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Brussels between Bern and Berlin: Comparative Federalism meets the European Union

By Tanja A. Boerzel and Madeleine O. Hosli¹

tanja.boerzel@rz.hu-berlin.de and mhosli@umich.edu

Abstract

In the current debate on the future European order, the European Union is often described as an “emerging federation”. The paper claims that federalism is not only useful in deliberating about the future of the European Union. It provides a better understanding of the current structure and functioning of the European system of multilevel governance than most theories of European integration. We combine political and economic perspectives of federalism to analyze the “balancing act” between effective political representation and efficient policy-making in the European Union. Drawing on the examples of Germany and Switzerland in particular, we argue that the increasing delegation of powers to the central EU level needs to be paralleled by either strengthened patterns of fiscal federalism or an empowered representation of functional interests at the European level. Without such “re-balancing”, the current legitimacy problems of the EU are likely to get worse.

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I. Introduction

In an attempt to re-launch the discussion on the future shape of the European order, Germany's Foreign Minister, Joschka Fischer described the European Union (EU) as a "European Federation".² His intervention provoked a heated political debate on how to organize the division and sharing of sovereignty rights among the different levels of government within the EU.³ The debate has gained further momentum with the Declaration of Nice, which calls for wide-ranging discussion on the future of the European Union.⁴ In this paper, we show that the concept of federalism is not only useful for reflecting about Europe's *finalité politique*, but it also provides a good tool for understanding the current structure and functioning of the European system of multi-level governance. A number of studies have invoked different concepts of federalism to assess the European "balancing act" between the representation of territorial and functional interests on the one hand (Sbragia 1993a; Schmitter 1991; Keohane and Hoffmann 1991), and the efficiency and rationality of policy-making on the other hand (Scharpf 1988, 1993; Dehousse 1992; Majone 1993). Yet, the political and economic dimensions of federalism are seldom linked, nor is their relationship systematically explored. Combining the two perspectives points to an inherent tension between effective political representation and efficient policy-making. Whereas arguments for economic efficiency may often provide powerful incentives for centralization, counterbalanced in this by the logic of fiscal federalism and competition among local jurisdictions, the accommodation of territorial interests and political reasoning justifies decentralization mainly in order to enhance legitimacy and democratic accountability.

Our paper explores the somewhat ambivalent relationship between effective political representation and efficient policy-making for the EU. In order to do this, we combine two important strands of literature on federalism: economic federalism, mainly concerned with an optimal distribution of policy competencies among the different levels or "tiers" of government, and political federalism, with its focus on different modes of political representation (section II). We will use this "integrated approach" in order to analyze the balancing of policy making efficiency and effective political representation in the European system of multi-level governance (section III). Drawing on the examples of Germany and Switzerland in particular,

² Joschka Fischer: *From Confederacy to Federation: Thoughts on the Finality of European Integration*, speech at the Humboldt University, Berlin, May 12, 2000, printed in Joerges, Mény, and Weiler 2000.

³ See, for example, Fischer's discussion with Jean-Pierre Chevènement in *Die Zeit*, June 21, 2000, pp. 13-18, and his speech of July 7, 2000 for the EP. On the latter, see "Fischer fordert Entscheidungen über die Zukunft der EU", *Süddeutsche Zeitung*, July 7, 2000 or "Fischer Proposes Directly Elected European President," *International Herald Tribune*, July 7, 2000.

⁴ For the various contributions to the debate see the website of the European Union on the Future of Europe – Debate www.europa.eu.int/futurum.

we finally argue that the increasing delegation of powers to the central EU level needs to be paralleled by either strengthened patterns of fiscal federalism or an empowered representation of functional interests at the European level. Without such "re-balancing", the current legitimacy problems of the EU are likely to get worse.

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

The Political Economy of Federalism

Theoretical concepts to judge on an adequate assignment of policy competencies to different government levels, viewed from a political-economic perspective, have mainly been developed in the framework of the economic theory of federalism and, more specifically, the theory of fiscal federalism⁵.

In the framework of such approaches, despite variations between authors, there appears to be a certain consensus that functions of (macroeconomic) stabilization⁶ and of distribution⁷ are best exercised on the central level, but the provision of public goods more generally may be located on different levels of government. More specifically, some public goods are more suitable to be provided on the central level (e.g. defense), whereas others (e.g. streetlights) may efficiently be provided by lower levels of government. Musgrave (1959) and Oates (1972) illustrated how an appropriate assignment of jurisdictions over public goods and taxes can lead to increases in social welfare.

In federal systems, problems of collective action are likely to be present, since individual jurisdictions may attempt to benefit as much as possible from collective efforts while assuming a lower share in the overall costs. This incentive mainly stems from political pressures, as representatives want to satisfy the requests of their local constituencies in order to enhance their re-election prospects. Generally, the provision of public

⁵ E.g. Musgrave 1959; Oates 1972. For a helpful overview of formal approaches to the study of federalism and a review of the respective literature, see Bednar 2000. A recent overview of fiscal federalism more generally is Oates 1999.

⁶ When a constituent unit of a federation experiences macroeconomic difficulties, fellow jurisdictions most likely are reluctant to provide "horizontal" financial assistance. A central authority, by comparison, may be able to provide the necessary support and hence, more generally, provide the public good of macroeconomic stabilization.

⁷ The power to redistribute income in a federal system may need to be located on the central government level in order to avoid "exit" from the constituent units by more well-off individuals and firms. On the concepts of "exit" and "voice", see especially Hirschman 1970.

goods, however, may be facilitated by the existence of asymmetric interests among the parties involved. In the extreme, one party may benefit from the provision of a public good to such an extent that it is ready to meet the full costs of its provision. Smaller numbers of actors, hence, may increase the prospects for cooperation (Olson 1965).⁸ Due to such potential rivalry among jurisdictions, Richard Musgrave recently emphasized that distribution should be a matter to be dealt with on the central level of government.⁹ However, even in some policy areas in which local provision appears to be most beneficial, such as elementary education or health care, it seems that although local or regional provision is desirable, the quality of these public goods is also important for the federation as a whole.¹⁰

In terms of the decentralized distribution of public goods, Olson emphasized the concept of "fiscal equivalence": according to this approach, in the framework of a federal system, public goods are to be provided to the group of actors willing to pay for their provision (Olson 1969). This reasoning provides incentives for provision of local public goods that satisfy the preferences and demands of local residents, and are paid by them. However, according to the logic of "fiscal equivalence", jurisdictions may be overlapping instead of being geographically separate units. In fact, a whole network of jurisdictions may co-exist - both horizontally and vertically with respect to the different levels of government – each being responsible for the provision of a particular public good. This idea has been elaborated by Alessandra Casella and Bruno S. Frey in their notion of "overlapping political jurisdictions" (Casella and Frey 1992).

Economic solutions to problems of spillover among jurisdictions may encompass the assignment of property rights and internalization of (negative) externalities. In the framework of political systems, however, there generally is a trade-off between attaining economies of scale and internalizing externalities ("spillovers"). Gordon Tullock illustrates the extent to which, in the framework of a federal system, externalities may be internalized (Tullock 1969). He shows that internalization may be maximized, but can never be complete without hurting efficiency (i.e., the prospects for attaining economies of scale).

Generally, fiscal federalism aims to ensure that the provision of public goods meets the preferences and demands of (local) residents. Charles Tiebout, in his seminal article, presented a model of competition among local jurisdictions in which inter-jurisdictional competition is found to be beneficial to overall social

⁸ For a more general discussion of the relationship between group size and prospects for cooperation, in the framework of international relations theory, more generally, see Milner 1992.

⁹ "... distribution policy must be a matter of national concern" (Musgrave 1997).

¹⁰ "Deeper difficulties arise in determining just what should be viewed as local, statewide, or national public goods. At first, for example, it may seem that education and elementary education in particular are eminently local

welfare,¹¹ mainly because it allows for the provision of a mix of tax levels and public goods that is most representative of local citizens' preferences. Citizens can "vote with their feet" and move to the jurisdiction that provides their most preferred combination of taxes and public goods, strengthening patterns of inter-jurisdictional competition (Tiebout 1956).

Tiebout's model, moreover, implies that inter-jurisdictional competition forces local government to provide services efficiently, and – if government is not viewed as being a "benevolent actor" – prevents it from drawing "rents" to the detriment of taxpayers. Accordingly, lobbying groups lose some of their leverage when inter-jurisdictional competitive forces are in effect, as the fear of losing taxpayers provides local government with an incentive to provide the levels and kinds of public goods that optimally reflect taxpayers' preferences. Competition among jurisdictions, hence, is viewed as a mechanism that increases the efficient allocation of resources even in the presence of public goods.¹² Generally, inter-jurisdictional competition, therefore, may alleviate "government failure" (e.g. Brennan and Buchanan 1980; Wintrobe 1987).

Linked to this discussion is the question to which extent regulatory activities – in the domain of products and services, for example – should be "harmonized" in federal systems and how much there can be competition among jurisdictions as regards regulatory activities. In the absence of negative externalities and of a possible "race to the bottom", scholars have highlighted the positive aspects of such competition in terms of leading to a search for more efficient regulations, and constraining effects on regulatory activities that favor special interest groups. This concept has been transferred to the analysis of competition among regulations within the EU, for example.¹³

These approaches, while focusing on political aspects of federalism, tend to be based on economic reasoning. By contrast, a comparison between different political concepts of federalism – especially dual and cooperative federalism – highlights some of the most crucial political aspects of federal designs, illustrating elements of current debates in the framework of comparative federalism.

functions. However, although education is conducted locally, its quality is also of national concern." (Ibid.). Subsequently, similar reasoning is applied to health policy.

¹¹ In his analysis, externalities and restrictions on the mobility of citizens are assumed to be absent.

¹² In addition to this, it has been argued that decentralization of information and authority, in addition to inter-jurisdictional competition, can provide more credible commitments to secure economic rights and preserve markets. "Market-preserving federalism" is a key concept (e.g. Weingast 1995; Quian and Weingast 1997).

The Federal Dichotomy: Dual and Cooperative Federalism

Comparative Federalism (see e.g. Loewenstein 1957; Duchacek 1970; Elazar 1987) draws on a distinction between two models of federalism, going back to different interpretations of Montesquieu's ideas of organizing political power as *séparation des pouvoirs* and *distribution des pouvoirs*.

Séparation des pouvoirs, or “dual federalism”, to which the model of the United States most closely corresponds, emphasizes the institutional autonomy of different levels of government, aiming at a clear vertical separation of powers (checks and balances).¹⁴ Each government level has an autonomous sphere of responsibilities. Competencies are allocated according to policy sectors rather than policy functions. For each sector, each level of government then holds both legislative and executive powers. As a consequence, the entire government machinery tends to be duplicated to some extent, as each level manages its own affairs autonomously. The sectoral or dual allocation of policy competencies is complemented by a rather weak representation of states (or sub-national units, SNU) on the federal level. The second chamber of the federal legislature, accordingly, tends to be organized according to the “senate principle”: states are represented by an equal number of directly elected senators, irrespective of the size of the geographical unit they represent. As a result, the senate does not reflect the territorially defined interests of state executives – in contrast to the model of the *Bundesrat* principle – but the functional preferences of the electorate or the political parties within these states (or SNU). States, essentially, articulate their interests through voluntary co-ordination and co-operation with the central government (the federal level), usually in the framework of intergovernmental conferences. Consequently, there is no need for a strong, vertically integrated party system promoting functional interest representation in order to counterbalance executive dominance. Institutional autonomy of each government level, finally, presupposes a fiscal system that grants states sufficient resources in order to exercise their competencies without financial intervention of the central level. This pattern is usually ensured by the establishment of a relatively comprehensive fiscal autonomy for the SNU, allowing them to levy their own taxes and hence, to have an independent source of revenue.

Distribution des Pouvoirs or *cooperative federalism*, a concept for which Germany serves almost as a “prototype”, is based on a functional division of labor among different levels of government. While the federation makes the laws, the states are responsible for implementing them. The vast majority of competencies are “concurrent” or “shared”. This functional division of labor requires a strong representation of the interests of the states at the federal level not only in order to ensure efficient implementation of federal

¹³ E.g., Siebert and Koop 1993; Hosli 1992; Woolcock 1995.

policies, but also to prevent states from being reduced to mere "administrative units". States' reduced capacity of self-determination is compensated by their strong participation in federal decision-making (mainly in the framework of the second chamber of the national legislature). Major policy initiatives, accordingly, always require the consent of both the federation and a majority of the states. The chamber of territorial representation is organized according to the *Bundesrat* (Federal Council) principle: states are represented by their governments, and in relation to their population size, but smaller states usually enjoy over-representation. Representation is not only disproportional, but also indirect: sharing of policy competencies in terms of a functional task distribution including sharing of tax revenue in the framework of a joint tax system (usually complemented by a system of financial equalization). The federal government and the states share the most important tax revenues, and the system of joint taxes allows for a redistribution of financial resources between states with stronger and weaker spending power. The functional and fiscal interdependence of the two levels of government not only gives rise to cooperative federalism, "interlocking politics" and "joint decision-making", but it also favors the emergence of a policy-making system in which policies are formulated and implemented by the administrations on both levels of government. This pattern of "executive federalism", in which territorially defined interests prevail, is counterbalanced by a strong and vertically integrated party system, providing for an effective representation of non-territorial (functional) interests at the federal level.

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

From this brief overview of economic and political models of federalism, it hence appears to be true that "dual federalism" is more closely related to concepts of fiscal federalism and inter-jurisdictional competition, whereas the emphasis of cooperative federalism rather lies on the implementation of tasks by the SNUs, being complemented by a strong representation of state interests in federal decision-making.

¹⁴ Another advanced industrial society being based on this principle is Switzerland. However, it seems that in recent years, the Swiss model has started to increasingly resemble German cooperative federalism (see Wälti 1996).

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

The EU can be described as a system of multi-level governance, in which sovereignty rights are shared and divided between supranational, national, and subnational institutions. While traditional theories of European integration have some difficulties to capture the multi-level nature of the emerging European polity,¹⁵ the constitutional language of federalism appears more adequate to analyze and discuss the ways in which the division of power is organized between the different levels of government in the European Union.

Generally, federalism refers to a spatial or territorial division of power between two (or more) levels of government in a given political system. Hence, both the federation and the component units are geographically defined.¹⁶ Both levels have to hold some autonomous decision-making powers which they can exercise independently from each other (the model of “dual federalism”, evidently, granting somewhat more sovereignty to the SNUs). Thus, sovereignty is shared or divided between the different levels of government, rather than exclusively located at one level.

Even without the legitimate monopoly of coercive force, the EU possesses sovereignty rights in a wide variety of policy areas. They reach from exclusive jurisdiction in European economic and monetary union (EMU) for the participating EU states to far-reaching regulatory competencies in sectors such as industry, trade, transportation, energy, and environmental and consumer protection. In addition to this, increasingly, EU regulations are penetrating even the core of traditional state responsibilities – including internal security in the framework of the *Schengen* agreements and of *Europol* – and, albeit to a lesser extent, foreign and security policy (cf. Bogdandy 1999: 2-28]). In most policy areas, Community law not only has supremacy over national law, but it also has “direct effect”, giving citizens the option to litigate against their states for violating rights attributed to them by Community law. Important in this respect is that Regulations, as issued on the EU’s “central level”, have direct effect, whereas Directives are to be transposed into the domestic law of the EU’s member states. Such tasks of “implementation” lend credit to the belief that the EU currently encompasses strong elements of cooperative federalism. As we will see below, it is paralleled by significant representation of SNUs, i.e. territorial interests, in central level decision-making.

¹⁵ For a critique see Marks, Hooghe, and Blank 1996; Risse-Kappen 1996; Jachtenfuchs and Kohler-Koch 1996.

The EU appears to be transforming itself into a political community within a defined territory and with a determined range of citizens. Originally, however, the European Community was set up and conceptualized primarily as a functionally circumscribed organization of economic integration (*Zweckverband funktionaler Integration*), based on neither fixed territorial boundaries nor a direct relation between its citizens and its institutions (Ipsen 1972: 196). The Community's founders did not envisage a truly federal structure. With the Treaties of Maastricht (1993) and of Amsterdam (1998), however, the EU's single market has been embedded into a political union with emerging external boundaries¹⁷ and a proper citizenship.¹⁸

Not only has the EU developed into a political community with comprehensive regulatory powers and a proper mechanism of territorially defined exclusion and inclusion (Union citizenship), but it shares most features of what is usually defined as a federal system (Wheare 1963; Bakvis and Chandler 1987). First, the EU is a system of governance based on at least two orders of government, each existing under its own right and acting directly to its citizens. Second, the European Treaties allocate jurisdiction and resources to these two main orders of government (but levels below the state are increasingly gaining leverage and institutional representation, e.g. through the Council of Regions). Third, there are provisions for "shared government" in areas where the jurisdiction of the EU and the member states overlaps. Fourth, Community law enjoys supremacy over national law. Fifth, European legislation is increasingly made on the basis of majority decisions, partially obliging individual states to accept decisions against their own priorities. Sixth, the composition and procedures of EU institutions are based not solely on principles of majoritarian representation, but guarantee the representation of "minority" views, as smaller entities (i.e. smaller EU states), tend to be over-represented in both the EP and the Council of the EU (despite recent adaptations agreed upon in the framework of the Treaty of Nice). Seventh, the European Treaties are not unilaterally amenable by one order of government alone, but require the endorsement by the governments and a given proportion of the voters or of a majority in the legislatures of the member states.¹⁹ Eighth, the European Court of Justice (ECJ) serves as an umpire to adjudicate conflicts between the European institutions and EU member states, as well as between citizens and their domestic governments. Finally, the EU, since 1979, has

¹⁶ In the framework of fiscal federalism, however, units may partially be overlapping, and not be strictly defined territorially (see above).

¹⁷ Article 11 of the European Union Treaty refers to the protection of the *integrity* of the Union and of its *external boundaries*.

¹⁸ The material substance of Union citizenship is rather weak, but it may serve as an indicator for the self-perception of the EU as a political community of its own citizens (Bogdandy 1999; Wiener 1998).

¹⁹ This mechanism largely induces "two-level games" as regards adaptations to the EU's institutional setup and to its scope of responsibilities in the framework of Treaty reform.

a directly elected Parliament, which, over the last decades, has managed to significantly increase its leverage in the framework of the EU's inter-institutional procedures.

The EU currently appears to especially lack two significant features of a federation, however. First, EU member states remain the “masters” of the treaties, in terms of holding the exclusive power to amend or change the constitutive treaties of the EU on the basis of unanimity²⁰ (and domestic ratification is required). Second, the EU has no real “tax and spending” capacity. In addition to this, rather importantly, it lacks an essential element of democratic control: the EU's executive is not yet determined by the EU's citizens, either directly, through the election of a president, or indirectly (i.e. by the EP).

If we accept that the EU is developing into a “federal-like” system, where sovereignty is divided and shared among the central level and the SNUs, the focus of the analysis shifts to the question of how the allocation of policy competencies and the representation of territorial and functional interests will need to be organized among the different levels of EU government.

The Distribution of Policy Competencies in the EU

The current distribution of policy competencies in the EU appears to correspond more closely to the model of cooperative than to “dual” federalism. The EU does not have an autonomous sphere of competencies in the sense of holding both legislative and executive responsibilities on its central level. Even in the area of “exclusive competencies”, the EU cannot legislate without the consent of the member states (as represented in the Council of the EU). There is no area in which the member states have completely ceded sovereignty to the EU's central level, to the extent of excluding their direct participation in decision-making. This is even true for the area of trade policy (e.g. Nicolaidis and Meunier 1999). Similarly, in the domain of agriculture, member states still have an important say, mainly through the institution of the Council of Agricultural Ministers.

To which extent have policy competencies been delegated to the EU's central level? It seems that strong and relatively encompassing and swift integration in the EU in economic policy areas has been accompanied by more modest progress in inherently political domains, such as foreign and security policy (including defense). However, despite European Economic and Monetary Union (EMU), the EU, at this stage, lacks efficient tools for macroeconomic stabilization. Similarly, in contrast to federal systems, the EU is not

²⁰ Without doubt, this principle, in view of significant EU enlargement in the near future, will render modifications to the EU's institutional structure increasingly difficult to establish.

endowed with an overall redistributive responsibility on the central level, despite the existence of the structural and cohesion funds. Hence, the EU's current setup strongly differs from federations by the lack of a general income redistribution scheme.

Neither direct income taxes nor corporation taxes are levied on the EU level. The EU holds a few independent sources of revenue. EU income is mainly derived from customs duties and levies charged on imports of third countries, a percentage of VAT collected by the member states, and financial contributions based on a fraction of EU states' GNP. The "ceiling" on the EU's current budget is 1.27 percent of overall EU GNP. The EU budget is rather small as compared to the one of the individual member states. In relative terms, EU expenses tend to be high in the domain of agriculture, despite a decrease in expenditures since the implementation of the MacSharry reforms in the early 1990s. In addition, "structural operations" – most notably the structural funds and the cohesion fund – assume a relatively high percentage of the total budget. As compared to expenditures in established federations allotted to redistribution, however, this share may nonetheless be relatively modest.

Thus, responsibilities for redistribution and stabilization measures mainly rest with the individual EU states. The virtual absence of taxation and macroeconomic policy as functions exercised on the "central" EU level could prove to be problematic in the medium-term future (while the EMU is aiming to establish its leverage – and credibility – in international monetary and financial affairs; see below). For example, currently, there is no true EU-wide policy to combat unemployment. But individual member states are no longer able to provide a stimulus to their economy by lowering interest rates, for example, as this responsibility has been shifted to the collective level (i.e., to the European Central Bank, ECB).

In the domain of goods and services, over the years, the tension between regulatory activities on the central EU level and the generation of more competition among national regulations has been shifted in favor of the principle of "mutual recognition" (Pelkmans 1987), and to more competition among national rules more generally (e.g. Nicolaidis 1992; Siebert and Koop 1993). This "new approach" was especially applied in the framework of the single market program with respect to product regulations and areas such as banking and insurance. Keywords for the approach are mutual recognition, regulatory competition, home country control, and harmonized minimal requirements.²¹ This strategy was later reinforced and applied to a broader range of policy areas by the introduction of the "subsidiarity" principle in the framework of the Maastricht Treaty.²²

²¹ The latter are largely introduced in order to avoid a "race to the bottom".

²² E.g., see Hosli 1995.

There are still other areas of jurisdiction in which policy competencies have not been transferred to the EU level, however. This is true, for example, with respect to elementary school education, as well as cultural and religious affairs. But all in all there are only few policy domains that have not been subjected to European regulation. The growing necessity for transborder regulation in the framework of the EU's single market, as to ensure the smooth operation of market forces, internalize externalities, and to allow attainment of economies of scale – strengthened by an expansive interpretation of EU competencies by the Commission and the ECJ – have sharply reduced the area of exclusive member state competencies. This holds even for traditionally “national” policy domains such as the media and communication (e.g. regulations on advertising of alcohol and tobacco).

In sum, the vast majority of legislative competencies in the EU are currently at least *de facto* shared or concurrent. Moreover, the distribution of power between the EU and the member states appears to be increasingly functional rather than sectoral, making the EU resemble cooperative federalism. In the area of policy execution, the EU depends on the member states for the implementation of its policies, as it only has a small administrative machinery of its own (in fact, an administration rather comparable to the size of a city administration).

The constrained legislative and financial autonomy of the EU vis-à-vis its member states, underpins a certain dominance of territorial interests in European policy-making. This trend is reinforced by the strong influence of member state governments in EU institutions, which is not balanced by an effective representation of functional interests.

The Dominance of Territorial over Functional Interests

>From the perspective of comparative federalism, the EU largely develops according to the model of cooperative federalism (cf. Börzel and Risse 2000). First, as mentioned above, the EU and the member states share most policy competencies. Even in the area of exclusive competencies, the EU cannot legislate without the consent of the member states. In addition, European policy-making follows a functional division of labor between the EU and its member states. While laws are increasingly made on the EU level, the member states are the main agents for implementing these provisions. Finally, the Council of the EU resembles a *Bundesrat*-type second chamber of the European legislature rather than a Senate. Member states are represented by their executives, and their voting power is weighed according to population size.

Like in other cooperative federal systems, the interlocking of policy competencies, the functional division of labor, and a *Bundesrat*-type second chamber cause a certain asymmetry in political representation, where territorial interests dominate over functional interests (cf. Watts 1988; Smiley and Watts 1985).

Certainly, the European Commission, the EP, and the ECJ represent functional rather than territorial interests (cf. Sbragia 1993b). Yet, members of these institutions are appointed, or elected, on the basis of territorial membership. Most prominently, even the President of the Commission still is not nominated by member state governments – despite the EP’s recent strengthening of leverage in the approval of the Commission – and the Council President is determined by governments by definition. Moreover, although the three major supranational EU institutions have gradually expanded their powers, the Council of the EU is still the EU’s most “weighty” decision-making body. Its relationship with the Commission and the EP, in spite of the Treaties of Amsterdam and Nice, appears to still be based on an asymmetrical power balance.

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

The dominance of executive and territorial interests in the EU may be even more pronounced than in established systems of cooperative federalism, as usually, some countervailing remedies exist. In Germany, for example, the *Länder* enjoy strong representation in central level decision-making through the *Bundesrat*, the second chamber of the federal legislation. But the federation, i.e. the *Bundestag* (first chamber) and the federal government, provide a powerful counterweight, based not least on the political identity and legitimacy which the federation generates, its dominance in the legislature and its spending power. By comparison, neither the European Commission nor the EP yet provide such a counterbalance. Moreover, political interest representation in Germany is based on a well-established system of vertical party integration in both chambers of the federal legislature. Finally, neo-corporatist forms of interest intermediation grant German economic interests privileged access to the policy process. The EU, by contrast, lacks an effective system of vertical party integration. No central arena of party competition exists – neither within the

legislature nor within the executive. Nor do European peak associations, such as UNICE or ETUC, effectively aggregate and represent the interests of European employers and employees in the European policy process.

Swiss federalism provides a different set of remedies for counterbalancing territorial interests in central policy-making. The *Ständerat*, the Swiss chamber of territorial representation, unlike the Council of the EU, is directly elected, as a result of which its members tend to act as representatives of the electorate rather than as defenders of cantonal interests (Bogdanor 1986). The Swiss cantons, unlike the German *Länder*, have no strong influence on federal policy-making (cf. Lehmbruch 1993). But they enjoy significant financial and legislative autonomy vis-à-vis the federal government, which compensates for their weak representation at the federal level.

The EU combines elements of Swiss and German federalism by granting the member states an even stronger role in the legislation and implementation of central policies than the German *Länder* play while leaving the member states more financial and legislative autonomy than the Swiss cantons have. This combination has favored the dominance of member state governments in EU policy-making, which is not effectively counterbalanced through the effective representation of functional interests.

IV. Brussels between Bern and Berlin

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

The efficiency of European policy-making is indeed quite extensive in some policy areas, given the diversity of interests among the member states (Héritier 1996). Yet, the EU does not have the capacity to perform important federal policy tasks such as macroeconomic stabilization and redistribution. At the same time, it

increasingly inhibits the member states from efficiently maintaining such functions (Scharpf 1996). The EMU largely deprives member states of the tools of national macroeconomic stabilization, whereas the EU as a whole does not (yet) possess the necessary instruments. Asymmetric "shocks" in one part of the EMU, which might, for example, sharply increase unemployment in an EU member state, are difficult to address by the collective strategies of the centralized institutions (e.g., the ECB). After all, interest rates are now determined collectively for all EU states that participate in EMU. Hence, the EU may face difficulties to achieve economic efficiency as long as the national business cycles in the EMU area are not yet developing in a harmonized way. As a result, the considerable legitimacy problems of the EU on the input side may be exacerbated by legitimacy problems on the "output" side.

From the perspective of comparative federalism, the EU has two basic options to escape this double "legitimacy trap". It can move towards the German model of cooperative federalism. Accordingly, the Council of the EU would develop into a second chamber of the EP, and the EP would be set on an equal footing with the Council in the EU legislation process (i.e. co-decision and qualified majority voting in the Council would constitute the default procedure). The European Commission would turn into a true European government, with its President being elected either directly by the European citizens or by the EP as the first chamber of the new EU bicameral setup. In addition, the EU would acquire stabilization and redistribution competencies. This would also presuppose a capacity of the EU, independent from the member states, to generate financial revenue.

Support for this model of cooperative federalism is strongly reflected in the position the German government as adopted in the debate on the future of the EU.²³ While the French government has rejected what it perceives as a German attempt to "export" their federal state structure to the EU, the French Prime Minister, Lionel Jospin, has suggested the establishment of a permanent Council of Ministers to become a co-legislator of the EP. The European Council, however, would then act as the EU executive, together with the European Commission, whose President would be appointed by a majority in the EP.²⁴ While Jospin's proposal aims at empowering the role of member state governments within the European institutional

²³ See the speech of the German President, Johannes Rau, to the EP, "*Plädoyer für eine Europäische Verfassung*", Strasbourg, April 4, 2001, (www.europa.eu.int/futurum/congov), and "*Leitantrag – Verantwortung für Europa*", draft party programme of the German Social Democrats, April 30, 2001. For the position of the German Länder, see the speech of the Prime Minister of Northrhine-Westfalia, Wolfgang Clement, "*Europa gestalten – nicht verwalten. Die Kompetenzordnung der Europäischen Union nach Nizza*", at the Forum Constitutionis Europae of the Walter-Hallstein-Institute for European Constitutional Law, Humboldt University, Berlin, February 12, 2001, www.nrw.de/europa/titel_europa.htm.

²⁴ See the speech of the French Prime Minister, Lionel Jospin, "*On the Future of an enlarged Europe*", Paris, May 28, 2001, www.europa.eu.int/futurum/congov, and "*Leitantrag – Verantwortung für Europa*", draft party programme of the German Social Democrats, April 30, 2001.

structure, a Commission supported by a majority in the EP might help to counterbalance an even more pronounced dominance of territorial interests in the EU policy process. The French and the German governments also appear to agree on the necessity to strengthen economic policy coordination at the European level. While a further policy transfer does not seem to be politically unrealistic, the real issue at stake may be the weakness of the EU's taxation and spending capacity. Its redistributive capacity is currently limited to 1.27 percent of the GDP generated by all member states (de facto, it lies at 1.09 percent). A spending power comparable to the German federation, for example, would correspond to a share of about 20 percent of European GDP! An almost twentyfold increase of the EU's redistributive capacity might strengthen the output legitimacy and effectiveness of European governance, but it is highly unlikely that the member states would agree to such a sharp decrease in their revenues.²⁵ Finally, a move towards the German system of cooperative federalism would require some additional balancing of territorial interests through the effective representation of functional interests at the EU level, by means of an integrated European party system or a working structure of European interest intermediation.

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

Inter-jurisdictional competition among the member states, however, would require the EU to move more towards a model of dual federalism. Its current structures of cooperative federalism favors European regulations that leave little room for true competition. As long as their constituencies have a preference for maintaining the high level of social regulation and societal redistribution that characterizes the European (continental) welfare state, member state governments have strong incentives to harmonize national standards at the EU level in order to avoid competitive disadvantages for their industry. Thus, for example, both the French and the German governments have called for a certain European tax harmonization in order to avoid "tax dumping".²⁶

²⁵ The plea of the President of the European Commission, Romano Prodi, for granting the EU a strong taxation and spending capacity, has so far been ignored by the member states; see Romano Prodi, "*For a strong Europe, with a grand design and the means of action*", speech given at the Institut d'Etudes Politiques, Paris, May 29, 2001, (www.europa.eu.int/futurum).

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

Summarizing, the EU is likely to continue its gradual move towards cooperative federalism. The logic of market integration, paralleled by a strong preference for preserving the welfare state, favors increasing centralization of national policy competencies at the EU level. As a compensation for their losses in sovereign decision making powers, EU member states retain strong co-decision powers in European policy-making, exercised by their governments. The transfer of stabilization and redistribution competencies to the EU level, complemented by a strengthening of the taxation and spending capacity of the EU, might help to increase policy efficiency and, hence, alleviate the EU’s legitimacy problems on the output side. Yet, problems of input legitimacy are likely to increase, since the mechanisms of functional interest representation remain weak. Additionally, there seems to be a perception that empowering the EP might not significantly better the situation, as there is skepticism that 700 deputies could be able to effectively represent the interest of some 500 million citizens in an enlarged Union. It remains to be seen, however, whether the EP might in fact play such a significant role, and possibly take over a function similar to the one currently performed by the U.S. Congress. Similarly, the introduction of EU-wide referenda – in order to increase EU citizens’ opportunities for “voice” – appears to have little chances for success. Currently, most hopes for increasing the democratic legitimacy of the EU seem to concentrate on an enhanced role of national parliaments. The British Prime Minister, Tony Blair, has called for a second chamber of the EP composed of members of national parliaments that would review the EU’s work in the light of an agreed

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

“Statement of Principles”.²⁷ Likewise, the French Prime Minister, Lionel Jospin, has suggested a “permanent conference of parliaments” that would monitor Community institution compliance with the subsidiarity principle and hold an annual “State of the Union” debate.²⁸ Yet, in order to bring the Union closer to its citizens, there is a need for intermediary institutions that are regularly involved in the every-day decision-making of the EU. Around 80 percent of national socio-economic regulations originate at the European level. Citizens should have the possibility to effectively voice their opinions before political decisions are made, since European law enjoys supremacy over national law and, hence, cannot be overruled at the national level.

The EU may increasingly resemble a federal system, but in order to function properly, its institutional setting needs to be truly democratic in order to be perceived as legitimate by its citizens. The Irish referendum, rejecting the Nice Treaty, forcefully demonstrated that EU citizens are no longer willing to accept political decisions that their governments have negotiated behind closed doors.

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²⁷ See Tony Blair’s speech to the Polish Stock Exchange, Warsaw, October 6, 2000, www.europa.eu.int/futurum/congov.

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

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