable. In the course of changing European integration rules, flexibility should be explicitly developed as a principle of governance that ought to be implemented in a rule-based and transparent manner and under the scrutiny of common institutions. This, however, can only be achieved if a clear model of flexibility is formulated and the provisions for "enhanced cooperation" undergo reform. Further investigations are required to explore ways in which flexible integration could be implemented and how flexibility could be institutionally framed in order to circumvent a rank growth of European integration by establishing incentive-compatible institutions that align the personal interests of policy makers and the common interest that they are supposed to pursue.

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TABLE 1: ECONOMIC HETEROGENEITY WITHIN THE EUROPEAN UNION					
<i>SOURCE: EUROSTAT</i>					
	GDP per capita in PPS (EU-25 = 100) (2005)	Unemploy- ment (% of labor force)	Inflation (2005)	Employment in the Agricultural Sector in % (2003)	Population in Million (2005)
Central and Eastern European Countries (CEECs)					
Bulgaria	32,1	10,1	5,0	25,9	7,8
Cyprus	83,1	5,3	2,0	NA	0,7
Czech Rep.	73,0	7,9	1,6	4,5	10,2
Estonia	57,4	7,9	4,1	6,1	1,3
Hungary	60,9	7,2	3,5	5,8	10,1
Latvia	47,1	8,9	6,9	13,4	2,3
Lithuania	52,1	8,3	2,7	17,8	3,4
Malta	69,3	7,3	2,5	NA	0,4
Poland	49,9	17,7	2,2	18,4	38,2
Romania	34,8	7,7	9,1	34,1	21,7
Slovakia	55,1	16,3	2,8	4,4	5,4
Slovenia	80,0	6,5	2,5	10,9	2,0
CEEC Average	57,9	9,3	3,7	14,1	Ca. 103,5 Million
Lowest-Highest	32,1 – 83,1	6,5 – 17,7	1,6 – 9,1	4,5 – 34,1	
Austria	123,2	5,2	2,1	2,9	8,2
Belgium	117,7	8,4	2,5	2,2	10,5
Denmark	124,2	4,8	1,7	3,3	5,4
Finland	112,1	8,4	0,8	5,1	5,2
France	109,0	9,5	1,9	4,1	60,6
Germany	109,8	9,5	1,9	2,4	82,5
Greece	82,2	9,8	3,5	16,0	11,1
Ireland	137,1	4,3	2,2	4,1	4,1
Italy	102,8	7,7	2,2	6,5	58,5
Luxembourg	247,8	4,5	3,8	1,3	0,5
Netherlands	123,5	4,7	1,5	3,3	16,3
Portugal	71,4	7,6	2,1	12,6	10,5
Spain	98,7	9,2	3,4	5,7	43,0
Sweden	114,7	7,8	0,8	2,3	9,0
UK	115,3	4,7	2,1	0,9	60,0
EU-15 Average	119,3	7,07	2,2	4,0	Ca. 385 Million
lowest-highest	71,4 - 247,8	4,3 – 9,8	0,8 – 3,8	1,3 – 16,0	

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