

FEDERALISM, SUBSIDIARITY, AND INTEREST GROUPS: A POLITICAL ECONOMY PERSPECTIVE

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1. Introduction

With the ratification of the Maastricht Treaty, the principle of subsidiarity has gained a legal basis in the framework of the European Union. Subsidiarity is still a loosely defined principle and it is evidently open to different interpretations, but it nevertheless has a considerable political potential¹. The subsidiarity clause is contained in Article 3b of the Treaty and basically states that the Union will only take action in areas if it cannot better be taken by the member states and that the Community ought not to go beyond what is necessary to achieve the objectives encompassed by the Union Treaty². Thus, in the Union framework, policy jurisdiction and responsibilities should remain at the lowest possible level of government, restraining the Community institutions, but also reducing their workload.

Subsidiarity has certainly become a word that seems to provide a remedy for all kinds of evils connected with enhanced integration, such as the fear of a centralization and of over-regulation by "Brussels" and of an usurpation of member states' competences by the institutions of the Union. Subsidiarity may have turned into a "fad" in "Eurospeak", but it may nevertheless be crucial for the future development of the Union, even though its effects in political economy terms may not always be immediately apparent.

The subsidiarity principle, as formulated in article 3b, basically contains two economic justifications for action by the Union: externalities and economies of scale. The definition of when these effects are large enough to justify Community action can however be expected to prove difficult in practice³.

This paper shows different effects implied by the subsidiarity principle as viewed from a rational choice perspective⁴. It is conceived as a survey of ideas and of the relevant literature. The article gives an overview of theoretical approaches relevant to the issue that bridge the dichotomy of economics and of political science. A main focus is on the link between institutional features and policy outcomes.

In this contribution, three main aspects of subsidiarity are looked at. Firstly, the allocation of decision-making power to lower political levels will have repercussions on the behavior of member states and on actors on the sub-national levels (such as national interest groups). In the absence of decisions by institutions of the Union, many policy areas will basically constitute collective action problems: mutually beneficial outcomes (or public goods) can only be secured if member states have no incentives to free ride and if special interest groups are prevented from obtaining benefits to the detriment of the "public interest". Such aspects are considered in Section II. Secondly, subsidiarity may lead to a redistribution of policy competences between the Union institutions and the member states. This has implications on the degree of centralization within the Union (and on political

legitimacy). Very prominently, it may to a certain degree introduce competition between national bureaucracies. These issues are addressed in Section III. Finally, enhanced legislative power for the member states will by necessity lead to the maintenance of a divergence in the laws and the regulations of member states with respect to several policy areas. From an economic perspective, within a common market framework, this implies that national rules and regulations will be in competition with each other -- an effect also provoked by the introduction of the "new approach" in the framework of the internal market program. Section IV provides an overview of theoretical approaches connected to regulatory competition and illustrates selected evidence from EC practice.

2. Collective Action, Externalities, and Majority Voting

Collective action theory deals with the fact that individual rational behavior may not always lead to collectively rational outcomes (Olson 1965)⁵. Transferred to the level of the Community, it implies that measures taken by single member states that seem to improve their individual position in the common market are unlikely to be beneficial to either general or their own welfare.

Collective action mechanisms are effective with respect to the provision of pure public goods, in which exclusion from the benefits is impossible and actors are likely to free-ride on collective efforts provided by others (see e.g. Buchanan 1975). In the framework of the Union, such a public good is the maintenance of a clean environment (especially air). Low environmental protection measures in one country by necessity cause negative effects on other members, while stringent protection in a member state benefits the others (thus generating a positive externality).

Similarly, national import restrictions and non-tariff trade barriers in single member states are unlikely to either enhance trade within the Community or benefit the country in question: free trade and a large market allow for the achievement of economies of scale and can be considered to constitute public goods for the Community (since exclusion of non-complying states is rather hard to achieve). If member states have incentives to apply discriminatory measures and to free-ride on the efforts of others, however, it is likely that the good is not provided at all, since free-riding is a rational strategy for each member.

Likewise, national protective measures are likely to benefit selected producers in that country to the detriment of the country's general public welfare. Similarly, when national actors apply discriminatory regulations such as specific rules with respect to public procurement, there are likely to be short-term economic gains in that nation -- as well as gains to specific producer groups -- to the detriment of overall medium-term welfare.

Collective action problems also exist with respect to industrial and to competition policy: while subsidies to national firms reinforce their position vis-à-vis competitors in other member states, they are likely to work to the detriment of overall welfare because of the ensuing distortion of competition (Brittan 1992). Member states, again, have incentives for non-compliance with respect to the provision of the public good "level playing field". Without central supervision -- and sanctioning mechanisms, such as the possibility to impose fines -- the collective good would be unlikely to be brought about, since free-riding is a rational strategy for all.

Thus, these problems could be conceived as n-person prisoner's dilemma (PD) games: while the individual member states aim at protecting their industries, the collective result is that all members may end up worse off than without protection (Neven 1992). In order to ensure a mutually beneficial outcome and the provision of public goods, institutional supervision and enforcement mechanisms on the central level are required.

These problems could also be viewed as "(negative) externality problems", since the uncooperative behavior of a member inflicts costs on the other Union states without an obligation for compensation. But they also contain another element that relates more to the institutional structures: while within member states market failures such as externalities or distortions of competition may be corrected by government intervention applying measures like tax incentives, subsidies, or fines, the absence of direct fiscal competences by the institutions of the Union requires the provision of selective benefits or of "coercion" in order to assure collective action and the provision of public goods.

Generally, institutions can coordinate the behavior of actors, monitor, and allow for game structures in which the collective outcomes are clearly Pareto-superior to the situation without

coordination⁶. Supranational institutions of the Community, for instance the Commission, can obviously play this role. The European Parliament, however, still is too weak an institution to do so. In contrast, the European Court of Justice also plays a monitoring role and it clearly is an "enforcer" of Community law⁷.

Integration may also help to overcome externality problems on the national level and thus promote member states' own economic development: collective action problems on the national level are likely to occur because special interest groups are generally much better organized than those representing general interests, since they can be expected to obtain "private benefits" from group action. However, if "supranational decisions" require certain adaptations in the country in question, there is much less risk involved that national representatives are punished by losing electoral support. That is, politicians can allow themselves to realize measures that serve the long-term interest, since they are not directly threatened by re-election constraints. Hence, unpopular political issues that may generate short-term costs -- especially to selected interest groups -- but long-term benefits can be realized because the Union can serve as a "scapegoat". Accordingly, compromises at the national level that are detrimental to general welfare, such as supporting ailing industries⁸, may get avoided due to the possibility of referring to supranational decisions.

Public finance theory has also differentiated between (pure) public goods and "club goods" (Samuelson 1954, Buchanan 1965). Pure public goods, in general, imply jointness in supply and non-excludability in consumption. Club goods, in contrast, may allow for partial excludability. Generally, increasing returns to scale with the number of users ask for centralization, while "congestion"⁹ makes smaller "clubs" with less members more favorable. Since generally "clubs" in the economic sense and geographical borders do not coincide, a system of "fiscal equivalence" has been suggested in public finance theory, advocating an overlapping network of governments that regulate the provision of particular public goods (Olson 1969). Similarly, with respect to the European Community, Casella and Frey (1992) advocate a structure of "functional federalism" that allows for a system of overlapping political jurisdictions.

Accordingly, the administration of public goods such as local police protection, regional hospitals, or schools which either are unlikely to generate benefits for all inhabitants of a country or whose effects transcend national borders, could be designed in accordance with the principle of "fiscal equivalence". This requires that the providers of the common goods -- that is the contributors or tax payers -- most closely represent the group of users. This economic justification also is a clear postulate for the attribution of more competences to local and to regional administrations.

An interesting, but not extensively explored question with respect to the provision of public goods in the Community is whether lobbying groups -- foremost business, agriculture, and labor -- are able to more effectively operate on the central level of the Union than within national frameworks¹⁰. Generally, it is easier for groups containing fewer members and representing very specialized interests to operate collectively than for large groups that advocate general interests (Olson 1965). Especially business interests may -- in Mancur Olson's terminology -- often constitute "privileged groups", in which single members are ready to bear the full costs of providing a particular collective good for the whole group since they expect a high payoff of its provision to themselves¹¹.

Organizations with more members however are likely to constitute "latent groups", in which a particular common good will only be provided if its provision is linked to other mechanisms, such as coercion or the provision of "selective incentives" such as private goods¹². Since the Union contains more "consumers" than member states do, it may be expected that collective action problems with respect to the advocacy of general interests are even more extensive on the level of the Union than within the member states (Frey and Buhofer 1986, Olson 1993).

However, within the common market, interest groups at times form alliances that do not primarily advocate their sectoral interest, but rather the one of their nation, since a strengthening of the national position in the internal market is expected to reward them with positive payoffs. This can for instance be observed in the case of common efforts between firms and labor unions that would be rather unlikely to voluntarily occur on the national level: cooperation may be rational for union members since the protection of their firms' competitive position in the common market may also protect their jobs (Lange 1992).

Generally, with respect to policymaking on the Union level, it has been observed that national governments are still much more influential than special interest groups¹³. Accordingly, bargaining

about policy issues is usually rather undertaken among national governments and between governments and the Commission (Sbragia 1992).

Finally, due to the redistribution of decision-making competences, subsidiarity is likely to imply that bargaining at the European level, log-rolling, side-payments and "package deals" between governments will to a certain extent get transferred back to actors on the national level. This may not only enhance the role of voters and of national parliaments, but also the one of national interest groups.

3. Decentralization and Enhanced Competition between National Bureaucracies

Decentralization may be a counterweight to enhanced integration which is required to maintain political legitimacy. With the steady expansion of the range of areas in which the Community has acquired legislative powers¹⁴, a delegation of policy competences to lower political levels -- and thus an extension of their participatory role with respect to policymaking¹⁵ -- is likely to be indispensable if popular opposition in the Union is not to rise beyond a certain threshold level. The problems that were observed in connection with the ratification of the Maastricht Treaty in member states such as Denmark and France, have clearly shown that a delegation of powers to national levels may be a necessity in order to maintain popular support¹⁶. The introduction of the subsidiarity principle into the Union Treaty may thus counterbalance some of the strong fears observed in the member states with respect to a centralization and a concentration of power in "Brussels" (which seems to be widely perceived as a kind of "anonymous monster").

Subsidiarity, evidently, supports "federalist" structures in terms of allowing for more decentralization. Enhanced decision-making powers for the member states, however, primarily cause increased room of manoeuvre for national governments. Indirectly, by the choice of their political representatives, it allows electorates to have more control on policy-making in the Union. This indirect influence may be crucial as long as the European Parliament -- whose members are determined by direct elections -- is relatively weak with respect to overall decision-making in the Union. However, enhanced room of manoeuvre for national governments may also increase the influence of national lobbying groups.

According to the early -- and very important -- economic theorist Adam Smith, the pursuit of individual gains in a market place enhances overall welfare. The process appears to be led as by an "invisible hand". Evidently, in the case of market failures -- such as externalities or the insufficient provision of public goods -- a "visible hand", such as government intervention, may however be required.

If the analogy is applied to the case of national governments and their activities, the conclusions may be more controversial. Government representatives may have other goals than increasing general welfare: elected politicians are likely to aim at enhancing their chances for re-election and members of national bureaucracies -- or bureaucracies more generally -- may hope to achieve more power, for instance by expanding the size of their departments. It has therefore been suggested that bureaucracies as "monopolies" may draw "rents" that waste tax-payers' money and hurt overall welfare. In contrast, more competitive structures might be a natural check on the performance of bureaucracies¹⁷.

"Public choice" theories emphasize such failures caused by the fact that policy-makers may not aim at working exclusively in the "public interest", but at enhancing their own personal benefits such as power, chances to get re-elected, or material benefits (e.g. Buchanan 1975, Frey 1984). Thus, in addition to "market failures", there may also be important "government failures".

Attempts to correct "market failures", however, may at times be linked to "government failure", and more prominently, there may be trade-offs between them¹⁸. This is especially likely if in the political process, special interest groups can obtain regulations that rather serve their than the public interest. Measures against market failures, such as tax incentives, subsidies or regulations, always have redistributive consequences. If lobbyists are successful, they can influence the regulatory process to their own advantage and thus enhance "government failure".

Governments are able to provide public goods by the fact that they can raise taxes within their jurisdictions. Competition between jurisdictions has been described as a strategy to enhance overall efficiency by counterbalancing the risk of expansionist bureaucracies: overall welfare is assumed to

increase by introducing competition between jurisdictions with respect to the level of taxation and the provision of public goods. Additionally, the preferences of citizens may find a better respectation.

A famous model in this context has been presented by Tiebout (1956). It however assumes the absence of externalities as well as perfect interjurisdictional mobility of the citizens¹⁹. According to Tiebout's model, within the framework of competition between (local) jurisdictions, citizens can "vote with their feet" by locating in another jurisdiction and thus select the mix of public goods provided and the level of taxation in a jurisdiction that corresponds best with their preferences²⁰.

Free mobility and competition between jurisdictions may thus provide citizens with the (economic) option of "exit" versus the (political) one of "voice" (Hirschman 1970). Hence, the market mechanism may provide for another means to demonstrate preferences, in contrast to -- or in addition to -- political articulation, such as elections or political demonstrations.

Similarly, Wallace Oates in his work on fiscal federalism (1972) argues that, in accordance with his "decentralization theorem", the optimal allocation of functions among jurisdictions with respect to meeting citizens' preferences is a decentralized system. Federalist structures have hence been described as a means to reduce the power of governments to coerce citizens against their will (Wintrobe 1987).

Niskanen (1971) holds that bureaucrats maximize the size of the budget under their control and, since they are monopolists, are generally able to obtain the budget they desire²¹. He assumes that bureaucrats have less power and that the budgets of bureaucracies are smaller in federal than in centralized systems²². Tullock (1969) also suggests that federalism may allow for a reduction of bureaucratic power by providing for external checks. Similarly, Brennan and Buchanan (1980) argue that competition between jurisdictions may provide an effective constraint on the government's power to tax and thus also on its expansionary tendencies²³. It may thus provide a control against excessive bureaucratization²⁴.

Advocates of centralization, however, argue that there are economies of scale in administration. A counterargument is that monitoring costs are usually less significant in smaller government units.

Finally, effects of the subsidiarity principle are linked to the institutional structures of the Union. For instance, the increased resort to majority voting in the EC Council of Ministers, established by the Single European Act and reinforced by the Treaty on European Union, may have intensified the need for the incorporation of the subsidiarity principle into EC law: while the requirement of unanimity basically ensured the consent of all member states in EC decision-making and thus also provided for considerable power of national actors, majority voting transfers power to the supranational level. Due to the decreased costs of agreement, majority voting is moreover likely to facilitate regulation. This may especially be true when log-rolling (vote trading) is permitted (Tullock 1959, Mueller 1989).

Generally, the size of direct expenditure programs is constrained by available budgets and thus by the size of government revenues²⁵. The costs of regulation are however met by market participants who have to comply with the regulations set. On the level of the European Community, regulatory activities are even less "costly", since the political and administrative costs of enforcing Community regulations are usually met by the member states (Majone 1993). Evidently, this makes the danger of over-regulation more significant. Additionally, firms are likely to have an information advantage over the regulators. This implies the risk of regulation rather being in conformity with producers' interests than with those of society.

The future institutional structure of the Community will be most decisive with respect to the orientation of Union policies: the prospect of further enlargement may make majority voting even more necessary, since the costs of agreement rise with an increase in the number of members. The level at which the requirement for a qualified majority will be defined will however be crucial in terms of the distribution of member states' voting power and thus, indirectly, to the determination of political outcomes (Hosli 1993). A possibility might be to allocate votes as it has been done so far. Another is to for instance introduce a double majority voting system²⁶. The latter option, due to the requirement of a majority of both member states and of total population, might however lead to more conservative policy-making, since the barrier to take both majorities is likely to be higher than just one (qualified) majority on the level of the EC Council of Ministers. Such innovations could however also imply that there are less institutional incentives for harmonized approaches. Finally, the balance of power between the Commission, the Council of Ministers and the Parliament will be of most crucial importance with respect to which policies will be decided upon and at what speed²⁷.

4. Regulatory Competition

On the basis of the subsidiarity principle, legislative power in the areas of shared competences will more often be delegated to national levels instead of dealt with by the Union and thus, a certain divergence in national laws will be a result²⁸. Evidently, this strategy is related to the one of the "new approach"²⁹ (e.g. Pelkmans 1987), which was mainly conceived to allow producers to comply with their national regulations instead of 12 different ones and thus to reduce transaction costs in the Community³⁰. The new approach helped to realize economies of scale, while the establishment of harmonized minimum requirements aimed at reducing the effects of externalities. Mutual recognition of national requirements introduced more competition between national rules and regulators (Neven 1992).

Generally, the principle of mutual recognition was applied in order to speed up integration and to counterbalance a perceived tendency to overregulate within the Community. It also aimed at constraining the scope of Community action.

It can be assumed that the costs of complying with competitive regulations, for instance for industry, are generally lower than the costs of complying with regulations that are set by ex ante political agreement. Moreover, mutual recognition allows for regulatory flexibility and innovation. Accordingly, it may be possible to learn from successful national experiences and to stimulate reform within national regulatory systems (Siebert 1990, Hauser and Hosli 1991, Siebert and Koop 1993)³¹.

While harmonization also aims at reducing transaction costs and at restricting the set of existing regulations, it is not a market result. Political regulation also bears the risk of being influenced by activities of special interest groups -- not least because they usually have superior information to the regulators.

A crucial element linked to regulation thus is information. With respect to the market in private goods, it is assumed that if the market by itself cannot supply enough information, the famous problem of "lemons" may be a result (Akerlof 1970)³². Imperfect and asymmetric information, it is argued, may thus generate a need for regulation, especially with respect to consumer protection³³. However, asymmetric information between producers and regulators may result in regulation that benefits the producers.

The Community's efforts in defining minimal requirements, whether it be in the domain of safety prescriptions for goods or requirements in the service sector, aim at limiting the potentially harmful effects of externalities and of a "race to the bottom" induced by a competition between national regulations. Provisions that affect safety and health were thus considered not apt for being subjected to the regulatory competition and minimum standards accordingly were harmonized. Hence, article 100a of the Single European Act requires the Commission to operate on a high level of protection with respect to health, safety, environmental and consumer protection³⁴.

In the domain of services, the Second Banking Directive³⁵ has established that banks and financial institutions can provide services in all EC member states as long as they comply with the national requirements (in accordance to the principle of "home country control"). The definition of minimum standards with respect to aspects such as prudential ratios and minimum capital requirements, as defined by later directives³⁶, was similarly introduced to inhibit a "race to the bottom". A related approach has been adopted with respect to insurance (life insurance excluded).

There have however been challenges to the assumption that the harmonization of minimum requirements is always necessary. According to Neven (1992), for instance, different levels of product reliability can coexist in a market as long as appropriate liability rules are effective (to reduce external effects). Moreover, competition may encourage the establishment of high quality standards as a means of product differentiation. When they are defined on a relatively high level, in contrast, minimal standards may in practice have a tendency to protect selected producers and sectors³⁷.

Similarly, a general argument holds that efforts to reduce income inequalities by instruments of social policy is not possible in a regulatory competition framework, because the free mobility of labor and the free establishment of enterprises would enhance externality problems. However, it is also conceivable that competition between national regimes in the domain of social policy will not necessarily lead to "regime shopping" or "social dumping", but may be counterbalanced by other developments (see Majone 1993). For example, empirical evidence suggests that foreign investment is

attracted not so much by regimes of low social wages (and low social protection), but rather by factors such as an elaborate infrastructure and a high level of worker productivity. Moreover, within the European Union, the attraction of "welfare magnets" may be reduced due to low labor mobility resulting not least from the existence of cultural and of linguistic barriers.

Evidently, the level of minimum regulation is determined by the Community decision-making procedures and thus by the institutional structures. It is also likely that the definition of what are considered "basic safety considerations" is influenced by the position of special interest³⁸. The line between "legitimate" safety and health considerations and barriers to free market access or a pure protection of industries may also be thin on the level of the member states. This is an aspect in which the European Court of Justice evidently has played a major role in decisions of both an economic and a political nature, litigating according to art. 30 and 36 EEC Treaty³⁹ (in which the free trade and the proportionality doctrines and their exceptions are specified).

There are always winners and losers of harmonization and of regulatory competition. For instance, in the case of product standards, some producers may lose⁴⁰ while consumers are likely to win by the introduction of the strategy of mutual recognition. In the case of income taxation, an introduction of regulatory competition would possibly profit the rich and mobile part of the labor force as well as the owners of capital, while the immobile part of the work force and landowners would be likely to lose (Kirchgässner and Pommerehne 1993).

In a competitive framework, internal redistribution policies that imply a redistribution tax from the rich and mobile are likely to be eroded by the "immigration" of poor individuals from other jurisdictions (states). Full factor mobility thus limits member states' independence with respect to redistributive policies and encourages a shift to regulation by the central government (Bureau and Champsaur 1992). On the influence of organized interests and of political parties on minimum regulation in social policy, however, see Lange (1992).

Both coordination and harmonization imply negotiations between "jurisdictions" or member states within the Union. Thus, there will be a certain amount of bargaining or transaction costs, depending, again, on the nature of the institutional structures. Generally, actors wishing to establish a high level of regulation on the central level should not place high demands, since the outcome of mutual recognition is likely to generally be lower than harmonization (Shapiro 1992: 134). Regulatory competition, evidently, makes protectionist regulation less likely, but it also counteracts high-level regulation. It however avoids bargaining costs on the central level.

Finally, efforts to reduce transaction costs may at times conflict with the aims of regulatory competition in the short run: while uniform Union-wide policies may involve less cross-border costs, regulatory competition will only reduce transaction costs after some convergence *ex post*.

As far as evidence with respect to the development of policies in the framework of the European Community is concerned, different tendencies can be observed. The Internal Market Program was most decisive with respect to defining Community strategies in various fields. Several policy areas were "deregulated" while minimum requirements were defined. The balance between finding "market solutions"⁴¹ and allowing for political harmonization is illustrated in table 1, which gives an overview of the different areas covered by the program and the respective approaches then envisaged.

[Table 1 about here]

Thus, the internal market program was clearly based on a combined approach: harmonization and mutual recognition were seen as complements (see also Sun and Pelkmans 1994a).

The Single European Act has extended the policy competences and responsibilities of the Community, for instance in the domains of research and development and environmental policy. In the latter domain, the principle of subsidiarity has been explicitly anchored⁴². The Single European Act however also largely increased the domains in which qualified majority voting is to be applicable (e.g., Sloot and Verschuren 1990, Moravcsik 1991, Hosli 1993).

Since the Internal Market Program started, however, some changes have taken place. On the one hand, some policy areas have been extended in scope (for instance, free mobility has been applied to new groups). Generally, the European Court of Justice played a decisive role, since its rulings served in several cases to specify elements of the program more precisely.

While the White Paper was basically known as an extensive deregulation program, it may however also have encouraged re-regulation (Egan 1991, Shapiro 1992). For instance, after the passage of the Single European Act, there has been an extensive growth in regulation with respect to the safety, quality, and packaging of goods. This is also true with respect to food additives, the naming and composition of food products, and the adoption of technical standards. Moreover, this quantitative expansion has been paralleled by a "qualitative deepening" of regulation⁴³ (Majone 1993).

An interesting development has also taken place since the introduction of the internal market program with respect to Value-Added Taxes (VAT): while the White Paper advocated the establishment of upper and lower boundaries for VAT rates (table 1), another approach has been followed in practice: the EC Finance Ministers, in June 1991, agreed on introducing a tax rate floor of 15 percent, while the EC member states would be free to apply higher rates. It is expected that competition between national VAT rates combined with the principle of the free movement of goods and services will lead to a convergence of national tax rates through market forces (according to the processes outlined before). "Harmonization" thus will be a result *ex post* instead of *ex ante* and be defined by the market instead of by political agreement⁴⁴. Empirical evidence, moreover, will have to show whether this harmonization *ex post* will result on the level of the legally defined tax rate floor or possibly on a higher level.

Indirect taxation still is an area, however, in which decisions require unanimity within the EC Council of Ministers⁴⁵. Had majority voting applied -- or had at least the possibility for majority votes existed -- agreement might have been more easily achieved, possibly resulting in more policy harmonization. The last point highlights a crucial issue: the institutional structure and the decision-making rules may decisively influence whether the strategy of harmonization or of regulatory competition is followed in practice.

Outside the internal market program, a rather centralized approach has for instance been followed in the domain of agriculture. The common agricultural policy (CAP) of the Community is known for a considerable transfer of resources from consumers and taxpayers to the agricultural sector, thus allowing producers to draw high "rents". Direct income subsidies instead of public price support defined on the EC level could somewhat counterbalance the macroeconomic distortions and the protectionist tendencies linked to the CAP. Evidently, since agricultural policy belongs to the domain of exclusive Community competences, a central role by the Union is further expected, as is the case with respect to fisheries.

Another area in which clearly centralized approaches are followed is regional redistribution. Over the last years, the Structural Funds that deal with geographical income disparities have decisively increased in volume⁴⁶. Moreover, with respect to regional income redistribution, the independence of the Commission from national governments has increased over time. More significantly, there are direct links between the Commission and sub-national levels. In this policy area, evidently, national governments may increasingly be circumvented to the advantage of the central level and of sub-national authorities (Marks 1992).

An increasing administrative autonomy of the Commission has for instance also developed in the domain of competition policy, another area of exclusive Community competence. Again, the margin for national action and thus for regulatory competition will be extremely limited in this policy area, since regulatory competition would induce collective action problems.

The Treaty on European Union again covers a broader range of policy domains than the Internal Market Program or the SEA did. It has created new competences on the central level⁴⁷ with respect to areas such as infrastructure networks, consumer protection, public health, culture, education, and vocational training. Moreover, it introduces Community competences in the crucial area of monetary policy and it adds cooperation with respect to "justice and home affairs" (citizenship of the Union) and a common foreign and of security policy as new pillars. The creation of a monetary union is one of the decisive new orientations since it will, within different steps, transfer a considerable range of national economic competences to the Union level. This is especially evident with respect to the creation of a central bank -- the "EuroFed" -- and the introduction of a common currency. National sovereignty to control macroeconomic variables will thus strongly decrease, as is true with respect to fiscal policy, since the last stage of monetary union requires prior convergence in domains such as inflation, long-term interest rates, exchange rates, and government deficits. Thus, as compared to participation in the European Monetary System, a vast domain of policy competences gets transferred to the Union level, creating another area of exclusive Community competence. Evidently, national

governments will have very little say with respect to these macroeconomic variables. This may imply that "political business cycles" on the national level will in the distant future be much less observable -- while they may eventually reappear on the level of the Union (given that more democratic structures will be established).

Again, the Treaty on European Union puts emphasis on a definition of minimum requirements⁴⁸ and extends the scope for qualified majority votes⁴⁹. While majority voting may facilitate and speed up decision-making in general, the opportunities at the central level to correct externalities and to allow for economies of scale or the provision of public goods may evidently also get enhanced. This is however likely to also increase the activities of lobbying groups.

The common citizenship introduced by the Maastricht Treaty will allow nationals of an EC country residing in another member state to vote and to stand as candidates in local and in European elections, but not in national elections. As compared to the possibility of freedom to move and reside throughout the Union, this implies that "voice" will be segmented and that the option of "exit" may gain relatively more weight. "Exit" is however not possible with respect to centralized policies on the Union level. Hence, in these domains, the ability of "government" and of actors influencing the decision-making process is not constrained by any direct market forces.

5. Concluding Remarks

Subsidiarity is a concept that so far has experienced little clarification within the Community as to its exact contents. Article 3b of the Union Treaty, however -- apart from reinforcing the principles of attributed powers and of the proportionality of Community action -- gives two (economic) justifications for Community action: the existence of externalities and the achievement of economies of scale.

In practice, however, it will be a difficult task to judge whether certain policy areas are better dealt with by the Union or by member states, not least because the effects of certain issues may be very different for different member states. Moreover, empirical evidence is scarce, and economic theory may not always have clear answers either. Finally, there may be a trade-off between market failures and government failures.

Needless to say: the mere fact that subsidiarity was not clearly defined in the negotiations may have considerably aided its inclusion into the Union Treaty: had all actors known about benefits or costs of the principle to themselves -- instead of reading a meaning into it that suits their own interests -- the principle would most likely not have been established, at least not in the main body of the Treaty (which is subject to judicial review).

This article has looked at three aspects that are connected to the subsidiarity principle: problems of public goods and of externalities on the Union level, competition between national bureaucracies, and regulatory competition. In conclusion, subsidiarity may, from an economic perspective, lead to more "market" within the Union in terms of generating competition between national regulations, but also between national bureaucracies. These are effects that are likely to improve efficiency and the search for successful legislation and therefore to enhance overall welfare. In order to combat market failures and to prevent a "race to the bottom" to occur, however, the definition of minimal requirements is resorted to with respect to various policy domains. Special attention has to be put on the risk that due to information advantages of interest groups over regulators, minimum harmonization may -- instead of benefitting the "public interest" -- work to their specific advantage. Thus, the links between institutional structures and regulatory outcomes and the trade-off between combatting market failures and government failures have to be carefully monitored.

These problems are rather new and this article can evidently not be an exhaustive analysis of the issue. It however aimed at illustrating implications of the subsidiarity principle that may not be apparent in the present discussions and to encourage further research in the field. Three main aspects for further inquiry are particularly encouraged: the relationship between decision-making structures and efforts to correct market failures such as externalities or to allow for economies of scale and for the provision of public goods; the influence of special interest groups on the Community decision-making process and thus, indirectly, on political and economic outcomes; and the connection between

majority voting and unanimity as decision-making principles in the Council of Ministers and the choice of either harmonization or regulatory competition with respect to specific policy domains.

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Figure 1: Harmonization and Mutual Recognition in the Domain of Goods, Services, Persons, and Capital According to the EC's 1985 White Paper ("New Approach")

Strategy	³ Harmonization	³ Mutual Recognition /
Policy area	³ Deregulation	
Goods and services:	³	³
Product standards	³ Harmonization of technical	³ "Reference to standards"
	³ minimum requirements for products	³ approach. Mutual recognition of
	³ concern ³ technical requirements.	
	³ ing the health and safety of	³
	³ con	³
	³ sumers (e.g. food and medicinal	³
	³ products). Creation of Europe	³
	³ an	³
	³ stan	³
	³ dards through stan	³
Testing and certifi	³ dardiz	³

cates ³ing ³Mutual recognition of national
³organiza ³testing and certifi
³tions (CEN, CENELEC, ³cation
³CEPT). ³procedures.
³ ³

Product inspections ³ ³
³ ³
³ ³
³ ³
³ ³

National import quotas ³ ³
³ ³Abolition of national import quotas
³Harmonization of veterinary and ³and other protective measures.
³phytosanitary minimal re ³
³quirements. ³

Intellectual and ³ ³
 commercial property rights ³ ³
³ ³
³ ³
³ ³

Transportation of goods ³ ³
³ ³Abolition of restraints on com
³Creation of an EC trademark and ³petition such as bilateral quotas.
³an EC patent. ³
³ ³
³ ³

Air transportation ³ ³
³Simplification of border controls. ³Abolition of re
³Harmoniza ³straints on compe
³tion of regulations for ³ti
³trucks and of provisions with ³tion such as agree
³respect to truck drivers. ³ments concern

Indirect taxation ³ ³ing ca
³ ³pac
³ ³i
³ ³ties and fees.
³ ³
³ ³
³ ³
³ ³
³ ³

³Definition of upper and lower ³
 Public procurement ³boundaries with respect to VAT ³
³rates (20 and 14 percent, for basic ³
³necessities 9 and 4 percent). ³
³Harmonization of taxes on alcohol,³
³tobacco, and fuel. ³
³ ³
³ ³
³ ³Deregulation and more
³ ³transparency with respect to
³ ³procure
³ ³ment policies.
³ ³

Banks ³Harmonization of minimum ³Freedom of estab
³requirements (e.g. solvency ratios). ³lishment and to

3 provide services.
 3 Principle of home country control.
 Insurance 3 Harmonization of minimum 3
 3 requirements (e.g. surveillance). 3 Freedom of estab
 3 lishment and to
 3 provide services (life insurance to
 3 be included later). Principle of
 Information servic 3 3 home country control.
 es 3 3
 3 Abolition of national restric
 3 tions
 3 Harmonization of national 3 constraining competition in the
 Media 3 regulations (e.g. with respect to 3 market for informa
 3 adver 3 tion services.
 3 tising). 3
 3 Abolition of restrictions on the
 3 media market. Cre
 Persons: 3 3 ation of a
 3 3 European broadcasting net
 Law of asylum 3 Harmonization of asylum laws and 3 work.
 3 policies concer 3
 3 ning refugees. 3
 3 3
 Visa policy 3 3
 3 Harmonization of nation 3
 3 al visa 3
 Border controls for persons 3 policies. 3
 3 3
 3 Abolition of securi 3
 3 ty and ident 3
 3 ity 3
 3 controls at bor 3
 Mobility of per 3 ders. Increased 3
 sons 3 cooperation between national 3
 3 police agencies (e.g. concern 3
 3 ing 3
 3 drug trafficking and terror 3
 3 ism). 3 Freedom of establishment and
 University degrees and diplomas 3 3 abolition of restric
 3 3 tions on the job
 3 3 market (extension on students and
 3 3 on retired people envisaged).
 Capital: 3 3
 3 3 Mutual recognition of university
 Cap 3 Harmonization of minimum require 3 degrees and diplomas.
 ital markets 3 ments. 3
 3 3
 3 3
 3 3
 3 3 Abolition of restrictions with
 3 Harmonization of relevant legal 3 respect to capital tran
 Company law 3 provisions with respect to banking 3 sactions
 3 and stock exchange. 3 (e.g. legal or tax barriers or
 3 3 constraints on foreign exchange).
 3 3
 3 3

³Introduction of a common³Deregulation to encourage cross-
³accounting system. Harmonization ³border merg
³of minimum require ³ers and acquisitions.
³ments (e.g. ³
³with respect to reserves and to ³
³evaluation). Cre ³
³ation of a statute ³
³for a European sha ³
³reholder ³
³company. ³

Source: Adapted from Hauser, Hosli, and Nydegger (1988); Commission of the EC (1985)